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CORPORATE GOVERNANCE**Structuring “co-CEO” Arrangements: A Guide for General Counsel**

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Recent developments suggest that “co-CEO” arrangements and other structures designed to facilitate shared senior executive authority are attracting new interest across industry sectors. The con-

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cept is not novel—shared executive structures have long been applied in industry sectors, such as the professional services, investment banking and higher education.¹ Yet it seems to be attracting a renewed sense of interest as a means of resolving sensitive senior leadership relationships and transitions. Such arrangements present unusual potential for rewards—as well as for challenges. Because of the particular legal and tax complexities associated with structuring these arrangements, the organization’s general counsel is well situated to play an important role in their development.

Different Contexts

co-CEO arrangements are increasingly being considered in a variety of different contexts. One is to facilitate succession of a long standing CEO, particularly when there are two equally qualified candidates for the CEO position. Another is to address difficult leadership decisions arising from a business combination, particularly when it is considered a “merger of equals,” and the parties’ CEOs are of similar age and qualifications. A related context is in the merger situation, when one of the two co-CEOs is more senior in tenure and is transitioning toward retirement in the near term. Another, perhaps more challenging situation is where a co-CEO is tapped to help supplement the skills and experience of the existing CEO during a period of financial or operational challenge for the company.

There are several recent notable public examples of this type of arrangement. In the technology sector, long-time Oracle CEO Larry Ellison stepped down in favor of his deputies Mark Hurd and Safra Catz, who had been serving as Oracle’s co-presidents since 2010.² The women’s apparel/accessories company Tory Burch

¹ See, e.g., Richard Feloni, *Why Major Companies Like Whole Foods and Chipotle Have 2 CEOs*, BUSINESS INSIDER, Mar. 10, 2014, available at <http://www.businessinsider.com/why-whole-foods-and-chipotle-have-2-ceos-2014-3#ixzz3It7aF5l>.

recently hired former Ralph Lauren executive Roger Farah as co-CEO to serve together with Ms. Burch, the company founder. According to media reports, Mr. Farah is expected to assist the company's expansion into a global fashion enterprise.³

co-CEO arrangements are now emerging in the health care sector, where large systems are combining in order to better respond to an evolving regulatory, reimbursement, patient care and financing environment. For example, a recently announced Illinois combination of a religious-sponsored health system and a secular health system features a co-CEO arrangement, in which the secular system CEO will, over a two year period, transition to retirement with the religious-sponsored system CEO assuming full CEO duties at that point.⁴ Another prominent health system co-CEO arrangement is the decision of a large Michigan health system to name an experienced health care executive from outside the system as the system president, then to assume the full CEO title upon the scheduled 2016 retirement of the current, long-standing CEO.⁵ Other nonprofit health systems are also giving consideration to co-CEO arrangements, according to media reports.

Unique Challenges

Despite their current rise in popularity, co-CEO arrangements remain out of the mainstream and certainly present unique legal, tax, human resources/compensation, governance and interpersonal challenges in their development and implementation. Substantial effort is often necessary to position these arrangements for lasting success. There is no well-established pathway toward their structuring; no "best practice" for their development; no accepted "right way" by which they are approached. They are typically intensely personal in nature, grounded in the degree of trust the co-executives have in each other and in the confidence of board leadership that the arrangement is in the best interests of the organization.

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Ultimately, the structuring and documentation of a co-CEO arrangement depends upon the appetite of the

² Jeff Green, *Oracle Choosing Two co-CEOs Risks Falling into Blackberry Trap*, 12 CORP. L. & ACCOUNTABILITY REP. 1194 (Sept. 26, 2014).

³ Shelly Banjo, *Tory Burch Brings on Apparel Veteran*, WALL ST. J., Sept. 24, 2014.

⁴ Peter Frost, *Advocate Health Care and North Shore to Merge*, CHICAGO TRIBUNE, Sept. 12, 2014.

⁵ Jay Greene, *Henry Ford Health System CEO Nancy Schlichting to retire, Wright Lassiter to transition to CEO*, CRAIN'S DETROIT BUS., Sept. 29, 2014, available at <http://www.crainsdetroit.com/article/20140929/NEWS/140929855/henry-ford-health-system-ceo-nancy-schlichting-to-retain-wright>.

involved parties—both the putative co-CEOs and governing board leadership—for detail, and if so to what extent. By "detail," we refer to a written resolution of the myriad of unique contractual and interpersonal issues arising from a co-CEO arrangement. In that regard, the analogy is sometimes (perhaps unfairly) made to a betrothed couple's decision to consider a prenuptial agreement. The suggestion that a detailed agreement is necessary may upset the balance of near-term trust between the parties, yet the presence of a detailed agreement may provide an element of long-term protection, particularly from the board's perspective.

A decision as to which approach works best under the circumstances will depend in large part on an appreciation by the parties of the legal/contracting, tax, compensation and oversight issues presented by such an arrangement. These include, but are not limited to the following.

1. Position Duties

This is the suggestion that there be a clear understanding of the respective duties of the co-CEOs. This could include areas of individual responsibility (e.g., the "I'm responsible for this and you're responsible for that" delineation). It could also extend to areas of shared responsibility (e.g., "these are the areas where we jointly make the call"). It could also be expected to address the length of the co-CEO arrangement (e.g., short term or permanent) and, where relevant, the transition timing of one of the CEOs.

For example, the new Oracle co-CEOs have divided their duties along specific service lines. According to the company's SEC filings, all manufacturing, finance and legal functions will continue to report to Ms. Safra Catz as CEO. All sales, service and vertical industry global business units will continue to report to Mr. Mark Hurd as CEO. (Both Ms. Catz and Mr. Hurd had previously been a President of Oracle). All software and hardware engineering functions will continue to report to Mr. Larry Ellison as Executive Chairman of the Board and Chief Technology Officer.⁶

Depending upon the desired level of detail, the understanding of the co-CEOs can extend across all of the traditionally accepted roles of the chief executive officer, e.g., responsibility for operating the enterprise; direction of strategic planning; risk identification/evaluation/management; annual operating plans and budgets; selection of senior management; establishing an effective organizational structure; and financial reporting and disclosures.⁷

Where appropriate, it can also address the "tie-breaking process," e.g., whether there is some formal or informal process by which the co-CEOs can resolve disputes in connection with areas of shared responsibility (or whether one co-CEO is empowered to make the final decision). There is also value in confirming the obligation of each co-CEO to share with the other any information or analysis known to one of them that is relevant to the decisionmaking and oversight obligations of the executive office.

⁶ Oracle Corporation Form S-K Filed Sept. 18, 2014, <http://www.sec.gov/Archives/edgar/data/1341439/000119312514350215/d793532d8k.htm>.

⁷ BUS. ROUNDTABLE, *2012 Principles of Corporate Governance*, available at <http://businessroundtable.org/resources/business-roundtable-principles-of-corporate-governance-2012>.

Sometimes, this understanding is reflected in a basic “handshake agreement” between the two CEOs. In other situations, it is memorialized in some detail in new employment agreements for the parties. It might also be contained in any applicable definitive merger agreement, where applicable.

2. Reporting Relationships

There is also value in reaching an agreement between the co-CEOs with respect to reporting relationships—both from the co-CEOs to the board, and from the members of the senior leadership team to the co-CEOs. Should the co-CEOs always jointly report to the board or do they divide reporting relationships based on an articulation of duties? Should guidelines be adopted on whether and, if so how, one co-CEO can independently initiate board level communication? What steps can be taken to avoid a “this month, let’s just let the board hear from me” approach?

Similar issues arise in the context of management team reporting. There may be benefit to a discussion, if not a written articulation, of the upstream reporting obligations of members of the senior management team. Is the expectation that all senior executives report to both co-CEOs? Do senior executives report to the office of co-CEO based upon the specific allocation of authority between the co-CEOs? Who is responsible for the evaluation and compensation recommendations applicable to the members of senior management?

3. Executive Compensation

Oftentimes, determination of appropriate compensation arrangements will be key to the successful implementation of a co-CEO arrangement. This determination should be conducted early in the process to assure reasonableness and to address issues of expectation management by the proposed co-CEOs. There should be no assumption that current base levels of compensation must increase simply because of the responsibilities with respect to a much larger enterprise. The compensation arrangement may need to include incentive compensation with targets based in part on the assumption the co-CEOs will work collaboratively and in good faith, without discord.

A related issue is whether the retirement benefits packages of either of the co-CEOs may need to be revised to accommodate the new relationship and related transition timing. In addition, any transition-based consulting agreement for a former co-CEO should be carefully drafted to assure reasonable and necessary services are being provided for an appropriate duration and for a reasonable level of compensation.

Pursuing a formal approach to compensation decisions (e.g., through the board’s executive compensation committee or similar body) makes sense even if the

overall co-CEO arrangement is more informal in nature. For tax-exempt organizations, the new arrangements should be structured to satisfy the rebuttable presumption of reasonableness. That notwithstanding, identifying comparability data will be challenging due to the novel nature of the concept.

More complex issues regarding negotiation, timing, approval and implementation of co-CEO compensation arrangements arise when the concept is being implemented as part of a merger.

The resolution of several of these operational, reporting and compensation issues may change if one of the co-CEOs is already designated to be the sole CEO after a specified co-CEO period. The presence of such an agreement would, or could, change the answer to many of the questions, particularly on breaking deadlocks, reporting to the board and the types of responsibilities each co-CEO undertakes.

4. Board Oversight

Critical to the success of a co-CEO arrangement—whether based on formal or informal understandings—is effective board oversight. The board chair (or co-chairs, as the case may be in a merger) should be tasked with the responsibility of establishing a process for board oversight of the arrangement. This might include, among other elements, a process by which the co-CEOs periodically communicate with the chair(s), guidelines by which the board can evaluate the ongoing success of the co-CEO arrangement, dealing with the death, disability or termination of one of the co-CEOs, and a process by which disputes between the co-CEOs can be resolved. It may address the need to “unwind” the co-CEO arrangement in circumstances of deadlock. Another board-level decision may relate to how the co-CEO relationship affects the protocol for who serves as principal public corporate spokesperson.

Summary

While still novel, co-CEO arrangements are emerging across industry sectors. They are being considered as a means of addressing several types of legitimate senior executive and corporate strategy needs. Some are established through informal agreements, and others are established through detailed written agreements. In any event, the establishment of a co-CEO arrangement implicates a number of unique legal, tax, human resources/compensation, governance and interpersonal considerations. Yet, there is no established template or “best practice” for their creation. For those reasons, the development of co-CEO arrangements will benefit from the close input of the general counsel.