The leadership structure of large US publicly traded companies has evolved significantly since the turn of the century away from the tradition of combined leadership power 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 that is independent from the CEO, through either an independent chair or an independent lead or presiding director. This has come about through private ordering, meaning the voluntary adoption of a governance practice by boards in response to changes in listing rules, disclosure requirements, shareholder pressures, and notions of effective governance.

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, and on the value of independent leadership. 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.

In her regular column on corporate governance issues, Holly Gregory explores recent developments in independent board leadership and the role of the independent lead director.

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Leadership in most S&P 500 companies is now shared between the CEO and, in a majority of S&P 500 companies, an independent 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 alternate independent leadership structure. 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 and non-management directors. The lead director role is becoming synonymous with leading the efforts of the board, as distinguished from the CEO’s role in leading the efforts of management and serving as the leader of 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 as a component of both CEO and board succession planning.

Against this background, this article explores:

- Pressures for independent leadership structures and roles.
- Current data on board leadership structures and independent board leader term limits, tenure, and compensation.
- The roles and responsibilities of independent board leaders, including trends associated with the lead director role.
- Issues to consider when making board leadership decisions.

PRESSURES FOR INDEPENDENT LEADERSHIP

The move toward independent board leadership and away from combining the chair and CEO roles has been driven by a number of forces. These forces have encouraged boards to revise their leadership structures to support the ability of independent directors to provide objective judgment and hold management accountable for the company’s performance.

Changes in listing rules and SEC disclosure requirements have focused attention on board leadership. Listing rules imposed in 2003 and generally associated with Sarbanes-Oxley Act reforms highlighted the expectation that independent directors provide objectivity in overseeing management. These rules require boards of NYSE and NASDAQ listed companies to:

- Be made up of a majority of independent directors.
- Hold executive sessions to provide outside and independent directors with the opportunity for objective discussion without the CEO and other members of management present.
- Have a fully independent compensation committee (in addition to the already mandated fully independent audit committee).
- Have a fully independent nominating and governance committee (NYSE) or independent director oversight of director nominations (NASDAQ).

Disclosure requirements mandated by the Dodd-Frank Act and adopted by the SEC in 2009 require disclosure of the board’s rationale for combining or splitting the chair and CEO roles and, 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.

Shareholders and proxy advisors have fueled this change through shareholder proposals and proxy voting policies that generally support shareholder proposals for an independent chair unless the company maintains a counterbalancing governance structure that includes 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)
- “Boards should have a strong, independent leadership structure. ... Some investor signatories believe that independent board leadership requires an independent chairperson, while others believe a credible independent lead director also achieves this objective. The role of the independent board leader should be clearly defined and
sufficiently robust to ensure effective and constructive leadership.” (Investor Stewardship Group, Corporate Governance Principles for US Listed Companies (2017), available at isgframework.org.)

■ “Governance structures and practices should be designed to provide some form of leadership for the board distinct from management ... [S]ome form of independent leadership is required, either in the form of an independent chairman or a designated lead or presiding director. (Rotation of the leadership position among directors or committee chairs on a per-meeting or quarterly basis is not favored because it does not promote accountability for the independent leadership role.)” (NACD, Key Agreed Principles to Strengthen Corporate Governance for US Publicly Traded Companies (2011), available at nacdonline.org.)

SHAREHOLDER PROPOSALS

Shareholder proposals seeking an independent chair continue to be prevalent. Shareholder proponents appear to target companies that they perceive to have board oversight or performance issues, with little regard to whether the company has adopted an independent board leadership structure that incorporates a lead director role with significant clearly defined responsibilities.

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. (James R. Copland and Margaret M. O’Keefe, Proxy Monitor, 2017 Season Review (Fall 2017), available at proxymonitor.org.)

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. (ISS) and Glass, Lewis & Co. (Glass Lewis), and they tend to receive significant shareholder support, albeit short of passing rates.

On average, independent chair proposals received support of approximately 30% of the votes cast in 2017, with nine proposals receiving support of 40% or more of the votes cast. In 2016, average support for these proposals was slightly lower (29%) and only six of the 46 proposals that went to a vote received support of 40% or more of the votes cast. 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% of the votes cast, with 21 proposals receiving support of 40% or more of the votes cast and four receiving majority support. (ISS Governance Analytics database, last accessed Feb. 13, 2018, available at isscorporatesolutions.com (subscription required).)

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%) proposals that went to a vote, compared to 34 of the 46 (74%) proposals that went to a vote in 2016 and 36 of the 50 (72%) proposals that went to a vote in 2012. (ISS Governance Analytics database, last accessed Feb. 13, 2018, available at isscorporatesolutions.com (subscription required).)

ISS bases its vote recommendation on a “holistic review” of the company’s board leadership structure, governance practices, and performance. ISS notes that the 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, which 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 to ensure that there is sufficient time for discussion of all agenda items;
  • having the authority to call meetings of the independent directors; and
  • if requested by major shareholders, ensuring that he or she is available for consultation and direct communication.


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. Glass Lewis does not describe the responsibilities it expects the lead director to have. (Glass Lewis, 2018 Guidelines: Shareholder Initiatives, available at glasslewis.com.)

CURRENT DATA

According to Heidrick & Struggles International, Inc., in 2016 only 6.4% of newly named CEOs were immediately named chair (down from 9.5% in 2013) (Jeffrey S. Sanders, Heidrick & Struggles, CEO Succession Trends in 2016 (July 11, 2017), available at heidrick.com).

Additionally, the 2017 Spencer Stuart U.S. Board Index, available at spencerstuart.com (Spencer Stuart Study), indicates that for the first time the majority of S&P 500 CEOs do not also serve as the chair. According to the Spencer Stuart Study:
51% of S&P 500 companies have separated the chair and CEO roles, up from 46% a decade ago, and of director respondents to a survey included in the Spencer Stuart Study:

- 7% report that their board separated the roles of chair and CEO in the past proxy year; and
- 31% report that their board has discussed separating the chair and CEO roles within the next five years.

Approximately 28% of S&P 500 companies have boards with an independent chair (compared to 13% in 2007), an increase of approximately 1.4% per year over the past ten years.

84% of S&P 500 companies have either a lead or presiding director, although 2% of these boards rotate the role among independent directors or committee chairs. (This figure includes companies with independent chairs who are also designated as the lead or presiding director and some companies that have both a lead director and an independent chair (for example, where the chair qualifies as independent for listing rule purposes but would not qualify as independent under proxy advisor guidelines).

Of the companies that designate a lead or presiding director, 74% use the title lead director, while 26% use the title presiding director or specify they have a director who presides over executive sessions.

TERM 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. The Spencer Stuart Study indicates that the average tenure of:

- Lead directors is approximately four years. Among these lead directors:
  - 29% have held the role for one year or less;
  - 41% have held the role for two to four years;
  - 30% have held the role for five years or more; and
  - 9% have held the role for ten years or more.

- Independent chairs is just over four years. Among these independent chairs:
  - 29% have held the role for at least six years; and
  - 28% have held the role for one year or less.

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% of independent chairs earn additional compensation.
- 66% of lead directors earn additional compensation.

The additional fees paid to independent chairs are also 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 and the median was $150,000 (with a wide range from $25,000 to $500,000). In contrast, the average additional fee for a lead director in 2017 was $36,868 (up 10% since 2016) and the average additional fee for a presiding director was $26,840 (down 16% since 2016).

BOARD LEADERSHIP ROLES AND RESPONSIBILITIES
Whether the independent board leader is an independent chair or a 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. Additionally, an independent chair or lead director usually leads and supports the board (with some variation regarding committee roles) in:

- Selecting the CEO and CEO succession planning.
- Evaluating and compensating the CEO.
- Monitoring CEO performance.
- Evaluating the strategic plan proposed by management.
- Overseeing the company’s financial reporting and internal controls, audit, compliance, and risk management.
- Determining the board’s governance structures and processes.
- Evaluating the board or individual directors.
- Selecting board candidates and overseeing board succession.
- Overseeing the company’s relations with shareholders and engaging with shareholders as appropriate.
- Engaging in crisis response, in certain circumstances.

Independent board leaders, regardless of title, are likely to take a leadership role in chairing meetings of independent directors and serving 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 (NACD Report) 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 non-management directors.

- Control of the board agenda and board information. Unlike the independent chair who bears responsibility and authority for determining both the board agenda and the information that will be provided to the board, 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.

(NACD, Report of the NACD Blue Ribbon Commission on The Effective Lead Director (2011), available at nacdonline.org (subscription required).)
These are key distinctions, and they build on other subtle differences in the roles and authority of the independent chair and the lead director regarding the board’s efforts 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 to the board and keeping the board informed between meetings.

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 non-management 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);† and
  - the board’s consideration of CEO compensation (three companies).†

*Indicates responsibilities ISS considers necessary for a lead director role to be robust.
†Indicates responsibilities that are not addressed in ISS policy.

Lead Director Responsibilities at Dow 30 Companies

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, who should serve in leadership roles, how leadership roles should be defined, and the rationale for why the leadership structure is appropriate for the company. 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. While independent directors make up a majority of the board and therefore have significant influence on a board’s leadership-related decisions, it is becoming more common for board leadership decisions to be made by the independent directors, in consultation with the CEO.

The board’s leadership structure should be designed to further board effectiveness. The optimal 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 from a combined chair/CEO structure 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 given that the chair/CEO leads the management team that the board is charged with overseeing. An independent leadership structure is viewed as a counterweight, but it should be designed with an understanding of the challenges that shared leadership may present, including:
Competing centers of power.
Confusion about leadership roles.
Misperceptions about a lack of board confidence in the CEO.

As a practical matter, having one individual 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 the delivery of clear and consistent messages.
- Leadership by the person most knowledgeable about the day-to-day operations of the company.
- The ability to develop key 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 building business relationships.

The challenges of shared leadership require attention, but are manageable through a combination of:
- Effective communication.
- Thoughtfully defined and well-articulated apportionment of roles and responsibilities among board leaders and management.
- Prudent selection of the individuals to whom leadership roles are given.

The relationship between the independent board leader and the CEO requires ongoing care to ensure that the chemistry is appropriate. The relationship of the independent board leader to the board members also requires attention to ensure that the board’s role is supported by the independent board 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

Key considerations in identifying a potential independent board leader include whether the candidate understands the nuances of leading the board without usurping board authority, and whether the candidate is likely to be able 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. 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 his or her leadership capacity and business judgment;
- respectful of the skills, contributions, and diverse viewpoints of individual directors;
- respectful of the distinction between the board’s role and management’s 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 accurately and effectively communicating sensitive messages from the board to the CEO and to fellow directors; and
- able to lead in a crisis.

Identifying potential candidates. In most circumstances, boards will 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, for example, when a board has had significant turnover, in which it may be beneficial or necessary to look externally for an independent board leader.

Involving the CEO to an appropriate degree, given the importance of the relationship that must develop between the independent board leader and the CEO. While the board should not delegate this decision to the CEO, the CEO and the independent 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 an 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 skill sets and relationships that need to develop for an effective board leader. The board should also consider whether there should be limits on tenure to support board leadership succession.

(See NACD Report.)

The views stated above are solely attributable to Ms. Gregory and do not necessarily reflect the views of Sidley Austin LLP or its clients.