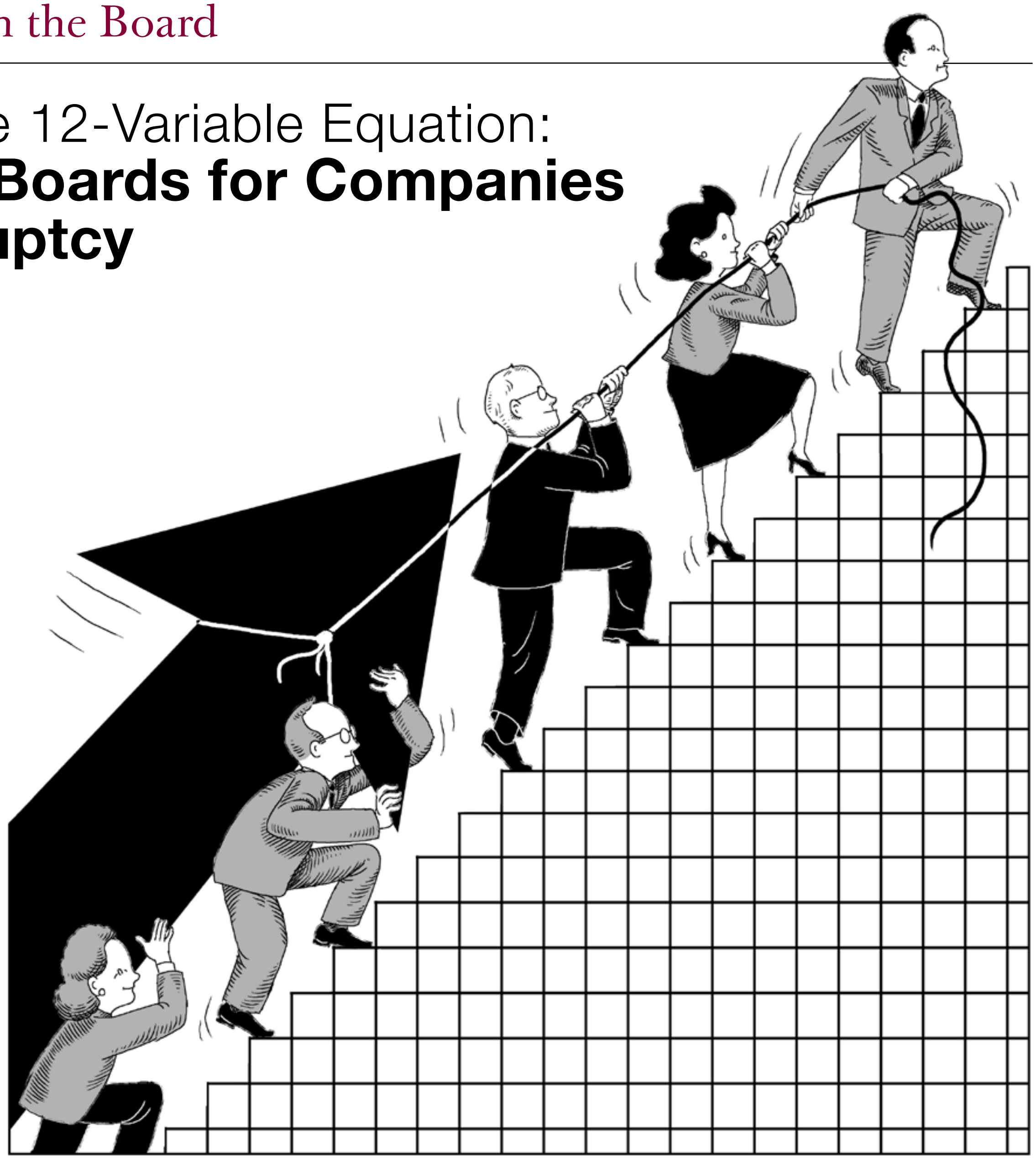
In Touch with the Board

Solving the 12-Variable Equation: **Building Boards for Companies in Bankruptcy**



In this issue, the Russell Reynolds Associates CEO/Board Services team discusses common challenges and best practices in putting together a board for a company emerging from bankruptcy. Our CEO/Board Services Practice has worked with numerous billion-dollar public companies to recruit new boards as part of Chapter 11 or parallel insolvency proceedings in other jurisdictions, including NewPage, Dynegy, SemGroup, Calpine, Quebecor Printing, SuperMedia, YRC, Kaiser Aluminum, Northwest Airlines, NorthWestern Energy, Mirant, NRG Energy, Xcel Energy, Canwest Newspapers and AbitibiBowater Holdings.

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In an age of activist shareholders, Sarbanes-Oxley and wary director candidates, every public company board search carries its own set of complexities, as well as a sense of working under the scrutiny of multiple constituencies. Nothing, however, quite compares with conducting a board search for a public company preparing to emerge from bankruptcy. All the factors at play in a traditional board search—prioritizing the qualities of desired candidates, balancing the perspectives of various factions, and managing the wooing process between candidate and board—are present to a heightened degree. As a result, bankruptcy board searches are an illuminating case study in the dynamics of corporate governance.

The Complexity of the Task

In a bankruptcy board search, of course, the mandate is to fill not just a single board seat but an entire board more or less from scratch—a condition that significantly complicates the task. In filling a single seat, determining the ideal characteristics of a new director is fairly straightforward, given that the qualities of all the other players are established. One knows the boardroom culture into which a new director must fit. In the post-Chapter 11 case, however, there is no pre-existing boardroom culture, only an empty table. Solving any equation with 10 or 12 unknown variables is a daunting task. To make the situation even more challenging, there almost always is significant time pressure, given that a board slate must be submitted several weeks before the hearing date set by the judge overseeing the case, and the exercise of naming a board usually gets pushed to the end of the bankruptcy process due to all the critical and contentious issues that also must be resolved, such as negotiating with banks and unions, before the composition of the board even can be considered. Thus, putting together a board does not begin until time is short and nerves are frayed from the heated arguments that have occurred along the way. From the perspective of the search firm advising the search committee, the charged nature of a restructured company board search usually is apparent from the beginning since the first task is to convince all parties represented on the committee—debtors, management and creditors (sometimes joined by incumbent directors)—that the search firm will be an objective facilitator that cannot favor one side over another. Fortunately, this normally is fairly easy to accomplish, given that the search committee's suspicions generally have more to do with each other than with any third party. It also is part of the search consultant's initial role to educate the search committee on the charge and keep the committee focused on the problem at hand. Unlike a standard search committee, which usually is composed of board directors who often are current or former CEOs and, thus, are well-versed in boardroom matters, a restructured company search committee frequently is largely populated by creditor representatives with limited direct experience in corporate governance issues. In an assignment to fill a single director seat, the first step is to develop a list of attributes likely to be required in that person—perhaps expertise in marketing or corporate finance, experience in emerging markets or track record as a change agent—as well as to identify the desired management style and governance philosophy to complement or counterbalance the existing board's personalities. When the charge is to fill an entire board, however, one must construct a list to cover the competencies needed by the entire group, as well as the collective governance style best suited to the task of moving the company forward. Getting consensus on the list of attributes—that becomes the filter against which potential candidates are screened—usually is one of the least contentious steps in the process. The difficulty, however, comes later, in assembling the right combination of table pounders and conciliators, up-through-the-ranks traditionalists and entrepreneurs, industry veterans and those from entirely different fields to result in a cohesive team that can provide a wide range of counsel and oversight to the new management.

The Search Begins

Ultimately, all parties agree on a wish list of candidates to approach. The executive search team further augments the list so that there are eight to 10 candidates for each seat to be filled. Doing so involves not only extensive database searching and research but also a great deal of internal discussion and discreet plying of sourcing networks to go past the usual suspects:

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- Who are the rising executives on the cusp of being elevated to CEO?
- Which CEOs might be near retirement and thus able to take on a new challenge?
- Who looks great on paper but might not have the temperament to shine in a turnaround scenario or who might be burdened with disqualifying conflicts?

Since some executives reject post-restructuring directorships out of hand, some potential candidates will be sounded out in general terms on the opportunity. (Such skepticism often is misplaced, given that companies emerging from bankruptcy are doing so with a clean slate. It is a pre-bankruptcy board one wants to avoid joining.) The process then returns to the search committee where the candidates are reviewed one by one. In addition to the pool that has been submitted, members of the search committee sometimes will have suggestions of their own. There is nothing wrong with that—as long as these candidates undergo the same process of scrutiny and analysis as everyone else. The premise of emerging from bankruptcy is a clean slate—so no one candidate should have an inside track to an oversight role.

The New Board Takes Shape

As the shaping of the board begins, the perspectives of the various players on the search committee become readily apparent. While debtors, management and creditors all have the same ultimate goal—for the company in question to successfully emerge from bankruptcy—they each are likely to have different priorities in how that is accomplished. For example, the debtors, who likely will be holding stock in the reorganized entity, might favor high-profile directors who will catch the eye of the business press and analysts and who will inspire confidence among shareholders. The new management, however, might have little interest in that brand of sex appeal, focusing instead on executives with purely functional expertise who can be counted upon to roll up their sleeves and be an active resource. And the creditors—whose ties with the company generally end on or shortly after emergence—usually are looking for all tasks to be wrapped up on schedule with a minimum of disruption. Board composition—like everything else in the bankruptcy process, even down to the location of meetings—is viewed by the participants as a zero-sum negotiation. The key to success is for members of the search committee to recognize that a range of abilities and approaches on the board will ensure that multiple objectives can be met, and this balanced composition makes for a strong board. Accomplishing this, however, demands a candidate pool that is both deep and wide enough to provide an array of options for each constituency. It also places a premium on identifying and highlighting candidates whose attributes satisfy multiple criteria—for example, a CEO who has overseen the shift from commodity to multiple product lines or a marketing chief who has significant international experience. So it is that

10 names per seat usually are winnowed to six, which is further cut to four once another round of due diligence uncovers disqualifying conflicts that were not readily apparent such as a relative who is an executive at a supplier. With the candidate pool now at 30 to 40 people, the search committee schedules several separate, full-day interview sessions. Interviewing candidates in a compressed time frame gives the search committee the additional benefit of comparing and contrasting candidates with each other and gaining a vivid sense of the chemistry mix offered by various candidate combinations. Interviews typically last an hour and center on the aspects of the candidate's career most relevant to the challenges faced by the emerging company; prior board experience; views on management/board relations, roles and responsibilities; and ability to commit the necessary time and energy. During the third interview day, incumbent directors who wish to be considered for the new board are interviewed along with the remaining candidates. This sets up the interesting dynamic of directors being interviewed not only by their peers (the other incumbent directors, if any, on the search committee) but by the debtors and creditors with whom they have been in heated and frequently acrimonious negotiations for the past several months. Not surprisingly, there often is an extra layer of cordiality as everyone tries to set aside past conflicts at least for the moment. But no matter how well-behaved everyone is, it is an uphill battle for an incumbent to stay on the reorganized board.

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Solving the Equation

After time for reflection, the search committee convenes again to make its selections. At this critical, high-pressure stage, some committees may revert to a zero-sum perspective and treat the proceedings like a major league sports draft, complete with I'll-give-you-yours-if-you-give-me-mine horse trading. Instead, committee members need to look at the big picture. After all, it is not a question of trading one candidate for another but rather solving an equation with 12 variables. And in focusing on how various combinations of people are likely to interact, there will be numerous occasions in which an excellent candidate will have to be cut from the list because he or she would unbalance, in one way or another, the board being built. Those hard decisions will have to be made collectively in the common ground that has been identified between each group's line in the sand of non-negotiables. Finally, somehow, the dust settles, and a consensus is reached. Offers are extended—and inevitable questions must be addressed. The first thing candidates usually want to know is who else has been asked to serve—who, in other words, will be in the foxhole with them? Prospective directors also will want a sense that the company really is working with a clean slate, with a new management team and a minimum of incumbent directors. Many times, evaluating the suitability of the incumbent CEO and senior management team is first on the new board's agenda. Members will want to know if any major acquisitions or divestitures are expected during the first year, given the significant due diligence work involved in those transactions, as well as upon which committees they might be asked to serve. For instance, offers that include requests to serve on the audit committee frequently bring serious pushback. There also will be standard inquiries about time commitments and logistics, including the frequency of board meetings outside the country and the possibility of phone participation. This last detail carries real significance: No one wants to be the person who dutifully treks across the country to a board meeting only to find that half the colleagues are phoning in. Given the challenges and time commitment of being a director of a company emerging from bankruptcy, why would someone accept in

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the first place? Just as some executives are drawn to start-ups or international postings, some simply are attracted to being part of a turnaround—an exciting fresh start for an enterprise. Others might have a particular fascination with the industry in question or see the experience as an important professional development opportunity. (If they are not retired, they likely will have to convince their own company's governance committee that there is a good reason to serve on this board before formally accepting.) Once the board is in place, the search committee usually convenes in a one- to two-day orientation session in which the incoming directors are briefed by the company's new management and key creditors, and time is scheduled so the directors have the chance to get to know each other and agree on how they will work together (including settling upon a work plan). This provides an opportunity for the board members to begin to outline their mandate prior to the formal assumption of fiduciary responsibility on the day the company emerges from bankruptcy.

Lessons to Consider

Building a board for a company emerging from bankruptcy is a special case in many ways. At the same time, however, there are several lessons that apply to more conventional director searches:

- **Look for candidates who can satisfy multiple skill sets.** It is inevitable that several members of the search committee will have strong ideas about the qualities that a new director should possess. It is worth the investment of energy to try and find those candidates who can meet multiple criteria.
- **Think through a new director's impact on the culture of the board.** Adding a new director is not just compiling a list of competencies. He or she—and the respective unique leadership style—will affect the dynamics of the board. The implications of choosing a particular candidate need to be weighed in the decision-making process.
- **Follow a structured process.** Given that the search committee likely has a great deal of experience working together, it can be tempting to cut corners in certain aspects of the selection process. But being deliberate about each step—determining criteria and sourcing and evaluating candidates—not only leads to better results but to a clearer understanding of the board's strengths and weaknesses, culture and the particular way in which it exercises its oversight role.

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