



Questions to Ask Before Joining a Board

By Priya Cherian Huskins, Esq. *

When you join the board of a public company, you are making a long-term commitment that carries with it the risk of tarnishing your professional reputation if things go seriously wrong. You might also have to endure the burden on your time of protracted litigation. There is even the possibility of unlimited personal liability. Thus, before joining a board, a systematic approach to conducting your diligence on the company is in order.

Of course you are going to read the company's financials, listen to recent analyst calls, and make sure you understand the business model. You are going to look for conflicts of interest and evaluate your fellow board members and the executive team for both ability and integrity—especially the CEO, CFO and General Counsel. You will likely also know at the outset if you are being asked to play the role of ongoing steward or if this is an “up-to-our-elbows-in-alligators” situation. In a lot of ways, the alligator soup situation is easier—the problems have emerged, and you can only improve the situation.

If it is an ongoing stewardship situation, how can you tell if you are being asked to join a board that works well together, properly influences management, and has successfully set the tone at the top? You will be doing a lot of work for the company after you join. It is well within your prerogative to ask tough questions and verify that the company will not surprise you with a difficult situation immediately upon joining it.

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To help you with your diligence, below is a list of questions you might consider. The list is divided into three categories: management-board dynamics, board process, and finally board protection. These questions have been compiled with the benefit of hindsight after having worked with boards where things have gone well...and with boards where things have not gone so well.

MANAGEMENT-BOARD DYNAMICS

1. How does the CEO regard the board?

You hope to find that the CEO and his team are comfortable with probing questions from the board. The answers you are given to questions along the lines of “which board members are the most challenging?” will give you good information both about the CEO's attitude toward the board and the board's comfort with its own role. In the best case, board meetings are an opportunity for a real exchange between the board and management and not an elaborately staged piece of theater leading to the board's rubber stamping management's decisions. One sign that you have a real exchange is a CEO who is comfortable with board members' communicating directly with the executive staff as needed. This is a reassuring sign that management trusts the board. Finally, as you are thinking about how the CEO regards the board, you will also want to assess whether the board trusts the CEO and the rest of the executive team.

2. How far in advance of a board meeting does management deliver the information board members need for their meeting?

Boards have a lot to accomplish during their meetings, and board members need sufficient time to prepare. The

thoroughness of the information delivered to the board in advance of its meetings—and its timely delivery—will tell you whether the company's management is willing and able to provide the board with the support that the board needs to do its job well. The timing of board meetings is important as well. Is everything being jammed into a one-day marathon session, or has thought been given to how the meetings might be more effectively broken up over the course of perhaps two days? Also, has time been set aside to allow the board members to spend time with each other as well as with the company's management?

3. What is the role of the legal department?

Ask management this question, and then ask the company's general counsel (GC). Beyond simply hearing corroborating answers, you will want to hear something about how the GC safeguards the interests of shareholders and the board over the interests of management. Consider also the disposition of the GC—is he or she a wooden lawyer without the kind of business sense that would make the GC valuable to the executive team, or can you imagine the executive team using the GC as a counselor and sounding board? Of course, there is something to a GC's not being "overly" collaborative either. Put differently, a GC that has been co-opted by the executive team may be a GC who is unable to defy management and go directly to the board if needed. Finally, you want to assess whether the GC—or at least someone high-up in the legal department—is knowledgeable about corporate governance and SEC disclosure requirements.

4. How does the company promote and reinforce ethical behavior?

Everyone has a published code of ethics. The better question is, what is the board and management doing to support employees in their efforts to comply with the code? This support should go beyond having a whistleblower hotline. You are also looking for an executive team that consistently and forcefully demonstrates its commitment to ethical behavior. For example, do executives look for ways to incorporate messages about the company's culture of integrity whenever possible, such as having the company's CEO

address the topic at the annual worldwide sales meeting?

5. What was the result of the last several whistleblower complaints?

If a company has employees, there have been complaints. How are these handled? What happened the last time a complaint looked "real"? A company that has not had any complaints might be a company with a culture of turning a blind eye to wrongdoing instead of reporting it. Finally, who is on the lead director's speed dial if a complaint suddenly escalates into a crisis situation? You are hopeful that the speed dial list includes independent counsel to the board, the name of a good forensics accountant, and an excellent public relations firm that is experienced in crisis management.

6. Are internal controls well conceived?

All the internal controls in the world cannot stop every instance of intentional fraud, nor should that be the goal. The real question is whether the internal control environment is one in which fraud will be revealed sooner rather than later. Run through scenarios—for example, how could a salesperson try to game the system in order to improve his or her year-end bonus? You are letting the company show you that they have considered and addressed these scenarios. Understand also what input the audit committee has in the on-going refinement of the company's internal control processes. If you can, talk to the outside audit partner and the internal auditor as well.

7. What is the board's role with respect to the company's enterprise risk management efforts? And what is the process for developing the list of risk factors in the company's SEC disclosure?

A board's ability to be strategic and to be a good monitor on behalf of its shareholders is premised at least in part on its understanding of the company's enterprise risk management process. This includes assessments of both obvious and non-obvious risks of the company. Whether these kinds of questions are being asked is especially important when things are going well because the answer will reveal whether the board you are about to join is a complacent one or not.

A related concern is the board's input on the company's risk factors. A company that develops its risk factors without any input from its board might be a company that doesn't take the input of its board seriously. Also, as you review the list of risks, consider if it seems complete and listen carefully as the board explains to you how it has addressed each of these risks. This is especially important for companies that do a lot of public offerings, a time when independent board members are particularly at risk for personal liability.

BOARD PROCESS

8. Is the board the right size?

Having seven to nine independent directors, with a very few number of employee- or former employee-directors, works well. A board that is too small will be hard pressed to field the number of committees and accomplish the amount of work required by the current regulatory environment. Moreover, a too small board runs the risk of suddenly being out of compliance with independent board requirements should one or two independent directors unexpectedly leave. This risk can lead to intense pressure to retain a director who should otherwise move on, perhaps due to health reasons or even due to poor board service. In addition, if one or two independent directors have conflicts of interest in a particular situation, there may not be an effective way for the board to address an important issue in a conflict-free way.

A board that is too large can also be a problem because it can be unwieldy. In addition, an overly large board may face the classic free rider problem—believing that some other board member will take the initiative. Each member may consequently shoulder less than his or her fair share of the work required for the board to properly perform its role.

9. What skill sets are represented on the board?

Does the background of board members demonstrate the board's understanding that having a diversity of skills and experiences is among the best ways to ensure that the board can address the unexpected issues that will confront the company in the future? If everyone on a board has a similar background—everyone has a technical or finance background for example—the board is less likely to be able to proactively identify new risks or recognize innovative solutions and strategies. Consider too the advantage of having at least one board member who has the skill set to be the director who will deal with difficult legal situations, such as an internal investigation or thorny litigation. A board that has no one capable of making independent legal judgments is a board that is at risk for blindly agreeing to do whatever its outside counsel tells them to do.

10. Does the board have a strong independent chairperson or a lead director?

This question goes to the heart of the way in which the board makes decisions. Having the current CEO on a board is not by itself problematic. Issues arise, however, if the independent chairman or lead director is weak. The independent chairman or lead director has to be able to influence the board's agenda as well as facilitate politically charged decisions, such as CEO succession planning or rejecting a sitting CEO's recommendation on an issue. Having said that, look also to see that the independent chairman or lead director has a solid, productive, and trusting working relationship with the company's CEO.

11. Is it a hard working board?

Consider the attendance record of individual board members, including attendance at committee meetings. You are looking for a board where each member is committed to giving the company the time required to do a good job. Also consider how the board spends its time. The modern board is weighed down with tremendous oversight responsibilities, but is there enough time being allocated to discussions of the company's strategy and future growth?

12. What additional resources does the board regularly access?

Modern boards know that they can require the company to pay for outside independent consultants, including legal counsel for the board as needed. You are looking for evidence that the board feels comfortable employing these resources. You are also, however, on the look out to avoid a board that seems to rely on outside consultants to excess, perhaps as a substitute for the hard work of forming its own judgments. Consider meeting with these independent advisors, especially counsel to the board. You want to be impressed by the practical business judgment of these advisors. You also want to see that they are truly independent from management.

13. Is the board actively engaged in succession planning, both for the executives of the company and for itself?

It has long been understood that one of the key jobs of the board is the hiring and firing of the CEO. But the board must also look at replacing itself in the due course of time. If everyone on the board is well north of 65 years old and there is no plan to address this issue, you may be talking to a board that has not taken one of its core duties to its shareholders seriously or has difficulty making tough decisions

14. What is the plan if the board is suddenly presented with an offer to purchase the company?

Oversight of M&A activities is another key role of the board. You will want to feel comfortable with the board's process for addressing the possibility of being purchased, including a hostile bid from an aggressive private equity firm. As a corollary, you should consider the diligence the board undertakes—and the timing involved—when management presents the board with an acquisition opportunity. Whether the company is buying or being bought, M&A activity is an inflection point for personal risk for board members.

BOARD PROTECTION**15. Does the company's charter exculpate directors from monetary liability where possible?**

Delaware General Corporations Law Section 102(b)(7) allows a corporation to exculpate directors from monetary liability associated with breaches of their duty of care, subject to some important limitations. These limitations exclude exculpation for breaches of the duty of good faith or breaches where a director derives an improper personal benefit. Many other states make similar exculpatory provisions available in their corporation laws. A company that does not have this type of provision in its charter may not be a company that has kept up with the modern legal environment to the detriment of its board.

16. What indemnification arrangements has the company put in place for its independent board members?

By law, the company may offer you a personal, contractual indemnification agreement that will respond if you are accused of an error or omission in your conduct as a board member. If the company is not offering such an indemnification agreement, find out why. Companies that do not offer their board members these types of agreements are woefully behind the times. It is not enough to have these arrangements in the bylaws of a company. One reason is that bylaws are never able to address the issues with adequate specificity.

17. What D&O insurance is in place?

Cash on the balance sheet today may not help you if you are sued at a financially distressed moment in the future. In such a situation, the company could suddenly find itself unable to indemnify you, leaving only your D&O insurance to respond. Rather than be content with summary information, consider having someone you trust review the actual D&O insurance contracts for you. Note that this review should be conducted by someone

who is an expert in this highly specialized field. If the day comes that you need to call upon D&O insurance, the money that will be deployed on your behalf by your D&O insurance carriers may well be much greater than the cumulative cash compensation you will have received through your board service.

Asking questions on the topic of personal protection might feel awkward or self-interested. However, consider the following: being a good board member is fundamentally about being a good steward. Board members who understand this role tend also to be board members who are good stewards of their own and their family's financial assets. Asking about personal protection for board service is wholly consistent with being a good steward.

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