Understanding the Advice of Boardroom Lawyers

By Adam J. Epstein

"If our corporate counsel's principal role isn't to guide the board with respect to best practices, then why are we paying him so much to attend our board meetings?"

That's the question I was recently asked by a flummoxed small-cap board chair when I advised him and his fellow board members that just because the board was complying with relevant sections of corporate law, that didn't mean that their conduct constituted best practices.

This board, like the boards of many pre-initial public offering (IPO) and small-cap companies, failed to appreciate a poignant nuance of boardroom counsel. For better or worse, the lion's share of corporate lawyering is focused on culpability avoidance as opposed to governance excellence.

To be sure, there are some corporate lawyers who have a keen sense of what corporate governance best practices currently look like and do a terrific job of educating and advising boards accordingly.

But it's critical for pre-IPO and small-cap directors, especially those who are comparatively new to board service, to keep two things in mind: not all corporate attorneys comprehensively understand governance best practices; and the default setting of boardroom counsel is to make sure board members are staying on the right side of Delaware's General Corporation Law (or other applicable laws).

Years ago, law firms were smaller and had fewer clients, so conflicts of interest were minimal. Today, firms are larger and advise clients that compete with and litigate against each other. This dynamic prevents many lawyers from serving on boards. Moreover, many lawyers have never attended a corporate governance continuing education program or counseled institutional investors. Accordingly, it's easy to see why myriad corporate lawyers simply aren't apprised of what constitutes a high-performing board of directors in today's capital markets.

Of course, the principal role of any attorney is to provide legal advice, not business advice. In a boardroom setting, legal advice often consists of ensuring that directors are discharging their relevant statutory and common law obligations and that, to the extent appropriate, evidence of the same is accurately memorialized.

The line that demarcates legal advice and business advice can be a fuzzy one, particularly in a boardroom. Moreover, lawyers and clients (board members in this case) are often inclined to conflate the two. Conflation can have serious consequences.

In the situation alluded to above, an investor had amassed a material ownership position and wanted to speak with the chair of the nominating and governance committee about how the board viewed its current composition. The company's lawyer advised the board that there was no such requirement under Delaware law and took the added step of discouraging the investor-director communication, saying that "board members have no legal obligation to meet directly with investors, and they shouldn't do it."

As it turned out, this lawyer was completely unapprised that investor-director communication has become commonplace under certain circumstances and provided that there are appropriate safeguards in place. The predominantly inexperienced board members were deferential to the attorney, believing that they were receiving timely, fulsome advice.

The matter escalated quickly when the aggrieved investor began conferring with other large investors about the company's unwillingness to address his questions about board composition. When the board members subsequently pushed back on the legal advice they had received, the attorney had to admit that he wasn't aware of the rapid evolution in capital markets communication practices.

The moral of the story is simple: boardroom legal advice and corporate governance best practices aren't always the same thing.

Adam J. Epstein was an institutional investor who now advises pre–IPO and small-cap boards through his firm, Third Creek Advisors LLC. He is the author of *The Perfect Corporate Board: A Handbook for Mastering the Unique Challenges of Small-Cap Companies* (McGraw-Hill, 2012).