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Dealing with the Unethical CEO

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The chief legal officer can play an important role in guiding corporate leadership's response to the results of an important new study on the termination of "unethical" CEOs. This, as boards seek to balance appropriate levels of executive accountability with the benefits of maintaining a close relationship with the CEO, and collaborate with the CEO to encourage entrepreneurship and informed risk taking.

The percentage of CEOs terminated for questionable behavior has increased approximately 36 percent over the past five years, according to the Study, mentioned in a May 14 report on CEO succession prepared by PWC's consulting affiliate, Strategy & Business. These lapses included environmental disasters, insider trading, résumé fraud, accounting scandals and sexual misconduct.

The study also determined that the rate of ethics-based termination dismissals was 44 percent higher among CEOs who simultaneously served as Chair than for those not serving in combined CEO/Chair positions. In addition, it also identified a series of trends that contributed to the increase in these ethics-based dismissals, including , lack of public tolerance for ethical lapses, improved corporate governance practices, increasing governmental regulation, greater operating risk, the impact of digital communications, and 24/7media attention.

The main thrust of the study is *not* that the number of CEOs removed for ethical lapses has dramatically increased. *Rather*, it is that terminations for ethical lapses are significantly increasing as a percentage of overall CEO successions. This is suggestive of a growing 'climate of accountability' in corporate boardrooms across the globe. Boards are now more willing to terminate CEOs for conduct they regard as unethical or otherwise inconsistent with corporate values. This is a notable consideration for corporate governance generally, especially the executive compensation and search/succession committees, and the standards they apply to monitor and evaluate the CEO and other senior executives.

Indeed, the influential National Association of Corporate Directors

recently provided its members with a series of questions that the board can raise in evaluating the risk of unethical CEO behavior. These questions focus on the clarity of CEO expectations for ethical leadership; the effectiveness of internal processes intended to help identify and report allegations of unethical executive conduct; the extent to which the whistleblower reporting system is accessible to, and has credibility with employees; and whether there is a consistent application of penalties, across employee and management levels, for ethical violations.

The CLO is uniquely well-situated to support corporate leadership in its consideration of the study; e.g., by evaluating its implications in the particular context of the company, the regulatory environment in which it operates, and of the company's existing compliance, ethics and other oversight mechanisms. The CLO can also recommend possible responses to the study, and to the NACD recommendations.

For example, the CLO's prominent position in the executive suite offers several ways to favorably impact CEO conduct. The CLO's dual role as both legal adviser and business partner to management positions him or her to continuously alert the CEO and other senior executives to the potential governance, legal standards and reputational concerns implicated by the CEO's conduct. As a "wise counselor, the CLO can recommend how senior executive may comfortably navigate ethical corridors. The officer's professional "reporting up" responsibilities provide the board with a particularly critical advance warning system of potentially unethical executive conduct.

The CLO's prominent role in the boardroom similarly offers ways to support the board's oversight of the CEO. For example, the CLO has the technical expertise to advise the board of the legal and reputational implications of CEO conduct. As a governance advisor, the officer can recommend new policies (e.g., "fitness to serve") and prophylactic measures (e.g., more frequent and fulsome executive sessions) the board can implement to enhance its oversight of CEO conduct. The CLO's awareness of key developments allows for briefing the board on evolving judicial standards of the duty of oversight.

The CLO can also be helpful in drawing the important distinction for the board between the executive who may indeed be engaging in unethical conduct and the ethical executive who is simply insensitive to risk (i.e., who may be pursuing initiatives outside of the board's established risk protocols). The board's response will differ based on the distinction.

The significance of this new study, and the CLO's prominent supporting role in responding to it, is magnified by the looming 15th anniversary of the enactment of SarbanesOxley. This seminal legislation prompted a number of lasting corporate responsibility principles that, if properly implemented, can reduce the risks identified in the PWC study.

The new study, and its observations, relate directly to the board's fundamental obligations to select the CEO, monitor his or her performance and establish a succession

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plan in the event of performance failures. The study indicates that boards are increasingly intolerant of what they perceive to be unethical CEO conduct. This is a significant development which directors should know, given the extent that it reflects a trend towards closer board oversight of executive management. The chief legal officer is uniquely well suited to assist both the CEO and the board in responding to the study's conclusions.

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