



Director Risk Management: Planning for the End Game

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for
A Board of Directors Retreat

Disclaimer



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Please seek appropriate professional advice before acting upon any information presented herein.

My Vantage Point



- Director of 4 public companies
- Former public company CFO, and then President & COO
- Former Big 4 audit partner
- I've run special investigations
- I've been sued



Begin with the END in Mind.

Are you strolling through a beautiful garden filled with:



- Colleagues
- Connections
- Directors' Fees
- Equity appreciation
- Prestige
- Professional & community standing?

Or, are you stumbling through an alley littered with IEDs*?



- Regulatory actions
- Special investigations
- Financial re-statements
- Director resignations / Loss of reputation
- Litigation / derivative actions
- Inadequate D&O insurance
- Potential personal liability?

*Improvised explosive devices

Defining Enterprise Risk



- Types of Risk
 - Strategic
 - Execution
 - Reputation
 - Compliance/Fraud
 - Legal
- Sources of Risk
 - Internal
 - Pressure to perform
 - Incentives
 - Rationalization
 - External
 - Competition/markets
 - Regulatory changes
 - Technology
 - Society

Source: Dr. Krishna Palepu, HBS

Mergers & Acquisitions



- Are especially treacherous whether you are:
 - Buying businesses,
 - Selling businesses, or
 - Selling the company.

- And, oh by the way,

Fair Value Accounting



- Is coming to a bank near you – FASB proposal would require fair value for all financial instruments including loans:
 - Fair value is a probability estimate
 - Fair values go up and down
 - Squishy accounting estimates could become quicksand for officers & directors



Liability is in the Eye of the Beholder.

Themes



- Shareholders come first.
- Conflicts of interest can be killers.
- Process, process, process...
- Indemnification agreements
- D&O value is in the Terms & Conditions

Shareholders come first.



- Duty of care
- Duty of loyalty
 - Duty of good faith
- Duty of disclosure (candor)
- Duty to monitor
 - Duty of Oversight

Conflicts of interest



- Real & perceived:
 - Personal / institutional relationships
 - > Oracle Board Special Committee
- Related party transactions:
 - Valuation
 - Accounting
 - > Who is benefiting? Ex – Conrad Black

Process, process, process...



- It's not about being right.
- Advisors matter:
 - Multiple advisors; -> multiple fairness opinions
- Material / major decisions require:
 - Adequate information
 - Adequate deliberations over multiple meetings
 - Adequate documentation – minutes, other materials
- --> Benefit of the Business Judgment Rule

Indemnification agreements



- Individual contractual rights
 - Supplement charter & by-law provisions
 - Cannot be changed after you leave
 - Should be regularly reviewed & updated
-
- *Schoon v. Troy Corp (Delaware 3/28/08)*
(Effectively overturned by subsequent legislation)

When you need it,



- Will your D&O insurance look like Swiss cheese?
 - Do you use an Independent broker?
 - Have you assessed the Carriers' strength?
 - Have you reviewed all of your policy's Terms and Conditions?

D&O - T's and C's



- Change in control provision
- Priority of payments endorsement
- Waiver of automatic stay provision
- Full severability provision
- Nonrescindable Side A coverage
- Separate Side A-only policies

D&O - T's and C's (cont.)



- Side A excess difference in conditions
- Insured vs. insured exclusion with a carve-out
- Fraud/crime exclusion fine print
- Extended reporting period (tail) coverage
- Regulatory exclusion
- Hammer clauses



My Personal Guidelines

Screening Boards



- Is this a business that I understand?
- Does the company have good growth prospects?
- Is it financially sound?
- Does the management have a reputation for integrity?
- Is the board primarily composed of independent directors as opposed to insiders?
- Is there an opportunity for me to make a contribution to the company's success?

Once on the Board



- Was everything as it seemed?
- Did I miss anything significant?
- Is the board actively engaged?
- Do the numbers add up?
- Do the explanations make sense?

My Three Cardinal Rules



1. Know what you are doing
2. Pay attention
3. Ask LOTS of questions



Q & A