Running effective executive sessions

When should they be held? How long should they be? Who should lead them? These are among the questions boards must consider to make their executive sessions successful.

By Richard H. Koppes and Heith D. Rodman

Section 404 seems to have received the lion's share of press on corporate-reform efforts stemming in part from passage of the Sarbanes-Oxley Act of 2002. A less-publicized result of these efforts has the potential to affect significantly the culture of the boardroom. Both the New York Stock Exchange and the Nasdaq Stock Market have added to their respective listing standards the requirement that boards meet in "executive session" without management.

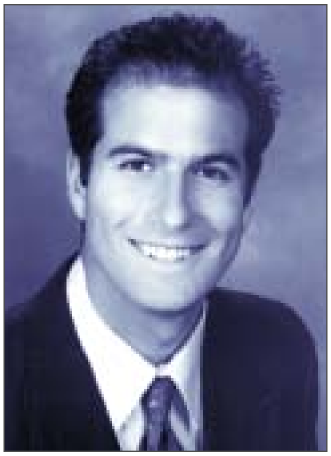
Specifically, the NYSE's Rule 303A.03 provides that in order "to empower nonmanagement directors to serve as a more effective check on management, the nonmanagement directors of each listed company must meet at regularly scheduled executive sessions without management." ("Nonmanagement" directors are all directors who are not executive officers, including directors who are not independent by virtue of a material relationship, former status as an executive officer, or family membership, or for any other reason.) The Nasdaq's Rule 4350(c) requires, in part, that "[i]ndependent directors must have regularly scheduled meetings at which only independent directors are present."

The impetus for such requirements is based in part on legend — or, at least, the "legendary" power that Roger Smith, former chairman and CEO of General Motors Corp., wielded over the GM board in the late 1980s and early 1990s. At that time, boards such as GM's had no power to meet in executive session. In order to discuss who would come after Smith as CEO, the GM board supposedly met in secret executive session without Smith's "permission" or knowledge.

Times have changed since then. In today's corporate environment, thanks in part to the reaction to "imperial" CEOs like Smith and many others, corporate boards have the opportunity to wield real power over management through executive sessions. The requirement that boards meet in executive session, without management, may emerge as the reform that most shifts the power in the boardroom away from management and to the directors, consistent with the corporate stewardship concepts rooted in state corporation law.

The basics to focus on

Such power should not be treated cavalierly, however. Indeed, boards should carefully consider how



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they want to handle executive sessions. In order to maximize the effectiveness of executive sessions, boards should consider carefully the following questions:

• *How Often Should Boards Meet in Executive Session?* Boards must assess how often they should meet in executive session. Although the listing standards of the NYSE and the NASD require "regularly scheduled" meetings without specifying a minimum amount, best practices would suggest meeting in executive session no less than at each regularly scheduled board meeting. Frequent, regular meetings provide the added benefit of preventing any negative inference from attaching to any particular executive session.

• *When During Full Board Meetings Should Executive Sessions Be Scheduled?* Executive sessions are typically held after the full board meets, though there is nothing that suggests boards cannot meet in executive session before the full board meets or, for that matter, both before and after the full board meets. The benefit of an executive session immediately after a full board meeting is obvious: The nonexecutive directors can have a frank discussion of the topics covered during the full board meeting, without fear of influence by management. Less obvious are the benefits of scheduling an executive session prior to a full board meeting: The nonmanagement directors would have the opportunity to discuss and supplement the agenda for the full board meeting and to set expectations for the upcoming management presentations.

The impetus for instituting executive sessions is based in part on legend.

• *How Long Should Executive Sessions Last?* While there is no best-practices standard for the length of time reserved for executive sessions, the sessions should not be rushed affairs, with (as is too often the case) one or more participants rushing off to other appointments or heading toward the airport to catch a flight. The executive sessions should not be relegated to afterthoughts of a full board meeting, but instead should be considered an important and valuable opportunity for the nonmanagement directors to exercise control over the affairs of the company.

• *Who Should Lead the Executive Sessions?* For companies that have appointed a nonexecutive chairman, the chairman would be the obvious choice to lead the executive session. Otherwise, the board should either choose a lead director to preside at all executive sessions or establish a process to choose a presiding director for each executive session. Note that unlike the Nasdaq, the NYSE requires companies to disclose the lead director or the process for choosing presiding directors.

• *Should the Board Keep Minutes of Executive Sessions?* The board must decide whether to keep minutes of the proceedings of executive session meetings (aside from mere mention in the minutes that the board did, in fact, meet in executive session). To encourage full candor during discussions among the independent directors, minutes might best be avoided. On the other hand, any formal decisions made by the board while meeting in executive session might never formally be recorded. Of course, the board could always reconvene in full session should there be any formal decisions made, and formally record such decision. (*Ed. Note:* For additional perspective on this procedural matter, see the sidebar on the pros and cons of recording minutes of executive sessions.)

• *What Level of Communication Should There Be with Management After the Executive Session?* As beneficial as an executive session of the board can be, any benefit will be lost without an established mechanism for communicating with management the concerns of the nonmanagement directors. This is especially the case should the board decide not to keep minutes of executive sessions. A procedure for regular, reliable communication with management after executive sessions ensures that directors' concerns will not "fall through the cracks." Moreover, an established procedure makes it easier for the nonmanagement directors to speak with one voice to management, even on subjects contrary to management and its desires.

• *What Level of Communication Should There Be with Non-C-Level Management During the Executive Session?* The board might consider whether to establish regular reports from management below the C-level (e.g., the vice president of finance as opposed to the CFO) as an added check on the power of senior management. Such reports would allow the independent directors to assess whether the CEO and CFO are unduly filtering the information provided to the independent directors. Regular access to this level of management would also assist the board in evaluating in-house successors to the C-level officers for regular succession planning purposes.

• *Should Committees Hold Executive Sessions?* Although not required by the listing standards, the board should consider whether its committees (to the extent their members are not solely independent directors) should be empowered to meet in executive session.

An important opportunity

Thoughtful consideration of these questions should help boards to establish procedures for successful executive sessions, promoting frank, open discussions among nonmanagement directors and providing an effective check on management. Treating executive sessions as a mere technical requirement of SOX-related reforms, on the other hand, would be mishandling an important opportunity to change the very culture of the corporate board. In today's business environment, executive sessions are an opportunity too good to miss. ■

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