
BOARD OF DIRECTORS

DUTIES AND LIABILITIES

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RESPONSIBILITIES

- The board of directors has a dual mandate:
 - **Advisory**: consult with management regarding strategic and operational direction of the company.
 - **Oversight**: monitor company performance and reduce agency costs.
- Effective boards satisfy both functions.
- The responsibilities of the board are separate and distinct from those of management. The board does not manage the company.

OECD Principles of Corporate Governance

“The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board’s accountability to the company and the shareholders.”

OECD (2004)

RESPONSIBILITIES

Selected advisory and oversight responsibilities:

- Approve the corporate strategy
- Test business model and identify key performance measures
- Identify risk areas and oversee risk management
- Plan for and select new executives
- Design executive compensation packages
- Ensure the integrity of published financial statements
- Approve major asset purchases
- Protect company assets and reputation
- Represent the interest of shareholders
- Ensure the company complies with laws and codes
- Review culture and “tone from the top”

INDEPENDENCE

- Boards are expected to be independent:
 - Act solely in the interest of the firm.
 - Free from conflicts that compromise judgment.
 - Able to take positions in opposition to management.
- “Independence” is defined according to regulatory standards.
- However, independence standards may not be correlated with true independence.
- Requires a careful evaluation of board member’s biography, experience, previous behavior, and relation to management.

OPERATIONS OF THE BOARD

- Presided over by chairman: sets agenda, schedules meetings, coordinates actions of committees.
- Decisions made by majority rule.
- To inform decisions, board relies on materials prepared by management.
- Periodically, independent directors meet outside presence of management (“executive sessions”).

Directors report spending 20 hours per month on board matters. Full board convenes 8 times per year in person or over the phone, and a typical meeting lasts 7 hours.

NACD (2019)

BOARD COMMITTEES

- Not all matters are deliberated by the full board. Some are delegated to subcommittees.
- Committees may be standing or ad hoc, depending on the issue at hand.
- All boards are required to have audit, compensation, nominating and governing committees.
- On important matters, the recommendations of the committee are brought before the full board for a vote.

AUDIT COMMITTEE

Responsibilities of the audit committee include:

- Oversight of financial reporting and disclosure
- Monitor the choice of accounting policies
- Oversight of external auditor
- Oversight of regulatory compliance
- Monitor internal control processes
- Oversight of performance of internal audit function
- Discuss risk management policies

Audit committees meet on average
8 times per year, for 3 hours each.

NACD (2019)

COMPENSATION COMMITTEE

Responsibilities of the compensation committee include:

- Set the compensation for the CEO
- Advise the CEO on compensation for other executive officers
- Set performance-related goals for the CEO
- Determine the appropriate structure of compensation
- Monitor the performance of the CEO relative to targets
- Hire consultants as necessary

Compensation committees meet on average 6 times per year, for 3 hours each.

NACD (2014)

NOMINATING AND GOVERNANCE COMMITTEE

Responsibilities of the nominating/governance committee include:

- Identification of qualified individuals to serve on the board
- Selection of nominees to be voted on by shareholders
- Hire consultants as necessary
- Determine governance standards for the company
- Manage the board evaluation process
- Manage the CEO evaluation process

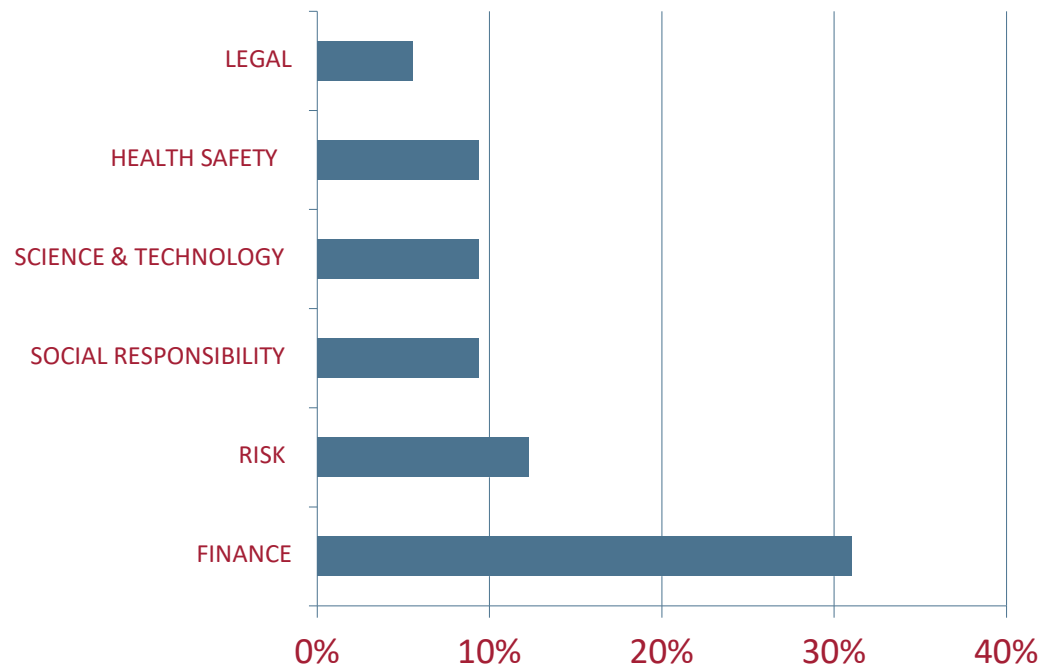
Nominating/governance committees meet
on average 8 times per year, for 2 hours each.

NACD (2014)

SPECIALIZED COMMITTEES

- Executive
- Finance / investment
- Corporate responsibility
- Strategic planning
- Risk
- Environmental policy
- Science & technology
- Legal
- Ethics / compliance
- Mergers & acquisitions
- Human resources / management development

PREVALENCE OF SPECIALIZED COMMITTEES



Spencer Stuart (2018)

DIRECTOR TERMS

- Two main election regimes:
 1. **Annual election**: Directors are elected to one-year terms.
 2. **Staggered board**: Directors are elected to three-year terms, with one-third of board standing for election each year.
- Staggered boards are an effective antitakeover protection.
- Staggered boards may also insulate or entrench management.

Prevalence of Staggered Boards

- Approximately 40 percent of all publicly traded companies have a staggered board.
- Small companies are more likely to have a staggered board than large companies.

SharkRepellent (2019)

DIRECTOR ELECTIONS

- In most companies, directors are elected on a one-share, one-vote basis.
- Shareholders may withhold votes but not vote against a nominee.
- Four main voting regimes:
 - **Plurality**: director who receives most votes is elected, even without a majority.
 - **Majority**: director must achieve majority, otherwise must tender resignation.
 - **Cumulative**: shareholders can pool votes and apply to selected candidates (rather than one vote per candidate).
 - **Dual class**: different classes of shares carry different voting rights (disproportionate to economic interest).
- Typically, only one slate of directors is put forth for election; in a contested election, a dissident slate is also put forth.

STATE CORPORATE LAW: LEGAL OBLIGATIONS

- Under state corporate law, the duties of the board are embodied by the principle of fiduciary duty.
- The “duty of care” requires that directors make decisions with due deliberation.
- The “duty of loyalty” requires that directors act “in the interest of the corporation” (Delaware courts have interpreted this to mean “in the interest of shareholders”).
- The “duty of candor” requires that the board inform shareholders of all information that is important to their evaluation of the company.

STATE CORPORATE LAW: LEGAL ENFORCEMENT

- Fiduciary duties are enforced by judicial intervention:
 - Injunction: court order that the board refrain from a specific action.
 - Damages: requirement that the board pay for losses sustained.
- Under the “business judgment rule,” the court will not second-guess a board’s decision if:
 1. The board followed reasonable process.
 2. The board took into account key relevant facts.
 3. The board made the decision “in good faith.”
- “Good faith” requires that the board act without conflicts of interest and not turn a blind eye to issues for which it is responsible.

BENEFIT CORPORATIONS AND “B CORPS”

- Companies chartered as a **benefit corporation** under state law are required to consider non-shareholder interests.
 - More than 30 states allow benefit corporations.
 - These statutes have not been extensively litigated; their meaning is uncertain.
 - How will courts balance shareholder and stakeholder interests in cases of conflict of interest or takeovers?
- Companies might choose to be certified as a **B Corp**.
 - Certification bestowed by B Lab, a nonprofit.
 - Companies agree to adhere to B Lab’s requirements for environmental, workplace, and societal standards.
 - Signals to stakeholders that company takes stakeholder obligations seriously.
 - Not a legal status. Not legally binding.

ENVIRONMENTAL, SOCIAL, AND GOVERNANCE (ESG)

- **ESG:** The broad effort to encourage companies to incorporate stakeholder interests in corporate decision making.
 - Premise: companies are too short-term oriented, leading to decisions that boost current earnings at the expense of long term.
 - By investing in stakeholders, companies create larger, more sustainable, more equitable outcomes.
- Legal implications are unclear.
 - Courts require companies to fulfill their legal obligations to shareholders.
 - Does ESG lead to a fundamental change to decision making, or is it an exercise in reputation management?

89 percent of companies believe stakeholder interests are important.

96 percent are satisfied with the job they do to meet stakeholder needs.

Stanford (2019)

FEDERAL SECURITIES LAWS: LEGAL OBLIGATIONS

- Under federal securities laws, directors have a legal obligation to disclose information to the public.
- Disclosure requirements are established by the Securities and Exchange Commission.
- In general, the company is required to disclose all “material information” – information that an investor would consider important in the evaluation of an investment decision.
- The board relies on external and internal auditors to ensure that material information is adequately disclosed.

FEDERAL SECURITIES LAW: LEGAL ENFORCEMENT

- Securities laws are enforced through private lawsuits and SEC actions.
- Private lawsuits are led by investors who claim to have been harmed by a violation.
- In order to be found in violation of securities law, the court must find that a disclosure to the public contained a material misstatement or the omission of material information, and that the misstatement or omission was the cause of loss.
- A director cannot be held liable unless the misstatement or omission was intentional or the result of recklessness.

DIRECTOR INDEMNIFICATION AND INSURANCE

- Director liability is reduced by three mechanisms:
 1. Exculpatory provision: company charter excuses director from liability for unintentional negligent acts.
 2. Indemnification: agreement that company will pay for costs associated with lawsuits (if director acted “in good faith”).
 3. Director and officers insurance (D&O): insurance contract that covers litigation expenses, settlement payments, and in some cases damages.
- Out-of-pocket payments by directors are very rare.

Between 1980 and 2005, there were only 12 cases where directors made payments not covered by insurance, including legal fees.

Black, Cheffens, and Klausner (2006)

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