

United States

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CORPORATE ENTITIES

The vast majority of US public companies are formed as corporations. While many of the principles discussed below apply to private companies and to other forms of entities, the discussion below is limited to the corporate governance rules applicable to, and the practices and principles of, US public companies. The focus is on federal securities law and Delaware law, as Delaware is the most common state of incorporation for major US corporations.

References to the Top 100 US Companies refer to the companies surveyed in Shearman & Sterling LLP's 2009 Trends in Corporate Governance of the Largest US Public Companies (2009 S&S Corporate Governance Survey), available at www.shearman.com/corporategovernance.

Subject to certain exceptions, the top 100 US companies consist of the 100 largest US public companies (as ranked in Fortune magazine's Fortune 500 list, by revenue, as published in 2009) that have equity securities listed on the NYSE or Nasdaq.

LEGAL FRAMEWORK

1. What is the regulatory framework for corporate governance and directors' duties?

Corporate governance practices and directors' duties are regulated by:

- Statutory law of the state in which the corporation is incorporated. Most US public companies are incorporated in the state of Delaware. The majority of other states base their legislation on Delaware law, or on the Model Business Corporations Act.
- Federal statutory law, including:
 - the federal securities laws, including the Securities Act of 1933 (1933 Act) and the Securities and Exchange Act of 1934 (1934 Act);
 - regulations, rules and other guidance promulgated by the Securities and Exchange Commission (SEC).
- Listing standards published by registered stock exchanges, most notably, the New York Stock Exchange Listed Company Manual (NYSE Listing Manual) and the National Association of Securities Dealers Automatic Quotation System Marketplace Rules (Nasdaq Marketplace Rules).
- Common law rules.
- The corporation's certificate of incorporation and bye-laws. Corporate governance guidelines and policies adopted by the board of directors (board) and the charters of board committees also influence the corporation's governance.
- Shareholder activism and litigation, which often influences reform of corporate governance regulations and directors' duties.

BOARD COMPOSITION 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 incorporated in the US almost always have a unitary board structure. Under most US state corporation statutes, board members are elected for a term of one year. State laws commonly provide the option to institute a staggered or classified board, which ordinarily divides the members into three separate classes, with one class being elected annually to serve a three-year term. However, due to shareholder activism, classified boards have been declining in popularity over the past few years, with only 24 of the Top 100 US Companies having classified boards in 2009 (*2009 S&S Corporate Governance Survey*). There has been some recent federal legislative pressure to eliminate classified boards.
- **Management.** The corporation's board is responsible for appointing the corporation's management. The board typically delegates the day-to-day operation of the business to a chief executive officer (CEO) and other management employees. The senior managers of the corporation generally include the CEO, the chief financial officer (CFO) and the chief accounting officer (CAO), among others.
- **Board members.** Members of the board are generally independent directors or members of senior management of the corporation, although some boards have members who are non-executive directors who are not independent (such as former senior executives of the company). While there are no state or federal law requirements to have a specific board composition, subject to certain limited exceptions, the NYSE Listing Manual and the Nasdaq Marketplace Rules require a majority of the board members to be independent. In 2009, independent directors constituted 75% or more of the boards of 88 of the Top 100 US Companies. The CEO was the only non-independent director at 49 of those Top 100 US Companies (*2009 S&S Corporate Governance Survey*).
- **Employees' representation.** Employees are not entitled to board representation and employee board members are nearly always executive officers.

- **Number of directors or members.** Most states do not require a minimum number of directors and leave the size of the board to be set by the corporation's certificate of incorporation or bye-laws. The corporation's certificate of incorporation usually sets the minimum and maximum number of directors that can constitute the board and provides that the exact number be set in the bye-laws or by a board resolution.

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

Age restrictions

There is no statutory age limit imposed on directors of corporations. A corporation, may, however, impose these restrictions in its certificate of incorporation, bye-laws or corporate governance guidelines. However, 86% of the Top 100 US Companies have a mandatory retirement age for their non-employee directors with 34 of these companies permitting exceptions to be made by the board or a board committee. Of the companies that have a mandatory retirement age, the majority impose a retirement age of 72. It is common practice for employee directors (other than the chairman under certain circumstances) to retire from the board when they retire from employment with the company (*2009 S&S Corporate Governance Survey*).

Nationality restrictions

Generally, there are no nationality restrictions on directors, although nationality may be relevant in some regulated industries. In addition, a director need not be a resident of the state in which the corporation is incorporated.

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 makes 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 require disclosure of the names of directors who are independent.
 - **Board composition.** The NYSE and Nasdaq require the board to consist of a majority of independent directors. 51 of the Top 100 US Companies have adopted policies requiring more than a simple majority of independent directors (*2009 S&S Corporate Governance Survey*). State law does not place any restrictions on a board's composition.
 - **Independence.** The NYSE and Nasdaq have different rules that determine whether a director is independent. An independent director must not fall within one of the standard categories prohibiting independence. Corporations must identify their independent directors, under NYSE rule, and disclose the basis for that determination. This disclosure is usually contained in the corporation's annual disclosures filed with the SEC. Both the NYSE and Nasdaq require that independent directors have regularly scheduled meetings, referred to as executive sessions, at which only independent directors or non-management directors are present.

- **Duties and liabilities.** Non-executive directors are generally subject to the same fiduciary duties and generally have the same liabilities as executive directors.

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

There are no legal restrictions on the combination of these roles and it is not unusual, especially in larger US public companies, for one individual to serve as both CEO and chairman. Proponents of good governance often tend to support the separation of these roles as best practice, and separation has become more frequent in recent years. In the current difficult economic environment, shareholders are more likely to request that companies have an independent chairman to counterbalance the CEO's power.

Of the Top 100 US Companies in 2009, the roles of the chairman and the CEO were separated at 31 companies, but only seven of these companies have adopted explicit policies requiring the separation of the two roles (*2009 S&S Corporate Governance Survey*). There are currently federal legislative proposals pending which would mandate separation of these positions.

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

Appointment of directors

Nomination. Generally, directors are nominated by the board for election at the annual shareholders' meeting (AGM). Companies listed on the NYSE normally must have a nominating/governance committee, composed entirely of independent directors, that identifies individuals qualified to become board members and recommends their nomination to the board. The Nasdaq has similar requirements, but does not require a formal committee.

Activist shareholders may also wish to submit their own director nominees to a shareholder vote in what is referred to as a proxy contest. Currently, shareholders are allowed to conduct a proxy contest under SEC rules and can recommend to other shareholders one or more director candidates. However, shareholders find this process cumbersome and costly as they must provide proxy materials to other shareholders at their own cost. There has been much debate in recent years as to the circumstances, if any, under which shareholders can nominate directors using the company's proxy materials. The SEC is currently actively considering amending its current rules and practices to allow proxy access under certain circumstances.

In 2009, Delaware enacted important changes to its General Corporation Law (*effective 1 August 2009*) to permit companies to adopt bye-law amendments that:

- Allow proxy access.
- Fix a record date for voting rights that is separate from the record date for notice of meetings.
- Permit reimbursement of proxy contest expenses.

Election. Directors are elected by shareholders at the AGM. State corporate laws generally provide that directors are elected by a plurality vote, in which a director nominee who receives the highest number of votes cast for an open director's seat is elected to that position. Under the plurality voting standard, the only votes that count are votes that are cast and withheld votes have no

effect. However, there has been a significant movement towards adoption of a majority voting standard for election of directors in the past several years. Under most majority voting standards, directors must be approved by more than 50% of the votes cast.

Pressure from shareholders on voting standards in director elections has resulted in a dramatic increase in the number of companies adopting a majority vote standard. 75 of the Top 100 US Companies now require directors to be elected by a majority of the votes cast, up from 11 companies in 2006 (*2009 S&S Corporate Governance Survey*). Of those 75 Top 100 US Companies, the vast majority require incumbent directors to submit their resignation from the board following their failure to receive a majority of the votes cast in favour of their election.

13 of the remaining 25 Top 100 US Companies that continue to elect directors by a plurality of the votes cast have adopted a policy that nominees receiving more withheld votes than vote for their election must submit or tender their resignation from the board.

See *Question 23*.

Removal of directors

State law and the corporation's certificate of incorporation and bye-laws set out the methods for removal. Generally, directors can be removed by the corporation's shareholders or by judicial proceedings. Shareholders can usually, by a sufficient vote, remove any director or the entire board with or without cause, although removal of directors where the board is staggered may be subject to different rules. Vacancies can generally be filled by a majority of the directors then in office, even if there are fewer directors than the quorum. A company's certificate of incorporation and bye-laws may also permit shareholders to fill vacancies.

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

Term limits for directors are relatively uncommon, although Delaware's General Corporation Law allows a corporation's certificate of incorporation or bye-laws to prescribe various qualifications for directors, including the term of appointment. While 65 of the Top 100 US Companies discuss the topic of term limits for directors in their proxy statements, only five have adopted mandatory term limits (*2009 S&S Corporate Governance Survey*).

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

Directors employed by the company

Directors do not have to be employees of the corporation. In fact, under the NYSE and Nasdaq listing standards, a majority of the board must be comprised of independent directors. In order to be considered independent, the director cannot be, nor have been within the last three years, an employee of the corporation.

Shareholders' inspection

Federal securities law requires extensive disclosure concerning directors' compensation arrangements, as well as related party transactions between the directors and the corporation. Public companies must disclose material transactions that exceed US\$120,000 (about EUR86,500) between the company and certain related parties, including directors. In addition, public companies must disclose their policies and procedures used in reviewing and approving these related-party transactions.

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

Directors are not required by law to own shares in the corporation. However, the corporation's certificate of incorporation, bye-laws or adopted policies may require the director to own a minimum number of shares. Share and stock option ownership by directors is often encouraged to align the directors' own interests with those of the corporation's other shareholders. Federal securities law requires disclosure of transactions by directors in the shares of the company in which they serve as a director and imposes other significant requirements on such ownership (see *Question 14, Securities law*).

10. How is directors' remuneration determined? Is its disclosure necessary? Is shareholder approval required?

Determination of directors' remuneration

Generally, unless otherwise restricted by the corporation's certificate of incorporation or bye-laws, the board can set the directors' compensation, subject to its common law fiduciary duties. This compensation may include cash, the corporation's shares or options on, or other derivatives of, the shares. Director compensation is generally determined by the board compensation or nominating/corporate governance committee.

Disclosure

Public companies are required by federal securities law to disclose their directors' remuneration in any proxy statement or annual report filed by the corporation with the SEC. There are separate requirements relating to disclosure of share ownership.

SEC rules require that investors receive the most complete and accurate description of a corporation's director and executive compensation practices, including a detailed discussion and analysis of its compensation decisions and its philosophy on compensation in a section called "Compensation, Discussion and Analysis (CD&A)".

Shareholder approval

Shareholder approval of directors' cash compensation is not typically required. Shareholder activists often propose mandatory shareholder approval of executive remuneration as a corporate governance reform. NYSE and Nasdaq listed companies must obtain shareholder approval of equity remuneration plans covering directors.

In recent years, shareholder activists have pressed companies to adopt certain compensation-related measures, including "say on pay", a policy allowing shareholders to annually pass a non-binding advisory resolution regarding the pay of certain executive offices.

MANAGEMENT RULES AND AUTHORITY

11. 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 certificate of incorporation and bye-laws typically regulate internal management of the corporation and where these documents are silent state law provides default rules.

Under Delaware corporate law, a majority of the total number of directors constitutes a quorum, and a vote of the majority of the directors present at a meeting at which a quorum is present is required to take any valid actions. However, these requirements can be altered by the certificate of incorporation or by-laws, with certain restrictions. The directors can also take valid actions without a meeting (that is, by written consent), unless the certificate of incorporation or by-laws provide otherwise.

12. 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

State corporate law and the corporation's certificate of incorporation typically provide that the board can exercise all of the corporation's powers. However, certain actions and transactions require shareholder approval under state corporate law, such as mergers and amendments to the certificate of incorporation.

Restrictions

The board's powers can be restricted by the corporation's certificate of incorporation or by-laws, and are subject to statutory limitations.

13. 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?

State statutory law and a corporation's certificate of incorporation normally expressly provide that the board can delegate many, but not all, of its powers to an individual director or to a committee of directors. For example, under Delaware law, a committee cannot generally:

- Amend the corporation's certificate of incorporation or by-laws.
- Adopt certain agreements of merger or consolidation.
- Declare a dividend or authorise the issuance of stock.

Although no particular committee structure is designated by state law, the US federal securities laws and NYSE and Nasdaq rules require public companies to have an audit committee composed entirely of independent directors. The NYSE also requires its listed companies to have a nominating or corporate governance committee and a compensation committee. Federal legislation is pending that would require public companies to have a compensation committee as well as a nominating/corporate governance committee (see *Question 36*). Subject to certain exceptions, all of these committees must consist only of independent directors.

DUTIES AND LIABILITIES OF DIRECTORS

14. 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.** Directors owe the corporation and its shareholders a:

- **Duty of care.** This generally requires that a director pay attention, ask questions and act diligently in order to become and remain fully informed and to bring relevant information to the attention of other directors;
- **Duty of loyalty.** This generally requires that a director make decisions based on the corporation's best interest, and not on any personal interest.

In determining whether a board of directors has satisfied its fiduciary duties, the courts generally apply the business judgement rule under which a board's decision is protected unless it is shown that the directors breached their duty of care or duty of loyalty.

Negligence on the part of a director does not result in personal liability unless the director failed to act in good faith.

Directors' decisions may be more strictly scrutinised with respect to certain transactions, including the sale or change of control of the corporation or in conflict of interest situations.

- **Theft and fraud.** A director can be criminally liable under both federal and state laws regulating theft and fraud. In addition, directors can be held liable under other federal statutory schemes.
- **Securities law.** Directors of public corporations can be held both civilly and criminally liable under state and federal securities laws in a number of circumstances. For example, directors cannot trade in a corporation's securities when in possession of material, non-public information (*Rule 10b-5, 1934 Act*). The federal securities laws also impose liability on directors for intentional or reckless misrepresentations or material omissions made in offering documents or proxy solicitations.
- **Insolvency law.** In recent years many courts and commentators have looked at whether the directors of a corporation that is possibly insolvent (or in the zone of insolvency) or actually insolvent owe their fiduciary duties to the corporation's creditors. The Delaware Supreme Court has held that where a corporation is in the zone of insolvency or clearly insolvent, the directors have a fiduciary duty to exercise their business judgement in the best interests of the corporation. Creditors of an insolvent Delaware corporation have standing to maintain derivative claims against directors on behalf of the corporation for breaches of fiduciary duties but have no right to assert direct claims for breach of fiduciary duty against corporate directors (*North American Catholic Education Programming, Inc v Gheewalla, 930 A.2d (Del 18 May 2007)*).
- **Other.** Directors are potentially personally liable under various federal statutory schemes in areas such as health, safety, the environment and anti-trust. For example, the Foreign Corrupt Practices Act of 1977 (FCPA) targets corrupt payments made by corporations to certain foreign officials. Directors may be criminally liable for knowing violation of the statute. The FCPA prohibits a company from indemnifying its directors and officers for fines under the FCPA.

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

Limiting director liability

Most states allow a corporation to eliminate or limit directors' personal liability to the corporation or its shareholders for breach of their fiduciary duty. However, there are often restrictions on the limitation of directors' liability. For example, Delaware law provides that directors' liability cannot be eliminated or limited for:

- Any breach of the director's duty of loyalty.
- Acts or omissions not in good faith or involving intentional misconduct.
- Wilful or negligent conduct in paying dividends.
- Any transaction from which the director derives an improper personal benefit.

Corporations often adopt provisions in their certificates of incorporation eliminating directors' liability to the fullest extent permitted by law.

Indemnification

State law also provides that a company can indemnify a director in certain circumstances. Under Delaware law, any person made a party to proceedings for being the corporation's director is entitled to indemnification, provided that the individual both:

- Acted in good faith.
- Reasonably believed that he acted in the corporation's best interests.

Indemnification is mandatory if the director is successful in the proceedings. Indemnification statutes often have restrictions (for example, a corporation cannot normally indemnify a director against liabilities owed to the corporation). Many corporations also provide contractual indemnities to their directors, in addition to the indemnification provided by state law.

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

Public companies typically obtain insurance on behalf of directors to cover any error, misstatement, misleading statement, act, omission, neglect or breach of duty. In addition, because one of the most serious concerns for officers and directors are the legal fees associated with frivolous claims, insurance typically covers the legal fees from a criminal proceeding or any formal civil administrative or regulatory proceeding. However, insurance cannot be purchased to protect directors against liability based on the director's fraud, dishonesty or violations of criminal law.

17. Can a third party (such as a parent company or controlling shareholder) be liable as a de facto director (even though such person has not been formally appointed as a director)?

A shareholder's loss is normally limited to the amount of its investment in a corporation. However, where the corporate form is misused, most typically for fraud, the courts can pierce the corporate veil, and controlling shareholders may be held liable for the corporation's obligations. Generally, the courts only pierce the corporate veil for closely-held corporations. Shareholders who

hold a controlling interest may have liability under the federal securities laws. Shareholders who hold a controlling interest may also be deemed to owe a fiduciary duty to minority shareholders.

TRANSACTIONS WITH DIRECTORS AND CONFLICTS

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

The duty of loyalty requires a director to act in the best interests of the corporation and not for personal profit or gain or for other advantages which do not benefit the corporation. A director can be held liable to the corporation if he allows an actual or potential conflict between his personal interests and the best interests of the corporation to obscure his ability to make decisions objectively.

Under the corporate opportunity doctrine, where a business opportunity becomes known to a director due to his position with the corporation, the director owes a duty to the corporation not to use that opportunity or knowledge for his own benefit.

Self-dealing transactions are voidable under common law, but many states have safe harbour statutes (for example, §144(a) of the Delaware General Corporation Law) that generally provide that a transaction is not voidable if either:

- It is approved by either informed or disinterested directors or shareholders.
- The transaction is fair to the corporation.

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

Section 402 of the Sarbanes-Oxley Act prohibits directors from receiving personal loans or extensions of credit from the corporation, with limited exceptions. Also, certain transactions between a company and its directors could impair director independence if the transactions are deemed to be a material relationship.

20. 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?

Generally, there are no restrictions on the purchase or sale of securities by a director of a public corporation, other than:

- Restrictions in relation to insider trading. A director cannot trade in corporation shares if he possesses material non-public information about the corporation. In addition, corporations usually have policies which regulate trading by officers and directors.
- Restrictions on trading during certain black-out periods tied to the corporation's pension fund.
- Restrictions on public resale of restricted and control securities in accordance with Rule 144 under the US federal securities laws. Rule 144 allows public resale of restricted and control securities if certain conditions are met, which may include a holding period and a limitation on the volume of securities to be sold.

Directors must disclose their holdings of shares and share options to the public, along with any transactions that result in a change

in their holdings (§16, 1934 Act). In addition, when a director acquires more than 5% of the corporation's shares, certain additional disclosures must be made (§§13(d) and (g), 1934 Act). As noted above, the related pension disclosure rules may also require additional disclosure.

DISCLOSURE OF INFORMATION

21. Do directors have to disclose information about the company to shareholders, the public or regulatory bodies?

Directors generally do not disclose information about the company directly to shareholders, the public or regulatory bodies. Such disclosures are made by the executive officers of the company and are generally reviewed by the directors before the disclosure. The directors are signatories to certain documents filed with the SEC, including the company's annual report of Form 10-K.

COMPANY MEETINGS

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

All public companies must hold an AGM. Under Delaware law for example, unless directors are elected by written consent an AGM must be held for the election of directors (§211(b), *Delaware General Corporation Law*). Many large US public companies use the calendar year as their fiscal year and hold their AGMs in the spring. Matters typically submitted to a vote of shareholders (some of which are mandatory) include:

- The election of directors.
- Approval of stock compensation plans.
- Changes to the certificate of incorporation.
- Ratification of the selection of the company's independent accounting firm.
- Company and shareholder sponsored corporate governance proposals, such as "say on pay" proposals.

In order to solicit proxies at an AGM, the 1934 Act requires a corporation to provide information to shareholders before the annual shareholders' meeting in the form of a proxy statement.

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

Generally, state statutes provide that shareholders can call special meetings if the corporation's organisational documents allow them to do so. With proper notice, shareholders' can generally make proposals at annual and special shareholders' meetings, but the corporation is not required to accept certain proposals.

Brokers that hold their customers' shares on behalf of the beneficial owner but registered in the broker's name, hold shares in "street name". Under the former NYSE Rule 452, brokers who held shares in street name, and who did not receive voting instructions from the shares' beneficial owners, could use the

share's voting rights at their discretion in routine matters, such as uncontested director elections.

In practice, brokers often used this discretionary voting power to vote in favour of management proposals, providing additional support for management. The SEC recently voted to approve amendments to NYSE Rule 452 to make election of directors a non-routine matter, thereby preventing brokers from being able to vote on the election of directors without specific voting instructions from the beneficial owners of the shares. This rule will also affect companies listed on other exchanges, such as Nasdaq as the rule applies to the brokers, who are members of the NYSE. Shareholder activists wish to see the elimination of broker discretionary voting for director elections because a substantial amount of retail holdings (that is, non-institutional holdings) are held in brokerage accounts in the US.

MINORITY SHAREHOLDER ACTION

24. 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?

A minority shareholder can:

- Bring a claim, either on behalf of the corporation (referred to as a derivative action) or as a shareholder class action, against the corporation's directors for breach of fiduciary duty.
- Call a special meeting of shareholders if the corporation's certificate of incorporation allows.
- Submit shareholder resolutions to the board.
- Engage the corporation in a proxy contest in an attempt to replace the board and the corporation's management (see *Question 6, Appointment of directors: Nomination*).
- Contact the board of senior management of the company to express the shareholder's view. The company is generally not required to respond to the shareholder's inquiries but may do so as an investor relations matter.
- Use any other grievance methods provided for in the corporation's certificate of incorporation or documentation relevant to a particular company.

INTERNAL CONTROLS, ACCOUNTS AND AUDIT

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

The rules adopted by the SEC under Section 404 of the Sarbanes-Oxley Act impose formal requirements on the corporation's internal control over financial reporting (which is a part of the corporation's internal controls). A corporation's annual report filed with the SEC must generally contain an internal control report:

- Stating the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting.
- Identifying the framework used by management to evaluate the effectiveness of the corporation's internal control over financial reporting.

- Containing an assessment, as of the end of the most recent fiscal year of the corporation, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.
- The corporation's independent auditor must issue an attestation report on the corporation's internal control over financial reporting.

The SEC regulations also require quarterly reports to discuss changes in internal controls over financial reporting. In addition, the CEO and CFO must annually and quarterly provide certifications that relate, in part, to internal controls over financial reporting.

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

Any director who makes or causes the making of any false or misleading statement in a document filed with the SEC can be held personally liable for the misstatement, including those made in connection with the corporation's accounts under various sections of the 1933 Act and the 1934 Act.

In the context of securities offerings, every director of an issuer corporation at the time of filing the registration statement can be held personally liable for any untrue statement of a material fact or omission of a material fact required to be stated or necessary to make the statements not misleading. Similarly, every director of the issuer corporation can be held personally liable for use of a prospectus that includes any untrue statement of a material fact or omits to state a material fact required to be stated or necessary to make the statements not misleading (*1933 Act*).

A director can avoid liability by proving that he had acted in good faith and with lack of knowledge. Under the Sarbanes-Oxley Act, directors can also face criminal liability for fraudulently influencing, coercing or misleading an accounting firm during an audit, with the intention of rendering the audit report misleading.

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

The annual financial statements of public companies must be audited by a registered independent accounting firm. Interim financial statements are not required to be audited but must be formally reviewed under applicable accounting literature.

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

If the corporation is a public company, the corporation's audit committee is responsible for hiring an independent registered public accounting firm as its auditor. The auditor must then be approved by the entire board and the retention of the firm is often put before the shareholders for ratification. While there is no requirement for the company to rotate the accounting firm, the accounting firm must change the lead accounting firm partner responsible for coordinating and reviewing the corporation's audit every five years.

29. Are there restrictions on who can be the company's auditors?

A public company's auditors must be independent under the federal securities laws and the rules of the Public Company Accounting Oversight Board (PCAOB). Auditors of public corporations must also be registered with the PCAOB. Certain relationships can disqualify an auditor from being independent.

30. Are there restrictions on non-audit work that auditors can do for the company that they audit accounts for?

Federal securities laws prohibit a corporation's auditors from performing certain services for their audit clients. The following are prohibited non-audit services:

- Bookkeeping or other services related to the accounting records or financial statements.
- Financial information systems design and implementation.
- Appraisal or valuation services, fairness opinions or contribution-in-kind reports.
- Actuarial services.
- Internal audit outsourcing services.
- Management functions or human resources.
- Broker or dealer, investment adviser or investment banking services.
- Legal services and expert services unrelated to the audit.
- Tax services during the audit engagement period to a person (or an immediate family member) in a financial reporting oversight role at an audit client generally.
- Any other service that the PCAOB determines is impermissible.

All other non-audit activities must be approved in advance by the corporation's audit committee.

31. 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?

Auditors are potentially liable to the company, shareholders and third parties if the audited accounts are inaccurate. Generally, auditors cannot limit their liability to their audit clients because such limitations are viewed as impeding their independence. It may, however, be possible for auditors to limit in their engagement letter the punitive damages an audit client can claim. An auditor can be held liable for negligent misrepresentation to third persons who are known to the auditors and for whose benefit the auditor provided the audit report. An auditor can be liable to shareholders for statements made either:

- In the audit or internal controls over financial reporting opinion.
- In the context of a securities offering by a corporation, under the 1933 Act, based on the financial statements and attestation to the corporation's internal controls over financial reporting included in the corporation's registration statement.

CORPORATE SOCIAL RESPONSIBILITY

32. 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 companies often highlight their achievements related to social and ethical responsibilities in their annual report. These disclosures are driven more by best practices and pressure from watchdog organisations than legal requirements. However, there are general disclosure requirements for certain of these matters as well as more extensive disclosure requirements on environmental matters and the potential impact of climate change.

ROLE OF COMPANY SECRETARY

33. What is the role of the company secretary in corporate governance?

The company's general counsel (or an assistant counsel) is often also the company secretary and in this capacity:

- Attends board meetings.
- Assists the board with respect to corporate governance issues.
- Prepares minutes of the meetings.
- Maintains corporate records, among other things.

ROLE OF INSTITUTIONAL INVESTORS AND SHAREHOLDER GROUPS

34. How influential are institutional investors and other shareholder groups in monitoring and enforcing good corporate governance? Please list any such groups with significant influence in this area.

Institutional investors and other shareholder groups have become increasingly influential in monitoring and enforcing best practices in corporate governance. Many large investors have established corporate governance guidelines that they want corporations in which they invest to follow and have published these guidelines on their websites. In addition, there are institutional advisory firms, such as RiskMetrics Group and Glass, Lewis & Co LLC that recommend how shareholders should vote on matters proposed to shareholders in corporations' proxy statements.

In addition, traditional shareholder activists, such as large pension funds, continue to be a powerful influence and are often successful in encouraging corporations to adopt their desired practices. Such institutional investors often submit shareholder proposals in corporate governance policies.

Institutional shareholders and hedge funds are increasingly engaging corporations in discussions of their perspectives on matters affecting the corporation, such as capital structure, use of capital, strategic investments and acquisitions. In 2009, 55 of the Top 100 US Companies included governance related shareholder proposals in their policy statements (*2009 S&S Corporate Governance Survey*).

WHISTLEBLOWING

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

Audit committees must establish procedures to enable employees to confidentially and anonymously submit concerns in relation to the corporation's accounting, internal controls or auditing matters. Companies are subject to potential civil, and in some cases criminal, liability if they can be shown to have taken retaliatory action against an employee whistleblower.

REFORM

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

The global financial crisis has increased activity and interest by regulators, legislators and the private sector in enhancing US public companies corporate governance practices. In this context, the role of US public company boards is again under intense scrutiny. There are numerous initiatives pending in the US Congress and being considered by the SEC, as well as certain rule changes that have already been adopted by the SEC. Federal legislation is pending that would require public companies to have a compensation committee as well as a nominating/corporate governance committee. In addition, in early 2010, the SEC adopted amendments to enhance a company's proxy statement disclosures relating to:

- Compensation policies and practices that present material risks to the company.
- Stock and option awards of executives and directors.
- Director and nominee qualifications and legal proceedings.
- Board leadership structure.
- The board's role in risk oversight.
- Potential conflicts of interest of compensation consultants that advise companies and their boards of directors.

Many of the proposed initiatives and recently approved rule changes are aimed at giving shareholders a greater say in the governance of the public corporations in which they invest.

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