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STAY TUNED … to Harvey Pitt's Rules of the Road

By Hank Boerner

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Stay Tuned … to Harvey Pitt's Rules of the Road

Former Securities and Exchange Commission Chairman Harvey Pitt could be described as the right man in the wrong place — at precisely the wrong time. As he assumed his post as the 26th chair of the SEC in 2001, Pitt's many supporters said he had the perfect resume to head the nation's most important securities regulatory body.

Critics of his appointment said he would represent the *laissez-faire* school of enforcement to please the man who appointed him — President George W. Bush — and that corporations would get a free ride on his watch. The unfortunate division of the U.S. electorate and governing class into "red" and "blue" nations meant that throughout his tenure, Pitt would be criticized and second-guessed for many of his decisions and initiatives on a partisan basis.

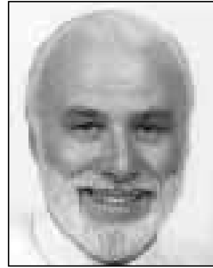
This writer has noted in the past that one of Chairman Pitt's enduring legacies could be the evolution of continuous corporate disclosure, moving away from the periodic filing and episodic quarterly updates from issuers. If it happens, thank (or curse) Harvey Pitt for starting the snowball rolling down the hill during his term.

Fast forward three years. Today, the former chairman is firmly focused on ethics, corporate governance, values, transparency and other aspects of corporate behavior. There is life for Harvey Pitt after SEC. He now heads Kalorama Partners, a Washington-based corporate governance consulting organization, and sprinkles his presentations with such quips as "when I practiced law …" to differentiate what he is doing now as a consultant.

Pitt now says that much of the recent executive misconduct was illegal "before Sarbanes-Oxley reared its ugly head." Now, corporate America must redouble its efforts to "do the right thing" and look beyond just complying with SOX and new SEC rules. "Promoting ethics in business is now critical if capitalism and our way of life are to survive and flourish," said Pitt. "There really is a strong relationship between ethics, corporate governance, corporate performance and improving investor confidence."

Rules of the Road for Corporations

In addition to his consulting firm, Pitt spends some of his time speaking about his "Rules of the Road" for corporate officers. I, along with other NIRI members, had the opportunity to hear him deliver the annual distinguished lecture for the New York Center for Business Ethics & Leadership at Molloy College. Pitt's rules for "avoiding becoming the next cautionary tale splayed across the front pages" are:


Hank Boerner

Rule 1: Always think. What you are seeing isn't happening to "them" — it's happening (or could happen) to *us!*

Rule 2: Learn the art of constructive co-existence. It helps no one if your company's outside directors are unduly pliant or unduly strident.

Rule 3: Being a corporate director isn't an innate or inherited skill. It is a learned trait; companies must now take the initiative to educate their directors. Pitt noted that a number of universities and colleges are now introducing director education courses and workshops.

Rule 4: Shareowners are not your enemy. Smart companies maintain regular contact and continual dialogue with their owners.

Rule 5: Developing a system of sound internal controls is a worthy objective. A strong internal audit function should ensure that problems are caught before a crisis occurs.

Rule 6: Seize on the SOX obligation to create a state-of-the-art, anonymous complaint-receiving mechanism. Use the system to learn about problems before they surface. Then resolve problems and help your company to avoid a crisis. SOX-mandated whistleblower complaints really only cover accounting issues; a company's system should cover the universe of expected complaints.

Rule 7: Beware of false illusions of value. Because your company may *appear* to be doing better than the competition doesn't mean *it is!* Therefore, it is critical to know *why* you are doing better and be able to explain it (to investors, analysts, etc.). The Royal Dutch Shell example shows that if you are doing better, it could mean your peers are more conservative in their measurements or assumptions.

Rule 8: Practice transparency, which is important both internally and externally. Make sure the company's constituencies are informed at the earliest moment of potential concerns. It's the best way to protect the brand and avoid a crisis of confidence.

Rule 9: Compensation of senior executives has to be thought through, so that leaders are rewarded for the right things and encouraged to closely align their interests with shareowners. Boards (and CEOs) are missing a huge opportunity to base compensation on instilling the right values in the organization, on generating performance that meets objective criteria and weaning analysts and shareowners away from earnings per share. It's usually a fictitious number anyway, said Pitt.

Rule 10: Ask yourself, what would you want to know if you were a shareowner? Then decide *what* and *when* to disclose — and *how* to grapple with a problem.

Rule 11: In a crisis, preparation is necessary before the crisis hits. Automatically assume the regulators will now insert themselves into potential or real problems far more rapidly than in the past.

Rule 12: During a crisis, your operative window is very short. "Waiting" for things to get better or more defined before making appropriate disclosure is like waiting for Godot. What to do? *Disclose, disclose,*

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disclose! Disclose what you must before your window of opportunity snaps shut. And stay away from the litigators: They want to win the case, and you want to salvage the company.

Finally, it is important not only to *do the right thing,* but also to be able to later prove that you did the right thing. This protects everyone.

Three Years of Tumult

Looking back, Pitt said the past three years have been among the most tumultuous for business in a century. Recent corporate, institutional and individual "behavioral" scandals created a feeding frenzy for business-bashers and directly led to a radical decline in investor confidence. The scandals also caused government to overlegislate, overregulate and overprosecute.

Stock market regulators have toughened their positions on governance, and institutional investors are now tending to be more active in challenging corporate governance and addressing lagging corporate performance.

Some characteristics of the recent era of excess that corporate America operated in included:

- More volatility in the financial markets, which instantly respond to surprises or negative news (or rumors).
- Companies obscuring, fudging or outright lying about their results.
- The outside, "watchdog" board members often simply "watching."
- Corporate compensation often lavishing rewards on substandard CEO performance.
- Accountants not auditing competently and not really being subject to independent quality controls. (They are now, with the Public Company Accounting Oversight Board in place.)
- Lawyers cavalierly allowing or facilitating the pursuit of improper — or even illegal — courses of action by corporate leaders.
- Mutual fund managers who let favored customers rip off "the great unwashed" (consumers).
- Corporate CEOs and CFOs demonstrating incredibly bad judgment. They — and investors and their organizations — paid a heavy price for their miscalculations.

These unfortunate characteristics, Pitt observed, really underscore a widespread abandonment of adherence to ethical, moral and legal obligations that occurred in the 1990s market frenzy. "Is it any wonder, then," Pitt mused, "that investors doubt businesses' integrity?" Everyone was in the hot seat: outside directors, gatekeepers, self-regulating organizations, regulators and prosecutors. Corporate governance is now — and will continue to be — an important political issue.

Finally, Pitt reminded us of the ancient Japanese proverb: "The reputation of a thousand years may be determined by the conduct of one hour!" He said he is optimistic about the future: "Ethical conduct is good business, and *good* business knows it, believes it, practices it." IRU

Hank Boerner is managing director-NY of Rowan & Blewitt, where he provides corporate governance and accountability counsel. The views expressed here are his own. He can be reached at hank@pb.net.