1. **REDEFINING THE LEAD INDEPENDENT DIRECTOR** by Holly J. Gregory
   How are lead directors using their new powers and responsibilities?

7. **BOARD EVALUATION: “FEED-FORWARD” INSTEAD OF “FEEDBACK”** by Paul Winum
   Evaluation focuses too much on past problems, too little on future aspirations.

12. **A PRIVATE EQUITY MODEL FOR PUBLIC COMPANY BOARDS** by Henry D. Wolfe
    Top private equity-owned company boards think, act and perform differently.

17. **FACING THE NEW TIDE OF SECURITIES LITIGATION** by H. Stephen Grace Jr., Ph.D. and Joseph P. Monteleone
    Today’s lawsuits and enforcement action demand new litigation teams.

22. **INFORMATION TECHNOLOGY GOVERNANCE** by Bob Zukis
    After all the cyber and data danger warnings, how do you change your board to respond?

26. **IN REVIEW** Index to actions, regulations and surveys.

30. **SPOKEN & WRITTEN** Excerpts of articles and speeches.

31. **DIRECTORS’ REGISTER** Recent board elections.

32. **CONVERSATIONS: HANNAH-BETH JACKSON** California mandates board diversity.
While the number of U.S. corporations with an independent board chair continues to increase, the lead independent director position has become the boardroom norm at many companies. The motivators for creating this lead director boardroom leadership structure, its status and powers continue to vary greatly from board to board.

The leadership structure of large U.S. publicly traded companies has evolved significantly since the turn of the century away from the tradition of combined leadership in one individual who holds both the CEO and board chair positions. The most prevalent public company leadership structure is now one in which the board has leadership independent from the CEO, through an independent chair or lead or presiding director.

Public companies are not required to have an independent board leader. Nevertheless, boards have altered their leadership structures as attention has focused on the role that independent directors are expected to play in providing objective oversight while holding management accountable.

Many shareholders now accept that a well-designed lead director role can provide an effective alternative to a separate chairman.

Independent leadership is viewed as particularly important with respect to board oversight and decisions regarding corporate strategy, management succession, performance and compensation, audit and internal controls, board composition and functions, and accountability to shareholders. Leadership in most S&P 500 companies is now shared between the CEO and a lead director selected by the independent directors (hereinafter, a lead director).

Large institutional investors and proxy advisors generally prefer that boards select an independent chair and avoid giving the CEO the chair title. Shareholder proposals seeking the adoption of an independent chair structure remain common, and pressures to move toward an independent chair may never fully abate.

While many shareholders favor an independent chair, many also accept that a well-designed lead director role can provide an effective alternative. As companies continue to develop the lead director role, it is becoming similar to the role of an independent chair.

The primary differences are in the title of “chair” versus “lead director,” and in the power to wield the gavel in full board meetings versus in executive sessions of the independent directors. The lead director role is becoming synonymous with leading the efforts of the independent directors, as distinguished from the CEO’s role in both leading management and the company for most external matters.

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

- Appropriate for the company’s particular circumstances.
- Effective in supporting board objectivity in business judgments and oversight.
- Well articulated in company disclosures and policies.

Boards should review their leadership structure on a periodic basis to ensure that it is appropriate for the company. Boards with a lead director should review the functions of that role on a periodic basis against emerging practices. Additionally, boards should consider the independent board leadership structure of the company.

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structure as a component of both CEO and board succession planning.

☐ **Pressures for independent leadership.** The move away from combining the chair and CEO roles has been driven by a number of forces. Changes in listing rules and SEC disclosure requirements have focused attention on board leadership. Listing rules imposed in 2003 (generally associated with the Sarbanes-Oxley Act) raised expectation that independent directors provide objectivity in overseeing management.

Mandates of the Dodd-Frank Act, adopted by the SEC in 2009, require disclosure of the board’s rationale for combining or splitting the chair and CEO roles. At companies where the chair and CEO roles are combined, disclosure of whether the company has a lead director and the specific role the lead director plays is required.

“**Every board needs a strong leader who is independent of management. The board’s independent directors usually are in the best position to evaluate whether the roles of chairman and CEO should be separate or combined.”**

Shareholders and proxy advisors have fueled this change. Shareholder proposals and proxy voting policies generally support proposals for an independent chair unless the company maintains a strong lead director role. Many institutional investors also favor independent board leadership through their proxy voting and governance policies, including BlackRock, State Street, CalPERS, CalSTRS, the New York City Pension Funds, and TIAA.

Independent board leadership is also supported by governance effectiveness guidance that expresses a “best practice” consensus that boards should have some form of independent leadership. Examples include:

☐ “Every board needs a strong leader who is independent of management. The board’s independent directors usually are in the best position to evaluate whether the roles of chairman and CEO should be separate or combined; and if the board decides on a combined role, it is essential that the board have a strong lead independent director with clearly defined authorities and responsibilities.” (*The Commonsense Principles of Corporate Governance, Preamble (2017), available at governanceprinciples.org.*)

☐ “The board should be chaired by an independent director. The CEO and chair roles should only be combined in very limited circumstances; in these situations, the board … should name a lead independent director who should have approval over information flow to the board, meeting agendas and meeting schedules to ensure a structure that provides an appropriate balance between the powers of the CEO and those of the independent directors.” (*Council of Institutional Investors, Corporate Governance Policies (Sep. 15, 2017), available at cii.org.*)

☐ **Shareholder proposals.** Shareholder proposals seeking an independent chair continue to be prevalent. Proponents appear to target companies that they perceive to have board oversight or performance issues, with little regard to whether the company has adopted independent board leadership.

According to Proxy Monitor, at Fortune 250 companies in 2017, proposals regarding an independent chair were the most frequent governance-related shareholder proposal, and the third most frequent shareholder proposal overall.

Although none of these proposals received majority support in 2017 or 2016, it is likely that they will continue to be submitted and the issue of independent board leadership will continue to be debated.

In 2017, 43 independent chair proposals went to a vote. These proposals are commonly supported by the two primary proxy advisors, Institutional Shareholder Services Inc. and Glass, Lewis & Co., and they tend to receive significant shareholder support, albeit short of passing rates.

On average, independent chair proposals received support of approximately 30 percent of the votes cast in 2017, with nine proposals receiving support of 40 percent or more. Generally, average support for these proposals has decreased since 2012, when the 50 proposals that went to a vote received support on average of more than 35 percent of the votes cast. Twenty-one proposals received support of 40 percent
or more, and four received majority support.

- **Proxy advisor policies.** ISS has historically favored shareholder proposals calling for independent chairs. In 2017, ISS recommended in favor of 30 of the 43 (70 percent) proposals that went to a vote, compared to 34 of the 46 (74 percent) proposals in 2016 and 36 of the 50 (72 percent) in 2012. ISS bases its vote recommendation on a “holistic review” of the company’s board leadership structure, governance practices, and performance. Factors it will consider negatively include:
  - The presence of an executive or non-independent chair in addition to the CEO.
  - A recent recombination of the role of chair and CEO.
  - A departure from a structure with an independent chair.

ISS will also consider “any recent transitions in board leadership and the effect such transitions may have on independent board leadership as well as the designation of a lead director role.” For companies that have a lead director, ISS will assess whether the role is robust. Generally this requires that the lead director:
  - Is elected by and from the independent members of the board.
  - Serves for a term of at least one year (rotating the role, for example, among committee chairs on a quarterly basis, is not considered sufficient).
  - Has “clearly delineated and comprehensive” duties. These include: serving as liaison between the chair and the independent directors; approving information sent to the board; approving meeting agendas for the board; approving meeting schedules; authority to call meetings of the independent directors; and availability for consultation and direct communication with major shareholders.

Glass Lewis generally supports shareholder proposals seeking an independent chair unless, among other things, the company has indicated it intends to separate the roles and has a clearly defined lead director role.

- **Current data.** According to Heidrick & Struggles, in 2016 only 6.4 percent of newly named CEOs were immediately named chair (down from 9.5 percent in 2013). Additionally, the 2017 Spencer Stuart U.S. Board Index indicates that, for the first time, the majority of S&P 500 CEOs do not also serve as the chair. According to Spencer Stuart:
  - 51 percent of S&P 500 companies have separated the chair and CEO roles, up from 46 percent a decade ago.
  - Approximately 28 percent of S&P 500 companies have boards with an independent chair (compared to 13 percent in 2007), an increase of approximately 1.4 percent per year over the past ten years.
  - 84 percent of S&P 500 companies have either a lead or presiding director, although two percent of these boards rotate the role among independent directors or committee chairs.
  - Of the companies that designate a lead or presiding director, 74 percent use the title lead director, while 26 percent use the title presiding director or specify they have a director who presides over executive sessions.

- **Terms and tenure.** Most boards do not set an express term limit for the lead 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. This study indicates that the average tenure of lead directors is approximately four years. For independent chairs, average tenure is just over four years.

- **Board leader compensation.** According to the Spencer Stuart Study, independent chairs of S&P 500 companies are more likely to be paid additional fees for their service than are lead or presiding directors. Specifically, 96 percent of independent chairs earn additional compensation, versus 66 percent of lead directors.

The additional fees paid to independent chairs are on average significantly higher than those paid to lead directors, and lead directors are paid more than presiding directors. The average additional fee for an independent chair of an S&P 500 company in 2017 was $162,751. In contrast, the average additional fee for a lead director in 2017 was $36,868 (up 10 percent since 2016) and for a presiding director was $26,840 (down 16 percent since 2016).
Whether the independent board leader is an independent chair or lead director, there are certain roles and responsibilities that are common. However, presiding directors often have more circumscribed roles, typically focused on presiding at executive sessions. In contrast, it is typical for an independent chair or a lead director to be involved in identifying issues for the board’s agenda and information to be provided to the board in preparation for board meetings.

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

Many view the role of a lead director as a viable alternative to an independent chair if the position is defined with real power and authority. A 2011 report by the NACD compared the roles of a typical independent chair to a lead director and found that the primary differences relate to:

- The power to call a board meeting. Unlike the independent chair, 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 nonmanagement directors.
- Control of the board agenda and board information. Unlike the independent chair, 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 roles and authority of the independent chair and the lead director. These include the board’s role 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.

A CEO, whether or not the CEO 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 the information provided, and keeping the board informed between meetings.

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**The Lead Director’s Job**

**Common Tasks At Top Company Boards**

A review by Sidley Austin LLP of the companies that comprise the Dow Jones Industrial Average (Dow 30) identified 23 companies with a lead director, and two companies with a presiding director. The most common responsibilities of these independent board leaders include:

- Serving as a liaison between the chair and the independent directors (25 companies).
- Approving information sent to the board (19 companies).
- Approving meeting agendas for the board (22 companies).
- Approving board meeting schedules (20 companies).
- Calling executive sessions or meetings of the independent directors (25 companies).
- Being available for consultation and direct communication with major shareholders (22 companies).
- Chairing executive sessions of independent or nonmanagement directors (25 companies).
- Having authority to call board meetings (nine companies).
- Advising on, recommending, or approving the retention of outside advisors and consultants who report to the board (seven companies).
- Presiding at board meetings in the chair’s absence (22 companies).
- Guiding, leading, or assisting with:
  - The board and director self-assessment process (13 companies).
  - The board’s annual performance evaluation of the CEO (12 companies).
  - The CEO succession planning process (five companies).
  - The board’s consideration of CEO compensation (three companies).

- **Board leadership roles and responsibilities.**
Decisions about board leadership should be governed by practical realities, rather than by best-practice theory.

Making board leadership decisions. The board is responsible for its own structure and processes, and should apply its business judgment to decisions on the appropriate board leadership structure. 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. It is becoming more common for board leadership decisions to be made by the independent directors, in consultation with the CEO.

The optimal board leadership structure is context dependent, and may change with the circumstances of the company and the board. Factors to consider include:

- Board culture and practice.
- Business circumstances.
- Characteristics, capabilities, and leadership styles of potential board leaders.
- Expectations of key talent.

Even those who prefer the independent chair structure concede that the time to consider a change is during a CEO succession event. Stripping a chair title from a sitting CEO is likely to be viewed as an indication of a lack of board confidence in the CEO.

The concern most often expressed about the combined chair/CEO role is that it may hamper the ability of the board to provide effective oversight. The chair/CEO has control of the agenda and information, and has inherent conflicts. An independent leadership structure is viewed as a counterweight, but should be designed with an understanding of the challenges that shared leadership may present. These can include: competing centers of power; confusion about leadership roles; and misperceptions about a lack of board confidence in the CEO.

As a practical matter, having one person serve as both chair and CEO may benefit the company and the board. These benefits include:

- A unity of command that avoids confusion about leadership roles by designating clear lines of authority and supporting clear and consistent messages.
- Leadership by the person most knowledgeable about the day-to-day operations of the company.
- Ability to develop business relationships in certain foreign jurisdictions where the chair title provides a higher level of stature than the CEO title. An independent chair is unlikely to be involved in these relationships.

The challenges of shared leadership require attention, but are manageable through a combination of: effective communication; thoughtful, well-articulated apportionment of roles and responsibilities among board leaders and management, and prudent selection of the people in leadership roles.

The relationship between the independent board leader and the CEO requires ongoing care to ensure that the chemistry is appropriate. The relationship of

### Independent Board Leadership

**What Is Desired?**

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.
- Respected by the directors and CEO for leadership capacity and business judgment.
- Respectful of the skills, contributions, and diverse viewpoints of individual directors.
- Respectful of the distinction between the board and management role, and of the CEO and management team.
- Supportive of the CEO as the leader of the company internally and externally.
- Capable of building and maintaining strong cooperative relationships.
- Excellent at communicating, including sensitive messages from the board to the CEO and to fellow directors.
- Able to lead in a crisis.
the independent board leader to the board members also requires attention to ensure that the board’s role is supported by the leader. Many directors describe the ideal style of an independent board leader as one focused on facilitation of the group’s endeavor, rather than a more directorial or autocratic style of leadership.

- Selecting an independent board leader. Considerations in identifying a potential independent board leader include whether the candidate understands the nuances of leading the board without usurping board authority, and ability to establish an effective relationship with the CEO. While boards vary in the methods they 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.
  - Identifying potential candidates. In most circumstances, boards choose an independent board leader from among the current directors. 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 when it may be beneficial or necessary to look outside for an independent board leader (such as when a board has had significant turnover).

- Involving the CEO to an appropriate degree, given the importance of the relationship that must develop between the independent leader and the CEO. While the board should not delegate 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.

- 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 assessment of the independent board leader’s performance. However, this is not a position that should rotate or change on an annual basis given the skills and relationships needed. The board should also consider whether there should be limits on tenure to support board leadership succession.

Holly J. Gregory
Board Evaluation: “Feed-Forward” Instead Of “Feedback”
by Paul Winum

Corporate board evaluation, now mandated in most economies, has proven contentious and flawed for many companies. Among the problems—evaluation measures the past performance of a board and its members, but offers too little intelligence on future improvements. What if board evaluation focused less on “feedback” and more on “feed forward”?

Since 2009, the New York Stock Exchange has required the boards of listed companies to conduct annual board performance evaluations. The corporate governance codes in Europe all stipulate that annual board evaluations be conducted. In the UK, the prescription is to use an outside facilitator for the process at least every third year.

In the first years of the NYSE requirement, many boards responded to the mandate with a rather cursory “check the box” process. This was motivated more by the compliance imperative than a desire to improve the board’s effectiveness. Often, it involved simply distributing a brief survey to all board members. The results were tabulated, and the boxes checked.

Best practices in governance today require a much more rigorous approach. In addition to a thorough evaluation of full board and committee effectiveness, individual director feedback should be part of a robust board assessment. However, a 2016 survey of 187 board directors conducted jointly by Stanford University’s Rock Center and The Miles Group revealed that only slightly more than half of boards actually delivered peer feedback. About one-third of the boards that did reported that those reviews were ineffective.

One of the chief reasons many boards forego individual director evaluations is that gathering and delivering feedback about director and board performance is a very sensitive process. Poorly done, it can damage the important collegial culture inside the boardroom, and inject caution and distrust into directors’ relationships with each other.

However, most directors who serve on boards are highly responsible, conscientious business leaders who genuinely want to contribute value, and would want to know if they are not performing as expected. In fact, over 90 percent of the 620 directors who responded to a joint RHR International/NYSE Governance Services survey indicated that they would like feedback about their performance as a director. So, the question is, how can important information be delivered to directors in a constructive manner?

A focus on what can be done differently going forward to maximize value is much more useful than a review of past performance.

One answer is feed-forward, not feedback. This distinction is more than semantic. The overarching intention of board and director evaluation is to continually enhance contributions in the future. Thus, a focus on what can be done differently going forward to maximize value is much more useful than a review of past performance.

While referencing former behavior may be helpful to highlight themes, the majority of boards and directors will benefit most from candid suggestions about how they can improve their contributions in the future. Drawing upon RHR’s experience in this field, here are a few recommendations for providing feed-forward.

- Be clear about the expected value proposition for the board and each director. Directors come into their board service with a variety of implicit assumptions about how they think they should contribute. Some, motivated by the desire to be helpful, can cross the line

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from governance oversight into management. Others, wanting to provide a rigorous check on management, can adopt an adversarial posture. The board chair and/or lead director need to be explicit about the expected value proposition of the full board and of each director in the initial selection and onboarding process, as well as in director evaluations.

Listed are ways to set up the board and director evaluations with a future orientation. Whether the evaluations are conducted internally or via an outside facilitator, the board surveys and interviews (the best-practice combination) should focus on how the board, committees, and individual directors can function more effectively in the future rather than how they have functioned in the past.

Board chairs and lead directors should give feedback and suggestions for improvement to each director in an ongoing fashion throughout the year. This is especially important in light of the fact that the RHR/NYSE study noted found that companies need different things from their boards as the operating landscape and company strategy evolve. Evaluations should focus on what governance needs will be in the coming year(s), and how directors can contribute to that future. Also, keep in mind that the best input is actionable, and any changing expectations should be clearly defined.

- Supplement the evaluation with ongoing input from the board chair or lead director. An annual evaluation is an effective way for a board to gauge how it is functioning, and how it can improve its effectiveness going forward. In addition, regular, immediate input provides the best opportunity for behavior reinforcement or modification.

Board chairs and lead directors should give feedback and suggestions for improvement to each director in an ongoing fashion throughout the year. This is a great way to follow up on recommendations from the annual evaluation.

In many cases, it may involve simply calling out what a director is doing well that adds value. In other cases, individual directors may benefit from timely course corrections about how they conduct themselves and how they can contribute more effectively in the future. This aspect of the role of chair and lead director is critically important, and takes a high level of interpersonal skill.

With the recommendations above in place, here is a suggested 10-step sequence for conducting a best practice board evaluation:

- **Step 1: Design the evaluation process.** The board chair, lead director or chair of the nominating and governance committee (the board evaluation sponsor) designs the evaluation process. This may or may not involve an external advisor. The evaluation process should ideally include input from both directors and selected members of the management team who interface with the board. Also, the process should include a method for gathering input from each director about how each fellow director can maximize their contribution in the coming year.

- **Step 2: Communicate the process.** The board evaluation sponsor communicates the process and
timing of the board evaluation in person at a board meeting. Communication of the process should emphasize the importance of full candor and convey the safeguards that will protect anonymity for all who provide input. Every director needs to be clear about how the results of the evaluation will be delivered.

☐ **Step 3: Written survey.** A written survey with customized items about how the board is functioning and how it can operate more effectively in the future is developed and distributed. This survey allows data to be generated and the board to be compared to other boards on various dimensions of effectiveness. The survey should address the following areas:

- The board’s value proposition. (What is the specific value that the company needs the board to deliver in the coming year?)
- Overall board effectiveness in delivering on that value proposition.
- How the board is contributing to the company’s growth strategy.
- Composition. (Does the board have the expertise, perspectives and capabilities needed to deliver the value proposition?)
- Committee functioning.
- Oversight of risk.
- Leadership of the full board and each committee.
- Partnership between the board and CEO.
- Board renewal. (Address both continuing education of the board and director succession planning.)

☐ **Step 4: Interviews.** After the surveys have been completed, individual, confidential interviews are conducted with each director and the members of the management team who interface with the board. The interviews can be conducted by the board chair, lead director, chair of the nominating and governance committee or by an experienced outside facilitator. Topics for discussion should mirror the topics in the survey.

☐ **Step 5: Peer reviews.** In addition to getting input on how the board and its committees are functioning and can evolve, during the individual, confidential interviews, each director should be asked to provide input about every other director. Input about how individual directors can enhance their contribution going forward can also be gathered from the selected members of the management team who work with directors in committee. Three simple questions to ask each person interviewed are:

- How has this director added value in the past year?
- What should this director continue, do more of, less of, or differently in the coming year to maximize his/her value contribution?
- Are there any other comments or suggestions you can offer about how this director can contribute going forward?

☐ **Step 6: Compile survey results.** After all interviews are completed, a summary of survey results and findings from the interviews can be compiled. Also, a brief report for each director should be composed summarizing the input gathered in response to the three questions above.

☐ **Step 7: Discuss the results.** Prior to the first board meeting after the evaluation, the results from the full board evaluation should be distributed to each board member. Then, at the board meeting, the results should be discussed, along with ideas for any changes to how the board needs to operate going forward. Recommendations and a board development action plan can be finalized over subsequent board and committee meetings.

☐ **Step 8: Meet with each director.** After the full board results are presented and discussed, meetings with each director are scheduled. These are conducted by the either the board chair, lead director, chair of nominating and governance, or independent facilitator if one was used. No attributions of who said what should be conveyed to individual directors—just a summary of the themes and suggestions for the future.

☐ **Step 9: Debrief the evaluation process.** Following the individual director meetings, a debrief of the whole board evaluation process should be done by the board sponsor or at the next full board meeting. Any suggestions to improve the process should be recorded and incorporated into the following year’s evaluation process.

☐ **Step 10: Implement and track recommendations.** Most importantly, the recommendations
from the board development action plan should be implemented and tracked at subsequent board meetings. Responsibility for implementation of individual director development should reside with each director. The board chair, lead director and chair of nominating and governance receives a copy of the development themes for each director, and provide on-going reinforcement throughout the year.

Evaluation with “third-party interviews almost always lead to more candid insights than a committee discussion, and typically is taken more seriously.”

Randall Larrimore serves as the chair of the nominating and governance committee on the boards of both Campbell Soup Company and Olin Corporation. He offers the following perspective about giving directors feed-forward input as part of evaluation:

“On both boards on which I currently serve I have led the effort to use director education, both committee and board evaluations, as well as individual director evaluations to do this. Quite frankly, the most valuable tool has been individual director evaluations where we try to identify how a director might use their skill sets to contribute more to board discussions.

Annually the governance committee, with input from the CEO, meets and discusses each director and how they could enhance their performance. Many times, the discussions revolve around being more outspoken and sharing their views. Sometimes it leads to suggestions that a director take less airtime so that others can speak.

A few times it has led to the conclusion that the skills the director has are no longer applicable to the company’s strategy. In all cases, either the lead director or non-executive chair of the board provides the confidential input to the individual director with subsequent follow-up as appropriate, often with assistance from the chair of the governance committee.

To maximize the value of this process, it is important to involve a third party on a periodic basis (say every third year) to conduct confidential interviews with each director on how they think their fellow directors could add more value to the board and then provide direct, unfiltered feed-forward to the director. The third-party interviews almost always lead to more candid insights than a committee discussion, and typically is taken more seriously than collegial feedback from a fellow director.

While often discussions and interviews about individual directors bring up past performance—good and bad—the focus should be on how the director can modify his/her behavior to add more value to the board going forward.”

This feed-forward approach is also valuable to provide guidance to the board chair, committee chairs and lead director. These are very critical roles that shape the culture and dialogue in the boardroom, and require highly developed group facilitation skills.

Beginning in 2015, the senior partners at RHR interviewed directors who collectively served on more than 100 boards to discover the ingredients that contribute to a highly effective board of directors. One factor that was consistently cited was great board leadership. Summarizing the interview data, we identified eight essential roles that board leaders (chairs, lead directors and committee chairs) must play for maximum board value. Those eight roles are:

- **The Orchestra Conductor.** The chair is the lead facilitator. They need not have all the answers, but they certainly ask the right questions and draw out the best thinking. They bring focus to the right issues at the right time with the right degree of intensity. They know where to poke and when to stop.

- **The Galvanizer.** Board leadership attracts great talent and enlists them in a common pursuit of special goals and achievements. They make sure people are engaged and inspired. They make sure they are aligned on key priorities and know where they want to go. They broker consensus amidst dissension.

- **The Culture Steward.** Great leadership creates an environment where all directors are fully engaged and involved. Every director gets “under the tent.” These leaders create a culture that promotes open discussion, the ability for everyone to be heard, service, and role clarity. They have genuine respect for people with different opinions.
□ The Visionary. Great board leaders always have their eyes and aspirations on the future, a future they set or a future they must react to. They set the framework within which other directors are going to develop strategy and direction for the business.

□ The Operator. Great leaders ensure the day-to-day matters are handled. They put in behind-the-scenes work to make sure directors are prepared for meetings. They set the agenda for board meetings. They have proper information flow and make sure people are properly educated on issues.

□ The Talent Manager. Great board leaders know the skills, experiences, and perspectives needed from other board members as well as from the senior team. They encourage growth on the part of the board members and get them to stretch their minds. They are engaged in evaluation and provide feed-forward (both individually and collectively).

□ The Advisor. Great board leaders are effective coaches; they listen, shape, and guide the CEO in very personal ways. These are personal relationships that must work for a board to be great. This person is a close partner and sounding board for CEOs and their team. They have the CEO’s trust and respect.

□ The Ambassador. Great board leaders have strong connections in the external world, including customers, competitors, suppliers, regulators, politicians, and other key stakeholders. They can access resources from outside.

In conducting board evaluations, we have found that directors often have very concrete suggestions about how board leaders are managing each of these leadership roles. Gathering and delivering that input about how the board leaders can enhance their impact and influence has been welcomed and appreciated.

Just as a CEO may often get limited or highly filtered feedback from subordinates, a board leader may be deprived of performance input from his/her board colleagues. An outside facilitator can provide a safe, objective way for the board chair, lead director and committee chairs to get go-forward suggestions.

Operating a board of directors is an expensive proposition. If you combine the fees for director pay, travel expenses for board and committee meetings along with the time expended by management teams to prepare for and participate in board meetings, the cost runs into the millions of dollars each year. However, when you consider the combined experience, perspective, expertise and networks that a well-composed, aligned and high-functioning board provides, the return on investment can be invaluable.

Directors who commit to board service want to be part of a group that is respected, effective and appreciated by the range of stakeholders on whose behalf they work. A robust evaluation process that incorporates a feed-forward approach can be a powerful tool to help maximize the value that a board delivers to the company it is charged with governing.
A Private Equity Model For Public Company Boards
by Henry D. Wolfe

Many efforts have been made to improve the failings of public company corporate governance (short-term focus, weak board oversight, reactive boards, executive capture). What if the public company governance model itself is the problem, with too many built-in failings and disincentives? The author notes that companies owned by private equity firms consistently outperform public companies—and that their governance model may be the reason why.

In effect, today’s successful private equity firms exploit what might be called ‘governance arbitrage.’

— McKinsey & Company

I am a proponent of blowing up the existing public company governance model and replacing it with one that emulates the governance model used by the most successful private equity firms’ portfolio companies.

Why is the private equity model the best alternative? According to a report by McKinsey, the top 25 percent of private equity firms not only outperform the stock market, they do so by a significant margin, and consistently. More importantly, the underlying operating and financial performance of their portfolio companies outperform their publicly traded peers over multi-year periods.

The best private equity firms are so successful because they are able to extract maximum value from the companies in which they invest, and they do this in large part by imposing a robust and effective governance model on the companies in their portfolio. In my experience, the private equity governance model results in a board that is more “value creation competent,” engaged, knowledgeable, accountable and effective; and a company that is more profitable and successful.

It is time to admit that the public company model is broken and that there is much to be learned—and gained—from studying the best practices of private equity investors, particularly in the sphere of governance.

Private equity firms typically own multiple companies at any given time, each with an average hold period of around five years. The best private equity firms (that is, those with the best returns to their investors over longer periods of time) have a board of directors at each portfolio company that drives the creation of significant value at the company being governed.

The boards of top private equity firm companies bring a singular and unceasing drive for maximum performance to the board roles, and hold management strictly accountable.

There is a much higher level of commitment on the part of the top private equity firms to maximizing their investments than is found at public companies. A deep-dive due diligence process is executed during acquisition of a portfolio company. Thus, the private equity executives who will serve on the company’s board develop an independent view of the value creation potential of the company and the levers that can be pulled for this value to be realized. This investment thesis does not stop once the acquisition is completed. Instead, it continues apace for the early days of ownership to ensure that the value maximization plans are as robust as possible.

The private equity dealmakers and operating partners who will serve on the board come more

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than prepared to govern for maximum value. In addition, any outside directors recruited will not only have access to all of the information compiled by the private equity firm but will be expected to also commit significant time to understanding the company, its industry and its value creation potential.

In short, the boards of the portfolio companies of the top private equity firms are a small group of highly sophisticated and competent individuals who are likely to be as knowledgeable, at least in regard to the value creation levers of the company, as its management. They bring a singular and unceasing drive for maximum performance to the board roles, and hold management strictly accountable for achieving results.

Most directors on private equity boards have an investor’s perspective much more so than an operator’s. Their singular purpose is driving the company to its full long-term potential.

Following is a more detailed look at the characteristics and components of the private equity governance model.

- **Mindset** is one the most critical attributes of board members in private equity portfolio companies. First, private equity directors must have a relentless focus on performance in order to maximize the company’s value over the holding period. This mindset is innate—one does not learn this in business school.

  Second, most of the directors on private equity boards have an investor’s perspective much more so than an operator’s. As such, they bring a view that is more analytical and slanted toward maximum returns than is found on public boards in general. Private equity portfolio company directors come to the board with the singular purpose of driving the company to its full long-term potential.

- **Director selection.** Typically, most board members for portfolio companies are members of the private equity firm. All of these individuals bring unique ability and experience to the value maximization process, which is invaluable at the board level. They not only bring the crucial mindset noted above but also, in most cases, years of experience and engagement in creating value over a wide range of different companies in different industries. They bring the skill of value creation.

  Other board members, whether operating partners of the private equity firm or outside directors, are selected based solely on their experience, abilities and track record in areas that are directly relevant. These independent directors will not be chosen simply for the sake of their independence, but for the specific and relevant competencies and perspective they can bring to the company. Generally, private equity firms are particularly careful to ensure that outside directors have demonstrated the ability to drive performance increases and value in the areas of their expertise.

- **Knowledge.** In-depth knowledge of the industry and the business is essential to any board functioning under the private equity model. This level of
understanding is derived primarily from the deep-dive due diligence that private equity firms conduct when evaluating and pricing a deal.

As Michael C. Jensen of Harvard stated, “The quality of those discussions [in private equity portfolio company board meetings] is just much higher than what takes place with most public company boards. In fact, my sense is that the due diligence process that the buyout firms go through in vetting and pricing a deal causes those principals and their managers to learn more about the business than probably has ever been known since it was a public company, or a division of a public company.”

This information is turned into an investment thesis for the business, which then provides the context for the identification of key initiatives and the development of a value maximization plan.

**Focused agenda.** A focus on the performance of the business versus plan includes clear agreement with management about what is important, and what are the targeted results. Superfluous issues that plague public company boards are not a factor. The latest governance hot topics do not distract boards of private equity companies from their objective of maximizing the performance and value of the business.

Private equity boards probe management at a deep level of detail that traditional boards would view as overstepping the line.

**Quick action when needed.** There is preparedness to act and to do so quickly. This is due to the knowledge of the business on the part of the board, their detailed monitoring of the value maximization plan and their high-performance mindset.

Private equity boards probe management at a deep level of detail. Traditional boards would view this as overstepping the line, but it is a hallmark of the best private equity portfolio company boards. Getting to the essence of issues is critical to ensure maximum performance and management accountability.

These boards show willingness to ask hard, detailed questions about performance variances, and push until concrete answers are provided.

Information flow to the board is very timely, frequent and well-designed. The information received by directors of private equity portfolio companies is almost exclusively prepared in the context of the company’s value maximization plan. While this information will include historical information (financials and other relevant reports), it also covers forward-looking metrics that have yet to be reflected in financials.

For example, there may be a plan to install robots in a certain number of the company’s manufacturing plants. Once accomplished, it is projected that there will be a specific increase in EBITDA resulting in a specifically targeted rate of return. The time horizon for completion of this plan is one year. In the early months, there are limited results that will be reflected in the company’s financials. Still, the board will want to receive a regular report, say monthly, on this plan. It would include:

- The number of installations for the month and year to date compared to plan.
- The total cost of each installation compared to budget for the month and year to date.
- Detailed explanations for any shortfalls in number of installations or cost variances, plans to correct shortfalls and individuals accountable for correction.

**Aggressive results orientation.** There is relentless search for the highest returns possible. Past performance levels typically provide no basis for future plans. In other words, the view of private equity portfolio companies is not limited by past assumptions or accomplishments.

Plans are not simply extensions of the past. They are intentionally forward-looking to drive aggressive improvements in company value and performance, rather than maintain the status quo or make mere incremental enhancements. This may include, but not be limited to, a zero-based budgeting approach. Much of the board’s time is spent on continually seeking new ways to drive value.

Directors develop their own viewpoint as to how the company can create value, and do not depend solely on management.
**Intense engagement.** Directors of the best private equity firms’ portfolio companies (typically, the private equity partners themselves) spend approximately 50 percent of their time at the company for the first three months after closing the deal. They learn everything they can about the business firsthand that was not uncovered during the due diligence process, and further confirm the diligence findings.

Directors develop their own viewpoint as to how the company can create value. They do not depend solely on management to understand the levers that can be pulled to increase performance and value. There is robust debate at board meetings, and a high level of contestability on key points. Board members frequently visit operations, communicate with staff and meet with customers.

**Long-term horizon and sustainability beyond ownership period.** Private equity firms typically hold their portfolio companies for three to five years. Some firms have established long-term funds that may have holding periods as long as 10 years.

The value maximization plans cover the entire holding period. However, these plans actually extend beyond the holding period timeframe, as portfolio companies have to be positioned for continued growth and performance increases to maximize value at exit.

The obsessive focus on quarterly results at public companies is obliterated in the private equity governance model, which takes a much longer view. This, however, does not imply that there is no focus on short-term results. There is, but this focus is in the context of the longer-term value maximization plan. A series of short-term objectives leads to attainment of longer-term objectives and targets and, therefore, must receive close attention from the board.

**Skin in the game.** Private equity firm personnel who are portfolio company board members have significant personal capital invested in each company where they are a director. This is a long-term investment that cannot be sold until the private equity firm exits. If that exit takes the form of an IPO, then the private equity firm personnel still may not be able to exit until sometime after the IPO. This results in a powerful motivation to ensure the company’s performance and value during the holding period.

In addition, private equity firm personnel are further incentivized via their share of the carried interest that is realized upon exit of the deal. However, there are investment thresholds that must first be met before any carried interest is realized.
Outside directors are also typically required to make a meaningful investment in the company. In many cases, they are given restricted stock that only vests at exit, and only if certain stringent cash-on-cash or internal rate of return investment hurdles are cleared.

There is no gaming of the payoff to the members of the board in the private equity world. If the private equity firm’s limited partner investors do not win, then neither does the private equity firm nor the members of a portfolio company board. The alignment between the board members and the investors is total.

According to a McKinsey study done with 20 chairmen or CEOs who had served on the boards of both public and private equity companies:

“Advocates of the private equity model have long argued that the better private equity firms perform better than public companies do. The advantage, these advocates say, stems not only from financial engineering but also from stronger operational performance. Directors who have served on the boards of both public and private equity companies agree, and add that the behavior of the board is one key element in driving superior operational performance. Among the 20 chairmen or CEOs we recently interviewed as a part of a study in the United Kingdom, most said that private equity boards were significantly more effective than those of their public counterparts.”

More specifically, the results of this study showed:

- Fifteen of the 20 chairmen surveyed said that private equity boards added more value; none said that the public counterparts were better.
- On a five-point scale (where one was poor and five was world-class), private equity boards averaged 4.6 and public boards averaged 3.5.
- The intensity of the performance-management culture of private equity boards was the single-largest variance between the two types of boards.
- Public boards focus much less on fundamental value creation and more on quarterly profit targets and market expectations.
- Public boards seek to follow precedent and avoid conflict rather than exploring what could maximize value. They are more focused on risk avoidance than value creation.

While certainly short of exhaustive, this study clearly demonstrates, based on the experience of 20 top business leaders, that the private equity governance model is superior to the public company model in regard to company performance and value creation.

At the best-performing private equity firms, the governance model is one of highly engaged directors with competencies directly related to maximization of the company’s performance and value, a relentless focus on the realization of the value maximization plan and with results that outperform their publicly traded peers across multiple performance and value creation metrics.

The asset value of the board is not something that is commonly recognized at public companies but is an essential component of the private equity governance model. It is clear that, in regard to capital allocation, company performance and value creation, the private equity governance model is superior to the public company model.
After a decade of relatively lighter litigation activity, the past several years have seen a growing boom in lawsuits against corporations and their officers. While there are several drivers for this trend, the scope and number of lawsuits demands rethinking of company defense strategies. Your traditional litigation teams may no longer be enough.

Virtually all credible chroniclers of litigation case filings agree that we are seeing a marked increase in the number of “securities cases” filed. Sources may differ on the precise number of cases each year because they employ differing definitions of what constitutes a securities case. Virtually all agree, however, that 2017 was a record year for new filings with a large increase over 2016, and a year much higher in new filings compared with averages over the past twenty years. After three quarters of 2018 under our belt, indications point to a continuation of this growth in 2018.

Today more than ever, corporate officers and directors need to be properly informed and prepared for the possibility of litigation involving their responsibilities and decisions in the entities in which they serve.

Securities litigation includes:

- **Securities fraud class actions.** These large exposure cases see damages often exceeding $1 billion, dependent upon the length of the class period and overall drop in market cap of the company.
- **Securities fraud actions filed by individuals or entities.** The typical plaintiff is a public employee pension fund, but there can be suits by individual shareholders and other private entities.
- **Securities fraud actions brought by government regulators.** These are usually brought by the Securities and Exchange Commission, but there have been a number of recent actions brought by certain state attorneys general, who have been active in this area.
- **Shareholder derivative actions.** These are suits typically brought by shareholders in the name of the corporation against one or more members of executive management or the board. The focus of these suits is upon mismanagement, contrasted with the securities fraud actions which typically focus upon disclosure issues.
- **Creditor claims.** Typically brought in the aftermath of a bankruptcy filing. Similar to shareholder derivative actions with respect to the basis for the claim. Typically brought by or on behalf of secured or unsecured creditors of the company.

In the face of current trends, it is important to focus on how companies, their insurers and counsel should respond to litigation claims. Among the many risk and governance issues to be addressed, once litigation has commenced there are two overriding strategic actions that can have major impacts on the outcome of a case.

Certain large insurers will have in place a “panel” of pre-approved defense counsel firms from which the insureds must make their selection.

- **Putting in place the defense team.** A first order of business is making decisions about your defense team.

D&O policies issued to public companies give the insurer no right to impose its selection of counsel on the company. That being said, certain large insurers typically have in place a “panel” of pre-approved defense counsel firms from which the insureds must make their selection. It is not unusual for the insurer

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to have negotiated beforehand an agreed hourly rate structure and other litigation management guidelines with these defense firms.

Do not be misled into believing these insurers have secured bargain-basement rates from unqualified counsel. The eminently qualified counsel on these panels have senior level partner rates generally ranging from $750 to $1,000 per hour per prior agreement. One is apt to encounter the lower end of the range outside the litigation hotbeds of the Southern District of New York and the Northern District of California. Outside of these panels, prevailing rates of senior lawyers have approached $1,250 per hour.

There are many fine firms that are not listed on such panels. Insureds can frequently negotiate to have their chosen securities litigation firm added to an insurer’s panel on a one-time basis.

Regardless of how defense counsel are chosen, it is critical for the primary insurer (and ideally, the excess insurers as well) to meet early with defense counsel and discuss the strategy for defending the case. However, excess insurers are not often involved at these early litigation stages. That is a mistake which in many cases ultimately works to their detriment, as well as to the interests of their insureds.

The coverage provided by excess insurers is a sig-
nificant motivator for a vigorous defense throughout a case. A “meeting” of all parties does not necessarily have to be in person. Initial and periodic teleconferences among the primary and excess insurers and defense counsel are an optimal way to ensure a good working relationship. Your “team” of insurers, defense counsel and others should be in place from the outset, and continue to work cooperatively through the entire life of the litigation, including resolution of any defense strategy, insurance coverage and other issues that may arise.

If the insured corporation has an in-house counsel, it is important to have her or him become involved in the process as a member of the team. Differences of opinion may develop between defense counsel and insurers over litigation strategy and costs of the defense. General counsel can be very effective in resolving these differences and instructing defense counsel on these issues. General counsel, however, may not necessarily hold any sway over counsel for independent directors or any counsel other than the firm representing the corporate policyholder and members of management.

Insurance brokers can also be helpful intermediaries in assuring a smooth working relationship between the insurers and defense counsel, notwithstanding any coverage issues that may have been raised by way of reservation of rights letters.

Very few securities fraud class actions ever proceed to trial on the merits. The reason for this is that the stakes for both sides are simply too high. A loss for the defense could result in a judgment far in excess of insurance policy limits, perhaps even in the billions of dollars. On the other hand, a loss for the plaintiffs can result in no recovery after having incurred millions of dollars in fees and expenses to take a case through trial.

- A very large percentage (up to 40 percent) of these cases are won by defendants upon a Motion to Dismiss or Motion for Summary Judgment. A Motion to Dismiss can be granted without prejudice to refile, and may only provide a temporary reprieve until plaintiffs craft a complaint that can withstand judicial scrutiny. A dismissal with prejudice, however, leaves the plaintiff with the only recourse of an appeal, and reversals on appeal are not readily obtained.

The D&O insurers will work with defense counsel to agree on a mediator, but the pool of well-qualified, available mediators is unfortunately quite small. For this reason, we see the same mediators over and again in securities fraud class actions. Of course, the pool of well-qualified plaintiff firms, defense counsel, and D&O insurers and their counsel are also limited. Thus, in many mediations there is an array of parties all well known to each other. This is actually positive in the facilitation of a settlement.

The ideal litigation expert is a credible management consultant with hands-on experience in corporate governance and business practices.

A sometimes overlooked player in the defense team is the consulting expert. This is someone who brings specialized knowledge and highly relevant business expertise to the litigated matter. A consulting expert can be a valuable addition to the defense team in nearly all situations.

Types of consulting experts differ, as do the services and products they provide. Damages analysts such as Cornerstone, NERA and others are frequently engaged to assess the extent of “plaintiff style damages” and opine on target settlement values. Their analyses are usually statistical in nature, based on historical settlements tempered by the specific events
in the case at hand. As a rough guide, class actions often settle for an amount at five percent or less of the plaintiff-style damages. This is where another type of expert can be invaluable, if engaged as a team member.

The ideal expert is a credible management consultant with hands-on experience in corporate governance and business practices. In particular, such an expert needs to be knowledgeable about the ways in which executive management and the board reasonably come to business decisions.

This is especially critical in claims brought on behalf of creditors in the aftermath of insolvency, where allegations are made that faulty decisions and actions of management and directors contributed to financial difficulties. However, a specialized management and business practices consultant should be considered at any time when management decisions are at issue in securities fraud litigation.

Often, securities fraud cases require the same expert testimony that is required in shareholder derivative and creditor actions. This is where the consulting expert may also serve as a testifying expert.

The questions the expert seeks to answer are two-fold. First, did the alleged acts or omissions of the directors and officers actually cause the loss sustained, or were other market factors at play that would have made the loss inevitable?

Second, in the case of a derivative action, did the directors and officers breach any fiduciary duties owed to the company? This is where the powerful defense of the Business Judgment Rule can pose an insurmountable hurdle for plaintiffs. That rule of evidence affords the board considerable deference in exercising its business judgment (other than where the board is grossly negligent).

The answers to these questions are developed by drilling into the business issues and contributing factors involved in a case, and examining the business merits of the plaintiff’s allegations. Following are three actual case scenarios that illustrate the value a knowledgeable consulting or testifying expert can bring to the table.

Case #1. In the first scenario, a global bank had acquired a large regional bank. This bank, in turn, owned a local bank which served as the indenture trustee of an investment made by the state retirement system from a special purpose development fund. The investee firm failed and the retirement system sued the bank in its role as trustee. The local bank’s trust department procedures were poor. It did not monitor documents required from the investee company nor exercise a potential default which could have led to the recovery of the investment.

The bank retained a consulting expert that understood pension plan/retirement systems, as well as the roles of indenture trustees. The expert confirmed weaknesses in the local bank’s procedures, but determined there was not a basis for declaring a default in the circumstance cited.

Further, the expert determined the retirement system’s special purpose development fund had lost 90 percent of its entire value. The chair of the retirement system’s board of trustees also had multiple conflicts of interest, and the retirement system had not been able to hire the personnel qualified to manage the investments undertaken.

The expert firm reviewed these points in mediation and in connection with the deposition of the retired executive director of the retirement system. Shortly thereafter, the retirement system dismissed its claims against the bank, while collecting over $100 million from all of the other defendants.

Case #2. A second case shows the persuasive effect of such an expert in the well-known Walt Disney shareholder litigation involving the hiring and subsequent termination of Michael Ovitz. A consulting expert was retained by the primary D&O insurer and its outside counsel to review the record and advise on corporate governance issues with a view toward reducing the potential settlement value of the case.

The work of the expert in Disney helped the primary insurer to convince the defendants that they could reasonably argue that Disney had a well-accepted compensation culture that was adhered to in its hiring of Ovitz. The consulting expert was retained by the primary D&O insurer and its outside counsel to review the record and advise on corporate governance issues with a view toward reducing the potential settlement value of the case.

The work of the expert in Disney helped the primary insurer to convince the defendants that they could reasonably argue that Disney had a well-accepted compensation culture that was adhered to in its hiring of Ovitz. The negotiating team had consisted of the chair of Disney’s compensation committee and a second committee member, both of whom were quite knowledgeable on Disney’s pay culture. Further, over 50 percent of Ovitz’s termination pay arose from the
25 percent increase in Disney’s stock price during Ovitz’s 15-month tenure.

The litigation ultimately proceeded to a trial on the merits and the Court entered judgment in favor of Disney on all claims. The judge pointed out that “what” they did was sufficient to carry the day, although “how” and “why” left much to be desired.

Case #3. Finally, in a third case involving a bankruptcy, the insureds’ defense counsel were anxious to conclude a settlement with the creditors funded entirely with insurance proceeds. The claim, however, was in its very early stages, and no formal complaint had even been filed. The creditors and the insureds simply proceeded directly into mediation with only a draft complaint from the creditors.

The creditors’ claims were supported by the potential testimony of a restructuring company retained by the creditors shortly before the bankruptcy. The chief restructuring officer was now running the company in bankruptcy, and his testimony would largely support his own recommendation.

The fact that a litigation expert could tell an alternative tale of management decision-making helped reduce the settlement value by about 40 percent.

The insureds’ counsel balked at retaining an expert to counter the views of the restructuring officer. (In the interest of full disclosure, this case involved each of the co-authors with one leading the effort.) Ultimately, the insured parties acquiesced when the insurers said they would withhold consent to any settlement based solely on the demands of the plaintiff lawyers and the views of the restructuring officer.

The fact that there was a potential expert ready, willing and able to tell an alternative tale of management decision-making was instrumental in convincing the plaintiff and defense counsel, and getting the ultimate settlement value reduced by about 40 percent.

In conclusion, the defense of securities litigation cases becomes more effective if changes are made in how defense teams are assembled, and how the cases are then carried out as the process continues.

First, it is important that excess insurers become more active in the process from the very beginning, in order to support and promote a vigorous defense. This should not create any undue burdens on these insurers or on defense counsel and the insured parties. Simply include the excess insurer in any communications, teleconferences and meetings intended for the primary insurer.

Second, greater consideration needs to be given to the engagement of an expert who can opine on both loss causation and business practices, as well as on corporate governance and management decisions directly related to the dispute. Such an expert can first be engaged on a consulting basis solely to provide information to insureds and defense counsel. Later, decisions can be made as to whether the expert may also become a testifying expert. Such experts are invaluable in assessing the overall exposure in the case and supporting the defense team.
Corporate boards have been receiving regular warnings on cybersecurity and digital disruption for years now. Yet a follow-up question remains unanswered: What should they do about it? How should boards reshape their membership, structure and processes to properly oversee their new digital reality?

From Yahoo to Target to Equifax, and now Facebook, the data breaches that have occurred over the last several years have significantly raised cybersecurity risk awareness at the corporate board level. The Global Data Protection Regulation (GDPR) in Europe has also highlighted a growing regulatory landscape that is waking up public interest on data issues.

SEC Commissioner Robert E. Jackson Jr. has called the rising cyber threat “...the most pressing issue in corporate governance today.”

Boards are also wrestling with the dynamic nature of technology driven disruptors that are altering the competitive landscape and changing industry dynamics. A Protiviti 2018 survey of global directors concerns summarizes their top risk issues as: “The rapid speed of disruptive innovations and new technologies within the industry may outpace the organization’s ability to compete or manage risk appropriately.”

Often referred to as “The Amazon Effect,” the seismic ability for digital transformation to disrupt and alter foundational competitive and economic drivers is becoming a high priority boardroom issue.

Frank Modruson, former Accenture CIO who currently serves on two public company boards explains it this way: “This rapid evolution of digital capabilities puts enormous pressure on businesses to keep up with new capabilities and to replace outdated ones. IT is also one of the largest G&A [general and administrative] budget line items for any business, and one that is often poorly understood by business leadership outside of IT.”

“Add to this the fact that there is a skills and competency shortage of talent who knows how to transform both IT and the business through these new digital capabilities. Plus, the very real and expanding risk of cyber disruption creates an environment where companies have to continually transform alongside protecting what they have, while always being focused on being more efficient and effective.

“From a governance perspective, it creates a volatile risk situation that extends throughout the business with huge implications.”

So now what? Directors are also starting to become aware of the disruptive impact that Amazon, and other digital natives have when they set their sights on a new industry. What do boards, and individual directors need to do next to make sure that digital transformation and cybersecurity risk oversight is a meaningful part of their contributions?

Digital governance is not a mature competency or practice in the U.S. corporate boardroom. Not one of the companies in the DJIA has a dedicated board level cybersecurity committee.

Awareness is a necessary first step, but has largely happened passively (except for the companies and boards that have unfortunately found themselves in crisis management mode as the result of a breach). Governing these issues is a new undertaking for most boards. The challenges include having the skills within the boardroom to understand these issues, organizing the board to manage its resources and time together, and executing a digital governance agenda for an unstable digital/cyber landscape.

Digital governance is not a mature competency or practice in the U.S. corporate boardroom. This is reflected in research conducted by public company

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intelligence firm MyLogIQ. They analyzed whether a boardroom technology or a cybersecurity committee exists for U.S. public companies as a starting point.

Based upon their data, this is currently an uncommon practice. Of the thirty companies in the DJIA, only five have dedicated technology committees, and not one has a focused cybersecurity committee.

The practice does not materially improve across the S&P 500 or Russell 3000, indicating that there is little distinction in digital governance maturity level regardless of company size. However, some companies have adopted the practice. The five companies in the DJIA with technology committees are American Express, J&J, Pfizer, P&G and Wal-Mart.

A remarkable 35 percent of the S&P500 make no mention of cybersecurity oversight in their disclosure documents.

These findings do not mean cybersecurity or technology oversight is an issue that corporate boards are ignoring. Rather, it identifies how they have organized themselves to govern these issues. According the MyLogIQ research, 42 percent of the S&P500 task their audit committees with cybersecurity oversight. Notably, Facebook tasks its audit committee with cybersecurity oversight. Still, a remarkable 35 percent of the S&P500 make no mention of cybersecurity oversight in their disclosure documents.
Tasking an audit committee with cybersecurity oversight, which may not have the necessary skills or time to focus on this complex issue, may limit the effectiveness of the cybersecurity oversight approach, as well as take time, focus and resources away from the significant responsibilities of an audit committee.

Robert Dixon is an Anthem and Build-A-Bear director, and former PepsiCo CIO and P&G executive. He was an early champion of boardroom digital diversity, and recalls:

“When I joined Anthem’s board, they were looking for a qualified business-savvy, technology executive who could provide thought leadership on the board’s governance agenda and management’s technology agenda. Those skills normally come with significant experience leading large-scale enterprise-wide transformations, innovation programs and an appreciation for all of the related cultural and change management sensitivities.

“While growing in importance, critical factors for increasing digital diversity, either through more representation or a Tech Committee, include the role of technology for your business. Does technology define your brand’s value proposition? Is technology at the core of your customer’s experience? Is it a strategic, ‘where to play’ plank in the broader enterprise strategy?”

Board committees play a vital role in how boards perform their duties. Research conducted in 2016 by University of Pennsylvania and Harvard Professors Kevin Chu and Andy Wu shows that committees convey several specific benefits. These include knowledge specialization, greater task efficiency and greater accountability of the board to the firm. They note that most of the work that a board accomplishes is done at the committee level, and a secondary benefit is that they signal commitment and focus around an issue to all stakeholders, internal and external.

However, committees do come with a cost, primarily the cost of information segregation. This can be mitigated, though. A director who sits on multiple committees, such as an audit committee and a technology committee, allows knowledge and information to more easily be shared and distributed across the entire oversight agenda.

While committees play a significant role in the effectiveness of overall board oversight, they also play an important role to the companies and management teams they oversee. Chen and Wu note that committees are generally empowered to “…directly set firm policy, inform the board via informal knowledge sharing or formal reports, and propose actions to be executed by the full board.” Moreover, committees work closely with firm management, thereby directly influencing the firm.

American boardroom committee structures gained a significant amount of standardization with the passing of Sarbanes-Oxley (SOX) in July 2002. After SOX, the audit committee, compensation committee and nominating and governance committee became the de facto baseline committee structure for U.S. listed companies. Beyond these three, however, structure varies greatly.

SOX also required boards to have an independent and qualified financial expert on their audit committee. This requirement was a first, and offers a lesson on qualified technology experts in the boardroom. A decade from now, most boards will have such deep digital and cybersecurity governance skills, and fully disclose this qualified expertise.

It took regulation to force qualified financial expertise into the U.S. boardrooms 16 years ago. Are we now at a similar point with the issue of digital oversight, and the need for qualified technology experts in the boardroom? Will regulators force this issue?

The proposed Cybersecurity Disclosure Act of 2017 (S. 536) would require U.S. public companies to disclose cybersecurity skills on their board. Despite languishing in Congress, it does signal regulatory attention on this issue. Former SEC Commissioner Luis Aguilar has cautioned, “[B]oards that choose to ignore or minimize the importance of cybersecurity oversight responsibility, do so at their own peril.”

An SEC interpretive release on cybersecurity disclosure in February 2018 leads off with: “Cybersecurity risks pose grave threats to investors, our capital markets and country.” The unmistakable regulatory trend is to assure transparency and corporate accountability on cybersecurity risk. This issue is squarely seen as in the public interest, which almost ensures
the inevitability of boardroom digital oversight. Policy will come, with or without corporate involvement.

“Whether or not you have a tech expert or a technology committee on the board, understanding the ramifications of technology is a full board responsibility.”

Sheila Stamps, board member at Atlas Air Worldwide Holdings, Inc. and CIT Group Inc., observes: “Of late, there has been a significant emphasis placed on cybersecurity risk; and this is important. However, we must be both defensive and progressive. We must build defenses against cyber incursion while putting in place innovations to better serve end users.

“There is also an opportunity cost (or risk) that should not be overlooked. How information technology creates and shapes sustainable competitive advantage, its impact on industry dynamics and its role in profitability and growth are all emerging boardroom issues.”

“Whether or not you have a tech expert or a technology committee on the board, understanding the ramifications of technology on your business is a full board responsibility,” Stamps adds.

Effective digital governance starts with getting the right skills and competencies into the boardroom. From here, how boards organize themselves around technology and cybersecurity oversight and what they spend their time on drives the effectiveness of their oversight. Boards will naturally evolve their approach as they gain a greater understanding of these issues—or it will be forced upon them through regulation.

One suggested model is the creation of a dedicated board committee that addresses both technology and cybersecurity risk oversight. This would place a technology and cybersecurity committee alongside audit, compensation and nominating/governance committees in the standing U.S. public company committee structure. One committee focused on both technology transformation and cybersecurity risk can minimize information segregation costs as well as effectively govern the management and organizational issues and conflicts that can exist between CIO and CISO reporting lines.

Digital transformation and cybersecurity risk are two sides of the same coin. Both need to be represented in the corporate boardroom for a board to be sufficiently digitally diverse. Boardroom research indicates that the most important boardroom topics of the future are technology, cybersecurity and digital disruption—all ahead of strategy as a boardroom priority.

Survey data also indicates that information technology expertise is the most underrepresented boardroom skill. This gap almost ensures that cyber breaches will continue, and the benefits of technology innovation will go unrealized.

The scope of corporate digital governance oversight covers a very broad range of issues for any company. These include:

- Alignment of business strategy and IT with enterprise architecture.
- Business continuity and disaster recovery.
- Cybersecurity risk, insurance and D&O obligations.
- Cyber threat intelligence.
- Data privacy and information lifecycle management.
- Device management.
- IT investment and strategy.
- IT service delivery.
- IT project prioritization, implementation and portfolio management.
- IT skills and capability management and organizational structure.
- IT hardware/software lifecycle management.
- New and emerging technologies.
- Regulatory policy advocacy and management.
- Social media monitoring and engagement.
- Third-party IT vendor and service risk management including business continuity.

The strategic and operational risks presented by the rapidly evolving IT environment create a daunting oversight environment. Corporate boards can and should address these issues themselves or regulators will force this issue if boards fail to do so.
Audit

Auditors earn solid confidence ratings from U.S. investors.

Eighty-one percent of American investors say they have confidence that public company auditors are effective in their investor protection roles, according to the Center for Audit Quality’s 2018 Main Street Investor Survey. The annual survey polls investors with at least $10,000 invested in the capital markets through retirement plans or direct holdings.

The survey’s top findings include:
- 74 percent of U.S. investors have confidence in U.S. capital markets broadly, down 11 percent from 2017.
- 78 percent have confidence in U.S. companies that are publicly traded, down 5 percent from 2017.
- 75 percent have confidence in audited financial statements, down 3 percent from 2017.
- 56 percent have confidence in capital markets outside the U.S., up 2 percent from 2017.

“Investor confidence is a pillar of healthy capital markets,” said a CAQ spokesman.

Among investors expressing confidence in U.S. markets, the top reasons selected were the strength of the U.S. economy, the performance of the stock market, confidence in the Trump administration, and belief in the free-market system.

For those showing a lack of confidence, the most prevalent factors selected were lack of leadership in the Trump administration, fear of trade wars or uncertainty around free-trade agreements, and lack of leadership in the U.S. Congress.

Boardroom Practice

Engineering and construction firms have untapped potential for corporate governance reform.

FMI Corporation has released its 2018 FMI/CIRT Corporate Governance Study, conducted in collaboration with the Construction Industry Round Table (CIRT). The purpose of this study was to explore industry-specific practices around governance processes and the degree to which these resulted in board efficacy. Researchers investigated an array of factors, including leadership and demographic composition of corporate boards, director training and development methods, and focus areas of engineering and construction (E&C) boards.

Highlights of the study include:
- 52 percent of board chairs are also CEOs at the same company. This reality presents unique challenges because the role of board chair is distinctly different than the role of the CEO.
- Board diversity is an issue in the E&C industry—71 percent of firms do not have a single minority member, and 50 percent of firms have no gender diversity on their boards.
- Just 34 percent of E&C firms onboard their new directors, according to survey respondents. Compared to other business sectors, boards in the E&C space are onboarding at an alarmingly low rate.
- Even though directors want training, just 11 percent of boards surveyed offer any type of formal training to their members.
- Less than one-third of boards conduct regular evaluations—neither individual director evaluations nor full board evaluations.
- Study respondents say they spend more time reflecting on past performance than planning for future results. Specifically, almost 40 percent of a board’s time is spent on financial results and regulatory matters, and just 25 percent is spent on the organization’s strategy.

Compensation & Recruitment

Disclosure dangers with executive perquisites.

According to a blog by Deb Lifshey of executive compensation consultant Pearl Meyer, while U.S. rules on executive perquisites have not changed, companies are clearly taking more privilege with the SEC’s somewhat flexible definition of a “perk” for reporting purposes.

In one incident, the SEC penalized Dow Chemical for its inadequate perk disclosure from 2013 to 2016. In this case, the SEC did an audit and found that the company failed to report around $3 million in value associated with:
- The CEO’s personal use of aircraft
- Travel to outside board meetings
- Sporting events
- Club memberships
- Use of personal assistant time
- Membership fees to sit on charitable organization boards.

In response, the SEC ordered the company to pay a fine for breach of securities disclosure rules of $1.75 million. It also criticized the company not only for failing to disclose, but for not training employees (including those drafting the CD&A and those keeping track of perks). Finally, the SEC ordered the company to retain an independent consultant for one year to review the company’s policies and controls on expense reimbursements and other payments as perks, and to adopt recommendations made by the consultant to ensure future compliance.

Dow did not admit or deny the charges, and no one person was deemed to be at fault.

Dow seemed to incorrectly apply a position that a business purpose (even if tangentially) related to the executive’s job was sufficient to determine that a benefit is not a reportable perquisite. The SEC found that the perquisites described conferred a benefit on the executive and were not “integral and directly” related to the job, so they should have been disclosed. The SEC rejected the argument that some of these perks may have had some ancillary benefit to the business, and did not need to be reported.

In the second reported incident, the failure to disclose perks was even more egregious. According to the SEC’s complaint, Energy XXI CEO John D. Schiller Jr. maintained an extravagant lifestyle by using a highly leveraged margin account secured by his Energy XXI stock. The complaint alleges that in
2014, when faced with significant margin calls, Schiller extracted more than $7.5 million in undisclosed personal loans from company vendors in exchange for business contracts with Energy XXI. The complaint also alleges Schiller received undisclosed pay and perks in the form of lavish social events, first-class travel, a shopping spree, donations to Schiller-preferred charities, legal expenses for personal matters, and an office bar stocked with high-end liquor and cigars. As a result, the SEC found that Energy XXI failed to report at least $1 million in excess compensation in its disclosures over a five-year period.

Companies are holding the line on salary increases.

According to Mercer’s 2018/2019 U.S. Compensation Planning Survey, salary increase budgets for 2018 are 2.8 percent—no change from 2017—and projected to be only 2.9 percent in 2019. A majority of firms are expressing concerns about attraction and retention. Fair and competitive pay is cited as the number one priority for employees. Even so, this study shows companies are not budging on budgets.

“Unemployment is falling. Job openings are increasing. Employees are gaining confidence in the labor market. Yet, companies are still not investing in base salary, even though it’s the reward employees value the most,” said a Mercer spokesman.

According to the survey, even the windfall of newly available investment dollars from December’s Tax Cuts and Jobs Act (TCJA) is not enhancing pay. Mercer’s survey finds that only four percent of firms have redirected some of their anticipated tax savings to their salary increase budgets. Moreover, just more than half of this small group (53 percent) plans to increase their budget by less than one percent of payroll.

With budget increases flat, programs beyond contractual rewards can help enhance the employee experience. These programs are becoming another way to effectively compete for talent. By supporting career development and training as well as assistance for financial, physical, and emotional well-being, companies can advance employees’ careers in meaningful ways, offer a greater sense of purpose, and provide a more compelling work experience overall.

Compensation for outside corporate directors increased three percent in 2017.

Total pay for outside directors at the nation’s largest corporations increased by a modest three percent in 2017, driven by increases in cash and stock compensation, according to an analysis by Willis Towers Watson. The study also revealed more companies are implementing annual limits on director pay in the wake of shareholder lawsuits alleging that pay for board members is excessive.

The analysis of Fortune 500 companies found median total direct compensation for directors climbed three percent last year to $267,500, up from $259,750 in 2016. Total direct compensation includes cash pay, and annual or recurring stock awards. The median value of annual cash pay increased four percent in 2017, to $107,500, bolstered by a five percent increase in the annual cash retainer to $100,000. Variable cash pay for board and committee meetings remained virtually unchanged. The median value of annual stock compensation rose three percent to just over $150,000. The average mix of pay remained constant at 57 percent in equity, 43 percent in cash.

Notes a Willis Towers Watson spokesman, “director pay continues to be a hot topic for boards in light of continued attention brought on by shareholder lawsuits over alleged excessive stock grants made to directors. As a result, boards are looking for ways, such as adding limits specific to directors, to mitigate exposure to lawsuits.”

Indeed, according to the analysis, the percentage of companies that implemented an annual limit jumped from 55 percent in 2016 to 61 percent last year. Fixed value limits (78 percent) are more prevalent than those based on a fixed number of shares (22 percent) as they offer a more clearly defined pay ceiling. Furthermore, limits continue to go beyond covering only annual stock grants—32 percent of annual limits now cover both stock and cash, compared with 29 percent in 2016.

Other findings from the analysis include:

- **Board leadership.** Almost half of companies (49 percent) separated the positions of board chair and chief executive officer in 2017, up from 47 percent in 2016. Conversely, the prevalence of companies identifying a lead or presiding director decreased from 73 percent to 70 percent. Lead directors received an additional $30,000 in pay last year.

- **Stock ownership and retention guidelines.** Companies continue to embrace stock ownership guidelines and retention requirements for directors. Ninety-four percent of Fortune 500 companies now have one or both mandates in place. The vast majority of ownership guidelines (84 percent) are based on a multiple of the annual retainer, while just over half of retention requirements (55 percent) require a holding period that lasts until the stock ownership guidelines are met.

- **Compensation review.** Nearly half of companies (49 percent) review their director pay programs at least annually while three in 10 (29 percent) review their programs “periodically” or “from time to time.”

### Corporate Responsibility

Large asset managers are failing to press companies on climate change.

A report analyzing the world’s thirteen largest asset managers’ U.S. proxy voting in carbon-intensive industries finds them exerting limited and uneven influence over management, despite calls from shareholders to de-carbonize corporate business models.

Overall, the asset managers demonstrated a high degree of alignment with company management. Moreover, the largest asset managers show the least support for shareholder climate proposals. BlackRock and Vanguard supported
IN REVIEW

only 23 percent and 33 percent, respectively, of proposals related to addressing climate change.

The study, 2018 Asset Manager Climate Scorecard, is authored by Kimberly Gladman with the 50/50 Climate Project.

“Despite investor calls to address the climate crisis, the largest asset managers are not putting pressure on the management of carbon-intensive companies,” Gladman said. “Investor votes speak louder than their words—and their voting signals a lack of concern and fails to incentivize progress when it comes to de-carbonizing.”

BlackRock, the world’s largest asset manager, stresses its climate-related engagement in various reports, but its proxy voting is inconsistent. The scorecard indicates that the company supported only 23 percent of climate-related shareholder resolutions, and opposed 100 percent of shareholder political influence proposals. Similarly, Vanguard supported only 33 percent of climate-related shareholder proposals and opposed every political influence proposal.

Both BlackRock and Vanguard showed a high degree of overall alignment with management. Each voted in line with management recommendations 98 percent of the time—voting in favor of 98 percent of executive compensation proposals and 99 percent of management-nominated directors.

However, PIMCO and Legal & General stood out as climate leaders. Both firms also supported 100 percent of shareholder proposals on political influence disclosure.

The report’s findings include:

☐ There is a trend of increasing support for shareholder proposals on climate change and political influence disclosure.

☐ There is a clear pattern of leaders and laggards, with the largest asset managers showing the least support on key climate and political disclosures votes.

☐ Lack of support from the largest asset managers resulted in lost opportunities to signal strong investor concern with climate at companies because asset managers with large ownership stakes voted with management.

☐ Certain asset managers, including BlackRock, refuse to vote in favor of shareholder proposals if the companies concerned are engaging with the asset manager, but they do not disclose to investors the results of those engagements.

The asset manager universe in the study includes the 13 largest global asset managers reporting mutual fund votes, each with more than $1 trillion in assets for the year ending December 2017.

Cybersecurity and regulatory demands are stretching corporate legal departments.

Legal departments are capping headcount and driving efficiencies, even while demands on their time increase, according to a Thomson Reuters report. The firm surveyed 462 attorneys and decision makers working in corporate legal departments nationwide to identify trends in managing resources and adapting to business needs.

One trend shaping legal departments is how general counsel are increasingly expected to serve as business advisers in addition to providing legal advice. General counsel are becoming more involved across their organizations, particularly in terms of advising the board of directors and business leadership.

The report stressed how corporate legal departments, already stretched by limited resources, are confronting new, as well as traditional, challenges. Respondents noted that data security and ethics and compliance remain key priorities, but cybersecurity ranked higher in importance in 2018. Among the factors heightening this concern was the May 2018 deadline to comply with the European Union’s General Data Protection Regulation (GDPR). This imposed new rules for how companies manage the personal data of those in the EU and significant fines for noncompliance.

Respondents are spending more time handling regulatory matters relative to a year earlier. Beyond the new EU requirement, another driver of the increase was the new administration in the U.S., which drove additional changes in government regulations (especially in areas including employment, data privacy and immigration).

The report highlighted the measures legal departments are implementing in order to operate more efficiently.

While most operational activities are still handled by general counsel and attorneys, GCs are increasingly relying on legal department operations managers to find creative ways to use resources, as well as track spending and time.

According to 41 percent of respondents, the top benefit of being more efficient is the ability to focus on strategic work.

The report found that beyond evaluating how they engage outside counsel, legal departments are improving productivity by deploying new technologies, including billing software, and by shifting work from lawyers to paralegals and other staff, among other measures.

The SEC withdraws two no-action letters on the use of proxy advisors.

On September 13, 2018, the SEC Division of Investment Management issued an Information Update in which it announced the withdrawal of two no-action letters concerning the circumstances under which a third-party proxy advisory firm may be considered independent under Rule 206(4)-6 under the Advisers Act. A Ropes & Gray client update notes that the rule was adopted by the SEC in 2003 to ensure that investment advisers vote proxies in the best interest of their clients and provide clients with information about how their proxies are voted.

In the Rule 206(4)-6 adopting release, the SEC stated that an investment adviser could demonstrate that its vote of its clients’ proxies was not a product of a conflict of interest if the adviser voted the proxies in accordance with a pre-determined policy based on the recommendations of an “independent” proxy advisory firm. The two withdrawn no-action letters concerned whether a proxy advisory firm would be considered independent if the proxy advisory
firm receives compensation from an issuer for providing advice on corporate governance issues (or otherwise had a potential conflict of interest that could make the proxy advisory firm incapable of making impartial recommendations).

The September update referred to, but did not withdraw, the staff legal bulletin. Therefore, it should not have any practical effect at this time on investment advisers that rely on proxy advisory firms.

In a July, 2018 statement, SEC Chairman Jay Clayton announced that the SEC will be hosting a “Roundtable on the Proxy Process” in the fall of 2018. Among the potential topics to be discussed at the roundtable is the role of proxy advisory firms. Areas that may warrant particular attention include:

- Whether various factors, including legal requirements, have resulted in investment advisers relying on proxy advisory firms for information aggregation and voting recommendations to a greater extent than they should.
- Whether there is sufficient transparency about a proxy advisory firm’s voting policies and procedures so that companies, investors, and other market participants can understand how the firm reached its voting recommendations.
- Whether there are conflicts of interest related consulting services provided by proxy advisory firms, and, if so, whether those conflicts are adequately disclosed and mitigated.
- Whether prior staff guidance about investment advisers’ responsibilities in voting client proxies and retaining proxy advisory firms should be modified, rescinded, or supplemented.

On the same day that the division issued the update, Chairman Clayton issued a public statement in which he reiterated the SEC’s “longstanding position . . . that all staff statements are nonbinding and create no enforceable legal rights or obligations of the Commission or other parties.” He also stated that “Several weeks ago, I instructed the directors of the Division of Enforcement and the Office of Compliance Inspections and Examinations to further emphasize this distinction to their staff.”

Shareholders & Investors

Prospects for the “hybrid” annual meeting.

The Institute of Chartered Secretaries and Administrators (ICSA) has released its inaugural project, titled “21st Century Annual General Meeting.” With input from Computershare, ICSA has produced a paper and a video encouraging companies to consider adopting hybrid meetings for their annual general meetings (AGMs), that is, to add an online platform to a physical AGM.

Attendance at AGMs for some jurisdictions is dropping, institutional investors rarely come to the meetings, and retail investors know that voting is often decided before the meeting is held. Also, those attending do not appear to represent the makeup of the broader retail shareholder population. “Shareholders collectively are owners of the company,” said Edith Shih, international president of ICSA. “We believe that companies should consider hybrid AGMs to better engage with shareholders.”

While there is not one size that fits all, ICSA believes that hybrid meetings will bring value by improving shareholder engagement when shaping strategy, promoting long-term shareholder retention and streamlining administration.

Retrospectives

20 years ago in The Corporate Board.

The easy part of pay for performance is high pay for high performance. But the hard part is low pay for low performance. Then the CEOs come to the board and shareholders and wash their hands of the problems, like Pilate did in the bible.

— Graef Crystal, Conversations, November/December 1998

10 years ago in The Corporate Board.

Suppose we view what the board does as combining the outsider expertise of consultants with the insider knowledge and responsibility of top executives. In that case, directors are earning a compa-
Spoken & Written
Articles & Speeches

Make sure there’s a “home” for ESG [environmental, social and governance] oversight, whether it’s with the chairman, lead director, governance committee, ESG committee, or somewhere else in the board structure. Effective oversight hinges on having the right people in the boardroom, supported with quality information to enable appropriate oversight.

— Dennis T. Whalen, KPMG LLP

Congress has taken away some of the most important tools we used to avoid catastrophe. Importantly, we have a new rule for dealing with a failing financial firm but the congressional intent is that no government money will be used. It remains to be seen how this will work because it takes government money to stop a severe panic.

— Henry Paulson, Former U.S. Secretary of the Treasury

Policy makers need to determine in advance how they will support the financial system in a crisis so that stakeholders can adjust. Just as important, they must explain these interventions and build public support for them by making sure the benefits reach ordinary Americans directly. One lesson of the crisis a decade ago is that the loss of such public support is very hard to regain.

— Glenn Hubbard, Columbia Business School

We have experienced the pain of unintended consequences with the Sarbanes-Oxley Act of 2002, which resulted in a precipitous decline in initial public offerings because of the expense and burden the law puts on companies.

The biggest risk I see in the California [board gender diversity] bill, which I see in blinking neon lights, is that even California-headquartered companies incorporated in Delaware would be subject to the new gender diversity regulation. Corporations carefully review and select where they will incorporate based on the protections and regulatory framework a particular state offers. Delaware has long been the most business-friendly corporate framework and is widely embraced.

Diversity also needs to reflect ethnic, global, digital and technology diversity, not just gender. Corporate boards are strongest when there is a range of perspectives, experiences and viewpoints.

— Betsy Atkins, Baja Corporation

I take issue with the term nonfinancial, because ESG factors aren’t nonfinancial if they are material. It was radical 75 years ago for a company to report revenue. That was competitive information! It was radical at one time to think about the composition of a board of directors or corporate energy use. Now it is practical to do all those things. At Cornerstone, we use the expression “racially practical investing.” Eventually, it will just be investing.

— Erika Karp, Cornerstone Capital Inc.

A sense of purpose is an understanding at every level of the company about its role in the world and in the community. Purpose unifies employees, helps companies see their customers’ needs more clearly, and drives better long-term decision-making. This is true whether you’re producing oil, making movies, or helping people plan for retirement.

— Larry Fink, BlackRock, Inc.

Real change can occur when the VC community starts to demand that people it invests in have diversity, the right values, and the right behavior. It’s like the pressure that #MeToo has put on corporate boards. When men or women raise a sexual harassment claim, the board can’t just tuck it away anymore. When [VCs] wake up to the fact that they’ll have to expect the same things, you’ll see a big shift.

— Melinda Gates, Pivotal Ventures

ESG is an approach that leads to a more complete investment analysis of a company because it includes considerations that might otherwise be overlooked. But ESG’s impact on performance depends on how it is being used and how well executed the strategy is. On the whole, most empirical studies show that companies with higher ESG ratings have better performance in both accounting and market terms. Materiality matters.

— John Hale, Morningstar, Inc.

Given the prominence that technology has assumed in our world, I think it can be a force for bad in the hands of the wrong people. We’ve seen this with fake news. We’ll have further challenges downstream with the rise of artificial intelligence, which is coming at a real clip.

Until the last few years, we probably didn’t see ourselves playing as big a role in society as we’ve ended up playing. I remain a technology optimist, but I also think we have to acknowledge there are unintended consequences that can be equally devastating.

— John L. Hennessy, Alphabet Inc.

Our society deploys technology faster than it can manage it. The management and maintenance of our technology is the root cause of our cybersecurity challenges. In the rush to get some feature or functionality online, people don’t pay attention to the side effects.

— Corey Thomas, Rapid7
Ball Corporation has elected to its board John A. Bryant, former chairman, president and chief executive officer of Kellogg Company.

Becton, Dickinson and Company has elected to its board Jeffrey W. Henderson, non-executive chairman of Qualcomm Incorporated.

Coherent, Inc. has elected to its board Mike McMullen, president and chief executive officer of Agilent Technologies, Inc.

Covanta Holding Corporation has elected to its board Owen Michaelson, chief executive officer of the Harworth Group PLC.

Cullen/Frost Bankers, Inc. has elected to its board Cynthia Comparin, founder and former chief executive officer of Animato Technologies Corp.

General Motors Company has elected to its board Jami Miscik, vice chair and chief executive officer of Kissinger Associates, Inc.

The Hanover Insurance Group, Inc. has elected to its board Kathleen S. Lane, former executive vice president and chief information officer of The TJX Companies, Inc.

Heritage Commerce Corp has elected to its board Jason DiNapoli, executive vice president of MidFirst Bank and president and chief executive officer of the 1st Century Bank division.

The Home Depot, Inc. has elected to its board Manuel Kadre, chairman and chief executive officer of MBB Auto Group.

Iron Mountain Incorporated has elected to its board Monte Ford, principal partner for the CIO Strategy Exchange and former chairman and chief executive officer of Aptean, Inc.

Kimberly-Clark Corporation has elected to its board Sherilyn S. McCoy, former chief executive officer of Avon Products.

Lincoln Electric Holdings, Inc. has elected to its board Patrick P. Goris, senior vice president and chief financial officer of Rockwell Automation, Inc.

Lumber Liquidators Holdings, Inc. has elected to its board Terri Funk Graham, branding strategy consultant and former chief marketing officer of RedEnvelope for Provide Commerce, Inc.

McKesson Corporation has elected to its board Dominic Caruso, former executive vice president and chief financial officer of Johnson & Johnson.

Mercantile Bank of Michigan has elected to its board Diane Maher, president and chief operating officer of DP Fox Ventures and Fox Motor Group, Joseph Jones, president and chief executive officer of the Urban League of West Michigan, and Kurt Hassberger, chairman and president of Rockford Construction Company.

Myers Industries, Inc. has elected to its board Lori Lutey, former executive vice president and chief financial officer of Schneider National, Inc.

Navistar International Corporation has elected to its board Kevin M. Sheehan, former president and chief executive officer of Scientific Games Corporation.

NextEra Energy, Inc. has elected to its board Darryl L. Wilson, former senior executive with General Electric Company.

Olin Corporation has elected to its board Scott M. Sutton, chief operating officer of Celanese Corporation.

QTS Realty Trust, Inc. has elected to its board Mazen Rawashdeh, chief infrastructure and architecture officer of eBay Inc. and former vice president of infrastructure operation engineering at Twitter, Inc.

Qualcomm Incorporated has elected to its board Martin Anstice, chief executive officer of Lam Research Corporation, and Irene Rosenfeld, former chairman and chief executive officer of Mondelez International.

Republic Services, Inc. has elected to its board Katharine Weymouth, chief executive officer of dineXpert and former publisher of The Washington Post.

Sears Holdings Corporation has elected to its board Alan J. Carr, managing member and chief executive officer of Drivetrain, LLC.

SM Energy Company has elected to its board Carla J. Bailo, chief executive officer for the Center for Automotive Research, and former senior vice president, R&D Americas for Nissan North America, Inc.

U.S. Concrete, Inc. has elected to its board Susan M. Ball, former executive vice president, chief financial officer and treasurer of CVR Energy, Inc.

United Technologies Corporation has elected to its board Denise L. Ramos, chief executive officer of ITT Inc., and Christopher J. Kearney, former chairman, president and chief executive officer of SPX FLOW, Inc.

Verizon Communications Inc. has elected to its board Daniel H. Schulman, president and chief executive officer of PayPal Holdings, Inc.
Conversations

Hannah-Beth Jackson: California Mandates Board Diversity

On September 30, 2018, California Governor Jerry Brown signed legislation that will radically empower the push for boardroom gender diversity in America. SB 826 requires California companies (not only corporations chartered there, but those headquartered in the state as well) to achieve a minimum number of women directors on their boards. Every publicly-held company would need at least one woman on its board by the end of 2019, and by 2021 corporate boards will have to reach a sliding scale of two or three women on their boards depending on the total number of directors.

The California legislation has drawn nationwide attention, both positive and negative. There are concerns about the legality both of government gender quotas and the bill’s extra-territorial reach. Federal litigation on the law’s applicability seems likely.

Principal sponsor of SB 826 was state Senator Hannah-Beth Jackson (D-Santa Barbara). She and Senate President Pro Tem Toni Atkins crafted the legislation with the aid of the National Association of Women Business Owners (NAWBO). Jackson has long been an advocate on women’s business issues, and was a driver in gaining the bill’s final approval by the California Senate on a 23 to 9 vote. This interview was conducted just prior to Governor Brown signing the bill into law.

The Corporate Board: What is the history on SB 826?
Hannah-Beth Jackson: In 2013, the California chapter of the NAWBO brought the underrepresentation of women on state boards to my attention. These women are executives themselves, and were concerned that there wasn’t any progress in getting women into real leadership positions at larger companies. That year, I authored a non-binding resolution urging California public companies to put more women on their boards to better represent the population. In California at that time, women represented 15.5 percent of board members, so obviously we wanted to see some improvement.

TCB: What happened in the following five years?
Jackson: By 2018, research showed that any increase was almost nonexistent. The women’s share had grown from 15.5 percent to 16 percent—that was it. Since we hadn’t made any progress by being nice, I introduced this legislation with the assistance of California NAWBO and their national group.

TCB: Why do you feel this is needed?
Jackson: Studies done by Credit Suisse and at UCLA Davis show women directors add value. The Credit Suisse study looked at 2000 companies worldwide, and found women on boards improved key metrics such as stock price, profits and productivity. This is just good for business and the economy, and it’s time for California companies to be as competitive as they can be. Women are 70 percent of consumers, yet they’re terribly underrepresented on corporate boards.

TCB: Will the supply of women board prospects be able to meet demand?
Jackson: There are millions of women business owners just in California. Stanford and the Harvard Business School have registries of women who are well qualified and eager to participate, and there are groups like 2020 Women with their own registries.

TCB: What specific qualities do you believe a greater number of women will bring to boards?
Jackson: Women on boards tend to be more risk averse; the data is quite clear on that. Research from MSCI found that companies with three or more women on their boards had an average of 45 percent higher earnings per share between 2011 and 2015.

TCB: Explain the specifics of the legislation.
Jackson: The bill requires each public company headquartered in California to have at least one woman on its board by 2019. By 2021, companies with five directors would have to include at least two, and those with six or more board members would need to have three. We can assume companies will want qualified women, and fortunately there are more than enough qualified women who’d like to be on boards. The main objections in the legislative process were that we were telling companies what to do, but we’re not. If you have five or more directors, you don’t need to kick anyone off, just add a seat for women. We’re not throwing men out of the boardroom.

TCB: One objection we hear is that the market is already moving toward more women on boards without mandates.
Jackson: I don’t think the market is moving at a good clip on this if we only moved the average from 15.5 to 16 over five years. We certainly hope to draw more attention to the issue with this legislation. We’re saying that we value all kinds of diversity, but women can change company culture and actions.

TCB: What about the legal objections, such as mandating board diversity for companies chartered outside of California?
Jackson: States have a great deal of leeway on guidance for companies that aren’t necessarily incorporated in the jurisdiction. We believe that issue has been raised by the naysayers, and if companies don’t want to cooperate, we may see litigation. But we strongly believe that this is a compelling state interest.

TCB: Any messages you’d like to send to corporate boards on the legislation?
Jackson: I’d tell directors it’s time to crack the class ceiling. Once they adjust, they’ll recognize the benefits. The other day I spoke to a local Rotary group. I recall when the courts ordered Rotary to open itself to women. Now, they agree that this made a positive difference. Change is hard, but necessary.
## Index
November/December 2017–2018

<table>
<thead>
<tr>
<th>Title</th>
<th>Authors</th>
<th>Issue Dates</th>
<th>Pages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Artificial Intelligence In The Boardroom</td>
<td>A. Agrawal, J. Gans &amp; A. Goldfarb</td>
<td>Mar/Apr 2018</td>
<td>16–20</td>
</tr>
<tr>
<td>Best Practices For Onboarding New Directors</td>
<td>Alisa Cohn</td>
<td>Nov/Dec 2017</td>
<td>11–16</td>
</tr>
<tr>
<td>Board And Director Evaluation Grows Up</td>
<td>Beverly Behan</td>
<td>Jan/Feb 2018</td>
<td>1–8</td>
</tr>
<tr>
<td>Board Engagement Throughout The Company</td>
<td>Dr. Dale J. Albrecht</td>
<td>Jan/Feb 2018</td>
<td>22–25</td>
</tr>
<tr>
<td>Board Oversight Of Joint Ventures</td>
<td>James Bamford</td>
<td>Jan/Feb 2018</td>
<td>9–12</td>
</tr>
<tr>
<td>Boards Must Prepare For The GDPR</td>
<td>Greg Reber</td>
<td>Jul/Aug 2018</td>
<td>5–9</td>
</tr>
<tr>
<td>Bringing #MeToo Into The Boardroom</td>
<td>J. Kennedy Park &amp; K. Spoerri</td>
<td>May/June 2018</td>
<td>1–6</td>
</tr>
<tr>
<td>Building The Board’s Relationship With Compliance</td>
<td>Michael Volkov</td>
<td>Mar/Apr 2018</td>
<td>11–15</td>
</tr>
<tr>
<td>Corporate Secretary’s Governance Role</td>
<td>Paul Marcela</td>
<td>Jan/Feb 2018</td>
<td>18–21</td>
</tr>
<tr>
<td>Digital Governance: The Price Of Convenience</td>
<td>Dottie Schindlinger</td>
<td>Nov/Dec 2017</td>
<td>16–21</td>
</tr>
<tr>
<td>Disclosing Your CEO Pay Ratio</td>
<td>James D. C. Barrall</td>
<td>Mar/Apr 2018</td>
<td>6–10</td>
</tr>
<tr>
<td>Do CEOs Need A “Chief Of Staff”?</td>
<td>Madeleine Niebauer</td>
<td>May/June 2018</td>
<td>13–17</td>
</tr>
<tr>
<td>General Counsel, The Board, And Corporate Culture</td>
<td>V. Richardson &amp; M. Blatch</td>
<td>Jan/Feb 2018</td>
<td>13–17</td>
</tr>
<tr>
<td>How Proxy Advisors View Your Board</td>
<td>Gary Larkin</td>
<td>Nov/Dec 2017</td>
<td>6–10</td>
</tr>
<tr>
<td>Information Technology Governance</td>
<td>Bob Zakis</td>
<td>Nov/Dec 2018</td>
<td>22–25</td>
</tr>
<tr>
<td>Is “Age Diversity” The Next Boardroom Concern?</td>
<td>P. Loop &amp; C. Bromilow</td>
<td>Jul/Aug 2018</td>
<td>10–14</td>
</tr>
<tr>
<td>Passing The Board Baton</td>
<td>K. Bohn &amp; S. Davis</td>
<td>Nov/Dec 2018</td>
<td>1–5</td>
</tr>
<tr>
<td>Private Equity Model For Public Company Boards</td>
<td>Henry D. Wolfe</td>
<td>Nov/Dec 2018</td>
<td>12–16</td>
</tr>
<tr>
<td>Professional Director Phenomenon</td>
<td>E. Fram &amp; R. Kellman Baxter</td>
<td>May/June 2018</td>
<td>23–26</td>
</tr>
<tr>
<td>Redefining The Lead Independent Director</td>
<td>Holly J. Gregory</td>
<td>Nov/Dec 2018</td>
<td>1–6</td>
</tr>
<tr>
<td>Reputation Management And The Board</td>
<td>Daniel Diermeier</td>
<td>May/June 2018</td>
<td>18–22</td>
</tr>
<tr>
<td>SEC Concerns On Cybersecurity</td>
<td>M. Rossi, L. Richman &amp; M. Burke</td>
<td>Sep/Oct 2018</td>
<td>21–24</td>
</tr>
<tr>
<td>What CISOs Wish They Could Tell Their Boards</td>
<td>Scott Corzine</td>
<td>May/June 2018</td>
<td>7–12</td>
</tr>
<tr>
<td>Women Board Members And Technology Companies</td>
<td>Dora Vell</td>
<td>Mar/Apr 2018</td>
<td>21–25</td>
</tr>
<tr>
<td>Writing Your Board Diversity Policy</td>
<td>Roel C. Campos</td>
<td>Jul/Aug 2018</td>
<td>1–4</td>
</tr>
</tbody>
</table>

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Presumption is our natural and original malady.
— Michel de Montaigne