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### Recommendations in Drafting Disclosure Relating to Board Leadership and Risk Oversight

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For some years now, corporate governance experts have debated the best model of board leadership for public companies. Studies have compared the historically prevailing U.S. model—in which the chief executive officer also serves as chairman of the board—with different approaches that are more common in other countries, such as the typical approach in many European markets of having an independent board chair. As U.S. public companies were caught off guard by the depth and severity of the most recent financial crisis, what seemed before to be primarily an academic subject became very real for U.S. public companies. Some observers suggested that the U.S. board leadership model (and specifically the failure of U.S. regulators to require an independent board chair) contributed to the crisis and to the failure of U.S. public companies to be prepared for the effects of the crisis. Legislators and regulators picked up on this theme, with suggestions that public companies should be required to have an independent board chair.

In the years between Sarbanes-Oxley and the 2008/2009 financial crisis, many boards realized that there were alternatives to having an independent board chair. For example, many companies continue to have a combined CEO/chairman, but have appointed a “lead” or “presiding” director. Even where there is no director holding such a title, many boards have called on particular directors (for example, the chair of the audit committee or the chair of the governance committee) to take leadership roles, on behalf of the independent directors. Moreover, with the tumult in some board rooms and executive suites arising out of the most recent financial crisis, boards in certain instances have chosen, in response to their specific circumstances, to go the route of having an independent board chair, at least until the crisis passes. Accordingly, as we enter 2010, it is no longer appropriate to say that there is one “prevailing” model of board leadership for U.S. public companies. Rather, boards increasingly are choosing their leadership models based on their specific circumstances, such as the talent and experience of the chief executive officer, the challenges that the company is facing, and the preferences of their large shareholders.



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Fittingly, given the changing nature of the board leadership landscape, beginning with the 2010 proxy season, every U.S. public company will be subject to a new requirement. Under revised disclosure rules adopted by the SEC on December 16, 2009, each company must—in the proxy statement for its annual meeting—describe its board leadership model and explain why it has chosen this model. In addition, companies must disclose the extent of the board’s role in risk oversight and the effect that this oversight has on the board’s leadership structure.

These new requirements are found in Item 407(h) of Regulation S-K under the Securities Exchange Act of 1934, which provides as follows:

Briefly describe the leadership structure of the registrant's board, such as whether the same person serves as both principal executive officer and chairman of the board, or whether two individuals serve in those positions. . . . If one person serves as both principal executive officer and chairman of the board . . . disclose whether the registrant has a lead independent director and what specific role the lead independent director plays in the leadership of the board. This disclosure should indicate why the registrant has determined that its leadership structure is appropriate given the specific characteristics or circumstances of the registrant. In addition, disclose the extent of the board’s role in the risk oversight of the registrant, such as how the board administers its oversight function, and the effect that this has on the board’s leadership structure.

The following are recommendations for public companies, as they begin their work in drafting the descriptions of their board leadership models and approaches to risk oversight, for publication in their 2010 proxy statements. We have previously published a [Client Alert](#) that includes samples of disclosure for different scenarios, and these samples illustrate many of points discussed in these recommendations.

1. **Have the Board Thoughtfully Review its Current Leadership Structure.** In recent years, some public companies have undertaken a “white board” approach to their board leadership structures, and made changes to address perceived shortcomings. Other companies have not undertaken a methodical review of their leadership structures from the ground up, but have made changes to their board leadership in reaction to specific events (such as an unexpected departure of a CEO or the need to take drastic actions as a result of the financial crisis) or even as a result of unusual personalities or politics. In preparing their 2010 proxy statements, it will be important for boards to review their leadership structures in light of their existing circumstances, to be able to explain why they have selected their current model. A company that is unable to defend its current board leadership structure in strong terms should consider what changes may be appropriate.
2. **Consider the Sources of “Leadership”.** In addition to “chair” and “lead director” titles, directors should consider other sources of leadership for their independent directors (for example, the work of the chairs of board committees). Boards should also consider how the leadership experience of individual directors supports the effective leadership of the corporate board, especially where there is no independent chair or lead or presiding director.



3. **The Lead Director—Responsibilities or Contributions?** Under the new disclosure rule, a company that has a combined CEO/chairman and a lead director, will be required to disclose “the specific role the lead director plays in the leadership of the board”. Companies may take differing approaches in describing the role of the lead director: Under a narrow approach, the company would describe the specific responsibilities of the lead director (for example, as specified in the company’s corporate governance guidelines). Under a broader approach, the company might discuss the value-added contributions of the lead director. Such contributions might include mentoring the CEO, keeping board discussions at the right level, ensuring that the board has the information it needs, acting as a liaison between the independent directors and the CEO and helping bring the board to consensus positions.
4. **Consider how the Model Might Change.** Every company will need to be cautious in describing the merits of its current board leadership model and especially in comparing this model to prevailing models for other public companies. The company’s own situation and board composition may change over time, with the result that the company may want to change its board leadership structure. Market practices may also change, for example, as there are shifts between the prevalence of combined CEO/chairmen, independent board chairs and lead directors. A board should be certain not to “paint itself into a corner,” in describing the merits of its current leadership model, so that it will be able to make future changes, as may be appropriate under the circumstances.
5. **One Free Bite at the Apple.** Prior to publishing their 2010 proxy statements, companies will be able to make changes in their board leadership structures, without having to expressly disclose that these changes have only been made recently. For example, a board could appoint a lead director or a permanent presiding director, or it could expand the responsibilities of an existing independent board chair or lead director. As companies begin to prepare their 2010 proxy statements, boards should consider whether they would like to make any such changes in advance. Similarly, boards may wish to consider whether they want to make changes in their approach to risk oversight (for example, by amending corporate governance guidelines or board committee charters to specifically address the subject). On the other hand, companies with long-standing models that have been successful may wish to emphasize the benefits that they have enjoyed from their historic approaches.
6. **Consider Your Audience (and Word Count).** Some companies will view the new disclosure requirements as a burden, to be addressed in as few words as possible. Other companies believe that they gain favor from investors, RiskMetrics and others based on their leadership models, and they will want to present the nuances of how their boards and board leaders function and the benefits resulting from their structure. Each company will need to determine whether it is better served by a short-form or a long-form approach.
7. **Draw the Connection to Risk Oversight.** Item 407(h) requires that companies disclose the extent of the board’s role in risk oversight and the “effect that this has on the board’s leadership structure.”



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The wording of this requirement is confusing, as it may often be difficult to describe how the board's risk oversight function affects its leadership structure. For many companies, it may be more useful to respond by describing how the board oversees risk and how its leadership structure supports the risk oversight function.

- 8. Get Started Early on the Drafting.** This disclosure will be sensitive for public companies, and is likely to require input from the independent directors, members of senior management, investor relations officers, corporate secretaries, risk management personnel and others responsible for securities reporting and governance. Those responsible for the production of the 2010 proxy statement will need to organize the process for drafting this disclosure quickly, so that input from these various groups can be reflected properly.

If you have any questions about these recommendations, or would like to discuss any of the new SEC disclosure requirements that will apply to 2010 proxy statements, please contact any of the authors of this Client Alert or the Partner at King & Spalding who advises your company.

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