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### **Commissioner Roel C. Campos Presents Views On "How to be an Effective Board Member," Option Backdating Cases**

On August 15, 2006, Commissioner Roel C. Campos set a high bar when presenting his views on "How to be an Effective Board Member" at the HACR Program on corporate responsibility. Beginning the speech with Justice Black's words, "The law has no place for dummy directors" and "Directors should direct," Commissioner Campos emphasized directors' duties to investigate, obtain competent legal advice, and make difficult decisions rather than delegate to others.

Addressing directors' legal obligations, the Commissioner noted that "participating in, overlooking, or ignoring red flags indicating possible fraudulent accounting is not a business decision." He went on to note that SEC Enforcement Actions occur when directors receive information regarding possible improper accounting practices or possible improper recognition of revenue that a reasonable director would investigate, but fail to do so. "If the directors do not conduct an independent investigation, they are not acting reasonably or in good faith and should not be protected by the business judgment rule."

Concerning "Option Backdating" cases, the Commissioner stated that "if the facts permit" it would not surprise him "to see charges brought against outside directors," in addition to officers. Expounding, the Commissioner stated,

[I]t's improper for a company to sign a contract in one quarter; have it dated "as of" a date in the previous quarter; and then attempt to recognize revenue in the previous quarter. I don't want to put anyone to sleep with an accounting discussion, but in general, there must be persuasive evidence that an arrangement exists in order to recognize revenue. And if there was no arrangement in place during a quarter, backdating a contract with an "as of" date doesn't get you there. Now, again, I want to emphasize that there can be legitimate reasons to use "as of" dates, but I think the problem is that using "as of" dates has become so pervasive that few directors question them any more, even in situations where it's not legitimate to use them. Hence my

admonition: don't use "as of" dates unless you're sure it's perfectly above-board to do so, after receiving advice from competent counsel.

Finally, the Commissioner advised directors not to "assign critical decisions to committees of one." He stated that he was not suggesting that committees of one are per se wrong, because they are permitted under Delaware law. However he found, "at best, it's far from being a 'best practice'" and "at worst, it's a signal to the company's officers that directors are not taking their obligations as a director seriously and are willing to let expediency guide their decision-making."

The complete speech is available online at  
<http://www.sec.gov/news/speech/2006/spch081506rcc.htm>

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