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Boardroom Best Practices

2007 NATIONAL DIRECTORS INSTITUTE

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At Foley's sixth annual National Directors Institute on March 8, 2007 in Chicago, "Boardroom Best Practices" was a featured session moderated by Benjamin F. Garmer III, partner, Foley & Lardner LLP. Panelists included Mark Angelson, CEO and director, R.R. Donnelley & Sons Company; Patrick Ryan, founder and executive chair, Aon Corporation; Jon Chait, chairman and CEO, Hudson Highland Group, Inc.; Christie Hefner, chairman and CEO, Playboy Enterprises, Inc.; Randall Hogan, chairman and CEO, Pentair, Inc.; and Cary Kochman, managing director, UBS Investment Bank.

The presentation focused on a variety of issues on the forefront of corporate governance and of principal concern to boards of directors and management. Among these issues, the panelists discussed the recruitment of new directors and the processes to be employed when conducting a search for appropriate candidates, the proper manner in which to identify and remedy problem directors, the recommended steps to be taken by CEOs upon being faced with an unsolicited offer to purchase the company, and the emergence of the "lead independent director" or "non-executive chairman of the board" and the important role this individual often plays as an intermediary between the CEO and the board of directors.

Finding the Right Director

The process of adding a new member to the board of directors can be a daunting task. No single personality trait or collection of experiences will ensure that an individual will fit with the existing board and bring the knowledge and ability a company desires of its directors. The panel identified certain general traits that companies should look for in any director candidate. Christie Hefner explained that the ideal candidate will bring diversity to the board of directors. Diversity, according to Ms. Hefner, means more than just race and gender diversity, but also diversity of experience and skill. Companies should search for individuals whose past experiences have provided them with the technical business skills and industry knowledge required to fully understand the intricacies of the company's business. Ms. Hefner also described certain qualifications common to all successful directors and among those qualifications are judgment, collegiality, interpersonal skills and a hard-working, role-up-your-sleeves type of personality.

Jon Chait explained that he believes companies should search for candidates with specific expertise in an area valuable to the company and not currently represented on the board. Mr. Chait also believes companies should search for individuals who currently serve or have served as CEO of another company. He noted that these individuals generally "understand how things work," and they have an intuitive sense of when progress is being made and when things are going in the wrong direction. Mark Angelson added that companies should look for director candidates with experience in the field of mergers and acquisitions. He explained that "deal–savvy" directors can be of great value in achieving successful growth for acquisitive companies.

In addition to the characteristics of the ideal director candidate, the panel also discussed the search process and the proper manner in which it should be conducted. The panel discussed two search methods: the "Rolodex method," whereby the search is focused on acquaintances of existing directors and executive officers; and the utilization of a search firm to locate potential candidates. The panel generally agreed that although the Rolodex method is useful for locating candidates whose personalities will mesh with at least one board member, engaging a search firm is generally the desired method. Randall Hogan explained that the Rolodex method generally does not promote the diversity of directors that companies should strive to obtain. The panel also briefly discussed the appropriate role of the CEO in the director search process. Patrick Ryan explained that although the CEO should have an opportunity to meet with and evaluate potential candidates, the CEO should no longer play the principal role in searching for directors; that role is more appropriately served by the Nominating and Corporate Governance Committee.

Problem Directors

One bad apple among a group of extraordinary directors can severely jeopardize the synergy of the board. The issue of how to identify and handle such problem directors was discussed at length by the panel. The panelists explained that a problem director is one who is frequently unprepared, speaks too often and at inappropriate times so as to interfere with meaningful discussion, doesn't relate to or connect with the business of the company, and who is more concerned with the prestige of sitting on a board than the responsibilities connected with board membership. They also added that a problem director could be someone who, despite being truly knowledgeable of the company's business, is too wrapped up in his/her personal affairs, be it another job or otherwise, to add any value to the board of directors.

The panelists explained that once a problem director has been identified, the appropriate next step is for the chairman or one or more members of the executive committee to approach the individual and explain the situation and let him or her know that it may be time for the company to make a change. The panelists noted that in most cases, the individual will be aware of the ongoing problems and will expect that some sort of action is forthcoming. One panelist noted that it is important to take advantage of peer to peer communication on the board of directors. Another member of the board, rather than the CEO or the chairman, should attempt to speak with the individual to make them aware of the problem and provide them an opportunity to remedy the problem before further action is taken.

Unsolicited Offers to Purchase the Company

The panelists also discussed the appropriate range of actions of the company's CEO upon being faced with an unsolicited offer to purchase the company. The focus of the discussion was the initial steps that should be taken by the CEO in communicating the offer to the board of directors. Cary Kochman noted that, rather than immediately making the entire board aware of the offer, it is appropriate to first inform the company's investment banker, CFO and general counsel to allow them to analyze the seriousness and desirability of the offer. The next step, according to Mr. Kochman, is to appoint a lead independent director to evaluate the offer and communicate the offer to the entire board, if the situation warrants. Mr. Kochman explained that, regardless of the specific actions to be taken by a company's CEO, companies should have a plan of action in place and have a response set out ahead of time. The CEO should be aware of the board's position on certain offers so that he/she may respond appropriately in the event such an offer is presented.

Mr. Hogan noted that, to comply with their fiduciary duties, the CEO and the board of directors must consider the maximization of near- and intermediate-term shareholder value. If the CEO believes that the offer may be best for shareholders, the CEO should make the board aware of the offer, regardless of the CEO's personal feelings with respect to the offer. Ms. Hefner added that the actions taken in response to a purchase offer will likely be scrutinized at some time in the future and, as such, the actions of all parties involved should error on the side of a respectful and documented process, even if it seems unnecessary under the circumstances.

The Lead Independent Director

Many corporations now have a "lead independent director" or "non-executive chairman of the board." Four of the six companies represented by the panel have made the move to appoint an individual to one of these positions. Mr. Chait explained that his company has appointed a lead director to foster communication between the CEO and the board of directors and to oversee management and executive directors. Mr. Chait noted that the lead director assists the CEO in becoming informed on issues of importance to the board and is helpful in molding a consensus between the CEO and the board. He also noted the importance of a lead independent director in challenging the actions of management and asking appropriate questions to ensure the company is being run in the most profitable manner.

Mr. Angelson, whose company has a non-executive chairman of the board, also stressed the importance of this individual in fostering communication between the board and the CEO. Mr. Angelson explained that, in his company, the CEO will communicate with non-executive chairman in preparation for an upcoming meeting of the board of directors, rather than spending the time to brief each of the individual directors. Mr. Angelson noted that this process saves valuable time for the CEO and also prevents the CEO from being surprised by any action taken by the board. Mr. Angelson pointed out, however, that certain complex or important issues should be discussed first with the non-executive chairman, but should then be followed up with a discussion with each member of the board.

Mr. Ryan expressed the key role of the lead director of keeping the board on track and preventing the board from wandering outside its responsibilities and interfering with the role of management. He also noted that the role of the lead director is critical in situations where management is challenged by shareholders. The lead independent director can prevent management from acting inappropriately and can relieve the concerns of shareholders that management is controlling the board of directors.

For More Information

For more information on this session or the sixth annual National Directors Institute, visit Foley.com/ndi2007 or contact the moderator directly.

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Save the date! The 7th Annual National Directors Institute will be held on March 6, 2008 in Chicago. Learn more at Foley.com/ndi.