

# LAW IN THE BOARDROOM



Each year, Corporate Board Member and FTI Consulting conduct research to better understand which current legal and governance issues are of highest concern for public company directors and corporate general counsel as well as to evaluate related trends. Earlier this year, more than 550 directors and general counsel responded to our survey request, allowing us to gather data and compare and contrast each group's perspectives as well as record their responses to a variety of targeted questions.

**BROAD THEMES**

Several broad themes emerged from the 2013 Law in the Boardroom study that we believe represent ongoing topics of discussion in boardrooms across America. While the traditional issues of executive compensation, succession planning, and M&A continue to dominate—compensation and M&A garnered the highest percentages on both directors' and GCs' lists of issues requiring the greatest time commitment this year—the newest area of major concern continues a trend noted in last year's study: data security and IT risk is one of the most significant issues for both directors and general counsel. More than a quarter of director and general counsel respondents earmarked cyber risk as an area that will require their attention in 2013 (Figure 1).

Other areas of focus include shareholder communications, patent/IP management, proxy advisory firms' voting guidelines, and crisis management. Interestingly, while strategic planning was not listed as a response option among the issues that will take the greatest time commitment, quite a few directors wrote in to tell us it's a topic for which they expect to spend significant time in the boardroom. Rounding out these primary themes are issues related to compliance and conduct, along with crisis preparedness.

The following sections of this report take a closer look at the most prevalent areas of concern for directors and general counsel.

**DATA/IT SECURITY AND CYBER RISK**

In terms of online communication and information exchange, it's the threats you don't see coming that can cripple your company. And defending against those threats has become more and more like a game of whac-a-mole and can cost a bundle, to boot. The

average annualized cost of cybercrime jumped 6% to \$8.9 million in 2012, driven up by denial of service, malicious insiders, and attacks on websites, according to an October 2012 study released by the Ponemon Institute.

It's hardly surprising, then, that data security (in a virtual tie with succession planning) is one of the top issues that keeps directors from resting at night, and that feeling was seconded by general counsel who also chose it as a chief area of concern, just after regulatory compliance. Accordingly, cyber risk was cited by both directors and general counsel as an issue on which the board will be spending considerable time this year, although it's interesting that GCs don't seem to think directors will be spending as much time on this topic as the legal department itself will.

Directors also feel that IT strategy/risk is a key area they need more information on, while general counsel feel the same about e-discovery and data management. Interestingly, GCs rate directors least effective at risk oversight related to e-discovery and cyber risks, and directors feel similarly about the general counsel's handling of these two areas.

Delving further, we asked our survey group to rate their level of confidence as to whether their company would be able to quickly detect a cyber breach and determine whether data had been compromised. Only a third of general counsel feel "very confident" in their company's ability to respond, and less than a quarter of directors agree (Figure 2). While more than half of both groups (51% of GCs and 63% of directors) are at least somewhat confident in their company's ability to handle a breach, is that enough, given the escalating risks in this new electronic era?

"The level of concern among board members and general counsel on data protection and security reflected in the survey is fully consistent with our recent work with multinational corporations," says Michael Pace, senior managing

FIGURE 1

**Where will you spend your time in 2013?**

**DIRECTORS SAY:**  
Executive compensation

**60%**

M&A preparedness

**42%**

Cyber risk oversight

**28%**

Shareholder communications

**21%**

Crisis planning

**18%**

**GCs SAY:**

Executive compensation

**46%**

M&A preparedness

**36%**

Patent/IP management

**28%**

Cyber risk oversight

**27%**

Proxy advisory firms' voting guidelines

**20%**

FIGURE 2

**CONFIDENCE CHECK:**

**Can your company quickly detect a cyber breach and determine whether confidential data was compromised?**

**DIRECTORS SAY:**

Very confident

**22%**

Somewhat confident

**63%**

Not confident

**14%****GCs SAY:**

Very confident

**32%**

Somewhat confident

**51%**

Not confident

**17%**

director and global co-leader of the FTI Consulting Global Risk and Investigations Practice. “On the response side, we’ve seen a significant increase in our investigative work for companies that are faced with everything from hacking and intrusions to obtaining sensitive personal or proprietary information to foreign nationals who may be funneling trade secrets and other IP to foreign competitors or governments—classic economic espionage.” This is particularly the case, Pace says, in high-tech, pharma, and certain government contractor segments. To help companies manage and mitigate this risk, he notes FTI is helping more companies inventory and map their IP assets, secure their data, and test their networks and systems for gaps and vulnerabilities. “Board-level concern is complicated by the fact that IT infrastructure and underlying technologies are fairly opaque to board members and certain executives, so part of our role is to demystify technology in addition to our core investigative, remediation, and prevention work,” Pace says.

#### EXECUTIVE COMPENSATION AND SUCCESSION

Few governance issues have drawn the level of scrutiny and concern in recent years as those driven by executive compensation. Whether the issue is the amount or type of pay, the ratio between executive and employee income, peer group comparisons, CD&A communications, or when or how to use consultants—executive compensation is a complex challenge for every public company board. But while most directors (60%) rate it one of their top issues in terms of time commitment, it’s only eighth on the list of issues that keep them up at night. Comparatively, a majority of general counsel also rate executive comp as one of the key issues that will require the greatest time commitment from both the in-house legal department and the board in 2013. But it still did not make their top 10 list in terms of issues they lose sleep over.

Meanwhile, 74% of general counsel did choose compensation consultants and the potential for them to create a conflict of interest as the top compliance issue they’ve recently reviewed with their board, followed by the PCAOB’s new standard on auditors/audit committee rules. These were the same choices made by directors, though in reverse order. On an encouraging note, say on pay/executive compensation is one of the top three areas general counsel are satisfied with in terms of management’s handling

of the issue and directors are satisfied with in terms of GC oversight. Similarly, general counsel give the board high marks for its oversight of risk management related to executive compensation (Figure 3).

Considering the level of talent most companies need to attract and maintain, succession is a topic that is often a companion to compensation. While succession planning was not one of the choices on our list of issues that will require the greatest time commitment from the board, it was one of the subjects directors wrote in to say they would be spending considerable time on, and it tops the list of issues that keep them awake at night (Figure 4).

“When we compare the board members’ legal survey results with much of our past research on boards’ feeling ineffective in their ability to perform this key responsibility, it is no surprise that succession is one of the issues that keeps directors up at night,” says TK Kerstetter, chairman, Corporate Board Member. “This has been the case for many years and what is most surprising is, we don’t see the results improving each year like you would expect.”

#### M&A, STRATEGIC PLANNING, AND OPERATIONS

As the economy recovers and shareholders mount pressure on companies to exploit new avenues for growth, many companies are expected to begin making moves to fulfill those expectations. Mergers and acquisitions are the natural outgrowth of the need to expand markets both domestically and internationally, enhance product offerings, and streamline efficiency, and from all signs, M&A is poised for growth. More than \$158 billion in deals has been announced so far in 2013, more than double the activity during the same period last year, according to Thomson Reuters Deals Intelligence.

It’s understandable, then, why more than one-third of those surveyed (42% of directors and 38% of general counsel) chose M&A preparedness as one of the issues likely to require the greatest time commitment for boards in 2013. Similarly,

FIGURE 3

**GCs SAY:**

**How effective is your board at overseeing compensation risk?**

Very effective

**49%**

Effective

**40%**

Somewhat effective

**7%**

Somewhat ineffective

**3%**

Not at all effective

**1%**

general counsel rated M&A as one of the top issues that will require the attention of the in-house legal department, and transaction risk is one of the top five issues directors said will be on their worry list this year.

This comes as no surprise to Allen Applbaum, senior managing director and global co-leader of the FTI Consulting Global Risk and Investigations Practice. “While the recent acceleration of M&A activity carries with it substantial opportunities, companies contemplating these transactions must also be conscious of the attendant risks. The operational and reputational consequences of forming a close relationship with the wrong company, and/or the wrong leadership team can be severe,” he warns. Moreover, serious problems are often not evident at first glance, especially in emerging-market situations. “A rigorous due diligence process, including a full program of research and analysis to fully vet the parties on the other side of the deal, is the best insurance against unwelcome surprises,” Applbaum says.

Strategic planning and operational effectiveness would seem to go hand in hand with deal-making activity, and the survey results bear that out. Operational effectiveness and efficiency is one of the top concerns on the minds of directors and general counsel; the latter also worry about the corporate reputation and, along those lines, say they will be spending time on patent prosecution and intellectual property management. Furthermore, directors and general counsel both included strategic planning and enterprise risk management as issues on which they

need better information and reporting.

#### COMPLIANCE, CONDUCT, AND SOCIAL MEDIA

It’s no understatement to say compliance concerns have never been more overwhelming for publicly traded companies. Framed against a backdrop of Dodd-Frank alone—with its more than

400 rules and mandates spelled out in 2,300-plus pages—not to mention new SEC and PCAOB guidance and disclosures on other matters coming out with regularity, the responsibility for boards and general counsel to oversee legal and regulatory matters is greater than ever. So it’s no surprise that regulatory compliance was the chief worry cited by general counsel and is also the top issue on which GCs feel they need better information and reporting. Additionally, it is among the top five concerns for directors.

Specifically, we queried respondents about the recent FCPA guide released by the Department of Justice and the Securities and Exchange Commission and the 2011 SEC guidance on disclosure of cyber breaches. Interestingly, only about 35% of GCs and even fewer directors (25%) indicated they’ve discussed these issues in the boardroom, even though arguably these areas should be part of any board’s regular oversight of enterprise risk management.

On a related compliance matter, the number of government and internal investigations has risen vastly in recent years, such that board members often have questions about the proper process and ethics of disclosure related to such matters. This year, we asked both directors and GCs whether boards should disclose internal investigations involving one or more members of the executive team. Eighty-two percent of GCs said no, and 63% of directors agreed (Figure 5). It is interesting that more than one-third of directors do feel such disclosure is appropriate. This is an area where there is no one, clear, best practice, but it is something board members ought to be discussing prior to such an event occurring.

“Any materiality assessment of an internal investigation involving management—and how best to disclose or self-report potentially concerning conduct—should always be based on individual facts and circumstances and should involve input from multiple constituents, including external legal counsel,” says Martin Wilczynski, senior managing director and leader of the FTI Consulting Forensic Accounting & Advisory Services practice. Moreover, he explains, the SEC’s whistleblower bounty incentive enforcement program has raised the stakes on this issue since nondisclosure of an investigation to regulators could affect the ability to receive cooperation credit at a later date if a whistleblower first reports the issue directly to the SEC. “Potential misconduct

FIGURE 4

### What keeps you up at night?

#### DIRECTORS SAY:

- 1 Succession/leadership transitions
- 2 Data security
- 3 Operational effectiveness
- 4 Regulatory compliance
- 5 M&A transaction

#### GCs SAY:

- 1 Regulatory compliance
- 2 Data security
- 3 Operational effectiveness
- 4 Managing outside legal fees
- 5 Corporate reputation

FIGURE 5

### Should boards disclose all internal investigations involving one or more members of the executive team?

#### DIRECTORS SAY:

Yes  
**37%**  
No  
**63%**

#### GCs SAY:

Yes  
**18%**  
No  
**82%**

or allegations involving senior management must therefore be investigated with urgency, be thorough, and be particularly focused and well executed to gather the salient facts necessary to support a well-conceived disclosure decision. Failing to investigate and consider all relevant risks could result in a costly and unnecessary disclosure of immaterial facts, or

worse, turn into a crisis or cause reputational damage for a corporation that mistakenly elects not to disclose an investigation involving potentially material information,” Wilczynski says.

One important aspect of any good compliance culture involves getting employees to buy in to the value of compliance. This led us to ask the survey group about their level of confidence that the company’s current code of conduct is effective in tying key guidelines to organizational values and ethical commitments that promote compliance. About two-thirds of GCs and directors are quite confident on this issue, with most of the remaining third at least somewhat confident (Figure 6). Fully 80% of both directors and general counsel surveyed indicated that their company code of conduct has been reviewed in the last year.

As an extension of this line of thinking, we also asked directors if their company has a formal policy on the use of corporate social media. More than 20% said no, and another 38% were unsure (Figure 7). After the brouhaha surrounding CEO Reed Hasting’s disclosure of a Netflix viewing milestone on Facebook last year, many compliance experts say companies would be wise to have such a policy and

review it periodically, and to ensure they have lines of demarcation regarding social media marketing and material disclosures. Earlier this year, in fact, the SEC issued a report of investigation on the application of Regulation Fair Disclosure to provide guidance on corporate use of social media outlets, clarifying that the rules apply to social media sites in the same manner as corporate websites.

Digging deeper into these issues, when we asked directors to characterize their board’s approach to the issues surrounding social media, only 16% reported they have discussed the topic formally and feel confident their board has a good understanding of the risks, 37% said the topic has been broached but they need more information to feel comfortable with the strategy and the risks, and 26% said their board has no plans to formally discuss social media issues.

There is little doubt this area will be ripe for further discussion as the use of social media communication continues to proliferate in the corporate arena.

“The SEC has recognized that social media is a real and valuable disclosure medium for communications with an important subset of stakeholders,” says Elizabeth Saunders, senior managing director and Americas chairman of the FTI Consulting Strategic Communications practice. “The SEC also identified that a set of followers exist—a potentially very important set—who use social media as their primary source of information and went so far as to admit there are instances where social media might be the right disclosure medium. With that, it now seems impossible for organizations to ignore social media as part of their communications program to investors and stakeholders.” Today, Saunders says, “It is critical that organizations have a social media strategy and policies in place in order to manage crisis and—perhaps more importantly—to capture the opportunities that social media provides.”

Corporate Board Member’s Kerstetter agrees. “This is an area that boards better get their arms around quickly or they will turn their concerns about IT risk into a self-fulfilling prophecy. In my mind, there is no excuse, with today’s proliferation of smart phones and personal electronic devices, for companies to not have policies around their employees’ use of social media, particularly with respect to company information.”

## CRISIS PREPAREDNESS

If there is one lesson learned from the last decade, it’s that no company is immune to a crisis: whether man-made or via natural disaster. Oil spills, tainted products, ethical embarrassments, and extreme weather can

wreak devastation on corporate operations and reputations—no matter how well protected a company believes itself to be. Though not high on the list in terms of time commitment or an issue to lose sleep over, more than one-third of directors and a quarter of GCs agreed that crisis management planning is an area they need updated information on to better fulfill their duties.

FIGURE 6

### CONFIDENCE CHECK:

**Does your code of conduct tie key guidelines to your corporate values to facilitate employees’ understanding of the value of compliance?**

#### DIRECTORS SAY:

Very confident

**66%**

Somewhat confident

**32%**

Not confident

**2%**

#### GCs SAY:

Very confident

**60%**

Somewhat confident

**37%**

Not confident

**3%**

FIGURE 7

### DIRECTORS SAY:

**Does your company have a formal policy on the use of corporate social media?**

YES

**41%**

NO

**21%**

UNSURE

**38%**

Specifically, when we asked directors when the board last reviewed the company's crisis management plan with the executive team, 57% said they had done so in the last year, though 9% indicated there had never been such a review at their company and another 7% were unsure. Furthermore, only 34% reported being "very comfortable" that the company's current crisis management plan covers the contingencies needed to sustain the business if crisis events unfolded, and 14% admitted they are not at all comfortable in their company's ability to handle such events (Figure 8).

"Often overlooked within an organization's crisis management plan are procedures and protocols for communicating—both internally and externally—to key stakeholders. Even a company with a robust operational plan for crisis response, without a communications component or integrated plan, can fall victim to reputational damage and diminished perceived and actual value among the investment community," says Saunders. "A proper crisis communications plan should outline how the organization should anticipate and prepare for a crisis and provide a road map for how to respond, control, and disseminate information internally and externally for when, not if, a potential crisis occurs."

Ryan Toohey, managing director and head of the FTI Consulting Strategic Communications' Crisis and Issues Management practice, explains that having a "break the glass" strategy for communicating through an incident decreases the response time to initial reports of incidents and crises; prevents the escalation of incidents into a full-blown crisis situation; prevents leaks of internal communications to external audiences; and, typically limits the duration of a crisis. "Perhaps most importantly, it can curtail business continuity disruptions by delineating roles of internal teams and facilitating proper coordination between operational response and stakeholder communications," he says. "This allows management teams to focus on the 'what' and not the 'how' and 'who' as they work to mitigate risk and protect the organization's brand, reputation, and valuation."

### THE ROLE OF THE CORPORATE CITIZEN

This year's legal study also tackled whether boards and management should play a role in shaping public policy. Directors offered a variety of opinions on this issue, with 51% saying the CEO should play an active role in relevant policy debates while 49% said the company should play an active role in such debates, although 27% disagree and said the company should not get involved. Another 38% said the board should play an active role, and 25% believe directors personally should get involved in these debates. General counsel are a little more decisive on this

topic, with 61% saying companies should play an active role in public policy debates, while 29% said companies should not do so. Nearly a third (30%) of GCs think CEOs should play an active role in relevant public policy debate.

### LOOKING AHEAD

Companies will continue to move forward, with general counsel working in tandem with management and directors to oversee and mitigate the current risks while watching for rising points of concern and new hot spots. In an effort to determine where the upcoming emphasis will be, we asked GCs about their company's legal spend and found that most expect a moderate increase in expenditures for outside legal and compensation advisers, pointing to continuing activity in the areas of M&A, compensation, and succession.

Directors, meanwhile, offered up their top list of issues for which they need better information, processes, and reporting to be as effective as possible. Succession planning and IT strategy/risk tied for first (chosen by 46% of respondents); followed by strategic planning at 43%; crisis management plans, 35%; competitive environment/ market landscape, 34%; and enterprise risk management, 33%.

Most if not all of these issues will likely continue to attract attention, though each year we see previously undetected or low-level concerns emerge as we follow trends on recurring ones. Corporate Board Member would like to thank its Law in the Boardroom partner, FTI Consulting, and the many survey respondents for their respective roles in our research. We hope the data presented here offers valuable insights to your board and legal department in the year ahead. 🌐

FIGURE 8

**Directors' level of comfort that their crisis management plan covers all contingencies needed to sustain the business:**

