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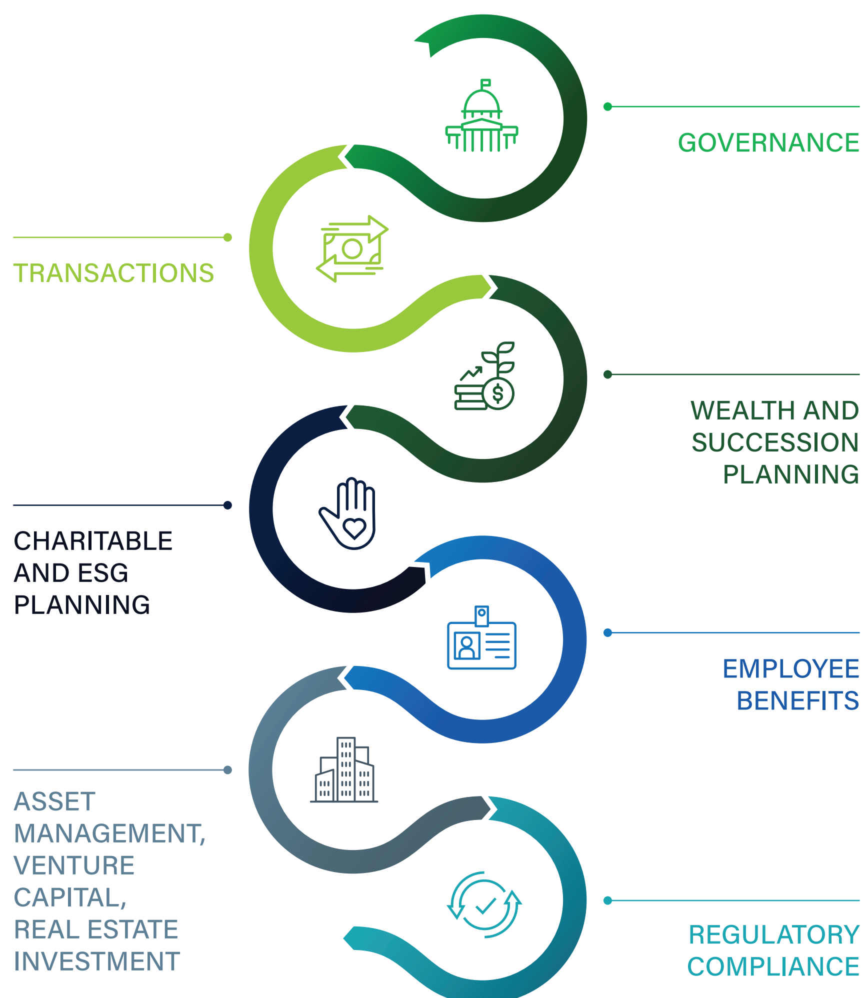
Family Office Services

Partnering with clients to manage multigenerational wealth and advance business interests

Family offices can play an important role in the integrated strategy for families that seek to invest, protect and grow assets using a coordinated approach. And the family office can also be an important vehicle to protect and strengthen familial bonds. However, this type of structure can be complicated and there is no single best practice or one-size-fits-all approach. Our experienced attorneys help clients develop or improve their existing family office and address their key concerns and priorities — to ensure such offices run efficiently and effectively.

All Operating on the Same Wavelength



Strength in Numbers

40+ family office professionals to serve as outsourced general counsel

1,200+ attorneys, consultants and professionals in total

21 locations across the U.S., London and Shanghai

Top 50 firm

Protecting Future Generations

With increased wealth comes the responsibility to protect accumulated assets for future generations, appropriately invest that wealth, responsibly give back to the community and protect the family, especially younger family members, from the risks that wealth can bring. Our team delivers deft guidance to reconcile discrete goals and help your family determine the appropriate ownership structures for your particular situation. We support clients on developing mission statements, combining family history with forward-looking goals and objectives, such as environmental, social and governance (ESG), and then implementing the appropriate structures to achieve their vision.

Creating Consensus

The ultimate plan involves creating consensus among family members on the details of how to structure the family's approach to its assets, and the governing documents, such as operating agreements and shareholder and partnership agreements. The family office team addresses legal or regulatory issues arising from corporate or investment-related transactions. We also provide sophisticated, tax-efficient trust and estate planning strategies. Spousal lifetime access trusts (SLATs), grantor retained annuity trusts (GRATs), complex wills, grantor and non-grantor trusts, generation skipping trusts, charitable reminder trusts and private placement life insurance represent just a fraction of our capabilities in the wealth planning arena. And we bring that same versatility and administrative and regulatory support to charitable and investment planning, from managing the compliance requirements for family foundations and related charitable vehicles to advising on Qualified Opportunity Zones, Section 1202 stock and other investment opportunities.

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Overview

Doug Raymond delivers constructive and strategic counsel for clients, advising on strategic acquisitions and joint ventures, high-stakes governance issues, securities transactions and complex legal matters. His intuitive understanding and thoughtful consideration of the business and strategic objectives of clients make him a trusted, results-oriented counselor. Highly regarded by clients and peers, Doug is even-tempered yet persuasive, and has an encyclopedic knowledge of the law, which he draws on to creatively solve clients' most intractable issues. Doug is a member of Faegre Drinker's board.

Chambers USA has noted the high esteem of his peers, with one reporting that Doug is "one of the finest lawyers I've ever worked with." Doug is particularly valued for his work in mergers and acquisitions, securities transactions, and other complex corporate matters. He also has the judgment and perspective to address the unexpected and provide informed, practical solutions in acute situations and on an ongoing basis. In the 2021 *Chambers* guide, Doug is one of only three Corporate/M&A: Securities attorneys in Pennsylvania to receive a "Band 1" designation.

Corporate Transactions

Clients rely on Doug to seamlessly execute the largest, most sophisticated mergers, strategic acquisitions, corporate divestitures, cross-border deals and joint ventures. Whether advising on a multibillion-dollar, debt-and-equity offering on the New York Stock Exchange or a strategic asset sale, Doug prioritizes client goals at every stage of the deal.

Doug has worked extensively in the area of social impact investing. He helped establish (and subsequently served on the board of directors of) one of the leading not-for-profits that provides social impact ratings to investors and other constituencies. He has worked for more than 20 years with Opportunity Finance Network, who works with Community Development Financial Institutions and others to ensure that low-income, low-wealth and other underserved people and communities have access to affordable, responsible financial products and services. He has also provided counsel to boards of directors and others considering forming or converting to a benefit corporation format.

Disclosure and Governance Counsel

Doug is an authority on corporate governance and disclosure issues. He advises extensively on governance matters for public and private companies and counsels boards of directors and special committees on complex governance challenges. Doug writes a regular column on governance matters for *Directors & Boards* magazine that highlights his pragmatic approach to boardroom issues.

Doug also has a focus on sophisticated family enterprises and is himself an independent (nonfamily) director of a fifth-generation family business with interests in industrial abrasives and related businesses.

Private Company Governance: Preparing for Sale

By Doug Raymond and Erin McKevitt

Deciding to Sell

It frequently is said that the two most important decisions a board can make are appointing the CEO and deciding whether to sell the business. Sometimes the owners' insistence or extrinsic circumstances will trigger an expedited need to undertake a sales process, including factors such as an unexpected death or the owners' urgent need for liquidity. More frequently, the decision can be made over time, and deliberately, after consideration of all relevant factors and constituencies. In these deliberations, the directors must be guided by their fiduciary duties of care and loyalty. Deriving directly from the most central principles of agency, the duty of care requires that the director act "with such care, skill and diligence as a person of ordinary prudence would use under similar circumstances." This care requires, among other things, that each director be reasonably informed of the material aspects of any proposed board action and take sufficient time to consider any proposed action. The duty of loyalty, on the other hand, "requires that corporate directors devote themselves to corporate affairs with a view to promote the common interests and not only their own, and they cannot directly or indirectly utilize their position to obtain any personal profit or advantage other than that enjoyed by their fellow shareholders." That is, directors may not use their role as such for personal gain or to advance interests that are not aligned with those of the corporation.

In many jurisdictions, including Delaware, the directors' obligations run to the stockholders — when they take action it must be in the best interest of the owners. In other states, including Pennsylvania, the director's obligation runs to the corporation and its interests, and not only to the shareholders of the corporation. Among other things, this means that the directors are not required to treat any constituency's interests as dominant or controlling when evaluating the best interests of the corporation. Although the directors may consider the interests of shareholders and may give their interests primacy, they are not required to do so, nor are directors required to give priority to shareholder interests over the interests of any other constituency. For example, when evaluating the best interests of a Pennsylvania corporation, the board may consider, to whatever extent it deems appropriate:

1) The effects of any action upon any or all groups affected by such action, including shareholders, employees, suppliers, customers and creditors of the corporation, and upon communities in which offices or other establishments of the corporation are located.
2) The short-term and long-term interests of the corporation, including benefits that may accrue to the corporation from its long-term plans and the possibility that these interests may be best served by the continued independence of the corporation.
3) The resources, intent and conduct (past, stated and potential) of any person seeking to acquire control of the corporation.
4) All other pertinent factors.

In considering whether a sale is the best course of action, the board should undertake a broad and comprehensive analysis. The board should consider not only the decision to sell, but also the timing of a sale and the potential impact on the business of the distraction created by a sales process. The board should also consider whether to explore alternative options, including an initial public offering, a private debt or equity offering, a joint venture or obtaining minority investors. In considering these issues, the board should evaluate the status (and success or failure) of succession planning; any unresolved or intractable disputes among owners, directors or management; and the liquidity requirements of the owners — as well as the capital needs and constraints of the business. The board should also consider whether to walk away entirely or to possibly seek to roll over equity and retain a stake in the business. Other issues to address at this stage include the impact of a possible sale on employees, customers and other stakeholders. The board should pay particular attention to importance of management continuity during the sales process and the need to retain essential employees. It may be necessary or prudent to put in place success or retention bonuses to help keep key employees during what can be an extended process.

The board should also look into the impact on a proposed sale of prevailing economic conditions, tax issues and technological change in their industry. The board should consider the potential impact of the following additional considerations on the sale process or price.

- Any contingent liabilities (e.g., pension obligations, environmental or intellectual property liabilities).
- How a bidder would evaluate future growth potential, supplier concerns, customer concentrations and intellectual property considerations.
- The strength of the company's industry and the impact of broader industry trends.
- The potential for distraction created by the sales process, including the risk that the news might leak to employees, customers or competitors.
- Whether to broadly market the company or instead offer it only to a very few potential buyers, either strategic or financial (see below).

Addressing Conflicts of Interest

Another important consideration in contemplating a sale is identifying and addressing potential conflicts of interest. Conflicts may exist where directors or shareholders have interests in the transaction that are different from those of the company and its shareholders generally. For example, a conflict is present where an officer, director or shareholder sits "on both sides of the transaction," as when the officer may lose their employment if the company is sold, or if a shareholder is the party offering to buy the business, or if a director has a business relationship with one or more potential buyers. Transactions in which some shareholders may receive "different consideration" than the other shareholders also implicate conflicts of interest. However, simply because a transaction may implicate a potential conflict does not mean the transaction should be avoided all together. The board should first consider the type of conflict and develop an appropriate mechanism to deal with any identified conflicts.

After identifying the type of conflict, the board should determine the best way to address the conflict so it does not affect the board's evaluation and negotiation of the potential transaction. In general, courts apply the business judgment rule to actions by the board of directors. This involves a very strong presumption that the directors were fully informed and acted in good faith in the best interest of the company in their decision-making. However, in certain

instances where there are conflicts present, courts may apply a more stringent standard of review, asking whether the deal process was fair and whether the directors obtained a fair price.

In general, the number of conflicted directors or shareholders determines the appropriate strategy to proceed with the transaction. If any officers or a minority of directors have a potential conflict, the board should screen the conflicted individuals from participation in negotiations with potential bidders and from discussions about the transaction. If a majority of directors are interested, the board should create a well-informed independent committee to negotiate and consider the transaction. Alternatively, or additionally, the board can obtain the fully informed and uncoerced approval of the disinterested shareholders.

If a controlling shareholder is conflicted, the board should adopt greater protections. Under Delaware law, in these situations the board should condition the transaction on the approval of a well-informed independent committee *and* obtain fully informed uncoerced approval of the unaffiliated minority shareholders.

If a special committee is necessary, the board should establish the committee before beginning any "substantive economic negotiations." Under Delaware law, the committee can consist of as few as one director; however, in practice, it is recommended that the committee have at least three directors to increase objectivity and decrease potential scrutiny. The board should ensure the committee remains fully independent and disinterested. The committee should have the authority to choose its own independent legal and financial advisers to aid in the decision-making process. Finally, the independent committee must have a broad grant of authority to act and negotiate on behalf of the company.

Positioning the Company for Sale

In deciding whether to put the business up for sale, the board, with management and the owners, should identify the company's core value proposition and refine the company's focus accordingly. Examples that frequently drive value include cash flow/EBITDA, competitive position, relationships with customers, strategic considerations, management/sales, intellectual property and growth potential (either organic or through M&A).

The board should work with management and the owners to conduct diligence on the company to prepare for sale and to candidly determine areas of strength and weakness. The board should review a range of issues for possible concerns, including: financial reporting, corporate records; shareholder agreements; material contracts and related party transactions; third-party relationships; assets; employee relations/benefits; legal claims; antitrust issues; insurance coverage; the strength of management; the strength and security of information systems; customer relationships; required approvals; contingent liabilities; and real estate, environmental and intellectual property issues.

After conducting diligence, the board should work with management and the owners to increase the company's value and prepare for the deal process. The board, management and owners should also address any issues that arose during diligence and, if possible, take corrective actions to minimize buyer concern. Further, the board, management and owners should evaluate opportunities to increase value arising from the diligence process. At some point in the process, the company should prepare an electronic data room where the company's information can be made available in a controlled environment to potential buyers. The data room should include enough detail to allow potential buyers to value the company and to conduct legal/financial diligence; however, the company should limit the amount of confidential/sensitive information disclosed, so that it is not compromised if the sale falls through. The company should also develop tax, legal and human resources strategies for the sales process and the sale itself. Additionally, a realistic timeline should be developed for sale to instill a sense of urgency, avoid deal fatigue and protect value. The board, together with the owners, should assemble a deal team in which they have complete confidence, and which should include representatives of the board, management and the owners, as well as accounting, finance and legal advisors. The choice of the right deal counsel and financial advisers can be critical to the success of the transaction.

Identifying the Right Buyer

The board, with management and the owners, should carefully consider to whom they should market the company. Strategic buyers include competitors, suppliers and customers that seek access to markets, talent, market share, proficiencies or intellectual property. These buyers are typically focused on the operations of the company. They tend to have greater industry knowledge and often offer higher valuations. However, these buyers often replace or reduce management roles (and frequently other employees as well), which can affect culture, morale and customer loyalty. Some strategic buyers move more slowly through deal processes. The board should also consider potential antitrust issues in deciding to sell to a strategic buyer. Finally, the board should be mindful of the risk of disclosing sensitive or competitive information if the deal fails.

Financial buyers, such as private equity funds, usually are focused on financial returns over a five- to seven-year period. They seek companies with strong cash flows, industry positioning, cash conversion, growth opportunity, credit and leverage. These buyers tend to fund transactions with debt and are concerned with management strength, EBITDA and cash flow. Current management and shareholders often remain involved and hold equity in the company after the sale. These buyers tend to have access to capital to fund growth opportunities (including acquisitions). Financial buyers tend to be more flexible with deal structure and less likely to disrupt morale, culture and customer loyalty.

Conclusion

In sum, the decision to sell is a monumental milestone in life of the company. To position the company for a successful sale, the board should take an active role in every step of the process, from deciding to sell to preparing for sale to choosing the right buyer. Finally, the board should be mindful to uphold its fiduciary duties of care and loyalty throughout the entire process.

Doug Raymond *is a partner in the law firm of Faegre Drinker Biddle & Reath LLP.* ***Erin McKevitt****, an associate, assisted in preparation of this column.*

Doug Raymond *delivers constructive and strategic counsel for clients, advising on strategic acquisitions and joint ventures, high-stakes governance issues, securities transactions and complex legal matters. His intuitive understanding and thoughtful consideration of the business and strategic objectives of clients make him a trusted, results-oriented counselor.* ***Erin McKevitt*** *brings to the table legal dexterity — and an academic background in statistics and business — to help clients understand and better respond to the market. She offers accessible and creative counsel amid strategic transactions, with special consideration given to tax efficiency.*

Tips on interviewing law firms

Readers frequently request guidance on how to evaluate advisory firms. This series of articles presents information on how to interview and compare advisers in a variety of disciplines.

BY F. DOUGLAS RAYMOND III AND VANESSA S. TABLER

There are more than 1.3 million lawyers in the United States, so most likely you know, or are even related to, a lawyer you might ask to help with a legal problem or challenge you are facing in your business or family. While proximity and familiarity can be valuable, they are not the best criteria for hiring a lawyer. It is important to understand the correct criteria for making this important decision.

When do you need a lawyer? Businesses operate in a heavily regulated environment, and litigation, even over trivial matters, is rampant. In addition, the complexities of the tax system, import and export sales and purchases, and the capital raising process could lead a family business owner to conclude that the business needs a regiment of lawyers on hand at all times. For some companies, this is true. But for many businesses, particularly smaller ones, there may be only an occasional need for a lawyer, and the type of lawyer needed will vary depending on the specific issues of concern.

Sometimes, it will be obvious that a lawyer should be called in — for example, if the family needs to raise money for the business or is thinking about an acquisition or sale of the business. Similarly, a lawyer will be needed if a lawsuit is being threatened (or has been filed) against the company, or if the business is trying to navigate a complex regulatory scheme. Estate planning, setting up the basic legal structure of the business and its ownership, and other actions that have long-term ramifications or that cannot be readily reversed are other instances where counsel may be necessary.

While a business may frequently be able to navigate a legal challenge on its own, if there is any doubt about the best course of action, it is advisable to consult a qualified lawyer.

What kind of lawyer do you need? While some lawyers are generalists, a business should look for a lawyer who has specific experience in addressing the issues at hand. For example:

- If the business is looking to expand its manufacturing footprint, it may want to consult with a lawyer who can navigate zoning and real estate development issues, as well as financing for the project.
- If the next generation is planning to become more involved in the family business, it might be desirable to look for a lawyer with strong corporate and trusts and estates experience.
- An employment lawyer might be the best person to call when negotiating the hiring of a new senior officer.
- If the business is launching a new product that depends on imported components, the call should go to a regulatory lawyer specializing in international trade matters who can advise on whether the new product is subject to customs regulations.

Given the wide variety of practice areas among lawyers, it is important to specifically identify the issues you want to address.

How important is it that the lawyer be experienced in dealing with family businesses? While solving an export or import issue may not require particular sensitivity to family business dynamics, experience working with family firms would be crucial in a meaningful recapitalization or generational transfer of voting stock. If there are several family members in the business, consider whether they all will speak with one voice on the

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issue. If not, it may be important that the lawyer appreciate the often-complex dynamics of a family business.

Most lawyers work in law firms that offer a range of specialties. While you start by looking for the individual lawyer with the expertise you require, if you will need different sorts of legal expertise, it may be more efficient to find a firm with strength across those areas. A single firm can coordinate the efforts of all lawyers needed to address your matter and may be able to save you money, because there are efficiencies created by lawyers working on a team, dividing duties and sharing information. If this is the case, you should be comfortable with the entire team put forward by the firm, and if you are not, you may be better off using counsel from different firms to work together.

How do I find the right lawyer for the situation?

Ask around. Everyone in your business network has hired a lawyer. If confidentiality is not a concern, reach out to members of your network whose opinion you value and ask for a recommendation. Even if they do not know a specialist in the specific area your business needs, they may be able to refer you to a trusted legal adviser who can make a recommendation. Additionally, third-party reference services such as Chambers USA identify well-regarded lawyers across a range of legal specialties, as can your local Chamber of Commerce.

Once some likely possibilities have been identified, you should review the websites of each referral to see the work done by the firm or lawyer, as well as the background and training of individual lawyers. You should also search the internet to see what other information may surface.

Make the initial calls. After you have targeted some promising possibilities, contact them to introduce yourself. Plan on spending 30 to 45 minutes on each introductory call to describe your family business and the help you need. In this introductory discussion, ask the lawyer to confirm that any information you divulge will be held confidential under the applicable standard of legal ethics. Because of the ethical rules governing lawyers, they have obligations to keep confidential information provided by prospective clients (subject to limited exceptions) and ordinarily would not need to enter into a nondisclosure agreement. You may want to ask the lawyer to make sure there is no legal conflict that could affect their ability to represent your business before you share confidential information (e.g., if they represent the real estate developer that your business is considering using to build a new facility). If you are unwilling to hire a lawyer or firm that represented a competitor, this introductory call is the time to make that clear.

After the initial call and confirmation that there are no conflicts, you should schedule a follow-up interview where the lawyer or firm can explain in further detail how they would approach the issue and why they would choose that approach, as well as expected costs, risks, timing, staffing and other details.

Prepare for the follow-up interview. Before the follow-up interview, identify your goals and desired outcomes for the representation and be prepared to answer detailed questions about them from the lawyer. Transparency will greatly assist the lawyer in assessing the best approach to resolving your issue.

Be candid about any family disputes or tensions because such dynamics will often inform the advice the lawyer will give you.

Prospective law firms may need to know about the family dynamics at the company. Be candid about any family disputes or tensions because such dynamics will often inform the advice the lawyer will give you. For example, if the company is seeking assistance with raising money for a project, the lawyer will need to understand the relationship dynamics among family members, which could affect whether the required funding could be obtained and the funding terms.

Ask the lawyer for a list of documents required for their review of your matter. Gather those documents and organize them in a format that can be easily shared with the lawyer. You can scan the requested documents and send electronic versions to the lawyer so that you can maintain the original files; however, if a document is particularly sensitive, you may consider requesting that the lawyer visit your office to review the document or describing the contents of the document over the phone.

Interviewing lawyers

When you interview lawyers, questions to ask include:

- What is the lawyer's experience with similar matters? How many and how similar were they, and what curveballs or unexpected issues arose? What does the lawyer think would be the likely issues that would need to be addressed in the matter at hand?
- What is the lawyer's experience in the industry in which your company operates? Frequently, although not always, industry experience can be more import-

ant than experience with the particular issue. In any event, the lawyer engaged should understand the industry dynamics and legal/regulatory background that are specific to your industry and are relevant to the issue.

• How is the lawyer or firm positioned to handle your matter compared to other firms? Lawyers obviously do not all possess the same skills or have access to the same resources. Ask whether the firm possesses the right mix of professionals to address all of aspects of your matter.

• What is the lawyer's experience with family businesses? The lawyer should be familiar with the unique challenges and circumstances family businesses face and should be able to navigate them.

• Who will be working on your matter, and what are the respective skills and backgrounds of those people? It is fair to ask whether the lawyer you are interviewing will be the one primarily working on your matter, and whether that person has enough time to take it on. It is important to understand what role the lawyer presenting the pitch will play in handling the matter and whether the other lawyers who may work on the matter have the right expertise.

• Ask the lawyer to provide two or three client references. Selecting a lawyer is a personal decision as well as a business decision. Consider not only whether the lawyer has the substantive skills you need, but also whether their style and personality are a fit for you and your company.

• How will the lawyer charge for their services, and is there more than one option for how they are compensated?

Checking references

Client references can be powerful predictors of your own experience in working with the lawyer. When contacting references, questions to ask include:

• Why did you select the lawyer (or firm)?
• How did they do in the project?
• Were they responsive?
• Were you satisfied with the outcome and quality of the work received?
• Are there any negative experiences with the lawyer (or firm) that you would mention?
• Was the matter completed within the agreed fee arrangement and schedule?
• Would you use the lawyer (or firm) on other matters?

Comparing fee structures

As with other specialists, different lawyers price their services differently. Consider how much realistically to allocate to legal fees, recognizing that the final cost may exceed the front-end estimate. Also, the lowest hourly rate may not be the most price-efficient solution. Many lawyers are willing to use alternative billing arrangements, including fixed fees, success incentives (and discounts for less desired outcomes) and other approaches designed to align their economic incentives with those of the client.

The type of fee arrangement should be agreed upon in an engagement letter between you and the lawyer (or firm) before work commences. Flat or fixed fees, as well as hourly billing with a cap, are frequently used. Similar to a capped fee arrangement, under an hourly billing fee arrangement the lawyer will bill you based on a set hourly rate for each hour (or fraction of an hour) of work performed; however, there is no cap. The type of fee arrangement that will work for you and the lawyer depends on your budget and the complexity of your matter.

Finally, as you look for counsel, remember that if you are successful, you may be able to develop a long-term relationship with someone who will be one of the most trusted advisers for you and your family. The advantages to you, your family and your business of having that kind of adviser can be invaluable, and certainly makes the search worth the effort it may take. FB

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The Duties They Are A' Changing

The role of board members is being reassessed.

BY DOUG RAYMOND

The last few years have brought boards of directors to the threshold of dramatic change for the first time in decades, and boards need to consider how they will respond to the new environment. The rules governing corporate boards did not change much for most of the last 35 years, but potentially significant changes are now on the horizon.

Directors have fiduciary duties, meaning that they must act in the best interest of the beneficiaries of that obligation. In the words of associate Supreme Court Justice Benjamin N. Cardozo, one of the great jurists of the early 20th century, the obligation of a fiduciary is "something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor most sensitive, is then the standard of behavior."

For directors, this obligation is divided into a duty of loyalty and a duty of care. The duty of loyalty requires that the director be singularly focused on the interests of the corporation — not on the director's own personal agenda — while the duty of care mandates that the director pay careful attention to their work and be actively engaged in decisions that affect the corporation. The implications of these fiduciary duties have been explicated and refined over thousands of lawsuits and reams of commentary and articles in learned journals, particularly in addressing situations that are fundamental to the corporation. Examples of such situations include a change in control or insolvency, or substantial conflicts of interest, such as self-dealing transactions or where a director is aligned with a third party that is seeking to effect a fundamental transaction.

Until recently, less attention has been paid to the required object of the directors' attention. The corporation law of many states, including Pennsylvania, provides that these fiduciary duties are to be exercised to benefit the corporation, but this is not

a particularly enlightening standard. A corporation is an abstract and intangible creation of state law and cannot itself be hurt or helped. And it is overly simplistic to presume that increasing revenues or profits is always in the best interests of the corporation. For example, consider a project being reviewed by the board that will increase earnings substantially, but will also require the corporation to take on a significant amount of new debt, cause a 10% reduction in employee headcount and potentially create environmental problems in the community. Under these circumstances, it is not obvious that seeking the increased profits would be in the best interest of the corporation.

In some jurisdictions, the law explains that in deciding what is in the corporation's best interest, the board has broad discretion and can look to whether and how various constituencies are affected by a proposed action. These stakeholders include shareholders, employees, customers, the communities in which the company operates and creditors, as well as other considerations that the directors believe are relevant to the decision.

In other jurisdictions, including Delaware, the law is reasonably clear that the board's decisions must be viewed through the single lens of how they benefit the stockholders, and while the board may consider the impact of a decision on other constituencies, the interests of the stockholders must be paramount. And, even in those jurisdictions where boards can treat the interests of other constituencies as equal in importance to those of the stockholders, many boards of directors will nonetheless choose to give primary consideration to the interests of the owners.

These formulations of the board's fiduciary duties have recently come under significant challenge, which may evolve into a new vision of the role of the directors. For example, many more companies have become publicly traded as benefit corporations, including the most successful IPO of 2020. Over the last year, at least 16 other public companies received shareholder proposals requesting that they convert to benefit corporations. A benefit corporation is a fairly new type of corporate legal structure that is seen as playing a broader societal role than just serving its traditional constituencies. Thus, when making a decision, the board must also consider the impact on society and the public, even if not directly related to the monetary value of the corporation.

A corporation is an abstract and intangible creation of state law and cannot itself be hurt or helped.

In addition, the current regulatory, institutional investor and societal focus on issues of ESG has made it all but certain that, at least for public companies, the corporation's record on these issues, particularly on environmental and sustainability issues, will become increasingly transparent. This will be correspondently important to investors, regulators and the stock exchanges, regardless of the board's own view of the significance of these concerns or their relevance to the constituencies on which the board had historically focused.

Another change that is rapidly impacting corporations is the growing importance of diversity in the boardroom, which is also at the top of the agendas of many regulatory bodies and legislatures, and a key focus for institutional investors, consumers and other groups. These groups are seeking much more influence for diverse directors and are not going to be satisfied if boards of predominantly older white men rely on "diversity of thought" in response to requests for diversity of color, background, etc.

Many boards will face challenges in how they will react to these changes, particularly in those companies where directors tend to be older and less diverse. The winds of change are starting to blow through the boardroom and may upend what has been a singular attention to shareholder returns in favor of a broader and more societally based focus. Thoughtful boards will want to consider how to react to these trends. ■

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Establish a Formal Process for the Board's CEO Oversight

The CEO runs the company, but the board must take responsibility for the lead executive's performance. **BY DOUG RAYMOND**

It is a fundamental principle of corporate law that the responsibility for managing the corporation sits squarely on the shoulders of the board of directors. As Delaware law states, "The business and affairs of every corporation … shall be managed by or under the direction of a board of directors…" But, in almost every business, the board delegates most of this responsibility to the officers — principally the chief executive officer, who typically hires the rest of the management team.

Notwithstanding this delegation of its authority, the board retains the obligation to oversee the management team and to ensure that the officers are performing at a high level, consistent with the strategic direction and the values of the company. Inevitably, most of the responsibility for this falls to the CEO, on whom the board must rely to operate the business on a daily basis. And CEOs have become accustomed to extensive autonomy in running the business.

Because the board relies so heavily on the CEO, it is often said that the most important duties of the board are the decisions to hire and fire the CEO. However, in part because of the crucial importance of the CEO role, the extensive involvement of the board in their hiring and the close relationship that a CEO has with the directors, the board is naturally very invested in the CEO's success. This investment and alignment are crucial for the board to be able to work effectively with management, but they can also make it difficult for the board to be objective in assessing the CEO's performance. As was reported in one possibly apocryphal story of when a new director joined the board of a global corporation, the new recruit asked a veteran director about the principal duties of the board with respect to the CEO. The answer? "Applause."

During the height of the pandemic and the social and political controversies that occurred at the same time, there was significantly less turnover reported at the top of public

companies compared with prior periods, according to Conference Board analysis. While the board's support of senior management in the face of these unprecedented challenges is understandable, the challenges do not appear to be abating, at least not for most businesses. The directors' fiduciary obligation to oversee the management of the corporation in the best interest of the shareholders and other constituencies includes oversight and evaluation of senior management, particularly the CEO. And despite the natural inclination to be supportive, in this evaluation the directors must not be overly deferential to the CEO. At the same time, the directors must also avoid becoming oppositional or intrusive.

The directors' duty of oversight is not limited to an assessment of the company's financial and stock performance, which realistically is often not really within the CEO's control. They also should evaluate how the CEO interacts with the board and the rest of the organization, including employees, stockholders and other constituencies, as well as the extent to which the CEO supports the board's strategic vision and the company's core values. Directors also should consider whether the CEO is sufficiently candid with the board or instead sugarcoats or deflects bad news when possible.

The recent Conference Board report also suggested that, notwithstanding the current extensive focus on diversity and inclusion, recently appointed CEOs remain overwhelmingly male and white. While each board must decide for itself the role that diversity should play in management and in the boardroom, institutional investors are increasingly focusing on this and other extra-financial issues, including sustainability and how the company engages with contentious political and social issues. As CEOs are required to navigate an increasingly complex set of issues beyond financial return and stock prices, the board must be attentive to the messages that management is sending to investors, employees, customers and other constituencies.

The success or failure of the CEO is the board's responsibility, and the board should make sure that it has taken full responsibility for the CEO's performance.

While boards will address these issues in many ways, boards should consider establishing a regular and well-articulated process for evaluating the CEO. This process should look back to the criteria that the board employed when the CEO was first hired, but also should address the current strategic focus of the business and other issues that are current board priorities. In too many companies, the CEO is not given a performance evaluation at all, or, if one is given, it is too often limited to determining whether the financial metrics have been met. If the board establishes a relatively formal process, with a clear cadence, it can avoid personalizing the evaluation or putting the CEO on the defensive. Especially if an outside consultant or advisor is involved, the evaluation can be structured to minimize both the risk of unwarranted deference and injury to the relationship between the board and the CEO. Depending on the board's structure, either the compensation committee or the governance committee can take responsibility for this evaluation, involving other directors and select members of senior management to make sure that the committee has a comprehensive view.

While a process that includes a periodic formal assessment of the CEO will not guarantee that the board's oversight obligation is limited to applause, it should encourage directors and the CEO to actively engage in the process. Ultimately, the success or failure of the CEO is the board's responsibility, and the board should make sure that it has taken full responsibility for the CEO's performance. ■

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