The General Motors directors were well aware that replacing certain members of management was not enough to make all of GM’s problems disappear. During the previous decade, GM’s shareholders had lost faith in the company. Also, the directors struggled with how they could ensure that GM would not make the same mistakes it had in the past, including a board unable to make independent decisions and management that could not cope with its current circumstances.

So the board and I met and we devised solutions to improve the company’s corporate governance practices. These included addressing board-meeting efficiency, succession planning, professional development, independent director executive sessions, and annual formal board evaluations. While it may be common for today’s boards to engage in these types of discussions, back when I was advising the GM board, it was almost unheard of.

Specifically, the directors, [in-house counsel] Harry Pearce, and I discussed establishing corporate governance guidelines for the effective governance of GM. Back then such guidelines pretty much didn’t exist. In January 1994, the board issued the “Board Guidelines on Significant Corporate Governance Issues,” designed to ensure active monitoring of management by an independent board.

The GM board adopted 28 corporate governance guidelines that I helped develop with the guidance of the directors. They were critical to the establishment of a new environment of “best practices” at the auto giant. Key provisions included independent board leadership through a separate chairman or lead director, independent director executive sessions, and annual formal board evaluations.

The guidelines codified many of the initiatives I had pressed for, including requiring that a substantial majority of directors be independent, that they have unrestricted access to management, and that they meet regularly on their own without management present. Requirements for an annual evaluation of the chairman and CEO, and a self-evaluation of the board itself and each of its committees, also ensured — at least in theory — the elimination of imperial CEO dominance and a new era of transparency between board members and top management. The GM corporate governance guidelines were called a Magna Carta for directors by the media and quickly gained the attention of corporate America.

Gaining traction

The GM Corporate Governance Guidelines gained real traction when CalPERS embraced them. Rich Koppes, another fearless “inside” counsel, was there to plan with me how best to implement the work already done by the GM board to create effective corporate governance policies at other American corporations.

In May 1994 CalPERS sent letters to the chairs of the largest 200 domestic equity holdings within its portfolio. The letters challenged these companies to follow GM in conducting self-analysis and defining what would be important (or not) in their effort to improve corporate governance. CalPERS acknowledged that specific governance models may differ among corporations but encouraged boards to evaluate their processes and reflect upon their own corporate governance structure. In August, CalPERS sent a second letter to the companies.
On the GM board, all heads turned to John Smale

Awareness of change came late to GM. It took a while for the board to realize that unswerving support of management could only lead to further losses and possible destruction. I spoke to members of the board, wondering who would be willing to stand up and say so, with management always present and controlling the agenda. One reliable old hand told me that when questions came up, heads in the boardroom invariably turned to John Smale for a first, or final, opinion. Natural selection seemed to point to him: he was the leader without campaigning or asking — he led simply by force of character, integrity and honesty.

And so when the situation at GM became severe, John was formally asked by the board to enquire further of top-level managers what they thought. And he did so, bringing back to the board a report that those who could be depended on for the company’s future saw the need for change, not only in management but in attitude. And John led that change — at the beginning with his own quiet dignified style, but later doing what had to be done.

What was John’s single contribution which I believe changed boards forever? It was a board-created, self-imposed, voluntary mandated “meet alone”!

Independent directors agreeing to meet alone in a chosen regularity, where they could talk honestly amongst themselves, not under management’s watchful eye, was considered by many in the “establishment” to be treason, totally contra to “good” corporate practice. But John had seen the need for this. The GM board had been inhibited to be critical under management’s watchful eye, and delayed change far too long. The first “meet alone” among those independent directors, led by John, set in process the needed change for GM management, and later the rest of corporate America. “Meet alone” became common practice, and rightly so.

It doesn’t sound dramatic now, but at the time it took a John Smale to risk criticism and see this basic change as the right thing to do, and then lead the others to have the courage to do it. I have been teaching corporate governance for some years, and in my classes I devote a section to ethics (a disappearing course of study). One of my guest lecturers is David Miller, formerly of Yale Divinity, now at Princeton. He shared with me a definition of ethics, which I now use regularly. The role model for this definition has, for me, always been John: “Ethics is the art and discipline of discerning the right, the good and the fitting action to take and having the creativity and courage to do it.”
that had failed to respond to its original request.

To give the survey some teeth, CalPERS embedded a clever follow-up mechanism: there would be no place to hide. The responses — spelling out what the companies were doing — would be analyzed, graded, and published. And CalPERS did what it said it was going to do. In September 1994 it published a report card for 200 companies, with grades from A+ to F, based on the process by which the boards defined their structures and corporate governance practices.

Of the 200 companies, 14 companies (7 percent) received an A+, while 41 (20.5 percent) received an F for failing to respond to the letter. Those that received an A+ had submitted a comprehensive list of guidelines, with the board of directors being “clearly involved in the process.”

The final grades

The CalPERS survey received much attention, both from boards of directors and from the media. Companies with failing grades were criticized and forced to defend themselves. With the CalPERS initiative full steam ahead, in December 1994 CalPERS sent a third letter to the next hundred largest companies in its portfolio, asking them to respond to the corporate governance survey. Then in May 1995 CalPERS published its “Final Report,” grading the 300 companies’ responses to the corporate governance challenge. Of these 300 companies, 86 (29 percent) received an A+, while 76 (25 percent) received an F.

What is noteworthy, and what signals to me that my efforts with CalPERS to engage large American corporations was successful, was that certain companies, like Allied Signal, Ameritech, Fleet Financial Group, and Gap originally received Fs for failing to respond to the survey but, in the 1995 Final Report, received an A+. The CalPERS corporate governance challenge encouraged directors to take their responsibilities seriously, which included evaluating their own board structure in an effort to implement effective corporate governance practices.

---

**Board life after the ‘Big Bang’**

*Ed. Note:* Ira Millstein hosted a roundtable discussion at the offices of his firm, Weil Gotshal & Manges, that resulted in the article, “The Legacy of Smith v. Van Gorkom,” published in the Spring 2000 edition of Directors & Boards. We did a 19-page exhaustive analysis of the Delaware Supreme Court’s seminal 1985 decision that the board of Trans Union Corp. breached its fiduciary duty of care in transacting in an uninformed manner the sale of the company. The roundtable participants — corporate directors, lawyers, investment bankers, D&O insurers, and board consultants — dissected the case on its 15th anniversary and traced the trajectory that corporate governance has taken since this “Big Bang.” Following is one of Millstein’s key comments from the discussion.

The point I would leave you all with is that this case focused on the board. That was the major contribution of Smith v. Van Gorkom to the state of the art. Whether in a social context, in M&A, or whatever, you were able thereafter to talk about what boards ought to do.

One of the things happening is that life is getting more complicated. Boards really are hitting perplexing problems to which there are no ready answers. Immensely difficult decisions are being made by a lot of boards around the world. Some of these things that we look at as formalities — the outside experts, the special committees — aren’t always charades. Boards want the best advice that they can get their hands on and they are rightly calling for help and getting it.

Is it a direct result of Smith v. Van Gorkom? It may not be a direct result but it is on the continuum. Years ago boards may not have thought that they had anything to worry about — let management do it, let management make the decision. Recognizing that they do have this job to do, many boards are legitimately trying with more information and assistance to make the really tough decisions.