NATIONAL DIRECTORS INSTITUTE | NDI Executive Exchange

What's on Your Mind?

Join Our Continuing Peer-to-Peer Exchange Exploring the Latest Corporate Governance Trends

The Role of the Non-Executive Chairman/Lead Director
November 14, 2012
10:45 a.m. – 12:00 p.m.

FOLEY
FOLEY & LARDNER LLP

CO-SPONSORS

AON
D. F. King
EVERSHEDS
FTI CONSULTING
KPMG

IN-KIND SPONSORS

Boardroom Bound
Reinventing Corporate America One Board at a Time
inFORUM BOARDACCESS
Women Enhancing Corporate Boards
NASDAQ OMX

Panelists: *Patrick Daugherty, Foley & Lardner LLP*
Liana O'Drobinak, Bay Consulting Partners LLC
Todd B. Pfister, Foley & Lardner LLP
Michael A. Sosin, Stefanini TechTeam, Inc.

Time: 10:45 a.m. to 12:00 p.m.

A. Law/History

1. Sarbanes-Oxley. Some shareholders view the CEO (or other management) serving as board chair as undermining the independence of the board as a whole. Supporters for independent chairman argue that an independent chairman can provide a check on the CEO's powers.[1]

2. NYSE / NASDAQ Requirements. Rules adopted in 2003 requiring the appointment of a presiding independent director.

3. Proxy Rules. Rules adopted in 2009 requiring proxy disclosure of board leadership structure, including whether the company has a lead independent director and what specific role that director plays in the leadership of the board.

4. Delaware Law: No requirements for lead directors or non-executive chairman.

5. Imperial CEO. Is the Imperial CEO no more? A review of Arthur Levitt Jr.'s opinion article seven years later.

B. Lead Director/Non-Executive Chairman vs. CEO-Chairman

1. Lead Director vs. Presiding Director vs. Non-Executive Chairman. Does the title matter? Yes, especially the distinction between the Non-Executive Chairman versus the Lead / Presiding Director. A quick review and breakdown of the numbers.[2]

2. Role of the Lead/Presiding Director. One size does not fit all – the role and responsibilities vary depending on company's situation/position. The following is a list of lead director duties in order of most common to least common:[3]

   a. Presiding over executive sessions of the independent directors;
   b. Acting as principal liaison between independent directors and CEO;
   c. Helping develop board agendas with chair ensures critical issues are included;
   d. Coordinating activities of independent directors;
   e. Interviewing board candidates;
   f. Overseeing board and director evaluations;
   g. Maintaining a lead role in the CEO evaluation;
   h. Recommending membership of board committees to chair;
   i. Serving as a representative of board with management and public;

---

[1] *JPmorgan Chase CEO to Shareholders: Mistakes were "Self-Inflicted"*, Huff Post Business, May 15, 2012

[2] In 2011, (a) 92% of S&P 500 boards had a lead or presiding director, and (b) 41% of S&P 500 boards separated the chairman and CEO roles. (*2011 Spencer Stuart Board Index*, Spencer Stuart (2012)).

[3] *A Closer Look at Lead and Presiding Directors*, Cornerstone of the Board – The New Governance Committee, Volume 1, Issue 4, Spencer Stuart.

j. Making recommendations about retention of consultants reporting to board; and
k. Facilitating communication between board and investors.

3. Role of the Non-Executive Chairman. "The Non-executive Chairman can play a critical role in representing the different constituencies in the company with an impartial viewpoint."[4] The following is a list of functions that the Non-executive Chairman performs, some of which create conflict for the traditional CEO/Chairman:

a. Monitor business plan execution in-depth;
b. Oversees & reviews CEO in-depth;
c. Oversees management in-depth;
d. Participates actively and regularly in operations;
e. Active participant in CEO succession planning;
f. Liaises actively with Board and management; and
g. Coaches and advises CEO and other senior management.

4. Relationship between CEO and Lead Director. The relationship varies from company to company and individual to individual, but the following are some factors that contribute to the relationship between the CEO and Lead Director:

a. The company's governance and leadership structure;
b. Challenges facing the company;
c. The CEO's want and need for guidance;
d. Prior experiences of the CEO and lead director;
e. The CEO's evaluation;
f. The company's performance; and
g. CEO succession planning.

5. Lead Director's Role in Major Transactions.[5]

a. Factor's that influence the lead director's level of involvement in a major transaction:

i. Size of the transaction;
ii. Company and industry of the counterparty/target;
iii. Deal structure; and
iv. Experience of management team and board.

b. Lead director's responsibilities during a major transaction:

i. Working with CEO and management team;
ii. Facilitating discussion among board members;
iii. Helping evaluate the transaction within the Company's strategic framework;
iv. Interacting with external advisers; and
v. Communicating with shareholders.

---

[4] *The Value of a Non-Executive Chairman*, Cullen Coates & Associates (2008).

[5] *The lead director's role in major transactions*, Lead Director Network Viewpoints, Tapestry Networks (March 29, 2010).

6. Lead Director's role after a financial crisis.[6]

   a. Ensuring directors understand the business and its strategy through management, outside experts and/or fellow directors;
   b. Ensure meeting agendas focus on strategic issues;
   c. Facilitate robust discussion and debate; and
   d. Communication of important messages to management.

7. Lead Director's perspective on corporate governance reforms. [7]

   a. Communicating directly with external stakeholders about consequences; and
   b. Controlling shareholder and board communication.

8. Determining Compensation for Non-Executive Chairperson.

   a. Typically in form of an annual cash retainer, meeting fees, and nominal long-term incentive grants (commonly stock options or restricted stock/units).[8]

   b. One method of setting the pay is using a pro-rata amount of the CEO's pay. Alternatively, broad discretion may be used to set compensation that the company believes is representative of market levels and is equitable based on the services provided. A general rule is that the more compensation that is given to a non-executive chairman, the more the perception of his or her independence is diminished.

   c. See Section C.2.e below for specific costs relating to CEO/Chairs.

C. Practicality

1. America vs. Europe – specifically the United Kingdom.

2. Data.

   a. "As of mid-2005, 94% of all S&P 500 boards had designated a lead or presiding director, up from 85% a year earlier and just 36% in mid-2003."[9]

   b. Over the last ten years, there has been a growing trend of separation of CEO and chair roles:[10]

      i. In 2011, 41% of all S&P 500 boards separated the CEO/Chair role;
      ii. In 2006, 33% of all S&P 500 boards separated the CEO/Chair role; and
      iii. In 2001, 26% of all S&P boards separated the CEO/Chair role.

---

[6] *Engaging with strategy after the financial crisis*, Lead Director Network Viewpoints, Tapestry Networks (August 4, 2011).

[7] *The lead director's perspective on corporate governance reforms*, Lead Director Network Viewpoints, Tapestry Networks (December 11, 2009).

[8] *Non-Executive Chairman pay Practices*, Hay Group's Executive Edition Newsletter, July 24, 2007.

[9] *A Closer Look at Lead and Presiding Directors*, Cornerstone of the Board – The New Governance Committee, Volume 1, Issue 4, Spencer Stuart. The article notes that the new NYSE listing requirements was a driving factor in formalizing the lead director role (2009).

[10] *2011 Spencer Stuart Board Index*, Spencer Stuart (2012).

c. Increasing independence among board chairman:[11]

i. In 2011, 21% of all S&P 500 boards had an independent chairman; and
ii. In 2006, 10% of all S&P Boards had an independent chairman.

d. "2012 proxy season saw resurgence of proposals requesting that companies separate the roles of CEO and chair, with 38 such proposals voted on at S&P 500 companies in 2012, an increase of more than 50% from 2011."[12]

e. Combined CEO/Chair cost more (results based on 180 mega-caps): [13]

i. Executives with a combined CEO and chair role earn a median of just over $16 million. CEOs who do not serve as chair earn $9.8 million in total summary compensation at the median (66% less than their counterparts who also serve as chair);
ii. Chairman only (all chairmen) earn median total summary compensation of $492,259;
iii. CEO plus a separate chairman earn a combined $11 million;
iv. CEO plus a separate, independent chairman earn a combined $9.3 million;
v. Less than 1% of companies with a combined chair and CEO and a market cap in excess of $20 billion score an ESG rating of above average compared to almost 20% of companies with separate roles; and
vi. Five-year shareholders returns are nearly 28% higher at companies with a separate CEO and chair.

f. 40% of public companies in the US divided the roles of chairman and CEO, up from 23% in 2000, but only up by 1% since the financial crisis in 2008. 19% of the board chairs are independent and six companies declared in their securities filings that they have an explicit policy to split the roles.[14]

3. <u>Recent Real World Examples.</u> Recent news relating to CEO's resigning or being dismissed from Chair positions:

a. Duke Energy
b. Goldman
c. Citi
d. JPMorgan
e. BATS Trading

[11] *2011 Spencer Stuart Board Index*, Spencer Stuart (2012).

[12] *Shareholder Proposals on Governance Structure: Independent Chair*, excerpt from Sullivan & Cromwell's 2012 Proxy Season Review, located on boardmember.com, July 9, 2012.

[13] *The Costs of a Combined Chair/CEO*, GMI Ratings, June 2012.

[14] *Chairman or Lead director: What's in a name*, April 4, 2011.