

# DUE DILIGENCE CONSIDERATIONS FOR NOMINEES

**JULY 28, 2011**

**ACKNEIL M. "TREY" MULDROW (AKIN GUMP STRAUSS HAUER & FELD) AND LOUIS KACYN (EGON ZEHNDER INTERNATIONAL)**

When individuals are approached to join the board of directors of a public or private company, they are often thrilled by the opportunity to provide strategic guidance and advice to a new business enterprise, build new relationships with board members and perhaps transition to a new point in their careers. It is rare, however, for a nominee to complete adequate and systematic due diligence on the prospective company and the members of its board of directors prior to joining.

The premise of this article is simple: due diligence should be a two-way endeavor, undertaken by the company as well as the nominee. This article provides practical advice for prospective nominees regarding the more refined issues they should consider and the questions they should ask prior to joining a board. With these inquiries significant considerations may be identified and then used in a nominee's decision calculus.

## PEERING BENEATH THE SURFACE

When considering a director position, a nominee often contemplates time commitments and reputational considerations associated with the board position. Now with increased scrutiny from global regulatory authorities — not to mention activist investors — nominees should be exceedingly thoughtful with regard to new board engagements.

The traditional due diligence approach used by nominees — and their advisors — is to review public reports filed by a company with a securities regulatory organization, relevant organizational documents, board committee charters and D&O insurance coverage. In addition, there are often conversations regarding the company's strategic plan and business opportunities. Due diligence by a nominee based solely upon these core categories of information, however, may not lead to an appropriately informed decision in today's world.

With that in mind, below are additional areas of consideration for nominees:

## BOARD RELATIONS

The SEC requires companies to disclose to its stakeholders the background and industry experience of its nominees. Additionally, companies are required to certify whether their directors are independent of the company's management. It is important, however, for a nominee to understand the interconnections among the directors that may have not required disclosure:

- How were the current directors identified?

- Do the current directors have meaningful mutual business or personal relationships?
- Are there historical voting relationships and patterns among the board members?

Nominees should also inquire about the general culture of the board and the level of collaboration the board has with senior management. A nominee who steps into a contentious or fractured environment may be joining a setting with enhanced risk and limited ability to achieve its operational goals. A nominee should seek to gain greater transparency into the relationships that may influence the deliberative process of the board and the outcome of its strategic decisions.

## SUCCESSION PLANNING/LEADERSHIP

One of a board's most challenging tasks is succession planning. Often a board will delay this conversation due to the discomfort that arises from this topic. The key question, however, is rather simple: is there a succession plan for the senior management team and the chairman/lead director? The absence of a plan, or a discussion of this topic by the board, is very telling and may presage a series of challenging discussions among the directors.

Another important issue relates to the composition of the company's leadership at the management and board level. Does the current senior management team and do the current directors possess the global business or governmental experience necessary for the company to achieve its mid- and long-term business goals and/or regulatory compliance needs? There can be a mismatch between the experience that has been required for the company's historic success and that needed for the company's emerging opportunities.

## SHAREHOLDER RELATIONS

A nominee should gain an appreciation for the company's approach to shareholder relations:

- Is the company's contact with its shareholders frequent, or is dialogue with shareholders less-structured and reactive?
- Has the company established a principal contact with its shareholders and is that person qualified for that position?
- What types of investors constitute the company's shareholder base (retail investors, mutual funds, activists), and has that group changed recently?
- Have any concerns been raised by governance groups with the company's management or board?



It is important to note that proactive shareholder relations may mitigate shareholder activist behavior or, at least, provide insight into the particular concerns raised by shareholders.

### DEFENSIVE PHILOSOPHY

Given increased M&A activity in the past 18 months (including a flurry of hostile transactions), nominees should also understand a company's defensive profile (or lack of defensive protections). If a company's directors are reluctant to put a poison pill "on the shelf" or consider other defensive protections, learning of this posture on a "clear day" may facilitate future discussions. While changes in circumstances may result in a change of the current directors' positions in this area, it is important to understand the boardroom's general philosophy on these issues.

### CORPORATE GOVERNANCE

Have there been disputes among directors and/or management regarding independence, codes of conduct or the exercise of fiduciary duties? Very nuanced conversations regarding these matters may not have been required to be disclosed to the marketplace. Nevertheless these types of discussions may have had a lasting impact on board relationships.

In the same vein, have the board or any of its committees initiated any internal investigations of directors or management? Learning of an internal investigation — and, more importantly, its findings — after an appointment can be very frustrating for a nominee.

Nominees may be asked to join certain committees of the board. Each nominee should strongly consider speaking with the respective committee chairman and the committee's advisor (i.e., legal, accounting, consulting) to discuss the advisor's prior recommendations with respect to the strength of the management team and the board of directors as well as any weaknesses or deficiencies identified by the advisor.

### GLOBAL INTERNAL CONTROLS

The business plans of many companies include global expansion and development. U.S. markets may not offer significant growth opportunities compared to the BRIC and MENA countries. The reach of the U.S. Foreign Corrupt Practices Act and the U.K. Anti-Bribery Act is quite long, however. Accordingly, the consequences for a company's noncompliance may be significant financially and reputationally. The challenge for many companies is that internal education regarding these policies may not reach the individuals who most need to be aware of them. Tone at the top and compliance programs are important for any nominee to review and fully grasp. Accordingly, inquiries relating to compliance controls of a company is an important point of discussion.

### CONCLUSION

The potential risks of joining a board have continued to increase during the past decade with the introduction of Sarbanes-Oxley and Dodd-Frank compliance requirements. While nominees have the benefits of social media and digital tools at their disposal that dramatically facilitate their ability to gain knowledge about prospective companies, such information only tells part of the story. A nominee should dig deeper and ask more targeted questions before he or she puts his or her reputation at risk.

### ABOUT THE AUTHOR

**Ackneil M. (Trey) Muldrow III** is a partner at Akin Gump Strauss Hauer & Feld, advises corporate, private equity, hedge fund and sovereign development company sponsors in sophisticated mergers, acquisitions and strategic investment transactions. This focus has allowed Mr. Muldrow to serve as lead counsel in a variety of domestic and international public and private mergers, acquisitions, divestitures and carve-out transactions, joint ventures and control and minority investments. Review Ackneil's full bio here.

**Louis Kacyn** is a senior partner at Egon Zehnder International's Chicago office. He is a member of the Board Practice of the Firm, placing executives into boards across all industries. He is formerly the Global Managing Partner of the Life Sciences Practice and the former Managing Partner of Egon Zehnder's Chicago Office. He has been quoted in the Wall Street Journal, Time Magazine, Corporate Board Member Magazine, Crain's, The Corporate Board and knowledge@Wharton. He has two Master's of Science Degrees from MIT, and an MBA from Kellogg at Northwestern University. Review more information on Louis here.