

## Board Member Status... *Losing Its Appeal?*

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BY THOMAS HAYS

**W**ith the recent bankruptcy of Enron, and the furious scrutiny which the company received from its disgruntled employees, government officials, and the news media — some of the very first public rhetorical questions were: “Where was the company’s board of directors in this mess? Who are they? Why didn’t they take some action? And, what were their motives?” The recession of the past two years, combined with symbols like Enron have now cast a pall over the opportunity of serving on a company board. Remember the days when a business executive couldn’t wait to get asked to serve on a company board! If you were invited for such a responsibility and title, it confirmed a certain level of attainment and status for you. It looked great on the resume. And it was the perfect enhancement during country club conversation when you could casually drop in: “Oh...I’m a member of the board of directors of XXX company...” A lot of hostility has erupted out of corporate activities like deflated investments, downsizing and reform. In many distressed businesses this has adversely affected the boardroom. It is no longer “fun” to serve on a corporate board. In fact, an invitation to join a board should now be examined with a suspicious, skeptical view. Going forward, forget the idea that the responsibility and amount of work expected from a board member can be covered over with formality, or by rubber-stamping the agenda. The hyper litigious setting which surrounds a lot of businesses, means that abundant oversight, checking, and monitoring in the future will make it very difficult for a board member to miss meetings or be disengaged from company activity. Today it is nearly inexcusable that they should be out of the loop considering the level of high technology which enables communication, information, and knowledge. A situation which appeared at first glance to take one day a quarter, or one day a month, has the potential to chew up multiple days on your calendar! More

than ever before, serving on a board is going to require your commitment to absorb all of the information, statistics, and data about the company’s operation. You must make it your business in finding out what is going on there. If you fail to ask the right questions, or do not demonstrate that you have properly investigated an issue, you could find yourself as a defendant in an encompassing suit by aggrieved parties who feel you committed misfeasance! (Keep in mind that the principals of many companies really don’t want you snooping around or making waves. So it is critical to clearly establish up front the definition of your role as a corporate director.) Insurance to protect the liability of board members is becoming increasingly important. And, if the compensation or perks for board members appears to be excessive, you can be assured there will be a chorus of protestors and critics. As a board member privileges which appeared harm-

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less in the past, like recommending your wife’s cousin for a job at the company, or obtaining a personal service contract from the company which helps your business — are now viewed as conflicts compromising the best interests of the company. These can come back to haunt you, big-time. When companies are moving toward the zone of insolvency, their directors’ obligations switch to creditors from shareholders. Many board members ignore or overlook this. For instance, a board may have several options: to conduct an orderly

winding down of operations where the shareholders would receive nothing, but the creditors would receive say, eighty cents on the dollar. Or, the board could try a very risky strategy, where there could be a real long-shot for the shareholders — but nothing left for the unsecured creditors. Again, this option puts the board members at enormous personal liability. (There is a well-known story how the chief executive officer at one of America's largest shipping and courier companies went to Las Vegas to cover a payroll shortfall. He won enough at the tables in order to cover the payroll. This is the exception.) A strike out is the general result of such a swing for the fences attitude. The legal obligation of directors is to choose the less risky option, which would provide the largest return to the creditors. There is a constant evolutionary process underway in most states with new laws and regulations now affecting directors of businesses. In New York State for example, the largest shareholders are targeted as the responsible entities for payroll. I have had personal experiences with several corporate boards, where their active engagement and efforts to do the right thing despite very difficult tests and adverse challenges, resulted in a successful outcome.

1) There was a biotech company where I was engaged by the board of directors as the turnaround management consultant. Shortly after that, I reported back to the board that the company was not viable. The directors immediately asked if we could come up with a plan to determine where the pools of value were, and how best to realize value from them. We cut costs, negotiated reduced leases, stretched payment schedules and more, while the chairman of the company went on a re-vitalized campaign to sell the technology. A major creditor came forward thinking they had a lien on the company's technology that proved wrong as the lien was not properly perfected. Once they were aware of this, the creditor, a state agency responsible for job creation, worked with the chairman to identify targets for the technology and assisted the purchaser with financing. The company was able to give all of the trade creditors 100 cents on the dollar. The technology was successfully transferred to another company. And the directors were left with a public shell, which our firm negotiated a reverse merger. The stock is now actively traded again, selling at many times its value at the time it was delisted from NASDAQ.

2) Another biotech company had a high cash burn rate, with a projected life of six or seven weeks. The company had been in business a number of years. It had raised substantial equity and had three products which were FDA approved. With the directors, I reviewed the different products in the pipeline which had long-term potential, those with near-term potential, and others which were no good. The board completed one technology sale that was in the works, agreed to take action on closing a subsidiary, shelved several products, and reduced the workforce from 175 down to fifty. The board identified a highly credentialed chief executive officer, to replace the interim officer running the company. The candidate had refused an earlier offer due to reservations on viability. After reviewing the turnaround plan, he realized the company had a good chance of flourishing. He accepted the job and has lead decisively. Within a period of time, the company's stock went from well under a dollar per share to settle around \$4 per share. Clearly, this active, interested, and engaged board of directors made a difference toward a successful conclusion.

3) I was brought in by a private equity firm into a service company dealing with employees. It had recently made a large acquisition that was not properly integrated. Additionally, one of their complex computer systems crashed causing them to lose financial control over key aspects of the company. The board met daily until we got things under control through key meetings with a supportive management team. I advised against continuing to invest money in the company, however some board members and investors decided to go forward and invest additional funds. They invested not purely for financial reasons but also to ensure aspects of their firm's reputation. The company has continued to survive and is now up for sale. The investors should be able to exit themselves from the investment with a small profit.

4) After allegations of fraud, a bank insisted that a new board of directors of a transportation company be elected. The company was in bankruptcy. The new board started to move the company forward. I was called in at the recommendation of the banks as the chief re-structuring officer dealing primarily with the bankruptcy process. The directors were also officers during my introduction to the process. This allowed them to take care of business while I took care of the bankruptcy related process. This experience pointed out that where a business organization and its board is represented by relatives and multiple family members, a new, independent board can be vital in creating credibility, especially after severe allegations. Again, the new directors had to make several difficult, painful decisions and they did not ignore or shirk their responsibilities. It was healthy that the replacement board was willing to stand up, speak out, and ask solid questions which required a recitation of facts. Ultimately the company was liquidated. Had it not been for the actions of the board, there would have been no recovery for creditors. According to a recent article in *Chief Executive Magazine*, new director appointments at S & P 500 companies have dropped 45% over the past three years.

If you are asked to join a board, you should interview the other board members to ensure that they maintain your high standards. If they don't, you should run! **m**

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