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FOLEY'S EIGHTH ANNUAL NATIONAL DIRECTORS INSTITUTE 2009 WEB CONFERENCE SERIES



## Board and Management Succession Planning

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# CEO Succession

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# Board Responsibilities

- Board has a fiduciary duty to ensure a plan for business continuity, both in an emergency situation and for the long term
- CEO succession is a board-driven planning process
- Independent directors should play an important role in the CEO succession process
- Advance planning for contingencies such as the departure, death, or disability of the CEO is also critical so that an emergency succession plan is in place

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## Elements of a CEO Succession Plan

- Schedule how often CEO Succession will be discussed by the Board/Committee
- Important that the Board has direct exposure to internal potential CEO candidates
- Establish and periodically update the qualities and characteristics necessary for the CEO because those needed strengths are often influenced by the company's strategic plan
- Identify multiple external CEO candidates and periodically monitor the development of internal candidates against these standards

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## Questions A Board Member Should Ask About CEO Succession

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- Do we have a succession plan for the CEO and top officers? How long will it take to get one? What changes to the organization need to be made to create room for a successor to be groomed?
  - Do we know the up and coming executives in the organization, one and two levels below the CEO? Have we seen them perform?
  - Should we have 360 degree feedback on the top officers (especially those in line for the CEO role) to understand their strengths and areas for improvement?
  - What plans are in place to build needed skills?

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## Behind Closed Doors In The Boardroom With CEO Selection

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## Difficult Real Life Scenarios

- Private company Founder/CEO wants to retire early—and the Board wants him to stay
- Private company Founder/CEO has grown the company beyond his capability and the Board wants him to move aside
- The Board has differing views on the capability of the CEO
- The CEO is not popular, but has certain strengths and skills that are needed
- Two internal candidates, but neither can take the top job immediately—do co-CEO's work?

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## Selection of Board of Directors

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## Independent Board Director

- Especially in private companies and smaller public companies, 80% of board seats are filled through networking with other fellow directors
- 20% are filled by external recruiting firms
- When a board is mostly "friends of" the Founder, sometimes there is a need for external expertise not found in the Founder's network of friends
- When a private company prepares to go public or because of a significant event, there is the need for independent directors

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## Board Questions on Selection

- Do we have the right skills/perspectives on the board for the company in its present state and future state?
- Do we have enough depth in the critical functional skills (e.g., financial expert) to be able to rotate committee chairs?
- Do we have enough breadth and depth in leadership capability on the board to allow for succession planning of the committee chairs, including lead director?

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## External Recruitment for Independent Board Directors

- The external recruiter will interview the CEO and the nominating committee about the desired background for prospective director candidates
- External recruiters provide a good objective sounding board to make sure the board is clear about what they want in the new director (functional skills and intangible qualities)
- The recruiter can also help assess the dynamics of the board and how it functions and help determine whether the potential candidate will fit in
- This process is also a good cover if the nominating committee wants to make sure "friends of" are not automatically put onto the board

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## Board Director Recruitment Resources

- Major Search Firms: Korn Ferry; Heidrick & Struggles; Spencer Stuart; Russell Reynolds
- Boardroom Bound is a national public service organization that is a recruitment resource for independent directors and diversity candidates
- Carrington & Carrington, Ltd., an African-American search firm in Chicago, works with Boardroom Bound to vet the best candidates

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## Should Board Directors Have Term Limits?

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## ISS U.S. Voting Manual on Term Limits

"[A] mandatory retirement age sends the message that older directors cannot contribute to the oversight of the company. Although establishing a retirement age or limiting the number of times a director may be elected to the board provides a mechanical or 'bloodless' means for addressing a real or potential performance issue with a director, it does not take into consideration the fact that a board member's effectiveness does not necessarily correlate with the length of his board service or his age. Time served is not a substitute for a thoughtful and rigorous board and director evaluation process, which is a better determinant of a director's fitness for service."

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## Term Limits

### Arguments against:

- Directors are recruited to serve for a long period because there is a learning curve in becoming familiar with the company
- It takes time to develop cohesiveness with other directors
- Losing contribution of valued members
- Most private company Boards do not set term limits for directors

### Arguments for:

- Mandatory retirement ages and term limits serve to bring fresh outlooks and perspectives to boards
- Directors who serve on a board for many years (often decades) may be less independent and objective
- Relatively painless way to remove non-performing directors

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## Sample Language on Term Limits

- Guideline 13 of the General Motors Board Guidelines states that terms limits are not necessary:

"The Board does not believe it should establish term limits. While term limits could help ensure that there are fresh ideas and viewpoints available to the Board, they hold the disadvantage of losing the contribution of Directors who have been able to develop, over a period of time, increasing insight into the Corporation and its operations and, therefore, provide an increasing contribution to the Board as a whole. "

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## Should Boards Have Age Limits?

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## NACD Blue Ribbon Commission

The National Association of Corporate Directors'  
Report from the Blue Ribbon Commission on  
Director Professionalism:

- "Unless boards have a process to evaluate the performance of individual directors, they should establish tenure conditions under which, as a matter of course, directors should submit a resignation for consideration or offer to withdraw from consideration for renomination."

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## Advantages of Age Limits

- About 80% of S&P 500 companies have a retirement age for directors. The percentage is much smaller for smaller corporations, but growing.
- The typical age limit is 70 or 72
- Retirement ages for directors can provide boards with an easy and legitimate way for non-performing directors to resign
- Age limits can save boards from confrontations that could cause permanent divisiveness on the board

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## Disadvantages Age Limits

- ISS generally recommends that investors vote against management and shareholder proposals that want to impose mandatory age limits or term limits on directors.
- Boards can lose valuable members because of an arbitrary guideline.
- Retiree directors (i.e., those without full-time jobs) can fill critical roles for the board as they normally have more available time than working directors

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## Working with Age Limits

- Some boards have the discretion to waive the retirement age and extend the service of a director who is providing valuable service
- However, waivers are difficult to administer as directors wonder why one director is granted a waiver and another is not
- Possible solutions:
  - grant limited waivers so that directors serve for just one more year
  - allow director to be a consultant to the company for another year
  - allow directors to attend meetings, but have no vote

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## Director Removals

- Director removal is one of the toughest tasks a board ever faces, from both a personal relationship and legal perspective
- As directors change employment or their non-board activities, they may no longer have the time and knowledge that led to their original nomination
- As a result, boards should review each director's potential contribution and determine whether it still fits the board's needs

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## Director Removals

- Some larger corporations have a policy requiring that directors resign upon change of their full-time employment
- Other companies use a softer policy - "expect" a director to resign --if their primary job responsibilities change
- The nominating committee can consider whether it will recommend that the board accept the tendered resignation
- Other companies leave it to the nominating committee to initiate a process to review the appropriateness of continued board membership

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## Behind Closed Doors In The Boardroom

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## Retirement Age Scenario

- A board member didn't want to retire, even though he had hit the retirement age
- He was also the most dysfunctional member of the board
- He insisted that the retirement age be moved further out
- While many of the other members wanted him to retire, they were unwilling to voice their wishes to him directly
- In addition, if he was required to leave, then he wanted to nominate his own replacement

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## Transparency and Disclosure to Director Candidates

- Potential merger or sale, but it was not public knowledge
- Simultaneously in the process of interviewing for a new board member
- We debated what we could say or not say about the pending transactions
- We also debated whether we should add a board member in the event the merger or sale appeared imminent

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## Considering Diversity When Recruiting Board Directors

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## Advantages of Diversity

- To expand the company's knowledge and experience base
- To better represent the interests of stakeholders
- Diversity of function, gender, ethnicity, geography—all bring various points of view and experience
- Guidelines can ensure that the board expends extra effort to achieve at least a minimum level of diversity

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## Difficulties in Promoting Diversity

- One challenge is finding female or minority candidates with CEO or corporate board experience to serve on boards
- Without written guidelines, a board may not exert the effort necessary to gain excellent diverse candidates

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