Corporate Governance 101

Corporate Counsel Women of Color 2018
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AGENDA

I. Understanding Governance

II. Governance and Growth

III. Governance and Risk Management
Understanding Corporate Governance
UNDERSTANDING GOVERNANCE

This module will help you to understand the basic scope and definitions relating to corporate governance.
What is Corporate Governance?

*Corporate governance* broadly refers to the mechanisms, relations, and processes by which a *corporation* is controlled and is directed; involves balancing the many interests of the stakeholders of a *corporation*. www.businessdictionary.com
UNDERSTANDING GOVERNANCE

Corporate Governance has two aspects:

I. Statutory
II. Process
UNDERSTANDING GOVERNANCE

I. Statutory
   - State Business Organizations Code
   - Delaware Code -- a model
   - Securities Act/Exchange Act/NYSE/NASDAQ
   - Industry-specific regulations

II. Process
   - Board oversight
   - Delegation of authority
   - Separation of duties
   - Code of ethics
   - Internal controls
UNDERSTANDING GOVERNANCE

- The governing documents of an entity are determined by the form of entity but have the same functions and purpose.
  - Articles of Incorporation/Certificate of Incorporation
  - Certificate of Formation
  - Certificate of Limited Partnership
  - Bylaws
  - Limited Liability Company Agreement
  - Limited Partnership Agreement
- Understand those regulated by the Secretary of State or Comptroller vs those the entity determines internally
UNDERSTANDING GOVERNANCE

- Forms of entities (Limited Liability):
  - Corporation (Subchapter S or C)
  - Limited Liability Company (LLC)
  - Limited Partnership
  - Limited Liability Partnership

- Forms of doing business (Unlimited Liability):
  - Sole proprietorship
  - General Partnership
  - Joint Venture
UNDERSTANDING GOVERNANCE

Role of a Corporate Secretary

- A Corporate Secretary is required by state corporation laws for every corporation. Individual corporate by-laws set forth the powers and duties of the Corporate Secretary.

- A Corporate Secretary is responsible for ensuring that the records, or minutes of the Board's actions during a Board meeting, reflect the proper exercise of the Board’s fiduciary duties.

- The role serves as the guardian and the advisor for procedural matters and the discharge of the Board’s fiduciary duties.
UNDERSTANDING GOVERNANCE
Public Sector

- Role of the Secretary of State

The Secretary of State is a state level executive office, elected in some states, appointed by the governor in others, that keeps records for the state. May be the chief election official. Registers businesses, and records the official acts of the governor. The duties vary by state.
UNDERSTANDING GOVERNANCE

Public Sector

- **Role of the Comptroller**

  A state’s chief accountant or financial officer. May be appointed or elected. Collects taxes of a Corporate and may issue good standing certifications. Enacts rules and guidelines or state business.
UNDERSTANDING GOVERNANCE

Role of a Corporate Secretary

- Manage Board and any of its Committees
- Attend and record minutes of all board and committee meetings
- Maintain key corporate documents and records
- Advise the Board on its roles and responsibilities
- Facilitate the orientation of new Directors and assist in Director training and development
- Director Searches
UNDERSTANDING GOVERNANCE

FILED WITH THE SECRETARY OF STATE

- Articles/Certificate of Incorporation
- Certificate of Formation
- Certificate of Limited Partnership

NOT FILED, BUT MAINTAINED BY THE CORPORATE SECRETARY

- Bylaws
- Limited Liability Company Agreement
- Limited Partnership Agreement
- Joint Venture Agreement
- Partnership Agreement
UNDERSTANDING GOVERNANCE

- Shareholders/Members/Limited Partners
  - Entity is governed for their benefit
  - Not actively involved in governance
    - (Exception Member managed LLC/General Partners)
    - Piercing the corporate veil
- Board of Directors/Board of Managers
  - The stuff of legend in the Delaware Chancery Court
  - Responsible for exercising their fiduciary duty and business judgment for the benefit of the shareholders
    - Aronson v. Lewis, 473 A.2d 805 (Del. 1984)
    - (Exception insolvency and bankruptcy when creditors are primary)
UNDERSTANDING GOVERNANCE

- Corporate officers
  - Day to day management of the entity
    - Delegation of authority
    - Separation of duties
    - Code of ethics
    - Internal controls
  - Different scope than directors
  - Tactical execution of the business
  - Primary officers of governance:
    - CEO-Chief Executive Officer
    - CFO-Chief Financial Officer
    - CLO-Chief Legal Officer
    - Corporate Secretary
    - CCO-Chief Compliance Officer
UNDERSTANDING GOVERNANCE

- Governance by process – the exercise of prudence and controls.
  - Duty of care – *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261 (Del. 1989) (active oversight required but not day to day management)
- Board of directors/managers- “manage with their nose not their fingers”
  - Committees
    - Executive
    - Nominating and Governance
    - Compensation
    - Audit
    - Special committee
    - Independent directors
UNDERSTANDING GOVERNANCE

- When do you need the shareholder vote vs Board vs Management (fiduciary duty)?
  - Corporate docs
  - LLC
  - Rights to vote
  - Timing of Board Meetings
  - Ratification—mulligan-first answer second answer (fix things already done)
UNDERSTANDING GOVERNANCE

- Subsidiary Governance
- Why do companies form subsidiaries?
  - Strategic and operational business needs
    - Business segments or lines of business broken out
    - Business flexibility
    - Tax planning
    - Local legal requirements
UNDERSTANDING GOVERNANCE

- Maintain subsidiary as a separate legal entity
  - Have its own Board/Members/Managers
  - Appoint its own officers
    - Typically employees of company or related companies, such as Parent entity
    - Having lawyers serve as directors/managers could risk attorney-client privilege
  - Hold own annual meetings / regular meetings
  - Keep own minutes
  - Protect piercing the corporate veil
  - Delegations to officers
    - Issue – often employees do not realize their authority is limited by entity within an organizational structure.
    - Authority for one entity does not translate into authority to other affiliated entities
  - Maintain subsidiaries in good standing
    - Ensure all required state or local filings are done
UNDERSTANDING GOVERNANCE

- Lifespan of Subsidiaries
  - Establish a process to have new subsidiaries approved internally
  - Advise key stakeholders (legal, tax, finance/controller team)
  - When no longer needed dissolve and withdraw any foreign qualifications
Governance and Growth
GOVERNANCE AND GROWTH

- Business success is all about growth
  - Customers
  - Markets
  - Revenues

- The ability to counsel your client on the execution of an effective growth strategy makes you part of the success engine of the business and not a roadblock
GOVERNANCE AND GROWTH

Scale requires:

- Taking on additional risk
- Decentralization of decision-making
- Development of processes
GOVERNANCE AND GROWTH

Taking on additional risk means additional variables to the operations and additional requirements.

- Investors
- Employees
- Creditors
GOVERNANCE AND GROWTH

- **Investors**
  - Fiduciary duties—More constituencies care if you lose money
  - Regulatory requirements—Additional legal requirements
  - Reporting/disclosure obligations

- **Employees**
  - More actors to be concerned about
  - Additional legal requirements attach with size

- **Creditors**
  - Covenants in credit facilities
  - More constituencies care if you lose money
  - Certifications and processes
GOVERNANCE AND GROWTH

Internal controls are the scaffolding of growth

- Mitigate risk
- Create culture and good institutional decision-making
- Support scale of the business
- Support liquidity events and acquisition/integration
Governance and Risk Management
A LITTLE STICK

2,410 occupational fraud cases lost more than $6.3 billion in 2016

The Fraud Tree

- Conflicts of interest
- Purchasing schemes
- Bribery
- Invoice kickbacks
- Bid rigging

- Theft of cash
- Skimming
- Write off schemes
- Fraudulent Disbursements
- Shell Company
- Ghost Employee

- Net worth over/understatements
- Concealed liabilities
- Recognition timing differences
- Improper disclosure

In 2012 JPMorgan Chase had no directors with risk expertise on the board’s risk committee—a deficiency that was corrected only after Bruno Iksil, the “London Whale,” caused $6 billion in trading losses through what JPM’s CEO, Jamie Dimon, called a “Risk 101 mistake.”

Source ACFE Report to the Nations 2016 Global Fraud Study
A LITTLE CARROT

Better governance yields better corporate results

- Continuity of Management and Talent retention
- Better decision-making with all affected parties weighing in
- Ability to capitalize on opportunities and act strategically
- Positive correlation between safety and operational performance

Determine what works for your company/industry

Look for the hidden opportunities and share them with management
Thomas Edison famously said, "**Good fortune is what happens when opportunity meets with planning.**"

- There is a surprising amount of focus globally on the role of corporate governance and how it effects performance.

GOVERNANCE AND RISK MANAGEMENT

It’s your house until it's not, a case study.
