Corporate governance is personal

Directors should make a complex decision as if they were facing a similar situation in their own business affairs or those of another close family member.

BY DOUG RAYMOND

Sarbanes-Oxley, Dodd-Frank, the explosion of litigation against directors and a myriad of other factors have added substantially to the obligations of boards of directors since this journal first began publication. These trends have been reported in these pages effectively and pragmatically over the last 40 years. In response, directors have naturally come to think of their roles as highly complex and difficult to master. Hundreds of treatises, 'master classes,' journals and consultants offer best practices, checklists and other advice on how to be a responsible and effective director and demonstrate proper and legally sound corporate governance principles.

The work that today's corporate directors are called on to do, particularly when they sit on boards of a public or global business, is undeniably complex, demanding, and subject to constant second-guessing by regulators and the plaintiffs' lawyers. However, at its core, the essential requirements of good corporate governance have not changed all that much. Good governance, and the legal obligations of directors, remain centered on the effective implementation of the fiduciary duties that directors owe to the company and its stockholders; principally the duty of care and the duty of loyalty.

Doug Raymond is a partner in the law firm Drinker Biddle & Reath LLP (www.drinkerbiddle.com).

When facing a challenge or a complex and nuanced decision, if a director wants a check whether they are on track they should ask themselves the fundamental question that has long been at the core of the directors' obligations: Are they doing everything that they would reasonably expect to do if faced with a similar situation in their own business affairs, or those of their parents or another close family member.

Readers of this journal know well that the duty of care requires directors to use reasonable care and prudence in carrying out their responsibilities. If a director is making an important decision for themselves or for a close relative, they would do their homework — looking at reviews of experts, examining the financial ramifications and seeking out the relevant experience of others whom they respect. They most likely would not make a hasty decision simply because a promoter had recommended it or had pressured them to decide. It is essentially the same when the board considers an important matter for a company. Directors should approach the issue as though it was their own money they were spending, or that of their relatives.

When we make decisions that are important in our personal lives, we take the time and effort to inform ourselves of the relevant risks, costs and long-term and short-term benefits. And we consider how the decision will affect other choices we may want to make in the future. For example, before making a large personal investment, we would find out how it had been priced, and whether others agreed that the price was fair and why they thought so. We would want to confirm that we could, in fact, afford the investment, and would understand how we would repay any debt assumed to fund the purchase. We would also want to understand our options if things did not go as planned.

In the boardroom, these questions are not very different. Directors should carefully discuss and consider with one another the value of what the company is receiving in a particular transaction, including short-term and long-term benefits. They should also discuss any important industry and market standards as well as laws that regulate them. And just as we look to professionals — a financial advisor, attorney, or personal physician — when making important personal decisions, boards need to call on professionals to help the directors understand the terms and risks of a proposed transaction, and how to realize synergies and avoid foreseeable risk and legal liability.

The same principle holds true when considering the duty of loyalty. Conflicts of interests frequently arise in the boardroom. As they would do in their personal lives, directors should ask whether the conflict will likely cause trouble or undue complications, or otherwise adversely impact their decision-making. The old adage, that "Caesar's wife must be above suspicion," has long been applied to board conflicts of interest, in part because it clearly conveys an important message about the need to avoid conflicts, and even the appearance of conflicts, in the boardroom.

Effective corporate governance requires tough decisions in complex and difficult situations, and these decisions are increasingly subject to second-guessing by others. However, boards and directors can help themselves successfully navigate these treacherous waters by keeping in mind the core principles that apply to their work as directors — and asking themselves if they have done everything they would have done if they were representing the important interest of their own family. ■

The author can be contacted at douglas.raymond@dbr.com. Emmanuel Brown, an associate with Drinker Biddle & Reath, assisted in the preparation of this column