BNA INC.

CORPORATE ACCOUNTABILITY

REPORT

Director Recruitment

Many Boards Now More Actively Engaging In Director Hiring and Boardroom Evaluations

In response to increased scrutiny of actions in the boardroom from shareholders and regulators, the boards of many public companies are taking a more proactive approach to recruiting and retaining directors, and are conducting regular evaluations of boardroom structure and performance, corporate attorneys told BNA in recent interviews.

''With the new emphasis on director qualifications and skills, boards are generally taking a more active, forward-looking approach to hiring directors,'' Jeffrey M. Stein, a corporate law partner at King & Spalding in Atlanta, told BNA April 27. ''In the current economic environment, board activity encompasses a lot more ongoing, 'real time' dialogue, and less formality,'' he said.

There are also a number of corporate governance measures currently being considered by federal legislators and the Securities and Exchange Commission that have the potential for significantly impacting boardroom activities, Jessica S. Lochmann, a transactional and securities law partner at Foley & Lardner LLP in Milwaukee, Wis., told BNA April 27.

''Overall, director time commitment capabilities and liability issues are among the top recruiting and retention concerns of boards,'' Lochmann, the moderator of an Apr. 12 Foley & Lardner web conference on trends in the recruitment and selection of directors, said. The discussion is part of the firm's annual National Directors Institute, a series of 13 web conferences on timely corporate finance and governance issues.

The lead director's role of focusing the board when difficult situations arise—especially those involving boardroom composition and other internal and external issues—will likely see a significant increase in the near future, according to an April 15 PricewaterhouseCoopers LLP report on top challenges for lead directors today.

New Rules Push Boards to Reevaluate Processes. In light of the Securities and Exchange Commission's new rules impacting the recruiting and retention of directors, many companies have found themselves evaluating their current processes for disclosure purposes, Lochmann said.

The SEC Dec. 16 adopted amendments to its proxy disclosure rules on a variety of corporate governance issues including requiring companies to provide more information about directors and director nominees, including their experience, attributes, or skills that led to their being chosen by the board (7 CARE 1464, 12/18/09).

''In their evaluations, many boards and governance committees have opened their eyes to the fact that their processes may not be ideal for their company or for best corporate governance practice in general,'' Lochmann said.

The impact of the SEC's new rules is to increase and enhance disclosure at this point, Lochmann said. This focuses boards on transparency and accountability, which in turn leads companies to think about how to better their processes in the near future, she said.

''While the amendments are still relatively new and have not had a true impact on recruiting or retention yet, over the course of the next few years, boards and their nominating committees will likely intensify their focus on improving their director nomination and hiring processes,'' Lochmann said.

Boards Must Make Independent Decisions. While sources such as outside consultants, governance experts, and outside counsel may be helpful to boards when it comes to director recruitment issues, these individuals do not possess firsthand experience with boardroom activities, Lochmann said.

''It is up to the board to do a thorough and honest job of evaluating how their group of directors is function-

 ISSN 1542-9563

ing, and identifying what the board's strengths and weaknesses are,'' Lochmann said.

Boards need to operate independently, Lochmann said. Specific demands of certain individuals or smaller groups of shareholders regarding issues such as director qualifications should not trump the board's fiduciary duty to shareholders as a whole, she said.

''Taking into account specific concerns of stockholders is important. Boards need to remember that these concerns should not lead a board to take actions that are not in the best interests of all stockholders,'' Lochmann said. Boards must make sure that dialogue with shareholders is considered as part of a mix of other factors, she said.

In recent years, several of the more vocal activist institutional investors have expressed that they generally consider boardroom diversity to be an element of good corporate governance, Lochmann said. ''It is safe to say that most boards are considering diversity as something that is important with respect to director recruiting and retention,'' she said.

Most boards are not, however, considering boardroom diversity as an isolated attribute for director recruitment, Lochmann said. ''These boards see diversity as high on the list of important qualifications for directors, among many other crucial items such as skills and experience,'' she said.

Prospective Directors Need Accurate Information. In regard to improving board composition, the most effective boards will take a ''holistic'' approach to making enhancements that best address the priorities of their companies, Stein said.

''A holistic approach will position the board to respond to today's challenges, as well as prepare for future challenges,'' Stein said. ''This includes examining the company's needs to determine appropriate director qualifications and preparing information for purposes of the prospective director candidate's due diligence,'' he said.

According to Stein, ''Information that prospective candidates will want to know includes current issues the board is facing, how the board is protected in terms of insurance and indemnification, and who supports the board. Candidates should not be provided with full disclosure, but should be given enough information to accurately consider the position.''

This information is important for convincing candidates to commit to and feel comfortable serving on a board, Stein said. ''There have been scenarios where directors have joined a board only to shortly resign. This makes everyone wonder what information about the company the director was exposed to that caused the resignation,'' he said.

Boards and Managers Must Communicate. In the current business environment, a new trend is emerging with respect to board communication with management, Stein said. ''Boards are increasingly establishing continuous contact and communications with more members of management at a variety of levels,'' he said.

Critical corporate areas that directors have begun looking for access to include strategic development and financial reporting, Stein said. ''Effective communication with the right members of management provides the board with valuable information and supports the board's succession planning process,'' he said.

To make the most of the board evaluation process, boards must have time to analyze the results and agree on a follow-up or changes that will improve the board's effectiveness, Stein said.

A member of management or a board member can serve to implement a number of effective processes for board evaluations, including evaluating the entire board or individual directors, Stein said. ''This can be done with a written questionnaire or even one-on-one discussions and interviews,'' he said.

''Effective board support will keep directors well-informed. Individuals who support the board must remain vigilant of current issues such as shareholder priorities and emerging interests among institutional investors, SEC guidance and rules, and trends and practices of other companies in the industry,'' Stein said.

Lead Director Plays Crucial Governance Role. According to the PwC report, many lead directors expect that in the near future, their role will include delving further into governance issues including more involvement in board composition and enhancing the independence of the board.

The report compiled survey and other data to look at lead directors' backgrounds, what they do, and what they see as the most important elements of their service now and in the future. The survey polled respondents from 16 sectors of the spectrum of U.S. industries, including companies with a range in revenue from $4 billion to $100 billion, the report said.

''Typically, the lead director's background is in general management of a public company, often as a past chair, CEO, or president, although a small number have not had any prior position with a public company,'' the report said. ''With experience in leadership and past exposure to corporate crises and complex problems, a lead director is well situated to offer helpful guidance to other independent members of the board and serve as a key advisor to the CEO,'' it said.

According to the report, the majority of the survey group spends six to 10 hours per month beyond the time they regularly spend as a director. ''In some cases, that commitment grows considerably to 16-20 hours or more. The vast majority, 75 percent, receive additional compensation to be lead director, regardless of how much time they dedicate to this role,'' it said.

Top Executives Should Bond with Lead Directors. The CEO and other top officers of public companies need to develop strong relationships with lead directors to facilitate the board's work in a difficult business environment, the report said. For example, management might see the lead director having increased involvement in the strategic direction of the company, board composition, development of executive compensation programs, and other regulatory matters.

The role of the lead director will continue to evolve as companies have more experience with the concept and as the spotlight remains on corporate governance issues, the report said. ''The most important contributions of lead directors have come not from the duties mandated by stock exchange requirements, but from the responsibilities that lead directors in fact have undertaken for their companies as the de facto leaders of the independent board members,'' it said.

Other tasks the lead director might take on include more responsibilities in dealing with governance issues

   ISSN 1542-9563

and board agendas, the report said. Directors want better information, better access to management and communications, and better use of third party advisors, it said.

''Management can smooth the path for a board to do its work by providing effective administrative support for the lead director through either the corporate secretary or general counsel's office,'' the report said.

BY TINA CHI

The PricewaterhouseCoopers report is available at http://www.pwc.com/en_US/us/forensic-services/assets/lead-director-survey.pdf.