

Lead Director Network ViewPoints

Issue 1 July 30, 2008



The role and value of the lead director

Introduction

On July 8, 2008, members of the Lead Director Network (LDN) met in New York City for the network's inaugural meeting. Members discussed the origins and value of the lead director role. The conversation also covered a broad overview of key issues confronting lead directors, with members agreeing that a deeper exploration would occur at future meetings of the LDN.

The LDN brings together a select group of lead directors, presiding directors, and non-executive chairmen of Fortune 500 companies for private discussions about how to improve the performance of their corporations and earn the trust of their shareholders through more effective board leadership.

This *ViewPoints* document is intended to stimulate timely, substantive board discussions about the issues confronting lead directors. *ViewPoints* reflects the network's use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments made before, during, and after meetings are not attributed to individuals or corporations. Members' comments are shown in italics. For further information about the network or this document, see "About this document," on page 10.

Lead directors¹ participating in the meeting included:

- Frank Blount, presiding director at Caterpillar and lead director at KBR
- Dan Carp, non-executive chairman at Delta Air Lines
- Pete Correll, lead director at Mirant
- Ray Gilmartin, lead director at Microsoft and presiding director at General Mills
- Bonnie Hill, lead director at The Home Depot
- Karen Horn, presiding director at Eli Lilly
- Phil Humann, presiding director at Coca-Cola Enterprises
- Bob Kidder, lead director at Morgan Stanley
- Jack O'Brien, lead director at TJX and non-executive chairman at Cabot
- Mike Sullivan, lead director at Constellation Energy

King & Spalding partners participating in the meeting were:

- J. Kelley, Partner, Chair Corporate Practice Group
- Chris Wray, Partner, Chair Special Matters and Government Investigations Group

¹ Please note: for the purposes of this network, the term "lead director" is used as shorthand to refer to all three titles – lead director, presiding director, and non-executive chairman – except where otherwise stated.

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Executive summary

Roughly one-third of LDN members are the initial lead directors at their respective companies. Of the remaining two-thirds, half were nominated relatively recently to the position. Given this mix of seasoned and newer lead directors, members were eager to hear their fellow lead directors' diverse perspectives on the topic of defining the lead director role. Members focused on the topics summarized below (with further detail on the following pages):

- **The origins of the lead director role** (*Page 2*)

LDN members discussed the catalysts behind the development of the lead director role. External factors, such as New York Stock Exchange (NYSE) listing requirements and increasing pressure from various stakeholders to separate the CEO and chairman roles, as well as internal factors, such as changes to a company's leadership and directors' own efforts to ensure board independence, have contributed to the appointment of a lead director at most U.S. public companies.

- **Value of the lead director role** (*Page 3*)

Members devoted a significant portion of the meeting to articulating ways in which lead directors add value to their companies that are rarely described in the charters or a company's disclosure documents. Members identified three in particular: first, by helping to develop a high-performing board, second, by building a productive relationship with the CEO and between the CEO and other directors, and third, by supporting effective shareholder communication – a role that is likely to grow in the future.

- **How the title affects the role** (*Page 8*)

Members analyzed the different meanings that lie behind the use of the three differing titles – “lead director,” “presiding director,” and “non-executive chairman” – and how the different titles relate to the responsibilities of the role. Although the title may signal differences in how the lead director is perceived by the board of directors, members concluded that lead and presiding directors often have essentially the same portfolio of responsibilities. The non-executive chairman, in contrast, usually assumes a larger role in company and board leadership.

- **Current issues for lead directors** (*Page 9*)

Members identified five topics that they feel are important for lead directors and that they will discuss in more depth in future LDN meetings: (1) board engagement in corporate strategy, (2) the lead director's role in crisis management, (3) the lead director's role in succession planning, (4) improving director and CEO evaluation processes, and (5) alternative governance models.

The origins of the lead director role

Over the past five years, virtually all large public U.S. companies have appointed an independent director to the role of lead director, presiding director, or non-executive chairman.² Members attributed the

² Research from Spencer Stuart reveals that in 2003, 36% of S&P 500 companies surveyed had appointed a lead or presiding director, while in 2006, 96% of companies surveyed had a lead or presiding director. Julie Hembrook Daum, Tom Neff, and Julie Cohen Norris, “A Closer Look at Lead and Presiding Directors,” *Cornerstone of the Board: The New Governance Committee* 1, no. 4 (October 2006), 1. Available at http://content.spencerstuart.com/sswebsite/pdf/lib/Cornerstone_LeadPresiding_Director0306.pdf.

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creation of the lead director role both to wider trends within the corporate governance space in the early years of this decade and to specific situational requirements at their companies. Amendments to NYSE listing requirements,³ Institutional Shareholder Services (ISS) best-practice recommendations, growing pressure in the aftermath of corporate scandals such as Enron, and challenging situations at individual companies have all led boards to appoint a lead director.

- **External factors.** One member said, *“Our lead director role came after the Enron fiasco and the mandate [from the NYSE] that you must have at least a presiding director.”* Other members agreed: *“Ours came out of the Enron situation.”* Another member added, *“NYSE, NACD⁴ and ISS recommendations [all contributed].”*
- **Internal factors.** Some members attributed the creation of the lead director role to a change in company leadership, a merger transaction, or to emerging from bankruptcy at their respective companies. One member said, *“At my company, we had a board trauma. We felt a lead director could prevent another drama from occurring.”*

Regardless of the factors that contributed to their companies’ original creation of the role, members underscored the importance of adapting the role to specific situational requirements. For instance, one member stated that the lead director role at his company quickly transitioned from having a relatively simple set of duties to embracing a more complicated portfolio of responsibilities: *“We created the role purely for compliance and defined it narrowly. [The role] then went from a ceremonial job to a difficult job very quickly,”* following a change in CEO.

Another member noted, *“Once you’re in the role, the conditions may change, and therefore the definition of your job may change. The role will have to change on a dime if conditions change, so we shouldn’t define the lead director role too narrowly. The definition must be fluid enough to adapt to the situation.”*

Value of the lead director role

LDN members believe lead directors of American public companies add value to their companies by improving the performance of the board of directors, helping to strengthen the directors’ relationship with the CEO, and stabilizing the company in periods of crisis or transition. Members have moved beyond the narrow definition of the lead director role articulated in corporate charters and governance guidelines. One member said, *“Most of what we are saying today about the role is not in publications.”* Nearly every aspect of the role – its origins, its responsibilities, and its challenges – reflects this ongoing evolution as lead directors tailor the role to changing requirements of their companies.

Although members now see the value of the lead director role, this wasn’t always the case. One member revealed, *“When I was chairman and CEO, the lead director’s job was to tell me what the directors said in*

³ The NYSE requires only that non-management directors meet at regularly scheduled executive sessions, that there be mechanisms for selecting a non-management director to preside at such sessions, and that companies provide a way to communicate with the presiding director (or the non-management directors as a group). See NYSE Euronext, *Listed Company Manual* (New York: NYSE Euronext, 2008), section 303A.03, “Executive Sessions.” Available at http://www.nyse.com/Frameset.html?nyseref=http%3A//www.nyse.com/regulation/listed/1101074746736.html&displayPage=/lcm/lcm_subject.ion.html.

⁴ National Association of Corporate Directors, *Report of the NACD Blue Ribbon Commission on Board Leadership* (Washington, DC: National Association of Corporate Directors, 2004), 3. Available at http://www.nacdonline.org/images/BRC_boardleadership.pdf.

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executive session that they didn't say to my face. And frankly, if you'd asked me if I needed a lead director when I was CEO, I would have said no. Now, the job keeps growing and becoming institutionalized, and I see the value of the role." Another lead director said, "The chair of the governance committee chose the lead director, and I argued against it, because we didn't want [to create] the two-tier board system, but eventually I understood [why the role is important]."

Many lead directors have moved away from the most basic form of lead director, in which the lead director presides over the executive sessions of the board and then reports the directors' views to the CEO after the executive sessions. One lead director said, *"The first six executive sessions just required me to take a bunch of notes and tell the CEO. Essentially, I was a conduit. I was feeding back without any opinion of my own ... I didn't add any value for those first executive sessions."* Another remarked, *"I don't like the conduit model."*

Members deliver value by responding to the needs of the board, the CEO, management, and the company's current circumstances. Members identified three principal ways in which lead directors create value for their companies and boards:

1. By developing a high-performing board

Lead directors are intimately involved in the smooth running of the board and its various committees. Among the tasks they take upon themselves are:

- **Driving the board to reach consensus and identify next steps.** LDN members believe an essential function of the lead director is to ensure that the board reaches a timely consensus on key issues. One member said, *"Executive sessions are valuable forums to reach agreements about next steps and actions, as well as to reach an agreement with the CEO on some of these issues. There is an opportunity to get consensus about the role of management and the board. Having a lead director can be very valuable in that respect."*

Lead directors must display a certain degree of artfulness in achieving consensus without seeming to push their own agendas: *"At some point, the lead director must take a point of view to keep the board from freezing [up]. You have to take a stand to drive issues through, but I also have to be careful about not pushing my own agenda."* Another member added, *"You must also have a sense of when a decision has to be made."* One director also observed that the lead director can be very effective in diffusing emotional situations in the board room.

- **Keeping the board focused on strategic decisions.** Lead directors contribute to the efficiency of board processes by ensuring that the board remains focused on larger company issues, rather than being dragged down into minutiae: *"We have to get ourselves focused on the macro issues."* Another member noted, *"The natural tendency of management is to dive down into details that really aren't that strategic. Management likes to talk about these issues, and most board members have good questions [for management]. But one of the key roles of a lead director is to set the agenda high enough in terms of thinking and making sure that the presentations stay high level when [management tries] to slip into [granular issues]."*

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- **Working with management to ensure the board has the information it needs.** Lead directors have begun contacting management directly and asking questions on behalf of the board. One member described how this has become an acceptable practice: *“Ten years ago, you would not go around the CEO and call up people in the company and ask them questions. Now it is considered good practice to do that. It is a more complex job to get that information and draw it out [from management].”* Another member outlined guidelines for the directors’ relationship with management: *“Since we are a very active board and interact with management on a regular basis, it was important for us to establish rules of engagement. This was done with the participation and support of the CEO.”* At the same time, another member cautioned, *“Lead directors have to be very cautious about traveling around the world and giving direction at company sites. That can hurt the shareholders and the company.”*
- **Dealing with difficult or underperforming directors.** A lead director can add value by helping the CEO and the board handle difficult or underperforming directors. Members believe lead directors should speak directly to the underperforming board member as soon as a problem surfaces. Another member said, *“On behavioral questions, you have to deal with it pretty quickly, or the person gets away with it for so long that when you finally speak to them about it, they’re stunned. If you deal with it up front, you don’t [let them] set the pattern [of poor behavior].”* Another lead director described a different approach with an “overperforming” member who constantly interrupts: *“I’ve made it my policy to sit beside this person in board meetings, so I can guide his contributions less obviously.”* On occasion, the lead director, in conjunction with the rest of the board, may suggest that it might be time for a director to step down or *“to be too busy to continue in the role.”*
- **Coordinating across board committees.** Several LDN members felt that the lead director should attend most, if not all, board committee meetings. One member said, *“I try to sit in on at least some part of each committee meeting because the broader discussions that take place in the board flow from the committee meetings.”* Some companies encourage all directors, not just the lead director, to attend as many committee meetings as possible: *“Half of the boards I’m on run sequential committee meetings. Everyone is invited. Everyone is in the same room [for all the committee meetings].”* Members underscored the protocol for any director when attending a committee on which they do not serve: *“Make a conscious attempt to stay in the background. When [the committee members] get to a decision point, they generally ask non-committee members for their opinions, but you don’t just volunteer your opinion.”*

However, other LDN members believe having non-committee members attend committee meetings is both unnecessary and, in the case of the lead director, threatens to create the impression of having a “super-director:” *“[Other board members] would think it was presumptuous for the lead director to attend meetings of the committees where he is not a committee member. It would be separating yourself too much from the equality notion with other directors.”* Another member cautioned against being perceived as a “super-director” who *“attends all meetings and knows all things ... I want to be really sensitive to other board members’ feelings.”*

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Lead directors' tips for running the executive session

- **Scheduling executive sessions in advance of board meetings.** One lead director observed that the executive sessions are more energetic and productive if they begin earlier in the day: *"Starting the executive sessions at the end of the board meeting [was] a disaster, because fewer people would attend because they had to get away and catch planes, and they are tired anyway. We switched the executive session to before the board meeting ... and the non-participatory members became participatory members and started contributing."*
- **Providing feedback to the CEO during the executive session.** One member reported that instead of having a private conversation with the CEO after the executive session, *"we invite the CEO back in after the executive session. I then summarize the discussion for the CEO [with the other directors present]. The benefit of that is that other board members know you are transmitting what they talked about accurately. It also provides the CEO with more context and flavor [of the discussion]."* Another member said this type of approach avoids having the lead director carry only *"a few choice comments to the CEO."*
- **Determining the appropriate agenda for executive sessions.** It is easy for the executive session to become overloaded. One member commented, *"I talk to directors between meetings to help shape the agenda."*

2. By building a productive relationship with the CEO

Members agree that building and developing a productive relationship with the CEO is one of the least defined yet most important aspects of a lead director's responsibilities. Many members saw intrinsic benefit in nominating a lead director who has served as a CEO: *"Having served as a CEO in your own right is very important. Interfacing with the CEO is difficult to relate to unless you've been a CEO. I'm not saying it wouldn't work [if a lead director has never been a CEO]; I'm just saying it would be easier."* However, another director disagreed, saying, *"If your lead director has not been a CEO, [this provides] a good balance because [the lead director] sees things in different ways and from different perspectives [than the CEO]."*

Although no agreement emerged on whether a lead director should be a former CEO, members were united in stressing that a lead director must cultivate a good relationship with the CEO:

- **Start building the relationship before there are any issues.** One member said, *"There is an advantage for a lead director to build a relationship with the CEO. This allows the lead director to develop some level of trust with the CEO before there's an issue at the company ... [However,] you can't be the CEO's friend – that's not your job. But on the other hand, you can't be his enemy."* Some members reported that they discussed expectations for the lead director role with the CEO in advance of being appointed: *"The key was to discuss what our expectations were of each other."*

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- **Ensure effective communication between the CEO and the board.** Many members struggle to ensure that the CEO communicates effectively not only with the lead director, but with the rest of the board: *“Our CEO tends to think a conversation with me satisfies his obligation to inform the board. Recently I had to say to him, ‘Time out: you need to communicate with the entire board on this issue.’”* Another member agreed: *“If the CEO says, ‘I’ll turn the board over to the lead director,’ then you also have a problem. Having good relationships with the board and the CEO allows the lead director to guide the discussion and guide conclusions on issues ... The lead director must also [encourage] better communication between the CEO and the directors.”*
- **Provide feedback to the CEO.** Members also stressed the importance of providing feedback to the CEO: *“It is hard for the CEO to weigh how much consensus there is [after executive sessions]. The lead director tells the CEO about the directors’ consensus on key issues.”*
- **Mentor and challenge the CEO.** At one member’s company, when a new CEO was hired, the lead director stepped in as a mentor for the new CEO: *“You have to help them deal with the Street, earnings reports, analysts, [and] shareholders.”* One member said, *“I needed to educate the CEO on what to expect from his staff versus what he was getting.”* However, not everyone agreed: *“We represent the board and shareholders, and are not personal coaches to the CEO, although we want to be helpful.”* Members recognize that CEOs need some mentoring, and acknowledge that any director, not just the lead director, can be effective in this role.
- **Undertake the CEO’s evaluation.** One member described the way they handle the process: *“I called all the directors beforehand, held an executive session, [and then] called the CEO in so that it was not my giving the CEO a report card, but the board giving the report card.”*

3. By supporting effective shareholder communication

With the increase in shareholder resolutions and shareholder activism in today’s corporate governance environment, one member predicted that the question of whether and to what extent the board should engage with shareholders will become ever more critical: *“As shareholders become more powerful, we need to incorporate that power into governance in as constructive a way as possible.”* In principle, though, lead directors agree that it is the CEO and management’s responsibility to communicate with outside shareholders: *“I had a lot of [outsiders] trying to get to me directly. My answer was, ‘All roads lead to me through the CEO’s office.’”*

In a recent meeting of the Audit Committee Leadership Network, a network sponsored by Ernst & Young and convened by Tapestry Networks, several audit committee chairs suggested that the lead or presiding director should be the primary contact person for outside shareholders, particularly if the shareholder’s agenda includes corporate governance and executive compensation.⁵ One LDN board’s preference was described as *“[an agreement that] it would be the lead director’s job to communicate with outside shareholders. I always had the head of HR or IR with me. Ultimately, [holding meetings with outside shareholders] worked to our advantage because we were able to develop a positive relationship with these parties and negotiate with them [in a more productive way].”*

⁵ Audit Committee Leadership Network in North America, “Board-shareholder communication,” *ViewPoints*, July 7, 2008, 7. Available at http://www.tapestrynetworks.com/documents/Tapestry_EY_ACLN_Jul08_View22.pdf.

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Selected attributes of a successful lead director

- Fearless, trusted director – communicates accurately with CEO and management on behalf of the board
- Skillful collaborator – moves effectively from mentoring and guiding the CEO to challenging management, acting as a counterweight to the CEO, when appropriate
- Diplomatic leader – acknowledges the delicacies of certain situations by “caringly confronting” other directors and the CEO when necessary, but is also willing to take criticism to keep the board functioning properly
- Active listener – summarizes directors’ priorities and key points from executive sessions
- Discussion moderator – facilitates discussion, draws out different views, but knows when to end the conversation and reach a consensus on next steps; keeps the discussion at the right level

How the title affects the role

Members discussed what the titles “lead director,” “presiding director,” and “non-executive chairman” communicate both about the position’s contributions to the company and the board’s expectations for the role. Of the ten LDN members who attended the meeting, several of whom hold more than one role, seven members hold lead director titles, four hold presiding director titles and two hold non-executive chairman titles. Members believe that the titles of lead and presiding director carry virtually the same responsibilities and expectations, whereas a non-executive chairman’s role is somewhat different. One member who serves on several different boards said of the first two, *“They’re essentially the same. I don’t notice any difference.”*

Lead or presiding director?

Some members contend that although the duties of a lead and a presiding director are largely identical, the choice of the presiding director title often reflects a desire to avoid the perception of – or actual trend toward – development of a two-tier board. One member explained that the adjective “presiding” connotes *“not so much a leadership position, but more so presiding over the meetings when the chairman is not around.”*

Members described two factors that contribute to the choice of title:

- **Reaction to board sensitivity.** One member said, *“We debated in a small group [of directors] at my company about whether ‘presiding’ or ‘lead’ would be perceived as overstepping the bounds and cause a wider sensitivity about a two-tiered board.”* Another member was even more explicit: *“We chose the ‘presiding director’ title because we didn’t want to upset the other directors.”* The crux of the lead director’s challenge was articulated by one member: *“It’s about being in charge without the appearance of being in charge.”*

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- **Lack of due deliberation.** Some members suspected little thought went into the decision regarding their title: *“I think we just chose it. That was it.”* Others suggested that the directors did not focus on the title, which came from governance guidelines drafted by the lawyers.

The non-executive chairman title

Members believe that non-executive chairmen tend to play a greater role than lead or presiding directors in building a strong relationship with the CEO, providing leadership in the company and externally with stakeholders, and running board meetings. One member with experience in the role said, *“I develop agendas with the CEO and prepare for our board meetings. I take the lead on behalf of the board with helping the CEO set goals for himself and the company.”* Another member said, *“The [choice of] lead director or non-executive chairman of the board set up different dynamics with the CEO.”*

One member noted, *“I think this area of choosing the title for the lead director shows how this entire topic is still evolving and changing.”*

Current issues for lead directors

Members identified a number of issues they face that they are interested in discussing in more depth in future meetings:

- **Board engagement in strategy.** One member said, *“At our company, the CEO comes up with the strategy, and if that doesn’t work out, you get a new CEO. It’s our job to intervene if we see problems with the CEO’s strategy ... but oftentimes, I feel we should be engaging on a more conceptual level [in developing the strategy].”* Another agreed: *“The days of management presenting strategy and having it rubber stamped by the committees are over.”*
- **The lead director’s role in crisis management.** One member asked, *“What is the role of the lead director in a circumstance where there is a crisis? What role does the public relations firm play in these situations?”* Members would also like to discuss the proactive steps a lead director can take in anticipating and preparing for a crisis situation: *“I would like to know the four or five things that could destroy the company and plan accordingly. [It is important] to disaster plan with respect to the strategy and keep in mind the big picture of the few really damaging things the company could encounter.”*
- **The lead director’s role in succession planning.** Members are concerned about the lead director’s role in succession planning for the CEO, the board of directors, board committee chairs, and the top tier of management.
- **The lead director’s role in evaluation processes.** One member said, *“I would like to look at how you evaluate CEOs to make sure that the CEO is working out on all variables of performance.”* In terms of board evaluation, another said, *“Any company that I’ve ever seen conduct an individual director evaluation has failed. And it is quite destructive when the evaluation is not done properly.”*
- **Alternative governance models.** Members are skeptical of the benefits of the European model of splitting the CEO and chairman roles: *“I would like to see ... one piece of data that shows that the separation ... actually benefits the company.”* Another member agreed: *“I am not supportive of splitting the chairman and CEO roles.”* Some members also expressed interest in analyzing the private

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equity model of governance: *“The notion [is] that private equity firms do a better job in running companies than [public companies do] ... Are there outside practices that could lead us to a more successful governance model? Perhaps the PE model is one of those models?”*

Conclusion

Lead directors often embark upon their tenure with little clarity about the expectations that fellow board directors, the CEO, and shareholders have of them. LDN members are addressing this dearth of guidance by encouraging and participating in dialogue around the lead director role. One member said, *“I joined [this group] because I am still defining the job [at my company].”* The challenge is finding a role that adds value to the company and the board (and thus for shareholders) without becoming the *“ultimate super director,”* alienating board colleagues, or becoming unable to adapt to changing circumstances. This challenge is one that impacts all large public companies in the United States. It is our hope, as the Lead Director Network begins identifying key issues and potential solutions for lead directors, that insight from our discussions will help other lead directors in their quest to add value to their companies and boards.

About this document

ViewPoints is produced by Tapestry Networks to stimulate timely, substantive board discussions about the issues confronting lead directors. The ultimate value of *ViewPoints* lies in its power to help all constituencies develop their own informed points of view on these important issues. Anyone who receives *ViewPoints* is encouraged to share it with those in their own companies and with their colleagues at other companies. The more board members, management, and advisers who become systematically engaged in this dialogue, the more value will be created for all.

The Lead Director Network (“LDN”) is sponsored by King & Spalding and convened by Tapestry Networks. The LDN is a group of lead independent directors, presiding directors, and non-executive chairmen drawn from America’s leading corporations who are committed to improving the performance of their companies and to earning the trust of their shareholders through more effective board leadership. The views expressed in this document do not constitute the advice of network members, their companies, King & Spalding, or Tapestry Networks.

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