Nathan the sensible

A thoughtful commentator on 'truly good corporate governance.'

BY HOFFER KABACK

I HAVE HAD OCCASION, in this space, to discuss Joseph Flom and Martin Lipton. Flom (of Skadden Arps) and Lipton (of Wachtell Lipton) were multi-decade adversaries in a huge number of takeover and proxy contests. In addition, Lipton (who has outlived Flom) has long espoused strongly voiced views on critical governance policy matters.

One-half generation behind Flom and Lipton in the M&A arena is Charles Nathan. Nathan started out at the Cleary Gottlieb law firm, segued into investment banking, then returned to practicing law. He is currently with Latham & Watkins.

Like Lipton, Nathan has been a thoughtful commentator on governance issues. As part of the source materials at Practising Law Institute's Tenth Annual Directors' Institute on Corporate Governance (held in September 2012 in New York City), Nathan provided a May 2011 memorandum titled, "A 12-Step Program to Truly Good Corporate Governance."

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I consider below several of the key points made in it.

1. "All the analogies in the corporate governance arena to political models remain analogies, not statements of inherent right or wrong.... To say that shareholders 'own' the company and therefore have certain rights is to misstate [their] relationship to the legal entity that constitutes the corporation and to confuse the discussion, rather than provide useful answers.... An overly simplistic analogy is characterizing directors as 'agents' of shareholders. The relationship of directors to shareholders is different from, and more complicated than, that of legal agent and principal.... Academic literature, which fails to evaluate proposed corporate governance policies in light of their ultimate impact, but only in the context of lessening or preventing agency cost, is neither sensible nor helpful."

Comment: Just so, in several respects. First, the entire notion of shareholder democracy, invoking as it does sunny visions of Athens as the best of all possible worlds, is — not to put too fine a point on it — nonsense. Second, and a core principle of American corporate law, is that directors are not agents of the shareholders (who are, in turn, not their principals). Third, if one craves a political analogy, not at all inapposite is this one: Directors are to shareholders as United States Senators are to their constituents. Neither directors nor Senators are agents of principals; instead, each member of these groups is elected to exercise his best, independent, non-snap poll-driven judgment about matters of corporate and national policy, respectively. See my column "Access Denied!" [Summer 2003].

2. "The remedy for getting more company and industry expertise into the board room [sic] is to have former members of senior management of the company serve as directors, even at the expense of having a lower number of independent directors, and/or to recruit retired senior executives from other industry players. Either way, truly good corporate governance will often be better served by sacrificing some director independence for superior company and industry knowledge and competency."

Comment: There are at least two issues to keep in mind when thinking about a director's independence (principally vis a vis the CEO). One is what Nathan says — namely, whether worshipping at the altar of "independence" means sacrificing competency.

The other is a point I have emphasized in these pages since 1997: That independence cannot be properly discerned or ferreted out through current disclosure practices. There are often significant false positives and false negatives about which of the directors are, in fact, independent from the CEO, and which are not. My inaugural column in this space, "Pals on the Board" [Winter 1997], showed why.

3. "Picking a candidate who does not have the skill sets and cannot create the personal chemistry necessary to be a good, value added independent chair for a particular board and CEO combination may do far more damage than not having the office."

Comment: Those who think that governance wisdom and purity can be assayed through litmus tests like separating the roles of chairman and CEO are misguided. In "To Split or Not to Split" [Fourth Quarter 2004], I presented both history and analysis on that point.

Two conclusions: a) The split/don't split decision should be bottomed on the individual circumstances of the specific company; and b) American business history has not generally embraced the notion of a separate, outside chairman.

Charles Nathan's governance commentary does not rise to the moral level of the pronouncements delivered to King David by Nathan the Prophet (2 Samuel 12). But it is sensible, and it merits thoughtful reflection. ■

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