

How Do I Know If I'm Doing a Good Job As a Director?

Introduction

Each time I visit with a group of directors about board governance and director liability, there is one overriding question that continues to surface: "How can I be sure I'm doing a good job as a director?" That question takes on added importance because of the assumption that if you are doing a good job as a director then you will be protected from personal liability. This article provides a simple roadmap for directors to follow in assessing their individual performance as a board member.

It is certainly no surprise that all directors, whether serving on for profit or not for profit boards, have a heightened awareness of the importance of their role, especially given the publicity in recent years about boards that have seriously underperformed. It is clear that the answer to the question of whether a director is doing a "good job" requires an examination of the basic elements of certain well established legal principles. The starting point for any review of director responsibility must focus on three basic fiduciary duties: 1) the duty of care; 2) the duty of loyalty; and 3) the duty of obedience. So the question that a director must address is: what specific actions do I need to take as a director to fully embrace those duties?

Duty of Care

Based on recent high profile cases, the fiduciary duty most often violated or ignored is the duty of care (sometimes referred to as the duty of diligence). Simply stated, it is the duty to educate yourself about the company, to understand the facts on which your decisions as a director are based and to make decisions with the honest belief that actions taken are in the best interests of the company. Key elements include:

- *Receiving adequate information before making decisions.* You should receive enough information in advance of board meetings to prepare you for the discussions that will occur at each meeting. How much is enough? It depends on the topic but enough background and detail is needed to

enable directors to come to the meeting feeling comfortable that they understand what they will be discussing at the meeting and, importantly, to have formed some initial questions/thoughts/ideas about the subject.

- *Pre-meeting preparation.* How much time should you spend before the meeting? The answer depends on the purpose and complexity of the meeting. If you are meeting with an outside auditor to review year-end financials and the results of a comprehensive audit, you may need to spend several hours previewing the material even though the meeting may only last one hour. On the other hand, if it is a more routine one-day board meeting, a couple of hours reviewing material in advance of the meeting may be enough.
- *Regularly attend all meetings.* Enough said!
- *Attentiveness and participation.* Of all of the duty of care elements, this is perhaps the most important. It is about carefully listening to the discussion, providing input and asking good questions. Many of the recent corporate debacles involved highly qualified directors who were unwilling to ask tough questions. Remember, however, that this does not mean being adversarial towards management. In many instances, it is about taking a good idea from management and offering suggestions that may make it an even better idea. The goal at the board meeting is to have good discussions, ask good questions, get good answers and make good decisions.
- *Staying informed about corporate activities.* This means understanding the company's business model, how the various departments and functional areas operate and interact, monitoring progress against the business plan, assessing threats and opportunities for success, understanding the competition, monitoring the performance and capabilities of the management team,

and monitoring other important indicators that are unique to each company. One word of caution is to be careful where you draw the line between board responsibility and management responsibility. Board members should avoid involvement in the day-to-day management of the business.

- *Use experts when appropriate.* When a significant change in direction or new business unit is being considered, it may be advisable to engage outside experts to supplement the expertise of management and the board.
- *Watch for Red Flags.* Are key financial ratios trending in the wrong direction? Were auditor's recommendations about internal controls ignored? Have there been unusual turnover in key positions? If the company has had three different CFO's in the last four years there may be reason for concern.

Duty of Loyalty

Again, the basic rule is easy to state-you must always act in the best interest of the company rather than in self interest. The underlying concept is that your personal interests, including those of your family members and other businesses you are interested in, must be subordinated to those of the company. Most of the so called "standards of conduct" or "codes of ethics" that have been adopted by many entities are based, in large part, on the duty of loyalty. Key elements include:

- *Disclosure of personal interests and potential conflicts.* The golden rule here is- when in doubt, disclose. Always remember that your actions will be judged with the benefit of hindsight by someone who is independent and impartial.
- *Abstain from discussions and votes when you have a personal interest.* There may be instances where you can provide helpful background information before you leave the boardroom, but generally speaking it is best to disclose actual or potential conflicts and excuse yourself while the rest of the board considers the matter at hand.

- *Never use inside information or corporate assets for personal benefit.* This should be obvious and easy to recognize. The question is whether your actions or inactions could potentially have an adverse effect on or take advantage of the company.
- *Never disclose confidential or proprietary information.* The test here is twofold: 1) did you get the information by virtue of serving on the board, and 2) is the information generally available to the public. If the answer to the first question is yes and the answer to the second question is no, then don't disclose the information to third parties. Common examples of confidential information include personnel matters (hiring/discipline/firing), contemplated purchases and sales of corporate property, merger discussions and litigation. Obviously, there will be circumstances that require careful evaluation and possible disclosure, such as the need for transparency to stockholders or where the information may involve criminal conduct.

Duty of Obedience

Directors must perform their duties in compliance with applicable statutes, regulations and the terms of the corporate charter and bylaws. Key elements include:

- *Obeying applicable legal requirements.* This is about taking reasonable steps to ensure the company is conducting its business and affairs in accordance with applicable state and Federal legal requirements and the terms of the corporate charter, bylaws and other self imposed requirements such as standards of conduct.
- *Seeking legal or other expert advice when appropriate.* Many entities have internal and/or outside legal counsel and other employees who will have responsibilities to monitor compliance in their respective functional areas such as human resources, financial, and tax; and they should always be consulted by the board when questions arise.

Conclusion

Common sense legal and ethical guideposts that capture the essence and the elements of the fiduciary duties discussed above are:

- take your job as a director seriously,
- avoid personal interest conflicts, and
- work hard.

These are certainly not new concepts but they have survived the test of time and will serve you well in the unlikely event you are called before a court to justify your actions as a director.

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