



Photograph by Peter Gregoire

Ira M. Millstein: The Thought Leader Interview

Reform board structures or accept more value destruction, the corporate governance doyen warns.

Thought Leader
by Michael Schrage

The global epidemic of directorial debacles and disgrace — at Enron, Disney, WorldCom, Tyco, Parmalat, and Vivendi, to name a few — is not close to over, says Weil, Gotshal & Manges senior partner Ira M. Millstein. “We can expect more scandal and more failure, from more self-dealing and more excessive compensation schemes, despite newly mandated process and structural reforms,” Mr. Millstein and Yale economist Paul MacAvoy aver in their new book, *The Recurrent Crisis in Corporate Governance* (Palgrave Macmillan, 2004), a pithy and provocative survey of the perverse incentives and pathologies afflicting and undermining boardrooms. The result, they fear, will be a “recurrence of massive destruction of investor value, to the loss of the economy as a whole.”

Yet Mr. Millstein, a visiting professor at the Yale School of Management, is hardly a pessimist. The sharp-tongued 78-year-old argues that most board members are too frequently beholden to chief executive officers who double as the chairman of the board. Mr. Millstein has

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relentlessly promoted separating the positions and importing the British tradition of the nonexecutive chairman. As de facto dean of America's community of legal scholars and activists shaping the rules, roles, and regulations of corporate governance, he champions an agenda of boardroom reforms that he believes will preserve and increase trust in publicly traded corporations and shareholder value, and avoid further regulation.

A former chair of the U.S. National Association of Corporate Directors (NACD) Blue Ribbon Commission on Director Professionalism, chairman of the Private Sector Advisory Group to the Global Corporate Governance Forum (a joint venture of the World Bank and the Organisation for Economic Cooperation and Development, or OECD), and a contributor to the OECD's *Principles of Corporate Governance*, Mr. Millstein has an interest in the future of governance that is as global as the companies he's advised. Over the past 53 years at the Weil, Gotshal law firm, he has worked with General Motors during its board restructuring in the 1980s and 1990s, and advised Sotheby's board during the compa-

ny's recent antitrust case, among many other matters. Mr. Millstein was also retained by the boards of the Walt Disney Company and Tyco to advise on governance reforms. For him, the recurrent crisis in corporate governance is a fact of life.

While quick to embrace litigation, regulation, or legislation that might prompt better governance as a second-best alternative to self-help, Mr. Millstein is concerned that sweeping initiatives such as Sarbanes-Oxley may go too far. He is concerned that more regulation will follow, unless boards reform themselves. He's confident that boards are now far more open and receptive to his recommendations. "I wish every board member in the country could attend my class at Yale," he told *strategy+business* in a recent conversation at his law firm's Manhattan office. "The exchange would benefit both of us."

S+B: When the board of directors confronts what they call a serious problem, is that really another way of saying, "What do we do with the CEO?"

MILLSTEIN: Generally, yes. But sometimes the board doesn't take the next step, doesn't ask the real

questions, doesn't probe deeper. Why? They may like the CEO. They might prefer to hope that there's nothing wrong, so that they don't have to do anything. Most boards were like that. Most boards in the past — before Enron and Sarbanes-Oxley — would have preferred to just go along, hope that they were being told the truth, and hope that the solution being proposed was really the right solution. They didn't want to challenge the CEO if they didn't *have* to. That's obviously been changing.

S+B: Where do you draw the line between a board that's too supportive of the CEO and management, and a board that's appropriately skeptical and challenging?

MILLSTEIN: That's the question that most boards are wrestling with today. I can't give you a bright line. To me it's a "gut" issue. A board member has to know the nature of the business well enough, know the CEO well enough, have a deep enough understanding of the company and the man or woman who's running it and its management, and judge when to be skeptical, and when to be supportive, or when to be both.

support of the CEO in a serious situation that didn't ultimately lead to "goodbye" for the chief executive. Because it means that you're so critical, you're so concerned, that you can't trust the CEO. The only way that it may work is in those instances where the CEO himself welcomes and supports the bypass.

The Big Problem

S+B: Then maybe the healthy thing to do would be for C-level managers to actively encourage the board to do that kind of probing, to neutralize it, and to show that they are open to board-level scrutiny.

MILLSTEIN: As I said, that would be nice, but it's probably counter-intuitive. Tell me about the manager who's secure enough to say, "I've messed up" or "I've got a problem that's unsolvable. Talk to my managers, and they'll tell you why." When can you count on the CEO alerting you to the big problem that may well involve his stewardship?

Take steel. Steel, for the last 20 or more years, couldn't be fixed without wrenching changes. It was going to be one Chapter 11 or reorganization after another, or moving into different kinds of businesses. What CEO do you know of in the steel business who came forward early on and said, "I can't fix this without disrupting labor and community relations, or maybe an early Chapter 11." Airlines today and rust-belt industries with high labor costs, and health-care and retirement obligations, fixed by contract, are in the same predicament. Perhaps history won't repeat itself.

S+B: You're arguing that many boards don't realize that these structural problems exist?

MILLSTEIN: Many of these rust-belt industries are being run for the benefit of employees and retirees, not for the shareholders, and I think that's clear to many boards. But even so, the "solutions" are wrenching and difficult to face. It's hard to be judgmental.

S+B: What would have made a board effective in the days when this evolution was occurring?

MILLSTEIN: An effective board in those days would have been a board that said, "How did we get into this fix? *Are* we ever going to get out of it? If so, what do we have to do — as tough as that may be?" It didn't happen that way.

S+B: What would an effective board do now with a similar set of sectoral problems?

MILLSTEIN: An effective board today will get to the issue a lot quicker. A lot quicker. The issue is, is the CEO leveling with the board? In the earlier era I am talking about, the answer was no. In the era we're talking about today, the answer is yes.

Let me be perfectly blunt. Very few of the CEOs I knew at that time would walk into the boardroom and say, "We have a major problem; we are in very big trouble." They would prefer to solve it on their own, and then report success. And where there was no success, it was often too late.

S+B: And today when a CEO walks in and says that, what's the board's reaction?

MILLSTEIN: The board's reaction is, "Let's work together and see how to solve this, if there's any way to solve it."

S+B: Does this approach work better?

S+B: Can't we say that, because of today's environment, thanks to Enron, WorldCom, and Tyco, the board's default position must be "the more serious the initiative, the more skeptical the board"?

MILLSTEIN: Clearly, the bar is raised. The more serious the issue, the bigger the problem, the more the board *should* be skeptical. No question about it. Because of "Sarbox," because of the scandals, that line is going to be crossed earlier rather than later. The tough questions will have to be asked sooner, to show "good faith" and diligence.

S+B: What does this mean in practice? Does that mean asking tough questions of the C-level executives? Or should directors actually go into the guts of the organization and do due diligence on their own?

MILLSTEIN: The latter is the last resort.

S+B: You don't believe the board should be quicker to bypass the C-suite to see how the business is really doing?

MILLSTEIN: When you start doing that, you're on a downhill slope with the CEO. I have never seen a board taking that next step without the

MILLSTEIN: Yes, I think so. The legal and regulatory emphasis on shared responsibility and shared accountability makes it work better and faster.

Seeking Consensus

S+B: Do you think directors should seek consensus? Or are we happy with open disagreement over board-level decisions?

MILLSTEIN: Disagreement is fine, but it should remain in the boardroom. Consensus for the sake of consensus is no longer acceptable. Alfred Sloan once said something like this about a management meeting: “If, gentlemen, we’ve reached complete agreement, let’s start over.”

S+B: Would it be healthier for boards if directors — inside and independent — chose to resign over issues of strategy and direction?

MILLSTEIN: No, I really don’t think so. Nobody is smart enough to be sure their answer is the only one. When do you resign? If something criminal is happening, if something immoral is happening that you can’t live with, then yes. Otherwise, I don’t think so.

S+B: How about, “I don’t believe in this multibillion-dollar acquisition, so I’m resigning from the board”?

MILLSTEIN: If you felt that strongly about it, fine, you should resign. But I can’t believe that people often feel that strongly about it. What they do is say, “I don’t think it’s a good idea. I don’t think this is what we ought to do.” You have your argument in the boardroom, and you lose. If you have a good board and people that you feel that you can rely on, you don’t quit. You say, “I don’t agree. I’ve had my chance.

We had a shot at it. We discussed it thoroughly. I understand you, you understand me. We don’t agree. But I understand that it’s 15 to one,” or six to one, or seven to one.

As a director, you also have your loyalty to the company. Fight in the boardroom, but don’t get to the point where you publicly throw the company over just because you don’t like a decision.

S+B: Couldn’t that be construed as advocating an absence of openness and honesty and disclosure about how the board made its decision?

MILLSTEIN: No, but dissent and healthy discussion is impeded if it has to take place in Macy’s window. The point is, as much as I didn’t like the typical boards in those days, I did respect what some were doing in the boardroom. Some of them pushed hard enough to make things happen. Eventually. It took a while. Directors cared and they argued but stuck it out, promoted their positions for change, and that was a good thing. I admired that.

S+B: So if John Smale, the Procter & Gamble chairman who served on the GM board during its crisis years in the 1980s, had threatened to resign...

MILLSTEIN: ...It would have been a disservice to the company.

S+B: If he had threatened to resign, do you think that would have undermined or enhanced his effectiveness?

MILLSTEIN: It never came to that, but I think it would have undermined his effectiveness. I think that the way he handled it was much better than threatening to resign. He had proven himself to be a responsible director, and when it was time for him to lead, the other directors accepted him.

Most Dangerous Job

S+B: Whom should directors go to for advice on how to manage themselves, both as individual directors and collectively as a board?

MILLSTEIN: I think you first turn to your inside general counsel, even though it is the most difficult job in America today. The burden on these people is enormous, because they represent the entire company. They’re hired by management and are expected to be independent enough to counsel everybody. The inside general counsel should have the total confidence of the CEO, or he or she really can’t do the job. But

“Inside general counsel is the most difficult job in America today. They’re hired by management and expected to be independent.”

if he has the total confidence of the CEO, he may have trouble fully disclosing information to the board. It’s a true test, but the good ones manage it well.

S+B: This sounds remarkably similar to the problem faced by recent White House counsels. Does the White House counsel represent the president, or does the White House counsel represent the person who is the president?

MILLSTEIN: The exact same issue.

S+B: That’s been resolved by the president getting his own personal counsel.

MILLSTEIN: Absolutely right. There are times when the CEO will be advised by general counsel, “You need your own lawyer.” There certainly are times today, more than a little bit, when the general counsel should say to the board, “Get your own counsel.” The first line of defense is a good general counsel who knows when outside help is needed.

S+B: This strikes me as almost a statutory rationale for the separation of CEO and chairman of the board. The role of the general coun-

sel comes with that legal conflict of interest baked in.

MILLSTEIN: No question. The separation is essential, otherwise the general counsel could be in a position of conflict. The general counsel’s role is one of the very good reasons for that. Most of us feel that the board ought not to have its own counsel on a regular basis. It just clogs up the boardroom. But the general counsel, if they’re good, will know when to recommend that the board should have outside counsel. Most directors today are sensitive enough, anyhow, to know when they need outside counsel.

S+B: What is this resistance to separating the CEO from the chairman of the board? Is it cultural? Organizational?

MILLSTEIN: I believe it’s ego and the culture of the American enterprise. The people who are defending it will say it’s “our culture.” What does “our culture” mean to them? It means that if you’re the boss, you must be the CEO and the chair in the United States, and if you’re not the CEO and the chair, then you’re not really the boss. That is a complete obfuscation of the fact that there are two jobs: one running the

company, and one running the board, and the two jobs don’t fit well under one hat.

S+B: Boards have finessed the issue by appointing lead directors. They’ve created gray markets in nonexecutive chairmen.

MILLSTEIN: Exactly. It won’t be long before it becomes clear that a true lead director is, de facto, the chairman of the board. The lead director began as a total finesse. “We’ll call it a lead director, and we’ll be home free, and nobody will pay attention.” That didn’t last very long. Now, the NACD is taking the position that if you’re going to have a lead director, you have to spell out what he or she does. *Explicit* delegation of power by the board. In my view, this lead director is by function, if not title, going to become the chairman of the board. If he does all the things that he’s supposed to do, he will be de facto chairman. Watch.

S+B: Won’t boards have difficulty hiring CEOs if candidates know that, whatever the title, they won’t have the authority of the chairman?

MILLSTEIN: Most boards don’t want to strip the CEO of the chair-

“Search firms are saying it will be tough to find a CEO who is not also the chairman. I don’t believe that.”

man title while he’s sitting. The reason they don’t want to do that is, given the culture of the U.S., it will look like a demotion. It isn’t. It’s simply a redistribution of the job. But, it looks bad to strip the title, and I would not recommend that.

The issue you should be asking about is when succession time comes, why don’t they just say, “We’re offering you the job of CEO but we’re going to get ourselves a new chairman.” Search firms and others are saying, “It’s going to be very tough to find a person who will take the job if he’s not the chairman and the CEO.” I don’t believe that. When succession time comes around, if the boards have the courage to do it, and say, “We are offering you the job of CEO, with great salary, bonus, and options,” the job will be taken. Being a well-compensated CEO is a pretty good position in life.

S+B: Why don’t the boards have the courage to do these things?

MILLSTEIN: That *is* about culture. You’re fighting 100 years of argument that there has to be one boss.

S+B: How will that culture be changed? Litigation?

MILLSTEIN: I wouldn’t want to force it down anybody’s throat. I hope and expect that boards will come to understand that it’s the right thing to do.

S+B: You’re an evolution, not revolution, kind of guy.

MILLSTEIN: Yes, generally, but on this issue maybe not.

Governance Revolution

S+B: Where do you want a revolution in governance?

MILLSTEIN: As succession time comes along, enough boards need to do the right thing: separate the CEO position from the chairman position. If that doesn’t happen — if in the next five years we don’t see a clear trend toward separation — I would then say we should, at least, mandate a “comply with it or explain why not” process.

Where do I really think the revolution *has* to come? I think the revolution has to come in the degree to which the directors are taking the job seriously. It’s about as serious a responsibility as exists in corporate America. The evolution of directors is essential to maintaining our system free of further intrusive regula-

tion. That’s the revolution I want. And I would do anything to make that happen.

S+B: How about limiting the number of boards on which a director can serve?

MILLSTEIN: You bet. Yes.

S+B: What should that number be?

MILLSTEIN: If you’re not employed, and all you’re doing is being a director, you can handle up to six comfortably, I think. But if you’re employed, I don’t see how you can handle more than two or three, and even that’s a lot. The number of boards you serve on is an indication of whether or not you’re really serious. If you’re going to be on 10 boards, forget it, you’re not a serious director. When somebody comes in and tells me they are on three audit committees, I question whether that person is really serious.

S+B: What qualities should an ideal nonexecutive chairman have?

MILLSTEIN: The separate chairman should be the person who thoroughly understands the role of the board and keeps it performing as it should, and no more. There will always be people in the boardroom

who want to do a lot more. The chairman should be the person to say, “Wait a minute. That’s not what we’re supposed to be doing. If we start doing that, we’re really getting into the business of managing.” If the separate chair is an intelligent person who understands what the job is and what the board’s role is, he can be of significant help to the CEO.

S+B: Are boards beginning to live up to their expanded responsibilities in this environment?

MILLSTEIN: I see boards becoming much more aware of what their responsibilities are, individually and collectively. I think good board members are respectful of one another, anxious to hear each other’s opinions, and anxious to understand what the other director is saying. I see some older members of the board still pontificating.

S+B: Do you think boards need to be younger?

MILLSTEIN: Absolutely. I think they should be younger, because I think younger people are much more likely to take the job seriously. I think that they have been brought up in the scandal era.

S+B: By younger, we’re talking men and women in their 40s, as opposed to their 60s?

MILLSTEIN: Chronology is not the test. By “younger” I mean “they get it.” What I want is people who have gone through this last 10 years, lived through it, know what it means, and know why this job has to be taken seriously. Some “older” people on boards do “get it,” but some don’t or are set in their ways.

S+B: Warren Buffett doesn’t get it?

MILLSTEIN: I don’t think so, because Warren believes that he knows best how to run his company. And he does — there’s no issue; he’s been remarkably good. But when it comes to his being on other people’s boards, I think he would put total confidence in the CEO. His view seems to be, if something is wrong, he’s going to fire the CEO. That, from what I have heard him say, is his notion of governance. If that is his view, then I disagree. I think the job is more than that.

Directors’ Diligence

S+B: Why do you feel that directors’ diligence has to go beyond hiring and firing the CEO?

MILLSTEIN: Because sometimes that’s too late. My view is, the function of the board is to try to find and help fix problems before they get to the crisis point. The company can go over a cliff while you’re waiting for something to change.

S+B: How happy are you with the requirement that directors meet outside the presence of the CEO? GE’s Jack Welch reportedly once threatened to resign if his board met without him present.

MILLSTEIN: That probably was the single most important change in the early ’90s. I believe it was devised by John Smale, who, in my opinion, probably is the individual most responsible for the changes at GM. He told me, “We’re going to meet without the CEO present.” That was essential to improving the conversation about the company’s future.

S+B: Are shareholder suits good or bad?

MILLSTEIN: Good.

S+B: You love Milberg Weiss and William Lerach?

MILLSTEIN: Love, no. But do they have to be there? Yes.

S+B: They’re necessary evils?

MILLSTEIN: They are part of the system.

S+B: Are you sorry that Eliot Spitzer is as successful as he is?

MILLSTEIN: No, I’m happy about it, because I think there’s a diligent public servant on the block.

S+B: What I mean is, don’t you think that his prominence is a reflection of the failure of corporate governance mechanisms over the past few years?

MILLSTEIN: No. I think it’s a failure of other regulators who were supposed to be doing their job.

S+B: Speaking of regulators, should Delaware be as important as it is?

MILLSTEIN: Yes.

S+B: Why? It’s like saying Mississippi should determine tort law in the United States.

MILLSTEIN: That’s silly. Delaware went out of its way to designate judges and courts that are fair, reasonable, and doing their jobs. It is, I believe, even-handed justice serving only the system, without a tilt to management, boards, or shareholders. They are effectively defining fiduciary duties. They have more experience handling these cases than any other court in the world. Fiduciary duty is what happens in the Delaware courts, based on years of experience in dealing with shareholders, boards, and managers. And all of us who practice there have comfort in a fair outcome. +

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