## Monday, October 20
## 9:00 am-10:30 am

# 001 Next Career Stop for In-house Counsel: The Board Room

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*Of Counsel*
Kirkland and Ellis LLP

**Lee Hanson**
*Partner*
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# Faculty Biographies

**Thomas Gottschalk**

Thomas Gottschalk is with the law firm of Kirkland & Ellis LLP in Washington, DC. His practice focuses on general litigation counseling, trial and appellate work with emphasis on complex litigation, class actions, defense of government suits, crisis management, and corporate compliance and governance.

Mr. Gottschalk was executive vice president for law and general counsel at General Motors Corporation. Prior to that he was partner at Kirkland & Ellis.

Mr. Gottschalk is a board member of the Institute of Legal Reform, The National Center for State Courts, Transparency International, American University, and Earlham College. He is also a member of the ABA, American Law Institute, Illinois State Bar Association, State Bar of Michigan, and the Bar Association of the District of Columbia.

Mr. Gottschalk received his JD from the University of Chicago Law School.

**Lee Hanson**

Lee Hanson is a partner with Heidrick & Struggles in San Francisco. In addition to her executive search work, Ms. Hanson serves on the firm's global partnership council and the Americas leadership team, and was a member of the firm's inaugural global nominating committee.

Prior to joining Heidrick & Struggles, Ms. Hanson was a director in the investment banking division of Merrill Lynch & Co. In this role, she was instrumental in establishing and building a group with client responsibility for the telecommunications industry. Ms. Hanson's clients also included companies in a broad range of other industries, including retailing, financial services, publishing, and consumer products. She was involved in assignments ranging from equity and debt financings, mergers and acquisitions, and general financial advisory projects. Ms. Hanson began her investment-banking career as an associate in the corporate finance division of Morgan Stanley & Co., Inc. in New York. Prior to her work as an investment banker, she served as a legal clerk to a federal district judge in New York.

She is a trustee at the Head-Royce School in Oakland, California and is currently chair of its board. Ms. Hanson also serves on the board of directors of Analysis Group Inc., and is a former vice president of the board of the Financial Women's Association of San Francisco.

Ms. Hanson graduated with a bachelor's degree, summa cum laude, from Yale University, and holds a JD from Harvard Law School.

**Gloria Santona**

Gloria Santona is the chief legal officer of McDonald's Corporation, the world's largest quick service restaurant company, with over 30,000 restaurants in more than 100 countries. In this role, she leads McDonald's worldwide legal, compliance, regulatory, and corporate governance functions. As part of McDonald's senior leadership team, Ms. Santona is also actively involved in the company's strategic direction and growth. Ms. Santona has fostered the legal department's diversity efforts and on-going engagement in pro-bono legal services, which have garnered the McDonald's legal department awards in recognition of the legal and educational services it has provided to underserved communities. Ms. Santona joined McDonald's as an attorney and subsequently held a number of management positions in the legal department. She became the company's corporate secretary and then general counsel.

She is a director of Aon Corporation, serving on its audit and governance committees and as chairman of its compliance committee. In addition, Ms. Santona serves on the boards of ACC and the Constitutional Rights Foundation of Chicago, and as a trustee of Rush University Medical Center. Ms. Santona has received numerous awards, including being named as one of the 100 Most Influential Hispanics by *Hispanic Business Magazine* and earning the Women with Vision Award from the Women's Bar Association of Illinois.

Ms. Santona graduated from the University of Michigan Law School.

**Laura Stein**

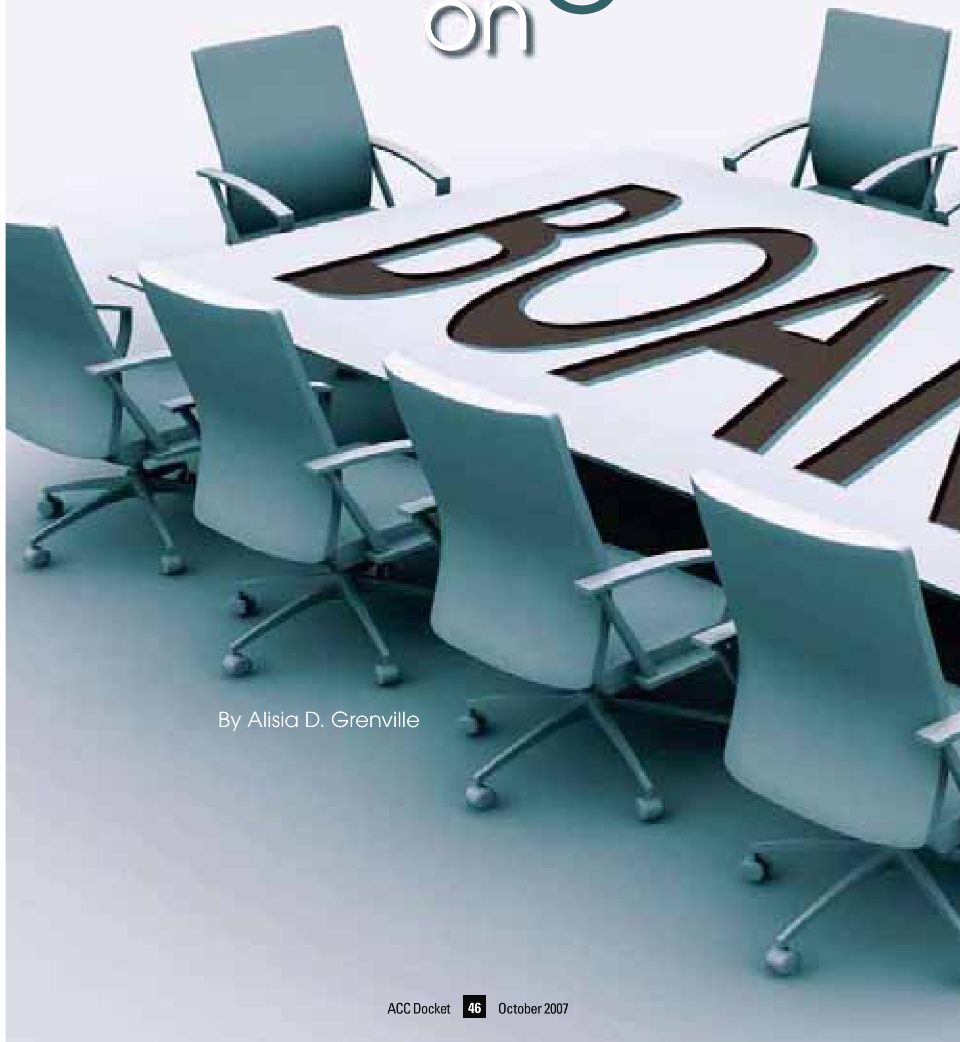
Laura Stein is the chief legal officer for The Clorox Company. At Clorox, Ms. Stein has responsibility for the company's worldwide legal, ethics and compliance, corporate secretary, corporate communications, crisis management, risk management, and internal audit matters. She also works closely with the Clorox board of directors on corporate governance. Ms. Stein chairs the Clorox women's employee resource group, and the Clorox crisis management team, co-sponsors the company's enterprise risk-management and social responsibility programs, co-chairs the Clorox disclosure committee, is a member of Clorox's employee benefits committee, and is Clorox's chief security officer.

Formerly, Ms. Stein was senior vice president, general counsel of the H.J. Heinz Company. Prior to joining Heinz, Ms. Stein served eight years with Clorox. Prior to joining Clorox, Ms. Stein was with Morrison & Foerster.

Ms. Stein is a director of Franklin Resources, Inc., and was previously a director of Nash Finch Company. She is the chair and serves on the executive committee of the board of directors of ACC. She chairs the ABA Asia Law Initiative Council, and co-chairs the corporate pro bono advisory board and the general counsel committee of the ABA business law section.

Ms. Stein received her JD from Harvard Law School and is a graduate of Dartmouth College where she earned undergraduate and master's degrees.

# Getting on




By Alisia D. Grenville

Some months ago, I mentioned to my husband that I wanted to sit on the board of a major company. It just seemed to be the next grown-up legal professional step. However, what I quickly realized was that I had no clue how to do this.

As we all know, the legal profession is filled with avenues, which can all lead to rewarding and fulfilling careers paths. As a junior lawyer, the avenues open to you may include a life in private practice or public service. As a more seasoned lawyer, you may wish to take your career down another road—that of the legal corporate counsel. Still onwards, way in the distance, there may be yet another avenue that you may wish to pursue once you have established yourself in your field of expertise and have built up some goodwill and credibility en route along the corporate highway—that of corporate director. And so, just like the myriad of choices you have as a lawyer when deciding your career path, there are just as many ways to achieve your goals. There is no right or wrong route in getting to the finish line, just the one that gets you there. And as such, even though there may be no "Interstate 87" board highway, the road to a corporate board seat can be more easily navigated with a proper map, compass, and the North Star to lead the way.

So you're wondering why I am writing this article when the question itself was the one I asked ACC to feature in the *Docket*. Because sometimes the only find you get are the ones that you answer yourself. Thus, when the editor in chief suggested that I research the question, I thought—why not? So I set out down this nebulous path to find the clues to what seemed to be an unsolvable mystery: How do you get that golden invitation to the boardroom if you are not the CEO of a major company?

In so doing, I realized that the rules are the same old ones to just about everything you wish to achieve in life. Think back to anything that you have been able to successfully accomplish professionally: getting through law school, passing the bar, and surviving the firm (with an exit strategy, I might add). More than likely, it took proactive foresight, planning, and basically just a lot of good old-fashioned hard work and initiative. We cannot all have Charlie's luck to get the last golden ticket to the chocolate factory by pure happenstance. Thus, the golden invitation to sit on a corporate board should not be left to chance. There are a few things that you can do along the way to ensure a more certain outcome:

- know your destination;
- plan out your route;
- service your engine;
- avoid highways lined with gold;
- don't always take the road less traveled (it may lead to a dead-end);
- be cautious of hitchhikers; and
- stop to meet the locals along the way.

So let's take off together and get on board.

## Know Your Destination

**Get a map, compass, or navigation system and figure out where you are going**

Like any journey, if you want to go to Paris, don't buy a ticket to Prague. So, first make sure that you have the things you need to get you to your desired destination. On the road to a board seat, know that just being a "lawyer" is not going to be the catalyst for the chair handing you the golden invitation. If you are selected, it is not because you can give legal advice. Your package of legal skill sets and professional development as a lawyer (i.e., what you can bring to the table, no pun intended) will garner his/her attention, and ultimately get you in the boardroom. According to Beverly Topping, ICD.D, president of the Institute of Corporate Directors in Toronto, Ontario, the key competencies for director effectiveness that a CEO or chairman is looking for when deciding to fill an empty board vacancy are:

- knowledge of specific industry, company, and its executive team;
- knowledge of the board and its role;
- process orientation;
- conceptual thinking skills;
- independent thinking skills;
- effective judgment;
- integrity;
- bias to learn;
- orientation to resolve conflict;
- effective communication and listening skills; and
- prioritizing relevant risks.[1]

Many of these competencies are already inherent to most lawyers. In our day-to-day jobs, we are asked to put these skill sets to use on a regular basis, so I say that we have a jump start on the competition. That does not mean, however, you can rest on your laurels for some of the other skill sets, such as:

- financial acumen;
- monitoring financial performance; and
- selecting, hiring, and evaluating top management.

These skills may not come so innately. If you are missing any one of these core competencies, then it is up to you to figure out how you are going to attain them.

## Plan Your Route

**Map-out where you are going**

When I was nine years old, growing up in Montreal, my sister, best friend, and I wanted to make a trip across Canada. Did I mention the fact that we planned to take along two 15-month-old toddlers and a four-month-old baby? We were so excited about the trip and our pooled savings of about $78.00 CAD, which was to last from Montreal to Vancouver. When we asked our parents for permission to make this trip, their collective answer was an astounding "no." We were shocked and devastated. We just could not understand why. We had saved all this money and were responsible young people—we had even taken the kids on walks before in their wagons and strollers, so taking them on foot from the East to West Coast of Canada should not have be problem in our minds. Why did those adults just not understand?

As I look back on the episode, I realize that besides the stupidity of the entire thought, it may have been more helpful if we had devised a plan that at least could have convinced the adults that we had really thought it through. (Nevertheless, something tells me that even with a plan, that idea just would not have flown). Anyone who knows me now, knows that I always have at least a plan A and B, and sometimes a plan C. Thus, it may be prudent to take some time to plan your route to the boardroom out, plans help you focus and convince others that you actually know what you are doing.

## Volunteer

**Volunteerism may be one route to take**

It is easy to think that you may be board material. If you want to find out—take a little test run. Get on a not-for-profit board in your local community and see if you are cut out for board work. Remember to choose something that you are passionate about and that you can handle time commitment. If you volunteer, take your commitment seriously as people will be depending on you.

Now, whether you choose to sit on the board of your local hospital or school, everything that you learn will be of value as you continue to build your portfolio of board director competencies. More than likely, in this setting, where you have come together with industry specialists and other volunteers who share a common interest, you will learn the importance of working collaboratively, which is required within such a structure. There is no doubt that being on a board requires teamwork—working within a small group of professionals and experts in order to achieve certain objectives. The ability to stand up and maintain your own convictions, all the while remaining open and responsive, is also a trait that is much sought after in this atmosphere. However, even though board members are chosen for their particular knowledge, they must be able to share and articulate that information to others. If you prefer to work solo and do not like consensus decision making, then you may not have the personality to serve on a corporate board, where you may have to back off and back down—your voice being heard, nevertheless—where majority prevails.

Don't see the volunteer or the not-for-profit board as just "kids' stuff." All these organizations serve very important constituents and they do count! I literally took this advice to heart. I have twin boys who attend an international school here in Geneva. When the founder of the school was looking for volunteer board members, I decided to throw my hat in the rink. What a great chance for me to be more involved in my children's education as an insider and not only from the parental perspective. Again, it is volunteerism, but I am—literally and figuratively—now on board.

## Servicing Your Engine

**Create a resume that is director-focused**

Horn the elevator pitch and be precise as to why you would make a good director. More than likely the first opportunity that you will have to create a good impression will be the curriculum vitae (CV) that is put in front of the chair. Therefore, your CV should be director-focused. It should emphasize the qualities and accomplishments that would be considered attractive to someone looking to fill a board position. Besides your expertise in a particular field, again consider the list provided by the ICD and ensure that your CV speaks to those points. Don't forget to get your CV out there. Even the greatest CV will not get you a board position if the right people do not know that you exist. Speak to the appropriate search firms that specialize in board appointments. I also suggest that you take a look at some of the more renowned search firms and contact them in confidence. According to Bev Topping, search firms place about 25 percent of directorship vacancies. You would be surprised how much you can learn by just surfing the websites of these companies or speaking to someone directly.

> **Remember** that being at the **top of your field** is going to get you some recognition; however, that is probably **not enough**.

**Do an Engine Analysis**

Remember that everything you do in your career is, and will become, a part of your ability to "profile build," and it is up to you to nourish and nurture your profile. Just like an engine without fuel, it will break down if it is not being serviced regularly. Your goal and aim should be to become "top of mind." Question is, how do you become the "it" guy or gal director that every chair wants to have on board? Remember that being at the top of your field is going to get you some recognition; however, that is probably not enough. How many of you know a smart lawyer who is great at what he does, but is not well known outside of the company, firm, or industry that he or she represents? That is probably because they have failed to take his know-how or knowledge to the next step: positioning. It is up to you to stay on top of your own career and your profile development. For this article, profile development means the nurture and nourishment of your professional recognition through the management of your professional development, growth, and reputation. That is the only way to be "top of mind" when a CEO or chair is thinking of filling a vacant board seat. So what do you need to do?

As in-house lawyers, we have a head start. Our profession requires us to continuously refuel by taking courses that keep us abreast of the ever-changing legal landscape. However, you have to take that one step further. Again, remember that your legal knowledge may get you the initial nod, but it may not get you to the table. When looking at continuing educational options, start to focus on business-oriented programs or programs that teach you how to assimilate your legal knowledge so that it better fits into the world of business strategies and management

development. Legal knowledge coupled with financial acumen is a winning combination. Therefore, bone up and choose courses that can give you the knowledge that you are missing. You may never become an expert in financial accounting, but you don't need to be. However, you do need to be able to read the P&L statement and understand if the company is going to have to issue a profit warning to the analysts.

Recently, I attended a course, "*Finance for Non-Financial Directors*," at the Institute of Directors in London, England. Despite taking many courses in accounting and finance before, this course gave me the knowledge that I was looking for when it comes to reading, understanding, and most importantly, interpreting financial statements.

### Due Diligence Questions

Before agreeing to serve on a board of directors, you may have to answer questions like the ones below. With tighter ethics and compliance controls in place, many companies are hesitant to approve an employee for a BOD position unless some research has been done.

- What is the company or organization's annual revenue or income?
- Does the board discuss and approve the annual budget?
- How often do board members receive financial reports?
- How is the board structured?
- Are there descriptions of the responsibilities of the board as a whole and of individual board members? If no description is provided as a whole, is the board governed by bylaws?
- Are there descriptions of board committee functions and responsibilities?
- Can you list the committees?
- Who are the other board members?
- Is there a system of checks and balances to prevent conflicts of interest between board members and the organization?
- Does the organization have an antitrust policy?
- Does the organization have D&O liability coverage?
- Is the policy limit of the D&O insurance program adequate?
- Does the D&O insurance program have "Side-A" insurance covering the directors separate and apart from the corporation?
- Is the policy limit intact?
- Can the insurers rescind the policies in the D&O program after a suit has been filed?

Furthermore, after the three days, I was able to see more than one nexus between corporate management strategy planning and legal analysis. It is important to embed in the minds of the corporate gurus that you can and have made that quantum leap. I can now better appreciate why certain decisions are taken at the corporate level, and how legal expertise plays a role in furthering those business objectives.

**Analyze the Results: Are You Being "Googled"?**

The results are in. The world has voted, but who will be the next "Corporate Director Idol"? Although it's probably not the answer you were looking for, that may be pushing it for you. However, the question remains outstanding: How do you move from being good to great? It means that you just cannot do your job and do it well; you have to step outside of your comfort zone and start to build a presence. Out of pure curiosity, google yourself. Do you pop up, and if so, what does someone learn about you from what has been written? If you do this and you find nothing, it is probably time to make a change. Again, it is all about profile building. Are you out there, letting others know who you are and what you can do? Here are some ways you can start to position your profile:

- **Be seen in your community:** Build a name for yourself by starting in the place you are probably known best. Get involved locally and be a positive role model; you will be surprised how word of mouth spreads. You have a better chance of winning the hearts and minds of the local community if you are seen to be active in it. If you have been expatriated to several different locations for limited time periods, your links to your new community may be nonexistent, but that does not mean that it is impossible. You may want to focus on the ex-pat community as a first instance. There are connections to be made in that community, not to mention the influencers you may be able to meet.
- **Join an association:** By getting involved with people who share your professional background and expertise, you will meet influencers in the field who will start to know your name and may remember it when a board seat becomes available. I can tell you from personal experience that the first thing I did when we moved from Germany to Switzerland, the seventh country in my list of residences, was to join a club that focused on executives. A little click on my computer put me onto several executive associations in my region. Membership in organizations like ACC also exposes you to thousands of corporate executives who may one day be part of a search team.
- **Write articles:** If you subscribe to industry-based magazines or journals, put pen to paper and write an article on some area of interest or specialty. You never know who may be reading it. Writing for the *Docket* is a good example.
- **Be a keynote speaker:** Volunteer to sit on a panel of experts or to be a keynote speaker for a conference you plan on attending. You never know who may be sitting in the audience and listening. Serving on a panel at the ACC Annual Meeting is such an opportunity.



**Like most things in life,** we have a tendency to think that **bigger is better:** a bigger house, a bigger car, or a bigger job. However, when it comes to a board seat, the **first appointment to focus on** may not be with a **Fortune 500** company.

**All That Glitters Does Not a Golden Highway Make**

**Don't be a one trick pony—being a generalist offers more avenues**

Being a specialist in one area may not always get you to the finish line. Just like the job of in-house counsel, which sometimes requires you to be everything to everyone, you may wish to diversify your expertise and portfolio and build on understanding and appreciating the significance of new legislation, but not only from the legal perspective. Sarbanes-Oxley is a great example of this. Think about it as a business strategist would. Remember, the CEO does not need another person who can interpret the law for him—she has in-house and outside counsel for that. What may be needed from a director with a legal background is the ability to understand the application of current legislation to transform it into a strategic business plan. A board member, who has this level of business foresight and thus understands the strategic vision, as well as the law, is someone who adds value.

**Slow and Steady Wins the Race**

Like most things in life, we have a tendency to think that bigger is better: a bigger house, a bigger car, or a bigger job. However, when it comes to a board seat, the first appointment to focus on may not be with a Fortune 500 company. First of all, if you do make it on the radar screen of the CEOs or the chairpersons of one of those boards, then you have already managed most skillfully to achieve your objective without this advice and, therefore, do not need to read any further. If, however, you have not, then it may be best to focus on smaller companies where you can make a difference. Think about it: A smaller, private company gives you the opportunity to learn and know the industry and make decisions that will affect business growth and sustainability, without the pressure of having to answer to a multitude of stakeholders whose expectation for share value may be distorted. Most directors will tell you that they started off on smaller boards.

Further, racing in the Grand Prix is very different from go-carting for your community team. You need skill and savior-faire, and you have to be savvy. Face it: Being a director is no cakewalk. Let's take a look at the latest boardroom scandals that have hit the airwaves in the latter months of 2006. In September of that year, the Hewlett-Packard spying shenanigans forced the resignation of Chairperson Patricia Dunn and its ethics director, Kevin Hunsaker. Dunn allegedly authorized illegal surveillance of HP board members, which resulted in George Keyworth losing his seat on the board for allegedly leaking confidential information to the media. The stakes are high when you sit so high up. Let us not forget the recent pasts of such doomed companies as Enron and Worldcom. Both companies had board members whose inability to control the senior management team and understand what was really going on in those companies led to the collapse of one company entirely and the restructuring of the next. From that moment forward, the boardroom was transformed from

### About the ICD

The Institute of Corporate Directors (ICD) is a membership association that represents the interests of directors in Canada with a view to strengthening the governance and performance of Canadian and interlisted corporations. With nine chapters across Canada and more than 2,500 members, the ICD educates directors through networking events, timely seminars, continuing education, and formal education programs. The ICD also peer-certifies directors with the ICD.D designation to ensure that they are well-prepared to discharge their fiduciary obligations in the boardroom. In 2005, the ICD helped found the Global Director Development Circle, an international governance network focused on raising governance standards worldwide.

being the playroom for retired executives and ex-CEOs. Directors are being held to a higher standard and are being held accountable for their actions. Knowing the liability attached to board directors should make you realize that taking on a seat and finding the time to really understand the business, for which you will effectively be taking responsibility, is no mean feat. Therefore, on your road to the boardroom, the back road may be better than the glittering lights of the golden highway. Indeed, the ride may be a little slower, but perhaps a lot more scenic along the way.

### Don't Always Take the Road Less Traveled

**Do your diligence—don't drive with your eyes wide shut**

Given today's litigious environment and the high standards to which board members are being held, not to mention their personal liability and accountability that attaches to the mandate, it may not always be smart to take the shortcut. (NB: Don't confuse the more scenic back roads with the shortcuts). It could lead to a dead-end and kill your career. If you are approached by an organization to join their board, remember, as suggested in former Mayor Rudy Guiliani's book on leadership: "Think, reflect and then decide." Remember that this is not a decision that should be made lightly. There is a lot at stake for you both personally and professionally, and you do not want to be caught in a quagmire. As I write this article, the former board of Swissair is on trial for the financial collapse of this once profitable and prestigious airline.

When deciding whether this board seat is right for you, look into:

- Fiduciary duties: Know your fiduciary duties as a director of a publicly-listed company in a given jurisdiction.
- Legal differences: If it is a foreign-listed company, find out what the legal differences are in that jurisdiction in comparison to the one with which you are familiar, and what your liability is as a director.
- Cultural differences: Cultural differences can be significant; learn about them and know what they are.
- Commitment: Understand what the board and company expect of you and understand your commitment (e.g., how many times they meet per year and where).
- Don't leap into anything. Remember that it may be easy to get on a board, but it may not be that easy to get off.

### Be Cautious of Hitchhikers Along the Way

You are judged by the company that you keep. Therefore, choosing the right board should not be something done indiscriminately. Be picky. Not only is your career on the line, but so is your reputation. Do your own due diligence. Don't just find out the basics about the company—look deeper. Research those people who are currently sitting on the board, as well as others who may have sat on the board in the past. Interview the directors if you have the opportunity. Or if you are being interviewed, ask the difficult questions.

**Rescuing damsels in distress—women on board**

We have all heard about the glass ceiling to the C-suite. Well, when it comes to the boardroom there seems to be a bolt and a padlock on that door as well. At times, it seems easier for women to make two simultaneous galactic flights into space then to get the golden invitation to sit on a board. In the past, the boardroom was no place to find a female unless she was serving cocktails. Today, more and more companies recognize the importance of having a diversified board, and therefore, being a woman with the right credentials can get you some recognition. That notwithstanding, it is like putting lipstick on a pig—the outcome still remains the same; not pretty. Sadly, even with that knowledge, good intentions have not proven to do the trick. Today's boards are no more representative of their overall stakeholders. Much still has to be done to improve the percentage of women who get that corporate seat.

According to a January 5, 2007, press release from the Equal Opportunities Commission, *Where are the nearly 6,000 women "missing" from our boardrooms and public life?*, "women are still woefully under-represented at the top." According to the article, women make up just about 10 percent of directors of FTSE 100 companies and at the very top, minority women are especially under represented, accounting for just 0.4 percent of FTSE 100 directors. This statement becomes more alarming when "ethnic minority women account for 5.2 percent of the population [of the United Kingdom] and 3.9 percent of the labor market, and this percentage is growing and increasingly well-qualified." In Canada, just 9-10 percent of women are on corporate boards, according to Topping. Women are, however, being sought out by corporations, and Topping agrees that improvement in being made this area. Again, women with a strong finance and accounting background improve their chances tremendously at being considered. It makes you wonder, when and if you do get the invitation, is it really because you were seen to be the most competent candidate, or is it "tokenism" or some quota that had to be filled that made the chairman or the CEO consider you?

Indeed, I think that women have to be aware that they may initially be considered for any of the conscience reasons mentioned above. Nonetheless, if that was the initial reason you got the nod, once you are there, you have the chance to prove yourself and make the pathway a little smoother for those who follow you.

### Stop to Meet the Locals Along the Way

Like anything that you do in your professional life, you must remember to keep it all in stride. Remember that in anything that you seek to achieve, you will have a better chance at realizing your goals if you are passionate and believe in what you are doing. Therefore, en route to the boardroom, stop to smell the flowers and to meet the locals along the way. Don't get so caught up in the mechanics of it all that the end goal drives every little thing that you do. Have a bigger perspective and take opportunities that give you pleasure and satisfaction. It all does not have to be so calculated in the end. Part of the mystery of life is that the road you thought might lead you to your final destination is not always the one that you would have chosen.

*The author would like to thank Donna Soble Kaufman and Beverley Topping, who were both interviewed for this article. Donna Soble Kaufman is a professional corporate director. Beverly Topping is president and CEO of the Institute of Corporate Directors (ICD) www.icd.ca.*

*Have a comment on this article? Email editorinchief@acc.com.*

NOTE
1. The comprehensive list of competencies as well as pertinent information about the services and courses offered by the Institute can be found at *www.icd.ca*.

## ACC Extras on…Boards of Directors

### *ACC Docket*

*Lawyers as CEOs* (Career Path, 2007). Many critics warn against placing lawyers in the position of CEO. In this article, Bill Mordan explains why having a lawyer as CEO may be in a company's best interest, especially when that company is increasingly dealing with legal and compliance issues. *www.acc.com/resource/v8405*

### Program Materials

- *Leadership: Getting a Seat at the Top* (2006 Annual Meeting). It takes more than being a good lawyer to be recognized as a valued member of the business team at any corporation. It takes initiative, keen decision-making abilities, and yes, even a little bit of luck. Join this open discussion among your peers to benchmark experiences and learn how you too can gain a seat at the top table. *www.acc.com/resource/v7276*
- *Moving Up the Ladder: How to Advance within the In-house Profession* (2006 Annual Meeting). Would you like to move up, either within your current company or at another company? Maybe become a senior lawyer at a large organization or a general counsel of an any-size corporation? You work hard and charting your advancement is always on your to-do list, but somehow it always stays at the bottom, thanks to company meetings and more. A panel of career specialists has shared meaningful ways for you to approach advancement in the in-house profession and shows you ways to build your skill set so that when the next big position comes along, your resume will get you in the door. *www.acc.com/resource/v7435*

## Search Firms Specializing in Board Appointments

Search firms that specialize in board appointments include:

- **Christian & Timbers:** For over 25 years, CTPartners has helped Fortune 1000, NASDAQ, FTSE 100, CAC 40, DAX, Sensex, and leading global private equity and venture-backed companies build world-class boards of directors. With a long and proud heritage of placing top executive talent across industries—including technology, financial services, life sciences, professional services, retail, and more—they are also exceptionally prepared to help identify outstanding board members that are qualified to help you achieve or maintain market leadership. *www.ctnet.com*
- **Egon Zehnder:** Egon Zehnder International has a dedicated practice specializing in board consulting and director search. The group focuses its efforts on the highest level of an organization and works in a collaborative manner with the chairman of the board and its members to recruit directors whose independence, intellect, integrity, and courage will strengthen the board and create sustained competitive advantage. *www.egonzehnder.com*
- **Heidrick & Struggles:** For more than 50 years, Heidrick & Struggles has specialized in chief executive, board member, and senior-level management search assignments for a wide variety of clients, including multinational corporations, mid-cap and startup companies, nonprofit entities, educational institutions, foundations, associations, and governmental units. *www.heidrick.com*
- **Korn/Ferry:** Korn/Ferry International has a dedicated team of global professionals whose sole focus is recruiting for boards of directors and consulting on matters of corporate governance. As governance issues continue to change, their board services team tailors its approach to the specific needs of each client. *www.kornferry.com*

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## Thinking of becoming a director?

Bricker & Eckler LLP
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USA
June 20 2008

Congratulations! You have been asked to serve as a director. Now what? Deciding whether or not to serve as a director for any corporation is a difficult decisions that must be considered carefully. Being a director is hard work, and while it can be an extremely rewarding and beneficial experience, one should not agree to serve without learning specific information about the corporation, including whether the corporation is private, public, for profit, or nonprofit.

Below is a checklist to assist anyone considering becoming a director to help facilitate their consideration of whether to accept the role.

- Company expectations. Discuss with the chief executive officer and, if different than the CEO, the boards chair the expectations of directors, including the frequency, typical duration and dates of meetings; expected availability of directors between meetings; any continuing education required of each director; any customer or client referrals expected of each director; and any charitable contributions required of each director.
- Directors' qualifying shares or contributions. Determine whether directors are required to purchase or otherwise own a minimum number of shares of capital stock and, if so, whether such shares are to be purchased at market or from the company, and, if from the company, at what price. For nonprofit corporations, one must determine if directors are expected to donate a specific financial contribution to the organization on a yearly basis.
- D&O insurance. Determine type of policy, policy limits (including deductible or retention), and endorsed coverages (securities law liability, ERISA, employment practice) of the company's directors and officers liability insurance. Have policy reviewed by lawyer or insurance consultant.
- Directors' indemnification agreement. Determine whether directors are indemnified by the company against liability and the extent of such indemnification under the company's governing documents. Consider seeking an indemnification agreement from the company and have this agreement reviewed by a lawyer in order to ensure this protection continues after your service has concluded and to ensure that you will receive advancement of fees immediately upon a claim being made.
- Net worth. Determine the company's net worth and the extent of its current assets to provide directors' indemnification.
- Compensation. Determine compensation of board members, including annual retainer and meeting fees (both board and committee); form of payment (cash or stock); ability to defer receipt; and policy for reimbursing expenses. Typically, compensation is a combination of an annual retainer for time spent in preparing for meetings and meeting fees. The amount of compensation should be commensurate with the work required and risk of liability.
- Audit committee financial expert. Determine whether the company's audit committee has someone meeting the Sarbanes-Oxley definition of an audit committee financial expert.
- Committee assignments. Determine committee assignments that you are likely to have. Do you believe you have competency in the matters handled by each such committee?
- Board vacancies. Determine whether there are any vacancies on the board, and if so, inquire why.
- Other independent directors. Determine the number of directors or non-management directors and their identity.
- Discussions with other independent directors. Discuss with other independent directors their perceptions of the company's business, the experience and competency of management, and the conduct of board meetings, especially the materials distributed (and whether in advance).
- Oversight committees. For those considering a seat on the board of a publicly traded company one must determine whether the company has required oversight committees (NYSE and NASDAQ require audit, compensation, and nominating committees) and the extent the composition of these committees consists of non-management directors.
- Discussions with the audit partner. Primarily, for those considering a seat on the board of a for profit corporation, consider discussing with the audit partner the company's cooperation in the audit process; critical accounting policies that the auditor believes the board should know; and the effectiveness of the company's internal accounting controls.
- Discussions with management. Discuss the company's prospects with the chief executive, chief financial, and chief legal officers. Do you feel they are competent and reliable? Is the chemistry between you and them good?
- Annual report. Those considering a seat on the board of a publicly traded company should review the notes to financial statements, as well as the management discussion and analysis of financial information in the company's most recent annual report to shareholders or Form- 10-K annual report filed with the SEC. Do the disclosures make sense? Are they written in understandable English? Are there any





problems you did not anticipate?
- Director orientation. Inquire whether the company will conduct or sponsor any form of orientation of you as a new director and, if so, by whom and when.

Finally, you should consult with legal counsel with any questions or concerns you have with the information you receive from the company, including review of the D&O policy, directors' indemnification agreement, and the company's annual report (if applicable).

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National Association of Corporate Directors

# DIRECTORS MONTHLY

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## A Perspective on Liability Risks to Directors

By E. Norman Veasey

**The former Chief Justice of Delaware offers comfort in light of current events.**

The recent proposed settlements by Enron and WorldCom directors, with payments coming from their personal funds, have ratcheted up media speculation about the perceived perils of service as a director. I would like to put this matter into perspective with respect to board service and hope to conclude with a more sanguine view of the world of board and audit committee service than one might glean from the plethora of recent sound bites.

### The Perspective

In my opinion, it is very important to keep in perspective the significance of these negotiated settlements of federal securities class actions, which are now being proposed for court approval. These payments are part of a compromise that would obviate a difficult trial and would be added to larger payments by insurance carriers, all of which would cover only part of massive losses alleged to have been incurred by investors.

(Continued on page 3.)

## About NACD

**National Association of Corporate Directors (NACD)**, an independent not-for-profit organization founded in 1977, is the country's only membership organization devoted exclusively to improving corporate board performance. The NACD conducts educational programs and standard-setting research, and provides information and guidance on a variety of board governance issues and practices. Membership comprises board members from U.S. and overseas companies ranging from large publicly held corporations to small over-the-counter, closely held, and private firms. NACD lists all interested members on The Director's Registry, which is used by member companies and others that seek qualified directors. With chapters in many major cities providing educational programs and networking opportunities, NACD operates at both a national and local level. To educate the corporate community and to provide networking links among NACD members, the NACD holds an annual Corporate Governance Conference, where it presents a Director of the Year Award.

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Directors of public companies are rightfully concerned about these developments and whether they represent a new trend that potentially puts at further risk the personal assets of conscientious fiduciaries. Although the WorldCom and Enron cases are aberrations that may be unique on many levels—and the exposure of the personal assets of faithless fiduciaries has always been a potential concern—the new trend is a practical concern.

The practical concern includes the tactical advantage and momentum that certain institutional investors and the plaintiffs' bar will seek to assert. They will increasingly demand personal payment of some "pound of flesh." Some plaintiffs' lawyers may sense blood in the water based on these settlements—and remember they are proposed settlements. There will be more high-profile cases featuring huge losses and alleged egregious misconduct that will head for a trial, after having survived a motion to dismiss. Those cases will be rare, but directors must be aware of the potential for things going awry, sometimes even when their own conduct is not blameworthy.

That means, in my opinion, that directors and their counsel should not panic. The "sky is not falling." First, directors, like Interstate motorists, should drive defensively. There are a lot of crazy drivers out there! Defensive driving, like best corporate practices, should avoid most pitfalls. To be sure, some drunk or impaired driver can careen across the median and kill you despite your careful driving. But those cases, like WorldCom and Enron, are aberrations. They should not make you get rid of your car. Nor should they necessarily keep you from faithful board service, although you may want to think twice before serving.

Moreover, directors should not be intimidated into settling and paying money to plaintiffs with shaky cases just to avoid an unlikely adverse court outcome. Sometimes—often, perhaps—they should stay and fight. Liability of directors is rare. Personal asset exposure of directors is rarer still.

### Take Heed

Yet one must take heed of these developments and some state law cases like *Caremark*, *Disney*, *Integrated Health*, *Abbott Laboratories*, and *Emerging Communications*. Take heed, that is. But, again, don't panic!

The new state law cases (some of which I will mention below) and the WorldCom and Enron settlements are not harbingers of new exposure of directors to personal liability by reason of any change in statutory or case law at either the state or federal level. Indeed, the law continues to be that conscientious directors who exercise due care, good faith, and independent judgment in the honest belief that they are acting in the best interests of the corporation and its stockholders should be protected by the courts. The time-honored business judgment rule is indeed alive and well under state law. Similarly, good faith and diligence should be a safe harbor under federal law. Courts are not ratcheting up new pitfalls for conscientious directors.

**In my opinion, directors and their counsel should not panic.**

Concerns about the protection of personal assets are certainly legitimate, but they should not necessarily stop directors who are willing to put in the effort and treasure the challenge from continuing in their important service. After all, the proposed settlements have no impact on jurisprudence, which for directors has not changed. To be sure, there are some court cases where directors may be held personally accountable. But they are not, in my opinion, a menacing trend, they are explainable as law, business mores, and expectations of directors continue to evolve.

Jurisprudence is not the whole story, however. Directors who might otherwise ultimately be exonerated by a court of law may sometimes face significant pressures to settle any case that survives the motion-to-dismiss stage. That is why such cases rarely go to trial, but settle within limits available through insurance and indemnification. The potential damages—especially in federal securities class actions—are often well beyond the directors and officers (D&O) insurance available. And in cases involving insolvent companies, like WorldCom and Enron, indemnification is often impaired.

The tactic by lead institutional plaintiffs and the plaintiffs' bar in the WorldCom and Enron settlements to require out-of-pocket payments as a condition of settlement changes the risk analysis in settlement. If this tactic is broadly adopted, it raises the risk to personal wealth resulting from service as a director.

While it remains to be seen if the tactic will be broadly embraced, I expect that it will be used primarily in those

**Director Summary:** The former chief justice of the Delaware Supreme Court analyzes the Enron and WorldCom settlements that may result in personal liability for the companies' directors. He finds that directors who are concerned that their own personal wealth will be at risk should find assurances in the business judgment rule and their own diligence and independence.

**The business judgment rule will normally protect the decisions of a board of directors reached by a careful, good faith process.**

aberrational cases where the likelihood of director liability is high and exposure of personal wealth is already considerable. WorldCom involved both the largest corporate restatement and the largest bankruptcy in U.S. history. Enron was not far behind. The potential damages in both cases defy comprehension. In both cases, indemnification was impaired and the D&O insurance was insufficient. In WorldCom, the directors are alleged to have missed detectable financial misreporting. In Enron, the ten directors who contributed personal assets to the settlement allegedly had benefited enormously from stock sales when the ship was about to go down, and disgorged part of that gain.

The risks to the directors were also heightened by investigative reports from court-appointed monitors and Senate committees that were highly critical of director conduct. These reports would likely influence the court proceedings but were not subject to the structured fact-finding process, with opportunity for cross-examination and rebuttal that occurs in judicial proceedings. For most directors it is unlikely that they will ever be faced with a similar set of circumstances.

The judicial articulation of principles of fiduciary duty law in Delaware is a constantly evolving process that has developed over about eight or nine decades. It is the quintessential application of the common law process. Directors are fiduciaries, duty-bound to protect and advance the best interests of the corporation and the stockholders.

When those interests conflict—or may conflict—with the personal interests of the fiduciaries, the fiduciaries' interests must be sublimated to those of the corporation and its stockholders. The evolution of fiduciary principles occurs not only because courts must decide only the cases before them, but also because business norms and mores change over time. Thus, concepts like "good faith" and "reasonableness" may acquire more defined content and doctrinal status over time as cases emerge addressing new business dynamics.

### Good Corporate Governance Practices

Delaware's emphasis on responsible corporate governance practices is intended to promote good decision making by directors, thereby obviating the spectre of judicial second guessing. Good governance practices permit the time-honored business judgment rule regime to operate with integrity by checking self-interest and sloth while permitting valuable and prudent risk taking.

As I see it, there are seven normal expectations that a stockholder should have of a board of directors. Although there may be others in some situations, the stockholders expect that:

- The stockholders will have a right to vote for the members of the board of directors and have a right to vote on fundamental structural changes, such as mergers;
- The board of directors will actually direct the management of the company, including strategic business plans and fundamental structural changes;
- The board will see to the hiring of competent and honest business managers;
- The board will understand the business of the firm and develop and monitor a business plan;
- The board will monitor the managers as they carry out the business plan and the operations of the company;
- When making a business decision, the board will develop a thorough understanding of the transaction and act in good faith, on an informed basis, and with a rational business purpose;
- The board will operate with basic honesty, care, and loyalty; and
- The board will take good-faith steps to make sure the company complies with the law.

What are the expectations that a stockholder has of the courts that are overseeing the stockholder's expectations of the board? Stockholders look to courts to enforce fiduciary duties in highly textured fact situations by applying the general principles that underlie the relationship between the investors and the board of directors.

As I see it, the courts have at least seven key obligations in deciding corporate law issues. Courts must: (i) be clear; (ii) be prompt; (iii) be balanced; (iv) have a coherent rationale; (v) render decisions that are stable in the overall continuum; (vi) be intellectually honest; and (vii) properly limit the function of the court. I think the experienced Delaware courts live up to these obligations.

When considering standards of conduct, one begins with the duties and responsibilities of directors. They are required to direct the management of the corporation. They are required to carry out their responsibilities in accordance with principles of fiduciary duty. Although the business judgment rule is a standard of review, these duties are embodied in the rule itself. That is, directors are expected to act—indeed are presumed to act, unless the presumption is rebutted—"on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the corporation." This means that when making a business decision directors are expected to inform themselves with all material information reasonably available.



**The concept of good faith has been in our jurisprudence for a long time.**

The business judgment rule will normally protect the decisions of a board of directors reached by a careful, good-faith process. The rule has been stated and restated.

It is very much in stockholders' interest that the law not encourage directors to be risk averse. Some opportunities offer the prospect of great profit at the risk of very substantial losses, while the alternatives offer less risk of loss but also less potential profit. A diversified investor often is willing to invest in seemingly risky alternatives that may result in loss because the losses in some stocks will, over time, be offset by even greater gains in others or be ameliorated by the stability of debt instruments, for example.

Investor interests will be advanced if corporate directors and managers honestly assess risk and reward, cost and benefit. In their strategic vision, directors should pursue with integrity the highest available risk-adjusted returns that exceed the corporation's cost of capital.

But directors may tend to be risk averse if they must assume a substantial degree of exposure to personal risk relating to ex post claims of liability for any resulting corporate loss occasioned by the business decision gone bad. They need not worry under our law for mistakes of judgment—even "stupid" ones. They should not worry about liability if they exercise care and loyalty in the good-faith pursuit of the best interests of the corporation.

### Evolving Expectations

In recent years, expectations that boards will implement modern governance norms, including the establishment of effective law compliance programs, have been increasing. For example, there is an evolving expectation that boards will set up and implement compliance programs, if for no other reason, because the Federal Sentencing Guidelines are reason enough. This principle was made clear in the now-famous Caremark decision in 1996.

This case is frequently cited as a landmark case that is part of the foundation of the oversight responsibility of directors. Although the language of the case was dictum and was not a Delaware Supreme Court case, it is seen as established law and provides specific guidance for audit committees. In *Caremark*, former Chancellor Allen discussed in the following language the potential liability of directors in failing to carry out their oversight responsibilities regarding healthcare law violations of subordinates:

> I am of the view that a director's obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists, and that failure to do so under some circumstances may, in theory at least, render a director liable....
>
> .... [I]n my opinion only a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system [exists]—will establish the lack of good faith that is a necessary condition to liability. Such a test of liability—lack of good faith as evidenced by sustained or systematic failure of a director to exercise reasonable oversight—is quite high.

The ongoing Disney case in the Court of Chancery also illustrates the evolving expectations of directors. There, the amended complaint alleged misconduct by directors and claimed that they did not act in good faith when they approved a lucrative contract for Michael Ovitz as president and then approved his termination 14 months later at an alleged cost to the company of $140 million. That complaint survived a motion to dismiss. In denying the motion to dismiss and in permitting the case to go to trial, Chancellor Chandler said:

> [The] facts alleged in the new complaint suggest that the defendant directors consciously and intentionally disregarded their responsibilities, adopting a "we don't care about the risks" attitude concerning a material corporate decision. Knowing or deliberate indifference by a director to his or her duty to act faithfully and with appropriate care is conduct, in my opinion, that may not have been taken honestly and in good faith to advance the best interests of the company.

The long trial in this case is ongoing and I don't think we will see a final decision in the trial court until mid-to-late spring. The Disney court's language that "conscious and intentional disregard" of known responsibilities may violate the "good faith" standard and result in personal liability was repeated recently by Vice Chancellor Noble in the Integrated Health Services case. Whether and when there will be a Supreme Court decision on this point is anybody's guess.

**Best practices, just like independence, must be realistic.**

### Good Faith

The concept of good faith has been in our jurisprudence and statutory law for a long time. It works as part of the articulation of the business judgment rule that applies to the directors' decision-making process and it is part of the directors' statutory oversight responsibility.

Some directors are questioning whether a new set of expectations on directors will play a role in a court's assessment of what information was "reasonably available" and whether the directors have "acted in good faith." But I firmly believe that Delaware law, the Sarbanes-Oxley Act, and the self-regulatory organization rules have not eroded the business judgment rule. If directors act reasonably and in good faith, they will be protected from liability.

Thus, directors seeking assurances should find it in their own diligence and independence. And this applies particularly to audit committee members. My advice is as follows:

- Be careful and thoroughly investigate the integrity and financial position of a company before agreeing to serve as a director.
- Embrace best practices in governance processes.
- Appoint a strong, independent board leader.
- Be certain that all directors are financially literate.
- Pay special attention to the board agenda—is the board focused on the right issues and is the board involved in making that determination?
- Make sure you have a reasonably complete understanding of the company's business, competitive environment, financial controls, and financial disclosures. The same is true of the need to have a thorough understanding of a particular transaction being considered for board action.
- Pay special attention to the board's information needs—does the board have access to the information it needs, and is the board in control of determining what information it needs?
- Actively engage in board discussions and deliberations with healthy skepticism always, and constructive criticism when called for. There is no such thing as a "stupid" question.
- Review board and committee minutes—and ask that they be circulated to all directors within a week for comments (not approval; that can wait)—to ensure they accurately reflect the matters considered, and capture the general extent and nature of the board's discussions, deliberations, considerations, decisions, and directions (not a transcript of who said what).
- Insist that management keep track of and report progress on items that came before the board that resulted in board decisions or directions.
- Take special care in reviewing registration statements.
- Make sure disclosures are clear and that you understand them; ask management for assurances and representations.
- Ask independent auditors for assurances of the integrity of the reporting and their due diligence.
- Understand what you sign.
- Beware of a CEO who manages to the market, or who tries unduly to manage the board.
- Resist a culture of complacency when things look to be running well.
- Rely in good faith on well-chosen experts.

Independence is the key—real, objective independence, intellectually and ingenuously—beyond an independent pedigree. Best practices, just like independence, must be realistic. Do not undertake to jump over an impossibly high bar of best practices. Failure to follow your own guidelines is not a good optic in court.

The challenge in this environment is for directors to focus on the task of directing without micro-managing or becoming overly risk averse in their oversight of corporate strategies. In most cases, the public policy of encouraging service from competent and conscientious directors outweighs the concern that aberrations like WorldCom and Enron will extract from directors significant financial penalties—well beyond any sums they could possibly earn from directorship—except for proven and egregious misconduct.

The corporate governance regime depends on an active board, and it works only when people of integrity operating in the right corporate culture make it work. The system depends on trust in people—especially the directors, regulators, and courts. The chairman of the SEC, William Donaldson, has said, "We can write all the laws we want, but in the final analysis it's going to be the human characteristic" that helps set the tone for the markets. ■

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# Boards Must Cast Wider Net When Recruiting Directors

**by Dale Winston and Mark Smith**

For many in corporate America, the Sarbanes-Oxley Act (SOX) and other regulations designed to increase corporate governance responsibility are viewed as an overreaction to the corporate scandals at Enron and WorldCom and as a fad that will soon pass into the rear view mirror of U.S. business. However, as time passes it has become increasingly apparent that corporate governance concerns continue to be on the rise.

The simple truth is that activist shareholders, ranging from the traditional large public pension funds to hedge funds and mutual funds, show no inclination to ease up on the pedal for improved governance initiatives. A recent study of more than 300 institutional investors by Institutional Shareholder Services revealed that almost two-thirds (63%) believe corporate governance will be more important to their firms over the next three years than it has been over the previous three years. The bottom line is that those businesses that embrace governance improvements, and change their tactics accordingly, will be rewarded in the new corporate landscape.

### Impact on Director Supply

One area that has been affected significantly by this era of increased corporate governance is the supply and demand of corporate director candidates. In the post-SOX regulatory environment in which we work, corporate directors are increasingly cutting back on the number of boards they will serve on. Directors who may have served on four or five boards a few years ago will most likely limit themselves to two or three in today's environment. This has had a major impact on the supply and demand of board candidates, and the competition to land directors for board positions at both large public companies and private middle market businesses has never been stiffer.

There are three main reasons why corporate directors are decreasing the number of boards on which they will serve—capacity, compensation, and risk.

Director Summary: Regulatory changes have created an environment whereby directors are decreasing the number of boards on which they serve: they must spend more time on board duties; compensation for board service has increased, so serving on fewer boards is not necessarily a financial loss; and increased risk of personal liability has made candidates much more discriminating in vetting and accepting offers.

### Capacity

Due to the growing emphasis on due diligence and increased regulatory requirements in recent years, the time commitment required by board service has increased steadily since the implementation of Sarbanes-Oxley. According to a recent PricewaterhouseCoopers study, in 2005 corporate directors spent an average of 22 hours a month on board matters. This represents an increase of 57 percent in time commitment from the pre-SOX days of 2002. Hence, the time spent serving on fewer boards is approximately equal to previous time spent serving on perhaps twice as many boards. This phenomenon is not limited to the largest public companies. SOX initiatives have percolated down to middle-market businesses, private, and even not-for-profit boards.

### Compensation

The PricewaterhouseCoopers study also reported that director compensation is increasing to reflect the augmented time commitment required by board service. A majority (58%) of directors had their compensation increased in 2005 and almost two-thirds of the directors (63%) feel their compensation is adequate. Therefore, corporate directors serving on fewer boards are not necessarily receiving less compensation.

### Risk

While the increased responsibilities associated with improved corporate governance initiatives clearly amplified the risk of board

service, the true "fear factor" really took hold last year when the boards of both WorldCom and Enron agreed to settlements of tens of millions of dollars from their personal funds. While these instances may be the exception and not the rule, the precedent of board members being sued personally has clearly been a turning point in the risk-reward ratio associated with board service. D&O insurance is no longer viewed as the shield it once was.

Candidates are now much more discriminatory in their own due diligence before agreeing to serve as a director. Today, it is not unusual for a candidate to request individual meetings with the chairman, CEO, CFO, and additional officers to get a better sense of how the company is run prior to joining a board. Some even ask to meet with vendors and customers to fully vet their concerns. Whether the risk is real or perceived, the bottom line is that limiting their board service is one way directors can minimize their risk exposure.

Each of these factors—capacity, compensation, and risk—has contributed to a shortage of qualified board candidates. No group has been more affected by these changes than current CEOs who have seen a major increase in demand for their time in the new regulatory environment. In many cases their companies have directed them to severely limit the number of external boards on which they serve. In addition, professional directors who may have served on more than half a dozen boards in the past are limiting themselves to far fewer seats due to the increased demands associated with board service.

### Filling the Breach

In order to succeed in this era of heightened competition for qualified board members, it is imperative that companies begin to cast a wider net in targeting candidates and consider pursuing multiple candidates simultaneously.

With the scarcity of available CEOs and professional directors, businesses must begin to look to new sources of candidates. In doing so, they will find qualified candidates eager to contribute at both the younger and older ends of the age spectrum.

By digging deeper into the current management pool to titles such as divisional general managers and senior vice-president of marketing, especially those that have global experience, companies can discover future executive stars eager to make their mark. This level of management is also more likely to yield diversity candidates, who may contribute a new and important perspective to the board dynamic.

At the other end of the age spectrum, perhaps the richest and deepest pool of talent for board candidates comprises retired and semi-retired executives. They are one of the few groups that has the capacity available to deal with the

**Directors who may have served on four or five boards a few years ago will most likely limit themselves to two or three in today's environment.**

greater time commitment associated with board service today. In addition, the increased compensation directors are receiving is an attractive inducement for these retirees to give up some of their free time. For many middle market businesses that do not have large business development teams, retired board members can serve as valuable ambassadors for the company based on the extensive contacts they have nurtured throughout their careers.

One group of retirees in particular, former partners of Big Four accounting firms, are very valuable candidates. Most of these professionals only retired due to mandatory retirement ages in their partnership agreements and are still eager to be involved and make a contribution to business. With the increased financial qualifications for board service, these retired partners make for ideal audit committee heads.

Given the increased competition for director talent, businesses need to revamp and accelerate their search process to remain ahead of the game. Traditionally, recruiters would work with the board to prioritize a list of possible candidates for open seats and then approach each candidate in descending order until a fit was achieved. Today, with competition at an all-time high, the possibility of rejection by a candidate is much higher and therefore, companies need to parallel process multiple candidates at the same time.

### Conclusion

Finding the right candidate for an open board seat has always been a challenge as a board's needs are constantly evolving due to changes in the marketplace. An effective and efficient board is a balance of complementary talents. Certainly, the far-reaching changes brought about by SOX compliance and other regulatory issues have had an adverse effect on the supply of traditional board candidates. However, by casting a wider net for candidates and accelerating their search process, forward-thinking businesses can meet this challenge and benefit from new sources of ideas and oversight. ■

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# The Attorney As Corporate Director

**By Bruce Dravis, David Caplan, and Rich Koppes**

The Sarbanes-Oxley Act (SOX), and associated rulemaking redefined the task of corporate governance and brought a new focus on the role of the board of directors.

Director independence from corporate management stopped being an academic debate pressed by institutional investors, and became mandatory. The audit committee emerged from SOX as the uber-committee, with significant powers, responsibilities, and claims on corporate resources.

For the moment, at least, corporate directors are intensely aware of the legal environment in which board-level decisions are made. With SOX, new thorns have grown in the corporate legal thicket.

One still-unresolved question is whether, and in what form, the Securities and Exchange Commission (SEC) will enact the pending portion of its rules regarding attorney conduct. Few boards to date have formed a qualified legal compliance committee (QLCC), but adoption of a "noisy withdrawal" rule should prompt many more to do so.

In such an environment, nominating committees for corporate boards that are tasked with seeking the right blend of skills and experience among directors to advance the company's interests might well want to add legal skills and experience to that mix, making it worthwhile for companies to consider adding lawyers as directors.

### Rule 205, Qualified Legal Compliance Committees, and "Noisy Withdrawal"

SEC Rule 205 should prompt public company boards to consider adding attorney board members as part of a mechanism for the company to retain control of corporate securities disclosure decisions, rather than leaving those decisions in the hands of counsel (either in-house or outside).

Rule 205 changes the lawyer-client dynamic on that small but important number of public company reporting decisions on whether, and what, to report about a potential violation of securities laws.

Under Rule 205, once an attorney in the course of representing a public company becomes aware of "credible evidence" of a "material violation" of the securities laws by that company or its officers or directors, there are only three possible outcomes: 1) The attorney is satisfied that the company has adopted an "appropriate response" to the attorney's concerns; 2) the attorney, if the company's response is not appropriate or not timely, resigns; or 3) a qualified legal compliance committee (QLCC) of the company accepts the role of determining the company's ultimate response to the attorney's concerns.

There are no particular experience qualifications for membership on the QLCC under Rule 205. A QLCC must consist of at least three board members, one of whom is an audit committee member and all of whom are independent; have written procedures for confidential receipt of a report of a material violation; and have specific authority from the board to investigate and resolve issues relating to securities law violations.

Logically, if having financial experts as members is good for audit committees (and hence the overall board), QLCCs and boards should benefit from having attorneys as members.

While there is not significant data about the number of companies that have adopted QLCCs, the number appears to be small. One survey in late 2004 put the number at about two percent of the public companies, including those that have made the QLCC function an added responsibility of the Audit Committee. General Motors and Time Warner are the highest-profile companies to have adopted a QLCC.

**Director Summary:** The proposed SEC rule requiring "noisy withdrawal" by an attorney who uncovers evidence of financial malfeasance may mean that more corporate boards recruit attorneys, and adopt qualified legal compliance committees.

One revision to Rule 205 proposed by the SEC may be crucial to a company's determination whether to form a QLCC: the SEC's proposal that an attorney who does not believe that the corporate client has delivered an "appropriate response" *must* resign as counsel *and notify the SEC* of the resignation (the so-called "noisy withdrawal"). The SEC is also considering a variation on the noisy withdrawal rule under which the company, not the attorney, would be obligated to notify the SEC of the attorney's resignation.

Under either version of noisy withdrawal, a company that does not have a QLCC potentially puts control of the disclosure decision in the hands of counsel. Formation of a QLCC keeps the ultimate decision under the control of the board itself. Even if a QLCC decides in a particular case that disclosure is warranted, the company still controls the nature of the disclosure, its timing, and the strategies for resolution of a problem.

The SEC's development of the QLCC concept represents a continuation of a securities law trend of recent years, that of making reporting and securities compliance issues matters of individual duty by specified officers or directors of a company, rather than defining compliance as an institutional obligation. Other examples include the CEO and CFO certifications of public company reports, and the specific duties and authority assigned to audit committees, including the obligation that the audit committee include a "financial expert."

The SEC did not adopt either of the noisy withdrawal elements under Rule 205 during 2004. If and when those provisions are adopted, the level of interest in QLCCs should increase.

### Boards without QLCCs

Rule 205 is not the only reason that a company might want to adopt a QLCC. Audit committees have significantly increased workloads as a result of SOX, and might need the help, particularly on securities disclosure matters that are not specifically related to finance. The recently adopted changes to Form 8-K require companies to make current reports on a greater number of events in a shorter period of time, and contain a number of disclosure items that are not strictly financial in nature.

Attorneys provide knowledge of the law but, more importantly, they bring to the boardroom seasoned experience and understanding of how to apply the law's rules to the specific facts at hand. Moreover, experience working in one area of the law, while it does not provide a knowledge of the working principles of all other areas of law, does provide a "feel" for how the law works that can give a lawyer a certain intuitive grasp of when a description of legal issues or legal analysis is flawed or incomplete.

**Nominating committees tasked with seeking the right blend of skills and experience among directors to advance the company's interests might well want to add "legal skills and experience" to that mix.**

Clearly, not only attorneys can understand legal issues. Many non-attorney board members develop sufficient experience dealing with legal issues to have their own intuitive grasp of how the law should apply. Boards typically have corporate counsel on hand for meetings to advise on specific legal issues that might arise. It is the job of corporate counsel to ensure that legal issues are explained in terms that a non-attorney client can appreciate and use to take action.

However, by bringing additional perspective and training in legal analysis, and the ability to appreciate the importance of critical facts in a legal setting, an attorney-board member can offer unique understanding in board decision making. An attorney can bring the habit of approaching a problem unemotionally, and seeking a thorough solution.

### What makes good attorney-board members?

As with any board members, the right traits are crucial. The style and personality of the attorney-board member is important. While putting a bad lawyer on a board is not worse than having a bad board member from any other profession, those of us who have dealt with bad lawyers can well imagine the havoc that an overbearing and under-talented advocate could create. Also, there are attorneys who consider pessimism to be "risk management," or who continue debate when others are ready to decide and act, and those characteristics would not play out well in the boardroom.

The requirement for independence also makes it important to ensure that the attorney's role does not extend to representation of the company, or to acting as a "supervisory attorney," as those terms are defined in Rule 205.

The requirement that a director-attorney not represent the company would implicate both the director independence requirements and the attorney conduct rules. Since Rule 205 (including any "noisy withdrawal" provision that the SEC may adopt in its final rules) regulates the activities of attorneys in connection with the representation of companies on securities law matters, neither the company not the attorney-board member would desire to see the regulatory impact of Rule 205 visited on boardroom deliberations.





**Judgments offered by a director-attorney must clearly not constitute legal advice, but be viewed as the contribution of one out of many directors.**

Judgments offered by a director-attorney must clearly not constitute legal advice, but be viewed as the contribution of one out of many directors. Discussions involving the director-attorney would be discoverable, not the confidential and privileged communications of a legal practitioner advising a client.

### Should an attorney serve on a board?

While there are economic benefits to board membership, directors are not generally overpaid in comparison to the significant responsibilities they assume, and there are issues that a potential attorney-board member should consider.

The independence rules of the stock exchanges and other self-regulatory organizations (SROs) do not preclude an attorney who represents a company from participating on a board, but the emerging theme of SOX and associated rulemaking is that conflicts of interest are disfavored, regardless of whether there are mechanisms to address the conflicts. Moreover, as noted above, an attorney who represents a company on securities law matters will be subject to the provisions of Rule 205.

In addition, participation on a corporate board by an attorney who is a member of a larger firm could create issues for the firm as well as for the attorney. An attorney serving on a corporate board would also want to be mindful of whether there were conflicts with other clients of the law firm, or the perception, for marketing purposes, of such conflicts.

A company could also find itself on one side of a legal issue while the attorney's firm represented a client on the other. Many law firms might take the view that an attorney respected enough to be a board member would generate more profit for the firm by providing services as outside counsel, rather than acting as a director.

Retired counsel and attorneys from academic backgrounds would not face the same economic conflict. Also, attorneys not associated with major firms or who are more accustomed to litigation or crisis counseling may be less concerned with the potential issues while still providing the analytical sense and perspective that make them valuable board members.

It is conceivable that the experience and training that would be of benefit to a board could expose an attorney-director to greater scrutiny in litigation. Depending upon the situation, an attorney on a board, unlike other directors, might for pleading purposes be treated as having a higher standard of care in acting on board matters, a "reasonable lawyer" rather than "reasonable person" standard.

The SEC, in adopting the rules relating to financial experts on audit committees, has taken pains to prevent the creation of a higher standard of care for the possessors of such expertise, so as not to scare them away from participating on boards. To promote the effectiveness of the QLCC concept, the SEC should take the same step for attorney directors.

In all events, any director, whether or not that director is an attorney, should be certain that the company has an officers and directors insurance policy in force, that the protection is adequate, and that the insurance is paid up. Litigation is never brought before-the-fact. When something goes wrong, even well-informed and well-intentioned decisions can generate litigation that requires the expenditure of time and money to fight, before a director's lack of culpability is demonstrated to the satisfaction of plaintiff's counsel.

### The right blend of skills

Directors need to discharge their duties with an awareness of corporate, SEC, and SRO governance requirements, and with a sense of the potential legal ramifications of disclosure decisions. For the same reasons that audit committees are now required to have at least one member who is financially literate, boards—or QLCCs—would benefit from having a lawyer to help steer the company past potential legal shoals. ■

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# Boards *think* they're doing a good job . . .

*. . . but CEOs disagree. What directors can do to bridge that disconnect.*

BY KEITH B. MEYER AND ROBERT S. ROLLO

SOME 95 PERCENT of directors rate their boards as either effective or very effective overall. That was the finding of a recent study of board effectiveness conducted by Heidrick & Struggles in conjunction with the Center for Effective Organizations at the University of Southern California's Marshall School of Business. The study incorporated responses from 768 directors, nearly 75 percent of whom are outside directors, at approximately 660 of the 2,000 largest publicly traded companies in the U.S.

CEOs tell a different story.

In our extensive work with boards, CEOs in informal conversations almost universally confide that they have at most one or two very effective directors who provide wise counsel, offer advice on key issues, and contribute both formally and informally to the direction of the company. A fortunate few CEOs say they have as many as three or four such directors.

Roughly, then, only about 10-20 percent of directors are seen by CEOs as effective. Further, say CEOs, their top management team often regards working with the board as a demotivating experience.

The good news is that this disconnect is of relatively recent making; its causes are clear, and there are readily available remedies to repair it.

## Converging culprits

A number of policies, practices, and philosophies have converged in recent years to create the current disparity between the views of boards and CEOs. Among the most prominent:

• *Differing Definitions of Success.* In part, assessments of board effectiveness diverge so dramatically because CEOs and boards define success differently. CEOs say they want directors who don't meddle in the day-to-day running of the business, offer a strategic sounding board for management, and bring to bear their wisdom and experience when the company encounters extraordinary circumstances such as hostile takeovers, shareholder activism, and significant business challenges. In short, they want independent directors who can help them make better, faster, and wiser decisions.

Meanwhile, many directors define success in terms of committee work, fiduciary responsibility, and keeping the company in compliance with legal, regulatory, and other oversight requirements. In our study, they gave themselves high marks in many of these areas. Some 95 percent of respondents rated their monitoring of the company's financial performance as effective or very effective; 92 percent said that their representation of the shareholders is effective or very effective, and 90 percent said that they were similarly effective at ensuring ethical behavior.

Yet in the strategic and advisory areas that CEOs value, directors gave their boards much lower marks. For example, only 59 percent of the directors responded favorably when asked to rate their boards' effectiveness in shaping long-term strategy. Only 61 percent said that their boards were good at identifying possible threats or opportunities critical to the future of the company. Less than two-thirds of directors reported that their boards are effective at one of their most important responsibilities: succession planning. Yet, the fact that 95 percent of the respondents rated their boards as effective overall clearly suggests that the strategic aspect of their performance weighs far less heavily in their definition of success.

• *A Hole in the Matrix.* In the face of globalization, emerging markets, and changing public expectations, nominating and governance committees have in recent years sought diversity of all kinds in new appointments to the board. They have understandably and laudably welcomed new perspectives in terms of geography, nationality, industry experience, and functional expertise. In doing so, they have created a matrix, literally or figuratively, within which they checked each of the diversity boxes as they were filled. But what is often missing in the matrix is a box for sound business judgment and diversity of thought. Certainly, they should continue to build boards that are diverse across many dimensions, but the advisory and strategic dimensions should also be given a prominent place in the mix.

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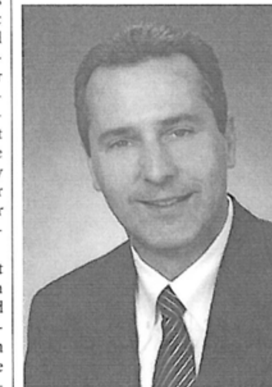
• *The Changing Talent Pool.* Almost invariably when we begin a board search, nominating and governance committees ask for a currently active CEO who has dealt with many of the same strategic challenges facing their company and who knows how to take an all-encompassing view of a business — in other words, precisely the kind of thought-partner CEOs say they want. But as a result of the good governance movement in recent years and increased pressure on CEOs to take direct responsibility for company performance and shoulder liability for financial reporting, far fewer sitting CEOs are willing to serve on outside boards.

Many companies now explicitly limit the number of boards their CEOs can join. In our 2006-2007 survey, we found that 54 percent of companies now enforce such limits, up from 23 percent in 2001. Forty percent have limits on the number of boards on which their outside directors can serve, a major increase from just 3 percent in 2001. As a result, the pool of potential CEO/directors who might provide the big-picture advice CEOs seek has shrunk dramatically.

• *The Law of Unintended Consequences.* Besides making the recruitment of CEO/directors more difficult, the good governance movement, with its institutional investor activism and regulatory reforms such as Sarbanes-Oxley (SOX), has had some additional unintended consequences. In the environment of the past several years, it's not surprising that independent directors would make compliance a prime measure of board success. Further, some boards work hard to get high marks from institutional investor ratings, rather than partnering with management to understand what is genuinely best for the business. As a result of increased shareholder activism, we also see a continuum along which, at one end, some independent directors take the activists' "full transparency" point of view, and, at the other end, directors who remain in a defensive crouch, counseling management to do nothing that is likely to stir up shareholders.

Ideally, of course, all independent directors, instead of being merely reactive when it comes to shareholders, would offer the CEO sound judgment based on the needs of the business, and thereby genuinely serve the shareholders. This is not to say that recent reforms weren't necessary or should be rolled back; only that boards should be on guard against their unintended consequences and, as with all of the trends cited here, take practical steps to neutralize them.



*Many new CEOs greatly underestimate the time that they will spend 'managing' the board.*

— *Keith Meyer*

## Healing the rift

In our experience, many new CEOs greatly underestimate the time that they will spend "managing" the board, and if the board is providing little in the way of genuine partnership the CEO's time could be better spent concentrating on the real needs of the business. In fact, the inability in such situations to balance managing the board with managing the business is often at the root of CEO tenures getting cut short. Such outcomes are in no one's interest — not those of the CEO, the board, or the shareholders. Boards and CEOs should therefore do all they can to make sure that the board provides the kind of support CEOs need so that everyone wins.

They can do so by adopting the following simple but effective steps:

**1. Make "advisory temperament" one of the job specs for new board members.** In searching for new board members, the nominating committee should explicitly attempt to determine whether a candidate is both independent of mind and simultaneously inclined to be a mentor, adviser, and sounding board. At one extreme, some candidates might wish to usurp the CEO's prerogatives, acting in effect as an additional CEO. At the other extreme, some candidates may be too passive, simply going along with the majority and offering little counsel to the CEO. As a practical matter, the advisory temperament of a candidate can be assessed through references and through personal interviews, both of which can uncover potential chair warmers, candidates who consciously or unconsciously want to run the company, and candidates who have the temperament to be of real help to the CEO.

**2. Collaborate closely with the CEO on setting the board meeting agenda.** The board cannot support the CEO if the board meeting doesn't address the issues that the CEO regards as critical to the business. In setting the agenda, where the chair and CEO roles are split, the board should make sure those issues get a prominent place on the agenda and get sufficient "air time" during the meeting. By carefully creating the agenda together, the chair and CEO can more closely align the flow of discussion with the CEO's need for meaningful feedback and review of management's initiatives and activities. Also, if the chair can responsibly push the "recurring" board responsibilities into committee agendas, more time can be freed up for other topics at the board meeting.

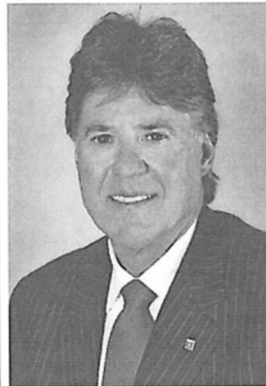
**3. Make the results of executive sessions useful to the CEO.** Often, following an executive session of the board, the results are communicated to the CEO in a brief conversation unaccompanied by any practical steps for achieving whatever conclusion was reached behind closed doors. CEOs receive what amounts to a to-do list on top of whatever to-do list emerges from full board meetings. In the most extreme cases, executive sessions function almost as a board within the board, obliging the CEO to respond to two boards at once.

Although executive sessions are required by Sarbanes-Oxley and the New York Stock Exchange, the intent is to improve governance, not create competing structures. Better governance means integrating the work from executive sessions with the work of the full board and with management. The lead director or nonexecutive chair who presides over executive sessions should therefore develop with the CEO a formal, detailed process that not only communicates the wishes of the nonexecutive directors clearly, but also provides the means by which the CEO might fulfill or respond to them.

**4. Expand board assessment and feedback.** Providing actionable feedback from executive sessions is only a small part of what should be a more all-encompassing feedback process between board members and the CEO and the leadership team. Almost all boards — 99 percent in our study — have a formal process for evaluating the CEO's performance, and 98 percent have a process for evaluating the board. However, few have mechanisms for explicitly evaluating how the board interacts with the CEO and the leadership team.

Board members need feedback not only about how well they do their committee work and the like, but how much they genuinely help the CEO and leadership team advance the interests of the company. Board assessments should include candid feedback from the CEO about the effectiveness of the board in terms of the CEO's definition of success. The head of the governance committee should meet regularly with the CEO to solicit the CEO's feedback about the performance of the board.

**5. Refine the role of the lead director or nonexecutive chair.** Previously in this space, we discussed at length the role of the lead director ("A Fine Balance: What Makes an Effective Lead Director," Randy Jayne and Robert S. Rollo, First Quarter 2007). As we wrote then: "The lead director shouldn't confuse real independence with mere contrarianism. True independence requires the kind of psychological security that is unthreatened by disagreement and acknowledges the integrity and contributions of others, on both the board and the management team. In that spirit, the lead director must forge a collaborative relationship with the CEO that is based solely on the good of the company and its stakeholders."



*Make 'advisory temperament' one of the job specs for new board members.*

— *Robert Rollo*

This role of lead director (or nonexecutive chair) is difficult to get right, and its breakdown is often the chief cause of board ineffectiveness from the CEO's point of view. The goal should be to help the CEO succeed, not merely to act as sheriff or alternate CEO.

Consider the case of a leading services company whose board, after a series of confrontations and serious disagreements with the chairman/CEO, decided to remove him and split the role between a nonexecutive chair and a new CEO, who was promoted from within. Under the circumstances, the new chair could have understandably kept the CEO on a tight leash and become deeply involved in the day-to-day affairs of the company. Instead, the chair announced his intention to be supportive of the new CEO in every way possible, and he followed up with concrete actions. He established oversight relations between the board and CEO that included significant CEO feedback about the board's — and the chair's — performance. The chair also designated individual directors to insulate the CEO from such distractions as activist shareholders and the constant press intrusions that resulted from the company's highly public troubles.

The chair's determination to help the CEO succeed in the area that really counts — superior quarterly results for shareholders — freed the CEO from spending inordinate amounts of time managing the board.

### Hastening the transition

As we've said, the disconnect between boards and CEOs in the assessment of board effectiveness arose at this particular time in history as a result of clearly identifiable conditions. It will pass into history for equally identifiable reasons, such as boards moving beyond the initial defensiveness that SOX provoked or more companies learning how to cope with the changed talent pool of board candidates.

In the meantime, we find ourselves in a period of transition between today's new-model board and its full effectiveness from all points of view. Boards and CEOs who recognize the gap and take concrete steps to bridge it can greatly hasten that transition. ■

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# Hiding in plain sight

*How to find and develop the next generation of directors.*

BY THAMES FULTON AND BONNIE W. GWIN

IT'S TOO SOON TO SAY that the CEO-director is a vanishing breed but ... a revolution in slow motion is certainly under way when we look around the boardroom.

At companies large and small, many CEO-directors are nearing retirement or have reached a point where they are fully "boarded up" and unavailable for service on additional boards. Some are dropping off boards to stay focused on the increasingly complex demands of their own companies. A number are not allowed by their boards to serve on outside boards or are restricted to one outside board. Finally, facing the requirements of Sarbanes-Oxley, activist shareholders, and increased SEC scrutiny, some CEOs just don't find outside board service appealing anymore.

So, what's a board nominating committee to do?

Faced with this rapidly shrinking pool of CEO-director candidates, boards face a formidable challenge: connecting with the next generation of board talent and recruiting them to boards. Most CEO candidates are visible and, in many cases, known to boards. In today's environment, nominating committees have to look in alternate places for talent, assess this new generation effectively for fit and readiness, and ensure that they are 'onboarded' appropriately and with care.

*Boards increasingly recognize the value of a director whose functional experience is relevant to a key area of the company's strategy.*

— *Thames Fulton*

Any one of these steps can represent a challenge for even the best and most skilled boards.

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### Where to look

The next generation of board members will likely be found in some familiar and not-so-familiar places, each with unique promise and problems:

- *Large U.S.-based global companies known for best practices in talent development:* International Business Machines, Procter & Gamble, Hewlett-Packard, and numerous other companies have rightly enjoyed stellar reputations for nurturing top talent and fully developing high-potential executives. Companies that invest in talent and leadership development are, of course, where boards would expect to find experienced and talented next-generation leaders whose careers have been well managed.

  However, because many boards are likely to look at these kinds of high-profile companies first, the competition for those who are genuinely qualified for board service is fierce. And most of these executives are allowed to serve on only one board, if any. There are many, less well known but equally impressive businesses with up and coming general managers on the CEO or similar track who can and should be considered for boards. The message here: Don't just look in the most obvious places.

- *Large non-U.S. global companies:* While the challenges of international travel to board meetings remain complex, looking at large, sophisticated non-U.S. global companies may be an option. Most likely candidates can be found in regions where executives

are familiar with Sarbanes-Oxley and have sophisticated board environments (like the U.K.). Also, many global executives have spent time in the U.S. and are comfortable with the business environment and have reason to travel here. These can be interesting board candidates as well.

• *Well-run private companies:* Traditionally, many boards have been unwilling to look to private companies for board candidates. Rightly or wrongly, directors regarded private companies as having different priorities from a public company and perhaps not generating the scale and scope of experiences required for service on the board of a large, publicly traded company. However, the surge in private equity (PE) investment and the recruitment of strong public company-trained leaders to the private company sector has changed the environment. In fact, many outstanding public company executives have migrated to private companies.

The challenge, however, is that PE firms expect these executives to devote their full attention to running their particular portfolio company. They often discourage or even forbid service on outside boards. Nevertheless, there is a rich vein of talent and it may be worth exploring. Further, there are some dynamic private companies that are also adept at developing leadership skills and are mirroring some of their public counterparts in this regard.

• *Top functional executives:* In the past, many boards have been reluctant to bring on executives with strictly functional depth rather than broad general management experience. Today, however, boards increasingly recognize the value of a director whose functional experience is relevant to a key area of the company's strategy. For example, the financial expertise of CFOs has long been valued, especially given the increased demands on audit committees. But now boards are looking even more broadly at other functional experts. For example, in industries where customer privacy, network security, and business recovery are critical, companies are considering adding CIOs to their boards. Companies in formerly heavily regulated industries facing unfamiliar marketing challenges are looking at CMOs to provide a customer-centric perspective to board deliberations. General counsels with deep M&A expertise can be valuable when a company is growing rapidly through acquisition.

The challenge here lies in finding the right balance: Functional depth has to be combined with a breadth of perspective. Seeing the world exclusively through one functional 'filter' will not necessarily be useful in the boardroom. A candidate has to demonstrate that he or she is a broader thinker and strategist who can comfortably add value in a general business context, not just in a specialty area. In addition, the board as a whole should be balanced. There must be a blend of skills and experiences that work well together. Too much of any one 'ingredient' is not healthy — but a balance of pertinent functional experts, general managers, CEOs, and others with a variety of experiences should result in highly interactive and rich discussions in the boardroom.

*The chief differences between the traditional CEO template and the new-breed template could best be expressed as 'fit' versus 'readiness.'*

— *Bonnie Gwin*

## Assessing the readiness of next-generation candidates

Rigorous, thorough, and effective assessment of candidates has always been critical in recruiting top talent for boards. Rigor aside, however, the template for assessment has often been based on the assumption that the candidate is a CEO or future CEO and should be evaluated in that light. The template for assessing new-breed board talent differs from that traditional template. It's not necessarily more difficult, but because it *is* different it can be tricky for nominating committees to navigate.

The chief differences between the CEO template and the new template could best be expressed as *fit* versus *readiness*. The CEO template assumes that chief executives generally are *ready* to serve on a board — they have had the requisite broad business and leadership experience that should enable them to make meaningful contributions to the work of the board. That's why CEOs have traditionally been the preferred choice of many nominating committees. The real question is whether they are a *fit* for the board — will they add positively to the culture and personality of the board?

Assessing next-generation board candidates, however, requires one key step before assessing fit. It requires assessing readiness for a seat at the board table. For example, one might ask whether this executive has competencies that can fill gaps in the board's knowledge or that are crucial for long-term strategy. Can they participate in broad discussions outside of their area of expertise — for example, do they have the agility of thinking and communication needed to ask the right questions and play a broader role? Do they have the seasoning and life experiences to add to the boardroom conversation? Are they comfortable sitting at the table with experienced and possibly high-profile CEOs and other top executives? Will they fit within the boardroom culture? There are many other questions of fit as well, but for non-CEO candidates who are possibly earlier in their careers the first question is all about readiness.

In assessing next-generation candidates in particular, these critical questions can help determine readiness to serve. Some of those questions might also be asked about CEO candidates, but they will be asked in a different register and from a different point of view, and the supporting evidence will be sought from somewhat different sources. But for new-breed candidates, these questions go to the heart of the issue of readiness:

• *How do they fit into their current company's organization?* Look at the organizational design of the candidate's company and the real nature of the candidate's job within it. Ideally, the candidate's work requires a broad view across the company, the opportunity to learn and grow, and frequent exposure to the top of the organization, including interaction with the CEO and board. Exposure to the board is especially important because it provides the candidate with experience in how directors think and behave.

• *Where have they been and where are they going?* Assess their career paths through both the rearview mirror and the windshield. Consider the job rotations, experiences, and roles they've had. You may want to determine if they have the potential to be CEOs, but in many cases — such as looking for someone with great functional depth — it's not critical. It is critical, however, to understand where they are in their careers. For example, if a board desires a future

## Onboarding: Protect your investment

**Like effective assessment**, effective onboarding is critical with any director. But for the new-breed director, who likely finds board service a far more daunting prospect than a CEO does, onboarding is doubly important. Because the new director's gaps in knowledge have been identified during the assessment phase, the process of closing those gaps can begin immediately.

In the **near term**, the onboarding process should:

• *Bring the new director up to speed on company strategy:* This should occur prior to the first board meeting and is critical for any incoming director. For the new member, the packet of pre-meeting reading that goes out to directors can be supplemented with key strategy documents and analysts' reports. A systematic call schedule or, ideally, in-person meetings can be arranged for top management team members to begin briefing the new director. The new director can also come to company headquarters prior to the first meeting for briefings on company strategy, preferably from, among others, the CEO.

• *Educate the new member about board processes and policies:* This, too, should occur prior to the new member's first board meeting. Policy and process documents can and should be supplemented with conversations or meetings with the corporate secretary, general counsel, and, critically, the lead director.

• *Identify a mentor:* A member of the board who has the experience, time, and the right style and personality should be enlisted to help the new director get acclimated to the board. He or she should get acquainted with the director well prior to the first meeting and remain available and in touch for the first year.

• *Use information from references to develop the onboarding plan:* References for a prospective board member should be asked for specific suggestions they may have around onboarding. These individuals will be best positioned to understand a prospective board member's strengths and areas for development that should be considered when onboarding.

For the **medium term**, the new director can:

• *Consider director education outside the company:* Numerous organizations like the National Association of Corporate Directors (NACD), Women Corporate Directors (WCD), and various universities offer director education. Because new directors may not fully understand the depth and magnitude of their responsibilities or what constitutes best-in-class behavior for board members, such outside education is essential.

• *Spend time with the leaders of the board:* Depending on how the board is structured, that should include the chair/CEO, independent chair, or lead director. During the interview process, which is usually handled by the head of the nominating committee, the new director is unlikely to have spent much time with other key leaders. The foundation of a solid relationship with top executives should be laid as soon as possible.

• *Visit headquarters and plant sites early on:* Such visits enable the new director to get a firsthand look at the business and to benefit from contact with key executives at many levels of the organization.

Over the long term, onboarding shades into continuing director development. That means a substantive system of director evaluation and feedback — not merely a "check-the-boxes" approach but a comprehensive assessment along all of the dimensions of director performance. Those should include oversight contributions in business strategy, compensation, audit, and overall governance as well as issues of teamwork and board dynamics. The system should include feedback from peers and, if necessary, coaching.

Careful attention to all of these stages — from near- and medium-term onboarding to long-term director development — ensures that the investment in looking for new-breed talent and assessing it appropriately will pay dividends now and far into the future.

— *Thames Fulton and Bonnie Gwin*

CEO, it is important to ensure that the candidate hasn't 'bottomed out' career-wise. Assessing a career trajectory requires careful referencing well beyond the board members of the candidate's current company.

• *Have they encountered the ups and downs of the business cycle?* If during their careers and in their industries they have known only prosperity, they are unlikely to be able to contribute much during lean times. Wisdom comes from adversity, and some of the best board members have experienced multiple business cycles and have the scars to show for it. Often, they can be helpful advisers to the CEO, the management team, and the rest of the board. A next-generation candidate may not have the same level of experience, but it is critical that he or she has experienced some ups and downs of a business cycle.

• *Do they have the requisite courage and wisdom for effective board service?* This is a crucial question for any board candidate, but because courage and wisdom are often forged in the crucible of experience it is particularly pertinent for next-generation candidates. The exercise of courage in the boardroom requires a delicate balance of candor and collegiality that is persuasive without being confrontational and that gets results. Further, courage must be supplemented by substance: the ability to provide wise counsel. The assessment process should determine whether these relatively early-in-experience candidates have the presence, self-confidence, and stature to speak up constructively in board deliberations. In the course of your interviews with them (and with references), it is critical to ask about the tough moments everyone encounters in a career and assess how they have dealt with taking an unpopular stand on a position or gone out on a limb for a strategy or initiative they believed in.

Taken together, the answers to all of these questions should help answer the overall question of readiness: Is this the right time to put this person on a board?

**Boards who don't begin considering the next generation may soon find themselves facing a shrinking pool of available board talent.**

### The opportunity… and the danger of delay

A great deal of outstanding non-CEO talent waits to be tapped. There is no reason not to go after it — and many compelling reasons to consider the next generation. Boards and their companies can benefit from the presence of board members who bring diversity of all kinds, including different experiences with markets, customers, geographies, or functional areas that are crucial to the company's strategy. They also bring a fresh perspective and new ideas.

Boards that carefully undertake such recruiting can be assured that they are adding real leaders to their ranks, and they may very likely be bringing on board future CEOs. Many forward-looking boards are already securing this new-breed talent. Those boards who don't begin considering the next generation soon could quickly find themselves facing a shrinking pool of available board talent just when they most need the best and brightest minds. ■

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# A classic model of onboarding

*Right from the start, reap the full value of the skills, expertise, and leadership that made the new director such an attractive candidate in the first place.*

**BY JOHN T. GARDNER AND LEE HANSON**

OVER THE PAST DECADE, a number of trends in board composition have greatly elevated the importance of successfully onboarding new directors. Evolving standards of good corporate governance, regulatory pressure, and the desire for diversity of all kinds — including the addition of new skills — have led boards to bring on more independent directors than ever. Further, not only are these outsiders new to the company, they are often new to board service because more companies restrict the number of outside boards on which their CEOs may sit and because many experienced directors, wary of the increased burdens that go with board service today, are reluctant to serve.

Yet despite the increasing need to smoothly transition new members onto boards, current practices range from the merely perfunctory to the highly sophisticated. It's only a slight exaggeration to say that, at one extreme, onboarding consists of little more than giving the new member the company's 10k and the date of the next board meeting. At the other end of the spectrum, some boards have developed comprehensive director onboarding programs designed to ensure the rapid integration of new directors and accelerate their ability to contribute to board work.

Surprisingly, we have found in our experience working with boards that the degree of sophistication in onboarding doesn't always correlate with the size or sophistication of a company. Further, even those boards in the vast middle, where onboarding certainly gets some attention, could benefit by taking a closer look at their onboarding programs. Those programs are essentially educational, and they should cover three distinct subject areas:

— the business and strategy of the company;

— board structure, processes, and role; and,

— nuances of the board culture that can't be found in a handbook.

While these categories are in some ways obvious, we have found that the devil is in the details. Depending on the structure of the board, the independent chair, the chair of the nominating committee, or the lead director is ultimately responsible for onboarding.

This "onboarding leader" must think carefully about the particulars of each category and make sure the board and management embark on the specific activities that will most effectively drive home the information the new director needs for success. Those are the two indispensable elements of any educational endeavor: a curriculum (*what* is taught) and a pedagogical approach (*how* it is taught). When boards get it right, they can expect to get the full value of the skills, expertise, and leadership that made the new director such an attractive candidate in the first place.

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### Business and strategy

Prior to joining a board, a new director will of course have engaged in some due diligence about the company: reading press clippings and analysts reports, talking to peers, and sounding out members of the board and management during the recruiting process. Don't assume, however, that new directors can get up to speed about the nature of the business and the company's strategy on their own. Instead, take these concrete steps to educate them as thoroughly and efficiently as possible:

• ***Give the new board member comprehensive, well-organized information about the company and board.*** Many companies maintain comprehensive manuals for new directors. But whether in a manual or an ad hoc packet, the information should include the company's strategic plan, relevant SEC documents, the bylaws of the board and the charters of board committees, the board's organization chart and committee assignments, descriptions of the company's products and services, and other relevant documents. It can be supplemented with presentations to analysts and the min-

utes of recent board meetings, as well as the pre-reading and agenda for the next board meeting.

• ***Encourage new members to reach out proactively.*** Explicitly inform new members that it's perfectly acceptable, even desirable, that they contact other board members and management in order to become educated about areas of interest. At the same time, let those board members and executives know that the onboarding leader has sanctioned this outreach.

• ***Establish a tone of candor.*** Before the new director meets with members of management, the onboarding leader should make sure the message gets out to management to be frank and open during such discussions.

• ***Arrange a substantive meeting with the CEO.*** Although a new director has likely met with the CEO during the recruiting process, a more substantive meeting should take place once the former candidate has become a full-fledged member of the board. The new director should come away from the meeting with an appreciation for the CEO's view of the company's most critical challenges — and how the board might help.

• ***Provide formal sessions with management.*** Prior to the new director's first board meeting, a series of meetings should be scheduled with key members of management. Ideally, these meetings would include senior corporate staff and key business unit heads.

• ***Have the director spend time at the "plant."*** Try to get the new board member to one or more of the company's key sites as early as possible in his or her tenure. Such visits give new directors a concrete context for the business that will help them better understand board discussions.

• ***Invite the director to an investor relations event.*** New directors can learn much about the company, including management's style, by listening to their presentations and their answers to questions about the state of the business. If the new director cannot attend an event in person, encourage him or her to look on the company Web site for the most recent presentations to analysts.

## Structure, processes, and role of the board

Orientation about the board's structure, processes, and role is particularly important for first-time directors. However, don't assume that the experience of new directors — including CEOs — who have served on other boards will necessarily translate directly to the new board. For experienced directors and first-timers alike, you should:

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• ***Schedule time with the chief legal officer or corporate secretary.*** Often, of course, the general counsel *is* the corporate secretary. In any case, the purpose is to thoroughly brief the new director about the board from a legal and procedural point of view. Further, a long-serving corporate secretary can be a rich source of knowledge about the technical workings of the board, the committee structure, and governance policies.

• ***Have the lead director supplement the general counsel/corporate secretary briefing.*** In addition to reinforcing the legal perspective, the lead director (who may also be the onboarding leader) can provide the new director with insight into the board's operating philosophy, how the CEO interacts with the board, and what the director can expect at a typical meeting. Make sure that he or she understands how and when decisions are made. For example, if important discussions usually occur at dinner the night before a board meeting, make sure that the board member understands and encourage him or her to commit to being there.

• ***Expose the new director to the work of various board committees.*** Initially, a new director should be assigned to only one committee, ideally a committee to which he or she can make a substantial contribution from the beginning. However, the new director should learn as much about all board committees as soon as possible through such activities as attending at least one session of each committee and then spending time with each committee chair.

• ***Make additional educational resources available.*** It's often helpful to have first-time directors participate in one of the numerous director education programs offered by a number of universities and such organizations as the Conference Board, the National Association of Corporate Directors (NACD), and Women Corporate Directors (WCD). These courses can go a long way toward helping first-timers fully understand issues of corporate governance, fiduciary responsibility, and the role of the board.

## The culture of the board

Understanding the culture of a board — its delicate balance of candor and collegiality, its implicit and explicit customs and norms, and its group dynamics — is in some ways the most important knowledge a new director needs to get off to a good start. To help impart such "cultural literacy," the onboarding leader can:

• ***Use information from references to help guide the newcomer's integration with the board.*** During the search process, references for a prospective board member should have been asked for their views of the prospective board member's strengths, personal style, and areas for development. This information should be used to elicit early contributions from the new director, avoid areas of weakness that would expose the director to embarrassment, and ease initial interaction with colleagues.

• ***Associate the new director with an experienced director.*** Because most directors, no matter how new to board service, come with considerable stature already, a formal mentoring program may not be appropriate. Further, mentoring succeeds only to the degree that both parties invest in it. We've certainly seen cases in which long-tenured board members, as part of their desire to create a legacy, volunteered to show newcomers the ropes. We've also seen cases in which experienced directors agree to take on the role of mentor, yet little happens. What the onboarding leader can do, however, is to think carefully about which individual on the board might connect best with the new director. Such simple measures as seating them together at board meetings and having the experienced member debrief the new member after meetings about the nuances of what transpired can often accomplish as much as a formal mentoring program. The real purpose is not to manufacture an artificial relationship but to provide an opportunity for new directors to get answers to questions that they may feel uncomfortable asking in a large forum.

• ***Avoid pigeonholing new directors.*** Beware of letting unwarranted assumptions or easy categorizations guide the cultural integration of newcomers. For example, if two or more new board members are coming on at the same time, don't treat them as if they were an incoming freshman class hived off from the larger board. Similarly, don't assume that a new female board member will necessarily want to work only with other women on the board or that they will all share common views on issues. Further, although a new board member may have been initially sought to fill a hole in the board's expertise — in a market, a geography, a discipline, etc. — don't sell the new member short by assuming that he or she can contribute only in one area or is purely the representative of a constituency or interest.

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> *— Lee Hanson*

• ***Tailor onboarding to the particular needs and interests of the new director.*** A productive, dynamic board culture is a function of the collective fit of all of its individual members. Certainly, those individuals are likely to be more diverse than ever — in background, age, national origin, gender, ethnicity, experience, and area of expertise. But every director, including those who fit the traditional mold, is unique. It is therefore critical to be sensitive to the differing needs of each new director during onboarding. For example, an academic coming onto a board that consists entirely of business people will need significantly more education on certain issues. Similarly, a new director who is significantly younger than the other directors may need to be encouraged to speak up in the presence of the other board members. In a recent board placement we conducted, the new director, with a background in IT, was particularly interested in meeting members of the company's IT organization. While such meetings are part of a director's education about the company's operations, they are also partly cultural in that they help integrate the newcomer by establishing connections between the larger organization and the board through the director's particular interests and expertise.

## A simple question

When new members fail to live up to their promise as contributors to a board's work, it is rarely because they lack the credentials or some essential ingredient of character. Rather, the fault often lies in the onboarding process.

Certainly, new directors sometimes neglect to invest the necessary time in educating themselves about the business, the board, and its culture. However, the ultimate responsibility for successful onboarding lies with the onboarding leader. Such leaders can begin by reviewing the effectiveness of their board's process in educating newcomers in all three of the areas discussed here. Then they should ask themselves a simple question: *When they were new directors, what was missing in their integration with the board?* The answer could well be the beginning of a superior onboarding process. ■