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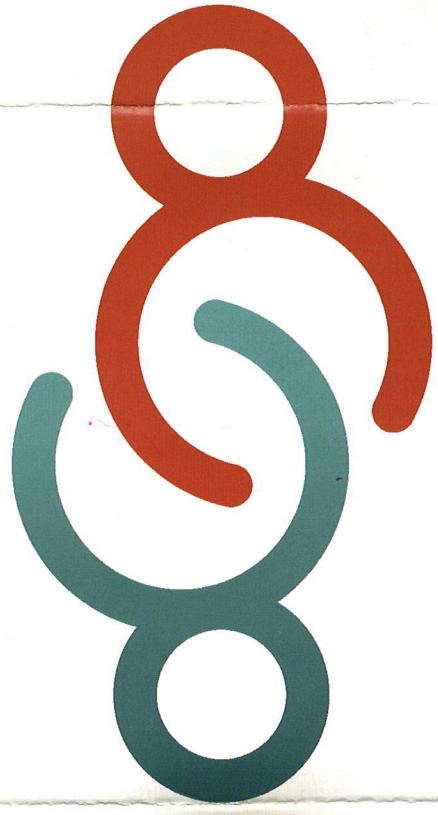

Assembling an Ideal Board for a Post-Bankruptcy Company

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Until recently, pre- and post-bankruptcy boards of directors were typically populated by a stalwart cadre of individuals representing creditors who were becoming equity holders and whose main focus was on short-term objectives rather than long-term strategy. However, a trend is developing to appoint situation-specific independent directors to serve the best interests of a company as a whole, not merely the creditors individually.

Such a board ultimately plays a critical role in maximizing stakeholder value, which in the end benefits creditors who have converted to shareholders. The issues attendant to assembling and recruiting these blue ribbon boards is explored in this article.

Initially, the differences between recruiting directors for financially healthy companies versus those emerging from bankruptcy must be understood. Usually the former involves seeking one or two directors when vacancies arise, particularly if the board is elected on a staggered basis.

Boards for post-bankruptcy companies, however, are recruited in their entirety and must be approved by the court in toto. Prior to this submission, various creditors have the final say in choosing all or some of the individuals included on the board slate. In a non-Chapter 11 company, the board's nominating committee, acting as a proxy for all stakeholders, puts directors on a ballot for election at the annual meeting.

In contrast, the bankruptcy process usually involves more-complex negotiations among creditors and the debtor to put together a slate of directors. Moreover, desirable director candidates are often understandably reluctant to serve on a post-bankruptcy board. Their fears abound. Will the company stay healthy, or will it revert to its old ways and be forced into a second Chapter 11? Is the new balance sheet sufficiently delevered? Have the necessary strategic reforms been instituted? Is the right management team in place? These are questions which, though carefully considered by any potential director, create particular apprehension in a post-Chapter 11 context.

At least three months before a slate is submitted to the court, a subcommittee of creditors should be chosen to consider retaining an executive search firm or other impartial advisor with bankruptcy experience.

Deliberative Process

So what is the best strategy to pursue in search of the ideal board for a company emerging from bankruptcy?

Above all, ample time must be allocated to the process, both in terms of hours and of scheduling. At least three months before a slate is submitted to the court, a subcommittee of creditors should be chosen to consider retaining an executive search firm or other impartial advisor with bankruptcy experience. A written position description should be developed that addresses three critical categories of director qualifications:

1. An individual's professional and industrial experience as it relates to the needs of the company going forward

2. A potential director's viability as a member or chair of one or more of the following board committees: audit, compensation, nominating/governance, and risk; one individual must qualify as chair or lead director

3. Diversity among board members and demonstrated ability as effective and collaborative members of a board

With regard to the first category, a post-bankruptcy company immediately faces issues critical to its future. As an example, it was determined that when Reader's Digest emerged from bankruptcy, board members needed expertise in areas pertinent to the specific challenges the company faced. Reader's Digest sought to transform itself from a traditional print media entity to a digitally focused one. Thus, someone steeped in e-commerce and new media was sought for board membership.

In addition, the company's cost controls were in need of tightening, so a director with a financial background and previous expense oversight was required. Given the company's growing presence worldwide, those involved in assembling the board slate agreed that a professional with substantial international credentials should be recruited. The company had also recently outsourced much of its information technology functions to India, so it was deemed wise to find a director who had substantial experience with offshore I.T. operations.

During the recruitment of the post-rehabilitation board for FGIC (Financial Guaranty Insurance Corporation), different requirements from those of Readers' Digest were paramount. FGIC's case is the largest to date to be brought before the New York State Insurance Department (since combined with the New York State Banking Department to form the New York State Department of Financial Services.)

FGIC is a monoline bond insurer that, upon emergence, would not be writing additional new policies. Instead, its sole activity would be "running off" its existing policies and paying creditors in accordance with the approved plan of rehabilitation. The process for appointing new board members differed from most cases in that management worked with the rehabilitator and an executive search firm to develop a slate of candidates for the board.

Of necessity, the new board included individuals with some or all the following competencies:

- Knowledgeable in dealing with highly complex transactions
- Some experience in monoline insurance
- A CPA, preferably a partner of a major accounting firm

- Legal experience in the insurance sector
- Credit trained; ideally, a top banking executive
- Familiarity with workout situations

As was true of the post-Chapter 11 Reader's Digest slate—and for that matter, of all boards—none of the directors could be conflicted due to creditor ties, competitive issues, or connections to major suppliers or customers. Total independence is imperative. For both FGIC and Reader's Digest, at least one of the directors needed to possess the leadership skills qualifying him/her to become non-executive chairman.

As mentioned earlier, it's essential that directors be qualified to serve on or chair designated board committees. At the same time, however, none of the candidates should be "overboarded," meaning that they serve on too many other boards of directors.

The audit committee is particularly key in a post-bankruptcy company. Under Sarbanes-Oxley legislation, at least one of its members must be a "financial expert" as the law defines it. In the FGIC board selection process, it was deemed advantageous to have nearly all the candidates qualified as financial experts. Other complex financial services companies emerging from Chapter 11 may be wise to do the same.

In short, each post-bankruptcy situation carries a set of special considerations that should factor into the selection of board members and should be diligently addressed by the creditors. A skilled search consultant or other impartial professional can work collaboratively with creditors, bringing original candidates into the mix and evaluating them together with those suggested by individual creditors to appoint a board best equipped to enhance the long-term value of a company.

To construct an effective board, it is essential to exclude those who merely go along to get along. Homogeneity is not the goal in selecting board members. Enlightened and constructive dissent fosters good governance. Thus directors, in setting a general strategy going forward, should arrive at consensus after healthy debate. Board members must have the capacity to buttress their positions with rigorous analysis of the issues before them.

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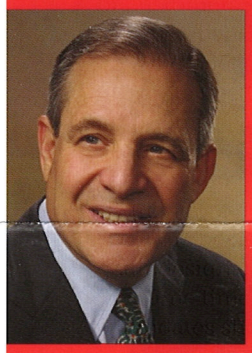

Steven A. Seiden is president and founder of Seiden Krieger Associates and specializes in recruiting top executives and directors for corporations in transition, including those emerging from bankruptcy and rehabilitation. A graduate of Yale University, he spent 17 years on Wall Street with a financial services and investment banking organization before founding his firm.

Those kinds of thought leaders are the most valuable directors and will likely need to be pursued using adroit recruitment techniques.

Once the position description incorporating the three items referenced earlier has been agreed upon, as well as directors' compensation, these are the recommended next steps in the process:

- A preliminary list of appropriate candidates, along with their biographies/resumés, should be presented to a committee appointed to oversee the selection process; the list should include at least three times as many candidates as board seats available.
- In-person candidate interviews should be conducted by one or more members of the committee.
- The candidate pool should be winnowed down to a reasonable number of desirable individuals; reluctant candidates who are deemed to be particularly valuable should be intelligently pursued.
- Once a list of finalists has been agreed upon, the candidates' references should be checked, both for background flaws (legal, credit, criminal, etc.) and particularly for their track records as directors.
- Assuming that the finalists have served on other boards, their fellow directors on those bodies should be interviewed in person to learn how effective candidates were in a boardroom. An indispensable technique, such in-person discussions are far more revealing than telephone conversations would be.
- Having determined the final slate, election to the board should be proposed in conformance with the court's prescribed submission procedure.

Thoughtful Selection

The process for board member selection described in this article is far different from that employed in many bankruptcies, where director selection is frequently a last-minute agenda item. All too often, with only a few weeks remaining before a plan is submitted to the court, a list of directors containing the names of "retreads"—people who make a profession of representing creditors on post-Chapter 11 slates—is hastily assembled, with little regard for the specific and unique needs of the company.

The best route to optimal board selection and recruitment is hardly a one-size-fits-all approach. Indeed, as much attention and effort as is focused on selecting an executive team must be devoted to the formation of an effective post-bankruptcy board of directors.