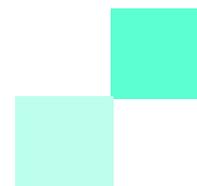


United States

David Fein and Mark Kaduboski, Wiggin and Dana LLP



www.practicallaw.com/3-201-8252

CORPORATE ENTITIES

Most large business entities are organised as corporations, which can be either privately or publicly held. Public corporations can be listed on a stock exchange. The two major US stock exchanges are the New York Stock Exchange (NYSE) and the National Association of Securities Dealers Automated Quotation system (NASDAQ).

A corporation is formed under the laws of one of the fifty states. Each state has its own set of corporation laws, which can impose different obligations on officers and directors. Most public corporations are incorporated in Delaware because:

- It has a flexible corporate legal framework.
- Its government agencies are generally efficient in addressing corporate regulatory matters.
- Its courts are experienced in handling corporate law matters and have developed a substantial corporate law jurisprudence.

Consequently, Delaware law is most commonly referred to when considering directors' duties or other corporate governance issues, and this chapter refers to Delaware law, unless otherwise stated.

LEGAL FRAMEWORK

1. **What is the regulatory framework for corporate governance and directors' duties? Please distinguish, where relevant, between the different types of companies and the mandatory rules of law and non-binding guidance/best practice which apply to them.**

Corporate governance is regulated by the following:

- Mandatory laws of the state in which a corporation is incorporated and a corporation's articles of incorporation (articles) (known in Delaware as a certificate of incorporation) and bye-laws (collectively known as charter documents).
- For public (and to a lesser degree, private) corporations, federal laws and regulations, such as:

- the Securities Act 1933, which requires public disclosure of financial and other information relating to issuing securities to the public;
- the Securities Exchange Act 1934, which requires the disclosure of:
 - a wide range of matters in current, quarterly and annual reports;
 - extensive information for proxy solicitations of shareholder votes;
- the Sarbanes-Oxley Act 2002 and Securities and Exchange Commission (SEC) rules, which have strengthened governance standards for public corporations by:
 - increasing the civil and criminal liability of corporate directors;
 - requiring greater independence of the board of directors;
 - increasing the transparency of corporate operations;
- the listing standards of the NYSE, NASDAQ and other exchanges, which set out substantive and procedural governance requirements.

Corporate governance is also influenced by publications of non-governmental organisations, based in the US and abroad, such as:

- Corporate Director's Guidebook (fourth edition, 2004), published by the American Bar Association's Committee on Corporate Laws.
- Statement of Corporate Governance 2002, issued by the Business Roundtable.
- Organisation for Economic Co-operation and Development Corporate Governance Principles 2004.

APPOINTMENT AND REMUNERATION OF DIRECTORS

2. What is the management/board structure of a company? In particular:

- Is there a unitary or two-tiered board structure?
- Who manages a company and what name is given to these managers?
- Who sits on the board(s)?
- Do employees have a right to board representation?
- Is there a minimum or maximum number of directors or members of the managerial and supervisory bodies?

■ **Structure.** Corporations generally have a unitary board structure, which is commonly referred to as the board of directors (board).

■ **Management.** State law generally requires corporations to be managed by their board and allows a board to appoint officers to manage many normal affairs of the corporation, subject to the board's supervision.

■ **Board members.** The board is comprised of individuals selected by the shareholders. Directors can (but do not have to be) shareholders, officers or employees of the corporation.

■ **Employees' representation.** Employees can have, but are not legally entitled to, board representation.

■ **Number of directors or members.** Corporations must have at least one director. There is no legal maximum number of directors. However, charter documents often set minimum and maximum numbers.

3. Are there any age or nationality restrictions on the identity of directors?

Age restrictions

There are no legal restrictions on the age of directors. However:

- Charter documents can set age requirements.
- Many public corporations impose a mandatory retirement age as a matter of corporate governance policy.

Nationality restrictions

There are no general restrictions on the nationality of directors. However, state and federal laws often impose restrictions on corporations engaged in certain activities, including those relating to national security.

4. In relation to non-executive, supervisory or independent directors:

- Are they recognised?
- Does a part of the board have to consist of them? If so, what proportion?
- Do non-executive or supervisory directors have to be independent of the company? If so, what is the test for independence or what will make a director not independent?
- What is the scope of their duties and potential liability to the company, shareholders and third parties?

■ **Recognition.** Federal securities laws and the listing rules of the NYSE and NASDAQ recognise and emphasise the role of independent directors of public corporations.

■ **Board composition.** Private corporations are not required to, and often do not, have non-executive or independent directors. However, a majority of the directors of most NYSE- and NASDAQ-listed corporations must be independent.

■ **Independence.** A director is independent if he has no material relationship with his listed corporation, either directly or as a partner, shareholder or officer of an organisation that has a relationship with the corporation.

A director is presumed not independent if, for example, he or an immediate family member:

- is (or recently has been) an employee of the corporation;
- receives (or recently has received) more than US\$100,000 (about EUR 84,617) per year in direct remuneration from the listed corporation, other than director and committee fees.

■ **Duties and liabilities.** Non-executive and independent directors have the same general duties and liabilities as other directors (*see Question 15*).

5. Are the roles of individual board members restricted? For example, can one person be the chairman and chief executive?

State law imposes no restrictions on the roles of individual directors. The same person can usually be the chairman of the board (chairman) and the chief executive officer (CEO). Many corporate governance commentators advocate a separation of the functions of chairman and CEO, and an increasing number of public corporations (albeit still a minority) are adopting this policy.

6. How are directors appointed? Is shareholder approval required?

Appointment of directors

Generally, directors are elected at each annual shareholders' meeting, unless their terms are staggered (see *Question 7*). Shareholders of private corporations sometimes elect directors by written consent of the shareholders in lieu of a meeting, but this process is often impractical for corporations with large numbers of shareholders. Unless otherwise provided in the charter documents, board vacancies and newly-created directorships can be filled by a majority vote of the directors then in office.

NYSE- and NASDAQ-listed corporations must maintain a nominating committee, composed entirely of independent directors, to identify individuals qualified to become directors and select nominees for the next annual shareholders' meeting. Public corporations must disclose a procedure by which shareholders can recommend nominees for the nominating committee's consideration (*SEC rules*).

Shareholder approval

Generally, each outstanding share allows a shareholder one vote for electing directors, and the director with the most votes is appointed. However, charter documents can change the manner of voting or composition of the board in numerous ways; for example, the articles can allow:

- **Weighted voting.** Certain classes of shareholders can be entitled to more votes than others.
- **Cumulative voting.** Shareholders can split their votes in different proportions for different directors, so that minority shareholders have a greater chance of ensuring the election of at least one favoured nominee.
- **Classified boards.** Certain classes of shares can vote for specified director positions or a certain number of directors so that their interests are directly represented on the board.

7. Are there any restrictions on a director's term of appointment?

Directors are generally elected for one-year terms and state law does not prohibit re-election. However, the articles can require staggered terms, where the board is divided into two or three groups each serving a staggered two- or three-year term. Boards of public corporations are sometimes structured in this manner.

8. Do directors have to be employees of the company? Can shareholders view directors' service contracts?

Directors employed by the corporation

Directors can, but do not have to, be employees of the corporation.

Shareholders' inspection

Shareholders have the right to inspect the corporation's books and records for a proper purpose. Public corporations must file all material contracts (including those between the corporation and its directors) with the SEC, which become publicly available.

9. Are directors allowed or required to own shares in the company?

Directors can, but are not required to, own shares in the corporation. Many public corporations encourage directors to own a certain percentage of shares and compensate directors, at least in part, with equity grants.

10. How is directors' remuneration determined? Does it need to be disclosed? Is shareholder approval required?

Directors' remuneration

Directors' remuneration is generally determined by the board.

Disclosure

State law does not require directors' remuneration to be disclosed to shareholders. However, shareholders may be able to discover this information by inspecting the corporation's books (see *Question 8, Shareholders' inspection*).

Federal securities law requires detailed disclosure of directors' remuneration arrangements for public corporations.

Shareholder approval

Shareholder approval of directors' remuneration is only required if set out in the charter documents. However, stock exchange rules may require shareholder approval for the adoption or amendment of equity plans for directors of public corporations.

REMOVAL OF DIRECTORS

11. How are directors removed? Can shareholders remove a director and, if so, what is the process and voting requirements?

Directors can be removed, with or without cause, by shareholders with a majority of the voting shares at a shareholders' meeting.

MANAGEMENT RULES AND AUTHORITY

12. How is a company's internal management regulated? For example, what is the length of notice and quorum for board meetings, and the voting requirements to pass resolutions at them?

A corporation's internal management is generally regulated by its charter documents. Boards can further regulate their affairs by adopting corporate governance policies and delegating duties to committees.

Although some notice of a board meeting (usually set by the charter documents) is typically required, a director can waive this requirement by attending the meeting.

A simple majority of the board must be present for a valid quorum, unless the charter documents provide otherwise. A majority of the directors in attendance at a properly constituted meeting can typically pass a resolution.

13. Can directors exercise all the powers of the company or are some powers reserved to the supervisory board (if any) or a general meeting? Can the powers of directors be restricted and are such restrictions enforceable against third parties?

Directors' powers

The overall business and affairs of a corporation are managed by its board (unless the articles or, in some cases, a shareholders' agreement restricts or eliminates the board's powers with respect to specified matters). The day-to-day operations of the corporation, however, are typically managed by officers, subject to the board's supervision. Shareholder approval is required for amendments to the articles and fundamental changes to the corporate structure.

Third parties

A restriction on the board's powers is enforceable against third parties if they have notice of the restriction.

14. Can the board delegate responsibility for specific issues to individual directors or a committee of directors? Is the board required to delegate some responsibilities, for example for audit, appointment or directors' remuneration?

The board cannot delegate responsibility for specific issues to individual directors in their capacities as directors, but can delegate responsibility for most matters to committees consisting of one or more directors (which have the same powers as the board).

Boards of NYSE- and NASDAQ-listed corporations must create certain committees consisting entirely of independent directors and delegate substantial authority to them for the following duties:

- Audit (*see Question 27*).
- Compensation (*see Question 10*).
- Directors' nominations and corporate governance (*see Question 6*).

DUTIES AND LIABILITIES OF DIRECTORS

15. What is the scope of a director's duties and personal liability to the company, shareholders and third parties? Please distinguish between civil and criminal liability under each of the following (if relevant):

- **General duties.**
- **Theft and fraud.**
- **Securities law.**
- **Insolvency law.**
- **Health and safety.**
- **Environment.**
- **Anti-trust.**
- **Other.**

- **General duties.** The two fundamental fiduciary duties of directors are the duty of care and the duty of loyalty.

The duty of care requires that a director must:

- be reasonably informed;
- participate in decisions;
- exercise independent judgement;
- discharge his duties in good faith, with the care that an ordinarily prudent person in a like position would reasonably believe appropriate under similar circumstances. Good faith means that the director must act and make decisions in the best interest of the corporation. Directors who have acted in good faith and in a manner reasonably believed to be in the best interest of the corporation, and with independent and informed judgement, are generally protected from personal liability (business judgement rule).

- The duty of loyalty requires that directors must act in the best interests of the corporation, rather than in their own interests or those of a third party. A director generally must not:
 - participate in any decision that benefits himself, directly or indirectly;

- use his position, or an opportunity available to the corporation, for individual personal advantage;
- compete directly with the business of the corporation.
- **Theft and fraud.** Directors are generally not personally liable for a corporation's crimes or torts, including theft and fraud, unless they are personally involved. In rare cases, directors are liable if they fail to take measures that they should have taken to prevent the corporation from committing a crime or fraud.
- **Securities law.** Directors can incur criminal and civil liability for breach of the anti-fraud provisions of state and federal securities laws. They can also incur liability for:
 - making an untrue statement of material fact;
 - failing to state a material fact;
 - engaging in a practice that operates as a fraud or deceit on purchasers or sellers of the corporation's securities.

Directors can face civil damages for signing a registration statement filed with the SEC for the sale of the corporation's securities if it contains an untrue statement of material fact or a material omission (*Securities Act*). No intent to defraud need be shown, although a due-diligence defence is available.

- **Insolvency law.** Generally, directors owe no fiduciary duties to creditors, except that they:
 - must protect the corporation's assets for creditors if the corporation approaches insolvency;
 - can be liable for damages incurred by creditors if they approve a conveyance found to be fraudulent under insolvency laws.
- **Health and safety.** Generally, directors are not personally responsible for corporate breaches of health, safety or environmental laws. However, they can be criminally liable if they intentionally violate state or federal health and safety laws and the Department of Justice has recently been willing to prosecute. A director can also be individually liable for monetary damages if he knowingly participates in tortious conduct that benefits the corporation, even he derives no personal benefit.
- **Environment.** See above, *Health and safety*.
- **Anti-trust.** Directors can be civilly and criminally liable if they knowingly participate in unlawful or improper acts that breach federal anti-trust statutes (principally the Sherman and Clayton Acts). In addition, a director can be civilly or criminally liable for certain anti-trust offences by the corporation that he authorises, such as improper price discrimination, bribes, tying arrangements or anti-competitive mergers and acquisitions.

- **Other.** Directors can be liable:
 - to the corporation and its creditors for any unlawful portion of a distribution of corporate assets;
 - civilly and criminally, for wilful failure to pay wages if they make payroll decisions;
 - civilly and criminally, for wilful failure to pay the corporation's taxes.

16. Can a director's liability be restricted or limited? Is it possible for the company to indemnify a director against liabilities?

A corporation's articles can limit the personal liability of directors for monetary damages arising from breaches of the duty of care, but not the duty of loyalty. Directors' liability cannot be limited in any way for:

- Authorising unlawful corporate distributions.
- Failing to act in good faith.
- Intentional misconduct.
- Knowing violations of law.

A corporation can also indemnify directors and other corporate agents against expenses, judgments, fines and other sums incurred in connection with service to the corporation, provided they:

- Acted in good faith.
- Acted in a manner reasonably believed to be in, or not opposed to, the corporation's best interests.
- Had no reasonable cause to believe that the conduct was unlawful.

Virtually all public corporations have adopted charter documents indemnifying directors.

17. Can a director obtain insurance against personal liability? If so, can the company pay the insurance premium?

A director can obtain insurance against personal liability for breach of a fiduciary duty and a corporation can pay the premium (directors' and officers' (D&O) insurance). Virtually all public corporations purchase D&O insurance in an amount sufficient to cover all anticipated damages claims against directors.

18. Can a third party (such as a parent company or controlling shareholder) be liable as a director for the issues identified in Question 15 (even though such person has not been formally appointed as a director)?

Generally, shareholders and other third parties not involved in the management of a corporation are not liable as directors. There are, however, a number of theories under which a shareholder might become liable:

- **Piercing the corporate veil.** Shareholders can be liable if:
 - they treat the corporation as their alter ego and ignore corporate formalities;
 - the corporation is inadequately capitalised;
 - they use the corporation to avoid personal liability or perpetrate a fraud.
- **Federal securities law.** A parent corporation could be liable under the controlling person doctrine (a legal person is considered to control a public corporation if it can direct or cause the direction of the corporation's management and policies, whether through owning voting securities, by contract or otherwise).
- **Environmental law.** A parent corporation or controlling shareholder can be held responsible for a corporation's environmental liability under state and federal law.

TRANSACTIONS WITH DIRECTORS AND CONFLICTS

19. Are there restrictions on transactions between a company and its directors?

State law requires that transactions between a corporation and one or more directors must either:

- Be approved after all material facts about the interest of the director who is party to the transaction have been disclosed, by either:
 - a majority of the directors who are independent of the transaction;
 - a majority of the voting shares held by shareholders with no interest in the transaction.
- Be fair to the corporation when it is authorised, approved or ratified by the directors, a board committee or the shareholders.

In addition, a public corporation cannot extend to or facilitate credit for a director, unless the loan is on no more favourable terms than is offered to the general public by the corporation in the ordinary course of business (*Sarbanes-Oxley Act*).

20. Are there general rules relating to conflicts of interest between a director and the company?

The laws regarding a director's duty of loyalty govern conflicts of interest between a director and the corporation (*see Question 15 and 19*).

NYSE- or NASDAQ-listed corporations must adopt and disclose a code of business conduct and ethics for directors, which establishes policies on conflicts of interests.

21. Are there restrictions on the purchase or sale by a director of the shares and other securities of the company he is a director of?

Private corporations

There are no restrictions on the purchase or sale of a private corporation's securities by its directors, although such sales are always subject to the anti-fraud provisions of state and federal securities law.

Public corporations

All open market sales of public corporation securities by its directors must be made under an effective registration statement or under the applicable provisions of an exemption from registration.

In addition, directors of public corporations, among other things:

- Cannot buy or sell shares of the corporation's stock if they are aware of material, non-public information at the time of the transaction.
- Cannot buy or sell shares during a retirement plan blackout period (when plan participants are restricted from adjusting their investments).
- Must report to the SEC their transactions in the corporation's securities before the end of the second business day following the transaction.
- Must pay to the corporation any profit realised in paired purchases and sales of the corporation's securities during a six-month period, subject to limited exceptions.
- Are prohibited from making any short sale of the corporation's equity securities (that is, borrowing shares from a broker and selling them, with the understanding that they must later be bought back and returned to the broker).

DISCLOSURE OF INFORMATION

22. Do directors have to disclose information about the company to shareholders, the public or a regulatory body, particularly under securities laws? For example, if offering securities to the public, or where there is inside information which is likely to have a significant effect on the company's share price.

Disclosure to shareholders

Directors must disclose information about the corporation if a shareholder makes a written request stating a proper purpose (a purpose reasonably related to the requesting party's interest as a shareholder).

Disclosure to the public

Federal securities law requires public corporations to disclose certain information to the public, including:

- All material facts related to the corporation's purchase or sale of its own securities.
- Specified disclosures in quarterly and annual reports, and in proxy solicitations of its shareholders.
- Current reports filed with the SEC covering numerous specified corporate events.
- Information that is disclosed to analysts or investors.

COMPANY MEETINGS

23. Does a company have to hold an annual shareholders' meeting? If so, when? What issues have to be discussed and approved?

Private corporations

Private corporations must hold an annual shareholders' meeting to elect directors, unless they are elected by shareholders' written consent in lieu of a meeting.

Public corporations

Public corporations generally must hold annual shareholders' meetings in accordance with state law and the rules of the stock exchanges on which their shares are traded.

When a public corporation solicits proxies to elect directors and address other matters, it must provide full disclosure to shareholders of the matters being voted on and many other matters (such as officers' and directors' compensation).

Issues to be discussed and approved

There are no specific requirements as to what matters must be addressed at annual shareholders' meetings, other than electing directors.

24. Can shareholders call a meeting or propose a specific resolution for a meeting? If so, what level of shareholding is required to do this?

State law

Under state law, shareholders can convene a special shareholders' meeting if the charter documents permit. The by-laws of many public corporations require shareholders submitting a proposal (or a director nominee) at a meeting, to give notice providing information about the proposal well in advance of the scheduled meeting date.

Federal law

SEC rules governing the use of proxies allow public corporation shareholders to propose specific resolutions for annual shareholders' meetings, if they own at least US\$2,000 (about EUR1,692) of securities or 1% of outstanding stock, and provide information about themselves and reasons for their support of the resolution, to be included in the corporation's proxy statement. Shareholder-proposed resolutions can be excluded by a company if they are improper under the laws of the jurisdiction where the corporation is incorporated, or for a limited number of other reasons specified by the SEC.

MINORITY SHAREHOLDER ACTION

25. What action, if any, can a minority shareholder take if it believes the company is being mismanaged and what level of shareholding is required to do this?

If a minority shareholder believes that the corporation is being mismanaged he can seek to change the directors. Shareholders of public corporations must comply with SEC regulations for election contests. A shareholder can also seek remedies in litigation by, for example:

- Commencing an action in the corporation's name against the directors for mismanagement or breach of fiduciary duty.
- Applying for the involuntary dissolution of a closely-held private corporation, on the grounds of mismanagement or oppression.

INTERNAL CONTROLS, ACCOUNTS AND AUDIT

26. Are there any formal requirements or guidelines relating to the internal control of business risks?

State law

State law imposes no formal requirements or guidelines for the internal control of business risks. The board, in exercising its general management responsibilities, must ensure that appropriate guidelines are adopted for the corporation.

Federal law

Public corporations must include in their annual reports a separate management report on the effectiveness of internal controls over financial reporting, which must be attested by the auditor (*Sarbanes-Oxley Act*). This requirement has proved to be very costly for the large corporations to which it applies and the SEC has delayed implementation for smaller corporations (see *Question 36, Internal controls and auditors' attestation*).

Listing standards

NYSE and NASDAQ listing standards require a board to establish an audit committee to set guidelines and policies governing the corporation's risk assessment and management process (see *Question 27*).

27. What are the responsibilities and potential liabilities of directors in relation to the company's accounts?

The board must ensure the integrity of the corporation's financial statements and similar information. Federal law provides that the audit committee of public corporations must both:

- Engage an independent accounting firm to audit the financial statements prepared by the management and supervise the work performed.
- Establish confidential and anonymous procedures by which employees can report concerns about the corporation's accounting practices.

NYSE and NASDAQ listing standards impose additional requirements on audit committees of listed corporations. For example, all audit committee members must be independent and financially literate, and at least one member must qualify as a financial expert under the listing rules.

Directors can be civilly liable for breach of their duties of care and loyalty in managing the corporation's accounts (see *Question 15*). They can also be criminally liable for committing securities fraud and obstructing justice in connection with accounting and other matters.

28. Do a company's accounts have to be audited?

The accounts of a private corporation do not have to be audited. Public corporations must file annual reports containing audited financial statements meeting the requirements of applicable SEC regulations. In addition, a public corporation's auditor must include in the annual report an attestation report on the management's assessment of the corporation's internal controls over financial reporting.

29. How are the company's auditors appointed? Is there a limit on the length of their appointment?

Directors of private corporations appoint auditors. Auditors of public corporations are appointed by the audit committee. Shareholders do not have to approve auditors' appointments, but public corporations usually seek ratification of appointments each year. There is no limit on the duration of an auditor's appointment, but SEC rules require the periodic rotation of an auditing firm's partners serving a particular public corporation client.

30. Are there restrictions on who can be the company's auditors? For example, do they have to be registered with a regulatory body or meet other professional requirements? Do they have to be independent of the company they audit accounts for? Are certain persons not allowed to be the company's auditors?

Generally, auditors of public corporations and their subsidiaries must be registered with the Public Company Accounting Oversight Board (PCAOB), and comply with any audit or quality control standards set by it. Among other things, the auditor must be independent (that is, they must not have any direct or materially indirect interest with the client).

Audits of private corporations must meet the auditing, ethics and independence standards set by the Auditing Standards Board of the American Institute of Certified Public Accountants.

31. Are there restrictions on non-audit work that auditors can do for the company that they audit accounts for? For example, are there certain types of work that auditors can and cannot do for the company?

A public corporation's auditor is prohibited by federal securities law from providing certain non-audit services, including:

- Actuarial services.
- Appraisal services.
- Bookkeeping services.
- Broker, dealer, investment adviser or investment banking services.
- Designing and implementing financial information systems.
- Internal audit outsourcing services.
- Legal services or expert services unrelated to the audit.
- Management functions or human resources.

If the auditor receives advance express consent from a public corporation's audit committee, it can perform other non-audit services, such as tax and consulting services.

32. What is the potential liability of auditors to the company, its shareholders and third parties if the audited accounts are inaccurate? Can their liability be limited or excluded?

Rules imposing liability on auditors vary between states. Auditors can be liable for breach of contract, ordinary or gross negligence, fraud, or securities law violations, but not for aiding and abetting another's misconduct. Auditors are usually liable to shareholders or third parties for ordinary negligence only if they were aware of the intended use of their accounts.

A party that acquires securities may be able to sue an auditor if its financial misstatements were material and included in a registration statement filed with the SEC.

An auditor can also be liable to a shareholder or other third party under the federal securities laws if all of the following apply:

- The shareholder or other third party can prove that the auditor acted with gross negligence in preparing accounts.
- The shareholder or third party relied on that misstatement in making a decision to buy or sell securities.
- The misstatement resulted in a loss.

A due care defence may be available to auditors who can prove that the audit was conducted in conformity with Generally Accepted Auditing Standards.

Auditors are prevented by statute from limiting their liability in relation to the corporation for audit work and there is generally no cap on auditor liability.

CORPORATE SOCIAL RESPONSIBILITY

33. Is it common for companies to report on social, environmental and ethical issues? Please highlight, where relevant, any legal requirements or non-binding guidance/best practice on corporate social responsibility.

Public corporations must:

- Disclose potential environmental liabilities facing the corporation in periodic filings with the SEC.
- Maintain and publish one or more codes of ethics for officers and directors and promptly disclose any waivers or violations of those codes.

Public corporations are also receiving an increasing number of shareholder proposals relating to matters of corporate social responsibility for consideration at annual meetings. Corporations typically make statements about the substance of those proposals in their recommendation to the shareholders on the relevant agenda items.

ROLE OF GENERAL COUNSEL

34. Is it common for the general counsel to be on the company's board or to have a formal role in corporate governance?

It is possible, but not common, for the general counsel to be on the corporation's board. Regardless of whether the general counsel is a director, he typically plays a crucial role in ensuring that the corporation observes corporate formalities.

Other employees and external lawyers must report to the general counsel, as the corporation's chief legal officer, evidence of material breaches of securities law, fiduciary duty or similar breaches by the corporation or its agents (*Sarbanes-Oxley Act*). If the general counsel receives such a report, he must respond appropriately by taking any necessary measures to remedy past, and prevent future, breaches.

The SEC has initiated actions against more than 75 lawyers involved in corporate wrongdoing over the past four years.

WHISTLEBLOWING

35. Is there statutory protection for whistleblowers (a person who discloses criminal activity or other serious malpractice within a company)?

Numerous federal statutes contain provisions protecting whistleblowers within certain limited and narrowly-defined circumstances. Most states also have statutory or common law whistleblower or anti-retaliation laws in place.

Employees of public corporations have significant protection from retaliation if they report, or co-operate in the prosecution of, fraud or breaches of federal corporate compliance laws (*section 806, Sarbanes-Oxley Act*). To be protected, a whistleblowing employee must reasonably believe that a breach of law has occurred and must prove that the termination was in retaliation for the protected activity. He can seek reinstatement with seniority, back pay, litigation costs, lawyers' fees and any other damages necessary to cover his losses. Federal criminal penalties can also be imposed against the employer and persons responsible for retaliation.

The audit committees of public corporations must establish processes by which employees can confidentially and anonymously submit concerns about accounting or financial practices (*section 301, Sarbanes-Oxley Act*).

REFORM

36. Please summarise any impending developments or proposals for reform.

The uncertainties created by recent business scandals and regulatory reforms continue to affect the actions of directors and their advisers. Three important areas are set out below.

Directors' personal liability

Former directors of Enron and WorldCom recently agreed to pay tens of millions of dollars personally to settle class action allegations of securities fraud. The WorldCom proposed settlement was subsequently rejected by the court due to concerns about its implications for non-settling defendants. These settlements prompted substantial commentary because directors of public companies, in the past, almost invariably had settlements paid for by corporation-purchased insurance. In both of these high-profile situations, however, the claimants insisted that they would only settle their liability claims if directors agreed to pay significant amounts personally. Many commentators believe that the very high-profile nature of these corporate collapses, and the severity of the alleged omissions by the directors, make the cases against these directors unique. It remains to be seen whether claimants and/or the government will seek personal liability in future actions alleging director negligence.

Directors' fiduciary duty and executive remuneration

US courts continue to analyse whether directors should be held liable for breach of their fiduciary duties in approving lavish executive compensation and severance packages. In a much anticipated decision, the Delaware Chancery Court found that Disney's directors did not breach their fiduciary duties by agreeing to a large severance package for former President Michael Ovitz (*In re Walt Disney Co. Derivative Litigation*, 825

A.2d 275 (Del. Ch. 2003)). The court found that the board did not act in bad faith or with gross negligence, despite the fact that Ovitz's short tenure at Disney ended in spectacular failure. The court noted that directors need not comply with best corporate practices to avoid liability for breach of their fiduciary duties or duties of good faith provided they make well-informed business decisions consistent with their fiduciary duties. Nonetheless, directors' roles in approving executive compensation and severance packages is likely to remain a focus of litigation in the future.

Internal controls and auditors' attestation

The management of a public corporation must report on its internal controls over financial reporting and the corporation's auditors must attest the management's report (*section 404, Sarbanes-Oxley Act*). This requirement currently applies to public corporations with equity securities valued at more than US\$700 million (about EUR592.3 million), and compliance has proved to be very time-consuming and expensive. The SEC has acknowledged that the costs of compliance have exceeded their expectations, and has delayed compliance for corporations with equity securities valued at less than US\$700 million until the first fiscal year ending after 15 July 2007. The SEC has also encouraged accounting standard-setting organisations to issue guidance allowing smaller corporations to ensure adequate internal controls over financial reporting in a more cost-effective manner.



PRACTICAL LAW COMPANY

Partners in know-how

My valuable invisible

“PLC Cross-border Handbooks are an extremely useful resource when it comes to instructing lawyers outside the UK. They are a quick way to become literate in a particular area of law so you can then instruct a firm in a much more focused way. In addition, if a firm has been chosen by PLC to write a chapter that is definitely one of the factors we will consider when choosing external counsel to advise on a transaction in that country.”

Steve Weatherley, Head of UK Legal
Scottish & Newcastle

www.practicallaw.com/crossborder

WIGGIN AND DANA

Counsellors at Law

Antitrust and Trade Regulation
Appellate
Biotechnology & Life Sciences
Business
Business Tax
Education
Employee Benefits
Emerging Companies and Private
Equity
Environmental
Finance
Franchise and Distribution
Health Law
Information Technology and Sourcing
Intellectual Property
Labor & Employment
Litigation
Mergers and Acquisitions
Real Estate Law
Securities and Venture Capital
Tax Exempt Organizations
Trusts and Estates
Utilities and Regulated Industries
White-Collar Defense, Investigations
& Corporate Compliance



DAVID B. FEIN

Partner

Stamford Office

Tel: 203.363.7603

Email: dfein@wigginc.com



MARK S. KADUBOSKI

Partner

Stamford Office

Tel: 203.363.7627

Email: mkaduboski@wigginc.com

NEW HAVEN • STAMFORD • NEW YORK • HARTFORD • PHILADELPHIA

WWW.WIGGIN.COM