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Should I Serve? Useful Considerations for Prospective Directors Deciding Whether to Join a Board and Incumbents Pondering Whether to Continue

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You don't need me to tell you that this is an uncomfortable time to be the director of a public company. Why else would you be here on a lovely autumn day at 8 o'clock in the morning listening to a judge give a speech? There are golf balls to be hit, night caps to sleep off, and, yes, maybe even some deals to be done.

But, where better than here to bemoan the fate of corporate directors, under siege by the (largely rhetorical) threat of life-savings-stripping liability at the hands of cagey and shameless plaintiffs' lawyers? Why serve as a director of a major public corporation? Is that $130,000 a year and assorted other perks really worth losing the vacation house? Or risking an adverse article in the *Wall Street Journal*?

I won't pretend that directors don't have a reason to be concerned. You do, but I am here to say that a lot of the doomsday rhetoric is irresponsible and, even worse, whiney. The legal reality today is identical to the legal reality a year ago: Independent directors who apply themselves to their duties in good faith have a trivial risk of legal liability. Let me repeat that: If you do your job as a director with integrity and attentiveness, your risk of damages liability is miniscule.

This is not to say that there are not directors who do run a more substantial risk of being found liable, even if layers of insurance and indemnification protection probably insulate their personal pocketbooks, if not reputations, from harm. But these directors consciously run this risk. How? In many ways, that is the prime topic of this address, but one that I intend to confront obliquely, rather than head-on.

Questions to Ask

Directors can find themselves facing legal scrutiny for many reasons. In the short time allotted today, I can't give you an exhaustive list of precautionary measures that will limit your exposure to criticism and damages liability.

Instead, during our brief time together, I hope to get you thinking about the questions that you should ask when you make an important decision—whether to accept a position as a so-called "independent director" of a public company. These same questions, I would argue, are also relevant to any of you deciding whether to continue serving in board positions you already hold.

The questions are designed to help you make a judgment about whether you can serve competently and impartially as an independent director on a particular company board. They are premised on the idea that a directorship is a relationship between a specific individual and a specific corporation. In order for any relationship to work, there has to be a good fit between the parties. In the case of a directorship, that means that the director must have the capability to perform her duties with skill and objectivity and that the corporation must have an ethos that enables good directors to carry out their legal responsibilities.

These questions are also based on my sense of the two key factors that determine whether directors are in legal peril: their own effectiveness and integrity. In my experience, directors run a risk of liability whenever their effectiveness or integrity can reasonably be called into question. In my time with you this morning, therefore, I will challenge you to consider a host of questions bearing on the issues of effectiveness and integrity as you ponder whether to join a new board or to continue serving as a director.

Effectiveness and integrity are the core components of an independent director's value. Can you perform the duties of a director with skill and attentiveness, *i.e.*, effectively? Can you put aside personal self-interest and relationships and pursue only the best interests of the company and its stockholders, *i.e.*, act with integrity? Without both of these elements, your ability to act as an effective independent director is, to some extent, compromised.

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The issues of effectiveness and integrity apply to the company involved in the prospective directorial relationship as well as to the director candidate. In examining whether to join or continue to serve on a board, the candidate must ask hard questions about these issues. The most impressive independent director is unlikely to be able to turn around a company whose management is pervasively mediocre and whose business is based on products or services that are outmoded or inefficient. Likewise, even an ardent reform-minded outside director might well hesitate before joining a company whose corporate culture involves a cowboy recklessness about legal compliance and an indifference to ethical norms. This is not to say that good people should not join the boards of such companies; it is only to emphasize that they should do so with open eyes and as part of an initiative to rectify these deficiencies in effectiveness and integrity and not as a shiny coat of reputational veneer designed to obscure a crumbling structure.

How should you go about determining whether you are a fit with a particular company in terms of effectiveness and integrity? One good way is to ask a host of penetrating questions. The list I will detail today is by no means exhaustive but is designed to be illustrative of the concerns that should be on your mind as you decide whether to serve. I have left out a lot of more obvious areas of inquiry, *e.g.*, whether the company provides mandatory advancement of legal costs in the event I am sued, in order to concentrate on a few issues that might not have occurred to you. Most of the questions will (if they are being asked and answered candidly) be revealing not only about yourself as a candidate but also about the company that wishes to have you.

First Question

I'll begin with a simple question that relates largely to the issue of effectiveness. The first question I would ask if I were considering joining a board is fundamental: How does the company make money? Let me repeat that. I know some of you are thinking that he can't have said that you should ask something dumb like, "How does the company make money?" But I did.

This is a fundamental and incredibly important question. Sadly, I believe it is one that many directors cannot accurately answer. It is also a very revealing question. By asking it, you are giving management a chance to explain the business to you. When they answer, consider how clearly they respond. Does the answer make sense? Is the company delivering a product or a service that strikes you as having a real value? Is it difficult to understand what the company does and the incremental value it contributes to the business sector in which it operates?

Quite obviously, the issue of how the company makes money raises a host of subsidiary questions involving the relative contributions of various business lines, the expected growth rates of certain company activities, and other industry-specific factors. All of these issues are important to consider because they help you evaluate whether you are well suited to serve as a director of the company.

First of all, an extended conversation about these core subjects will give you a sense of the competence of the company's management. If they are unable to satisfy you that they understand the company's business and have a vision for its future, this might well dissuade you from serving, unless you are specifically being asked to join the board as part of a reform movement involving the replacement of the very management that is giving you incomprehensible answers to your simple question.

Assume, however, that you come away believing that management has its act together. You still have a question or two, this time for yourself. Once you know what the company does (or more accurately, have received a deep briefing about that subject), you have to ask your- self: Can I really understand this business sufficiently well to function effectively as a director?

You are doing neither the world nor yourself a service if you join the board of a company that is in a business line that you can't fathom. One of the wonderful things about humanity is our diversity. It is no sign of weakness to acknowledge that there are areas of commerce that are beyond your capacity for mastery. After all, you are trying to make a contribution. If you perceive that the company's business is not one that you can readily understand, you are identifying a key limitation on your ability to deliver value as a director.

A related question of effectiveness arises. Posit that you have been given a satisfactory answer about how the company makes money. After that conversation, you are assured that the management has real skills and that the company's business plan has real potential. But you also recognize that what the company does is complex and subject to rapid change. You are not an expert in the field but feel sure that you can understand what's going on and help guide things if . . .

Time Availability

If what? If you have enough time to actually prepare for and attend meetings. That is, it is vital that you ask about the time demands of the directorship. This should involve a two-step process. First, you should ask the company what it expects of the independent directors. How often do they meet? What committee duties are expected of them? Second, you should ask yourself, what time commitment do I have to give to be comfortable that I am discharging my duties diligently and in good faith?

It is useful to compare the company's estimate with your own. Is it really possible for me to be a good director if we only meet four times a year as a full board, and if the audit committee meets only for an hour before each board meeting? Gee, you might think to yourself, the finances of this company are pretty complex. How can we really be up on things if this is the sum and substance of our effort? Are you comfortable taking on duties that you perceive to require more effort than management expects to be given?

Likewise, what if the CEO indicates that the audit committee meets six to eight times a year for full-day sessions and that the company wants you to serve on it? This makes you feel good about him, because he appears to understand that the company's balance sheet is complicated and that the outside directors need to spend a good deal of time making sure the company's accounting is clean. But then you have to look inward: Are you prepared to put in that level of effort?

You have to be brutally honest with yourself here. If the subject matter of this company's business is already challenging to you, you should be even more reluctant to take on the job if you also are worried about making the time to do the job right. The fact that you might be able to be a really good director if you had 200 hours a year to spend on the assignment is not meaningful if you have only half that time to spare for that task. In this regard, the question of effectiveness is inextricably linked to the concept of integrity. No matter how intelli gent you are, you cannot perform your duties with effectiveness or integrity if you won't—or can't—put in the hours required to do the job.

Why Me?

A related line of questions is quite awkward, but critical in assessing whether you can serve effectively and with integrity. You need to ask company officials, including the CEO and the nominating committee: Why do you all want me to join this board? What attributes do I bring to the boardroom table that you value? What assignments do you want me to tackle?

It should instill confidence in you if the company articulates good reasons for wanting you, matching your talents to the challenges the company faces. By contrast, it should stimulate you to ask more questions if the answer is less substantial. Are you to be a figurehead who fills out the expected roster of outside directors? Have all the more obvious choices said no?

Do you have what it takes to say "no" to people who have other roles in and influences upon your life?

Oh, that's right. The CFO was my business school classmate. Or, I am a CEO and another outside director of the company happens to be the chairman of my company's compensation committee. Or, the president of my university, which receives large contributions from the corporation, mentioned my name to the CEO. Yeah, that's it. That's why they thought of me.

If these sorts of reasons pop up, you need to look in the mirror. Do you have what it takes to say "no" to people who have other roles in and influences upon your life? As a result of these concerns, should I go on the board only with the proviso that I will not serve on certain committees, such as the audit committee or any special litigation or transactional committees? If push comes to shove, am I willing to displease other directors in a position to harm me, either professionally or emotionally, if that is necessary to protect the public stock- holders? Do these people think I'll be a good director or just a good patsy? Or, do they think that that's the same thing?

Now, you might think this whole line of inquiry betrays some cynicism about the concept of independent directors, and it does. Judges are exposed to cases that suggest that the sociology of board selection is premised on certain implicit understandings, one of which is that the independent directors should not be too independent. There are codes of unwritten etiquette that constrain independent directors who fear doing what is just "not done," at least not routinely—brooking the wishes of those who handpicked them.

Management's Interaction with the Board

Which brings me to another line of questions, which should be asked of both the CEO and the nominating committee. How does the CEO interact with the board? Does he, or less commonly she, encourage questions? Is he comfortable with respectful dissent? Does he challenge his managers to debate and flesh out the company's strategy, or does he surround himself with the male equivalent of Stepford wives who dutifully respond, "Yes, sir," to whatever the CEO says? How much information do the directors receive, and how much access do they get to top management when they want more?

How does a typical board meeting go? Forty-five minutes of PowerPoint followed by a nice lunch? Or, do the directors have a real give-and-take with management on key issues, which is followed up at the next meeting with a refinement of management's thinking and further deliberations by the board?

Now, some may simply view different answers to these questions as reflecting different managerial styles and as bearing little on the issue of corporate integrity as opposed to effectiveness. I see it a bit differently. By law, the board of directors is charged with overseeing the company's management.

If during normal times the board is perceived by management as a group of "others" to be managed rather than as the superior partner in a collaborative endeavor to promote stockholder wealth, why is that relationship likely to be improved in a corporate crisis, during deliberations about executive compensation, or when a major transaction is on the table? When top managers are prickly about board questions, when they resist providing complete information to the board, and when they limit director access to staff help, independent directors have reason to be nervous. Even if this managerial atti tude is simply a manifestation of a controlling personality and not of any bad faith toward stockholder welfare, its presence endangers the enterprise because it impairs the ability of the board to perform its monitoring function. What the board does not know can hurt it, as well as the company.

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The board is the CEO's boss, and if he doesn't know it, I'd be careful about joining his board. If you can't be the CEO's boss, at least in the sense of monitoring his performance, setting limits on his authority, and being prepared to fire him if warranted, you shouldn't be a director of that company.

Getting a handle on management's attitude towards the role of the board is useful for another reason. It provides a clue to management's style of dealing with government agencies and investors. If the CEO is reluctant to trust the board with full information and too insecure to involve the board in real discussions about difficult issues, how likely is it that he has an open attitude towards full financial disclosure or in other areas of corporate operations in which candor and transparency are useful to ensuring corporate responsibility?

Outside Advisors

Another inquiry relevant to the questions of corporate effectiveness and integrity is: Who are the company's financial and legal advisors and why? Properly functioning company accountants and outside counsel are of huge assistance to a board attempting to fulfill its over- sight responsibilities. Talented, well-qualified professionals charged with helping the company comply with existing laws rein in excesses, channel corporate behavior into the legal and ethical mainstream, and divert creative schemes inspired by the less worthy angels of managerial natures.

The ability of outside advisors to play this role is, to a large extent, dependent on their relationship to the board. If the outside advisors believe that their future with the company hinges primarily, if not exclusively, on the good graces of top management alone, then those advisors may be tempted to bend to the wishes of management in circumstances when they should not.

For this reason, it is worth asking: How did the company come to hire its counsel and accountants? What other clients do these advisors, the individuals, not just the firms they work for, have? Are their careers largely dependent on working for our company? Who hooked them up with us? The CEO? How long have they been our advisors? Does the board have any say in whether they continue with the company or in setting the terms of their compensation?

Are there occasions when committees of the board meet alone with the outside advisors? If not, are other routes of direct communication to the board open in case the advisors believe that the board should be informed of an issue or a material fact?

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Gauging management's, and an outside director's, reaction to these questions about outside advisors will be helpful in obtaining a comfort level. If the company's advisors are talented professionals with several blue- chip clients, this should be confidence-instilling, even these days. Likewise, it is a good sign if the CEO expresses an open and enlightened mind about the board's relationship with the outside advisors, which signals his appreciation that, although these advisors report day-to-day to management, they ultimately represent the company and owe concomitant duties of candor and loyalty to the board of directors as the company's ultimate authority

By contrast, be cautious of situations when it appears that the outside advisors are extremely dependent on the company. It is one thing for an outside advisor to consider a company an important client; it is another thing altogether if the loss of the company's business would essentially gut the advisor's practice. In that case, it is even more critical that the advisor perceive himself as owing his continued service to the good graces of the board, because the advisor's economic dependence makes him vulnerable to managerial pressure. In that situation, listen carefully to your nominating committee contact—who I assume to be an independent director— just how involved has she been in retaining the advisor and how much contact has she had with him? If you are, by any chance, to be assigned to the audit committee, I would suggest that you focus even more closely on this issue and have an in-depth conversation with the chair of thatcommittee.

Inquiring about advisors is important for two other reasons. For one thing, it provides a useful insight into management. Poor leaders often surround themselves with weak advisors who do not threaten their insecure egos. For another, company advisors are critical to avoiding crises. Changing advisors after you're deep into the thick of an emergency is rarely an adequate remedy for having the wrong advisors in the first place.

How Does the Board Function?

There are, of course, other lines of questions that I would ask if I were being asked to serve on a board. I can't cover all of them today, but I will leave you with a final one that focuses on whether the board's way of doing business makes sense. That is, does the board you are being asked to join operate in a manner that enables its members to make all the decisions required of them in a thoughtful manner?

Complex organizations subject to crosscutting political and business pressures have a tendency to respond to the prevailing winds by creating structures and rules that whack the mole that most recently popped up. This tendency exists in public corporations. When environmental compliance is the issue of the day, corporations adopt board policies to monitor it. Ditto workplace discrimination. Foreign Corrupt Practices Act compliance. Minority contracting. And so on.

One of the problems with that *ad hoc* approach is that the responses to these demands are often unrealistic and stated in aspirational terms unmatched by a proportionate commitment of organizational resources. To be more concrete about this problem, consider the fate of audit committee members whose committee has been charged with the responsibility for overseeing all the legal compliance mechanisms in the firm. Does this make sense?

The membership that one would want on a committee charged with assuring the company's compliance with fair accounting standards is arguably quite different from on a committee responsible for guaranteeing that the company has sufficient mechanisms for complying with environmental, employment, and antitrust laws. Even more important, how much time do the audit committee members have to fulfill their duties? Does it make sense to heap a ton of duties on three members of the board, leaving them with responsibilities that demand close to a full-time effort to accomplish? Or, would it be preferable to create a separate legal compliance committee that focuses on areas of compliance outside the accounting and securities disclosure realm, thus improving the board's overall monitoring capacity and allowing the audit committee to do a better job on their core duties?

Put bluntly, a board of directors is like any other organizational structure. Unless it is designed properly, with an eye toward the responsible completion of particular tasks, the board will not carry out its functions optimally. Before you join a board or continue on one, it would serve you, and the company, well to consider this issue. It is all well and good to have an ideal audit committee charter; what matters is whether it can be brought to life by real-life committee members, company staff, and advisors.

Conclusion

Lest I wear out my welcome, let me bring this to a close. I began by telling you that I believe that directors who carry out their duties in good faith have little reason to fear legal liability. In the course of this address, I have identified a number of questions that prospective directors can ask that will help them decide whether they can serve with confidence. These questions, if posed and answered candidly, will go a long way in revealing whether you can function with effectiveness and integrity as an independent director. They will also help you learn about whether the company that seeks your services is worthy of having you or, even more, needs you and others to join on the condition that you have the clout to clean up the place.

There is another aspect to these questions that is revealing: If you feel uncomfortable even asking them or are troubled by the answers to them, you might not belong on the board of that particular company. To add value, directors must bring their best, impartial thinking to bear on the corporation's problems. That requires an ability to understand the company's business, a willingness to ask hard questions, a commitment to spending the time necessary to address difficult issues, and the stomach to say no to the CEO and other directors, even if that upsets them. For a person who can do these things, a corporate directorship remains a rewarding, challenging, and *safe* role.

Your commitment to being here and learning about how to be a better director suggests you are well suited to fulfilling this important public trust. Don't let the tumult rattle you. Now is not the time to bail out; our nation needs good directors more than ever.