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Board 3.0: Bringing the Private Equity Model to Public Companies

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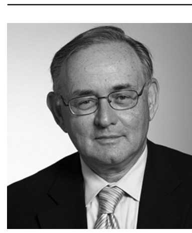

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SESSION III:
Board 3.0: Bringing the Private Equity Model to Public Companies

Kathryn Judge: Good afternoon, I'm Kathryn Judge, and I feel privileged to be moderating this panel. We have seven highly accomplished panelists, which has me worried that we are about to run into the same challenge as the other panels of too little time for too much material. But I will do my best to make sure we bring the wealth of experience and insights we've lined up today to bear on the set of important corporate governance issues that we're discussing.

As we saw with the last panel, if Board 3.0 is nominally the focal point of this conversation, we're really using that model as a way of thinking through not only what we can learn from private equity governance, but what insights we can use from all kinds of transactions and arrangements to help us in rethinking the possibilities of public company board governance. And because I can't imagine a better group of panelists to help us in this effort, let me say a word about each of them now—and I'll present them in the order in which they will be speaking:

Les Brun is Chairman and CEO of Sarr Group. Les was Managing Director and Head of Investor Relations at CCMP, and founder of the private equity advisory and management firm Hamilton Lane. He is Chairman of Broadridge Financial Solutions, Incorporated, and CDK Global Incorporated. Les is also the lead director at Merck and serves on the boards of Corning and NXT Capital.

Stephen Fraidin is a partner at Cadwalader who was described recently in *American Lawyer* magazine as "an M&A legend with decades of dealmaking experience who has entered the SPAC world with a splash." The reference here is to Steve's role in the launch of Pershing Square Tontine Holdings, for which he was named the 2021 Dealmaker of the Year.

Sandra Wijnberg is a former partner of the private equity firm Aquiline Capital Partners and serves on the boards of Cognizant, T. Rowe Price, Automatic Data Processing, and Hippo Holdings. Sandra has also served on a range of other boards, including the Tyco International board that, with Ed Breen as Chairman and CEO, did such an effective job of restructuring an unwieldy conglomerate and creating massive shareholder value.

Edward Rock is the Martin Lipton Professor of Law at NYU, as well as the co-director of the Institute for Corporate Governance and Finance at NYU Law School. Along with Ron Gilson and Jeff Gordon, Ed is one of the longtime leading scholars on the law and governance issues that we've been discussing today.

Yvonne Hao is Managing Director, Co-founder and Operating Advisor at the private equity firm Cove Hill Partners. Yvonne has spent her career in strategic operating roles within the consumer technology and private equity industries.

Brian Murphy is the Managing Director at the private equity firm BRG. Over his career with various firms, he has served as the primary operating executive in over 20 private equity investments, partnering with management and private equity deal teams to establish post-investment strategy, improve performance and install strong governance.

Gaby Sulzberger has served on numerous public and private company boards. She is currently on the boards of Mastercard, Eli Lilly, Brixmar Property Group, and the newly public Cerevel Therapeutics. In addition to her board work, she serves as a special advisor to Two Sigma Impact and Center Bridge Partners.

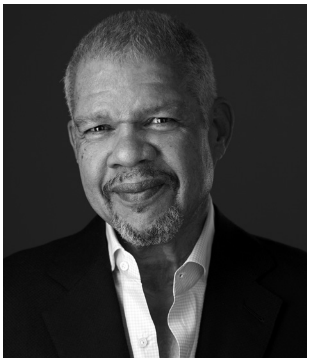
Board 2.0: Strengths and Limitations

Judge: Having introduced our distinguished cast, I will now turn the floor over to Les Brun. Les, with all your experience on public company as well as private company boards, you might be viewed as at least in some respects the embodiment of Board 2.0. Could you use your experience in those various settings to tell us a little about what you see as the strengths and weaknesses of the current model? Do you agree with Jeff and Ron's assessment of current public company boards as "thinly informed, under-resourced, and boundedly motivated?" Or to put the same question a little differently, do the public company boards on which you now serve have the information and incentives to serve as effective representatives for their shareholders?

Les Brun: That's a profound and multisided question, Kate, but I'll give it my best. I'd like to think of myself as board 2.75, or maybe even board 2.8. I have had the privilege and benefit of considerable private equity experience as well as some public board experience. And I think of boards as having evolved quite a bit, largely driven by Sarbanes-Oxley and Dodd-Frank, but especially Sarbox.

When I first joined a public company board, I was astounded at how ill-informed and how little desire there

Public company boards have to find a way to evolve toward something that more closely resembles the activist board members. How that happens will have to be driven by each independent board member because we all have the opportunity to demand greater levels of resources from the companies on whose boards we sit in order to exercise the functions that we've been charged with exercising. —Les Brun



was for more information on the part of my fellow board members. And it was shocking to me how few things were thought important enough to challenge management or develop an independent point of view on. Since that time, I think public company board members have become much more conscientious about meeting their obligation to learn more about and better understand the company's dynamics and the marketplace in which the company operates.

But having said all this, I do think that we are at a disadvantage as independent Board 2.0 model members. Unlike our private equity brethren, who I tend to view as "governing" boards, I think of public company boards as occupying one of three buckets: "collegial," "collaborative," or "directive." Depending on how well the company is doing and where the company is in its development, you can either be collegial and just get together every now and then and pat yourselves on the back about how great the company is doing. Collaborative is when you've got a younger management team that's more involved on the part of the board. In such cases, you get greater insights and access to information and data than in most public company settings. And then there's the category directive, which are those cases when things are not going well that the boards, particularly if they're significant owners, basically end up telling managements what to do.

But because directors generally don't get the opportunity to be directive in public company settings, as a public company director you basically have to educate yourself independently about the company. Where I see the distinction in the public company board in terms of 2.0 versus 3.0 is when activists show up, and how boards respond to them. The typical activist has the opportunity to spend an extraordinary amount of money in developing the investment pieces around whatever company they're engaged with. They'll spend the money to hire the consulting firms and the accounting firms. And they'll hire a law firm to do an extraordinary legal review. So, when activist directors show up at a board meeting, they're infinitely better prepared having had the benefit of far greater resources than the typical public board member.

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And I'll stop there and hope that helps frame the conversation a bit.

Designing The Governance of a SPAC

Judge: Thanks, Les. Let's now hear from Stephen Fraidin, who as I mentioned was named the 2021 Dealmaker of the Year for the role that he played in the launch of Pershing Square Tontine Holdings. Steve, would you tell us a little about the structure of Tontine, with particular focus on governance and how you thought about and tried to address the issues we've been talking about of board motivation, and the information and resources available to the board?

Stephen Fraidin: Thank you, Kate. Let me first point out a couple of what I think are important factors about Pershing Square Tontine Holdings, which I'll just call "PSTH" for short. Number one, PSTH is a public company. So, unlike the private equity model that Ron and Jeff have been talking about, this is a public company, with all of the factors and considerations relevant to its public status.

And before I go any farther, let me just quickly say that I think that

I would argue that the best example of Board 3.0 is a board of directors that's dealing with an M&A situation. Under those circumstances, the board is almost bound to become thickly informed [because] [t]he board hires investment bankers and lawyers who are knowledgeable and experienced in those kinds of transactions… And the board decisions that come out of such a process… are really richly informed. They are motivated by a desire to serve the interests of the public shareholders who end up owning an investment in the acquired companies. —Stephen Fraidin

the limitations of Board 2.0 for public companies owe a lot to what I view as the misguided efforts of corporate lawyers to protect board members from legal liability. Concerns about director liability have been greatly exaggerated. The number of board members who have been personally liable is incredibly small, and so have the associated penalties and fines. But none of that has stopped lawyers from telling their boards, "Look, you're at very considerable risk as a public company director, and you really need my help in dealing with that risk. And I'm going to help you limit that risk by creating a whole lot of very highly articulated processes that will protect you even if you get things wrong."

One of the interesting things about the examples that Ron and Jeff have described as board failures, the JP Morgan-Whale fiasco, the Wells Fargo consumer bank scandal, and the two Generals—General Electric and General Motors—is that the directors may have been inattentive. And they may have been ineffective. But they have never been held liable for any of that. And so the structuring of boards and board processes to avoid liability is something that I think has been done to excess.

The second observation I would make about PSTH is that the company has been designed specifically and expressly to engage in an acquisition. And I would argue that the best example of Board 3.0 is a board of directors that's dealing with an M&A situation. Under these circumstances, the board is almost bound to become thickly informed. The board hires investment bankers and lawyers who are knowledgeable and experienced in those kinds of transactions. There is a substantial amount of information provided to the board. The board has an opportunity to interact with these experts and with management. And the board decisions that come out of such a process, at least in my experience, are really richly informed. They are motivated by a desire to serve the interests of the public shareholders who end up owning an investment in the acquired companies. And whether they're right or not, they're at least the kinds of judgments that I think Ron and Jeff have been talking about. So, when you look at PSTH, it's a board for a public company that's designed to engage in a merger and acquisition transaction that creates value for all the relevant constituencies.

The third observation I would make about PSTH—and this is inescapable—is that the selection of directors, which was largely done by the sponsor of the SPAC, which is Pershing Square, has been very well thought out and deliberate. And the result is that the people on this board are of incredibly high quality. If you put on a board people like Mike Ovitz and Joe Steinberg, who's the head of Jefferies and Company, and Lisa Gersh and Jackie Reses and Bill Ackman, you're going to get a thickly informed board; these are people of high intellect with lots of energy who don't take no for an answer. And they are highly motivated people because we structured the compensation to motivate them.

So, we fully expect them to function like the best of the private equity boards. This is a public company whose directors are sophisticated enough to understand that they will be protected from liability by being careful and honest and diligent. And I think that's

Jeff and Ron's analysis focused on the importance of boards becoming thickly informed and better resourced. I would argue that the essence of good governance is ensuring that the board, and not management, sets the agenda. To the extent committees help all the directors become more informed, they end up helping boards set the agenda. —Sandra Wijnberg

going to work very well. But, as I said earlier, it's a very peculiar example of a public company in that it is designed to do the very thing that I think boards do best, which is merger and acquisition analysis.

The Role of Corporate Committees in Creating Informed Boards

Judge: Thanks, Steve. Let's now turn to our next panelist, Sandra Wijnberg, who serves on the boards of three public companies: Cognizant, T. Rowe Price, and Automatic Data Processing. Sandra, you currently chair a number of committees on those boards. Steve just noted that there are certain circumstances in which directors tend to become better informed because of a transaction they are contemplating. And I would guess that committees are another mechanism that works in somewhat similar fashion; we effectively say that we're going to choose a solid subset of the board to become much more informed or engaged on certain, perhaps more challenging or pressing, issues. Sandra, would you please tell us your thoughts on the possible role of committees in bridging some of the differences between the Board 2.0 and Board 3.0 model?

Sandra Wijnberg: Sure, Kate. I've enjoyed listening to the prior panels, and to Les's and Steve's comments. I told Jeff on our pre-call yesterday that one of the boards that has really informed my own view of life as a board member is the Tyco International board, which I joined in 2003 and served on for almost 14 years. In my view, and based on my experience since then, the Tyco board was way ahead of its time in terms of board evolution and governance effectiveness. We brought in a whole new board. Working with the company leadership team, we changed something like 200 of the top 300 managers. We twice split up the company into three parts—and then we ultimately merged the remaining business with JCI. And because that was my first board, it was like going to graduate school in board governance. It turned out to be a clear success and a great story—creating a huge amount of shareholder value in the process.

When you think about committees and what they do, I think you have to conclude that committees are essential to effective governance. But before I get to that, I wanted to say that much of the magic, or the secret sauce, comes from the composition of the board, as Steve just said, and from the culture of the board. For board committees to operate effectively, the culture has to be engaged, proactive, and willing to engage in constructive conflict.

Jeff and Ron's analysis focused on the importance of boards becoming thickly informed and better resourced. I would argue that the essence of good governance is ensuring that the board, and not management, sets the agenda. To the extent committees help all the directors become more informed, they end up helping boards set the agenda.

Many people, including Ron and Jeff, have argued that Board 2.0 has become too focused on regulatory compliance. As the chair of two public company audit committees, I would say the audit committee agenda has expanded from a compliance orientation into full-blown enterprise risk management. Enterprise risk management is a discipline and a framework that encompasses strategy, operations, finance, IT, and talent, as well as legal and compliance. The effects of all those other risks on the business model are germane not just to what's happening at the audit committee, but also end up influencing the agendas for all the other committees and the full board. The ERM framework will identify key areas of enterprise risk, and so be a catalyst for deep dives around the most critical risks.

And one very important point that people tend to miss: effective risk management is not about avoiding or minimizing risk. It's about finding the *optimal level and kinds* of risk for the company to bear, and in what operations. The best-performing boards and committees view enterprise risk as their "guard rails on the highway." Once we know we have good guard rails, we can drive the car much faster than if we didn't have them.

Many boards have a "strategy and finance"—or a "finance and operations"—committee that really digs deep into issues that there isn't perhaps otherwise time for at the full board. Sometimes you'll see a technology committee. And all of the boards I've served on regularly schedule deep dives on all sorts of topics—though a disproportionate number of them have been guided by the enterprise risk management framework.

Committees, as written into their charters, generally have the ability to access external resources. And the best committees take advantage of that, seeking help and guidance from outsiders without being in the middle of a crisis or an M&A transaction. Committees also have the ability to make use of and internally direct resources in the company for special projects and initiatives.

Another important function of committees, and of full boards as well, is engaging with talent below the C-suite, which is really important for understanding what's going on in the company. You're usually doing so without the CEO in the room. And some of the boards I serve on have meetings with next-gen talent without any member of the C-suite present. That's likely to be really important because a huge issue for everybody right now is having a deep focus on talent and the talent pipeline.

Finally, committees also play a really important role in engaging with shareholders, and not just during proxy season. As an audit chair, I've had a number of conversations with our shareholders about a variety of different topics. The nominating + governance and comp committee chairs also do this, as does the lead director. So, those are some of the ways in which I think the committee structure really does create a more thickly informed board and also helps with the resource question.

The Promise of Validation Capital

Judge: Thank you, Sandra. Now let's hear from Ed Rock, who as I said is the Martin Lipton Professor of Law at NYU, as well as the co-director of the school's Institute for Corporate Governance and Finance. Ed, can you tell us about your concept of validation capital, and how it might relate to Board 3.0?

Edward Rock: I'd be glad to, Kate. And thanks to you and to Ron and Jeff for inviting me to participate in this really interesting conference.

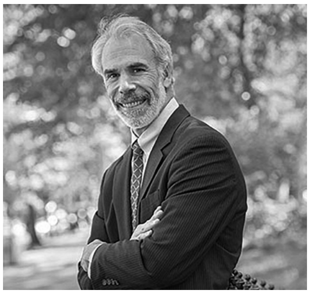
Let me start by saying that there are no good ideas that are really new. In 1972, Arthur Goldberg was invited to go onto the board of TWA. And Goldberg famously said he would, but only on the condition he be given the resources to hire a staff to help him become informed. TWA declined, and Goldberg did not go on the board. I view this Goldberg model as a precursor to Ron and Jeff's prescription that directors become thickly informed and well resourced.

There seem to me to be two critically important questions that companies and their boards need to get right. What is the best strategy for the company? And how do we communicate that strategy to the market?

On the first, we know that the locus of strategy decision-making is in the executive suite, which in a two-level system like Germany's, is known as the management board. And management boards are, of course, assumed to be very well resourced and well informed, and provided with strong incentives. The function that the board plays in the U.S. system is mainly that of a monitoring or oversight board. By comparison, Jeff and Ron's 3.0 Board appears to play a more active role in determining a company's strategy, and in communicating that strategy to its shareholders and the markets in general.

As Christina pointed out in the last panel, the world of publicly held companies is incredibly varied, ranging from microcaps and small caps to large and very large caps. And the current model of board governance, Board 2.0, is hardly monolithic. It's best viewed as a description of the boards of large and very large cap companies—which suggests that any new model for board governance has to be sensitive to the heterogeneity of the universe of companies. In moving in that direction, you want to start with models that work and then think about whether they can be scaled. In that context, it seems to me that what has come to be known as "validation capital" is very promising.

One of my favorite illustrations of the concept is Trian Partners' 2014 purchase of a 2.5% stake in BNY Mellon without consulting Mellon's top management. This $1.05 billion investment came with a statement explaining Trian's rationale for the investment, and its plan for turning BNY Mellon into a best-in-class financial institu-



Validation capital… offers a very good example of thickly informed, well-resourced, and well-incentivized directors, with their well-funded staff back at the home office. The problem, of course, is that there are not a lot of Trians and ValueActs around. The opportunities for such investors are limited by the number of situations with substantial upsides where incumbent management teams are open to some sort of partnership. —Edward Rock

tion. Upon learning that Trian was a shareholder, Gerald Hassell, the CEO, began talks with Trian; and eventually Ed Garden, one of the Trian partners, went on Mellon's board, after having talked extensively with management about their strategy.

A year or two later, when a hedge fund called Marcato showed up and said that BNY Mellon was underperforming and called for the firing of Gerald Hassell, Trian came to management's defense, saying, "We've been deeply involved in the company. We have $2 billion or $3 billion of our own money at stake. We think that the current strategy is the winning strategy, and we just need to implement it."

That support of management by Trian took the wind out of Marcato's sails, which made no headway with the other decisive shareholders, notably the largest asset managers, some of whom are represented here today. That model has since come to be known as validation capital. ValueAct has done this successfully in a number of instances. They did it at Microsoft, and also at Seagate. And ValueAct's founder Jeff Ubben has made a massive investment in Exxon Mobil with his new firm, Inclusive Capital Partners.

I bring up validation capital in this context because it offers a very good example of thickly informed, well-resourced, and well-incentivized directors, with their well-funded staff back at the home office. The problem, of course, is that there are not a lot of Trians and ValueActs around. The opportunities for such investors are limited by the number of situations with substantial upsides where incumbent management teams are open to some sort of partnership. And it should be pointed out that neither BNY Mellon's nor Microsoft's management were at first enthusiastic when Trian and Value Act showed up. Quite clearly, neither investor was invited or welcomed.

But I want to emphasize that the independence of such investors ended up serving the companies well, by making them credible validators of management's strategy. They had arrived without any sort of prenegotiation with management.

In a paper I've written with Dorothy Lund and Alon Brav, we've looked more closely at validation capital to see if we could find a dark side, a situation where it could be used to entrench instead of discipline management. But we were not able to find it. I think the reasons we couldn't find it are really instructive for Board 3.0 going forward. It appears to be a combination of disclosure and governance. The disclosure piece is that any sort of "side payment" by managements and boards to a potentially self-dealing provider of validation capital would have to be disclosed. And that very disclosure would make the capital provider much less credible when it asks the market to support management's strategy. In other words, disclosure of side payments reduces the value of the endorsement at the same time as it taints the reputation of the provider.

The key here is that the purveyor of validation capital does not itself provide sufficient capital to insulate management from a control challenge, but only plays an intermediary role in convincing the market. In this context, we believe that corrupt, or self-dealing, forms of this kind of investment will be extraordinarily rare if they exist at all.

The question, as I said earlier, is whether this kind of investment can be scaled? Can one move from the Trian-ValueAct model to one in which reputable directors with market credibility exercise effective oversight and reassure outside investors, but without the same stakes in the company or the resources at the home office to provide the support that Arthur Goldberg asked for? What if we were to say to an outside director, "You get to hire a McKinsey to advise you, while the management team is getting their advice from Booz Allen?" Will that turn the outside director into somebody like Ed Garden at Trian? I'm doubtful, but let me stop here.

Why and How Private Equity is Different

Judge: Thank you, Ed, that was great. Now let's turn to Yvonne Hao, who is Managing Director, Co-founder and Operating Advisor at the private equity firm Cove Hill Partners.

Yvonne, one of the conversations happening in the background is how much effort is going into compliance and oversight, as compared to the strategic and operational decisions that a firm really needs to focus on to succeed. Having been involved in a number of successful public companies that have had to be simultaneously engaged in both of these conversations, can you talk a little bit about that balance and how that informs our conversation?

Yvonne Hao: Thanks, Kate, and thanks especially to Jeff and Ron for putting together this conference. Board governance is a topic that is near and dear to my heart because I've had the chance to serve on a couple of company boards, private company boards, nonprofit boards—but I've also been an operator, working on the other side of the table under board oversight.

To answer your question, Kate, let me start by saying that Jeff and Ron are right about public company boards. What I've found in public boards is that by necessity, there's just a lot more time spent on having to go through compliance and all the formal processes around legal and regulatory matters. These things have to be done, but it does take up a lot of time.

To combat this pressure, one response by public company boards is to carve out enough time for dedicated strategy sessions. For example, the public company board I'm on right now decided at its meeting yesterday to add an extra day to our next board meeting to focus just on long-term strategy. And that's something you're more likely to see in private equity boards, where you don't have so many committees or compliance concerns. In fact, in PE board meetings, pretty much the entire board meeting is dedicated to strategy, execution, organization, capital structure, and M&A—things that bear directly on operating performance and value.

In listening to this conversation, I've been struck by the variety of different types of boards. And I think what Sandra said earlier is important to keep in mind. She reminded us that boards are pretty small collections of people—and so changing even just a couple of them and how you set the agenda can really make a big difference.

In describing what boards do, you can't use the standard paintbrush. For example, when someone on the last panel said that private equity is all about financial engineering, and that's the only thing the boards care about, my first thought was, "Gosh, I've been at Bain Capital for a long time with Brian, and I'm now at Cove Hill, and financial engineering is definitely *not* what we spend our time thinking about." What we spend most of our time on are the two or three big strategic opportunities that are going to really move the needle and create value for this company. And we talk a lot about operations, and about the talent we think we have, and maybe need more of.

Yet another comment I would make—and it's part of a discussion I've been having with Jeff—is that although there are many things about a private equity model to admire, there's a wide range of private equity funds and some less-than-admirable practices. I've seen private equity board members overreaching and micromanaging operating teams in very distracting and demoralizing ways. I've also seen PE boards who've said, "OK, you hit your numbers. We don't need to have a board meeting." Or they say, "I'm in the board meeting, but since you're doing fine, I'm going to focus on my emails." So, let's not exaggerate the virtues of private equity boards. There are certainly things about the PE model that are useful and that can and should be ported into public company settings, but I've also seen public company boards whose practices are worth imitating.

The last observation I'll make has to do with what it feels like to be an operator under different kinds of boards. I've been a CEO and a COO and a CFO working with boards. Running a company is a lot of work. You're in the day-to-day guts of dealing with all kinds of crises, customers, employees. You're trying to hit your numbers. You're trying to get folks on strategy. And then, on top of all this, you have the board meeting. And the discussions I've had with my executive teams would start with, "OK, since we have to have a board, we should try to help make it a good board, just like we should try to make our customer service team a great customer service team." But that requires planning and effort and a degree of commitment. What you don't want is a board meeting—and I've experienced a few of these as an operator—where you

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and your executive team puts all the work into it, and the board either just doesn't pay attention or they're really negative and kind of pull you in a million directions. When you leave that kind of meeting, you're exhausted, sucked of energy; I call it the "vampire effect."

What you really want is a board that you know has your back and is there to support you, but also to challenge you, to offer different perspectives. But at the end of the day, they're there to try to be helpful. And that dynamic of trust and transparency to openness is really important on both sides.

So with that, Kate, I'll hand it back to you.

Judge: Thanks, Yvonne, that's very helpful in our efforts to flush out the ecosystems across these different areas and try to think about some of the nuances that matter an incredible amount when you're actually shifting towards execution. I particularly like the idea of adding a day on strategy. It complements Sandra's conversation about committees and how they provide a bridge to more specialized information. And it gets back to Les's point about Board 2.75 and how we might arrive at a blended model that works in a public setting.

Strengths of Private Equity

Judge: With that, I want to move to your former colleague, Brian Murphy, who is the managing director at BRG. He has been the primary operating executive in over 20 private equity investments, partnering with management and private equity deal teams to establish post-investment strategy and install strong governance. Brian, would you build on the conversation we were just having with Yvonne by telling what you see as the particular strengths of the private equity model? How much of that do you think is tied to the finite nature of the investment, and the control exercised by PE boards, and what if any parts of the model could effectively be ported over to the public company setting?

Brian Murphy: First of all, thanks for the privilege of being part of this distinguished panel.

Part of my job as an operating partner is to provide a bridge between the management team of the portfolio company and the PE board. Sometimes I would sit on the board, sometimes I wouldn't. But I always spent a lot of time with the management team. You're trying to get alignment on the most important three or four things you're trying to accomplish. But if you can get that shared understanding and find a way to communicate it to everyone involved while also ensuring you have the right people, then you've laid the basis for ongoing weekly and monthly discussion, and for board meetings, too.

Another part of my job was to create a moving picture, if you will, of the firm's performance, as opposed to the quarterly snapshots you see in standard financial reports. A moving picture is supposed to provide an understanding of what's going on in the daily lives of the management team, both good and bad, helping you to make quicker decisions and get to your goals faster. And in private equity, your IRR is determined by how quickly you make the investment work.

Yvonne was right when she said that you can't paint private equity boards with one brush, because I've seen all kinds. In the worst situations, we never reached that alignment on strategy and execution. We had board meetings with too many people, with too many ideas. And they were mostly all good, smart people with lots of great ideas for the management team. But there was little connection between the conversation and what we were doing. And at the end of the board meeting, people would thank the board, and then get back to their daily lives. By contrast, in the good situations you have the kinds of day-long strategy discussions that Yvonne described that help boards make

In PE firms, often the lead deal partner is effectively the chairman. Many public companies are splitting this job between the CEO and the chairman, not with the intent of having the board run the company, but to make the board more effective in a public company setting. [T]hat could be a valuable step for public companies—a lesson from PE in a way, but one I think that public companies are now learning on their own. —Brian Murphy

decisions and decide where our capital needs to be spent.

So, again, I've seen effective boards with lots of outsiders. That can be good because it can bring lots of good opinions. It puts pressure on the CEO because there's lots of people to talk to and prepare for prior for the board meetings. And I've also seen some small boards, which can be very efficient, but also prove to be very myopic. So, there's always a little bit of a balancing act that you want to have.

I think public boards can learn from some of the ways private equity uses to keep people informed. We talked earlier about PIPEs as one example of collaboration. And there's also the case of "reverse LBOs," in which companies return to public ownership after having been taken private by a PE firm. In both of these situations, you have private equity involvement with or participation on public company boards.

And now we have the emergence of SPACs, where the de-SPACing process has created exit opportunities for private equity and some very interesting board combinations in public companies. The PE partners of the selling firms stay on the de-SPAC board because they won't be able to exit for several cycles. And you'll have the professional managers hopefully in the SPAC themselves who hopefully won't trade out.

So, we're going to see an interesting group of board members that will carry some of these investments forward. And I'm sure some will be great, but some won't be that great. As has been said many times by many people, the downside of being a public CEO is the intense *public* scrutiny. But I will tell you that the downside of being a private equity CEO is the intense *private* board scrutiny. Now, if you have both of those things, I'm not sure how many CEOs are going to love that. I think that the SPACs are going to need the market credibility, some institutional backing, to succeed. Private equity spends a lot of money on consultants and getting well informed, but public companies also have to gain the credibility of the market to say, "We've got the right strategy here. Give us some time." Now, I can see certain individuals having a kind of halo effect on the de-SPACs, but I think such firms will also ultimately need some institutional backing. These de-SPACS will provide an interesting experiment for Ron and Jeff's hypothesis.

In Defense of Public Boards

Judge: With that, let's turn to Gaby Sulzberger, who's served on numerous public and private company boards, and currently serves on the boards of Mastercard, Eli Lilly, Brixmar Property Group, and the newly public Cerevel Therapeutics. Gaby, what do you think public company boards already do well? Are there areas where you think the 2.0 model actually shines?

Gaby Sulzberger: Well, I agree with Les that I think under any scenario the world is getting more complex, and the companies are getting more complex. And that means that Board 2.0 has to be evolving. But I do think that there are also some innate strengths of public company boards. And I take some exception to some of the comments in Jeff and Ron's article.

Take the assumption that, in many cases, public company directors are not well informed. My response is that public directors are well informed, but it's a different kind or quality of information. So, yes, I've been in activist situations where they come in with

A private equity director… understands that part of his or her job is figuring out what the exit is going to be. It's not really a long-term job… PE directors have to think in terms of a different time frame… [and] a narrower set of constituents… [The terms of] public company directors… are typically at least five years, and in some cases ten years. —Gaby Sulzberger

their independent reports. But the ability to work and develop a trusted relationship with the senior management team is a big part of what Yvonne has just told us about effective public company boards. And I can't think of a better source of quality information about what a company is actually dealing with than its public directors.

I also take exception to this idea that there is little or no motivation when you're on a public company board. Board members of public companies are provided with all kinds of incentives. In the private equity world—and I'm on two private equity boards now—clearly the motivation is different. But in some ways, the most important motivator is the reputational risk that every director assumes when taking the job.

The other thing that I would observe is that, as Yvonne said, the private equity director role is different. There isn't this whole compliance function. And a private equity director who's coming onto the board also understands that part of his or her job is figuring out what the exit is going to be. So, it's not really a long-term job. If he or she ends up on this board more than three or four years, something is maybe not going right.

So, to really discharge their fiduciary responsibility, PE directors have to be thinking in terms of a different time frame. And they're thinking about a more narrow set of constituents. As public company directors, our terms are typically at least five years, and in some cases ten years. In that sense, our interests and perspective are much better aligned with those of the management team and longer-term shareholders.

And I would argue that this longer-term perspective gives us the ability to think and do more about things like ESG. Whereas the focus of private equity company directors is more narrow, and their accountability is a lot more limited, public company directors have a much broader accountability.

Take the case of diversity. The data around private equity-backed boards is not great from a diversity perspective. So, I think the issues raised by this conference are really complicated. Yes, there are some practices that I've observed on my private equity boards that could help make public company boards more effective. But also I think that the roles are just fundamentally different, and I'm a little more bullish on public company board members than Jeff or Ron. I think Les described them as 2.7 and I'll stick with that story.

ESG and Long-Run Enterprise Value

Judge: One of the big challenges that public companies are facing today is this shift toward ESG that Gaby just mentioned. It's coming through a variety of different mechanisms, and a variety of different jurisdictions. Does anyone have any thoughts on how the push for ESG relates to or could inform either the need for board experimentation of the kind that Jeff and Ron have proposed, or perhaps a different kind of evolution that would allow boards to put more real focus on concerns like sustainability? Les?

Brun: Well, the first challenge is to try and come to some agreement on what exactly the ES and G really mean; there's not much of a consensus. But for me at least, the ESG movement highlights the reality that the folks who populate boards these days and tend to have particular expertise in one leg of that stool or another should be able to add to the discussion and the debate that's going on in the board meetings.

One tendency of boards I've noticed is to take the acronym of the day and drive too much energy and focus on it to the exclusion of everything else. We're all operating in this one giant ecosystem, as Steve pointed out, where all these pieces are interrelated. And although thinking about ESG is important for every organization, the specific concerns are somewhat different in each case. Yet there's a desire to overlay this generic hue of what ESG is to satisfy certain constituents—which, again, tend to be somewhat different in each case. And though it's consistently on the minds of directors, companies' responses are likely to differ, and to draw on and reflect the specific expertise of their directors in these different disciplines.

Wijnberg: I will just add to what Les said by saying that ESG should be thought of as an integral part of enterprise risk management, or ERM. And as I was saying about ERM earlier, ESG also needs to become part of the DNA of everything you do. To maximize long-run value, companies need to think hard about how they take care of, and invest the right amount of attention and capital in, all their important stakeholders. And for this reason, I completely support the current focus on ESG and corporate efforts to communicate their aims and accomplishments to both investors and their broader group of stakeholders.

At the same time, however, I would argue that well-run companies have long been thinking about what's now called ESG; in fact, it's almost impossible not to be thinking about your stakeholders when you're thinking about the long-term value of the enterprise. The hard part, though, is figuring how to measure and keep track of your progress, and that's what is new here, and where I think some of the newer frameworks are likely to be helpful. But, again, I would argue that the key to ERM and ESG is getting a stakeholder as well as shareholder focus into the corporate culture so that it informs basically every decision that you're making. As I said earlier, you can't increase long-run shareholder value without taking good care of all your key stakeholders.

The Problem of Public Director Risk Aversion

Judge: Sandra, I really like the way you tie ESG back to enterprise management and long-term value. But I wonder if we can tie that back to the earlier argument that one of the challenges facing public company boards is excessive focus on compliance. Steve suggested that lawyers are encouraging too much risk aversion, and that's likely one important explanation for ineffective public boards. In the earlier panel, Elisabeth de Fontenay said that both Delaware and federal law have been structured in ways that lead public company boards to err on the side of conservatism. Is that a problem? And what can we do about it, particularly if we think it might be seeping into the DNA in particular ways?

Sulzberger: I haven't found it to be the problem that is being characterized in this way. I've been on bank and other highly regulated public company boards and, as Sandra was saying earlier, there is a clear risk management function that happens mostly at the committee level. So, I think that boards have figured out how to discharge that set of responsibilities. And yes, it does take time and management support. But does it really kind of bog down the agenda of the board? That's just not been my experience.

Hao: I would just add to Gaby's comment that I think all of these governance laws and regulations all emerged for very good reasons. They force public companies to focus on some potential vulnerabilities. So, I think the intention is good and that it does create some positive focus.

But problems can arise from the tendency of regulation to be "one size fits all"—which means that, when companies are asked to check boxes on a long list of things that aren't all well suited to the corporate circumstances, the companies can get hamstrung. So, you just need to have a management team and set of board members who are going to be thoughtful enough to say, "OK, our goal is to do the right thing for shareholders, and not focus only getting a perfect score with ISS or Glass-Lewis." If our goal in life was only to hit their metrics, we could miss some nuances in the company and may fail to compensate our management team correctly. How do we thread the needle and do the right thing for the company by making sure that we retain and reward our executives with strong performance incentives, while also making sure we are doing a good job following the guidelines and metrics from places like ISS?

So, today's laws and regulation raise the demand for board members who are willing to do the work to be more nuanced and thoughtful.

Directors on Too Many Boards?

Judge: One of the many remarkable things about this particular group is that so many of you have served on a number of different boards. One concern with that is that people are attention constrained and so aren't able to dive as deep. On the other hand, there clearly can be insights that you garner from one area that help you bring a different perspective to some of your other board roles. Do any of you want to comment on what you see as the advantages or perhaps drawbacks of serving on multiple different boards, or on private equity?

Brun: I will venture to say, Kate, that this concern largely disappears if we keep in mind what our role is. We're not there to manage, right? Our job is to oversee and to assess the effectiveness of the management team executing an agreed-upon strategy and to either compensate or not compensate for the achievement or lack of achievement of that strategy.

In responding to your questions, I think it's important to recognize that we operate each individual company in a unique ecosystem, if you will, that is singular to that enterprise. There will be some common elements within its industry, but each enterprise is unique. And we're driven to bring perspectives that can inform the thinking of management in developing and articulating the strategy. So, I think there's a benefit to having that diversity of experience. It's the same reason why certainly at the public company level, many emerging companies encourage their executives at a certain level to have at least one outside board position to help inform their thinking about their own business.

And I think this diversity of thinking and approach may be even more valued in the private equity space. You tend to have different kinds of boards in the PE space than you do in the public company space, in terms of backgrounds of the directors. But in either instance, I think having that diversity and breadth of perspective makes for better decision-making.

Wijnberg: It's like exercise, Les, right? The more you do, the better your muscle structure is.

Brun: Not true in my case, Sandra, but I'll take your word for it.

Wijnberg: You can overdo it and get injured and then you're not effective. But I believe that there's a lot of value that comes from crossing industries and gaining the experience that comes with it. And if you've been through a crisis, you never get rid of that wound. You call on that experience to help get the company through the next crisis when it comes.

Closing Thoughts

Judge: Well, this has been a wonderful session. Before we turn it back over to Ron and Jeff for their responses, I want to ask our panelists if they want to share one or two closing comments in today's conversation. Les, do you want to start us off?

Brun: I think it's important to keep in mind that we're living in a world of constant and high-velocity change, and that board roles and the skills and talents necessary to help inform the movement of that agenda evolve quickly over time. And though I find these kinds of conversations are very helpful, I don't think we should expect to reach a destination, a definitive set of answers, any time soon.

Judge: Steve?

Fraidin: I'd like to make a couple of comments. First, on the issue that Les raised initially, and Ed Rock later, the thickness of information that hedge funds sometimes create, I think that Ed is absolutely right about the sophisticated hedge funds, the ones he refers to as providing validation capital. And in the past, corporate managements were opposed to bringing such people on their boards. In some of those cases, managements would claim to be developing strategic information and alternative plans themselves; and they didn't want the hedge funds to have an advantaged position relative to the other directors.

To deal with this situation, I once persuaded a company I was representing to ask the hedge funds to make their information available to all the directors, thereby putting everybody on an equal footing. This way we let everyone take advantage of the richness of information that these very sophisticated investors can put out.

Second, at the risk of being a contrarian, I would say that although there's a significant initiative these days to developing more diverse boards, which I'm all for, there's an unintended side effect of the increased diversity of boards—which is that people are getting on boards who have not been directors before. In the past, one of the important criteria for board searches was where else have people served? What's their board experience?

So we're seeing a lot more first-time directors. And my observation is that often these people bring a perspective that is very useful and, in fact, their lack of experience as board members has sometimes proved to be a real plus.

Judge: Sandra?

Wijnberg: I believe that refreshing boards on a regular basis, having really good mindfulness about the composition as well the culture of the board is important. Like Brian Murphy, many people who serve on boards are operating partners at PE firms. And I think that a lot of the things that come from PE have already started to migrate onto public company boards. Part of it is having an engaged, proactive, constructive culture. Some of it is the digging deep. Some of it is a sense of urgency and deal acumen.

So, I agree with Les's beginning premise, which is that a lot of public company boards are already at 2.75. And I too think of this as a journey. Many companies could use more 3.0 thinking, but there already are lots of companies and boards on that journey.

Judge: Ed Rock?

Rock: I think this has been a terrific panel—one that has convinced me that the Board 2.0 model that Mel Eisenberg argued for in 1976 and that was accepted so widely has in fact evolved. So, I agree that in many companies, we are now at something like Board 2.75. What Mel accomplished in his book was to project a new view of the board, the monitoring board. I see Ron and Jeff as presenting the outline of the next version, which can lead to clinical or case studies of really great practices that illustrate this thickly resourced, thickly informed model of the director that they're pushing for.

In this panel alone and in the previous one, we have seen a variety of examples. We've had some discussion of PIPEs. Brian just mentioned reverse LBOs—PE firms that go public where partners of the PE firm stay on the board for a number of years. We've talked about the de-SPAC companies and some examples of validation capital. I think each of those transactions would be worth a chapter in a book they could write about new models of effective models of thickly informed, well-resourced directors that contribute to the value of the company, while building credibility in the marketplace.

Judge: Great, Ed. Yvonne?

Hao: I'll just say that I think there are strengths and drawbacks to the public company model and certainly strengths and drawbacks to the private equity model. So, the key is to have these conversations and learn from each.

Judge: Brian, do you want to chime in, quickly?

Murphy: One practical thing: In PE firms, often the lead deal partner is effectively the chairman. Many public companies are splitting this job between the CEO and the chairman, not with the intent of having the board run the company, but to make the board more effective in a public company setting. And I think that could be a valuable step for public companies—a lesson from PE in a way, but one that I think public companies are now learning on their own.

Judge: So, it's good to see public companies adopting at least parts of the PE model. Gaby, any last thoughts?

Sulzberger: That's actually what I was going to say. Although I was challenging parts of the PE model, there are clearly pieces of it that provide opportunities for public company boards to get better. At the end of the day, we're a team, right? So, in thinking about how to help our senior executive teams, we want to find the combination of strength of individuals, as well as the dynamic of the group, that ultimately allows our companies to be most effective. There's always opportunity to grow and get better.

Judge: I cannot thank our panelists enough. I've learned a huge amount from this conversation. Thank you to Ron and Jeff for starting it off—and I'll turn it back over to you both for last words.

Summing Up

Jeff Gordon: Thanks so much, Kate, for running such a great session. There's certainly a lot to reflect upon. Ed's invitation to write a book is a daunting suggestion. But what Les said is that in a sense maybe we already have board 2.75. That's a provocative thought—and it's supported by the observation that we are already seeing new-style directors on boards, many of them ported over from PE firms themselves, including some retired partners at those firms. That might be an interesting empirical piece to follow up on.

The one thing I thought the panel kind of danced around is the implication to be drawn from the frequency and success of activist challenges—both of which I think should be viewed as signs of the failure of public company boards. I'm inclined to view Ed's example of the validation role played by Trian as a version of relational investing. And like Ed, I'm interested in understanding the extent to which Trian's MO could become a more general approach, and not limited to just the few hedge funds who have made a business of it.

But it is the high proportion of the successes among the activists' challenges that suggests to me that institutional investors are not persuaded that the boards of these public companies are delivering a credible defense of the management strategy. And I think it's that recognition of board failure in these cases that's pushing me to continue to believe there could be considerable value in sketching out, even in perhaps overly dramatic ways, an alternative model that could give boards the resources to deal with this new world.

And I'll stop with that. Ron?

Ron Gilson: I'm going to close by making a few brief and very much out-of-character references to my own experience rather than to academic research. I found Brian's closing comment about the board chair to be very powerful. If we expect public company boards to work—and particularly if we're going to provide the board resources and the things that we think a board needs to be effective—there needs to be leadership on the board. And the conversations I've heard about having an independent chair tend to miss that. The important thing about having a lead director who's not part of management is not that the lead director is second-guessing the strategy or interfering with the operation of the company. Rather, the lead director's role is making the board function more effectively.

I'll mention just one example that I think warrants attention. Namely, how does a CEO communicate with the board? Of course, the CEO could call everybody on the board one by one, but that would take a significant chunk of the CEO's time. Alternatively, the CEO could write a memo. But that's going to go through the general counsel's office and what's going to come out of it is going to be radically more constrained and less current.

But if I'm the lead director, then the CEO can just call me. And my job is to make sure that the board stays fully informed because being able to do that increases the incentives of everyone involved to provide the information. The reason I mention this is because I think I used the term "engineering" to describe this exercise. It is engineering in the sense that we're taking pieces of things that have been put them together and then reassembling them in different ways. And this process underscores the fact that the whole discussion, including the Board 3.0 characterization, is an exercise in demonstrating that one size doesn't fit all. Industries vary a lot, and so do time frames and circumstances. And framing what the board needs as a general matter is a different question from the engineering challenge of providing those things to different boards with different histories and characteristics. Today's three panels have just been terrific at making that point.

One Last Question

Gordon: Let me just put one last question to the panel about the possible trade-off between becoming a thickly informed, fully engaged director and becoming an insider. Given that there's an irreducible element of monitoring involved in the role of being a director, including willingness to dismiss the CEO, if necessary, what happens when a director becomes in effect part of the inside group? Even while starting from the outside, does the director nevertheless develop perhaps too strong a commitment to the management and the strategies being implemented? Does that person lose the capacity to be a monitor?

Wijnberg: I don't think it creates a conflict. But it does require one to be eyes on but hands off, as they say. Being thickly informed makes you more effective in the quality of the questions that you ask in your monitoring capacity. And you obviously have to avoid useless meddling. But being well informed allows you to act more quickly when you need to.

Rock: Jeff, let me jump in there for a second. That's the classic argument about the problem with Arthur Goldberg's fully staffed board concept, which Mel talks about in his book. The concern is that an outsider either becomes an insider, in which case we're duplicating the function of an executive team, or the outsider becomes an alternative center of power, in which case it becomes unclear who's running the show.

What's interesting, of course, is that when Warren Buffett goes on the board after acquiring 80% (or even just 10%-15%) of a company, nobody asks whether there's a concern that he will be captured by the insiders. There may be a danger that he'll meddle, but there's no danger that he'll be captured because he has such a large investment that you're confident that he's going to think about this primarily as an investor. However cordial his relationship with the management, he's not going to get captured in the sense that you worry about with respect to outside directors who end up becoming that involved with the corporation.

Fraidin: Jeff, I was recently on the board of a relatively large public company. I was indeed thicky informed about that company and that level of information permitted me in fact to get the CEO to be replaced. Because I understood what the failings and the problems were, I think that information was an advantage and not a problem or reason for concern.

Gordon: That's a positive note on which to end. This has been really a great gift to Ron and me, as we try to think through this idea and maybe push forward with it. As Ron said, by coming up with the metaphor 3.0, we're not trying to impose yet another one-size-fits-all scheme on a particular model. The point of Board 3.0 is to inject optionality to the current board model. What we've heard is that there is already a considerable amount of experimentation going on in today's boards. Maybe it's not been described in quite the way that would demonstrate some of this optionality, but my hope is that this meeting encourages more experimentation because, as Ron and I started by saying, we want to avoid the suggestion that to achieve to "first best" governance, companies have to migrate to private markets rather than remain public companies.

So, anyway, thanks very much. There's already been a great value I think in a collective discussion. We had a sign-up of 600, and our "peak load" was around 250 participants. So I think we've collectively added to the global discussion on these issues, and we appreciate all who've taken part.

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