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Close Ties Bind CEOs, Boards of Troubled TARP Companies

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The Obama administration's plan to replace a majority of the General Motors board casts a light on boards of other companies that have accepted bailout money, and there is at least one similarity at GM (GM), American International Group (AIG), Citigroup (C) and others that have so veered into financial straits.

Troubled Asset Relief Program, or TARP, recipient companies were much more likely than the average company to have had independent directors on the board with social or professional ties to the CEO.

Independent directors aren't employed at the company, and shareholders rely on them to speak up if they see it heading for disaster. New research finds that many of those independent directors have connections to the CEO, including memberships at the same country clubs, attendance at a college at the same time, or volunteerism with the same charitable or non-profit organizations.

For example, among all large, publicly traded banks, 14% of independent directors have social or professional ties to the CEO, similar to the 15% at all companies. But at banks that later accepted bailout money, 39% of independent directors had such ties.

The study by finance professor **Geoffrey Tate** and doctoral candidate **Cesare Fracassi** was done at UCLA Anderson School of Management. It examined 20,000 board members of 2,080 firms year by year from 1999 to 2007 to identify connections. It found that when connections increased, so did earnings restatements and the likelihood of mergers that hurt a company's performance.

At *USA TODAY*'s request, Tate re-examined his data to focus on the smaller universe of 24 publicly traded companies that later accepted TARP money.

Tate says 30% of the independent directors at GM had ties to now-former CEO Rick Wagoner, who was forced out on Monday. GM is the only publicly traded auto company to have accepted government bailout funds. Throughout the auto industry, just 2% of independent directors have social and professional connections with the CEO, Tate says.

In 2006, independent directors included John Bryan, who was chairman of Catalyst, where Wagoner was also a director, as was GM independent director Karen Katen. Independent director Eckhard Pfeiffer and Wagoner were both council members of the Business Council.

"Membership in groups like the Business Council, an association of chief executive officers of major companies, and Catalyst, a group that works to promote the interests of women in business, is vital for keeping our board members informed and engaged with the broader issues of our time," GM's Julie Gibson says. If more than one GM board member "is involved with such worthwhile organizations, we don't consider it a problem to be addressed, but rather a very positive practice."

Bryan, the former CEO of Sara Lee who is on the GM board, says something as minor as a Catalyst directorship with Wagoner would not create a lack of independence in fulfilling his board duties at GM.

"I suppose (relationships) create a lack of independence, but it's understood that board members have a high responsibility to the shareholder, and I have not seen any evidence of people making judgments otherwise," Bryan says.

No company has sparked more public ire of late than AIG, and Tate said he was surprised to find that there were zero ties in 2006 between the company's independent directors and Martin Sullivan, who was AIG's CEO from 2005 to 2008. The insurance industry as a whole had 20% of independent directors with such ties.

But the board that served when Sullivan was CEO had been formed in 2004 when Hank Greenberg was CEO. With Greenberg in charge, two-thirds of independent directors had ties to him. AIG spokeswoman Christina Pretto declined to comment.

When former Citigroup CEO Sandy Weill was building a financial supermarket through acquisitions more than five years ago, he had ties to eight independent directors. "Citigroup's extensive list of connections is far above the norm," Tate says.

Citi spokeswoman Shannon Bell says six of the independent directors at the time are gone. Citi Chairman Richard Parsons has said the board will be reconstituted. Of the 15 current board members, three won't stand for election at the April annual meeting, and two others will retire.