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Conducting Board Self-Evaluations in Compliance with NYSE Rule 303A.09

By Charles H. Baker and Thomas P. McGovern

Overview

New York Stock Exchange (“NYSE”) Rule 303A.09¹ requires the board of directors of all companies listed on the NYSE to conduct a self-evaluation at least annually to determine whether it and its committees are functioning effectively. The Rule does not prescribe any particular method of self-evaluation, nor does it require that the self-evaluation be written or that any part of the process be conducted using written materials.

The threshold issue to consider is whether the self-evaluation should be undertaken orally or through the use of written questionnaires (or similar forms) to be completed by individual directors (and/or compilations thereof) and retained as part of the record of the evaluation. In light of the inherent risks involved in retaining a written record of director self-assessments that disclose ratings, scores and comments, as well as the chilling effect such risk may have on the efficacy of the process, as more fully described below, we do not recommend using and retaining such material.

Individual or collective feedback or input regarding board or committee effectiveness can be appropriately conveyed orally during the course of a board meeting. In addition, a company can effectively demonstrate compliance with the NYSE rule by creating a record of the self-evaluation that evidences that the evaluation process was thorough and undertaken with due attention and deliberation. Therefore, we recommend that you conduct the self-evaluation orally and create and retain a written record that documents the board’s self-evaluation process, but that does not contain completed questionnaires or similar forms reflecting ratings, scores, comments (or compilations thereof), either in hard copy or electronically.

Advantages of an Oral Evaluation

The first and most obvious advantage of not retaining a written record of director self-assess-

ments that disclose ratings, scores and comments is that no such written materials will be discoverable during potential future litigation. Given the risk that a court may refuse to recognize the protections of the self-evaluative, the attorney-client and the work-product privilege with respect to the evaluation process, memorializing the process by using written questionnaires and other written records may increase the risk that the company will be faced with disclosure of misleading and potentially damaging evidence resulting from the process.

Because of the risk of discovery, another advantage of not keeping written records of director self-assessments that disclose ratings, scores and comments is the potential effect on director candor (whether or not the process provides for anonymous submission of questionnaires). If directors feel that their self-assessments may eventually wind up in the hands of parties adverse to their company, they may be hesitant in answering certain questions. Such hesitancy may lead to them not disclosing information that otherwise would have been revealed had they been comfortable that no record of their disclosure would be retained by the company. Further, such lack of candor may limit the positive effects of the entire self-assessment process by not providing the company with the information needed to improve or correct current procedures.

Conducting an Oral Evaluation and Memorializing the Evaluation Process

To avoid the pitfalls of using written questionnaires or similar forms that disclose ratings, scores and comments, but to create a record that still evidences a thorough evaluation process, the board may wish to adhere to the following guidelines:

1. Prepare a formal topic agenda that lists the areas that the board will discuss as part of the self-evaluation process;



2. Distribute the agenda to the board members sufficiently in advance of the discussion meeting so that each director has ample time to reflect on the topics;
3. Conduct a meeting (which can, but need not, be run by counsel) at which the agenda topics should be discussed in detail, and give each director at the meeting the opportunity to participate in the discussion; and
4. Reflect in the minutes that the session took place, the participants involved, and any action items taken or to be taken as a result.

Adhering to such guidelines will effectively memorialize the board's evaluation process without creating potentially damaging, discoverable material.

In addition, if the board is so inclined, the group discussions can be supplemented (or preceded) by individual interviews of board members, although such individual interviews are not required.

Safeguards for Conducting a Written Evaluation

If a company's board determines to conduct the self-evaluation through the use of questionnaires or similar forms, consideration should be given, in consultation with counsel and consistent with applicable law, regulation and policies, as to whether and when such questionnaires should be destroyed or retained following the self-evaluation process. In appropriate circumstances, completed documents might be destroyed after they are used during the evaluation process, unless there is a particular subpoena, discovery request or proceeding pending or threatened that might preclude such destruction and mandate preservation and/or production of the documents.

Some companies have elected to use compilations of completed questionnaires; if such compilations are used, similar consideration should be given to the destruction of such documents after their use during the evaluation process. However, in light of the inherent risks involved in destroying documents, a board's determination to destroy evaluation materials should only be made after consultation with counsel.

Furthermore, if a company's board prefers to use and retain as a record of the self-evaluation written questionnaires or compilations thereof, which is not recommended, all efforts should be made to secure the benefit of the self-evaluative, the attorney-client and the work-product privilege doctrines.

The law is not yet well developed on how courts will treat claims of privilege for self-evaluation materials. Although many commentators are urging the development or recognition of a self-evalu-

ation privilege to apply to director evaluations, at this time, it is not possible to know if judges will heed the call. Nevertheless, we recommend that the board conduct any written evaluations in a manner that could maximize the protections under such privileges.

While there is no safe harbor to define precisely how a board should utilize the privileges, the following non-exclusive checklist provides useful guidance:

1. Counsel (in-house or outside) should advise and assist with the conduct and documentation of the self-evaluations. If in-house counsel advises, such counsel should expressly articulate and function in an entirely legal capacity and such role should be noted in any materials developed for the board. If outside counsel advises, such counsel should be retained with an engagement letter (a) explaining that counsel is being hired for the purpose of legal analysis and guidance, (b) stating that the self-evaluation and all related communication should be treated as confidential and privileged information, (c) affirming the purpose of the self-evaluation, which include the comprehensive fulfillment of the NYSE mandate and the desire to maintain and improve board efficiency and competency in performing its duties and implementing policy, and (d) expressing that the self-evaluation is being performed in anticipation of potential litigation.
2. In completing their respective evaluations—whether oral or written—the board members should convey that the manner in which the self-evaluations are being executed is predicated upon the expectation that all materials will remain privileged and confidential.
3. The evaluation documents themselves or the individual interviewers must indicate that any compromise to the confidential or privileged nature of the self-evaluations would profoundly affect the corporation's decision in rendering subsequent self-evaluations.
4. Self-evaluation forms and interviews should begin with notice of the requirement for confidentiality.
5. All questions, concerns and comments regarding the self-evaluations or the process adopted to carry out the self-evaluations should be directed solely to, and interviews with directors should be conducted solely by, counsel—no unnecessary people should be present at the interviews.
6. All self-evaluation materials should be marked with a cautionary legend indicating

that the materials should be treated as confidential and were created in contemplation of the attorney-client privilege.

7. Self-evaluation materials should not be filed with other business documents.
8. The board members' transcripts, notes, self-evaluation forms and communications regarding the self-evaluations should be destroyed—the results of these materials should be preserved only to the extent that they are incorporated within counsel's analyses.
9. Facts and statistics gathered during the self-evaluation process should be embedded in counsel's legal analysis.
10. Circulating any self-evaluation materials should be done with a high-level of discretion—employees and shareholders should have access only to the broad analyses and the general process of the self-evaluation.
11. Counsel should be responsible for hiring any non-legal professionals who are assigned to support the self-evaluation process and such persons should be under the direct supervision of counsel.
12. Disclosing the results of the self-evaluation to a third-party, including governmental and administrative agencies, should be done only when necessary and in as limited capacity as possible—if the results are divulged to a third party, the corporation should expressly indicate that the confidential and privileged status of the self-evaluations are not generally waived by such limited disclosure.

Conclusion and Recommendations

In the aftermath of the scandals leading to the adoption of the Sarbanes-Oxley Act, the NYSE

substantially overhauled its corporate governance requirements, which included the implementation of Rule 303A.09. While important in practicing good corporate governance, the beneficial purpose of these self-evaluations may be profoundly impeded if the directors' fear of disclosure impacts their responses or the results of such self-evaluations become a part of a potential litigant's arsenal.

In view of the foregoing and as discussed in greater detail above, we recommend that you create and retain a written record that documents the board's self-evaluation process, but that does not contain completed questionnaires or similar forms reflecting ratings, scores or comments (or compilations thereof), either in hard copy or electronically. This will minimize the risk of discovery in the event of litigation and remove that impediment to greater candor from the directors during the self-evaluation process, thus assuring a more effective process.

Note

1. NYSE Listed Company Manual, § 303A.09.

For further information on conducting board self-evaluations please do not hesitate to contact any of the following attorneys:

Charles Baker (212) 318-6250
charlesbaker@paulhastings.com

Kevin Logue (212) 318-6039
kevinlogue@paulhastings.com

Michael Zuppone (212) 318-6906
michaelzuppone@paulhastings.com

Thomas P. McGovern (212) 318-6727
thomasmcgvorn@paulhastings.com