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GOVERNANCE QUARTERLY

CORPORATE BOARDS... OR SOCIAL CLUBS?

By Beata Gocyk-Farber

In this issue, it is our pleasure to share with you insightful corporate governance observations by *The New York Times'* Pulitzer Prize-winning financial reporter and investigative journalist, Gretchen Morgenson. In "Just a Friendly Group of 'Independent' Directors," Gretchen explores the meaning of directors' independence and questions the adequacy of regulatory definitions ascribed to this term. The timeliness of this issue is highlighted by many of the recent corporate scandals, including, for example, the failure of Hollinger International's board to prevent what has been described as "aggressive looting" of Hollinger's coffers by its top officers, Lord Conrad Black and David Radler.

A report prepared by a special committee of Hollinger's board and filed with the Securities and Exchange Commission in August characterized Hollinger as a company in which corporate abuse and malfeasance prevailed. For example, the special committee's report found that in the period 1997-2003, Lord Black and David Radler siphoned off more than \$400 million from the publishing concern, representing approximately 95.2% of Hollinger's adjusted net income for that period. The report also observed that, while Black and Radler "were by far the most culpable people in causing damage to Hollinger, ... Hollinger's board (and particularly the audit committee) was not alert and didn't notice when Black and Radler were driving their bloated fee requests past them." According to the report, Hollinger's board "functioned more like a social club or public policy association than as the board of a major corporation, enjoying extremely short meetings followed by a good lunch and discussion of world affairs ... [a]ctual operating results or corporate performance were rarely discussed." The Report further noted that with respect to the compensation of Hollinger's founder, Lord Black, the board displayed "inert behavior."



A board's abdication of its fiduciary responsibilities on matters relating to executive compensation has become a recurrent topic in corporate America. In our last issue, we highlighted the Delaware Chancery Court's seminal opinion in *In re The Walt Disney Company Derivative Litigation*, 825 A.2d 275 (2003), in which Chancellor Chandler concluded that the decision by Disney's board to approve Michael Ovitz's \$140 million compensation package for less than fifteen months of service "suggest[s] that the [the board] consciously and intentionally disregarded their responsibilities, adopting a 'we don't care about the risks' attitude concerning a material corporate decision" *Id.* at 289.

The theme of inert directors present in *Disney* and *Hollinger* only highlights the need for director independence. As long as directors lack true independence from corporate executives, corporate officials will continue to be paid at astronomical rates bearing no relation to the earnings these executives deliver to the company's shareholders.

Gretchen Morgenson's article is reprinted here in its entirety because of its importance to institutional investors as they consider the important gatekeeping role of boards of public companies.

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