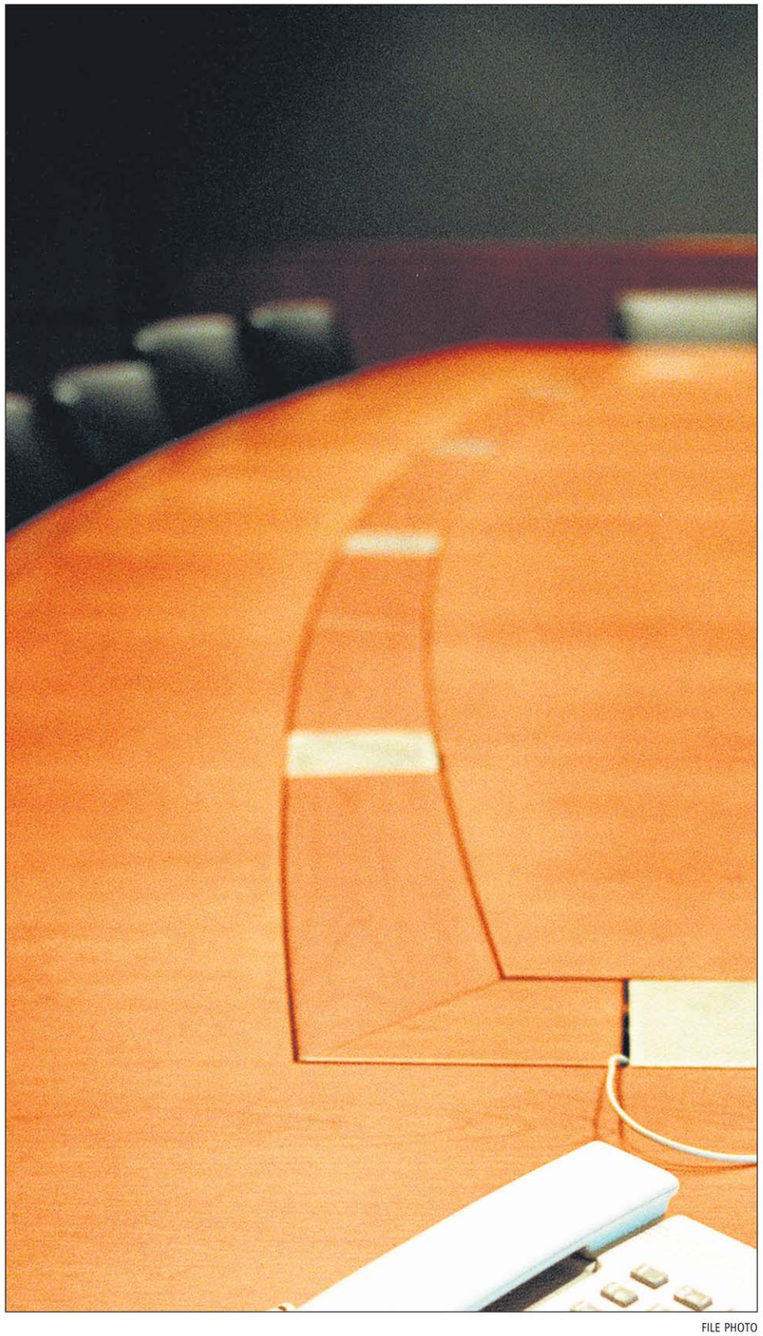
Headline: Lawyers in the boardroom
Source: *The Business Times,* Who's Who in Law, p3
Date: 18 May 2011

Lawyers in the boardroom

They have an important role to play in helping to improve corporate governance but there is also the potential for conflict of interest



FILE PHOTO

By **MAK YUEN TEEN**

LAWYERS play an important role in the corporate governance of listed companies, both as legal advisers and in many cases as independent directors of these companies.

In an ongoing study on board diversity for the largest domestic companies in the Asia-Pacific region, jointly undertaken by Korn/Ferry International and myself, we found that lawyers are common on boards of these companies. For example, in Australia, an estimated 72 of the largest 100 companies have at least one lawyer as a director, and these companies have a total of 115 lawyers. In Singapore, an estimated 62 of the largest 100 companies have at least one lawyer on the board, and these companies have an estimated 84 lawyers in total.

However, there is an interesting difference. In Australia, an estimated 80 of the 115 lawyers, or 70 per cent, are retired. However, in Singapore, the situation is almost the reverse, with very few retired lawyers serving as directors. Only an estimated 12 out of the 84 lawyers (14 per cent) serving as directors on Singapore boards are retired. This raises an interesting question as to why there is such a difference.

One explanation is that in Australia, there is far less acceptance that a lawyer who is providing legal services, either personally or through his firm, and who is serving on the board as a director can be considered independent.

In Australia, the ASX Corporate Governance Principles and Recommendations state that "an independent director is a non-executive director who is not a member of management and who is free of any business or other relationship that could materially interfere with – or could reasonably be perceived to materially interfere with – the independent exercise of their judgment".

It goes on to state that in determining the independent status of a director, the board should consider if he "has within the last three years been a principal of a material professional adviser or a material consultant to the company or another group member, or an employee materially associated with the service provided".

While the tests for independence are subjective, Australian boards appear to be relatively conservative in applying them. This was confirmed through checks with two experienced lawyers in Australia, one retired and currently serving on boards there and another who works actively with boards and companies but who does not serve on any listed boards.

According to them, if a director personally or indirectly through his firm provides legal services to the company of any materiality, then it is unlikely that the "independence" test would be satisfied. At the least it would lead to questions about independence. The prudential threshold is more of "insignificance" than "materiality". Further, the "safe harbour" accorded to directors under the business judgment rule in the Corporations Act is not available where a director has a "material personal interest".

Practising lawyers tend not to serve as directors of listed companies because of the risk of being perceived as a "related party" and having a conflict of interest. There may also be professional indemnity risk as a lawyer as questions may arise as to where legal advice starts and finishes, compared to commercial judgment as a director. This may put insurance policies at risk.

Objective tests

The company's legal function is also generally seen to be the responsibility of the management, and not the board. Lawyers, usually retired lawyers, who are appointed to boards are there for their business acumen, ability to analyse issues and discipline in thought, rather than for their legal knowledge. Perhaps the fact that in Australia, directors are often held to account for their actions by regulators and other stakeholders, much more so than in Singapore, explains why practising lawyers in Australia are much more careful about conflicts and threats to independence.

In Singapore, there are both subjective and objective tests for independence in the Code of Corporate Governance. One of the objective tests relates to a situation where a director is a partner with a stake of 5 per cent or more, or who is an executive officer or director of a for-profit organisation which receives from, or provides payments to, the company exceeding $200,000 per year.

In Singapore, it is not uncommon for a lawyer on the board to be considered an independent director even though his firm is providing legal services to the company. In some cases, these legal services can exceed $200,000 a year. I have seen annual reports over the years with explanations such as this:

"The board considers non-executive director, Mr XXX, an independent non-executive director, although he has a relationship with the company by virtue of his position as a senior partner of XXXX rendering professional services to the company. Notwithstanding this relationship, the board assesses him as an independent director due to his manifest ability to exercise strong independent judgment in his deliberations in the interests of the company."

In the case of public accountants, the professional rules do not allow a person to be a director – let alone be called an independent director – if he or his firm is the external auditor. There have been some cases, however, where accountants serve on the board as independent directors, even chairing audit committees, while their firm or its affiliates provide other forms of accounting services.

I have criticised such practices, such as in Kian Ho Bearings in 2009, and more recently in China Sky Chemical Fibre. However, I believe that they are far less common than lawyers serving on boards as independent directors while also providing legal services, either directly or through their firm. This begs the question as to why the rules for lawyers should be so different.

Some years ago, I discussed this issue with a lawyer and the response essentially was that "accountants are different from lawyers". From a good corporate governance standpoint, that is a poor excuse for allowing potentially significant conflicts of interest and threats to the independence of the director to become accepted practice.

Over the years, a number of lawyers have expressed to me their concern about such practices. One highly respected lawyer told me that a director whose firm currently provides minimum legal services aims to build on even that relationship with the client and may therefore be disinclined to offend the client by challenging management decisions at board meetings. I was even told of "veiled threats" from a client, that the company will not use the firm if the director does not serve on the board.

It may be timely for the legal profession and for those who set corporate governance standards here to reflect on this seriously as we strive to improve the quality of corporate governance. Lawyers do have an important role to play in helping to improve corporate governance, but there is also the potential for them to undermine corporate governance if they are serving as independent directors while they or their firm are providing legal services to the company.

In Singapore, it is not uncommon for a lawyer on the board to be considered an independent director even though his firm provides legal services to the company. In some cases, these legal services can exceed $200,000 a year.

The writer is an associate professor at the NUS Business School