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REMARKS

BEYOND WHAT IS DEFENSIBLE TO WHAT IS RIGHT

LIZANNE THOMAS*

I am, indeed, a governance practitioner. I started my career about twenty-seven years ago doing public company mergers and acquisitions, and it has morphed into a governance practice. I like to tell people that I practice it, teach it, and live it.

By living it, I mean that I serve as a director of a tiny little company with a big name, Krispy Kreme Doughnuts. Serving as a director for Krispy Kreme Doughnuts has been a great experience, and it has informed my perspective on how I should advise companies regarding governance issues. I also think it has changed the way I approach governance issues.

I am not going to talk about financial institutions, but what I can tell you is that I think the meltdown that we have experienced in the financial industry is going to affect how decision makers make choices throughout corporate America.

My client base does not come from New York, like much of the financial industry, but rather from the heartland—those who make widgets and those who provide services to those who make widgets. All are similarly affected by some of the issues we have talked about. That is the perspective I am bringing here today.

I want to start by telling you a story about the first time I began to realize the limitations of my contribution to good governance as a lawyer and how it has informed my perspective. A number of years ago, I was representing a company that was very much in a state of crisis. At a real turning point in its corporate history, we were negotiating a transaction that would have been a transformative one, and the negotiations, I am sorry to say, were not going well. I was in New York, having done these negotiations, and we were not satisfied with where things had landed, and the result was that we all trooped back to the corporate jet to fly home, feeling as

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though the negotiations had stalled. We were not sure what direction the company would take from there.

The CEO was surrounded by me (a very vocal and talkative lawyer), a CFO who had very strong opinions about the financial implications of these stalled negotiations, and a marketing person—a PR person—who had her own views about what ought to happen next. The three of us yammered, and yammered, and yammered at this CEO for half of the flight home from our own particular perspectives on what he ought to do and what recommendation he ought to make to the board.

There finally came a moment in which he said, "Stop. I've heard enough. I don't want to hear anymore." He turned to me, and he said, "L.T., I'm going to make a decision that's a legal one, but it's not going to make you happy." He turned to the CFO and said, "I'm going to make a decision that I think is prudent financially, but it's not going to make you happy." Then, he turned to the marketing person and said, "And I'm going to make a decision that takes into account what you said, but it's not going to make you happy either."

He said, "What I'm going to do is more than what is defensible. I'm going to do what is right." I remember the moment. I paused and said to myself, "Don't forget this message, because this is the lesson that should guide us in corporate decision making going forward," particularly those of us who intend to be corporate advisors in the future.

So, that is my theme today—that what we need to do is to move beyond that which is defensible and toward that which is right.

As a public company lawyer, I live in "business-judgment-rule land." I try to place my clients within the business judgment rule, or I try to move them as close as I possibly can. I hope most of you know what that means. The business judgment rule is a legal presumption that protects corporate decision makers from liability.[1] It is a presumption that board members have fulfilled their fiduciary duties if they have acted in good faith and fulfilled their duties of loyalty and due care.[2]

Now, we could spend all afternoon parsing out how the business judgment rule really works. However, my point here is that even well-intentioned people have allowed, over time, our emphasis on staying within the business judgment rule to cause us to emphasize process when what we ought to be emphasizing is substance. I think we have lost focus. In losing focus, we have lost great meaning.

I doubt there is a public company director or a public company C-level officer, CEO, CFO, or chief legal officer existing today who could not recite for you—quite well—the business judgment rule that I just referenced. They hear about those concepts all the time from chatty lawyers like me. I

1. Gimbel v. Signal Cos., 316 A.2d 599, 609 (Del. Ch. 1974).
2. Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

am in boardrooms probably one hundred times a year, and I can vouch for the fact that the ones who talk the most are the lawyers. So, our clients can recite well those business judgment rule precepts. However, at the same time, if you turn to any director and ask, "What are the three most important drivers for your business, right now, and what are the most specific risks to each of those drivers?" you will hear much ducking and weaving. Directors are not as conversant, not as focused on the substance of what drives our business, and we are less aware than we should be of the risks attendant to all those decisions.

In my experience, most directors, other decision makers, managers, and even lawyers are earnest people. They intend to fulfill their duties and do their job very, very well. Of course, there are pockets of unfettered greed and arrogance. However, most corporate people and most corporate leaders are neither fundamentally greedy nor fundamentally arrogant. Yet, here we are with such a degree of earned distrust that we must move at light speed, if we are to get ahead of efforts to legislate or regulate trustworthy corporate conduct, and it may be too late.

Now, I am not challenging the concept of regulation in the financial services industry. I am really more focused on whether or not general corporate conduct is going to be regulated into trustworthiness, and, to that, I am unabashedly opposed.

As I told my teenage sons when they went on their first date, "Trust is hard to earn, easy to lose, and nearly impossible to win back." That is the situation we are in today. What can lawyers do? What can corporate lawyers do to try to earn back that trust that we have lost? I have three suggestions, two that are general and one that is snatched out of today's headlines:

1. Remember, relish, and assert your role as an independent counselor.
2. Never allow a board or a management team to approve what they do not understand.
3. Take the lead in advocating fundamental change in executive compensation. Take the lead. (This is my headline point.)

Let's talk about each one of these points in a little bit more detail.

1. Remember, Relish, and Assert Your Role as Independent Counselor

As an independent counselor, I really, *really* hate it when I hear a lawyer say, "That's a business decision, not really my space," particularly when I hear it too early. Our clients are paying for our experience, our judgment, importantly, our independence, and perhaps just as importantly, our professionalism. If we, as lawyers, are going to assert the right to continue to be self-regulated, then we are called upon to act with that kind of independent judgment that earns self-regulation.

Now, what that sometimes means is that we must speak truth to power. A mentor of mine once told me one of his philosophies. He said,

> You know, I love being in the private practice of law. I just love it. I love the independence of it. I love my role as a counselor, and I love the fact that I can tell a client something they don't like. I can get fired by a client, and I come to work the next day, and I go find another client. I love that independence.

It was such a positive, enthusiastic description of our role that I will never forget it.

Another general counsel made quite an impression on me just a week ago when we were talking about a moral conundrum with which she was dealing. She said, "You know, I know how I'm going to answer this particular issue." She works for a company that is very much in the headlines right now. She said, "I know how I'm going to deal with this because I'd rather be unemployed than unemployable." She was going to hold on to her reputation, if not her job, by making sure that the advice she was giving to her client was right, if unwelcome.

So, my rule number one: seize and hold on to that role as an independent counselor. Celebrate it.

2. *Never Allow Clients to Approve What They Do Not Understand*

Rule number two, and this might actually be my favorite: never allow your clients to approve that which they do not understand. Look all the way back to Enron, to WorldCom, even to Disney—the infamous Michael Ovitz case—and certainly this most recent meltdown.[3]

It was all just as much a function of not understanding—a lack of comprehension—as it was a function of greed and opportunism. I guarantee you that, had the board members of some of those companies that failed and some of those investment banks that failed really appreciated the long-term consequences and the fact that the dance would have to end, they would have engaged in a different kind of conversation that would have caused a different result.

I have two stories to tell in that regard. I want to talk about the CEO of another client that I had the privilege to represent. He is an incredibly plain-spoken man; he does not even have a college degree. Yet, he is the CEO of a New York Stock Exchange-traded company that is and has been at the top of its industry for quite some time.

He understands his business and is always ranked as the number one CEO in that particular industry, and the company itself performs at that high level as well. He has a policy—not because I taught him, not because anybody else taught him, but because it is the right thing to do: he never

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3. *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27 (Del. 2006).

allows any proposal to go to the board without specifically delineating the top three risks it presents, and he does this in the simplest little PowerPoint you can imagine.

He offers up three risks to the plan, and sometimes when he presents those risks, the board has said, "We hear you on that. They scare us more than they scare you. Don't do this deal." However, the point is that there is real clarity and a real sharing of information, and I think it improves the quality of the decision making.

For those of you who are lawyers or future lawyers, one of the concepts I want you to understand is that you are joining a profession that is not, strictly speaking, defined by legal issues and legal demands. The general counsel of another client tells me she does not consider herself to be head of the legal department. She says, "The department that I run is the department of difficult issues," and in her company, it is true. It does not matter where the issue originates. If it is hard to figure out, it ends up with the lawyers in the legal department. That, I believe, is because their intelligence, their discipline, and their judgment is respected internally.

My partner, Bob Profusek, who heads our mergers and acquisitions practice, said it best. Regarding the responsibility to really understand what we are doing, he said,

> This stuff is hard, and this stuff is multifaceted. You have to know the business backwards and forwards. You have to know the industries; you have to know the risks, and the people who can handle the hard stuff are hard to find. They need more than a pedigree from a top-flight business or law school. They need to have a little dirt under their fingernails as well.

3. Advocate Fundamental Change in Executive Compensation

Let us turn to executive compensation. Credit here goes to Frederic Cook, one of the nation's leading compensation consultants, for coming up with a phrase that I think is going to catch on if we have even the most remote opportunity at getting ahead of legislated solutions on executive compensation beyond the TARP-benefited institutions.

Cook calls it, "pay for sustainable performance."[4] I like how it plays on the green concept, but I also like what I think it means—that is, that rich rewards for a short-term bounce, particularly when the backside of that bounce is something we do not know yet, are no longer acceptable by any standard. They are no longer defensible, no longer right.

That sounds terrific, but I want to issue a warning about the concept of sustainable performance and the move away from "short-termism" in com-

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4. *See, e.g.*, Frederic W. Cook, Fred Cook Speaks to Directors About Executive Compensation, Stanford Directors' College (June 20, 2005), *available at* http://www.fwcook.com/alert_letters/FredCookStanford%20speech%206-20-05.pdf.

pensation. Note that this concept of focusing on longer-term, sustained performance for executive compensation is in actual conflict with what shareholder activists have wrought. We have eliminated classified boards.[5] We have implemented majority vote.[6] Proxy access is well on its way.[7] All of these result in the potential for rapid year-over-year turnover in corporate leadership.

So, while we want short-termism removed from executive compensation, we seem to want short-termism in corporate governance. I think the two are in absolute conflict, and while I feel that I am a bit of a lonely voice on this point, I believe I will be vindicated soon. This conflict is going to crystallize over the next five years, and I would argue that those on the side of good corporate governance need to pick one model. Pick long-term, or pick short-term, and stick with it, but do not leave this in conflict.

I hope that some of you saw the documentary that shows up from time-to-time on PBS called *The Corporation*.[8] It explains, as you all know, that as a legal matter, a corporation is deemed to be a person. However, as a person, so this documentary says, a corporation is effectively a psychopath.

The documentary argues that corporations themselves are devoid of an internal moral code. It makes sense that a company, arguably, will do what is right only in order to avoid penalties and negative sanctions, rather than out of a sense of moral duty.

I do not see it quite so starkly, and (if you have not already gathered it) I am a believer in the corporate enterprise. I think the board and management are the conscience of the company. To you lawyers out there: you are the little voice inside their heads. Boards and management, with your advice and your independent counsel, should be animated by a much more subtle and moral understanding of what it means to maximize shareholder value.

I hope we have now learned, once and for all, that shortcuts, workarounds, untrammeled greed, feelings of entitlement, ignoring risks, or worse, not comprehending risks, all ultimately impair shareholder value. If you are devoted to paying attention to those considerations, you will advise your clients in a way that ultimately will yield maximum shareholder value.

For the lawyers in the room, your mission and mine is to advise not merely that which is defensible, but that which is right.

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5. Jared A. Favole, *Big Firms Increasingly Declassify Boards*, RiskMetrics Group, http://www.riskmetrics.com/press/articles/011007_WSJ2.html (last visited June 5, 2009).

6. Subodh Mishra, *2008 Preview: Director Elections*, RiskMetrics Group, Jan. 4, 2008, *available at* http://www.riskmetrics.com/governance_weekly/2008/001.html.

7. *Id.*

8. The Corporation (Zeitgeist Films 2005).