Corporate Governance - Proactive Legal Advice

Bell Gully

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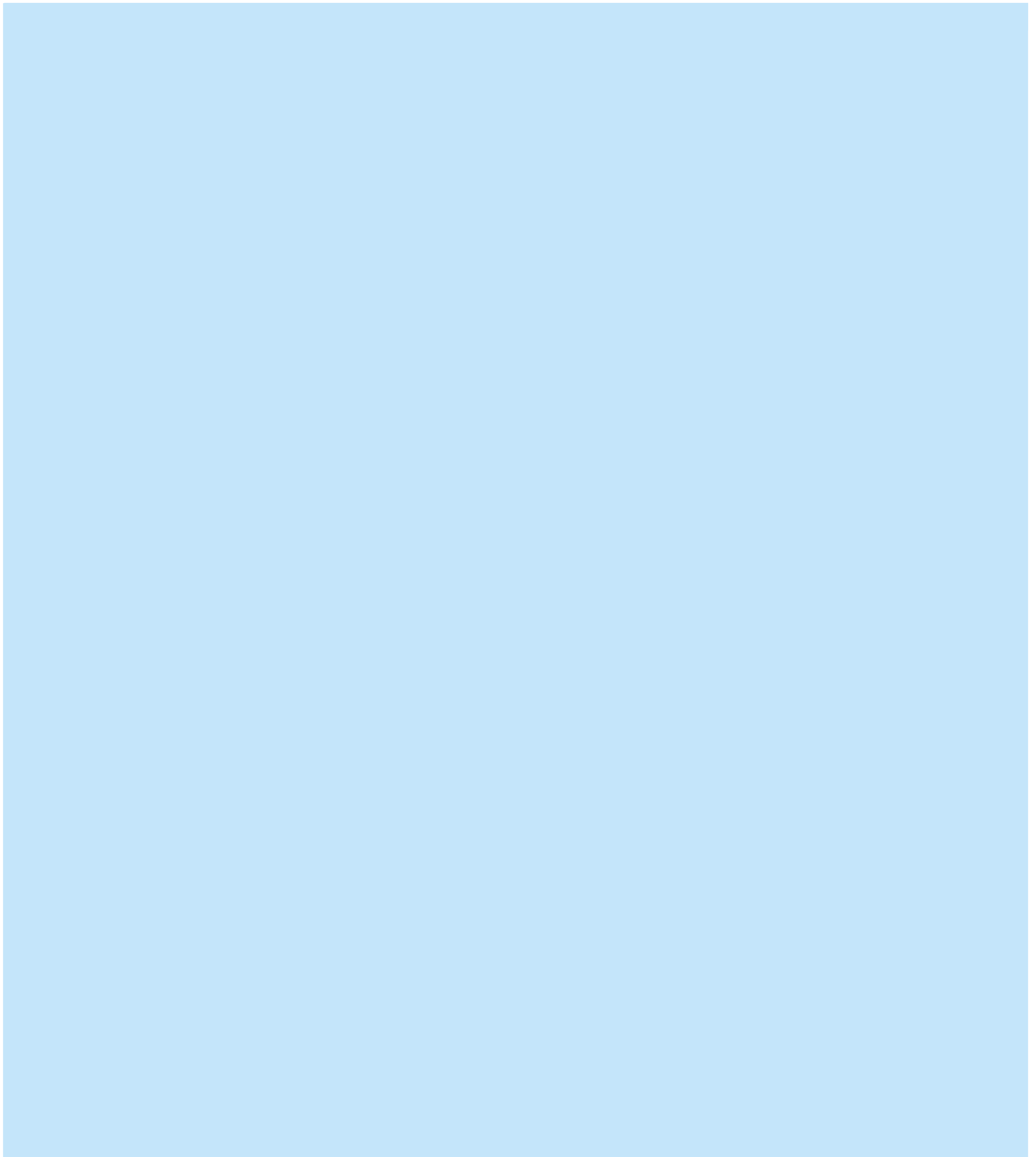

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Developing a corporate governance framework

The best corporate governance framework will depend on the type of organisation involved, as well as the individuals involved.

There is no "one size fits all". What is best for a listed company, will not be appropriate for an SOE or other government body. What is best for a small family business, will not be best for a partnership structure or a trust.

There are many prescriptive rules which apply to organisations such as listed companies, government bodies and even partnerships.

The first thing to do when developing any governance framework will be to examine the specific rules which are applicable to the organisation. For listed companies these are found in the New Zealand Stock Exchange Listing Rules, Securities Commission guidelines, Companies Act 1993 and accounting standards. For government bodies and others, the establishing legislation will commonly prescribe at least some of the governance rules. A specific example of this is Crown entities, for which there are governance rules established by the Crown Entities Act 2004 which provides an overall framework for the governance of Crown entities. This is supplemented by policy papers issued by the states services commission. Banks, insurance companies and others will have industry rules which will apply. Trusts need to comply with the trust deed. Clearly establishing these prescriptive rules and incorporating them in a framework of parties and precedents is the first step in establishing a governance framework.

Relevant to all organisations however are the more general good governance principles. These are often more difficult to establish and put in place than the prescriptive rules. They are more principle based and as such are more open to differing approaches, depending on the nature of the organisation and also the nature of the individuals involved in the organisation.

What are these general principles, what is involved and why are they important? It is now widely accepted that better governance means improved shareholder and other stakeholder value. This is borne out by a number of studies. Good governance is about whole of organisation management – and striving for best practice. The legal aspects are but a subset of governance in this, its widest, sense. Legal aspects are, necessarily, focused on topics such as legal obligations, risk, compliance and process. However, governance principles and their importance go well beyond this.

A very good articulation of the importance of governance in its widest sense is:

To grow and prosper, New Zealand businesses must inspire confidence in local and international investors, partners, suppliers and customers. For this to happen, our Corporate Governance must be world-class. …Good governance is vital not only for public, listed companies but for other forms of business entity as well. …Ultimately, good governance should help businesses become more innovative, competitive and financially sustainable. **Jane Diplock AO, Chairman, Securities Commission.**

The following statement from the ASX is also worth repeating because it correctly focuses on the core principles of good governance:

Corporate Governance is the set of structures and behaviours by which a company or other business entity is directed and managed. The structures and behaviours guide how the entity sets objectives, develops strategies and business plans, monitors and reports on performance, and manages risks. They also guide how directors and managers meet all expectations and that they be responsible and accountable in their respective roles.

There is no single model of good governance: the particular structures and behaviours that are best for one entity will depend on factors including its form, size and type, and its stage of development. But with any good Corporate Governance, there is an emphasis on ethical conduct, transparency, legal compliance and sound business practice.

The best practice recommendations are not prescriptions. They are guidelines, designed to produce an efficiency, quality or integrity outcome. This document does not require a "one size fits all" approach to corporate governance. Instead, it states aspirations of best practice for optimising corporate performance and accountability in the interest of shareholders and the broader economy.

ASX Corporate Governance Council's Best Practice Recommendations

The HIH Royal Commission Report, written by Justice Neville Owen by appointment from the Australian Parliament, had some interesting comments about corporate governance. Justice Owen pointed out that at its broadest:

…the governance of corporate entities comprehends the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled in corporations. …Boards and management that are focused on the use of corporate resources for the benefit of their shareholders and others with an interest, other than their own benefit, in effective management of risk, accurate and reliable financial reporting and proper disclosure are well on the way to good corporate governance.

While not particularly "practical" as our topic requires, I wanted to stress these general principles at the outset. Given the central role that lawyers play in governance issues, it is important that we approach it from this wide-ranging, best-practice perspective. To do otherwise risks governance being dominated by process, form-filling and focusing on mere compliance. There are those who view the recent proliferation of private equity funds as being directly related to the increased rules and regulated environment in which the corporate entity operates – and particularly those which are applicable to listed companies. They see the private equity fund managers as being free to focus on improving value for investors, by being entrepreneurial, without being bound up in compliance, reporting, and process etc. We all need to play our part in ensuring governance is approached in a principled manner in order to achieve optimal outcomes.

A good starting point for these general principles are those of the Securities Commission. The Securities Commission identified nine principles for corporate governance in their February 2004 report *Corporate Governance in New Zealand: Principles and Guidelines.*

These are:

(a) Directors should observe and foster high ethical standards.

(b) There should be a balance of independence, skills, knowledge, experience, and perspectives among directors so that the board works effectively.

(c) The board should use committees where this would enhance its effectiveness in key areas while retaining board responsibility.

(d) The board should demand integrity both in financial reporting and in the timeliness and balance of disclosures on entity affairs.

(e) The remuneration of directors and executives should be transparent, fair, and reasonable.

(f) The board should regularly verify that the entity has appropriate processes that identify and manage potential and relevant risks.

(g) The board should ensure the quality and independence of the external audit process.

(h) The board should foster constructive relationships with shareholders that encourage them to engage with the entity.

(i) The board should respect the interests of stakeholders within the context of the entity's ownership type and its fundamental purpose.

Under each principle, guidelines are listed setting out structures and processes to help issuers achieve the principle. The key findings from consultation are set out (the details of these findings are attached as an appendix to the Securities Commission paper) and the Commission's view on the principle is provided. This report will be useful in developing the general principles of a good corporate governance framework.

A "holistic" approach is best. Good governance should be a factor in all activities of an organisation. From the lawyer's perspective, it should be a factor which is considered in all aspects of work - be it regulatory matters, transactions or advisory work.

As with similar organisational matters, such as "visions and values", it is important that the importance of corporate governance is embraced by the leaders of the organisation – the board (in the case of a company) should take the lead in discussing and agreeing these principles and what governance approach will be adopted by the organisation. This leads well for the next topic – how a lawyer can help.

Selling the role of lawyer

The lawyer is clearly well placed to assist in the promotion and development of thinking about governance and its implementation.

A further observation made by Justice Owen in the *HIH Royal Commission Report* is set out below:

> From time to time as I listened to the evidence about specific transactions or decisions, I found myself asking rhetorically: did anyone stand back and ask themselves the simple question – is this right?

This is a question lawyers should ask themselves when giving advice.

A lawyer has the skills and resources to gather the relevant specific rules, and should also be able to obtain relevant best practice examples and promote meaningful discussion of the topic and issues arising. Importantly, lawyers also have a background in ethics.

When the organisation is being set up, governance topics will naturally be on the agenda. Establishment is a natural time to do this for new companies and any organisation.

For existing entities, the introduction of a new director or CEO or general counsel may well also provide an opportune time to prompt a review of existing governance practices.

An annual review paper for the board on best practice/governance trends may also be a useful thing to consider. Governance rules and practice are

developing at a reasonable speed, so it might be a good idea to have it as a standing agenda item annually.

In selling the role of the lawyer this provides an opportunity to tackle governance issues. As a lawyer you can obtain the relevant rules, get best practice examples and discuss best practice with colleagues in similar organisations. Outcomes in the form of policies and provisions can be written into documents such as joint venture agreements and internal procedures, for example.

The lawyer's professional role also empowers him or her to prompt discussion on some of the more sensitive topics in governance. We cover later in this paper examples of situations where we typically give governance advice.

Some practical examples from the external counsel perspective

How does a firm like Bell Gully get involved at a practical level?

We can help with the design of a governance framework, as outlined earlier:

(a) understand the relevant organization;

(b) assist in the design of governance structures for start-up companies;

(c) distil the relevant specific rules;

(d) advise on the general principles applicable and assist in focusing on the most relevant best practice; and

(e) advise on what is typical, based on our experience, including best practice from other organisations, what committees may be appropriate and the base legislation (eg Crown Entities Act for Crown entities).

We advise on specific governance issues as and when they might arise – as per many of the topics covered by other speakers today. We also help with developing policies processes and training etc – be they for the board or elsewhere in an organisation. We are also well placed to share best practice and current regulatory body thinking. We cover all forms of entities – listed companies, government bodies and large trusts.

I would like to focus on one aspect of this today. Increasingly we are seeing directors seeking comfort from external counsel that what they are doing is legally sound and that they are fulfilling their duties as directors. The legal basis for this is of course section 138 of the Companies Act – directors are entitled to rely on proper advice.

Directors are not looking to us to support their business decision. They do expect us to respect the role of directors and other people involved in the organisation and not to overstep the mark in terms of legal advice. They are asking us to advise them on the process they have adopted – and

ultimately sign-off that they have properly fulfilled their duties as directors. We see this, in particular, with large transactions where increasingly boards and/or independent directors will seek specific legal and sometimes financial advice for this purpose. Sometimes this advice is sought from advisers who are independent from the company.

This is perhaps the most important (or, at least, most interesting) role of external counsel. Increasingly boards are seeking this comfort from legal counsel – be they internal or external – that they have acted in a manner which satisfies their legal obligations and fulfilled their duties.

This might be relatively new ground for lawyers, but is not something we should shy away from or try to wriggle out of by saying it is a matter of commercial judgment. While ultimately there will be commercial decisions to be made, there is no reason why a legal view can not, or should not, be expressed as to whether in reaching that decision the board has satisfied its legal obligations to act in the interest of the company and that the directors have acted reasonably.

We are in a position to express such an opinion. If it ever were to come to court, a judge will reach a view on this on the basis of the facts presented. That is all we are doing in providing advice – albeit in a more proactive and timely manner. It is worth noting that the court's view will be reached after hearing from expert witnesses – i.e. other directors in similar positions, giving evidence as to what they would have done in the circumstances. Thus directors are inevitably to be judged by the highest standards applicable at the time. Judgment is made with the benefit of hindsight in circumstances where the decision is under intense scrutiny.

These legal opinions should be viewed no differently than now common "due diligence" opinions given to directors on prospectus liability. In those, an opinion is given as to whether the directors have acted reasonably and that the process followed would provide a due diligence defence.

This is no different in substance than providing an opinion to the board that they have fulfilled their duty to act reasonably in reaching a decision to enter into a large transaction. It will certainly have lots of qualifications, but in essence we provide comfort to the directors that the process they followed and information they had (etc) was appropriate.

We mentioned earlier that sometimes these opinions are sought from advisers who are independent of the company. Whether this trend is efficient and effective is rather unclear. But nevertheless it is a trend and it is incumbent upon us lawyers to make sure that if it does happen, it is done in the most effective and constructive manner. In particular we need to avoid cost duplication by clearly defining roles and responsibilities at the outset. If we don't, we all risk a negative reaction and less than desirable outcomes for our clients.

Partly related to this is a topic I wanted to briefly touch on. It is a very important consideration for lawyers – who is your client?

This simple question leads to wide ranging considerations – which have a governance impact. When we act for a company, our duty as lawyers is to that company – not to the chief executive, the general counsel, any particular director, the management team or to the deal itself. Our legal obligation and duty is to the company. What does this mean? Well it means we have to view any governance issues involved from the perspective of the company. We have duties to ensure any concerns are heard at the appropriate level.

We also see this manifesting itself at a day to day level in our reporting procedures for example. Many general counsel now expect and rely on us to report to them on all matters – even if they are not involved in the day to day instructions.

The general counsel or chief executive etc is quite correct in expecting us to alert them to any major issues or problems, which we may see. This is something not always welcomed by the relevant business people you may be dealing with. Some US clients, for example, are now incorporating this "whistleblower" type obligation in the formal terms of engagement. In a sense, we become an important part of the governance checks and balances in an organisation.

A valuable resource is *Ethics for In-house Counsel*, published by the Australian Corporate Lawyers Association and the Corporate Lawyers Association of New Zealand. This re-launched second edition contains a substantial new section for public sector lawyers and updated commentary on important topics such as whistle-blowing. This is available online at www.acla.com.au. Best practice guidelines are covered for a range of topics including professional representations, external legal service providers and competitors. Hypothetical situations are also set out covering, among other issues, discovery, choice of counsel and privilege.

Conclusion

We trust that this paper and the discussion have been useful in setting out the role of in-house and external lawyers at a practical level.

We have given you practical examples of how both in-house and external lawyers can be of assistance in designing and implementing a corporate governance framework incorporating the overriding principles of good governance.

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Garry is a corporate partner at Bell Gully with over 20 years experience specialising in mergers and acquisitions, company restructurings, securities offerings, joint ventures and major infrastructure projects.

He advises corporates, Crown and local body entities on all areas of business law and corporate governance. Garry has advised the electricity sector for over 10 years, and is a member of the New Zealand Accounting Standards Review Board.

Andrew Brown, Bell Gully, Wellington

Andrew Brown is a member of our Corporate and Commercial Department and has been a partner since 1991. His areas of specialisation include mergers and acquisitions, corporate governance, flotations and stock exchange matters, electricity and gas industry matters, joint ventures and company and commercial law.

Andrew has led the Bell Gully team on a number of significant transactions in recent years, including the successful merger of INL and Sky TV, a deal that was recognised as New Zealand Deal of the Year at the 2006 ALB Australasian Law Awards.

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