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Red Rules FOR BOARDS

By Barry S. Bader

In industries where safety is critical and quality must come first, such as airlines and nuclear power, "red rules" refer to protocols that must be followed "to the letter" – all work stops until they are. A commercial airliner doesn't leave the gate if the pilot spies a possible leak or flat tire; a nuclear plant operator or even a Toyota assembly line worker can "stop the line" when he spots a critical flaw.

The Agency for Healthcare Research and Quality (AHRQ) says one example of a red rule in healthcare might be: "No hospitalized patients can undergo a test of any kind, receive a medication or blood product, or undergo a procedure if they are not wearing an identification bracelet." The moment a patient is spotted who does not meet this condition, all activity ceases until the patient's identity has been verified and an identification band is in place.

What differentiates red rules from many "standard rules," says AHRQ, is that red rules are "always supported by the entire organization. When someone at the frontline calls for work to cease on the basis of a red rule, top management must always support this decision," notwithstanding any inconvenience, time lost or financial costs.

The concept of red rules can also be applied to governance. There are some practices that are so intrinsic to the effective functioning of a board that they always must be followed and enforced by the board's leadership and the CEO. Here are seven such practices — or "red rules of governance" — for your board to consider:

1. Never compromise (or lose sight of) the mission and values of the organization, no matter what. If you can't reconcile a strategy, decision, initiative, or policy with the fundamental mission and values of the organization, stop action and question why you're doing it. Recommendations to expand or close a service line or community clinic, reduce staffing, redesign benefit packages, or hire physicians to cover the emergency department have major financial implications and may be the right course of action – but only after a thoughtful and disciplined exercise to consider mission and values, weigh options, and make the best choice.

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2. Never be passive on a matter of importance. "I'm not convinced the project management is proposing makes strategic or financial sense, but the CEO seems to really want it, so I didn't question it." How many times have you heard board members express such comments?

Boards have to put significant trust in management and their board leaders, encourage risk taking, and recognize failures will occur. Good boards do not endlessly nit-pick every management recommendation or shortfall.

But on major decisions and policy matters, if a board member has serious concerns, passivity paves the road to ill-founded decisions. Red rule: speak up. In a famous example of governance abrogation of responsibility, when the CEOs of Time Warner and America Online surprised their directors with a proposed merger, only two board members voiced concern. Later, Ted Turner at Time Warner and Alexander Haig at AOL regretted that they acquiesced so readily; they didn't try to rally the board to stop the train and allow a full board examination of a "bet the farm" deal that would fail miserably.

The lesson: Directors should never be cowed into silence on a major issue until all legitimate questions have been raised and answered with good data and sound arguments.

3. Never tolerate a disruptive board member. "Disruptive" refers to any behavior that interferes with the orderly and appropriate work of the board. Disruptive board members include those who show disrespect toward their colleagues or management, interfere with management, deliberately violate confidentiality, regularly arrive late or leave early, constantly interrupt or harangue at meetings, fail to meet minimum attendance requirements, or come to meetings unprepared.

Conversely, disruption is *not* candid comment, voting with a minority, or raising strong questions of management – those are necessary and appropriate behaviors. Every board can benefit from a contrarian or two, and all directors should on occasion constructively challenge the prevailing wisdom, but effective directors can disagree without being disagreeable.

Too many boards tolerate disruptive behavior that drags down the entire board's performance. The director's position description or a code of conduct should articulate a high standard of performance. When disruptive behavior occurs, the board chair should take action appropriate to the situation. In some cases, a quiet word after the meeting will do, but in other cases a more formal "visit to the woodshed" may be in order. The Executive or Governance Committee may be called to consider the matter. If the behavior continues, the board should not hesitate to remove the disruptive member.

4. Never ignore violations of the conflict of interest policy. Conflicts of interest involving directors put management in an uncomfortable, even untenable position. They open the board to criticism from the press and government overseers. The board should have a clear definition of what constitutes a conflict and require full disclosure annually and whenever a conflict arises. A committee of independent directors should review all conflicts, determine whether they are acceptable, prescribe action to protect the organization (e.g., competitive bidding process), and submit a report summarizing all conflicts to all board members.

The conflict of interest policy should include a section describing a clear process for any board member to follow if, in the middle of a meeting, they think someone may be conflicted. It takes a bit of the sting away for a director to "invoke paragraph 9b" rather than explicitly discussing a colleague's possible conflicts. The process could include a "stop action" that is called by the chair and an immediate break for the independent directors to confer on the situation.

Even when the board determines a member with a conflict may serve on the board (and many great board members do have appropriately disclosed conflicts), the conflict of interest policy should clearly prohibit directors from using their position or information gleaned as a director for personal gain.

If a board member violates this proscription or inadvertently fails to disclose a conflict, an immediate warning is called for. Repeated or deliberate violations can have only one resolution: removal from the board.

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The board should adopt clear rules on sticky situations – such as whether physicians who invest in competitive ventures have a disabling conflict that should bar their continued board membership. Once the rule is set, follow it. Tolerance is worse than having no rule at all.

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5. Never surprise the CEO. If a director plans to air serious reservations about an upcoming matter or the performance of a program, common courtesy and good board process say to give the CEO a heads-up. Advance notice allows the CEO to come prepared with facts and data and to give thought to the appropriate response. CEOs are not omniscient – they cannot be expected to know every detail of a complex enterprise. Surprising a CEO triggers understandable defensiveness. Even if the board raises good questions, a CEO who feels ambushed can lose objectivity and may be unwilling to reconsider a matter for fear of looking weak.

The intent of a "no surprises" rule isn't to bar spontaneous questions but to respect management and allow good preparation. If a director deliberately or repeatedly violates the red rule against surprises, the Board Chair should speak with the member and – if the behavior continues – stop the sneak attacks when they occur.

6. Never surprise the board. Similarly, when CEOs bring significant decisions to the board at the eleventh hour, without advance information or thorough committee review, members naturally resent being treated as a rubber stamp. True emergencies requiring expedited board process will occur, but they should be rare.

If a CEO or senior executives fall into a pattern of asking for approval of done deals, the board should apply the red rule and say "No, we'll consider the matter though the appropriate committee and vote next time." Once should be enough to send the signal that diligent governance oversight requires sufficient notice.

7. Never bring operational questions or data to the board. CEOs and senior executives who complain that their boards get into operational details should examine their own practices first to ensure they are providing the right level of information to directors. Is the strategic plan really a management implementation plan that doesn't focus the board on a few critical strategic success factors? Does the CFO bury critical financial indicators in voluminous financial statements instead of highlighting them on a dashboard? Is the board looking at every JCAHO core measure instead of rolled-up or bundled measures, such as the percentage of heart attack patients who received "all appropriate care?"

If operational reports are going to the board or a committee, stop the assembly line and ensure that the board gets governance information, not management detail.

For their part, boards should articulate what they want to know, and they should ask for information that's strategic, trended, contextual, and compared to best practice. If the board doesn't get a comprehensive performance

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dashboard or balanced scorecard, invoke the red rule and ask management to work with the board to create one.

If a CEO thinks his board is wandering into operational territory, he should tactfully raise the issue and try to reframe the matter in larger policy or strategy terms. Complaining to subordinates after the fact doesn't fix the problem. If some board members regularly "get lost in the weeds," education or discussion of board roles at a retreat may be the remedy.

Following red rules for boards won't produce results as dramatic as no nuclear mishaps or airline accidents. They will, however, help a board and CEO work as a team, approach tough decisions with candor, and sleep soundly because they've protected the mission and provided the organization with sustainability for the long term. *What are your board's red rules?*

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