

2008 SPECIAL SUPPLEMENT



# Weighing In On the Issues

General counsel and directors express priorities and challenges for the year ahead in the *Corporate Board Member/FTI Consulting 2008 Legal Study*.

# Weighing In On the Issues

Each year, *Corporate Board Member* and FTI Consulting conduct a comprehensive survey of U.S. directors and corporate general counsel to rank directors' choices of the most respected law firms both nationally and in 25 metropolitan statistical areas. This year, in our eighth annual survey, 10,000 corporate directors and 2,392 general counsel at publically listed companies had the opportunity to rank law firms and answer questions about legal issues they face in fulfilling their various duties.

This special supplement to *Corporate Board Member* gives a comprehensive report of respondents' opinions on such issues as managing e-discovery, seeking advice on M&A and corporate risk, and maintaining good director/general counsel relationships. In addition, it offers helpful analysis and commentary from the experts at FTI Consulting and *Corporate Board Member* on these areas.

## Highlights from this year's survey include:

### Accountability

There's no clear consensus on where general counsel's loyalties should lie. Most general counsel say they are equally accountable to the CEO, the board, and the shareholders. Directors say the GC should report to the CEO.

### Risk management

The majority of directors have a positive feeling about the effectiveness of their companies' risk management efforts.

### Top Concerns

As a group, general counsel named legal cost containment as their highest concern for their company; directors' top concern was in the area of mergers and acquisition.

### E-discovery

Nearly half of general counsel are dissatisfied with the way their in-house legal department handles e-discovery; however, directors overall are content with the status quo.

### Technology

Most general counsel say their companies involve their legal department in decisions regarding implementing technologies and managing technology risk.

## Board/General Counsel Relationships

Ensuring the performance mechanisms of a successful company requires a strong, trusting bond between the board and general counsel. But the degree to which general counsel should be involved in specific board functions and to whom each function is accountable is not always crystal clear, as our survey shows.

“We were fascinated by many of the results of this year’s survey, but we also found that the research demonstrated the very same trends we see on the ground every day with both GCs and company boards,” commented Neal Hochberg, FTI senior managing director and North American leader of Forensic and Litigation Consulting. “What is clear is that boards and GCs have differing sets of priorities and concerns, which is natural and healthy, as long as the divergence does not interrupt effective management and oversight of the company. Boards and GCs each will respond differently to matters such as enterprise risk, economic weakness, the credit crisis, or cost containment. What’s important is having a response appropriate to the company.”

### Accountability

Board members are ultimately accountable to the corporation and its shareholders, but when asked to identify to which entity the general counsel should be primarily accountable, the survey showed mixed results. Only 28% of general counsel respondents and 10% of directors say the GC should be primarily accountable to the corporation and shareholders. Directors were more inclined to say the GC should be accountable to the CEO, while a large number of both director and GC respondents say the GC should be equally accountable to the CEO, the board of directors, and the corporation and shareholders (Figure 1).

These results show a twofold conflict. First, directors and general counsel do

not always agree on where the general counsel’s primary loyalty should lie, which could lead to concerns about general counsel’s independence. Second, and perhaps more problematic, these results are evidence of conflicting perceptions from both the GC’s point of view as well as those of parties to whom he or she is accountable.

“I guess we shouldn’t be surprised that GCs feel great loyalty to the CEO since he or she hired them to serve on the management team,” says TK Kerstetter, president and CEO of *Corporate Board Member*. “And what board member doesn’t first look to the GC as his or her trusted governance and legal adviser? This question, and the subsequent answers shown here just reflect the conflict and challenge for today’s GCs as they strive to counsel these important constituencies while not forgetting their ultimate accountability to the shareholders and corporation,” Kerstetter says.

### Hiring general counsel

Closely related to the issue of general counsel accountability is the issue of how involved the board should be in hiring or replacing general counsel. Most directors and general counsel in our survey say the board should interview the candidate, but the CEO should make the final decision (Figure 2). Interestingly, however, some hold the opposite view: the CEO should interview the candidate, but the board should make the final decision. Only 13% of directors say the CEO should be entirely responsible for hiring or removing general counsel, while 24% of general counsel feel comfortable with this option. Very few say the board should have that exclusive privilege.

### Involvement in evaluations

Admittedly, the general counsel’s involvement with the board touches many points, including as a facilitator of board evaluations. But quite a few directors (45%) have reservations about the GC’s role in that situation and

**Figure 1**

To which entity should the general counsel be primarily accountable?

	DIRECTORS	GENERAL COUNSEL
<b>CEO</b>	39%	27%
<b>Board of directors</b>	18%	11%
<b>Corporation and shareholders</b>	10%	28%
<b>All of the above, equally</b>	33%	34%

**Figure 2**

What role should the board play when general counsel is hired or replaced?

	DIRECTORS	GENERAL COUNSEL
<b>The board should interview the candidate but the CEO should make the final decision.</b>	56%	65%
<b>The CEO should interview the candidate but the board should make the final decision.</b>	29%	11%
<b>The board should not play a role; it should be entirely the CEO’s decision.</b>	13%	24%
<b>The CEO should not play a role; it is strictly a board decision.</b>	2%	0%

**Figure 3**

Is it fair and reasonable for a board to ask general counsel to be the facilitator of a board evaluation when sensitive director performance issues could result?

	DIRECTORS	GENERAL COUNSEL
<b>Yes</b>	55%	73%
<b>No</b>	45%	27%

**Figure 4****Seeking Outside Advisors**

General counsel rated these as the top five areas in which they would seek outside legal advice in the next year:

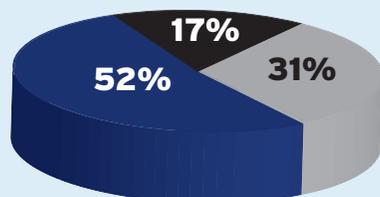
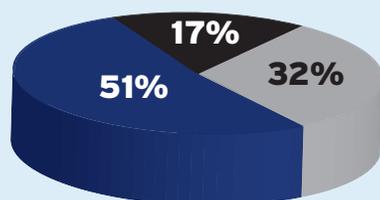
<b>Labor and employment</b>	78%
<b>M&amp;A</b>	76%
<b>Intellectual property</b>	73%
<b>Regulatory compliance</b>	71%
<b>Contract disputes</b>	51%

Directors rated these as the top five areas in which they would seek outside legal advice in the next year:

<b>M&amp;A</b>	80%
<b>Regulatory compliance</b>	60%
<b>Intellectual property</b>	38%
<b>Labor and employment</b>	35%
<b>Contract disputes</b>	27%

**Figure 5**

How effective is your general counsel and/or chief risk officer at managing your company's risk?

**Directors' response****General Counsels' response**

- very effective
- effective
- somewhat effective

answered “no” when asked if it is fair and reasonable to request that the general counsel facilitate board evaluations when sensitive director performance issues could surface (Figure 3).

Most GCs don't shy away from the role of serving as the facilitator because they feel comfortable managing the process and with the attorney/client privilege that would apply to the shared information, says Kerstetter of *Corporate Board Member*. Yet, the best evaluations will be accomplished by a facilitator that is not conflicted, he explains, because there are too many issues that can arise where a director might be hesitant to really speak his or her mind. “In those situations, unless you have an objective facilitator, I think you either compromise this very important board exercise or you potentially put the GC in a very awkward situation, especially if the problem is the board chairman or the head of the governance committee,” Kerstetter says. “If your GC typically facilitates the board evaluation, at least every third year, the board should consider bringing in a professional outside facilitator to interview or survey directors.”

**Managing Concerns and Resources**

Although general counsel and the board often work in tandem, the focus and concerns of each group vary, as do the roles they play within the organization. However, some areas of concern by general counsel and directors are aligned, such as M&A, governance, regulatory compliance, and risk management.

**Top of mind**

In this year's survey, we gave directors and general counsel a list of 19 issues and asked them to rate each according to the level of concern it gave them for their company. Not surprisingly, our two survey groups differed in their precise rankings. Directors rated M&A as their top concern, followed by governance and Sarbanes-Oxley,

regulatory issues, investor relations, and executive compensation. General counsel expressed the highest levels of concern over outside legal fees, followed by e-discovery, M&A, governance and Sarbanes-Oxley, and regulatory issues.

“These are the matters that we see day in and day out and that clearly are weighing heavily on the minds of both GCs and directors,” commented Basil Imburgia, FTI senior managing director. “Because M&A, Sarbanes-Oxley, and issues associated with risk management are top concerns for both GCs and directors, companies often are very motivated to tackle such concerns. We also find the issue of legal cost containment is especially compelling, and it is a concern we see very clearly in the marketplace as confirmed by our survey.”

Indeed, that general counsel are very concerned about outside legal fees comes as no surprise when considered alongside results of a related finding in which 100% of general counsel respondents say they will use outside legal counsel in 2008. (Compare this with 80% of directors who say their boards will hire outside legal counsel in the same year.)

However, despite concern over budgets, outside expertise is a necessary tool all general counsel must use in certain situations. General counsel say they expect to seek outside legal advice on issues of labor and employment, M&A, intellectual property, regulatory compliance, and contract disputes. Many will also seek counsel on antitrust and trade regulations, arbitration, product liability, and e-discovery (Figure 4).

Directors also anticipate seeking outside legal guidance on key areas of concern. Among the 80% of directors who say their boards will engage outside legal counsel, many say their boards will seek independent counsel on issues related to M&A, regulatory

compliance, intellectual property, labor and employment, and contract disputes.

### Seeking nonlegal assistance

In addition to having somewhat different plans for hiring outside legal advisers, directors and general counsel respondents also differ in their intention to engage independent, outside, nonlegal advisers. While 61% of directors anticipate their boards will seek nonlegal consultants, only 45% of general counsel plan to do the same.

Among those directors who say their boards will seek nonlegal advice, 60% say they will be looking for outside expertise in M&A. Others will look for advice on regulatory compliance (26%), labor and employment (18%), enterprise risk management (14%), and intellectual property concerns (8%).

General counsel who plan to seek outside nonlegal advice demonstrate a bit more of a spread in topic ranges. Among the 45% who will look for nonlegal expertise, areas of interest will be data retention (34%), crisis management (33%), product liability (33%), labor and employment (26%), e-discovery (21%), criminal defense (13%), fraud mitigation (13%), bankruptcy (9%), intellectual property concerns (9%), and antitrust and trade regulations (7%).

### Risk management

Enterprise risk management is widely acknowledged to be a growing issue for both boards and general counsel, a trend evidenced by results of our 2007 study. This year, directors report they are fairly confident about their company's risk management efforts. Most say their company's general counsel and chief risk officers are either very effective (31%) or effective (52%) at managing their company's risk. Similarly, 32% of general counsel say their executive officers and board members are very effective at managing their company's risk. Over half (51%) of general counsel

surveyed say the executives and directors are effective (Figure 5).

While much more emphasis has been placed on improving risk management in recent years, it is important not to become complacent, urges FTI's global leader of Forensic and Litigation Consulting, Roger Carlile. "It is clear from this survey that both GCs and directors see the need to mitigate against risk. But they often have a somewhat siloed view of where risk exists, with directors often focused on general business risk and GCs taking a wider view that incorporates regulatory and legal risk. This divergence is normal, but the real key to managing risk across the company is to ensure that there are solid communications protocols between general counsel and the board which serve to improve enterprise risk management across the business."

### E-Discovery: A Hot Issue

Technology has forever changed the way the discovery process works in legal proceedings, spawning many new efficiencies as well as generating a host of new concerns for the office of general counsel. The way these concerns are handled could affect the board in terms of its ability to responsibly act as a fiduciary for shareholders as well as mitigating risk of personal liability.

The amended Federal Rules of Civil Procedure require a party to provide an enormous amount of information about its electronically stored information at the very beginning of a lawsuit. Most companies are unprepared to do so. The timetable is very aggressive, and few companies are in full compliance. This leads to a range of risks, from losing the opportunity to present certain defenses to sanctions for spoliation of evidence and even criminal liability. Mindful of this risk, some companies are taking steps to improve overall compliance independent of specific lawsuits, but many are not, and the board is typically unaware of the risk.

"It's no surprise that electronic discovery is a major issue of concern for general counsel across the United States. The amendments to the Federal Rules of Civil Procedure mean companies have no choice but to have greater foresight in relation to information risk management initiatives," says David Remnitz, senior managing director and practice leader, Technology, FTI Consulting. "What is interesting is that four-fifths of the directors surveyed are happy with the implementation of e-discovery procedures in their firms, despite the very obvious worries expressed by GCs. Clearly there is a disconnect here that must be addressed."

### Who's managing the process?

Just how well companies are handling their e-discovery process may be up for debate, depending on the perspective of those asked to assess it. Our study shows that while 83% of responding directors are satisfied with their in-house legal department's management of e-discovery, only 54% of general counsel are of the same mind (Figure 6). And while general counsel respondents rate e-discovery for litigation and investigations as a top-level concern (second only to managing outside legal fees), it's quite far down on the list of concerns for directors, coming in at number 15 out of a list of 19 potential issues. The difference is significant and is good reason for boards—even those that are satisfied—to check in with their general counsel on e-discovery processes and worries to make sure the plans they've put in place are operating smoothly.

The good news is that 75% of general counsel say their company has a formal communications practice in place for responding to regulatory audits, preservation notices, and legal holds—62% of directors say the same. However, combined with the fact that nearly half (46%) of general counsel in our study are dissatisfied with their legal departments' handling

**Figure 6**

Are you satisfied with your in-house legal department's management of e-discovery?

	DIRECTORS	GENERAL COUNSEL
<b>Yes</b>	83%	54%
<b>No</b>	17%	46%

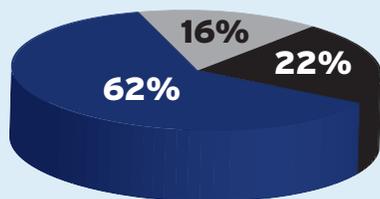
**Figure 7**

Does your company have formalized communications practices for responding to regulatory audits, preservation notices, and legal holds?

	DIRECTORS	GENERAL COUNSEL
<b>Yes</b>	62%	75%
<b>No</b>	13%	22%
<b>Don't Know</b>	25%	3%

**Figure 8**

When the IT department selects new or changes existing technology, to what extent does it involve the legal department?



■ always  
■ sometimes  
■ never

of e-discovery, it is worth noting that approximately one in five general counsel respondents say their companies don't have a formal communications practice for responding to regulatory audits, preservation notices, and legal holds. A similar number of directors (25%) say they don't know if their companies have such procedures in place—and 13% of directors say their company has no such formalized practice (Figure 7).

### Getting GCs involved

While setting up a good system for handling communications notices is advisable, in practice, there are often real implementation difficulties. Because companies involved in litigation or regulatory audits may be required to immediately change what types of data are retained, search data for specific content, and provide it in an accessible format, the underlying technology system can have a large impact on the successful handling of an e-discovery request.

Therefore, decisions to change existing technologies that heretofore would have been strictly in the realm of the IT department—like switching an e-mail program or changing a server—now involve the board's input, because under certain circumstances, they can dramatically affect a company's legal liability. In fact, 22% of general counsel respondents now say their company's IT department always involves the legal department when selecting new or changing existing technology. Another 62% say the legal department is sometimes involved. Only 16% say the legal department is never involved (Figure 8). *Corporate Board Member's* Kerstetter says the legal department's increased involvement in every area of the company is indicative of the pervasiveness of risk throughout the corporate enterprise today.

### Communication is key

Among other things, information technologies can play a huge part in

how effectively and efficiently a legally required information freeze is communicated and implemented throughout an organization. We asked general counsel and directors alike to tell us what methods (both low-tech and high-tech) their companies use for communicating legal holds and collection notices.

The majority (63%) of general counsel respondents say that in response to subpoenas for information, their legal counsel sends an e-mail notice that includes a link to a company computer system. They also capture receipt of the e-mail notice and attestations of the individual's compliance to the collections notice and legal hold. One in five (20%) general counsel respondents say they communicate by phone to the relevant individuals, custodians, and systems owners. One in 10 say they send a paper-based survey that individuals must answer and return to counsel's office. Most directors (61%) say they don't know how their legal department handles such requests.

"It's not surprising that the majority of directors couldn't pinpoint the precise means their company uses to handle these requests," says Adam Bendell, senior managing director in FTI Consulting's Technology group. "But the more important issue is whether there is a communication system in place between the office of general counsel and the board," Bendell says. Safeguarding the company's data and other intellectual property is a critical matter, and the board needs to know that proper protocol is followed when e-discovery requests take place, he explains.

The lack of complete alignment of knowledge between general counsel and director responses on e-discovery and information technology demonstrated by the survey results points to information risk management as an emerging issue for board agendas. General counsel respondents agree,

with 72% saying that the development of best practice standards for identifying, preserving, and collecting data in response to legal discovery is one of their top three priorities within the next 12 months. The two other high priorities identified by general counsel are formalizing records management policies for high-risk content types and deploying and implementing automated records management and retention workflow applications throughout the enterprise.

## GC and Board Interaction

The role of the general counsel has expanded to the point where the GC is asked to attend many committee meetings, as well as those of the full board on a regular basis. For their part, general counsel respondents seem willing and eager to attend board committee meetings; however, according to the survey, many directors do not feel regular involvement is necessary.

Directors are keen to involve the general counsel when a special committee on M&A is called, largely because such meetings involve an upcoming transaction which has many financial and legal ramifications. Many are also in agreement that inviting general counsel to the governance/nominating committee meetings, as well as to audit committee meetings, is a good idea. But they are lukewarm with regard to the need for general counsel to attend other committee meetings regularly (Figure 9).

The results of this year's survey show that despite many of the common areas in which both GCs and director play a role, they often have very different views on corporate priorities and concerns.

In fact, certain proprietary concerns have led many boards to take the step of hiring independent counsel to standby in case they feel the need for an outside independent advisor who

answers only to the board. A little over half of the directors surveyed agreed such action has merit as a best practice (Figure 10).

“Were this a survey of only GCs or only directors, the results would not be especially shocking insofar as the findings mirror the market realities,” concludes FTI Consulting’s Carlile. “Only when we juxtapose the views of GCs and directors do we see the marked differences of opinion. GCs and boards will never and should never be in total agreement on every issue, but they do need to be just as mindful of each other’s respective concerns as they are of their shared priorities.”

## Conclusion

Although directors and general counsel will continue to approach their duties from different perspectives, it is important to maintain open communication so that boards and general counsel operate with shared intelligence and move in the same direction. Boards and general counsel should work to eliminate bumps in the road, such as confusion on general counsel’s ultimate accountability, the need for general counsel to attend committee meetings, and the desirability of general counsel to facilitate board evaluations. In addition, keeping pace with the acceleration of demands that technology has made on general counsel—especially when it comes to e-discovery—will continue to be a growing challenge for both general counsel and the board. The stakes are high and the company’s management, shareholders, and directors could share the risk if inefficient or ineffective e-discovery processes exacerbate legal trouble. Thus, strong communication between the board and general counsel is imperative to keep the governance process on track and running smoothly.

**Figure 9**

Should general counsel be invited to attend any of the following committee meetings as a regular attendee?

	DIRECTORS	GENERAL COUNSEL
<b>Special M&amp;A</b>	78%	96%
<b>Governance/ Nominating</b>	69%	97%
<b>Audit</b>	63%	95%
<b>Compensation</b>	45%	83%
<b>Social Responsibility Committee</b>	44%	79%

**Figure 10**

As a best practice, do you believe the concept of having a board retain standby independent counsel has merit?

	DIRECTORS	GENERAL COUNSEL
<b>Yes</b>	57%	34%
<b>No</b>	43%	66%

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