Lead Director Network
ViewPoints

Issue 10 March 24, 2011

The relationship between the lead director and the CEO

Introduction

The ninth meeting of the Lead Director Network (LDN) took place on March 1, 2011, in New York. Members discussed the CEO–lead director relationship.[1]

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 their companies. Members' comments are shown in italics. For further information about *ViewPoints*, see "About this document," on page 8. For a full list of participants, see the Appendix on page 9.

Executive summary

Members have long recognized the importance of the CEO–lead director relationship[2] and used the March 1, 2011 meeting to examine it in detail. This issue of *ViewPoints* offers perspectives from Fortune 500 lead directors on the intimate, nuanced relationships at the heart of corporate governance. Members focused their comments in two broad areas, which are discussed in detail on the following pages:

- **Factors affecting the CEO–lead director relationship** *(Page 2)*

  Members emphasized that no two CEO–lead director relationships are the same. Nevertheless, members recognized three central factors that define the relationship: (1) prior experiences of the CEO and lead director, (2) the unique challenges and opportunities facing the company, and (3) company leadership structure. Contrary to the prevailing view, Members agreed that in their experience, the lead director's title ("non-executive chairman," "lead director," or "presiding director") has not affected the relationship or the lead director's responsibilities.

- **Lead director responsibilities and the CEO–lead director relationship** *(Page 4)*

  Members commented on the unique balancing act they perform in interacting with the CEO and board members. They considered how responsibilities such as agenda setting, facilitating productive meetings, and establishing the frequency and content of CEO communications affect their relationship with the CEO, the relationship between the CEO and board, and company performance. By consensus, members agreed that their most important responsibility is chairing the executive session. They also noted the importance of evaluating the CEO and said that lead directors have a responsibility to support the CEO until the board reaches a consensus that the CEO demonstrates serious deficiencies.

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[1] The LDN brings together a select group of lead directors, presiding directors, and non-executive chairs from Fortune 500 companies for private, candid discussions about ways to improve board governance. For the purposes of this network, the term *lead director* is used to refer to all three titles – lead director, presiding director, and non-executive chairman – except where otherwise stated. For a discussion of substantive distinctions – or lack thereof – see the box on page 3.

[2] Lead Director Network, "The Role and Value of the Lead Director," *ViewPoints*, July 30, 2008.

Factors affecting the CEO–lead director relationship

Members repeatedly emphasized the context-dependent nature of relationship between the CEO and the lead director. One member said, *"The relationship absolutely depends on the individual personalities in the roles."* Another member noted, *"This just isn't something you can easily put a label on; it is different at every company I'm [affiliated] with."* Members agreed that there is no one-size-fits-all model, but did find common ground on several factors that influence the relationship: CEO and lead director experience, challenges and opportunities facing the company, and company leadership structure.

CEO and lead director experience

Prior to the meeting, members observed that CEOs with less industry experience may want or need more guidance from the lead director on particular subjects, while CEOs who have extensive company and industry experience will have less need or desire for such guidance.

New CEOs may need guidance when it comes to interacting with the board: *"Some new CEOs don't fully understand how to utilize and interact with the board … That comes with time and experience."* The lead director often plays a role in advising a newly appointed CEO on board interactions: *"I had a new CEO, and it took me a year to convince him that the lead director's role does not alleviate him of the responsibility of dealing with the board. In fact, it's in the CEO's best interest to build a real relationship with the full board, and I coached him on that."*

The lead director's experience is also a critical factor affecting the relationship. Members remarked that a CEO may draw more substantively on a lead director who has prior industry experience or has served as a CEO of public company: *"I think it's helpful to be a former CEO. If you've been a CEO, you have a sense of whether your CEO is performing. You have empathy – not sympathy, but empathy – for what [the CEO] is trying to do."* However, some members remarked that even if the lead director does not have CEO experience, the relationship can still be productive and strong: *"For those who weren't CEOs, there's a lot they can bring to bear in their responsibilities, such as expertise in working through interpersonal and governance issues."*

Challenges and opportunities facing the company

The CEO–lead director relationship changes depending on the challenges facing the company. The broader economic climate, geopolitical events, and the strength of a particular company's leadership team can all affect intercompany relationships. Company performance also has an influence. One member said, *"The relationship is a function of how the company is doing."* Another member said, *"If a company is doing well, the top team is reasonably solid, and they're not hiring anyone new, there is less interaction [between the lead director and the CEO]. Interaction ramps up when there is an issue and the company isn't performing – which is appropriate."*

Acute challenges can strain relationships, but may also enable greater collaboration between CEOs and lead directors. King & Spalding partner Jeff Stein explained, "No situation requires greater collaboration between the CEO and the lead director than when the company finds itself addressing a major event or a

crisis … The lead director will not only provide the CEO with independent, objective advice, but can be helpful in dealing with key constituencies."[3]

Company leadership structure

LDN member companies utilize varied leadership and governance structures. Some have a lead director and a CEO who also holds the chairman title; others have a CEO and a non-executive chairman, and in a few cases, the companies have a CEO, lead director, and non-independent chairman. A company's leadership structure fundamentally affects the relationship between the parties.

Members agreed that a three-person leadership structure (a CEO, lead director, and a non-independent chairman) presents unique challenges for the lead director. *"None of us thinks that the ideal structure is a CEO, non-independent chair, and lead director … but when you have a non-independent chair, the lead director does his job for the good of the board and the company, and it can work. The lead director just has to work a little harder to strike a balance between the two individuals [chairman and CEO]."*

Lead director and non-executive chairman: is there any difference?

Fundamentally, members do the same things, regardless of which title they carry. For instance:

- **Chairing board meetings:** *"Ultimately, if you're a non-executive chairman or lead director, your role in board meetings … is the same."* However, chairing the meeting is different from controlling the meeting. As described on page 5, the chair – whatever his title - regularly turns the meeting over to the CEO.
- **The CEO relationship:** *"I've been on boards with lead directors and non-executive chairmen, and there's no difference in what they're doing and how the CEO views them."*
- **In agenda setting:** *"I don't think there's a difference in the roles the lead director and non-executive chairman play in agenda setting."*

The only distinction, according to members, is in stakeholders' eyes: *"Outside observers see a difference, but in reality, there is almost none. Day-to-day, non-executive chairs and lead directors are doing the same things."*

Another member agreed: *"We elected to not give our new CEO the chairman title, so I became non-executive chairman. I was shocked at the external community and how they reacted. I think the lead director and non-executive chairman role is exactly the same. When I became lead director at another company, nobody called to congratulate me. When I became non-executive chairman in this situation, I got all these congratulatory calls, as if I was doing something more important. The external community doesn't understand that there's no distinction, and when you talk to employees or shareholders, they don't either."*

[3] Jeff Stein, "How Should Lead Directors Manage Relationships with CEOs?" *Agenda,* January 24, 2011.

Lead director responsibilities and the CEO–lead director relationship

The lead director's responsibilities are outlined in the company's proxy statement and corporate governance charter, which define the role in terms of certain key tasks, such as agenda setting and chairing executive sessions.[4]

Members agreed, however, that these documents do not offer a comprehensive description of the lead director role. *"The definition [of the lead director role] in the proxies is so skinny; it doesn't capture the full extent of the role,"* said one. Another observed, *"The lead director, board, and CEO figure out what the role really means day-to-day and how it's going to work. It's only once those conversations have taken place that you have a true understanding of the role."* Another member stated, *"It's important to pound out the definition of the role with the CEO, even if it leads to uncomfortable conversations. It's the details of how the role unfolds that count."*

Although the concept of a lead director has existed for roughly a decade,[5] many members observed that the lead director role *"has evolved significantly since it was institutionalized seven or eight years ago."* According to one member, *"Seven years ago, there wasn't a lot of institutional support for lead directors, and even now, there's still a lot of learning going on with the role. With this much change, no lead director–CEO relationship is the same."*

Although there are significant differences, members found common ground in analyzing their responsibilities, including agenda setting prior to the board meeting, chairing executive sessions and facilitating productive board meetings, and CEO communication and evaluation outside those meetings.

Establishing expectations for the lead director–CEO relationship

Although there is no *"handbook"* for creating a productive, effective CEO–lead director relationship, members agreed that the relationship can be defined through conversations between the CEO, lead director, and the full board. In fact, 11 out of 13 attending members said that they discussed mutual expectations with their CEO in conversations at the beginning of either party's tenure.

Members downplayed the need to capture the outputs of these conversations in a written document: *"You can memorialize what comes out of those discussions, but the relationship is so fluid and situational [I wonder] how accurate a written-down description will be."* Another member said, *"We have a document about the characteristics the board looks for in the lead director … but it's harder to memorialize a relationship. Describing activities or characteristics for the lead director is fine, but how they interact and work with the board and the CEO is much more than a list of attributes."* King & Spalding partner J. Kelley cautioned that if the parameters of the relationship are set out in writing, both parties should ensure the guidelines are met to avoid any liability issues.

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[4] Lead Director Network, "The Role and Value of the Lead Director," *ViewPoints,* July 30, 2008.

[5] In 2002, the New York Stock Exchange (NYSE) Corporate Accountability and Listing Standards Committee and other key stakeholders, including the National Association of Corporate Directors, increased pressure on boards to nominate an independent lead director, and since then, the role of lead director has gained prominence and clout. The National Association of Corporate Directors' recommendation is available at New York Stock Exchange, *New York Stock Exchange Corporate Accountability and Listing Standards Committee* (New York: New York Stock Exchange, 2002), A-92.

Agenda setting

A typical corporate governance charter states that the lead director is responsible for approving board meeting agendas and setting agendas for executive sessions.[6] This is borne out in practice, according to members: as one member noted, the lead director has "*final say on the agenda, even though the … CEO has input.*"

The lead director sets the agenda after engaging with the CEO and other directors. Members had differing opinions on whether the board or the CEO should be consulted first:

- **Develop the agenda with the full board and then solicit the CEO's input.** *"The agenda comes from a discussion with the full board. I see my role as a lead director as getting the board's perspective about the key issues for the agenda. Ultimately, the CEO and the corporate secretary and I have a call before the agenda is sent out, making sure that we have everything right."*
- **Develop the agenda with the CEO and then ask the full board for feedback.** *"The agenda comes out of a discussion between me and the CEO … Then we always circulate the agenda to the full board for review."*

Oftentimes, lead directors steer agenda-setting conversations with the CEO from logistics into more substantive areas: *"Many conversations with the CEO are not actually about agenda setting, even though they're labeled as such. They're actually a much more comprehensive conversation."* Another member said, *"If there's a big strategic issue, or the CEO isn't performing or some element of the strategy is off-course, those conversations take place between the lead director and the CEO as part of the agenda formulation. It's not just agenda-specific conversation; it's more substantive."*

Chairing executive sessions, but not full board meetings

The independent directors convene for at least one executive session at each board meeting. Members noted the increased importance of executive sessions, particularly as CEOs play such a significant role in board meetings: *"The single most important development was executive sessions being run by someone other than the CEO. That started changing the way boards work, because the CEO couldn't control the discussion when they're out of the room, and you were able to really have a [productive] discussion."*

The lead director does not typically chair more than the executive session: *"The CEO leads the board meetings. As lead director, I set the agenda, but he runs the board meetings."* A member who serves on the board of a company with a non-executive chairman stated, *"At my company, the non-executive chairman sets the agenda for the board meetings, but the CEO actually runs the meetings."* Another member observed, *"At companies where there is a non-executive chairman, the non-exec chair doesn't really run the meetings. He merely opens the discussions, turns it over to the CEO, and then closes the discussion … That's maybe 4%–5% of the meeting that the chairman leads."*

[6] In a sample of 12 corporate governance charters from companies represented in the LDN, 10 companies described the lead director's responsibility as "preparing and reviewing agendas for executive sessions" and 11 companies described the lead director's responsibility as "reviewing agendas in advance of board meetings."

Facilitating productive board meetings

Lead directors are expected to encourage and facilitate high-value discussions at board meetings. The lead director has several key responsibilities in facilitating constructive board meetings:

- **Drawing out differences of opinion.** *"It's my job to make sure that every director's perspective is aired and addressed during board meetings, especially if there are significant differences of opinion."*
- **Driving boardroom discussion to a conclusion.** *"You can have 12 independent minds working with no central direction, and it's very difficult for the CEO to come to a conclusion or resolution. When the lead director isn't there to drive a conversation to some kind of a conclusion, it doesn't give clear direction to the CEO."*

Communicating with the CEO

Members provide the CEO with feedback after executive sessions, albeit in different ways. One member said, *"I don't actually bring the CEO back into the conversation after the executive session. I have found that the most productive method is for me to represent the board's view in a one-on-one conversation with the CEO. I have better experiences being the funnel between the CEO and board members after executive sessions."* Another member disagreed: *"It's important that [lead directors] not act as a funnel between the board and the CEO. We're there to encourage and facilitate communication."*

Members also addressed how difficult it can be to share feedback with which they disagree, an important but thorny task: *"Sometimes I don't agree with what the rest of the board is asking me to tell the CEO, and I might say, 'I don't have this view, but three other directors do.' There are other cases where I feel strongly about the position the board communicates, and it is my view, and then I may feel more conviction when I speak to him.*"

Overall, members emphasized that the most effective lead directors make the board more productive and efficient by minimizing unnecessary tension while still confronting difficult or contentious issues with the CEO. One member described it as *"a balancing act … I'm always thinking about what I can do to help the company and the CEO perform to the best of their ability."*

Outside board meetings, CEO–lead director conversations are commonly face-to-face. One survey found that 50% of lead directors talk to the CEO more than five times between board meetings.[7] Many members reported frequent informal meetings, though what they considered to be "frequent" differed. One noted, *"We have frequent, less structured conversations – probably a few times a month,"* while another said, *"We talk quite frequently, maybe one to two times a week."* Lead directors may also invite board members to meet individually or in small groups with the CEO, as necessary. One said, *"Sometimes when the CEO comes to me with a question, my response is to bring in other board members for a conversation. For instance, if it's a risk question, I bring the risk chair into the conversation."*

[7] Erik Skramstad, ed., *Lead Directors: A Study of Their Growing Influence and Importance* (New York: PriceWaterhouseCoopers, 2010), 3.

Members described two broad categories of subject matter for conversations between the CEO and the lead director:

- **Strategic business issues.** *"I get involved in strategy discussions. Every good board member should be involved in strategy discussion and governance issues, and as lead director, that's absolutely part of my role."* Another member said, *"The most valuable conversations that we have are around strategy and the business. He uses me as a sounding board before trying out new ideas either on the board or senior management."*
- **Governance.** *"Our conversations are typically about process or board relationships, not about strategy."* Another member observed, *"I give advice about the CEO's relationship with the board, rather than about a particular question related to the business."*

The CEO typically initiates meetings with the lead director, something members thought was productive. If the lead director reaches out too often to schedule one-on-one conversations with the CEO, he may interfere with the CEO's daily responsibilities and impede the CEO's performance: *"On a daily basis, we're not talking to the CEO. CEOs do their jobs, and call if they have concerns – that's how it should be."*

Evaluating the CEO

The compensation committee is typically responsible for the CEO's annual evaluation. According to NYSE listing standards, the compensation committee must "review and approve corporate goals and objectives relevant to CEO compensation, evaluate the CEO's performance in light of those goals and objectives, and, either as a committee or together with the other independent directors (as directed by the board), determine and approve the CEO's compensation level based on this evaluation."[8]

However, many lead directors are deeply involved in ongoing CEO evaluation, working directly with the compensation committee chair to define the CEO's annual goals, work with the CEO to develop a self-evaluation, and aggregate and share the board's feedback. Prior to the meeting, one member said, *"In our bylaws, the CEO evaluation is unequivocally the responsibility of the compensation committee. But when I came on as lead director, I changed that. I put a structured process in place so that the full board had an input into the CEO's evaluation. My responsibility as lead director is to make sure the board is working well, and part of that is ensuring that the full board has input into the CEO's evaluation."*

Members agreed that this conversation is one of the most challenging the lead director and CEO can have. Prior to the meeting, one member said, *"Now I'm having a conversation with the CEO about his compensation targets. Compensation is one of the issues that always tests the relationship between the CEO and lead director."*

Terminating the CEO

Poor performance will result in discussing a change in leadership. Members agreed that there are certain clear signs that suggest the CEO's performance is faltering: *"The board gets more involved in decisions,*

[8] New York Stock Exchange, *Final NYSE Corporate Governance Rules* (New York: NYSE Euronext, 2009), 8–9.

and directors get more anxious about the CEO's decisions, and the board can sometimes step over into operations. It's the lead director's role to drive the discussion [about the CEO's performance] if he or she sees these signs."

The lead director is often responsible for initiating conversations about the CEO's termination: *"You want to support the CEO and give him constructive actions to take, but at some point, if they've lost the support of the board, you begin to negotiate his departure, and that responsibility usually falls to the lead director."* Effectively leading these discussions is one of the lead director's most difficult tasks.

Sometimes the lead director must temper hasty board action: *"You support the CEO until you can't anymore. When it comes to that conclusion, you have to present that decision to the CEO. You also have to recognize when the board is going off on a posse chase and caution them to count to ten before they shoot."* Other times, a lead director must lead the charge: *"My CEO knows I'm his biggest supporter, but if things change, I'll also be the first one to tell him it's time to go."*

Conclusion

CEO–lead director relationships vary considerably, but each relationship is shaped by similar factors. Moreover, the most successful partnerships share certain characteristics – shared expectations, collaborative agenda setting, open communication, and fair and reasoned CEO evaluations – that may be achieved in surprisingly different ways. Because the relationships are inherently context dependent, there will be a variety of best practices for the lead director to employ.

One thing is clear: successful CEO–lead director relationships are not predicated on the title of the lead director. Members emphatically reject the conventional wisdom that lead directors and non-executive chairmen are fundamentally different. Many things affect CEO–lead director relationships; title does not.

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, members of 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.

Appendix: Network meeting participants

The following network members participated in the meeting:

- Frank Blount – lead director, KBR
- Roy Bostock – non-executive chairman, Yahoo!
- Dan Carp – non-executive chairman, Delta Air Lines
- Dan Feehan – non-executive chairman, RadioShack
- Bonnie Hill – lead director, The Home Depot
- Karen Horn – lead director, Eli Lilly
- Phil Humann – presiding director, Coca-Cola Enterprises and Equifax; non-executive chairman, Haverty Furniture Companies
- Ed Kangas – non-executive chairman, Tenet Healthcare
- Bob Kidder – non-executive chairman, Chrysler; lead director, Morgan Stanley
- Linda Fayne Levinson – lead director, NCR
- Jack O'Brien – lead director, TJX; non-executive chairman, Cabot
- Ken Powell – lead director, Medtronic
- Jim Robinson – presiding director, The Coca-Cola Company

The following members took part in post-meeting discussions:

- Peter Browning – lead director, Nucor
- Gene Fife – presiding director, Caterpillar
- Ray Gilmartin – lead director, Microsoft and presiding director, General Mills
- Dick Goldstein – presiding director, Interpublic Group
- Bob Lawless – lead director, Constellation Energy
- Wes von Schack – lead director, Bank of New York Mellon

King & Spalding partners participating in all or some of the meeting included:

- Bill Baxley, Corporate Practice Group
- Robert Hays, Chairman
- J. Kelley, Corporate Practice Group
- Michael Smith, Business Litigation Practice Group
- Chris Wray, Chair, Special Matters and Government Investigations Practice Group