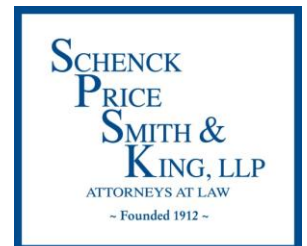


BUILDING A HELPFUL BOARD & UTILIZING IT EFFECTIVELY

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Celebrating 100 Years



DEVELOPING & UTILIZING THE BOARD

IA. Statutory Board of Directors

- ▶ A Trip down Statutory Lane

Certificate of Incorporation

N.J.S.A. § 14A:2-7(h)(i)

- ▶ The certificate of incorporation shall set forth
 - The number of directors constituting the first board and the names and addresses of the persons who are to serve as such directors

Organization Meeting of Directors

N.J.S.A. § 14A:2-8

On or after the effective date of the certificate of incorporation, an organization meeting of the board named in the certificate shall be held, at the call of a majority of the board so named, to adopt bylaws, elect officers, authorize the issuance of shares and transact other such business as may come before a meeting. The board members calling the meeting shall give at least 5 days notice by mail to each director, which notice shall state the time and place of the meeting

Board of Directors

N.J.S.A. §14A:6-1

- ▶ The business and affairs of a corporation shall be managed by or under the direction of the board
- ▶ Directors must be at least 18 years of age
- ▶ Directors need not be US citizens or residents of the State or shareholders unless the certificate of incorporation otherwise provides
- ▶ Directors each determine what he/she reasonably believes to be in the best interests of the corporation

Number of Directors

N.J.S.A. §14A:6-2

- ▶ The board of directors shall consist of one or more members
- ▶ Subject to the certificate of incorporation, the bylaws shall specify the number of directors or provide a maximum/minimum

Term of Directors; Resignation

N.J.S.A. §14A:6-3

- ▶ Directors named in the Certificate of Incorporation shall hold office until the first annual meeting of shareholders until their successors shall have been elected and qualified.
- ▶ A director may resign by written notice to the corporation.

Classification of Directors; Restriction of Right to Choose Directors N.J.S.A. § 14A:6-4

- ▶ A certificate of incorporation may provide for the classification of directors in respect to the time for which they shall severally hold office, but no class of directors shall hold office for a term shorter than one year or longer than 5 years and term of office of at least one class shall expire in each year.
- ▶ A certificate of incorporation may grant shareholders of a class the right to elect one or more directors upon the occurrence of stated events for a specific term

Vacancies and Newly Created Directorships

N.J.S.A. §14A:6-5

- ▶ Unless otherwise provided in the certificate of incorporation, any directorship not filled at the annual meeting, any vacancy and newly created directorships resulting from an increase in the authorized number of directors may be filled by the affirmative vote of a majority of the remaining directors even though less than a quorum of the board.
- ▶ Any directorship not filled by the board may be filled by the shareholders at an annual meeting or a special meeting of shareholders

Removal of Directors

N.J.S.A. § 14A:6-6

- ▶ One or more or all the directors may be removed for cause or unless otherwise provided in the certificate of incorporation, without cause by the shareholders by the affirmative vote of the majority with certain qualifications
- ▶ A certificate of incorporation or a bylaw may provide that the board has the power to remove directors for cause and to suspend directors pending a final determination
- ▶ The Superior Court may review the removal or suspension in a summary manner
- ▶ No act of the board during the period of the director's suspension or removal for cause shall be invalidated solely on the account of the suspension or removal if the suspension or removal is thereafter rescinded by the shareholders or by the board or by final judgment

Directors Conflict of Interest

N.J.S.A. §14A:6-8

- ▶ No contract or transaction between a corporation and one or more of its directors or between a corporation and any firm or association of any type or kind in which one or more of the directors are otherwise interested shall be void or voidable solely by reason of such common directorship or interest or solely because such director is present at the meeting of the board or a committee that approves the contract or transaction if certain conditions are true:
 - Contract is fair and reasonable as to the corporation
 - The fact of the common directorship or interest is disclosed or known to the board/committee and it approves the contract by unanimous consent, provided at least one consenting director is disinterested or by majority vote of disinterested directors
 - The fact of the common directorship is disclosed or known to shareholders and they authorize the contract
- ▶ Common or interested directors may be counted in determining the presence of a quorum
- ▶ The board, by affirmative vote of a majority of directors irrespective of any personal interest of any of them, shall have the authority to establish reasonable compensation of directors for services to the corporation as directors, officers or otherwise

Executive Committee; Other Committees

N.J.S.A. §14A:6-9

- ▶ If the certificate of incorporation or bylaws provide, the board, by resolution adopted by a majority, may appoint from among its members an executive committee and one or more other committees, each of which shall have one or more members.
- ▶ No committee shall
 - Make, alter or repeal any bylaw
 - Elect or appoint any director; remove any officer/director
 - Submit to shareholders any action that requires shareholder approval
 - Amend or repeal any resolution

N.J.S.A. § 14A:6-9 (cont.)

- ▶ The board by resolution adopted by a majority may
 - Fill any vacancy in any such committee
 - Appoint one or more directors to serve as alternate members of any such committee
 - Abolish any such committee at its pleasure
 - Remove any director from membership on such committee at any time with or without cause
 - The designation of a committee and delegation of authority shall not operate to relieve the board of any responsibility imposed by law

Place and Notice of Directors' Meetings

N.J.S.A. § 14A:6-10

- ▶ Unless otherwise provided in the certificate of incorporation or bylaws, meetings may be held inside or outside of the state
- ▶ Regular meetings may be held with or without notice as provided in the bylaws. Special meetings shall be held upon notice as provided in the bylaws
- ▶ The business of the meeting and/or the purpose of the meeting need not be provided in the notice unless required by the bylaws
- ▶ Directors have a right to participate in the meetings by telephone or any other means of communication unless otherwise provided in the certificate of incorporation or bylaws

Liability of Directors in Certain Cases

N.J.S.A. § 14A:6-12

- ▶ Directors who vote for or concur in any of the following actions:
 - Declaration of any dividend or other distribution of assets to the shareholders contrary to any restrictions in the certificate of incorporation
 - Purchase of any shares contrary to this Act or to any restrictions in the certificate of incorporation
 - Distribution of assets to shareholders during or after dissolution without paying or adequately providing for all known debts, obligations and liabilities only to the extent of the value of assets so distributed and to the extent such debts are not thereafter paid or discharged
 - Complete liquidation and distribution of all assets to its shareholders without dissolving or providing for dissolution and the payment of all fees, taxes and other incidental expenses except directors are liable only to the extent of the value of assets so distributed and to the extent such debts are not thereafter paid or discharged
 - Making of any loan to an officer, director or employee or any subsidiary contrary to the act; are jointly and severally liable to the corporation for the benefit of creditors or shareholders to the extent of any injury

Liability of Directors; Presumption of Assent to Action taken at a Meeting N.J.S.A. § 14A:6-13

- ▶ A director who is present at a meeting at which action on any corporate matter referred to in 14A:6-12 is taken shall be presumed to have concurred in the action unless his dissent is entered into the minutes of the meeting or files his dissent to the secretary immediately prior to or after the adjournment
- ▶ A director who is absent from the meeting at which such action is taken is presumed to have concurred unless he files his dissent with the secretary

Liability of Directors; Reliance on Records and Reports

N.J.S.A. § 14A:6-14

- ▶ Directors and committee members shall discharge their duties in good faith and with that degree of diligence, care and skill such ordinarily prudent people would exercise under similar circumstances in like positions
- ▶ In discharging their duties, directors and committee members shall not be liable if, acting in good faith, they rely:
 - Upon the opinion of counsel of the corporation;
 - Upon written reports setting forth financial data of corporation and prepared by an independent accountant;
 - Upon financial statements, books of account or reports of the corporation represented to them to be correct by the president, officer having charge of its books of account or person presiding at meeting of the board
 - Upon written reports of the committees of the board
- ▶ A director will not be personally liable to the corporation or its shareholders for damages for breach of duty as a director to the extent such liability has been eliminated or limited by the certificate of incorporation authorized by N.J.S.A. § 14A:2-7

Officers N.J.S.A. § 14A:6-15

- ▶ The officers shall consist of a president, a secretary, a treasurer and if desired, a chairman of the board, one or more vice presidents and such other officers as provided in the bylaws. Unless otherwise provided in the bylaws, officers are elected by the board
- ▶ Any two or more offices may be held by the same person but no officer shall execute, acknowledge, or verify any instrument in more than one capacity if the instrument is required by law or bylaws to be executed by two or more officers
- ▶ Any officer elected shall hold office for the term for which he is so elected and until a successor is elected and has qualified, subject to earlier termination by removal or resignation
- ▶ All officers as between themselves and the corporation, shall have such authority and perform such duties in the management of the corporation as may be provided in the bylaws or as may be determined by resolution of the board not inconsistent with the bylaws

Removal and Resignation of Officers; Filling of Vacancies

N.J.S.A. § 14A:6-16

- ▶ Any officer elected by the board may be removed by the board with or without cause
- ▶ An officer elected by the shareholders may be removed with or without cause, only by the vote of the shareholders but his authority to act as an officer may be suspended by the board for cause.
- ▶ The removal of an officer shall be without prejudice to his contract rights, if any.
- ▶ An officer may resign by written notice to the corporation.
- ▶ Any vacancy occurring among the officers, however caused, shall be filled in the manner provided in the bylaws. In the absence of such provision, any vacancy shall be filled by the board

Statutory Board of Directors – Responsibilities

- ▶ Makes all business decisions not explicitly or implicitly delegated to officers
- ▶ Cannot delegate extraordinary business decisions
- ▶ Can limit or expand the authority of the officers
- ▶ Officers typically engage in transactions in the ordinary course of business without any prior authority from the Board
- ▶ Should be made clear to officers that Board must authorize all contracts and transactions outside the ordinary course of business (usually expressed in bylaws)

Board Responsibilities (cont.)

- ▶ Authorize charter amendments, a merger or consolidation, a sale of substantially all of the assets not in the ordinary course, share exchange or dissolution (subject to shareholder approval)
- ▶ Determine consideration to be paid for stock
- ▶ Authorize cash/stock dividends/divisions
- ▶ Approve director conflict of interest transactions and indemnification of corporate agents

IB. Advisory Board

- ▶ Can be composed of outside advisors to the company that give the CEO–founder and management specific input or expertise as needed
- ▶ Advise on various topics
- ▶ Have no legal power or authority, no enforcement power
- ▶ Can consist of legal counsel, accountants, consultants, marketing or technology experts, senior owner–managers, persons with possible connections to various markets and possibly representatives of non–participating shareholders
- ▶ Serves at the pleasure of the company CEO or president or as provided in the company documents

IC. Functions of the Board Statutory

- ▶ Ensure Effective Governance
- ▶ Monitor and Improve Business Policy and Strategy
- ▶ *Provide Advice and Counsel to Management**
- ▶ *Oversee Succession Planning (business and family)**
- ▶ *Support Shareholders (shareholders and family members/shareholders)**
 - Monitor liquidity plans
 - Encourage consensus reaching among family members
 - Strengthen the business culture
- ▶ *Enhance communication and conflict resolution**
- ▶ Monitor company and hold it accountable
- ▶ Actively participate
- ▶ Select CEO

**Advisory Board can assist*

Functions of the Statutory Board (cont.)

- ▶ Monitor compliance with law
- ▶ Further company interests
- ▶ Periodically assess the management and board itself
- ▶ Protect the shareholders
- ▶ *Oversee the family's participation in the business**
- ▶ *Assist in "big picture" decisions**
- ▶ Interface with management on behalf of shareholders
- ▶ Maximize shareholder value
- ▶ *Can assist in resolving family squabbles and keep business on track**

**Advisory Board can assist*

Duties & Authority

Statutory Board v. Advisory Board?

- ▶ Boards' role is to supervise rather than manage.

ID. Value Added and Advantages of having a Board of Directors

- ▶ Vietri, Inc.

The case of Vietri, Inc.

Vietri, Inc. is a wholesaler of Italian ceramics founded by two sisters and in the same year they founded the business, assembled a board of directors made up of themselves, close friends, and experts. Success immediately followed. With success, they put in place a formal board of directors to guide them through growth and the growing pains of their lucrative dinnerware import business. One thing the sisters did wrong, however, was to appoint themselves as co-presidents of a thriving company. Certainly, tensions erupted between them that threatened the very fabric of the family, not just the business. But since they had the foresight to create a board at the infancy stage of the business, it became easier to manage and resolve the crises that came about. The board they instituted was not an independent board; rather, upon their father's counsel, it was a board composed of friends who had experiences in certain areas of business that the sisters did not. Although the board met only once a year, the sisters communicated with their board members individually half a dozen times per year, whether to seek business advice or as a sounding board for ideas. Despite being an insider board with one annual formal meeting, it was still a body that was able to assist, serve, and advise the founders.

Vietri, Inc. (cont.)

At one point, Susan was approached by a dinnerware company that wanted to be bought out by Vietri, Inc. She was very interested and excited with the prospect. But after consulting with the board, it was decided that the businesses were not complementary. Had she not listened to the board's sound advice, or if Vietri, Inc. had no board at all, then the sisters could have immediately jumped into a business venture not knowing the traps and liabilities of that company. In time, the board proved instrumental in making the sisters-owners more mature and sensitive in their approach to the business. Susan eventually became the president and Frances became the vice-president for marketing. They were able to "[carve] out separate domains" for each sibling. Many years later, when the board recommended to Susan that she needed to designate a successor just in case something happened to her, she maturely, yet painfully, anointed Vietri, Inc.'s ten-year accountant instead of her sister, Frances. The latter accepted the decision. The board, in essence, played a key role in ensuring that the sibling rivalry ordinarily found between sisters did not threaten to consume the enterprise. Vietri, Inc. continues to be a profitable business today.

IE. Summary of Liability for Failure of Board/Officers to meet Responsibilities

- ▶ If breach fiduciary or statutory duties, can be held personally liable
- ▶ Can be punished for knowingly “making” dividends, repurchasing shares, or over-issuing shares if purpose is to defraud
- ▶ Personal liability if violate antitrust laws, under ERISA for unpaid pension plan contributions, under immigration laws for unauthorized aliens, committing environmental torts, insider trading, unlawful distributions to shareholders

II. Responsibilities of Directors v. Officers

- ▶ How to recognize boundaries
- ▶ Relationship between the CEO and Directors – cultivation and care

III. Frequency of Meetings and Content

- ▶ Prepare and send out the agenda and materials for review at least a week before a meeting
- ▶ Include key staff members in relevant portions of Board meetings
- ▶ Invite outsiders to Statutory Board meetings – i.e. Advisory Board, counsel, accountants or consultants
- ▶ Have the Board assess the performance of the CEO, officers and key employees
- ▶ Avoid having the meetings simply rubber stamp all strengths while avoiding discussion of the weaknesses or areas needing improvement

Board Meetings

- ▶ There are no statutory requirements or limitations on location, time or notice of regular meetings
- ▶ Notice does not have to specify the purpose of the regular meeting
- ▶ Regular meetings can be held with or without notice (best practice – give 7–10 days' notice)
- ▶ Special meetings to be held on notice

Board Meetings (cont.)

- ▶ Statutes do not provide norms for meetings; bylaws determine the procedures
- ▶ Minutes should be kept for each meeting and circulated to Board members
- ▶ Directors may vote on their own compensation as directors or as officers

IV. Size of Board

- ▶ Determined by:
 - The Certificate of Incorporation; or
 - The Bylaws
- ▶ Depends on the size of the company

V. Terms and Term Limits

- ▶ Determined by:
 - The Certificate of Incorporation; or
 - The Bylaws
- ▶ Director holds office until the successor has been elected and qualified
- ▶ May resign by written notice
- ▶ Best practices for terms and term limits in privately held companies

VI. Considerations in forming a Board

- ▶ Directors and Officers Insurance
- ▶ Corporate and Shareholder Indemnifications
- ▶ Product and Environmental Liability Insurance

VII. Identify Candidates Developing & Mentoring your Board

- ▶ Identify the skill set needed
 - Look at Clemens example
- ▶ Prepare all Board candidates for membership
 - Get them involved and knowledgeable early
 - Set expectations for their participation

VIII. Mentoring your Board

- ▶ Orient them initially as to the Company mission, financials, key personnel, family expectations and overall issues
- ▶ Don't avoid the hard questions!
- ▶ Meet with your Board members and communicate regularly
- ▶ Seek the input from those with a different, objective and perspective
- ▶ Communicate with Directors as to their performance and contributions
- ▶ Independent Director(s)

VIII. The Model Independent Board

- ▶ The Clemens Family Corporation (Hatfield Quality Meats)

A family business

- ▶ In 1999, the board was puzzled as to why the company was in a downward financial spiral. After consulting with the board, Phil Clemens spearheaded a rapid, behind-closed-doors corporate upheaval that revitalized the entire company, but also bred familial discord, albeit temporarily. With the help of a strategic consultant, it was decided that a succession planning committee should immediately be formed and given plenary powers. After three months of deliberations, the resolutions of the committee were astounding and radical: long-entrenched family directors and employees were asked not to return to the company. The board, which was originally composed of ten family representatives and two independents, was disbanded. It was also decided that two family middle managers needed to gain outside experience. The board of directors was heavily reconstituted with four old family directors asked not to return; two thirty-five year family employees were dismissed; a parent company known as Clemens Family Corporation was created; and an Owners' Advisory Council was established

A company with a very humble foundation and deeply rooted in values, the Clemens Family Corporation did not always have an independent board. There was a majority of family members as directors with just a handful of outsiders. These outsiders were listened to at first, but their ideas were not implemented simply because of a prevailing attitude that the “family members know better.” Part of the strategy was to create an Owners’ Advisory Council whose main objective, other than to set owners’ expectations, was to interview and recommend candidates for the Clemens board. The board meets five times per year, has four standing committees, and is subjected to annual review. In an interview with Phil Clemens, he stated that the typical family business board in the United States is composed of all insiders. This is due to the fact that the founder-owner and the board believe they already know everything about the business, which is simply incorrect. He pointed out that independent directors have a variety of tasks that cannot be done by the very subjective founders or family members, such as serving as balancers on the board, and interviewing for and selecting the next CEO. In Phil’s opinion, directors also must not serve too long, as they will easily become attached to personnel, become friends with the CEO, and thus lose their independence. He asks: how can you vote against the CEO when he has already become your friend and colleague? Phil Clemens thus suggested that the minimum time to serve should be three years (electable every year) and the maximum ought to be ten. This time period will leave a comfortable average of around seven years of board service. Based on his own experience, independent directors who become close friends with the CEO should resign.

There are times when independent directors can play mediating roles, but the maintenance of family unity is not one of their chief functions. On the charge that independent directors do not know the business they are asked to monitor, Clemens stated that independents are not tasked to know every corner of the business. The nature of the job of an independent director is to select the next CEO, provide insight from the outside, oversee management, give a different yet fresh perspective, and present the bigger picture objectively. It is not the nature of their job to interfere with the day-to-day affairs or to know everything there is to know about the company. His company's criteria for independent directors are:

- (1) currently a senior management individual from a successful business, with preference for Presidents or CEOs;
- (2) strong financial background and clearly understands the need and value of business metrics;
- (3) unquestionable ethics and integrity;
- (4) embraces the visions, values, and culture of the Clemens Family Corporation; and
- (5) proposed directors shall not have a conflict of interest with any Clemens Family Corporation business.

Recap

- ▶ Statutory Board (adds value)
- ▶ Advisory Board (adds value)
- ▶ Independent Advisors (add value)

- ▶ Responsibilities
- ▶ Obligations
- ▶ Liabilities
- ▶ Requirements

End of Part One

- ▶ Questions?
- ▶ Comments?
- ▶ Discussion