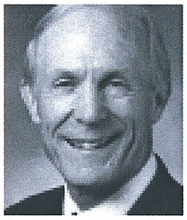
On Directors' Minds

CEO-Board Relations

WE ASKED DIRECTORS to discuss the greatest challenges they face in dealing with chief executives, and the effect Sarbanes-Oxley has had on those relationships. Here's what some directors think.


BOB JOSS

One of the most positive features of Sarbanes-Oxley is having more executive sessions. **The reality of it is that there are people who are natural lead independent directors. It's a process of formalizing what was informally happening anyway.**

Having the [non-executive] meetings has created a new tension. As a CEO I hated to sit outside when people were having meetings without me. You really have to bring the CEO back into the discussion. That's where the lead independent director can be very valuable.

▶ **BOB JOSS, E.piphany, BEA Systems, Shanghai Commercial Bank** and **Wells Fargo**

"I [personally] haven't seen any stress caused by Sarbanes-Oxley and all the increased responsibilities and accountabilities [with regard to the relationship to incumbent CEOs]. The relationships were already strong, and I don't mean by that close, but strong prior to Sarbanes-Oxley... **I will say there's stress in trying to get all the work done because there's a lot more work to do."**

▶ **JANET HILL, Dean Foods, Wendy's, Nextel**

I chair the comp committee, and tension comes from negotiating on behalf of the committee and board. That is a challenging discussion. Now, it's OK to have challenging discussions among colleagues. Shareholder interests are not served if all the discussions are Melba toast. I'd be concerned if these were not challenging discussions.

The CEO has certain needs or desires [because of his family, etc.], and I'm representing the shareholders. It's strenuous for me, just like any kind of business negotiation.

The material change is that the comp committee now retains independent consultants, which is good because the board gets a view of peer companies. Ultimately it's up to the board, but I'm a strong believer in independent [information].

[As far as lead directors], number one, it's important in the lead director role—it's imperative—that other directors share any concerns during and between meetings about the direction of the company and that lead directors have the courage to share those observations with the CEO in a discreet and respectful manner. You have to have the intestinal fortitude and a strong enough relationship with the CEO.

▶ **STUART LEVINE, Gentiva**

Theoretically, there is a potential problem among either family-dominated companies, even though they're publicly traded, or entrepreneurs who may have bought companies out of leveraged buyouts. It's often difficult for them to understand a new paradigm of transparency. There is a natural tension between their basic entrepreneurial aggressiveness and a board's need to protect minority shareholders.

I think a future potential source of tension is in compensation, where you have a pattern of a growing disparity between the top executives and management and the rest of the company, and you have shareholders beginning to really express concerns about whether compensation has gotten out of hand. The board has to be in there as the driving force to get appropriate but not excessive compensation.

I think there have been some unfair stories. There was one in the paper today about CalPERS criticizing some company for a huge amount of compensation. A big chunk of that was in a change of control situation, [including] pensions and restricted stock based on the performance of the company. Compensation packages have not been fairly reported, and that's created a misunderstanding.

I think boards are going to have to question more diligently the compensation consultants.

▶ **JIM JONES, Anheuser-Busch, Kansas City Southern**

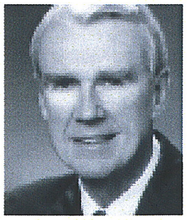
People are giving more thought to things like making sure the comp consultants by engagement letter understand that they report to the comp committee and not the management and that they don't come to the comp committee with a plan that they worked out with management. As it should be, the committees still consult with the CEO.

The subtleties of making sure the procedures that you follow are set up in such a way that they strengthen the independence of the committees have become routine. When it comes to a board search, the CEO goes out of his or her way to make sure they do not initiate the names.

I think that for the first six months after a board makes some of these changes it's not unusual that the CEO wonders whether this portends an adversarial relationship... and might have his or her feelings hurt, [thinking] that they weren't doing things the right way before.

After a few months I don't feel any discomfort or tension, but at the outset I think there was a little bit.

▶ **BILL OUCHI, Aecom Technology, Sempra Energy, Allegheny Technologies, FirstFed Financial** and **Water-Pik Technologies**


JIM HENDERSON

My view is first that boards that have been functioning well before SOX continue to function well and in fact there has not been a lot of change in board dynamics.

I think the purpose of Sarbanes-Oxley has been to ensure that there is full disclosure and full discussion of important issues... I would guess that it's had a positive effect in some situations... certainly both the CEO and the board are very clear about what Sarbanes-Oxley requires because we've had to document [everything]. **What Sarbanes-Oxley can't legislate is full disclosure or ethical behavior.** That's why as a director you do have to be careful about the boards you join.

▶ **JIM HENDERSON, SBC**