wealth tied up in company stock that the director might become too risk adverse. Although this situation is unlikely to occur for CEOs of other companies, it may well occur for persons from nonprofit institutions, such as foundations or universities. This problem could be alleviated by capping the amount of company stock required to be owned. After reaching this cap a director would receive all of his or her compensation in cash instead of stock. Alternatively, the director could obtain special approval to own less stock.

Third, some directors may require director's fees for current income. But a director who owns few shares and who depends on director's compensation for current income would clearly have important personal financial goals that in some cases would conflict with the goals of shareholders.

Conclusion

In conclusion, I believe that a coherent program to improve corporate governance should include a change in director compensation packages so that 50 percent of total director compensation is paid in restricted stock. This program could apply to any directors selected in the future and, to ease adjustment problems, could be phased in over a few years for existing directors. The required amount of stock could be capped when the value of the shares equalled perhaps ten times the director's total compensation.

True, no single change will be a panacea, but increasing substantially the ownership of stock by directors should improve corporate governance by providing additional incentives for directors to overcome the inertia that sometimes prevents them from making tough decisions. ▶

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Drexel's Chapter 11 Proceedings: A Case History of Dynamic Governance

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Directors can learn valuable lessons from "the world's most notorious bankruptcy."

The bankruptcy of Drexel Burnham Lambert provides a case history in the awesome power of corporate governance and in the value of individual corporate directors. Over the course of years of involvement in Drexel's bankruptcy I have come to have enormous respect for corporate directors. Despite all the controversy about what boards do and do not do, who should be on them, and how they should operate, it is nevertheless still the case that the board of directors is the place where the buck stops. I am proud to be a member of an association of other people asked to make so many important and lonely decisions.

In this brief article I cannot really give you any sort of authoritative insight into the Drexel bankruptcy proceeding, but I can try to give you some of the flavor. I am speaking strictly from my own personal experience as a human being. I am not a bankruptcy authority, I am not an attorney. I am not really even an expert on Drexel, although I have been an employee of the company and a member of the Drexel board. I am just a normal ordinary person who felt strongly about a particular subject and took some action.

Three Questions

In this article I will tell you what I did, answering three questions.

First, what's a nice girl like her doing in a place like that—the world's most notorious bankruptcy? Second, what does any board do in a Chapter 11 proceeding, and what did this board do? And finally, what's going on with Drexel?

Nice People

Drexel at its peak employed over 10,000 people, of whom the very great majority were unambiguously uninvolved in anything that might ever look like insider trading or other alleged Drexel sins. They did keep coming to work and they did continue to own their shares. The only way to sell stock was to die or leave the company. There was no market in the stock; employees were given the opportunity to buy it every year since the firm's incorporation in the early 1970s.

I was one of those employees at the time of Drexel's bankruptcy filing. I was an investment banker in the mortgage finance area, the high-grade side of the business (not the low-grade, high-yield bond side). I had been there for about six years and had been spending 1989 forming my business plan for Solon Asset Management, an investment management firm my husband and I started. I was planning to leave; but I had been asked to stay for the first quarter of 1990 in exchange for help getting my firm started.

As an employee, I was one of the owners of Drexel. Although Group Bruxelles Lambert, a Belgian operation, owned around 25 percent of the firm, the balance of the shares were held not strictly by the principals, but directly or indirectly by the entire employee population. For the most part, the big money

When we heard the news, we stopped dead in absolute shock. Chaos followed, but so did an extraordinary discipline.

that was taken out of the firm was not proportionately put back into the firm in the form of stock investment, so the typical Drexel shareholder was someone from the systems department, 58 years old—a 35-year employee who hadn't looked for a job for a long time, and who suddenly found himself in a position where he did not have much time to find another job and rebuild his retirement savings.

As the decade of the 1990s began, we employees were totally unprepared for what was to happen at Drexel. To be sure, there had been problems with the Securities and Exchange Commission—settled in 1988—but nothing prepared us for February 13, 1990, when Drexel filed for bankruptcy that day.

I was sitting on the trading floor with 600 or so others. When we heard the news, we stopped dead in absolute shock. Chaos followed, but so did an extraordinary discipline. A $40 billion balance sheet had to be liquidated, commencing immediately. There was an enormous amount of work going on. There was also a fierce rage among people who had continued to fight for a company under a cloud, spending their own personal credibility every day to keep their customers from taking business away in a very competitive environment. That rage was the flip side of the employees' love for the company. There was a lot of pain, complicated pain, at the apparent betrayal by a management whose words they had believed.

My plans all set for leaving, I did not have a position to liquidate. I was trying to help, so I started collecting names and addresses, figuring that everyone was going to be terminated rapidly and cast to the winds. The list rapidly grew to include hundreds of people and became the inspiration for the actions I later took.

I started doing research on shareholder rights in bankruptcy and learned about equity committees. With the help of some top-notch bankruptcy attorneys who are now principals in the law firm of Marcus, Montgomery, Wolfson & Burten, I found that employee shareholders did have some say in bankruptcy proceedings. In fact, when there is significant net worth (Drexel had $800 million in net worth at the time of the filing) and a wide number of shareholders (there were about 5,000 employees/beneficial shareholders by this time) it was not uncommon for the trustee in the bankruptcy court to appoint equity committees. However, the trustee in this case, Terry Jones, would not do that deliberately without being asked. He had to be lobbied, because nobody but shareholders wants an equity committee. It adds a layer of expense and increases potential for litigation, so it is not something that happens automatically.

Having explored these issues, I resolved to explain it all to somebody else and go off and start my business. My husband disagreed. "There is no way you can do that," he said. "We'll put our business aside. You've got to get this ball rolling, because somebody has to do it. The shareholders have been ignored in this company for much too long. This is a matter of an important principle."

A Committee Forms

So in I went to organize the equity committee, thinking that I could get a lot of people involved and duck out. Working to rally the group, I found that numbers of people said "You are the perfect person to do this. Go talk to so-and-so." After I had made enough noise about this I was committed. I had to keep going. I could not stop. The effort could not fail. So, I spent days, it seemed, traveling up and down the elevator banks, going to copy machines that kept running out of paper as supplies were disrupted. I was going from floor to floor asking people, "Are you a shareholder? Are you a shareholder? Are you a shareholder?" The upshot was that I got several hundred shareholders to come to a meeting held at the New York Society of Securities Analysts about a week after the filing. We agreed to form an unofficial equity committee to petition the trustee for official status. I was elected chairman of that group and became the center of an extraordinary flurry of paper from shareholder-employees located around the world as we worked to get official standing.

The trustee did grant that status on April 12, 1990. And much to my amazement, because my own shareholdings were very small, I was appointed to that committee and elected chairman. (Usually these committees emphasize the people with the largest stakes, figuring that since these are unpaid roles, those people would be most motivated to continue to work diligently on the cause.) All in all, nine people were appointed: eight of the 100 largest shareholders and me.

Voice of Reason

Why was I doing this? At the time I could not possibly have told you. It was clearly something that had to be done; I had the capacity to do it. It therefore became something that I had to do. I vowed to be a voice of reason. I had been there for six years. My shareholdings were not an enormous part of my net worth. I was relatively young; my future was still in front of me. I was not emotionally disabled by this bankruptcy, so I was able to proceed in a tone of reasonableness when my colleagues were angrily suing each other. I was expected to be and wanted to be reasonable. I did not want to seek vengeance anywhere, and I wanted everybody to get out of this situation with as much moral dignity and financial recovery possible.

Despite my small stake, I knew I had to play to win. I had to forget any other issue I thought I was going to be spending my time on during that period of time and work on this full time and with full dignity.

The dignity issue was an important one, because there was an enormous level of vitriol in the early days of the Drexel bankruptcy.

There were constant movements to replace management with a trustee. There were constant quarrels and recriminations over decisions made. Re-

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member, there was still a basic, continuing, operating business going on.

Most of the outstandings were still being brought down and everybody was arguing about whether this or that decision to sell was right, whether the market would be better next week; how to sell ; who should sell; who should buy; who should not be able to buy, etc. There was role reversal as subordinates blamed superiors. Creditors and others were bitter and embarrassed to be found in this situation. The emotional quality of the "arguments, too, was intense. Many, many complex technical and legal issues were being hammered at under high degree of scrutiny. This was, after all, Drexel. Litigation was constantly in the offing.

Fortunately, between indemnification on the one hand (namely charter protection under Delaware law and corporate bylaw protection enacted to reinforce it) and D&O insurance on the other, we had some measure of protection.

The Work of the Committee

But liability was not foremost in our minds. We had work to do. The equity committee was the most junior of the four committees ultimately appointed. There was a creditors committee for the parent, a creditors committee for the operating company/broker dealer, and a creditors committee for the commodities trading unit. Several other oversight committees were formed later to represent the creditor litigants and various other classes of claimants. Appointed by the bankruptcy court, they could appoint their own advisors—bring suit on behalf of the parties they represented. Their expenses were paid by the estate.

So there I was, having formed this committee, trying to figure out how I was going to influence the case as the junior-most class of creditor yet the one with the best understanding, perhaps, of what Drexel was and might have available as sources of value. By then the balance sheet had been brought down to about $3 billion in assets, mostly illiquid, with high intrinsic value that was currently unrealizable. In addition, there were a couple billion dollars in liabilities, plus enormous contingencies pro and con—not to mention large amounts of prospective litigation. Corporate memory was critical to maximizing returns and minimizing liabilities.

Role of the Board

The equity committee began immediately to look at the role of the board. This was at the time a predominantly inside board, with six management members and three outsiders who had been appointed as part of the Securities and Exchange Commission consent decree. Management's dominance of the board was clear.

All the members of the equity committee were very interested in restructuring that board. We had a difficult task before us. The notion of independent boards might have been sweeping the rest of the country, but it certainly was a novel concept within Drexel.

Fortunately, between indemnification on the one hand, and D&O insurance on the other, we had some measure of protection.

I spent about six weeks in dialogue with management on this subject. In their view, my proposal was completely impossible. No one would be interested in walking into as volatile a situation as this was, they said; no outsider could ever understand the complexity of what was Drexel at that time. Although I had tremendous sympathy with those managers, I strongly disagreed. I felt that the only chance for any kind of arms-length resolution of the process would involve new independent directors—people of standing who could bring some credibility to the carrying out of the complex fiduciary obligations that the board then faced.

We went on talking about how to do this, when to do that, and so forth, for quite some time. Finally, we got down to identifying criteria. We determined that we needed people who had operating company backgrounds that could complement our prevailing investment banking culture, because many of the assets that the company owned were substantial interests in operating companies. Working constantly to convince a dubious management, we proceeded to identify a small group of candidates acceptable to all. Then I started calling people. I could almost hear the betting going on: will she or won't she get this done? I had the sense that long odds were offered on my success.

Director Recruitment

So now it was time to recruit those outside directors. First, I called and got a wonderful man of some stature on the telephone. I explained to him what I wanted and he said, "I'm sorry, I have retired. I don't want any kind of contention like that. I thank you for thinking of me. Good-bye." For some reason I held the phone to my ear an instant longer and I heard him saying to someone in the background "You wouldn't *believe* what this woman just asked me to do!"

The next call, fortunately, was to someone of a different cast of mind. He was also retired, but intrigued, even though the job would involve leaving Arizona to come to New York a few days a week. He said "I'll talk with my wife, in case she thinks that I really did retire." So I called him back a little bit later and he said, "I talked to my wife. After 45 years she's continuing to rise to occasions. She says if I want to do this that's fine. This was by the way, Fletcher Byrom, former chief executive of Koppers Company who had retired in 1982. We regarded enticing him into this struggle as a major coup, and he proved to be a very significant asset to the proceedings.

I then let the other shoe drop. "You have never seen me and you haven't thought about the Drexel case very much, but this is Thursday. There is major litigation scheduled to commence next Thursday, a week from today. Is there any chance you could get on a plane and come to New York on Sunday for dinner with management so we could install you on the board on Monday?" He said, "Fine, I'll make reservations right now."

He arrived none too soon. The meeting got pushed back a couple of days to

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a Wednesday and on July 18, 1990 we rearranged the board. Four people resigned, and three new people went on. I was among the new directors because of management's concern that an all-outside board lacking historical company perspective would have no basis for interpretation of what was happening. Management chose me because I fit its bill: it was hard to find a direct shareholder who had not been conspicuously well compensated, was not part of the partnerships, did not now work for any other securities firm or commercial bank, and would have the interests of the shareholders in mind. Knowledge of the case to date and a willingness to work were also important considerations. We got down to a tiny list of candidates. So there I was.

We restructured the board and created traditional kinds of committees that had not been really observed within the Drexel environment before. We created an executive committee; we created an audit committee and a committee on personnel called the "compensation, nomination, succession planning and employee benefits committee," which I chaired.

So the board at this point consisted of seven members. The internal people were Fred Joseph, the former chief executive, John Sorte, the new chief executive, and Dick Wright, the chief financial officer. As for outsiders, former SEC Chairman John Shad had been there under the SEC consent decree as chairman, he resigned and Ralph Saul, former chairman of CIGNA Corporation replaced him. The three other new members were Fletch Byrom, Fred Zuckerman, then Treasurer of Chrysler Corp. and later treasurer of RJR Nabisco. I was a member of the executive committee, the audit committee, the committee on personnel and the administrative committee which oversaw the termination and liquidation of the employee benefit plans, a very complicated process.

The entire process was extremely time-consuming, as my fellow directors and I soon learned.

It takes a lot of time to be a director in a Chapter 11 situation. I lost count when I got to 150 meetings of the board and its committees in the first year after taking my seat on the board on July 18, 1990. That included 75 board meetings and about 75 committee meetings. It was an extremely intense process, encapsulating what would normally be decades of board experience.

The SEC-appointed directors were paid at a flat rate of $190,000 a year, which sounds like an enormous amount for a normal directorship, but this was not one of those. In the early days of the bankruptcy, when every director was there every day, that was not looking like handsome compensation. What we worked out as a compromise for the new directors coming on was that all of the nonmanagement board members would be compensated the same way, with the exception of the chairman, and we structured an agreement for him that was intended to match other bankruptcies.

A Vote for Reorganization

The equity committee was the earliest of the committees to come to the conclusion that a reorganization would be a sensible alternative. We had several reasons for that. One of them was simply a matter of economic conditions: the assets Drexel held were sufficiently distressed that recoveries would be radically reduced if they were sold out immediately in a fire sale. If we could buy time through a reorganization, recoveries for all parties might be substantially increased. The classic bankruptcy process is too expensive to provide that environment, with professional fees running about $100 million a year, so it would not have taken very long to completely dissipate the remaining assets of the estate in that kind of framework. That was the kind of economic concept underlying the notion of some kind of reorganization.

In addition, there was the issue of a potential net operating loss. This significant asset of the estate which would not be realized or used in the case of total liquidation. Finally there was the issue of the discharge. If a company can get a plan of reorganization adopted by all the parties and interests and approved by the judge, then he or she will grant a discharge from bankruptcy. This then reduces one's legal exposure. This certainly had some value in this particular case. All these factors came together to make reorganization something that all parties were interested in discussing.

The question then became how and what to reorganize, and who would do it. That is what we spent most of our time working on with the various committees, with extraordinary legal counsel on all sides.

The disclosure statement, the bankruptcy equivalent of an offering circular, became the basis for discussion with all the parties in interest about whether they would accept the plan. The disclosure statement, which looked like a telephone directory, correctly anticipated that there would be a liquidating trust established as the umbrella organization that would basically be responsible for the assets in their entirety. The plan was approved as drafted, and is a reality today.

Decisions

Our committee had to make many decisions. For me, it was difficult to make decisions and leave them, yet I had to. I was trying to get my company started at the same time as I was doing all of this, and I had to learn do make decisions and then let them go. I also learned that I was certainly never going to be able to make all of these people happy. All I could do was measure myself as a professional and more importantly as a human being.

If I was comfortable at midnight over something I had done at noon, that had to be my test. I had to be able to explain it to myself, and to my children. I had to understand on an intuitive level. I had to

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be willing to continue to ask every possible question until those terrible bankruptcy lawyers would explain to me what they actually meant. Experience with bankruptcy lawyers is like experience with no other lawyers. They are wonderful and they are terrible; they are magicians and manipulators.

First Principles

I think it is important to go back to first principles for the deepest understanding of the Drexel drama. It taught me that people make an extraordinary difference even in the most technically complex kind of environment. To be motivated by a principle is to assume a very complicated role, but it is nevertheless quite possible to make a difference. It was a privilege to serve with my fellow board members at Drexel.

This board was not the result of a management-directed board restructuring, although if management had expressed a major reservation about any individual, of course we would have considered it. Out of the Drexel fire came an extraordinary working group in which the standards of care were very high. There was an enormous amount of paper to read and digest, an enormous number of meetings to attend, and very little in terms of economic incentives for the independent board members, without whom it is highly unlikely that the reorganization could have occurred.

In a time when the role of boards of directors is receiving a high degree of scrutiny, this group provides a shining example of the value of independence, persistence, and staying power in a volatile situation. The group was able to restore the tattered credibility of the debtor and then had the courage to make some agonizingly difficult decisions, often unpopular with the varied parties in interest, for the benefit of the estate.

While I come away quite skeptical about a number of individual parts of the bankruptcy process, on the whole, I think that the process has worked quite well. The weight of the obligation one assumes when shepherding other people's money is important to remember and has too easily been forgotten.

New Street

Remarkably, confirmation of the plan and consummation of the reorganization occurred on schedule on April 27, 1992. Drexel the corporate entity ceased to exist; its successor organization, New Street Capital Corporation, was born, and the DBL Liquidating Trust created. As planned, shareholders received DBIs in the trust, which owns New Street, and were also the only recipients of New Street warrants. The nominal value of their recovery at the time was $35.3 million, or 5 percent of the total estimated recovery. This amount, however insignificant it may have seemed to the beleaguered shareholders at the time, was truly incredible in the face of a stated shareholders deficit in April 1992 of over $700 million and competing claims of over $30 billion. Actual recoveries as of August 1, 1993 are both much higher and much faster than even the most sanguine claimant imagined. More than $30 billion in claims have been recovered, and Drexel emerged from bankruptcy in two years—record time. The trust anticipates full repayment of all claims by the end of 1993.

How did the shareholders fare so well? Most importantly, they secured a seat at the negotiating table through the formation of the equity committee. They also had unusually talented legal advisers who presented the shareholders' essential position in a compelling way. Their putative "equity," said an adviser, was not truly equity. The attorneys pointed to the way we, the employees had bought it, and to the extremely limited disclosure management made of critical factors, including the existence of Drexel's now-infamous investment partnerships and the seriousness of the government's investigations. In effect, shareholders were therefore not shareholders but participants in a profit-sharing plan; really a compensation plan. In fact, in many respects, it fell under the purview of the Employee Retirement Income Security Act of 1974 (ERISA).

Lessons

The Drexel drama contains a number of clear lessons.

- It showed that a securities firm, a service business with no fixed assets, has the potential to reorganize.
- Drexel's demise was, according to one's point of view, necessary and inevitable or tragic and forced; an act of God or of the devil.
- It showed that important new law is made every day. The Drexel case established a number of legal precedents, especially with respect to ERISA.
- It proved the value of an independent board of directors in an extremely contentious situation; and
- It showed that in the end, justice—not merely legalistic power—can prevail. The equity committee significantly influenced the outcome, despite its weak position in the hierarchy of claims.

The most valuable lessons, though, will come from a study of Drexel's ambiguities. The firm's surge to prominence early in the '80s was made possible by ambiguities in market valuations and in securities laws. Its nine lives in the face of relentless investigation and innuendo reflected the employees' conviction that the company was being punished for being a brash and successful upstart. On the other hand, the regulators and investigators thought they saw a rogue elephant that needed to be stopped. Drexel's demise was, according to one's point of view, necessary and inevitable or tragic and forced; an act of God or of the devil.

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Epilogue

What has become of me? My husband and I did manage to start our firm, Solon Asset Management which we sold, last summer to Montgomery Asset Management, an independent affiliate of Montgomery Securities, based in San Francisco. I am now building the Montgomery Funds, a family of no-load mutual funds. We are working hard to deliver performance, service, and information to shareholders. I am amazed everyday to find how vigilant our shareholders are.

If I had to choose one single message to carry forward from my Drexel experience, it is that shareholders must recognize both the rights and the responsibilities of ownership. They have an obligation to keep themselves informed about the activities of the companies in which they invest. The most important way they can do this is to select independent board members who truly recognize their obligation not only to company management but, surpassingly, to company owners.

Had Drexel formed a truly independent board at the time of the settlement with the SEC in 1988 instead of adding a minority of independent directors and only then at the behest of the SEC, the fate of the company might have been very different. ▶

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Major Constituency Management: A Director's "Crystal Ball"

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Every director knows the importance of constituencies— but what to do about it? Here are some helpful blueprints for action.

As the spotlight shines ever brighter on the responsibilities of our nation's corporate board members, just the thought of having the ability to look ahead at your company's future performance sounds more like a specially designed fantasy ride at Disney's Epcot Center than an experience any of us could realistically comprehend. Imagine how the pressures of serving as a director could be alleviated if we knew of our decisions as director would bring about corporate results pleasing to all major constituencies—customers, shareholders, and employees alike.

While a crystal ball monitoring system has not yet been produced in finished form, there are tools today that both inside and outside directors can and should use to monitor their company's current operations and foundation for success in the future. One of those tools is major constituency management. Simply put, major constituency management is the *science* of measuring and analyzing a company's key stakeholders to determine an organization's foundation for success and the *art* of using constituency data to develop strategies to enhance performance and company value.

In the major constituency management concept, key stakeholders are the major constituencies: customers, employees, and shareholders. Some corporations use a fourth major constituency labeled either society, environment, or community. Others go so far as to add suppliers and creditors. While only the three most common stakeholders will be addressed in this article, it is easy to add target constituencies to customize the methodology offered here by adding target constituencies.

Major constituency management is an outgrowth of the corporate culture influence of the late '70s and early '80s. Its basic business principles are nothing new. The concept is establishing itself as an effective management and board tool due to the simplicity of its structure and its ability to provide clear direction. It is particularly valuable to directors who do not have a comprehensive grasp of their company's business and financial operations, but wish to more actively participate in the board's monitoring activities.

Customers

The first constituency that must be monitored is the customer segment. This segment is probably the most widely used segment of the major constituency management concept today, although I'm sure there are many companies whose directors are unaware of their customers' perceptions of their organization. Almost all businesses conduct research on their customers' attitudes and beliefs relating to the company, its products, and its services. This data is then used in the corporate plan to formulate a situational analysis that covers changing customer opinions and what those trends can mean to the company's future, and assist in developing key strategies.

Figure 1 depicts the important customer determinants and service satisfaction for a commercial bank.