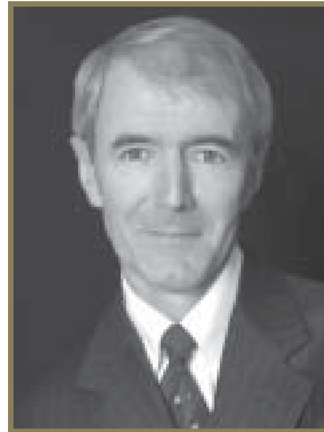
Being a director: The future isn't what it used to be



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The traditional fiduciary duties of directors of public companies are well known. State statutes, the courts and commentators have succinctly articulated a director's duty of care, duty to be free of conflicts, duty to make informed decisions, the familiar business judgment rule and the emerging duty of disclosure. But today, shareholder, public and regulatory expectations about just *how* directors and boards of public corporations should carry out the execution of their fiduciary duties are changing dramatically. Where this will lead, and how public company boards will respond, is not clear. One thing, however, is certain: The future isn't what it used to be.

The catalyst

The reaction of government leaders, regulators, business leaders, the media and the public to the enormity of the events leading to the downfall of Enron is understandable. How could this happen? The incredulity, denial and then anger of Enron's own employees were added to the cacophonous, discordant symphony of recrimination and outcry, and the mood surrounding the Enron debate, fanned by political and media opportunists, turned ugly. Enron was positioned to be the catalyst for the next step in the evolution of corporate governance. And subsequent revelations about WorldCom, Qwest, Tyco, Xerox, Merck, Global Crossing and Arthur Andersen contradicted the notion that Enron was an anomaly. The ensuing investigations and charges have been anything but a balm of confidence in the integrity of corporate America.

A frequent comment has been made, somewhat in jest, somewhat in earnest, that none of the Enron directors—all of whom have resigned—will outlive the lawsuits that are being filed. Gallows humor is reputed to have frequented boardrooms as directors wrestled with how best to respond and as they asked if what happened at Enron could ever happen at companies on whose boards they serve.

The initial response

In the initial aftermath of the Enron revelations, one could read daily accounts of what was happening to Enron and to its auditors, Arthur Andersen, but one could only imagine what was happening, and is likely still happening, behind closed doors in other boardrooms across the nation. Enron was big news. The reaction and ripple effect was immediate.

Directors are human. They are typically selected because they are successful, highly qualified and well credentialed. They mean well. They want to do a good job and, for the most part, they do. But being human, their immediate response to the Enron debacle was likely to have been nervous looks for bright-line assurances from management, and from each other, that all was well, followed by recommendations from the board to management that it should double the guard. There also was undoubtedly a renewed sense of interest and heightened sense of hindsight awareness of the fine print involving matters of both financial and non-financial compliance and disclosure. Perhaps there was an undertone of self-reflection that "Maybe we/I should have/could have been looking and listening a little more closely."

Even when everything turns out to be just fine, during the early stages of potential threat and "siege from the outside," normal defensive postures surface. One can be sure that

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personal security questions were asked in many boardrooms: "How do the indemnification provisions in the company's bylaws work?"; "Tell me again what our D&O insurance coverage is." One can also be sure that a more collective concern was voiced about how individual boards and their committees could better carry out their responsibilities as fiduciaries for their respective constituents.

Now what?

The "now what?" question is the subject of the balance of this article. The future really isn't what it used to be. And it's going to get personal.

Much of what will change in the boardroom after the dust has settled in the post-Enron environment will be the result of new and potentially onerous requirements imposed by laws and rules born in a punitive incubator. The risk is that these new rules and laws will be painted with populist assumptions verging on extreme stereotypes: Companies are bad and no company can be trusted. The revised listing requirements of the New York Stock Exchange will be debated, and the Sarbanes-Oxley Act has got to be supplemented with detailed regulations by the Securities and Exchange Commission, so exactly what the new requirements will be is uncertain. What is certain is that there will be change. We can only hope that common sense prevails.

But there is more a board can do on its own initiative, without waiting for details from Washington, and there are compelling reasons to get on with it right away. None of the directors at Enron "wanted this to happen," but it did. None of the Enron directors "thought" this *could* happen, but it did. No director of any company wants something similar to happen either and, even if there is no similarity of a company's business to the business or circumstances at Enron, the debacle there can serve as a call to action for your board and your company. It starts at the top. It starts in the boardroom. It can start now.

Signals before Enron

Using a nautical analogy, the first aid to navigation in these troubled waters that had the significance of a lighthouse was the 1996 *Caremark* decision handed down by the influential Delaware Chancery Court. Up until then, the guiding light was found in another Delaware decision, *Allis-Chalmers*, in which the Delaware Supreme Court said that "absent cause for suspicion there is no duty upon directors to install and operate a corporate system of espionage to ferret out wrongdoing which they have no reason to suspect exists." *Caremark* changed all that. The new, more proactive standard suggested by the court in *Caremark* is that officers and directors of a corporation have a duty to assure "that information and reporting systems exist in the organization that are reasonably designed to provide to senior management and to the board itself timely, accurate information sufficient to allow management and the board, each within its scope, to reach informed judgments concerning both the corporation's compliance with the law and its business performance." But how does a board go about it? What can a board do to meet the standard suggested by the *Caremark* decision and new requirements that remain in the formative stage? How can a board avoid the breakdown that apparently took place at Enron and the other companies now in the headlines? That is the key question.

The board's state of mind

Albert Einstein is reputed to have instructed that you can't expect to solve problems using the same logic system and awareness that created them. The governance logic system in place until now appears to have been almost mechanical and to have fostered an environment more complacent and more passive than the governance environment of the future will tolerate. Even with the advent of the suggested governance standards and requirements of *Caremark*, the assumption has been, up until now, that "the system works—don't fix it unless it's broken." The evolution of the more passive Allis-Chalmers-style board to a more proactive Caremark-style board does not appear to have been quickly embraced. Because of the public reaction to the Enron and post-Enron corporate disclosures, however, boards now have reached a critical mass of collective introspection necessary to create a new standard of governance reform that relies less on the assumptions of the past and more on truly reforming oversight and decision-making processes.

Public company boards should now lead by their own example by reviewing their own practices—not to "fix" anything that isn't broken, but to identify and think through what it does, what it doesn't do and what it should be doing in order to best fulfill its oversight responsibilities. There is no one answer to questions that are now being raised that will satisfy the needs of all boards. There is no standard checklist of things a board should do that fits every company all of the time. Questions and issues now before American boards must be heard from the investors' and regulators' points of view to really understand their concerns, their frustrations and their commitment to reform.

Asking questions and developing consensus

Resolution of the issues and answers to questions raised can be used by a board to chart a new course only if there is consensus among directors, and consensus can only be reached if there is a continuing, open and honest dialogue among members of the board and between the board and management about their respective roles and missions. The relevant questions include:

- Which governance practices are appropriate for *this* board, for *this* company, at *this* time?
- How good are we at the art of listening—how can we improve?
- What does our board stand for—what are our values and what signals are we giving to management?
- What motivates us to be on this board?
- What is our mission, and how best can we work with management to fulfill it?
- Just how well do we know each other's business styles and how open, direct, honest and effective are we individually and collectively in discharging our oversight responsibilities?
- Are we adequately discharging our responsibility to be a resource for management?
- Even though we meet only occasionally, how do we stack up as a team, and do we have agreement about what we expect of one another as directors?
- Are we willing to devote the individual and collective time and energy necessary to be effective?
- Can we count on each other to perform?

The call to action

It's time for directors to role up their sleeves and have at it. The dialogue required is not a one-hour session. It will require some time, work and considerable thought and courage for it to amount to anything of real value. Confidentiality and discretion are of utmost importance until the board is ready to speak with one voice and go public. The subject matter of the dialogue and discussion should include the following:

- Development or reexamination of the board's committee charters to be sure that the oversight framework necessary to monitor management's compliance with the myriad of regulatory requirements is in place;
- Development or reexamination of the board's corporate governance generally to be sure there is a broad consensus on governance guidelines that the board feels are appropriate to the business and that are sufficient to generate investor confidence in the board's ability to best represent investor interests;
- Development or reaffirmation of a statement or code of board, management and company values and ethical business practices that are genuine, well-thought-out and serve as a compass for the entire company that, when published, will help restore or reaffirm the confidence in the integrity of the company among those with whom it deals;
- Institution of a disciplined practice of annual board self-evaluations to lead by example and demand performance no less stringent than that required of others in the company; these evaluations should include respectful and discrete assessment and feedback for individual directors as well as general feedback for the entire board and can best be sponsored and led by an independent lead director;
- Discussion of the board's mission and its oversight role as compared to management's mission and management responsibilities—who has responsibility for what, and how best can the board and management work together to achieve their missions?
- Discussion of individual skill sets and performance expectations of current directors and for director positions yet to be filled—job descriptions, if you will, to be sure that every director knows what is expected.

Boards must respond

The future truly isn't what it used to be. The foundations of past assumptions have crumbled, and the effectiveness of past practices is being seriously questioned. The demand for reform is strong. Much of what will happen as new legal and regulatory requirements are enacted is beyond the control of a board. But the board does have control over how it responds, and respond it must. Therein lie both the opportunity and the challenge. D

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