



THE

# Chairman's Forum

*Opening the door to new ideas*

NEWSLETTER

*Gerrish McCreary Smith, Consultants and Attorneys*

*October 2008*

**CHAIRMAN'S ALERT: A SPECIAL CHAIRMAN'S FORUM NEWSLETTER DISCUSSING CAPITAL PLANNING OPTIONS AND THE NEW TROUBLED ASSET RELIEF PROGRAM (TARP) WILL BE FORTHCOMING. KEEP YOUR EYE ON YOUR INBOX!**

In this month's edition of the Chairman's Forum newsletter, we initially begin the process of looking at who should be on our Board and how we begin to evaluate directors. One way is to remove disgruntled directors or directors that impede the overall flow and process of your organization. In upcoming editions of the Chairman's Forum Newsletter, we will look at actual evaluation tools such as questionnaires, peer evaluations and the like.

In this edition, we also briefly discuss the issue of advisory boards as well as take a quick look at a key case that just came out which reaffirms the Chairman's need to maintain his Board's adherence to core fundamental duties of care and duties of loyalty. We trust that this information will be useful to you.

Happy Reading!

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## *CHAIRMAN'S SUMMARY*

- ◆ Be prepared to handle the dirty work of dealing with problem directors, it is your responsibility.
- ◆ Review your Articles and Bylaws to ensure that there are appropriate mechanisms that can be triggered to remove a problem director without difficulty.
- ◆ If you have an advisory board, consider whether it is still useful.
- ◆ One Chairman elected to convert to a virtual advisory board, perhaps you should, too.
- ◆ Core director duties are still critical. The Chairman should ensure an adequacy of process in certain decisions to make sure core duties are being met.
- ◆ The Chairman and the Board in general cannot simply relieve themselves of duties by passing decisions along to stockholders.

## *DEALING WITH PROBLEM DIRECTORS*

Recently we have encountered a number of situations with boards who are dealing with what might best be described as “problem” directors. Often times, this can be a director who does not seem to be on board with the general direction of the rest of the board members, an individual who is disgruntled over a particular issue, or an individual who is simply so antagonistic to the rest of the board members that the overall progress of the organization is being impeded. Typically, you would think that the short answer is to

simply get rid of the troubled or problem director. However, many of these organizations find that they really have no appropriate corporate tools at their disposal to remove the director and, if they simply ask the director to resign, they find that apparently the director takes great comfort in being the thorn in everyone's side and refuses to resign.

As Chairman of the Board, the responsibility will typically fall to you to handle the dirty work of dealing with the problem director or even asking him or her to resign. Generally speaking, our typical advice in that situation would be as follows. If there is a clear consensus on the board that the individual is disruptive to the overall process and the organization as a whole would be better off without this particular director, then the board should authorize the Chairman to directly discuss the matter with the director, perhaps give the director an opportunity to correct his or her actions during some type of probationary period or otherwise to ask the director to resign immediately. However, in the event that a direct approach in asking the director to resign or take corrective action does not produce positive results, the Chairman of the Board needs to be prepared to take the next step to follow a process to have the director removed.

The problem we have encountered in some current situations is that, even if a majority of the board wants to have a problematic director removed, the Chairman has no real authority to do so, and neither the Articles of Incorporation nor By-laws of the company provide a mechanism to do so. Typical "boilerplate" Articles and By-laws may contain provisions that provide directors can be removed for "cause", but may not define what cause is or may only define it as something like "conviction of a crime", or "any activity causing financial loss to the organization" or something similar. We encourage chairmen to take the lead in constantly reviewing Articles of Incorporation, By-laws and other corporate documents of the organization to ensure that the Chairman has the appropriate tools necessary to manage these types of issues.

While it is probably too much power to allow that directors can be removed "without cause", we believe that a proper definition that defines cause should be expanded beyond mere criminal activities and include other areas that might give the

Chairman some leeway in making decisions such as “any activity likely to produce injury to the overall reputation of the organization”, “engaging in any conduct which a majority of the board believes is detrimental to the overall financial or operational success of the organization”, or other similar language. It might also be as simple as having Articles of Incorporation or By-laws amended to provide that, while shareholders can only remove directors “for cause”, a director may be removed by a simple majority of the remaining directors with or without cause.

By making those types of corporate changes in your key documents, the Chairman of the Board will be better empowered to handle disgruntled directors and make appropriate changes when necessary.

### *ARE ADVISORY BOARDS USEFUL?*

One of the primary functions of the Chairman of the Board is to ensure an overall structure of the organization that promotes the financial and managerial well being of the organization. Many organizations have an appropriate corporate or bank board structure, but often may also have advisory boards which may or may not contribute to the overall success of the organization.

Advisory boards may be favored as a way of having a group of people involved in the management of the affairs of an organization in outlying areas, where an organization has a branch or just as a general second-tier board that can provide input to the organization or serve as a training ground for service on the actual board. However, the Chairman’s job should be to ensure that those individuals remain involved in the day-to-day affairs of the organization, do not get left out of the process and, otherwise, are functioning appropriately.

A recent situation in which we were involved was with an organization which had maintained multiple advisory boards over the past two decades. Over time, there was no real uniformity of how the boards operated from the various geographic areas. One board might meet every month, another advisory board might only meet a few times a year, there was no uniformity of communication, no concerted action of all of the advisory boards and, otherwise, no overall form and structure to the advisory boards. As a result of much discussion among all the board members, the Chairman of the Board was charged with creating a better overall structure. The idea that came out of this discussion was an elimination of the traditional advisory board structure and creating what might best be called a “virtual” advisory board. By this, the Chairman elected to blend current technological developments with an advisory board structure.

The idea was to create an advisory board newsletter that would be sent to each person willing to serve on the advisory board to provide current information about products and services, updates of what advisory board members should be focusing on and the like. Advisory board members could also then respond through a common email contact at the bank to indicate what questions they had, what contacts they had made for business referrals, how they developed business, etc. By doing so, they eliminated actual “sit down” meetings of advisory boards and instead promoted a common source of communication to all advisory board members, and created overall uniformity. They eliminated the outdated mode of advisory boards and instilled a new modern structure. Time will tell if this works for the benefit of the organization, but it appears to be well received at this point. Keep those and other similar techniques in mind for your advisory boards or other areas that might need technological updates.

### ***BASIC DUTIES NEVER END***

A recent Delaware case continues to point out the need for Chairmen to ensure that the Board always exercises its core fiduciary duties of care and loyalty even in the face of circumstances that might make it seem like a technical exercise of the duties is not

required. The case in question involved a Board of Directors that was considering an acquisition offer. The Board of Directors approved a sale of the organization for a 45% market premium (this was not a bank, so don't get excited just yet). The Board of Directors obtained a fairness opinion with regard to the price and the stockholders overwhelmingly approved the transaction. The Board deemed the transaction to constitute a "blow out" offer price.

A stockholder challenged and the Board of Directors attempted to have the case thrown out of court under the idea that the price was so great that they could not possibly be challenged for breaching their duties of care and duties of loyalty. The court has initially refused to throw the case out noting that the Board of Directors approved the transaction in less than seven days based on only six or seven hours of actual meetings. The case serves as a reminder that the Chairman of the Board is primarily charged with making sure the Board, even in the face of positive extenuating circumstances, must exercise due care to follow an actual definitive process, the Board also cannot simply relieve itself of its duties by passing along decisions to stockholders. Accordingly, the Chairman of the Board should be the primary individual responsible in all merger and acquisition and similar types of transactions that heighten directors' duties to ensure a structured process is in place and that core duties of care and loyalty continue to be followed.

### *MEETING ADJOURNED*

The past month has seen dramatic changes in the financial services industry. As of last month's Chairman's Forum Newsletter, none of us had heard of the Troubled Asset Relief Program ("TARP"). Now, it is forefront in many organizations' minds and the Chairman of the Board, for one, will need to lead the charge in having a frank and candid discussion about the program as a strategic alternative. In an upcoming edition of

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the Chairman's Forum Newsletter, we will review the program and provide Chairmen some inside thoughts. In the meantime if you have further questions, please let us know.

UNTIL NEXT TIME,



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