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Opinion

INDEPENDENT BOARD LEADERSHIP

In her regular column on corporate governance issues, Holly Gregory explores recent developments in independent board leadership and discusses key considerations when selecting a board leader.

The past decade has witnessed a remarkable shift in the leadership structure of large publicly traded companies. The tradition of combining leadership power in one individual who holds both the CEO and board chair positions has eroded significantly in favor of a model of shared or diffused leadership power. S&P 500 companies now typically have a form of board leadership that is separate and independent of the CEO, appointing either an:

- Independent board chair.
- Independent lead or presiding director.

Independent board leadership structures have become the norm and there is a fair degree of consensus that a well-designed independent lead or presiding director role can provide an effective alternative to an independent chair. However, the number of shareholder proposals seeking to impose an independent chair has grown over the last several years.

According to Proxy Monitor, in 2012 and to date in 2013, proposals regarding an independent chair were the second most frequent shareholder proposal brought at Fortune 250 companies. Despite public failures of proponents to win support for these proposals this year, it is likely that these proposals will continue to be submitted and the issue of independent board leadership will continue to be debated.

Boards and their advisors should follow developments in this area and should ensure that the leadership structure they have adopted at any point in time is:

- Appropriate for the company's particular circumstances.
- Effective in supporting board objectivity in business judgments.
- Well-articulated to the company's shareholders through published corporate governance guidelines and in proxy statement disclosure.

In addition, boards should consider the independent leadership structure as a component of planning for CEO succession, as well as the implications for board leadership tenure and succession.

Against this background, this article explores:

- Current data on board leadership structures and independent board leader term limits, tenure and compensation.

- The roles and responsibilities of independent board leaders, including independent chairs and independent lead or presiding directors.
- Issues to consider when making board leadership decisions, including choosing a leadership structure and selecting independent board leaders.

Search Chairman and CEO Split: Understanding the Pros and Cons for more on separating or combining the chair and CEO roles.

CURRENT DATA ON BOARD LEADERSHIP

According to a recent Conference Board report, *CEO Succession Practices: 2013 Edition*, in 2012 only 19% of new CEOs were also given the title of board chair. However, a study by Spencer Stuart, *The 2012 Spencer Stuart Board Index* (Spencer Stuart Study, available at *spencerstuart.com*), indicates that only 18 S&P 500 companies have adopted a formal policy or by-law requiring that the board have an independent chair. Rather, most companies and boards value maintaining flexibility for the board to determine the best leadership structure at any point in time.

The overwhelming majority (97%) of S&P 500 companies now have boards with an independent chair or an independent lead or presiding director. Only 3% of S&P 500 companies have not disclosed some form of independent board leadership.

According to the Spencer Stuart Study:

- 43% of S&P 500 companies split the CEO and chair roles (compared to 35% in 2007). (This figure includes both independent and non-independent chairs.) Specifically:
  - 23% have boards with a truly independent chair (compared to 13% in 2007); and
  - 20% have a chair that does not qualify as independent, and the chair is typically either a former CEO of the company or a current executive of the company. Among these companies, 91% have an independent lead or presiding director.
- 54% of S&P 500 companies have a CEO who also holds the chair title and an independent lead or presiding director. The number of S&P 500 companies with boards designating independent lead directors has more than doubled since 2004, while the number designating independent presiding directors has decreased by more than one-third.

TERM AND TENURE

Most boards do not set an express term limit for the independent lead or presiding director. According to the Spencer Stuart Study, of the companies that do set a term limit, a one-year renewable term was the most common.

Regarding tenure, the Spencer Stuart Study indicates that:

- At present, the average tenure of current lead or presiding directors is approximately three years. Among these lead or presiding directors:
  - 36% have held the role for less than two years;
  - 45% have held the role for two to five years; and
  - 19% have held the role for more than five years.
- The average tenure of current independent chairs is just over four years. Among these independent chairs:
  - 26% have held the role for at least six years; and
  - 23% have held the role for one year or less.

BOARD LEADER COMPENSATION

According to the Spencer Stuart Study, independent chairs are more likely to be paid additional fees for their service than are lead and presiding directors:

- 94% of independent chairs earn additional compensation.
- 54% of lead and presiding directors earn additional compensation.

The additional fees paid to independent chairs are also on average significantly higher than those paid to lead and presiding directors. The average additional fee for an independent chair is $168,155 and the median is $150,000 (with a wide range from $20,000 to $765,000).

In contrast, the average additional fee for a lead or presiding director is $26,374 and the median is $25,000 (with a range from $5,000 to $90,000).

BOARD LEADERSHIP ROLES AND RESPONSIBILITIES

Whether the independent board leadership role is held by an independent chair or an independent lead or presiding director, there are certain roles and responsibilities that are common. For example, it is typical for the independent board leader to be involved in identifying issues for the board's agenda and information to be provided to the board in preparation for board meetings. Additionally, the independent board leader usually leads and supports the board (with some variation regarding committee roles) in:

- Selecting the CEO.
- Evaluating and compensating the CEO.
- Monitoring CEO performance.
- Evaluating the strategic plan proposed by management.
- Overseeing the company's relations with shareholders, financial reporting and internal controls, audit, compliance and risk management.
- Determining the board's governance structures and processes.

SHAREHOLDER PROPOSALS TO SPLIT THE CHAIR AND CEO ROLE

The 2013 proxy season has already been marked by several highly public campaigns to pressure boards to adopt policies requiring that the board be chaired by an independent director. Often these proposals are supported by proxy advisors, such as Institutional Shareholder Services, Inc. (ISS) and Glass Lewis & Co., and they tend to achieve respectable shareholder support, although that support appears to be declining. On average, these proposals received more than 35% of the votes cast in 2012. In 2013, average support is running at about 29% to 30%.

Shareholder proponents target companies that they perceive to have board oversight or performance issues, with little regard to whether the company has adopted an alternative independent board leadership structure that incorporates a lead or presiding director role with significant clearly-defined responsibilities. ISS appears to be applying its policy for what constitutes an acceptable countervailing independent board leadership structure more literally than in the past and companies are well-advised to review that policy.

A coalition of large institutional investors recently brought a shareholder proposal at JPMorgan Chase & Co., seeking to pressure the board to amend the by-laws to require that the role of chair be held by an independent director. While the proposal did not ask for the ouster of CEO Jamie Dimon as chair, it became a referendum on his competence as a manager and the board's competence regarding oversight of risk management. The shareholder proposal was defeated, with only 32.2% of the votes cast in its favor, down from 40% in favor of a similar proposal the previous year.

- Selecting board candidates.
- Engaging in crisis response, in certain circumstances.

Many view the role of an independent lead director as a viable alternative to an independent chair if the position is defined with real power and authority. In the National Association of Corporate Directors (NACD) Blue Ribbon Commission report, *The Effective Lead Director* (NACD Report), the NACD compared the roles of a typical independent chair to a lead director. The differences in the roles relate to:

- **The power to call a board meeting.** The lead director generally does not have convening power for full meetings of the board, but does have the power to convene sessions of the independent and non-management directors.
- **Control of the board agenda and board information.** Unlike the chair who bears responsibility and authority for determining both the board agenda and the information that will be provided to the board, the lead director collaborates with the chair/CEO and other directors on these issues.
- **The authority to represent the board in shareholder and stakeholder communications.** Typically the chair/CEO represents the board in communicating with shareholders and external stakeholders. The lead director plays a role only if specifically asked by the chair/CEO or the board directly.

These are key distinctions, and they build on other subtle differences in the role and authority of the chair and the lead director regarding the board's efforts in management oversight, CEO succession, strategic development, board and director assessment, board relations with the CEO and C-suite executives, board diversity and succession, and board risk oversight.

Independent board leaders, regardless of title, are likely to take a leadership role in chairing meetings of independent directors and serve as a communication point for delivering sensitive messages from the independent directors to the CEO. They often take a lead role in evaluations of the CEO and, increasingly, evaluations of the board and individual directors.

In contrast, a CEO, whether or not he has the title of chair, is usually the public spokesperson for the company and communicates with investors and the public. The CEO also must play a critical role in developing the board agenda, ensuring the quality and timeliness of information provided to the board and keeping the board informed between meetings.

Search Lead Director: Understanding and Filling the Role for more on the lead and presiding director roles.

MAKING BOARD LEADERSHIP DECISIONS

The responsibility for selecting a leadership structure and determining who should serve in leadership roles falls to the board, particularly the independent directors. The board leadership structure should be determined based on a number of factors, including the board's culture and practices, business circumstances, and the expectations, personal characteristics, leadership styles and relationships of the potential leaders.

CHOOSING A LEADERSHIP STRUCTURE

As with any governance practice, the challenge in selecting and implementing a board leadership structure is to do so in a way that adds to, rather than detracts from, board effectiveness. As a practical matter, splitting leadership roles poses challenges that need to be addressed, including the potential for:

- Competing centers of power.
- Confusion about leadership roles.
- Misperceptions about a lack of board confidence in the CEO.

The board leadership structure should be determined based on a number of factors, including the board's culture and practices, business circumstances, and the expectations, personal characteristics, leadership styles and relationships of the potential leaders.

However, the erosion of the traditional leadership structure in the form of a combined chair/CEO role has been aided by:

- Listing requirements that require boards to hold executive sessions without the CEO and other members of management present.
- SEC disclosure requirements regarding the board's rationale for combining or splitting the chair and CEO roles.
- Proxy advisor policies that favor an independent chair, unless the company maintains a counterbalancing governance structure that includes a strong independent lead director role.
- Shareholder proposals calling for the separation of the chair and CEO roles.

While many shareholder activists and other proponents of independent board leadership favor the appointment of an independent director as board chair, board leadership needs to be carefully tailored to the needs and circumstances of the company. Even those who prefer the independent chair structure concede that the time to consider a change from a combined chair/CEO structure is during a CEO succession event, because stripping a chair title from a sitting CEO is likely to be viewed as an expression of a lack of board confidence in the CEO.

A strong, independent lead director can be an effective alternate means of supporting board objectivity. In the past several years, the role of the lead director has become associated with greater responsibility and the role is becoming very similar to the role of a board chair (often with the exception of wielding the gavel).

SELECTING A BOARD LEADER

Key considerations in identifying a potential independent board leader should include whether the candidate has an appropriate understanding of the nuances in leading the board without usurping board authority, and whether the candidate is likely to be able to establish an appropriate relationship with the CEO.

While there is variation in the methods boards use to select an independent board leader, the process often includes:

- Defining the independent board leadership role and determining the criteria desired in the board leader. An independent board leader should typically be:
  - independent from management (no personal or business relationships) and independent-minded;
  - free from any economic or egotistical need for the role;
  - able to commit the necessary time and energy to the role;
  - capable of facilitating consensus and bringing out the best in the board (does not dominate discussions, compete for power or adopt an autocratic style);
  - respected by the directors and CEO for his leadership capacity and business judgment;
  - respectful of the board's role, individual directors and the CEO and management team;
  - able to build relationships and communicate; and
  - able to lead in a crisis.
- Identifying potential candidates. When feasible, the board should consider choosing an incumbent director. Incumbent directors are already familiar with the board's culture and the company's business, and their ability to work toward consensus and communicate with other directors, as well as other strengths and weaknesses, are already known. However, there are times, for example when a board has

PRACTICAL POINTERS

The board is responsible for its own structure and processes and needs to apply its business judgment to board leadership decisions. Given the importance of board culture and group dynamics to board effectiveness, decisions about board leadership should be governed by practical realities rather than by best practice theory. In particular, boards should:

- Carefully define the leadership role of the independent chair or lead or presiding director and consider publishing information about how the role is defined in their governance guidelines.
- Periodically review the description of the leadership role to ensure that it accurately reflects the leadership role.
- Clearly articulate the board's rationale for its leadership structure.
- Periodically compare the leadership role against proxy advisor policies. ISS has recently become more rigid in applying its policies on how board leadership roles are defined.
- Consider specifying that the lead or presiding director:
  - is an independent director;
  - is selected by the independent directors; and
  - serves for a term of at least one year.
- Clearly delineate the lead or presiding director's duties, including:
  - presiding at board meetings when the chair is not present;
  - convening and presiding at executive sessions of the independent directors;
  - serving as a liaison between the chair and the independent directors;
  - approving meeting schedules, meeting agendas and board information; and
  - communicating, as appropriate, with significant shareholders if requested to do so.

had significant turnover, in which it may be beneficial or necessary to look outside for an independent board leader.

- Involving the CEO to an appropriate degree, given the importance of the relationship that must develop between the independent board leader and the CEO. While the board should not abdicate this decision to the CEO, the CEO and the board leader must be able to work closely together, and therefore the CEO's views should be considered.
- Evaluating the strengths of potential candidates, but avoiding a contest.
- Carefully considering whether it is appropriate for the independent board leader to also chair the governance committee. This could result in efficiencies, but it could also result in too much centralized power.
- Calling for a formal discussion and vote of the independent directors.
- Carefully considering term and tenure. The annual selection of the independent board leader is in line with the annual election of most directors, and provides an opportunity for an assessment of the independent board leader's performance. The board should also consider whether there should be limits on tenure to help support appropriate board leadership successions.

(See *NACD Report*.)

Search Lead Director Charter for a model charter a company can use to set out the responsibilities and duties it expects the lead or presiding director to undertake.

According to the Spencer Stuart Study, about 55% of independent chairs have served as chairmen, vice chairmen, presidents or CEOs of other companies and are now retired from active employment. Among independent chairs:

- 9% are active executives of other companies.
- 11% are investors and investment managers.
- 87% already served as directors of the company (for an average of just under eight years) before becoming the independent chair.

While the backgrounds of independent lead and presiding directors are generally similar to those of independent chairs, there are more active senior executives (16%) serving in the lead or presiding director role. Among lead and presiding directors:

- 43% are retired chairmen, vice chairmen, presidents or CEOs.
- 12% are other corporate executives, both active and retired.
- 10% are investors or investment managers.

The views stated above are solely attributable to Ms. Gregory and do not reflect the views of Weil, Gotshal & Manges LLP or its clients.