

LESSONS LEARNED

Corporate governance is Job One

For followers of the “Oracle of Omaha,” the recent controversy over former Warren Buffett heir apparent David Sokol’s personal Lubrizol Corp. stock trades has delivered a shock to the system. The resulting resignation, renunciation and litigation played out, really, more like a “what not to do” manual than the renowned cool, corporate competency of Berkshire Hathaway’s billionaire chairman and CEO.

For those not playing at home, the *Reader’s Digest* version goes like this: Last fall, Berkshire — best known for its investments in well-known brands like GEICO, Dairy Queen and Fruit of the Loom — began to look at possible acquisition targets, including specialty chemical company Lubrizol. Shortly thereafter, Buffett lieutenant Sokol invested north of \$10 million in Lubrizol for his own account. When Berkshire inked its March 2011 deal to acquire the company for \$9 billion, Sokol’s personal investment jumped a cool \$3 million in value. After news began to leak out about the prior purchase, Sokol’s letter of resignation was — no surprise here — tendered on March 28. Characterizing the conduct as “inexplicable and irrational,” Buffett affirmed the audit committee’s finding that Sokol had abused the company’s code of ethics and rules on insider trading.

On the surface, it looks like a simple case of insider trading, right? Something most considered well beneath the likes of Buffett. Where, then, did the wheels fall off? In a word: disclosure.

At Berkshire’s recent annual shareholder’s meeting, Buffett conceded that he neglected to dig further into Sokol’s



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independence because of Sokol’s overwhelming contributions to the company’s

prior financial success. This is an all-too-familiar chapter of the old corporate book called “Financial Success Will Ethically Blind Even the Best of the Best.” More important, it stands as a costly reminder that the key to corporate responsibility is proper board governance. If there’s one lesson the Berkshire flap underscores for the rest of it, it’s the oft-overlooked recognition that true corporate responsibility goes hand-in-glove with effective corporate governance.

So ... what’s a board to do?

By definition, a corporation is a legal entity capable of entering into contracts and, as necessary, of suing and being sued in its own name. A board of directors is, then, the guardian of this “corporate fiction” for the benefit of its shareholders, or in the case of a non-profit, the community as a whole. In this role, board members have a fiduciary duty to define the business’ mission; to create and implement operating plans and strategies; and to steward corporate resources and opportunities for the exclusive benefit of their constituents.

Boards should ensure that the organization complies with applicable regula-

tions and laws and define the moral, ethical and operating standards of the company’s conduct. Most important, the Board must create systems to hold both executives and employees accountable for these policies and define consequences for violations.

The take-away from the Lubrizol scandal for all executives and boards:

- Represent the company’s owners and constituents before your own.
- Be competent and committed in conducting the company’s business.
- Transact all of your organization’s business transparently and independently.
- Act with integrity, ethics and responsibility.
- Strive for diversity in representation.
- Renew board membership to prevent entrenched ideology.
- Hold management accountable to policies and applicable laws.

Berkshire now publishes its insider trading policy (effective 1994) on its website. Whether Sokol was aware of this apparent conflict of interest will undoubtedly be the subject of deposition testimony. Yes, there is now a lawsuit seeking to disgorge Sokol’s profits for the benefit of all shareholders.

As Warren Buffett can attest, the days of a “ceremonial” board are officially over. Board membership? No longer so easy a cave man can do it.

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