Bloomberg BNA

Corporate Accountability Report®

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DIRECTOR EFFECTIVENESS

Corporate Governance: a Primer on Board Member Evaluation

BY BILL CAPPS AND ROB STEINBERG

The heightened focus on corporate governance by regulators, stock exchanges, and investors over the past decade has made periodic evaluation of members of a board of directors increasingly important. A robust program of evaluation of individual board members, as well as that of the whole board of directors and committees of the board, can assist in protecting shareholders against board entrenchment and, when combined with training and continuing education (which will be discussed at the end of this article) can play a critical role in assisting in the ongoing improvement of performance by individual board members and the entire board.

Whether we are thinking about public companies, private companies, or nonprofits, each is faced with considering the evaluation process. Public companies, of course, may be required to do this by regulators, institutional investors, or their exchange listings. However, private companies and non-profits will have their own reasons for maintaining an ongoing program of evaluation.

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What does an evaluation process look like in the case of individual board members?

1. What is being measured?

Typically, the evaluation is intended to measure ''board competencies.'' These are the range of characteristics the board members are supposed to possess. Evaluation can happen in the process of selecting a board member or in considering whether or not to renominate the board member. Think of the competencies as a checklist for the perfect director.

The sought after ''competencies'' will vary from company to company but here are some examples:

- Basic knowledge (examples are knowledge of a specific industry, the company, and its executive team; knowledge of risks specific to the company or its industry; knowledge of board responsibilities);
- Technical and analytical skills (examples are financial and accounting expertise, transactional savvy, and demonstrated individual decision making);
- ''Soft'' inter-personal skills (examples are contributions to group decision making, tolerance of opposing positions, professionalism, and communication skills);
- Professional reputation;
- Community service;
- Diversity enhancement (adding women or disadvantaged minorities);
- In the case of non-profits, passion for the subject matter and ability to ''give or get'' (i.e. contribute money or find contributions).

2. Who is doing the evaluation?

Typically, there is either a specific corporate governance committee or a committee charged with the nomination or re-nomination of board members. In some companies, this might be handled by an executive

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committee. This function is sometimes wholly or partially ''farmed out'' by the responsible committee to independent consultants. An example of such a resource is http://www.corpgov.deloitte.com/site/us/ (the so-called Center for Corporate Governance maintained by Deloitte). Of course, such a resource is more appropriate in a public company where the stakes (and requirements of third parties) may be greater.

A problem with a large board of directors is that it is difficult to tell in a large setting whether or not a particular director has defective performance. That means the intelligence gathering about a director's performance has to be distributed so that the evaluating committee learns facts from (a) other individual board members, (b) the chair or members of committees on which the board member serves (because in that smaller group, defective performance is more noticeable), or (c) the member himself through self evaluation. (Self evaluation is typically used to identify areas of training that a director identifies as being useful to him.)

Understandably, directors are often reluctant to disclose defective performance of their peers. This no doubt results from among other things the personal relationships of the directors, fear of retaliation and a general desire not to get involved. The company must emphasize that the first duty that it is owed by a director is the duty to the company and not to fellow directors. Perhaps this can be further ameliorated by emphasizing positive aspects of identifying personal development opportunities for directors themselves.

Clearly, in the case of ''minor'' problems with a given director's performance, counseling among board members may be done without necessarily raising the perceived problem to the level of the committee.

3. Keeping track of evaluations.

A sensitive subject is whether or not and how the committee keeps track of evaluations. There is not one written test that can effectively measure director capability and performance. The hard data points (e.g. attendance at meetings and committee meetings) are few and, as a result, board members often rely on questionnaires that frame possible issues but leave the opportunity for open-ended responses. One fear is that written evaluations might be fodder for lawyers in the event of litigation or dispute. Although the nomination of directors is not protected by the myriad of laws relating to employment discrimination, this boundary can be blurred where a director works for the company.

Another fear is that putting evaluation materials in writing tends to concretize matters which are probably less defined. For example, a committee chair might want to inform a committee member that he was disappointed with his preparation for or contribution to a meeting without necessarily creating a writing which overly emphasizes the problem.

Another issue is the problem of intellectual honesty. Directors must have the courage to stand behind their criticism of other directors, as painful as this may be. Otherwise, the director being criticized may believe that he is being singled out unfairly for personal or other reasons not related to his performance.

4. Additional considerations.

One issue about which directors should be educated (which makes the evaluation process easier) is the concept that their service is for the benefit of the company and not themselves. This emphasizes that the directorship is not a lifetime sinecure. Directorship is based on the needs of the company. So, for example, a director may have perfectly fine performance but if the company at that time requires a different skill set (e.g. cybersecurity experience, marketing expertise), the director may not be re-nominated.

Typically, other techniques are used to ''refresh'' boards of directors. These include term limits, mandatory retirement at certain ages, changes in job responsibility (someone who became a director because he was the CEO of a strategic partner or customer who has now left the employ of the strategic partner or customer). In some cases, an ''advisory'' or ''president's'' board may be an appropriate way to continue to have the capability of a former board member who simply lacks the time or energy for a full board position.

5. The ''ecosystem'' of training providers and opportunities.

Orientation and continuing education of directors is encouraged under NYSE listing rules, and also encouraged by many institutional investors and investor organizations. These factors together with the perceived enhancement of director performance that results has engendered a robust ''ecosystem'' of training providers for boards and individual directors. More reputable examples are described below, but, as in many areas of training, some providers seem to be more about colorful certificates and titles than useful information. Accordingly, directors should be careful to assure that training programs are appropriate.

Business schools at major universities provide not only training but ''certification'' of training. The three day immersion in board best practices offered by the UCLA Anderson School of Management is typical. Another example is the directors' consortium which also provides three days of training in corporate governance at Chicago Booth, Dartmouth Tuck, and Stanford business schools.

In addition, the National Association of Corporate Directors (''NACD''), a non-profit association generally recognized as a leading provider of board education for directors, offers a variety of board programs. NACD's current topics offered as board programs are typical for training programs offered by other providers and include:

Director Professionalism;

Audit Committee: Improving Quality, Independence and Performance;

Board Effectiveness: Improving Communication and Decision Making;

Fiduciary Responsibility;

Financial Statements: Fundamental Questions Every Director Should Ask;

Role of the Board in Corporate Strategy and Risk;

Role of the Nominating & Governance Committee: Raising the Bar;

Directors and Officers Liability: Update;

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CARE ISSN 1542-9563

Role of the Board in Crisis: Preparation, Response, Communications, and Post-Crisis Evaluation;

Role of the Board in Mergers and Acquisitions;

Technology: Increased Risk for Board and Leaders;

China: Opportunities and Risks.

Of course, the topics above are generally applicable to most companies. Specialized training is often available for specific industries. For example, an insurance company will offer training in its industry or regulatory topics. In addition, a director who perceives himself or herself as affiliated with a particular group (e.g. women, minority groups) may find training specific to that group. The training can be very narrowly defined indeed (women on boards of insurance companies; see the IICF Women in Insurance Global Conference held recently in New York). Some companies will have sufficient in-house capability to design their own programs and do not need the imprimatur of an outside training organization.

There is no doubt board and board member evaluation and training will continue to play an important role in corporate governance. Lawyers will be helpful advisors to their clients if they can help the company navigate its way through this landscape.