

The Metropolitan Corporate Counsel[®]

www.metrocorpcounsel.com

Volume 20, No. 4

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April 2012

Questions To Ask When Your Director Or Executive Officer Wants To Join Another Board

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Introduction

Counsel for public companies are often asked to assist in vetting new candidates for a board of directors. Just as important is reviewing the issues that arise when a current director or executive officer (the candidate) of a public company (Company A) is asked to join the board of another public company (Company B). Asking questions about Company B and the candidate's future role *before* the candidate is appointed to Company B's board can avoid potentially embarrassing disclosures or, worse, the need for the candidate to resign from a board position. The Clayton Act, Securities and Exchange Commission (SEC) disclosure rules, rules of the stock exchange on which the stock of Company A is traded and Company A's governance documents will all play a role in determining the feasibility, and advisability, of the candidate joining Company B's board.

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What Are The Facts?

In order to conduct a thorough review of the implications of service to both companies, the first step is to gather information regarding Company B and the roles the candidate will have on Company B's board. Company B's business, size and location of operations, as well as the identity of its directors and executive officers, should be determined. The Company B board committees on which the candidate is expected to serve should also be identified.

Is The Clayton Act Implicated?

The next step is to consider these facts in the context of Section 8 of the Clayton Act, as this is the most likely law or rule to present an absolute prohibition on serving both companies. The Clayton Act generally provides that a person cannot serve as a director or officer in any two corporations that are competitors. The Act provides exceptions to this prohibition, including in connection with the type of companies, the size of the companies based on capital, surplus and undivided profits, and the competitive sales of the companies. If there is a possibility that Company A and Company B are competitors, counsel will want to look closely at the Clayton Act to ensure

that an exception to the general prohibition is available. Counsel for Company A and Company B may want to confer if there is a potential issue because it is clearly in the interests of both companies to come to the correct conclusion.

Are There Other Prohibitions Or Is Board Approval Required?

The next step is to review Company A's governance documents and any applicable exchange rules for limitations on serving other companies or approvals that are required prior to the candidate accepting a position on Company B's board. In particular, the corporate governance principles of many companies limit the number of public company boards on which one of its directors may serve, or require a finding by the company's board that service on another board will not interfere with the director's existing board commitments. In determining whether service on Company B's board will interfere with service to Company A, the number and type of committees on which the candidate will serve on Company B's board will assume a prominent role in making any determination that may be required. Service on audit committees and compensation committees in particular is likely to involve a substantial time commitment.

Even if Company A's governance documents do not require any board approvals, the rules of the exchange on which Company A is listed may. For example, New York Stock Exchange (NYSE) rules provide that if an audit committee member simultaneously serves on the audit committees of more than three public companies, then the board of the listed company must deter-

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mine that such simultaneous service would not impair the ability of such member to effectively serve on the listed company's audit committee.

If Company A's board is required to make any approvals in connection with the candidate's service to Company B, counsel will want to provide Company A's board with the details of the approval requirement and the disclosure and investor considerations outlined below. Company A's board may also want to discuss with the candidate his or her current time commitments and any resulting impact the candidate anticipates by adding service on Company B's board. That way, Company A's board will be fully informed prior to granting any required approval.

What Are The Disclosure Implications?

Regardless of whether Company A's board is required to take any action, Company A likely will need to modify its future public disclosures if the candidate joins Company B's board. These modifications range from the obvious, such as revision of the candidate's biography to disclose service on Company B's board, to other disclosures that may not be apparent without a detailed review of SEC rules, any applicable exchange rules and the company's corporate governance documents.

Under SEC rules, if the candidate is an executive officer of Company A and an executive officer of Company B serves on Company A's compensation committee, then Company A would be required to disclose this in its annual proxy statement or annual report. Similarly, if the candidate is an executive officer of Company A and serves on Company B's compensation committee and an executive officer of Company B served as a director of Company A, then Company A would be required to disclose this in its annual proxy statement or annual report.

Turning again to the NYSE rules as an example of exchange requirements, if the candidate will serve on the audit committee of more than three public companies and Company A's board has determined that this simultaneous service will not impair the ability of the candidate to serve on Company A's audit committee, then NYSE rules require

Company A to disclose such determination either on or through its website or in its annual proxy statement (or if Company A does not file an annual proxy statement, in its annual report on Form 10-K). If this disclosure is made on or through Company A's website, then Company A must disclose that fact in its annual proxy statement or annual report, as applicable, and provide the website address.

The policies adopted by Company A could also trigger disclosure requirements. Particular attention should be paid to Company A's code of conduct and, if Company A and Company B do business with one another, any independence standards or related-party transaction policies that Company A has adopted.

If Company A places any limitation on its directors or executive officers serving on other boards and that limitation is part of, or incorporated by reference into, Company A's code of conduct, then any waiver of such limitation to allow the candidate to join Company B's board could require disclosure. If the waiver relates to Company A's principal executive officer, principal financial officer, principal accounting officer or controller, SEC rules require disclosure in a current report on Form 8-K or the company's website. If the waiver relates to any other officer or a director, both NYSE and NASDAQ rules would require Company A to disclose the waiver in a press release, in a current report on Form 8-K or on the company's website, depending on the circumstances.

The relationships that would by definition under NYSE or NASDAQ rules disqualify a Company A director from being independent should not be implicated by an otherwise independent Company A director joining Company B's board. However, if Company A's board has adopted more stringent independence policies and Company A and Company B do business with each other, there is the potential that the candidate will no longer be independent. Also, if Company A's board considers the candidate's service on Company B's board in determining the candidate's independence, that may need to be disclosed in Company A's proxy statement or annual report.

Similarly, Company A's related-party

transaction policy should be reviewed. Although Company A would not be required to disclose as "related-party transactions" in its SEC reports any transaction with Company B solely because a Company A director is also a Company B director, if Company A has adopted a related-party transaction policy, Company A will want to be sure it complies with any approval or disclosure requirements contained in its policy.

Will Our Investors React Negatively?

Finally, Company A should consider how its investors will perceive the service on both boards. In this regard, Institutional Shareholder Services (ISS) policies and recommendations may have an impact. ISS has articulated a concern with "over-boarding," which is not surprising given that the National Association of Corporate Directors has reported that a single directorship required an average commitment of 228 hours in 2011. Accordingly, ISS has indicated that it will recommend withholding votes for director nominees who are chief executive officers and serve on more than three public company boards (although ISS will not recommend withholding votes for the CEO on his or her own company's board in this case) and will recommend withholding votes for directors who are not chief executive officers and serve on more than six public company boards. In addition, news reports indicate that at least two institutional investors have stated they will likely oppose re-elections at 2012 annual shareholder meetings of certain chief executive officers serving on more than one outside board.

Conclusion

In the current atmosphere of heightened scrutiny on corporate governance, capable directors are in high demand. No one wants to inform a qualified executive officer or director that he or she cannot serve on another company's board. However, a careful review of the relevant prohibitions and limitations will allow you to inform both the candidate and your company's board of any potential issues and required approvals, allowing the candidate and your board to make a fully informed decision as to the candidate's additional board service. This simple process can avoid potentially embarrassing situations or disclosures.