



CENTER FOR CAPITAL MARKETS
C O M P E T I T I V E N E S S

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January 19, 2010

Ms. Elizabeth Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Facilitating Shareholder Director Nominations
Release Nos. 33-9086; 34-61161; IC 29069
File No. S7-10-09

Dear Ms. Murphy:

The U.S. Chamber of Commerce is the world's largest business federation, representing more than three million businesses and organizations of every size, sector, and region. The Chamber created the Center for Capital Markets Competitiveness (the "CMCC") to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy. To achieve this objective, it is an important priority of the CMCC to advance an effective and transparent corporate governance structure. Accordingly, the CMCC is pleased to provide further comment on the amendments to the proxy rules under the Securities Exchange Act of 1934 (the "Exchange Act") proposed by the Securities and Exchange Commission (the "SEC") on June 10, 2009, in the release entitled "Facilitating Shareholder Director Nominations" (the "Proposal"), as supplemented by the SEC's request for further comment on December 14, 2009, in a similarly entitled release.

The CCMC filed its initial comment letter on this proposal on August 14, 2009, (the "August letter") and is pleased to be able to participate in this second round of comments.

As you know, the August letter expressed serious reservations regarding the Proposal and requested that it be withdrawn. The CCMC believes that, since then, the basis for our concerns have grown and have been further validated. Accordingly, the CCMC once again urges the SEC to withdraw the Proposal.

The CCMC continues to believe that the Proposal is unwise, unnecessary, and exceeds the SEC's statutory authority. As explained in detail in the August letter, this position is predicated on the following premises:

- the Proposal exceeds the SEC's authority under Section 14 of the Exchange Act;
- adopting the Proposal would be costly and disruptive to companies;
- adopting the Proposal will impair the functioning of boards of directors to the detriment of all shareholders;
- there has been no compelling or objective showing of need for the new rules; and
- the SEC has failed to address significant issues in the proxy process, including the ability of activist investors to "rent" the voting interests of a large number of shares.

Before addressing these concerns and the materials referenced in the December 14, 2009, release, the CCMC would like to enter into the record a report authored by Professor Brian R. Cheffins of the University of Cambridge, entitled, *Did Corporate Governance "Fail" During the 2008 Stock Market Meltdown? The Case of the S&P 500* ("the Cheffins report").¹ The Cheffins report concludes that in 2008, during the most severe financial crisis since the 1930's, the corporate governance systems of those companies that were most impacted by the crisis generally worked and did not contribute to the demise of those companies. Viewed differently, these companies were impacted by a financial crisis rather than a corporate governance crisis, and the case for dramatic governance reform has not been made. The CCMC believes that

¹ The study was authored by Brian R. Cheffins, S.J. Berwin Professor of Corporate Law, Faculty of Law, University of Cambridge. The article appeared in *The Business Lawyer*, vol, 65, November 2009.

the SEC should consider the implications of the Cheffins report as it continues its deliberations on the Proposal

Additionally, a number of issues exist concerning proxy voting systems. Adding additional stress to voting systems through proxy access, while the system attempts to cope with the repeal of the broker vote, is a recipe for disaster. This is particularly true when coupled with the SEC ignoring pressing issues such as the disenfranchisement of retail shareholders and renting of voting interests. This would hurt public companies and send shockwaves throughout an economy trying to recover from the worst economic crisis in 75 years. While the CCMC's concerns are listed in more detail below, we wish to reiterate that the SEC should withdraw this rulemaking.

I. The Business Roundtable Reports

The SEC has requested additional comment on the two reports submitted by the Business Roundtable: *Report on the effect of Proposed SEC Rule 14a-11 on Efficiency, Competitiveness and Capital Formation in Support of Comments by Business Roundtable* and *Why Did Some Banks Perform Better During the Credit Crisis? A Cross-Country Study Impact of Governance and Regulation* ("the Business Roundtable reports").

The CCMC believes that these reports present ample additional evidence that the Proposal is unworkable, will harm investors, undermine the management of companies, and erode shareholder value.

As these reports indicate, if the Proposal were to be adopted, it would result in less qualified boards of directors, potentially lead to "activist" board members whose goals could be inconsistent with the fundamental objectives of maximizing shareholder value, create a significant disincentive for companies to incorporate or operate in the United States, and impede capital formation. The negative ramifications of the Proposal would be felt throughout the economy, resulting in lower growth rates, less job creation and, ultimately, lower tax revenues.

Further, management will be distracted from their principal purpose and managerial time and focus will be diverted to the annual director election process, taking attention away from running the business. This possibility may lead to greater "short-termism" on the part of shareholders as they look for companies that are not

dealing with such distractions. Both of these possibilities will harm shareholders and corporations alike.

The CCMC also notes that greater shareholder involvement in the director selection process is not a safeguard against catastrophic market events and may leave companies and their boards of directors ill-equipped to effectively respond to sudden and potentially adverse developments. For example, it appears that financial institutions with shareholder-friendly boards did not fare as well as other financial institutions during the 2008 financial crisis. The CCMC believes that the assumptions underlying the premise that shareholder-comprised boards are more effective are dubious assumptions, and warrant further review and reconsideration. In this regard, the Cheffins report, as well as the final report of the Financial Crisis Inquiry Commission expected later this year,² should provide additional data which the SEC should consider.

Finally, it should be remembered that, as the utility of the corporate form becomes more problematic, alternative means of business and capital formation—sole proprietorships, partnerships, private equity, etc.—become more attractive. Similarly, this uncertainty enhances the attractiveness of other jurisdictions as a domicile, an ever-present concern in an increasingly global economy. As the disincentives to operating a public company in the United States continue to grow, the risk of businesses relocating to more hospitable locations or choosing an alternative business structure through which to operate also increase. Over the past decade there has been a trend of the number of public companies falling in the United States and the number of public companies rising in other jurisdictions. As has been repeatedly noted, this will reduce capital formation within the United States (ultimately preventing the economy from reaching its full growth potential or stimulating job creation) and limit opportunities for investors.

II. The Shareowners Education Network and Council of Institutional Investors Report

The report submitted by Shareowner Education Network and Council of Institutional Investors, *The Limits of Private Ordering: Restrictions on Shareholders' Ability to*

² The Financial Crisis Inquiry Commission (“FCIC”) was established by Congress to uncover the causes of the 2008 financial crisis and issue recommendations. The first hearings of the FCIC were held on January 13, 2010.
<http://www.fcic.gov/>

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Initiate Governance Changes and Distortions of the Shareholder Voting Process (the “CII report”) centers upon private ordering. Essentially, this report calls for a “one-size-fits-all” approach to shareholder access to the corporate proxy materials.

The CCMC believes that investors have benefited from the diversity of choice that the State corporate law system has created. Shareholders and directors can choose structures that work best for a particular company, while investors can base their investment decisions, among other things, on the type of corporate governance framework that they believe will lead to the largest return or satisfy their other investment objectives. As was discussed in the August letter, over the years this system has proven sufficiently flexible to allow for experimentation with and adoption of a variety of governance reforms. While these reforms may differ from jurisdiction to jurisdiction, they share one common feature—they were created through a robust shareholder-director dialogue without governmental mandates or incentives.

The CCMC further believes that the current State law system has led to reforms that, in the long-run, are likely to be more effective than any universal proxy access framework. As we noted in the August letter, Delaware has enacted a law that allows a company to include a provision in its bylaws that requires the company, under certain circumstances, to reimburse a stockholder for the expenses incurred in soliciting proxies in connection with the election of directors. The Delaware statute permits companies to fashion the terms and conditions of this bylaw within certain broad limits. The CCMC believes that this approach, which can be tailored to a company’s specific situation, as determined by management, the board of directors, and shareholder, will be more effective in responding to the underlying objective of board access than a universal proxy access framework that would force companies to accommodate numerous generalized requirements that may not work within their existing corporate governance systems and unfairly favors institutional investors over retail investors.

While a “one-size-fits-all” approach may have appeal to some, ultimately investors will have less choice, shareholders and directors will lose the ability to experiment and innovate. This will force corporate governance to operate through a centralized “command and control” approach rather than the organic process that has led to the most productive economy in world history. Such a system will harm shareholders and investors alike and lead to a smaller rate of return. It may be a truism, but shareholders hold the ultimate power in their dealings with a corporation-

the right to sell. This is a power that has received scant attention during the deliberations of the proposal.

III. The SEC Should Consider the Cheffins Report in its Deliberations

In its original release of the proposal, the SEC stated that “[i]n light of the current economic crisis and these continuing concerns, the Commission has determined to revisit whether and how the federal proxy rules may be impeding the ability of shareholders to hold boards accountable through the exercise of their fundamental right to nominate and elect members to company boards of directors.”³

As was noted earlier, the Cheffins report analyzed companies within the S&P 500 during 2008, with a special focus on those companies that experienced the most stress during the financial crisis.

The Cheffins report found that, during a time of severe financial stress, the governance systems of these companies worked relatively well—their boards of directors were very active in managing the company and dealing with the crisis. The report also notes that the United Kingdom, which has a more liberal shareholder access regime, experienced a steeper drop in shareholder value than in the United States. The report goes on to conclude that a case for governance reform has not been made.

The Cheffins report calls into question the SEC’s intent in revisiting these rules and again demonstrates the failure of the SEC to provide compelling reasons to federalize access to the company proxy, overturn 150 years of State corporate law, and endanger shareholder rights and board management. The costs of the proposed new requirements clearly outweigh the benefits and, as the Cheffins report suggests, the Proposal is a solution in search of a problem.

IV. Impact of Potential Financial Regulatory Reform Legislation Upon the Resources Needed to Monitor and Regulate Corporate Elections

Since the end of the Proposal’s initial comment period, various legislative proposals that would reform corporate governance practices have been debated by

³ Federal Register, Volume 74, No. 116, Thursday, June 18, 2009, Proposed Rules at 29025.

the House of Representatives and the Senate as part of their ongoing examination of the financial services regulatory system. While the House of Representatives has passed H.R. 4173 the “Wall Street Reform and Consumer Protection Act of 2009,” the Senate has only begun deliberations and the process is expected to go on for some time.⁴ The House bill contains more than 20 new mandates for the SEC that will require substantial increases in staff, expertise, and resources. It is unclear how any Senate bill or final bill will impact the duties and resources of the SEC.

Nevertheless, it is appropriate for the Proposal to be considered in the context of these legislative considerations. If the Proposal were to be adopted, the SEC would be responsible for monitoring and regulating proxy access for nearly 15,000 public companies in the United States. The CCMC is concerned that the SEC currently does not have the resources or experience to undertake this responsibility. Consequently, its proxy access duties will have to compete for resources with the inevitable new responsibilities imposed on the SEC as part of the restructuring of our financial regulatory system.

This competition for resources and knowledge will have an adverse impact on corporate elections at a time when any new access requirements are just being implemented; further harming the rights of investors. In short, the SEC will be taking on too much too quickly and shareholders and the economy will suffer as a result.

V. Conclusion

The CCMC appreciates the opportunity to provide additional comment to the SEC on the Proposal and would be pleased to discuss any questions the SEC may have with respect to this letter. Based on the forgoing, it is the conclusion of the CCMC that the SEC has failed to demonstrate a compelling need for this rule-making or how capital markets will be made more efficient by its adoption. Indeed, the CCMC believes that the reports identified by the SEC, as well as the Cheffins report, provide strong evidence to support this view. If the Proposal were to be adopted, it will undoubtedly result in unintended consequences that would harm corporate governance practices, shareholder value, and future economic and job growth in the United States.

⁴ The House Bill, H.R. 4173, the Wall Street Reform and Consumer Protection Act was passed in December, 2009

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Accordingly, the CCMC again respectfully requests that the SEC withdraw the Proposal and engage in other projects that will assist the safety and soundness of the capital markets in these trying times.

Sincerely,

A handwritten signature in black ink that reads "David Hirschmann". The signature is written in a cursive, slightly slanted style.

David Hirschmann

Did Corporate Governance “Fail” During the 2008 Stock Market Meltdown?

The Case of the S&P 500

By Brian R. Cheffins* | [Author Bio](#)

In 2008, share prices on U.S. stock markets fell further than they had during any one year since the 1930s. Does this mean corporate governance “failed?” This Article argues generally “no,” based on a study of a sample of companies at “ground zero” of the stock market meltdown, namely the thirty-seven firms removed from the iconic S&P 500 index during 2008. The study, based primarily on searches of the Factiva news database, reveals that institutional shareholders were largely mute as share prices fell and that boardroom practices and executive pay policies at various financial firms were problematic. On the other hand, there apparently were no Enron-style frauds, there was little criticism of the corporate governance of companies that were not under severe financial stress, and directors of troubled firms were far from passive, as they orchestrated CEO turnover at a rate far exceeding the norm in public companies. Given that corporate governance functioned tolerably well in companies removed from the S&P 500 and that a combination of regulation and market forces will likely prompt financial firms to scale back the free-wheeling business activities that arguably helped to precipitate the stock market meltdown, the case is not yet made for fundamental reform of current corporate governance arrangements.

INTRODUCTION

In 2008, corporate America experienced financial turmoil surpassing anything encountered since the Great Depression. Stock prices dropped further than they had in a single year since the 1930s. Venerable, blue chip Wall Street investment banks were sold at distress prices (e.g., Bear Stearns), ended up bankrupt (Lehman Brothers), or felt compelled to transform themselves into commercial banks (Goldman Sachs, J.P. Morgan Chase). While the commercial banking sector had to be propped up by governmental rescue schemes, industry leaders such as Washington Mutual and Wachovia disappeared nonetheless.

* S.J. Berwin Professor of Corporate Law, Faculty of Law, University of Cambridge; ECGI Fellow. The author thanks Mathias Siems and Lawrence Hamermesh (the reviewer) for helpful comments.

A striking aspect of the stock market meltdown of 2008 is that it occurred despite the strengthening of U.S. corporate governance over the past few decades and a re-orientation toward the promotion of shareholder value. As the twentieth century drew to a close, growing institutionalization of share ownership fostered a shift to price-oriented investors, less passive in the conduct of corporate affairs than the typical individual stockholder. Boardrooms became dominated by independent directors not obviously susceptible to “capture” by corporate insiders. Executive pay became much more incentive-driven, implying that managers who delivered good results for shareholders profited handsomely. Corporate scandals that came to light at the beginning of the 2000s demonstrated weaknesses in managerial accountability, but a prompt legislative response in the form of the Sarbanes-Oxley Act of 2002 sought to fortify the existing corporate governance model.

Share prices rose smartly during the mid-2000s, implying all was well. Then came 2008, when shareholder value took a massive hit. Many are convinced the stock market meltdown proved current corporate governance arrangements are not fit for their purpose. “*Boards Fail—Again*,” a 2008 piece in *Business Week*, claimed that “board failures represent . . . a signal failure of the broad [corporate] governance movement that gained momentum at the beginning of this decade.”¹ The head of corporate governance at the California Public Employees’ Retirement System (“CalPERS”), a major public pension fund, concurred in a 2009 op-ed, saying “the governance deficit . . . undoubtedly exacerbated the scale and depth of the financial crisis” and “[t]he financial crisis exposed many boards as weak and incompetent.”² A 2009 report by the Organisation for Economic Co-operation and Development (“OECD”) concluded “that the financial crisis can be to an important extent attributed to failures and weaknesses in corporate governance arrangements.”³ Similarly, the Shareholder Bill of Rights Act of 2009, introduced to the Senate by Charles Schumer and Maria Cantwell in May 2009, contains a clause deeming Congress to have found “among the central causes of the financial and economic crises that the United States faces today has been a widespread failure of corporate governance.”⁴

This Article assesses whether corporate governance in fact “failed” during the stock market turmoil of 2008. The methodology used is a detailed examination of corporate governance practices in the thirty-seven companies that were removed from the iconic S&P 500 index of publicly traded companies during this traumatic year. The S&P 500 index is an apt departure point because the companies that make up the index dominate the U.S. stock market in terms of market capi-

1. Ben W. Heineman, *Boards Fail—Again*, BUS. WK. ONLINE, Sept. 26, 2008, http://www.businessweek.com/managing/content/sep2008/ca20080925_789001.htm.

2. Anne Simpson, *America’s Governance Revolution Must Not Be Ducked*, FIN. TIMES, May 26, 2009, at 9.

3. Grant Kirkpatrick, *The Corporate Governance Lessons from the Financial Crisis*, FIN. MARKET TRENDS, July 2009, at 2, available at <http://www.oecd.org/dataoecd/32/1/42229620.pdf>. The report was published under the auspices of the OECD Steering Group on Corporate Governance.

4. Shareholder Bill of Rights Act, S. 1074, 111th Cong. § 2(1) (2009), available at [http://www.corpfinblog.com/uploads/file/bill-text-shareholders-bill-of-rights-act-of-2009\(2\).pdf](http://www.corpfinblog.com/uploads/file/bill-text-shareholders-bill-of-rights-act-of-2009(2).pdf).

talization and because the financial firms that were at ground zero of the stock market turmoil were well represented in the cohort removed from the index.

The study is based primarily on searches of Factiva, a Dow Jones news database encompassing more than 20,000 sources, including newspapers, business magazines, and trade journals. The searches were structured to find out what corporate governance mechanisms were activated in the six months before and six months after a company’s removal from the S&P index, with the objective being to assess how responsive and effective corporate governance was during the stock market turmoil. As such, the study constitutes the first detailed empirical analysis of the operation of corporate governance during the stock market meltdown of 2008.

One key finding is that financial firms were a breed apart. Among the ten sectors represented in the S&P 500, the financials sector, which encompasses investment banks, commercial banks, thrifts, and mortgage lenders, monopolized the category of what can be termed “at risk” companies, namely firms removed from the index because their market capitalization had collapsed, a “rescue merger” was required to stave off likely bankruptcy, or bankruptcy actually occurred. Moreover, boards of companies in the financials sector were criticized to a much greater extent than boards of companies in other sectors. In addition, executive pay prompted more controversy in this sector than in others, and appropriately so because the prospect of stratospheric rewards likely gave managers incentives to undertake risks with the future of their firms unjustified by prospective returns.

Though there clearly were exceptions within the financials sector, corporate governance generally functioned tolerably well among companies removed from the S&P 500 during 2008. In contrast with the corporate governance scandals occurring at the beginning of the 2000s, even companies that were under considerable financial stress were largely fraud-free. Boards of directors generally performed satisfactorily enough to avoid public criticism and directors of troubled companies were not merely sitting on their hands, as CEO turnover greatly exceeded the norm. With respect to executive pay, once the financials are taken out of the equation, the arrangements in place generated little controversy. Finally, while mutual funds and pension funds were largely mute, a few hedge funds persevered with their particular brand of shareholder activism under difficult conditions.

These findings have important normative implications. To the extent corporate governance in fact “failed” during the stock market meltdown of 2008, it seems to follow that reforms should be introduced to prevent future mishaps. As a representative of the Council of Institutional Investors said in a November 2008 interview, the financial crisis “represent[ed] a massive failure of oversight at all levels,” meaning, in turn, “[c]orporate governance should be part of any regulatory overhaul that’s coming down the pike.”⁵ Based, however, on what occurred at the thirty-seven companies removed from the S&P 500, lawmakers would be

5. Barry B. Burr, *Shareholders See Victory in Obama Administration*, PENSIONS & INVESTMENTS, NOV. 10, 2008, at 1.

unwise to treat the stock market turmoil of 2008 as a justification for sweeping corporate governance reforms.

Mistakes no doubt were made by key corporate governance players in 2008. However, the arrangements in place proved responsive in key respects to the challenges posed. Moreover, it is far from clear that a differently configured system of corporate governance would have done more to contain the damage. Shareholders, directors, and executives in major U.S. public companies clearly failed to appreciate how shaky the foundations of success were as stock prices climbed in the mid-2000s. However, they were hardly alone. Various people did predict a disaster was coming, but their views were marginalized because their prognostications fit awkwardly with the *zeitgeist* of the era.⁶ Too few regulators, stock market analysts, and journalists appreciated the magnitude of a credit “bubble” affecting the economy and foresaw the havoc that would follow if and when it burst. Given the underlying consensus, a stock market crisis likely would have been in the cards even if model corporate governance arrangements had been in place.

The experience in the United Kingdom is instructive on this point. Various corporate governance experts argue that enhancing shareholder rights will do much to improve managerial accountability. Shareholders in U.K. public companies have greater authority under corporate law to exercise influence over how their companies are run than their American counterparts. Nevertheless, stock prices fell faster in Britain during 2008 than they did in the United States,⁷ underpinned by a banking crisis every bit as serious as America’s.

The verdicts this Article offers must be treated as tentative in various respects. There no doubt will be further studies of the interaction between corporate governance and the stock market meltdown of 2008 and these conceivably could uncover evidence of corporate governance breakdowns that Factiva searches failed to bring to light. Also, while excessive risk-taking by corporate executives may have played a role in the stock market meltdown, this Article does not attempt to assess corporate governance’s impact along this dimension. Corporate governance perhaps was largely beside the point in this regard. As the *Economist* pointed out in early 2009, the balance sheets of non-financials in the S&P 500 were structured conservatively (they accounted for only about a third of national corporate debt while generating a majority of the profits), but “banks, with identical governance structures, worshipped at the altar of leverage.”⁸ The data sources relied on for the purposes of this Article—again, primarily those available on Factiva—lack sufficient financial precision to test for possible linkages between corporate governance, risk-taking, and the stock market meltdown.

Moreover, the Article is not advocating legislative passivity *per se*. The financial sector could well be a special case, not only because the financials were a breed apart with respect to the operation of corporate governance but also because

6. See Thomas Frank, *Financial Journalists Fail Upward*, WALL ST. J., Mar. 18, 2009, at A13.

7. STANDARD & POOR’S, MONTHLY REPORT: WORLD BY NUMBERS 4 (Dec. 2008), available at http://www2.standardandpoors.com/spf/pdf/index/123108_WorldbyNumbers-Report.pdf (indicating stock prices in the United Kingdom fell 50.9 percent as compared with 38.7 percent in the United States).

8. *Company Balance-Sheets: The Sensible Giants*, ECONOMIST, May 2, 2009, at 79.

within this sector there is a subset of firms where the implications of corporate governance breakdowns could well be sufficiently serious to merit special attention from lawmakers and regulators. With most companies, if executives make awful mistakes, directors are asleep at the wheel, and shareholders are complacent, there can be devastating consequences for investors and employees of the company in question, but the collateral impact on the economy at large will be minimal.⁹ However, within the financial sector, there can be firms which, if they collapse, will saddle a range of market participants with huge, unanticipated losses, thereby shattering confidence and disrupting credit flows. Given this sort of systemic risk, combined with the potential hit taxpayers will take if policymakers opt for bailouts, a case could be made that strict corporate governance requirements should be imposed on financial firms apparently “too big to fail.” Subject to this potentially important caveat, however, the findings outlined here suggest that lawmakers should refrain from introducing wholesale changes to the corporate governance scheme currently in place.

Part II of this Article describes how the corporate governance model that currently prevails in U.S. public companies developed and in so doing introduces the corporate governance themes the Article focuses on, namely independent directors, executive compensation, shareholder activism, and private equity buyouts. Part III describes in general terms the stock market meltdown of 2008. Part IV discusses the rationale for the empirical research that forms the core of the Article, explaining why the calendar year 2008 has been chosen as the reference point for analysis and why the focus is on companies dropped from the S&P 500. Part V describes the results. Part VI analyzes the policy implications of those results and Part VII concludes.

II. THE DEVELOPMENT OF CORPORATE GOVERNANCE IN U.S. PUBLIC COMPANIES

A. MANAGERIAL CAPITALISM IN THE POST-WORLD WAR II ERA

In order to assess the responsiveness of corporate governance to the stock market turmoil of 2008, it is necessary, as a preliminary matter, to identify the key corporate governance mechanisms in public companies and ascertain the role they are expected to play. On this count, history is instructive, as it reveals the corporate governance challenges that have been addressed and the logic underlying the “fixes” that have evolved. Only a succinct summary is necessary for present purposes; detailed historical analysis is available elsewhere.¹⁰

Economists Sanjai Bhagat and Brian Bolton and law professor Roberta Romano have said that “[t]he key focus of U.S. corporate law and corporate governance systems is what is referred to as an agency problem: an organizational

9. See, e.g., Joe Nocera, *Geithner’s Plan on Pay Falls Short*, N.Y. TIMES, June 13, 2009, at B1.

10. See, e.g., MARY O’SULLIVAN, CONTESTS FOR CORPORATE CONTROL: CORPORATE GOVERNANCE AND ECONOMIC PERFORMANCE IN THE UNITED STATES AND GERMANY 105–07 (2000); Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950–2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465 (2007).

concern that arises when owners—in a corporation, the shareholders—are not the managers who are in control.”¹¹ However, in the years immediately following World War II, it seemingly mattered little whether there were mechanisms in place to ensure managers were properly accountable to shareholders. With the United States experiencing a prolonged post-war economic boom and global economic preeminence, successful corporations grew rapidly and, as an incidental by-product, shareholders profited.¹² Amidst this corporate prosperity, the internal governance of companies was not a high priority. The general consensus was that those who relied on corporations for employment, goods and services, and investment returns could place their faith in corporate executives.¹³ Boards, supposedly guardians of shareholder rights, were expected to be collegial and supportive of management, a reasonable presupposition given that top executives strongly influenced the selection of directors.¹⁴ As for stockholders, they were “known for their indifference to everything about the companies they own except dividends and the approximate price of the stock.”¹⁵

With successful corporations such as IBM, General Motors, General Electric, Sears, U.S. Steel, and Alcoa becoming not merely household names but worldwide prototypes of managerial capitalism, the manager-oriented model of the corporation was preeminent.¹⁶ However, the fact that executives lacked potent incentives to focus on shareholder returns became increasingly evident.¹⁷ CEO pay in post-World War II public companies was composed primarily of salary, and salary was closely correlated with company size.¹⁸ As a result, chief executives were typically eager to grow their companies by acquiring other firms, often operating in disparate economic sectors.¹⁹ Growth by acquisition, however, was frequently not good news for shareholders.

One problem with merger-driven growth was that numerous deals failed to live up to expectations and ended up destroying shareholder value.²⁰ Moreover, executives struggled to maintain control over their sprawling corporate empires. Penn Central, a railway company that had diversified into pipelines, hotels, in-

11. Sanjai Bhagat, Brian Bolton & Roberta Romano, *The Promise and Peril of Corporate Governance Indices*, 108 COLUM. L. REV. 1803, 1809 (2008).

12. See O’SULLIVAN, *supra* note 10, at 105–07; Ira M. Millstein, *The Evolution of Corporate Governance in the United States—Briefly Told*, in CORPORATE GOVERNANCE: CRITICAL PERSPECTIVES ON BUSINESS AND MANAGEMENT 263, 271 (Thomas Clarke ed., 2005).

13. See, e.g., A.A. BERLE, JR., *THE 20TH CENTURY CAPITALIST REVOLUTION* (1954).

14. See Bengt Holmstrom & Steven N. Kaplan, *Corporate Governance and Merger Activity in the United States: Making Sense of the 1980s and 1990s*, 15 J. ECON. PERSP. 121, 129 (2001); Joel Seligman, *A Sheep in Wolf’s Clothing: The American Law Institute Principles of Corporate Governance Project*, 55 GEO. WASH. L. REV. 325, 330–32 (1987).

15. J.A. LIVINGSTON, *THE AMERICAN STOCKHOLDER* 81 (1958).

16. See Millstein, *supra* note 12, at 271; Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 444 (2001).

17. See Holmstrom & Kaplan, *supra* note 14, at 123.

18. See Frank Dobbin & Dirk Zorn, *Corporate Malfeasance and the Myth of Shareholder Value*, 17 POL. POWER & SOC. THEORY 179, 183 (2005).

19. See *id.*; Cynthia A. Montgomery, *Corporate Diversification*, J. ECON. PERSP., Summer 1994, at 163, 166.

20. Dobbin & Zorn, *supra* note 18, at 183.

dustrial parks, and commercial real estate, collapsed in 1970 amidst personality clashes, mismanagement, and lax board oversight.²¹ International Telephone and Telegraph, another sprawling conglomerate, was wracked in the early 1970s by allegations that senior executives had authorized improper political donations to secure favorable antitrust treatment and had been involved in the controversial overthrow of a left-wing government in Chile.²² Subsequently, dozens of public companies, prompted by the threat of prosecution, admitted having made bribes, kickbacks, or other illicit corporate payments in the United States and abroad.²³ In the aftermath, it became clear that while senior executives typically were well aware of the payments, outside directors were too far “outside the loop” to act as a check on unethical corporate behavior.²⁴

B. THE CORPORATE GOVERNANCE COUNTERREACTION

Widespread awareness that directors had been passive amidst the Penn Central collapse and the “questionable payments” scandal fostered a consensus that boards of public companies proactively should exercise independent oversight so as to enhance managerial accountability. In 1977, the New York Stock Exchange (“NYSE”), at the request of the U.S. Securities and Exchange Commission (“SEC”), amended its listing requirements to require each listed company to maintain an audit committee composed of independent directors.²⁵ While regulators had not previously focused on board committees or outside directors, this initiative was not particularly radical because public companies were already restructuring their boards.²⁶ Even before the NYSE amended its listing rules to provide for the establishment of audit committees, nearly 90 percent of the largest corporations in the United States had taken this step.²⁷ Likewise, a 1978 report on corporate accountability based on interviews with companies in seventeen countries referred to the United States as a “cauldron of experimentation,” with the basic shift being toward more active and independent boards.²⁸

By the early 1980s, there was a growing consensus that “the ‘outside’ director has won.”²⁹ Legal reforms sealed the victory. During the 1980s, Delaware court decisions involving derivative litigation and the invocation of takeover defenses indicated that judicial acceptance of board decisions to sidetrack derivative suits and

21. See Gordon, *supra* note 10, at 1515; ROBERT SOBEL, *THE RISE AND FALL OF THE CONGLOMERATE KINGS* 171, 175–76 (1984).

22. See SOBEL, *supra* note 21, at 186–87.

23. See Gordon, *supra* note 10, at 1516.

24. See Seligman, *supra* note 14, at 335–36; Frederick Andrews, *Management—Changing America’s Executive Climate*, N.Y. TIMES, June 3, 1977, at D1 (discussing bribes and kickbacks by Lockheed).

25. See Seligman, *supra* note 14, at 338.

26. See Thomas B. Hubbard, *Company Boards Don’t Need Uncle Sam*, N.Y. TIMES, June 24, 1979, at F14.

27. See Seligman, *supra* note 14, at 338.

28. Ann Crittenden, *World’s Companies Changed by Moves for Accountability*, N.Y. TIMES, Jan. 4, 1978, at D7 (discussing a report by Business International Corporation).

29. Thomas C. Hayes, *Board “Outsiders” Win Favor*, N.Y. TIMES, Mar. 31, 1980, at D1.

hostile takeover bids hinged on outside directors playing a decisive role while acting in accordance with a process designed to ensure they were exercising independent judgment.³⁰ In 1993, Congress endorsed the idea that executive pay should be dealt with by independent directors, enacting legislation stipulating that performance-based executive remuneration could be exempted from a new \$1 million deductibility cap under the Internal Revenue Code only if a compensation committee made up entirely of outside directors approved the relevant arrangements.³¹

Outside directors in turn became increasingly vigilant as monitors of management, recognizing that they had a mandate to scrutinize executives that was separate and distinct from their advisory and managerial functions.³² Correspondingly, by the 1990s, boards increasingly evaluated managerial performance by reference to shareholder value and became more willing to fire underperforming chief executives.³³ The boardroom emphasis on shareholder returns dovetailed with other corporate governance trends. One was the rise of institutional investors (primarily pension funds and mutual funds), which became strong proponents of a shareholder-oriented model of the corporation at the same time they became “the dominant group controlling the flow of money into the stock market.”³⁴ Traditionally, it was taken for granted among shareholders, whether individual or institutional, that the appropriate response to dissatisfaction with how a company was being run was to exercise “the Wall Street rule” and sell.³⁵ During the 1980s and 1990s, however, institutional investors began shifting away from this purely reactive approach in favor of challenging management to create value for shareholders.³⁶ They did this from a position of strength, as the proportion of shares in U.S. public companies held by households as compared to domestic institutional investors shifted from 84 percent and 14 percent, respectively, in 1965 to 49 percent and 45 percent, respectively, in 1985.³⁷

Institutional shareholders, in their new activist mode, initially focused on fighting anti-takeover initiatives.³⁸ The 1980s was known as “the Deal Decade,” exemplified by bidders relying on aggressive, innovative financial techniques to engineer daring takeover bids.³⁹ Executives reacted defensively and sought to

30. See Gordon, *supra* note 10, at 1481, 1523–26; see also *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985) (takeovers); *Moran v. Household Int'l, Inc.*, 500 A.2d 1346 (Del. 1985) (same); *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981) (derivative litigation).

31. Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, § 13211, 107 Stat. 312, 469–71 (codified as amended at I.R.C. § 162(m) (West Supp. 2009)).

32. See Millstein, *supra* note 12, at 278.

33. See Gordon, *supra* note 10, at 1531–33.

34. Dobbin & Zorn, *supra* note 18, at 188; see Holmstrom & Kaplan, *supra* note 14, at 134.

35. See Dobbin & Zorn, *supra* note 18, at 188; ROBERT A.G. MONKS & NELL MINOW, *CORPORATE GOVERNANCE* 107 (1995).

36. See CAROLYN KAY BRANCATO, *INSTITUTIONAL INVESTORS AND CORPORATE GOVERNANCE: BEST PRACTICES FOR INCREASING CORPORATE VALUE* 81 (1997).

37. O'SULLIVAN, *supra* note 10, at 156. The figures do not add up to 100 percent due to foreign ownership, which was 2.0 percent in 1965 and 5.9 percent in 1985. *Id.*

38. See BRANCATO, *supra* note 36, at 84.

39. See O'SULLIVAN, *supra* note 10, at 161; BRUCE WASSERSTEIN, *BIG DEAL: 2000 AND BEYOND* 167–69 (2000).

introduce management entrenchment devices such as the poison pill.⁴⁰ Institutional investors, often sellers of large blocks of shares in takeovers, responded in turn by opposing managerial attempts to block unwelcome tender offers and by lobbying to protect their right to tender their shares to the highest bidder.⁴¹

Institutional shareholders soon expanded their agenda. In the late 1980s and early 1990s, they began concentrating on the board as a vehicle for improving managerial accountability and correspondingly pressed for changes designed to enhance the monitoring capabilities of directors, such as ensuring key board committees were staffed entirely with independent directors.⁴² Institutional investors also pressured companies to overhaul existing executive pay arrangements to replace the traditional bias toward “pay-for-size” in favor of pay-for-performance.⁴³ The message got through, as a dramatic increase in equity-based compensation—most prominently the awarding of stock options—served to increase pay-for-performance sensitivity tenfold for CEOs between 1980 and 1998.⁴⁴

As the 1990s drew to a close, trends in corporate governance seemed highly positive. Boards had been strengthened, executive compensation had been restructured to align pay more closely with performance, and shareholders appeared prepared to begin stepping forward to protect their interests. Economists Bengt Holmstrom and Steven Kaplan correspondingly predicted in a 2001 survey of corporate governance that “a more market-oriented style of corporate governance than existed up to the early 1980s is here to stay.”⁴⁵ Moreover, with corporate governance reform coinciding with strong economic growth in the United States, ideological and market-driven momentum built up for companies elsewhere to converge toward a U.S.-style, shareholder-oriented corporate governance model.⁴⁶ To quote Holmstrom and Kaplan again, “Since the mid-1980s, the U.S. style of corporate governance has reinvented itself, and the rest of the world seems to be following the same path.”⁴⁷

C. THEN CAME ENRON

While Holmstrom and Kaplan strongly endorsed U.S. corporate governance in 2001, they conceded a mere four years later that “[t]o a casual observer, the

40. See Gerald F. Davis, *Agents Without Principles? The Spread of the Poison Pill Through the Inter-corporate Network*, 36 ADMIN. SCI. Q. 583, 586–87 (1991).

41. See BRANCATO, *supra* note 36, at 84; O’SULLIVAN, *supra* note 10, at 176; Holmstrom & Kaplan, *supra* note 14, at 132.

42. See BRANCATO, *supra* note 36, at 84–85.

43. See Dobbins & Zorn, *supra* note 18, at 189; John C. Coffee, Jr., *A Theory of Corporate Scandals: Why the United States and Europe Differ*, in CORPORATE GOVERNANCE POST-ENRON: COMPARATIVE AND INTERNATIONAL PERSPECTIVES 3, 11–12 (Joseph J. Norton, Jonathan Rickford & Jan Kleineman eds., 2006).

44. See Holmstrom & Kaplan, *supra* note 14, at 133; see also JOHN C. COFFEE, JR., GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE 62 (2006).

45. Holmstrom & Kaplan, *supra* note 14, at 140.

46. See, e.g., Hansmann & Kraakman, *supra* note 16, at 444.

47. Holmstrom & Kaplan, *supra* note 14, at 141.

United States corporate governance system must seem to be in terrible shape.”⁴⁸ A dramatic drop in share prices set the scene for disenchantment. With the demise of the late 1990s “dot-com” bull market, the Dow Jones Industrial Average (“DJIA”) fell 36 percent between January 2000 and September 2002 and the S&P 500 dropped 48 percent between March 2000 and September 2002.⁴⁹ A series of major corporate governance scandals simultaneously rocked investors, with nearly \$313 billion worth of shareholder wealth being wiped out at Enron, WorldCom, Tyco, Global Crossing, and Adelphia due to managerial malfeasance.⁵⁰

Some interpreted the corporate governance scandals as a damning indictment of the shareholder-oriented capitalism that had developed in the 1980s and 1990s and called for a profound reassessment of existing orthodoxies.⁵¹ Others, while prepared to acknowledge that the scandals revealed various imperfections that should be addressed by regulatory intervention, argued that any sort of fundamental overhaul would be unwise because the U.S. system of market-oriented capitalism had proven itself successful in creating growth and prosperity that exceeded that of all other countries.⁵² The latter view ultimately prevailed, as public officials moved quickly to introduce the Sarbanes-Oxley Act of 2002 (“SOX”)⁵³ to restore confidence in the markets.

President George W. Bush said SOX encompassed “the most far-reaching reforms of American business practice since Franklin Delano Roosevelt,”⁵⁴ and the legislation was highly controversial when it was enacted. SOX did impose various new requirements on public companies and their executives and directors.⁵⁵ Generally, however, it did not constitute a radical departure from past practice, building instead on existing federal regulations, state laws, accounting practices, and corporate governance conventions.⁵⁶ As a result, SOX was part of a larger process of strengthening corporate governance rather than a fundamental departure from past trends. As Ira Millstein, a well-known expert on corporate governance, said,

48. Bengt Holmstrom & Steven N. Kaplan, *The State of U.S. Corporate Governance: What's Right and What's Wrong?*, in *CORPORATE GOVERNANCE AT THE CROSSROADS: A BOOK OF READINGS* 71, 71 (Donald H. Chew & Stuart L. Gillan eds., 2005).

49. As of early January 2000 the DJIA was 11,722 and in early September 2002 it was 7528. In March 2000 the S&P 500 peaked at 1527.5 and fell to 800.6 in September 2002. These numbers are derived from historical charts available on web sites for the NYSE and NASDAQ on Yahoo! Finance, <http://finance.yahoo.com/> (last visited Sept. 9, 2009).

50. On the pre- and post-scandal market capitalization of these companies, see ZABIHOLLAH REZAEI, *CORPORATE GOVERNANCE POST-SARBANES-OXLEY* 28–29 (2007).

51. See, e.g., Simon Deakin & Suzanne Konzelmann, *Corporate Governance After Enron: An Age of Enlightenment?*, in *AFTER ENRON: IMPROVING CORPORATE LAW AND MODERNISING SECURITIES REGULATION IN EUROPE AND THE US* 155, 156–58 (John Armour & Joseph A. McCahery eds., 2006).

52. See, e.g., Holmstrom & Kaplan, *supra* note 48, at 71, 82–83; ROY C. SMITH & INGO WALTER, *GOVERNING THE MODERN CORPORATION: CAPITAL MARKETS, CORPORATE CONTROL, AND ECONOMIC PERFORMANCE* 21–22 (2006).

53. Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified in scattered sections of 11, 15, 18, 28 & 29 U.S.C.).

54. SMITH & WALTER, *supra* note 52, at 245.

55. For a succinct summary of the changes SOX introduced, see REZAEI, *supra* note 50, at 37–38.

56. *Id.* at 36, 247; SMITH & WALTER, *supra* note 52, at 245.

“SOX did directly what it was supposed to do: take the best practices of director independence and audit procedures and make them mandatory. . . . All that Sarbanes did was to take ‘should’ and ‘could’ and turned [them] into must. And it worked.”⁵⁷

Reforms SOX introduced concerning corporate boards and financial reporting illustrate how the legislation built upon existing corporate governance trends. With boards, audit committees were already a firmly entrenched aspect of corporate governance before Enron.⁵⁸ From this departure point, SOX mandated changes to the NYSE and NASDAQ National Market listing rules that spelled out the formal duties of audit committees, required companies to have an audit committee composed entirely of independent directors, and obliged firms to offer an explanation if the committee lacked a member who was a “financial expert.”⁵⁹

As for financial reporting, SOX created a new oversight panel to regulate accountants and discipline auditors, prohibited auditing firms from offering a broad range of consulting services to companies they audited, and mandated that chief executives and chief financial officers of public companies certify the accuracy and completeness of quarterly and annual financial reports.⁶⁰ Part of the impetus for the accounting-oriented SOX reforms can be traced back to the shift from cash-based to equity-based executive compensation that began in earnest in the 1990s. As law professor Jack Coffee has pointed out, a “dark side” to option-based compensation is that more stock options tends to mean more fraud, as senior executives have powerful financial incentives to manipulate earnings in order to maximize payouts available from exercising the options.⁶¹ Earnings restatements became endemic as the 1990s drew to a close, reflecting at least in part a desire by executives to hit performance-oriented compensation targets, and complex accounting-oriented frauds designed to prop up the share price were a hallmark of the iconic Enron and WorldCom scandals.⁶² This all implied that existing checks, such as external auditors and independent boards, were an insufficient counterweight to the “dark side” of equity-based executive pay. SOX in effect aimed to redress the balance without displacing the ability of public companies to seek to motivate their executives with performance-oriented compensation.⁶³

D. PRIVATE EQUITY

According to law professor Jonathan Macey, “The most important market-inspired component of the U.S. corporate governance infrastructure is the market

57. REZAEI, *supra* note 50, at 36.

58. See Gordon, *supra* note 10, at 1491.

59. See Troy A. Paredes, *Enron: The Board, Corporate Governance, and Some Thoughts on the Role of Congress*, in ENRON: CORPORATE FIASCOS AND THEIR IMPLICATIONS 495, 515–16 (Nancy B. Rapoport & Bala G. Dharan eds., 2004).

60. See REZAEI, *supra* note 50, at 37–38.

61. COFFEE, *supra* note 44, at 62–64.

62. See *id.* at 15.

63. See Gordon, *supra* note 10, at 1536; Ronald J. Gilson, *Catalyzing Corporate Governance: The Evolution of the United States System in the 1980s and 1990s*, 24 COMPANY & SEC. L.J. 143, 156–57 (2006).

for corporate control.”⁶⁴ This market involves the purchasing and selling of controlling interests in companies and provides incentives to managers to maximize shareholder value because they know an unwelcome bid for control could be forthcoming if share prices are in the doldrums.⁶⁵ It was particularly vibrant during the 1980s “Deal Decade,” with the most striking type of deal being the public-to-private buyout, where financiers operating as LBO (leveraged buyout) associations would borrow heavily to buy up all of a company’s publicly owned shares and take the company private.⁶⁶

As the 1980s drew to a close, Delaware courts and state legislatures provided strong legal backing for managers minded to fend off unwelcome tender offers.⁶⁷ A tightening of credit markets also made it much more difficult to orchestrate public-to-private buyouts.⁶⁸ Holmstrom and Kaplan argued in their 2001 survey of corporate governance that this sort of transaction was obsolete anyway.⁶⁹ They reasoned that the key rationale for a public-to-private transaction, namely restructuring underperforming assets, was no longer relevant because public company executives, spurred on by incentive-based executive compensation and closer monitoring by shareholders and directors, were already seeking to maximize shareholder value.⁷⁰ In fact, a revival of the public-to-private deal was just around the corner.

LBO associations—rechristened private equity firms—took advantage during the 2000s of enthusiasm for “alternative” investment strategies among pension funds, endowments, and wealthy private investors frustrated by uneven stock market returns to accumulate huge pools of capital available for buyouts.⁷¹ Private equity firms also found it was easy to borrow large sums on attractive terms, meaning they had the financial firepower required to acquire all but the very biggest public companies.⁷² Correspondingly, “[i]n 2006, the value of . . . ‘public-to-private’ buyouts surged to a record \$120 billion, or about 1.5 percent of Gross Domestic Product, up from just over \$70 billion in 2005.”⁷³

While private equity is known for taking companies off the stock market, the surge in private equity buyouts plausibly constituted a catalyst for better corporate governance among publicly traded companies generally.⁷⁴ Private equity bid-

64. JONATHAN R. MACEY, *CORPORATE GOVERNANCE: PROMISES KEPT, PROMISES BROKEN* 118 (2008).

65. See FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 172–73 (1991).

66. See Holmstrom & Kaplan, *supra* note 14, at 124; Brian Cheffins & John Armour, *The Eclipse of Private Equity*, 33 *DEL. J. CORP. L.* 1, 18–19 (2008).

67. See MACEY, *supra* note 64, at 122–26; Holmstrom & Kaplan, *supra* note 14, at 126–29; O’Sullivan, *supra* note 10, at 167.

68. See Cheffins & Armour, *supra* note 66, at 21.

69. Holmstrom & Kaplan, *supra* note 14, at 132.

70. *Id.* at 132–36.

71. Cheffins & Armour, *supra* note 66, at 11, 23.

72. See *id.* at 22–24.

73. *Id.* at 3.

74. For an overview of the points raised here, see BRIAN R. CHEFFINS, *CORPORATE OWNERSHIP AND CONTROL: BRITISH BUSINESS TRANSFORMED* 397–98, 403 (2008).

ders prefer to work in cooperation with incumbent executives rather than make “hostile” bids.⁷⁵ Nevertheless, in buyout negotiations the bargaining position of the incumbent management team will be strengthened if the company is well-run, and underperforming executives easily could find themselves on the outside looking in during a private equity restructuring. Private equity thus potentially has a disciplinary effect on public companies something akin to old-style hostile takeover bids.⁷⁶ As economist Irwin Stelzer said in 2007:

We might, just might, be entering a new phase of capitalism. Firms taken over by private equity funds will have to improve their performance; publicly owned firms competing with them will have to respond by improving their own profitability. Life at the top of corporate America will be less pleasant. Which is what dynamic capitalism is all about—change that discomfits the comfortable.⁷⁷

E. HEDGE FUND ACTIVISM

The market for corporate control focuses around tender offers designed to secure a majority stake that will ensure the bidder can select the directors of the target and thereby control the corporation. An investor who targets an underperforming company alternatively might refrain from seeking to obtain voting control and instead build up “offensively” a sufficiently sizeable minority stake to capture management’s attention and use that leverage to lobby for changes intended to increase shareholder value.⁷⁸ During the 1990s, a handful of institutional shareholders—most prominently CalPERS—began analyzing the performance of executives and boards to identify underachieving companies to be targeted for shareholder action.⁷⁹ However, pension funds and mutual funds ultimately proved reluctant to go further in challenging public companies than periodically following recommendations of a shareholder advisory service to vote against policies management supported.⁸⁰ A key obstacle was that these investors emphasized diversification as an investment philosophy.⁸¹ Since improved returns in a particular company likely were to have only a marginal impact on a diversified investment portfolio and since activism was time-consuming, costly, and not always successful, the sums simply did not add up.

75. Cheffins & Armour, *supra* note 66, at 12.

76. See William W. Bratton, *Private Equity’s Three Lessons for Agency Theory*, 3 BROOK. J. CORP., FIN. & COM. L. 1, 9–10 (2008).

77. Irwin Stelzer, *Don’t Close Gate on Private Equity “Barbarians,”* SUNDAY TIMES, May 13, 2007, at 4. See also Paul Rogers, Tom Holland & Dan Haas, *Private Equity Disciplines for the Corporation*, J. PRIVATE EQUITY, Winter 2002, at 6, 8.

78. For a discussion of the notion of “offensive” shareholder activism, see CHEFFINS, *supra* note 74, at 392–93.

79. See BRANCATO, *supra* note 36, at 82, 85.

80. See Iman Anabtawi & Lynn Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255, 1277–78 (2008); see generally Stephen J. Choi & Jill E. Fisch, *On Beyond CalPERS: Survey Evidence on the Developing Role of Public Pension Funds in Corporate Governance*, 61 VAND. L. REV. 315, 317–18, 326–34, 347–51 (2008); Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1028, 1043–45 (2007).

81. See Anabtawi & Stout, *supra* note 80, at 1278.

While neither pension funds nor mutual funds proved willing to engage in “offensive” shareholder activism, hedge fund managers began in the 2000s to step forward in earnest and target underperforming companies.⁸² The typical tactic was to build up quietly a sizeable position in the targeted company and then agitate for change, with common demands being that management return cash to shareholders by way of a stock buyback or a one-off dividend payment, sell weak divisions, or even put the company itself up for sale.⁸³ For activist hedge funds, the lure was the prospect of selling out at a sizeable profit after value-enhancing changes had taken place.⁸⁴ The upside could be particularly lucrative if the hedge fund could acquire its shares at discount prices before it was forced to divulge its stake under Schedule 13D of the Securities Exchange Act of 1934, which requires the filing of an ownership report within ten days after the acquisition of 5 percent or more of a public company’s shares.⁸⁵

Activist hedge funds are generally less likely to target big companies than small firms because a large amount of capital is required to acquire a sufficiently sizeable voting block to make offensive activism worthwhile.⁸⁶ However, with assets under management by hedge funds growing substantially during the 2000s, and with hedge funds being able to increase their financial firepower readily through borrowing due to debt being plentiful and “cheap,” hedge fund managers with a shareholder activism mandate could, and did, challenge management at very large firms.⁸⁷ This meant that “[h]edge funds [had] become critical players in . . . corporate governance.”⁸⁸ The *New York Times* put the point more strongly in 2007, saying “activists have captured the center ring and are directing the main event.”⁸⁹ A *Wall Street Journal* columnist observed similarly in 2008, “Like a rebel proudly declaring victory, shareholders can declare their revolution nearly complete.”⁹⁰

Critics of hedge fund activism argued that hedge funds were hyperactive traders, apt to pressure managers of a targeted company to take steps that might raise the share price in the short term but would not help the company, and might even

82. John Armour & Brian R. Cheffins, *The Rise and Fall (?) of Shareholder Activism by Hedge Funds* 21–22 (ECGI Law Working Paper No. 136, 2009) available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1489336.

83. See MACEY, *supra* note 64, at 245; Anabtawi & Stout, *supra* note 80, at 1279.

84. See Armour & Cheffins, *supra* note 82, at 9–10.

85. See Securities Exchange Act of 1934 § 13(d), 15 U.S.C. § 78m(d) (2006) (providing the statutory foundation for this requirement).

86. See Alon Brav, Wei Jiang, Frank Partnoy & Randall Thomas, *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729, 1752 (2008).

87. See Armour & Cheffins, *supra* note 82, at 27–28; Susan Chandler, *Hedge Funds Put the Pressure On*, CHI. TRIB., Jan. 27, 2006, at C1. Examples of companies targeted included Circuit City, General Motors, H.J. Heinz, McDonalds, and Time Warner. See William W. Bratton, *Hedge Funds and Governance Targets*, 95 GEO. L.J. 1375, 1429–32 (2007); MATTEO TONELLO, CONFERENCE BD., HEDGE FUND ACTIVISM: FINDINGS AND RECOMMENDATIONS FOR CORPORATIONS AND INVESTORS 14 (2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1107027.

88. Kahan & Rock, *supra* note 80, at 1024.

89. Charles Duhigg, *Gadflies Get Respect, and Not Just at Home Depot*, N.Y. TIMES, Jan. 5, 2007, at C1.

90. Dennis K. Berman, *The Game: Activist Holders Sit Pretty; Boards' Clout Wanes, Bringing Big Changes*, *Martin Lipton Fumes*, WALL ST. J. (EUR.), July 9, 2008, at 19.

harm it, over the long haul.⁹¹ Others offered a more favorable assessment, saying that hedge funds were improving corporate governance by enhancing managerial responsiveness to shareholder value. For instance, finance professors Alon Brav and Wei Jiang and law professors Frank Partnoy and Randall Thomas claimed on the basis of a detailed empirical study of hedge fund activism “that activist hedge funds occupy an important middle ground between internal monitoring by large shareholders and external monitoring by corporate raiders.”⁹²

Professor Macey has put the case in favor of hedge fund activism even more strongly, saying “hedge funds . . . are an extremely important addition to the market for corporate control in any nation’s arsenal of corporate governance devices.”⁹³ He argues that the benefits do not extend merely to companies targeted by hedge funds. Instead,

the key role being played by hedge funds . . . in corporate governance affects *all* companies in a very profound way. Even companies that want to *avoid* being the target of an activist fund can only do this by improving corporate governance extensively so that there are no longer any arbitrage possibilities that allow fund managers to take a position in the target company and then start agitating for reform.⁹⁴

To the extent this assessment is on the mark, the emergence of hedge funds as offensive shareholder activists in the 2000s would have supplemented existing corporate governance mechanisms that served to provide managers with incentives to focus on shareholder returns.

III. THE 2008 STOCK MARKET MELTDOWN

While Enron, WorldCom, and other corporate scandals combined with the collapse of the dot-com bubble to undermine confidence in the U.S. system of corporate governance, by the mid-2000s the outlook was much brighter. SOX had introduced various legislative changes intended to enhance managerial accountability, and private equity buyouts and hedge fund activism were providing a fresh market-oriented impetus for the promotion of shareholder value. Correspondingly, Christopher Cox, chairman of the SEC, seemed on the mark when he told Congress in 2006, “We have come a long way since 2002. Investor confidence has recovered. There is greater corporate accountability. Financial reporting is more reliable and transparent. Auditor oversight is significantly improved.”⁹⁵

Improved confidence in corporate governance coincided with a robust stock market recovery. During early October 2007, the DJIA hit its all-time high of 14,280, a 90 percent jump since September 2002. Likewise, the S&P 500 peaked in early October 2007 at 1576, a 97 percent improvement over the same period

91. See Anabtawi & Stout, *supra* note 80, at 1290–91.

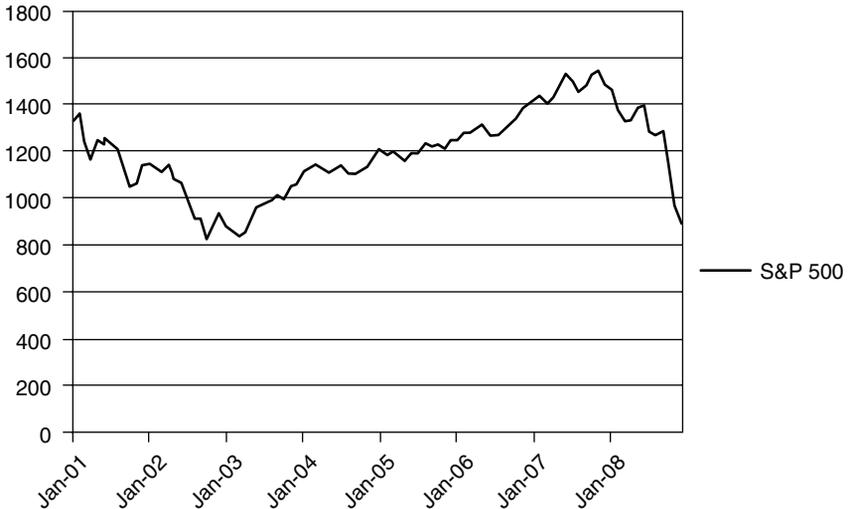
92. Brav, Jiang, Partnoy & Thomas, *supra* note 86, at 1733. See generally David Haarmeyer, *The Revolution in Active Investing: Creating Wealth and Better Governance*, 19 J. APPLIED CORP. FIN. 25 (2007).

93. MACEY, *supra* note 64, at 241.

94. *Id.* at 250.

95. REZAEI, *supra* note 50, at 36.

Figure 1
S&P 500 Index, January 2001–December 2008 (based on prices at the beginning of each month)



Source: Derived from figures available on Yahoo! Finance

(Fig. 1). The stock market even took in stride rising oil prices in 2007 and a late summer “credit crunch” precipitated by pressures that surging mortgage defaults were imposing on banks and investors.⁹⁶

By the end of 2007, the stock market had dropped moderately from the October 2007 peak, with the DJIA standing at 13,043 and the S&P 500 average at 1468. Prices continued to dip in the opening months of 2008 but by mid-May stood at much the same level as they had at the beginning of the year.⁹⁷ Then the bottom fell out (Fig. 1).

At the close of trading on December 31, 2008, the DJIA was 8776, a drop of 33.8 percent over the year, and the S&P 500 average was 903, representing a 38.5 percent annual decline. 2008 was the worst year for the S&P 500 since 1937 and the worst for the Dow Jones since 1931.⁹⁸ Across all U.S. stock markets, an estimated \$6.9 trillion in market value was wiped out.⁹⁹ Moreover, the decline af-

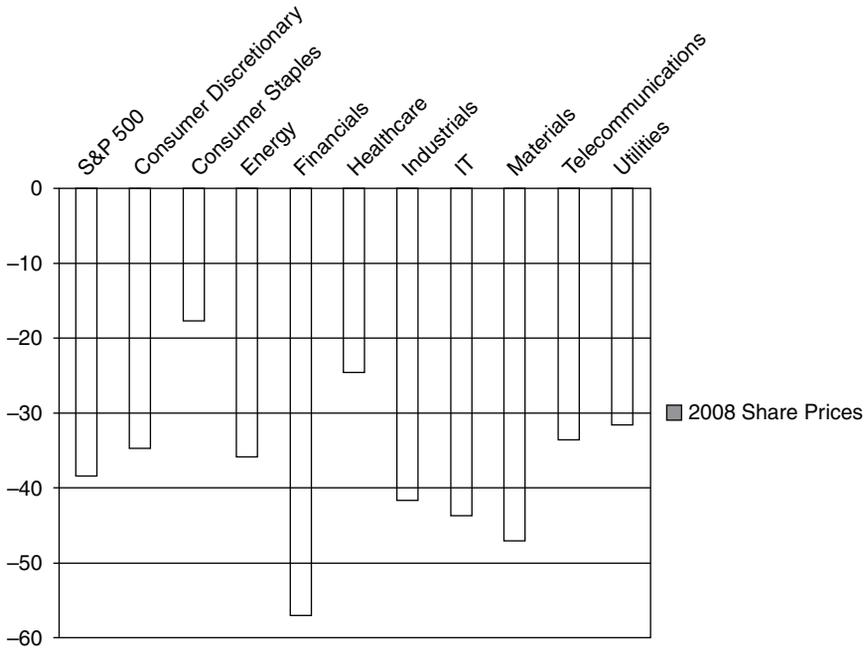
96. See Dean Calbreath, *Market Proves Resilient*, S.D. UNION-TRIB., Jan. 2, 2008, at C1.

97. During the week of May 19th, the DJIA high was 13,717 and the S&P 500 high was 1440.2.

98. See Matt Krantz, *Markets' Fall Was Worst in Seven Decades*, USA TODAY, Jan. 2, 2009, at B1. The index officially reported by S&P for 1926 to 1956 contained only ninety stocks. The modern version of the S&P 500 index, with 500 stocks, was launched in 1957. See Jack W. Wilson & Charles P. Jones, *An Analysis of the S&P 500 Index and Cowles's Extensions: Price Indexes and Stock Returns, 1870–1999*, 75 J. Bus. 505, 507–08, 512, 514 (2002).

99. Krantz, *supra* note 98.

Figure 2
Share Price Performance S&P 500 Sectors, 2008



Source: Compiled using data from *Standard & Poor’s, Monthly Report: World by Numbers* (Dec. 2008).

ected all types of companies. Financials were particularly hard hit, but all sectors within the S&P 500 suffered major price declines (Fig. 2).

The sharp decline in stock prices suggested that something was seriously amiss with the shareholder value-oriented system of corporate governance that had begun to take shape in the 1970s. As the *Financial Times* pointed out, “The irony is inescapable. The golden era of the shareholder value movement—the idea that businesses should be run in the interests of equity holders—has delivered one of the worst stock market performances ever.”¹⁰⁰ The proximate cause of the stock market’s disastrous performance during 2008 was a global financial crisis that originated with the 2007 credit crunch and ultimately precipitated government bail-outs of numerous major financial firms around the globe. Nevertheless, a system of corporate governance checks and balances oriented around the promotion of shareholder value seemingly had failed to deliver what implicitly had been promised. The breakdown allegedly was particularly acute at the U.S. financial institutions at ground zero of the market crisis. As a *Business Week* columnist observed,

100. *Shareholder Value*, FIN. TIMES, Feb. 4, 2009, at 14.

[R]egulators, corporate leaders and the governance movement need to do some soul-searching about why there was such a widespread default of fundamental director (and CEO) responsibilities in financial services—why the much discussed checks and balances of the governance movement couldn't constrain the commercial pressures and greed that led to such unbalanced behavior and ultimately to devastation.¹⁰¹

Did corporate governance in fact fail during 2008? Using the stock market as the sole barometer, the answer seemingly must be yes. However, there is more to the story. Corporate governance is not the primary determinant of share prices, as reflected by the fact that academic testing of the hypothesis that good corporate governance improves corporate financial performance has yielded inconclusive results.¹⁰² It therefore is possible corporate governance in public companies generally operated satisfactorily amidst general market trends that inexorably drove share prices downward. At this point, we simply do not know. Despite much speculation that corporate governance shortcomings contributed to the 2008 stock market meltdown, systematic analysis of how corporate governance functioned during this turbulent year has been lacking. The remainder of this Article constitutes a pioneering effort to address this gap in our understanding, with the approach adopted being to examine corporate governance in the thirty-seven companies removed from the S&P 500 index during 2008.

IV. SAMPLE SELECTION AND SEARCH STRATEGY

A. RATIONALE FOR THE SAMPLE SELECTION

A fully systematic test of whether corporate governance “failed” during 2008 would require analyzing structures and outcomes for all publicly traded companies. Because there are around 17,000 such firms in the United States,¹⁰³ undertaking such an assessment is unlikely to be feasible. Among these 17,000, it makes sense to focus on the largest firms because they are markedly more important from an economic and investment perspective than their smaller counterparts. The fact that the S&P 500 stock market index, which is composed of 500 leading U.S. public companies, covers approximately 75 percent of the total value of the U.S. equities market illustrates the point.¹⁰⁴

101. Heineman, *supra* note 1.

102. See, e.g., Bernard Black, *Does Corporate Governance Matter? A Crude Test Using Russian Data*, 149 U. PA. L. REV. 2131, 2133–34 (2001) (summarizing the U.S. evidence); Colin Melvin & Hans-Christoph Hirt, *Corporate Governance and Performance: The Missing Links*, in *THE BUSINESS CASE FOR CORPORATE GOVERNANCE* 201, 201–04 (Ken Rushton ed., 2008) (arguing that studies, on balance, indicate better corporate governance is correlated with better corporate performance but acknowledging the evidence is conflicting and saying the direction of causation is unclear).

103. See Thomas J. Donohue, Pres. & CEO, U.S. Chamber of Commerce, Remarks at Three Sector Summit—Hitachi Foundation Board Dinner (July 14, 2003), available at http://www.uschamber.com/press/speeches/2003/030714tjd_hitachi.htm (“There are more than 17,000 publicly traded companies in the U.S. . . .”).

104. See STANDARD & POOR'S, S&P 500 (2009), available at http://www2.standardandpoors.com/spf/pdf/index/SP_500_Factsheet.pdf (last visited Sept. 9, 2009) [hereinafter S&P 500].

Even studying the operation of corporate governance for all companies in the S&P 500 is a potentially daunting task. The obvious response is to focus on a sample from within this cohort. Those carrying out empirical research on a subset of a particular population typically rely on a random sample, in the sense each item in the population has an equal chance of appearing in the sample, with the objective being to argue that findings from the sample extrapolate reliably to the population at large.¹⁰⁵ In this particular context, however, much of the story may well be lost by adopting this methodology, since troubled companies are likely to be at the center of the action with respect to corporate governance. There may, for example, be scandal scenarios, where, Enron-style, a company’s board and shareholders remain oblivious until too late as senior executives exploit their positions in a self-serving manner. Even absent a scandal, corporate governance deficiencies, such as lax boardroom oversight and executive incompetence, that might be a mere afterthought in a buoyant market are unlikely to get the same sort of free pass if share prices are plunging. At the same time, bad financial news can prompt corrective action. The board of a troubled company may respond by shaking up the executive team, the shareholders may begin to lobby loudly for a change of direction, or the market for corporate control might kick into operation as a bidder deduces there is a bargain to be had.

With the S&P 500 there is a readily identifiable group of companies likely to fall into the “troubled” category, these being the companies that are removed from the index. The S&P Index Committee, made up of Standard & Poor’s economists and index analysts,¹⁰⁶ will automatically remove companies from the S&P 500 that have been acquired or have gone bankrupt.¹⁰⁷ The committee also may remove a company on the basis that it fails to meet the criteria for inclusion.¹⁰⁸ To be eligible for the S&P 500, a company typically must be based in the United States, be an operating company rather than a holding company or other investment vehicle, have a track record of positive earnings, have a market capitalization of \$4 billion or more, and have 50 percent or more of its outstanding shares publicly traded.¹⁰⁹ The S&P Index Committee also takes into account sector representation and seeks to ensure the S&P 500 offers a balance between key economic sectors.¹¹⁰ By contrast, the Fortune 500 is composed of the 500 largest public companies in the United States ranked by gross revenue without adjustment for industry representation.¹¹¹

105. CHARLES H. FEINSTEIN & MARK THOMAS, MAKING HISTORY COUNT: A PRIMER IN QUANTITATIVE METHODS FOR HISTORIANS 10–11 (2002).

106. See S&P 500, *supra* note 104.

107. *Id.*

108. *Id.*

109. *Id.* The market capitalization threshold was increased from \$3 billion to \$4 billion in 2008. See Press Release, Standard & Poor’s, Standard & Poor’s Announces Update to the U.S. Market Cap Guidelines and Changes to U.S. Indices (Sept. 25, 2008), <http://www2.standardandpoors.com/spf/pdf/index/Fastballdancer.pdf>.

110. See S&P 500, *supra* note 104.

111. See C. Michael Carty & Herbert D. Blank, *The Fortune 500 vs. The S&P 500*, FIN. ADVISOR, Jan. 2003, <http://www.fa-mag.com/component/content/article/624.html?issue=28&magazineID=1&Itemid=73>.

The S&P Index Committee strives to minimize unnecessary turnover within the S&P 500, which is reflected by the fact that continued index membership is not conditional on a company continuing to fulfill all guidelines for inclusion.¹¹² Most significantly, the index committee will not remove a company merely because its market capitalization falls below \$4 billion. For instance, in September 2008, the Federal Home Loan Mortgage Company (a.k.a. “Freddie Mac”) was removed from the S&P 500 only when its market value fell to \$614 million, the Federal National Mortgage Association (a.k.a. “Fannie Mae”) was removed at the same time with a market capitalization of \$1.04 billion, and General Growth Properties, a mall operator, was removed in November 2008 with a market value of \$128 million.¹¹³ Companies therefore are typically not dropped from the index unless they are in conspicuous financial trouble or “disappear” in an acquisition.¹¹⁴ Removal, moreover, is a fate an S&P 500 company usually will want to avoid (absent a merger) because when this occurs its share price typically falls as fund managers of index-tracking funds sell out.¹¹⁵

Companies removed from the S&P 500 index during 2008 should provide an instructive sample for assessing corporate governance responses to the “stress test” posed by the year’s dramatic fall in shares prices. Numerous headline grabbing, crisis-ridden financial services companies are on the list, including not only Freddie Mac and Fannie Mae but also Bear Stearns, Lehman Brothers, Washington Mutual, and Merrill Lynch. At the same time, because a majority of companies removed from the S&P 500 in 2008 were not financial companies,¹¹⁶ the sample provides a platform for analyzing how corporate governance functioned across the economy as market conditions deteriorated. In addition, because companies can be removed from the S&P 500 without suffering a severe financial setback, the sample offers insights on the quality of corporate governance in firms that were not in “crisis mode” during the stock market meltdown.

Because the sample used here was not constructed in a random fashion, the findings cannot be treated as truly representative of trends among the full cohort of S&P 500 companies, let alone public companies at large. However, to the extent there is sample bias, its direction seems predictable. “Good” corporate governance plausibly reduces downside risk for corporations, which implies well-governed firms are less likely to run into trouble than their poorly governed counterparts. To the extent this is the case, corporate governance should have been *better* in the rest of the S&P 500 during the stock market meltdown than it would have been in the companies comprising the sample used in the present study.

112. S&P 500, *supra* note 104.

113. Press Release, Standard & Poor’s, Standard & Poor’s Announces Changes to U.S. Indices (Sept. 9, 2008), <http://www2.standardandpoors.com/spf/pdf/index/lychnobitic374.pdf>; Press Release, Standard & Poor’s, Standard & Poor’s Announces Changes to U.S. Indices (Nov. 11, 2008), <http://www2.standardandpoors.com/spf/pdf/index/worzobson.pdf>.

114. GARY L. GASTINEAU, *THE EXCHANGE-TRADED FUNDS MANUAL* 148 (2002).

115. See *id.* See also Press Release, IAC, New IAC Poised to Get Cheaper After Break-up (Aug. 19, 2008), <http://iac.mediaroom.com/index.php?s=53&item=232> (discussing the share price impact of IAC/InterActive Corp.’s exit from the S&P 500) [hereinafter IAC Press Release].

116. See *infra* Part IV.B.

While focusing on the list of companies removed from the S&P 500 during 2008 means there will be sample bias in favor of substandard corporate governance, various potentially noteworthy corporate governance lapses that came to light during the stock market meltdown will not be taken into account. Circumstances involving AIG, an insurance/asset management conglomerate with \$860 billion worth of assets at the end of 2008, and Citigroup, a diversified financial service company holding company with assets of \$1.94 trillion, illustrate this point.¹¹⁷ These firms were at the epicenter of the financial crisis during 2008 and evidently suffered from suboptimal corporate governance.¹¹⁸ For instance, the Citigroup board reputedly lacked sufficient objectivity due to overrepresentation by current and former executives, and the AIG board allegedly collectively had insufficient expertise to understand AIG’s multi-faceted and often risky businesses, while senior management stood accused of failing to exercise proper oversight of key parts of AIG’s far-flung empire.¹¹⁹ AIG and Citigroup retained their positions in the S&P 500 throughout 2008, in large measure because of highly publicized government bailouts. The present study, due to the sample used, does not take into account events occurring at these and other similarly placed firms, meaning the analysis of corporate governance failings of financial companies is necessarily partial. Nevertheless, because troubled financials are well represented among the cohort of firms removed from the S&P 500 in 2008, the findings set out here do provide a valuable departure point for understanding the operation of corporate governance in the financial industry during the stock market meltdown.

B. SAMPLE CHARACTERISTICS

The S&P 500 index is divided into ten sectors derived from the S&P Global Industry Classification Standard (“GICS”), namely energy, materials (e.g., chemicals, mining, and paper products), industrials, consumer discretionary (e.g., apparel, automobiles, leisure, and retail), consumer staples (e.g., food, beverages, and household products), financials, healthcare, information technology, telecommunications services, and utilities.¹²⁰ More than two-thirds of the thirty-seven removals from the S&P 500 during 2008 were in the financials (15) and consumer discretionary (10) sectors (Fig. 3), disproportionately large numbers given

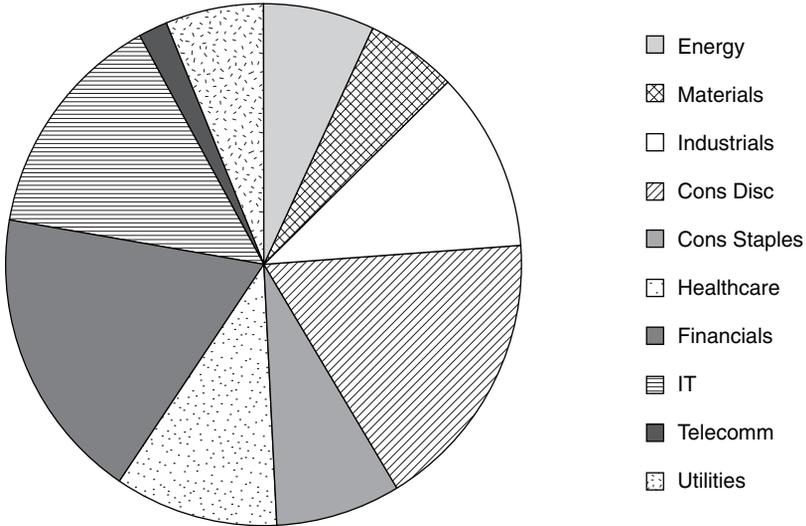
117. On asset values, see Am. Int’l Group, Inc., Annual Report (Form 10-K), at 6–8, 36 (Mar. 2, 2009); Citigroup, Inc., Annual Report (Form 10-K), at 2, 4 (Feb. 28, 2009).

118. See Stevenson Jacobs & Tom Krusher, *What if Washington Bailed Out of Bailouts?*, BUS. WK. ONLINE, Mar. 25, 2009, http://www.businessweek.com/investor/content/mar2009/pi20090320_839114.htm?chan=investing_investing+index+page_top+stories (explaining why, among companies afflicted by the crisis, Citigroup and AIG qualified as “too big to fail”).

119. See Francesco Guerrero, *Proposed Split Leaves Pandit’s Role in Question*, FIN. TIMES, Jan. 15, 2009, at 14 (Citigroup board); Terence Corcoran, *Guess Who Killed AIG*, NAT’L POST, Sept. 18, 2008, at FP15 (AIG board); Raymond J. Lehmann, *Greenberg, Whistleblower Both Fault AIG Internal Controls*, BEST’S INS. NEWS, Oct. 8, 2008 (on file with *The Business Lawyer*) (AIG oversight).

120. On categories within the GICS sectors, see STANDARD & POOR’S, THE GLOBAL INDUSTRY CLASSIFICATION STANDARD (GICS): AN OVERVIEW FOR STANDARD & POOR’S U.S. SECTOR INDICES app. A1, at 6–8 (2002), available at <http://www2.standardandpoors.com/spf/pdf/index/GICSIndexDocument.PDF?vregion=us&vlang=en>.

Figure 4
S&P 500 Sector-by-Sector Breakdown, Number of Companies, Dec. 31, 2007



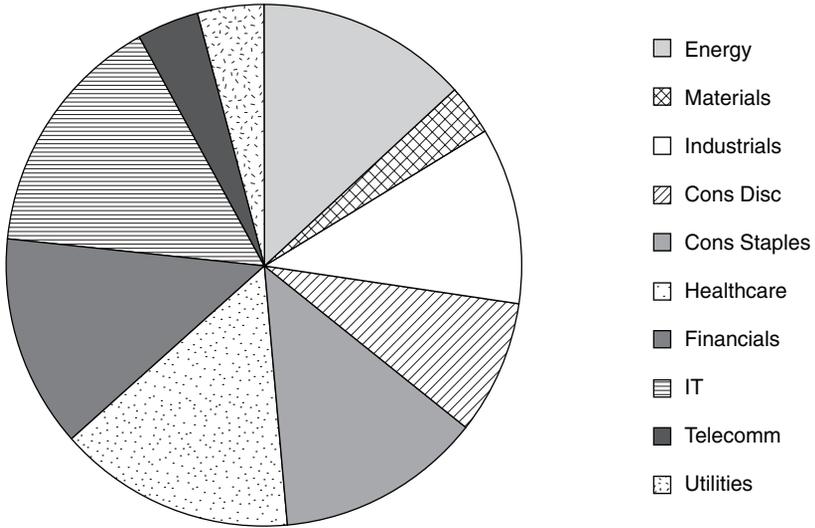
Source: Compiled from interactive chart available on the S&P web site

Among the thirty-seven companies removed from the S&P 500 in 2008, as the Appendix to this Article indicates, a total of thirteen were removed for the same reasons as Freddie Mac, Fannie Mae, and General Growth Properties, namely that their market value had dropped too far to justify continued inclusion in the index.¹²⁴ Sixteen companies were dropped from the index after being acquired by another company. Half of the time the acquirer was another S&P 500 company,¹²⁵ seven times the acquirer was part of another S&P index, whether for smaller U.S. firms or for companies based in other countries, and in one case (Wm. Wrigley

124. Standard & Poor’s, in the press releases it issues to announce the reconfiguration of the S&P 500, typically gives the reasons for removing a company. For companies removed in 2008, it only refrained from doing so for two companies, Circuit City and Barr Pharmaceuticals. Circuit City apparently was removed because of a dramatic fall in its market value. See Jonathan Birchall, *Activist Targets Circuit City*, FIN. TIMES, Mar. 1, 2008, at 9 (indicating Circuit City’s share price had fallen by more than 70 percent in the past year). Barr Pharmaceuticals was removed because it was acquired by Teva Pharmaceutical Industries Limited, an Israeli company. See David Marcus, *Deals & Suits: Teva Barr*, CORP. COUNSEL, Nov. 2008, at 31.

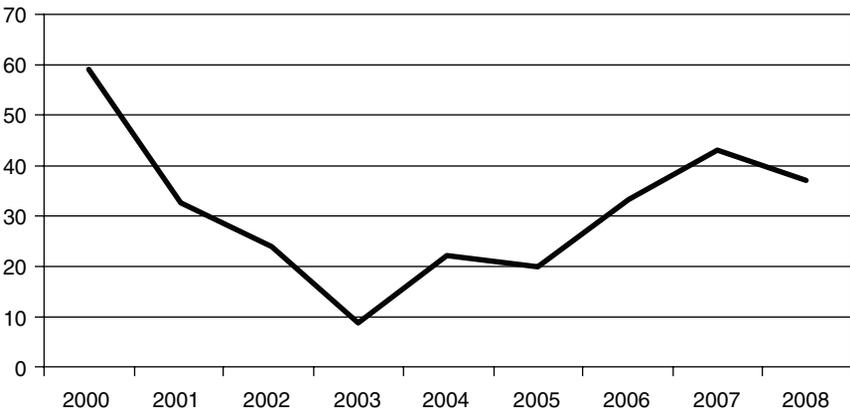
125. Republic Services, Inc., has been included in this category because its acquisition of Allied Waste Industries meant Republic Services, Inc., took Allied Waste’s place in the S&P 500. See Press Release, Standard & Poor’s, Standard & Poor’s Announces Changes to U.S. Indices (Nov. 26, 2008), <http://www2.standardandpoors.com/spf/pdf/index/stopgapname500400600.pdf>.

Figure 5
S&P 500 Sector-by-Sector Breakdown, Market Capitalization, Dec. 31, 2007



Source: Compiled from interactive chart available on the S&P web site

Figure 6
S&P 500 Turnover (Number of Companies), 2000–2008



Source: Compiled from S&P web site

Jr. Co. being bought by Mars, Inc.), the acquirer was a private company. In six of the sixteen instances—all involving financials—the sale was a rescue merger occurring “under duress,” in the sense that federal regulators facilitated the sale, the enterprise faced an imminent threat of bankruptcy, or both.

Of the remaining seven companies removed from the S&P 500, two were dropped because they became dramatically smaller by spinning off key operations, though in one instance (E.W. Scripps/Scripps Networks Interactive) the spun-off company replaced the parent in the S&P 500. Two companies were removed after being taken private by private equity firms. Two were dropped because they re-domiciled in Europe to reduce tax liabilities.¹²⁶ Finally, one company—Lehman Brothers—was dropped because it filed for bankruptcy.

Of the thirty-seven sample companies, a total of twenty can be categorized as “at risk” firms, in the sense that the business was under substantial financial pressure in the period leading up to removal from the S&P 500. The thirteen companies dropped from the index due to being “too small” all fall into this category because their market value would have fallen dramatically. The six companies involved in rescue mergers also qualify since their options had dwindled to a precious few by the time of removal. Lehman Brothers also must be categorized as an “at risk” firm, given that the firm’s collapse was so sudden that it fell into bankruptcy before it could be sold or removed from the S&P 500 on the basis it was too small. Though one of the companies removed due to a spin-off had suffered a large drop in its share price prior to the deal (IAC/Interactive),¹²⁷ and one of the companies taken private would have faced difficult choices if the buyout had fallen through (Clear Channel Communications, Inc.),¹²⁸ none of the other companies removed from the S&P 500 were truly “at risk” at the time of removal.

Financials dominated the “at risk” removal category to an even greater extent than they dominated overall removals from the S&P 500 (Fig. 7). Circumstances underlying mergers precipitating exit were the key reason. While all six of the rescue mergers involved financials, in the other ten instances where a merger precipitated an exit from the S&P 500, only three of the companies were from this sector.

C. SEARCH STRATEGY

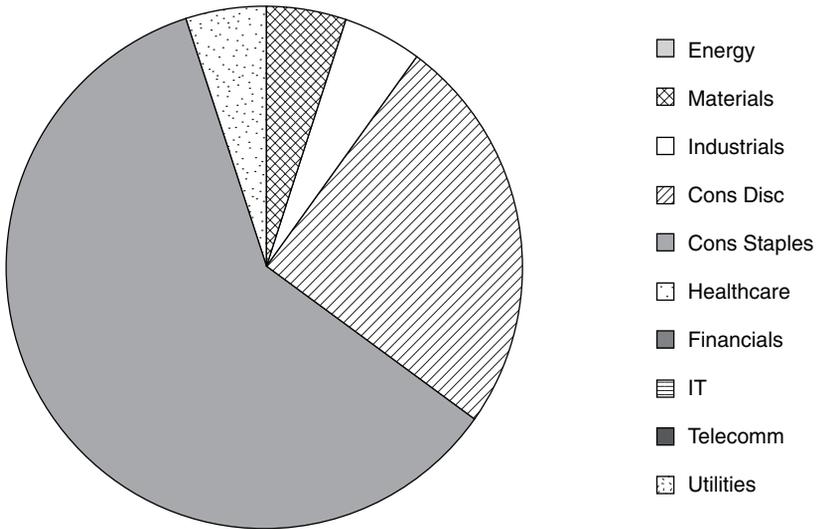
In order to assess the operation of corporate governance in the thirty-seven companies removed from the S&P 500 in 2008, the primary search strategy adopted was to carry out a thorough analysis of press and newswire coverage of the relevant companies. Factiva, a Dow Jones database that provides access to

126. See Sam Mamudi, *Tax Moves May See Index Shake-ups*, MARKETWATCH, Dec. 23, 2008, <http://www.marketwatch.com/story/tax-moves-may-see-index> (discussing ACE Ltd. and Transocean Inc.).

127. By August 2008, IAC/Interactive shares were trading at \$17.75, well off a 2008 high of \$80. See IAC Press Release, *supra* note 115; *Mogul v Mogul*, ECONOMIST, Mar. 15, 2008, at 76.

128. See Sarah McBride, *Clear Channel’s Outlook Is Cloudy as Buyout Flops*, WALL ST. J. (ASIA), Mar. 31, 2008, at 22.

Figure 7
S&P 500 “At Risk” Removals, Sector-by-Sector Breakdown



Source: Appendix

newswires, trade journals, newspapers such as the *New York Times*, the *Wall Street Journal*, and the *Financial Times* and magazines such as the *Economist*, *Forbes*, and *Fortune*, was relied on for this purpose.¹²⁹ A wide-ranging set of searches was conducted for each of the sample companies, with the intent being to find sources providing information on corporate governance reform, managerial fraud, boardroom shake-ups, executive pay, private equity intervention, and shareholder activism.¹³⁰ For search purposes, the date range was set at six months prior to removal from the S&P 500, so as to find out how companies responded as trouble brewed, and six months after, so as to determine what the fallout was. The cut-off dates were necessarily arbitrary and increasing the date range might have yielded more complete results in some instances. However, for various high-profile companies, key searches (e.g., [Company name] and “corporate governance”) would

129. On Factiva’s content, see Dow Jones Factiva, <http://factiva.com/sources/contentwatch.asp?node=menuElem1522> (last visited Sept. 9, 2009).

130. For each company, the following searches were run: [Company name] and “corporate governance”; [Company name] and “shareholder value”; [Company name] and “outside directors”; [Company name] and “shareholder activism”; [Company name] and “activist shareholder”; [Company name] and “executive pay”; [Company name] and “executive compensation”; [Company name] and “Sarbanes Oxley”; [Company name] and “private equity”; [Company name] and “leverage”; [Company name] and “buyback”; [Company name] and “Chapter 11”; [Company name] and “fraud.”

have generated too many results to analyze if the time period covered had been extended markedly. Moreover, events occurring more than six months prior to removal from the S&P 500 were taken into account to the extent they were referred to in the sources analyzed.

Due to the prominence of companies that are part of the S&P 500, the Factiva searches should have brought to light most material corporate governance developments concerning the sample companies during the prescribed date range. Nevertheless, the Factiva searches were supplemented in various ways. First, Georgeson's *2008 Annual Corporate Governance Review*¹³¹ was relied upon to find incidents of shareholder activism that the Factiva searches may have missed. In particular, the list of companies removed from the S&P 500 was cross-referenced against the Georgeson volume to find instances where incumbent directors were challenged by way of a proxy contest at the annual shareholder meeting and where shareholders made formal requests that resolutions be put to a shareholder vote.

Second, searches were conducted using the Stanford Law School Securities Class Action Clearinghouse database.¹³² The intention here was to find class actions in which it was alleged the sample companies were involved in securities fraud. The search was generally restricted to cases filed between January 2008 and June 2009, with the search being extended back to January 2007 for companies leaving the S&P 500 before July 2008.

Third, data was collected on CEO pay for 2007. SEC filings concerning chief executive compensation, collated by the AFL-CIO for a web site on executive pay, were consulted to find out how the sample companies stood in relation to peers in the S&P 500.¹³³ A *Forbes* web site providing data on 2006 was used to collect data on the small handful of sample companies for which 2007 figures were unavailable.¹³⁴

V. CORPORATE GOVERNANCE AND S&P 500 REMOVAL, 2008

Analysis of corporate governance in the companies removed from the S&P 500 in 2008 can be appropriately subdivided as follows: fraud, board issues, managerial turnover, executive compensation, private equity, and shareholder activism. Fraud merits specific attention because of the corporate governance scandals afflicting Enron, WorldCom, and various other high-profile corporations in the early 2000s. Was the dishonest behavior that characterized these scandals a feature of the stock market turmoil of 2008? As for board issues, reform has been a

131. GEORGESEON, 2008 ANNUAL CORPORATE GOVERNANCE REVIEW (2009), available at http://www.georgeson.com/usa/flash_viewer.html.

132. See <http://securities.stanford.edu/fimi/xsl/SCACPUDB/findrecords.xsl?-view> (last visited Sept. 9, 2009).

133. AFL-CIO, Executive Pay Watch, <http://www.aflcio.org/corporatewatch/paywatch/> (last visited Sept. 9, 2009).

134. FORBES.COM, SPECIAL REPORT: EXECUTIVE COMPENSATION (2007), http://www.forbes.com/2007/05/03/highest-paid-ceos-lead-07ceo-cz_sd_0503ceo_land.html.

hallmark of corporate governance since the 1970s.¹³⁵ Given all of the water under the bridge, how did directors respond to the challenges 2008 posed? Were they subjected to criticism publicly? Was boardroom turnover a regular feature of the stock market meltdown? Did directors respond proactively to the stock market turmoil by replacing the CEO or other senior executives?

With executive pay, while historically there were concerns that managerial remuneration did too little to promote shareholder value,¹³⁶ more recently critics have argued performance-oriented elements of compensation packages are unjustifiably lucrative and distort incentives because managers focus on their specific targets rather than on the overall promotion of shareholder value.¹³⁷ With the stock market meltdown of 2008, was executive pay part of the problem or part of the solution? Finally, both private equity and the “offensive” shareholder activism in which hedge funds engage theoretically provide managers with fresh incentives to be on their toes. How did these market-oriented corporate governance devices perform among companies facing removal from the S&P 500?

The assessment of corporate governance provided here is by no means exhaustive. In particular, it is simply taken for granted that, measured purely in terms of share price performance, the results were poor indeed. Also, evidentiary limitations preclude any sort of assessment whether the companies removed from the S&P 500 engaged in “excessive” risk-taking.¹³⁸ On the other hand, the evidence at hand does indicate how responsive key corporate governance players were to the challenges the stock market meltdown of 2008 posed, and thus offers insights on the extent to which the case for fresh reform is made out.

A. FRAUD

SOX was enacted in response to the corporate scandals occurring at Enron, WorldCom, and assorted other major public companies at the beginning of the 2000s.¹³⁹ According to some observers, the stock market meltdown of 2008 demonstrated that the reform effort had failed. As a *Wall Street Journal* columnist argued in October 2008, “Today’s financial crisis has shown what a real debacle looks like. And it has made clear that executives’ duties to public companies have, if anything, been loosened, not reinforced.”¹⁴⁰ If outright dishonesty had been a hallmark of the stock market meltdown of 2008, this would have been a damning indictment of SOX. However, it seems SOX passed this admittedly basic test. As the *Economist* said of the financial crisis in a 2009 survey of U.S. business, “[S]windles were not typical. The crisis owe[d] far more to incompetence than

135. See *supra* notes 25–33, 59 and accompanying text.

136. See *supra* note 43 and accompanying text.

137. See, e.g., LUCIAN BEBCHUK & JESSE FRIED, *PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION* 6–7, 9–10, 121–22, 137 (2004).

138. See *supra* note 8 and accompanying text.

139. See *supra* notes 53–60 and accompanying text.

140. Dennis K. Berman, *The Game: Enron Lessons Are Thin; Crackdown Lulled Washington to Sleep; That Crisis Is a ‘Gnat,’* WALL ST. J. (EUR.), Oct. 29, 2008, at 24. See also Michael Skapinker, *Every Fool Knows It Is a Job for Government*, FIN. TIMES, Nov. 18, 2008, at 13.

criminality.”¹⁴¹ Developments at the thirty-seven companies removed from the S&P 500 fit the pattern, in that fraud was apparently very much the exception to the rule.

Court proceedings, the press, and public officials (as of March 2009, at least six congressional committees were investigating the financial crisis) may ultimately expose a few out-and-out scoundrels among the thirty-seven companies.¹⁴² This could be the case, for example, with mortgage lender Countrywide Financial Corporation. In June 2009, the SEC filed a civil suit claiming Angelo Mozilo, the company’s charismatic co-founder and former CEO, dumped \$140 million worth of shares while he was aware of growing dangers Countrywide faced by underwriting high-risk loans, and that Mozilo and other top executives falsely assured investors about the soundness of the company’s mortgage business.¹⁴³ Future revelations also could arise with various other “at risk” financials removed from the S&P 500 in 2008, given that by mid-2009 the SEC and the U.S. Department of Justice had launched “dozens” of investigations into companies at the heart of the financial crisis.¹⁴⁴

Generally, however, in the immediate aftermath of the stock market meltdown of 2008, there was no blatant evidence of the sort of intentional manipulation of financial statements that went on at Enron or a Ponzi-style scheme of the sort executed by disgraced former NASDAQ chairman Bernard Madoff.¹⁴⁵ Also, in those instances where intentional managerial misconduct came to light at one of the thirty-seven companies removed from the S&P 500, the dishonest behavior was typically peripheral to the company’s departure. For instance, Vernon Hill, the charismatic founder, chairman, and CEO of Commerce Bancorp, was forced to step down in late 2007 after federal regulators uncovered various problematic related party transactions, but the bank was still in sound enough shape to be sold for \$8.5 billion in early 2008 to the Toronto-Dominion Bank.¹⁴⁶ At Bear Stearns, dropped from the S&P 500 in June 2008 after a rescue merger with J.P. Morgan, there were criminal and civil charges based on allegations of lying about flimsy subprime loan holdings, but these were filed against two of the firm’s fund managers rather than against senior executives.¹⁴⁷ Similarly, with Wachovia Corporation, removed from the index in December 2008 after a rescue merger by Wells Fargo &

141. *The Coming Recovery*, *ECONOMIST*, May 30, 2009, at 17.

142. See Roger Parloff, *Wall Street: It’s Payback Time*, *FORTUNE*, Jan. 19, 2009, at 56; Paul M. Thompson, *White Collar Crime: Investigating the Economic “Villains,”* *NAT’L L.J.*, Mar. 9, 2009, at S1 (discussing congressional committees).

143. See Gretchen Morgenson, *SEC Accuses Countrywide’s Former Chief of Fraud*, *N.Y. TIMES*, June 5, 2009, at A1; Kara Scannell & John R. Emshwiller, *Countrywide Chiefs Charged with Fraud*, *WALL ST. J.*, June 5, 2009, at C1.

144. Zachary A. Goldfarb, *Bank of America Pays \$33 Million to Settle Merrill Bonus Charges*, *WASH. POST*, Aug. 4, 2009, at A11.

145. *The Coming Recovery*, *supra* note 141.

146. See Holly Sraeael, *Vernon Hill’s Magic as CEO Was Also His Downfall*, *U.S. BANKER*, Aug. 2007, at 8; *TD Earns Kudos for Bold Southern Foray*, *TORONTO STAR*, Oct. 8, 2007, at B03.

147. Andrew J. Ceresny, Gordon Eng & Sean R. Nuttall, *Regulatory Investigations and the Credit Crisis: The Search for Villains*, 46 *AM. CRIM. L. REV.* 225, 251–52 (2009).

Company, Wells Fargo agreed in June 2009 to pay \$40 million to settle claims that employees of a Wachovia mutual fund operator misled investors about the value and safety of the holdings of one of its funds during the financial crisis.¹⁴⁸

While unambiguous, intentional wrongdoing by executives apparently did not afflict the companies exiting the S&P 500 in 2008, there well may have been instances where senior personnel who honestly believed what they were saying made statements or authorized disclosures that were in fact highly misleading. The filing of securities fraud class actions provides an indication of companies where this scenario was most likely to be involved. As of June 2009, cases of this sort had been filed in relation to thirteen of the thirty-seven companies removed from the S&P 500 in 2008 (Table 1), the outcome of which all remained pending at that point.¹⁴⁹ All thirteen were financials, save for retailer Liz Claiborne, and eleven fell into the “at risk” category. The remaining twenty-four companies apparently escaped securities lawsuits despite 2008’s dramatic drop in share prices.¹⁵⁰

Taken together, with respect to fraud, it appears companies removed from the S&P 500 during 2008 were not Enron imitations and were apparently largely fraud-free. To the extent that there was managerial malfeasance, it seemingly was restricted largely, if not entirely, to “at risk” financials, despite the pressures imposed on firms generally by the largest drop in stock prices since the 1930s. SOX thus may have helped to protect investors in S&P 500 companies from outright financial dishonesty. It could not protect them, however, from business failure,

148. See Jennifer Levitz, *Wells Fargo, BofA Pay to Settle Claims*, WALL ST. J., June 10, 2009, at A25. On the acquisition of Wachovia being a “rescue merger,” see Arthur E. Wilmarth, *The Dark Side of Universal Banking: Financial Conglomerates and the Origins of the Subprime Financial Crisis*, 41 CONN. L. REV. 963, 1044 (2009).

149. Pinpoint cites have not been provided for propositions advanced in Table 1 and other tables in this Article. Microsoft Word files containing the relevant sources, organized chronologically by when companies were removed and subdivided on a company-by-company basis, are available on request from *The Business Lawyer*. The sources included in the files are the relevant articles and news-wire reports derived from searches of Factiva and pertinent excerpts from the Stanford Law School Securities Class Action Clearinghouse database, *supra* note 132, the AFL-CIO web site on executive pay (for 2007), *supra* note 133, and the *Forbes* web site on executive compensation (for 2006), *supra* note 134.

150. Washington Mutual and its (former) directors did face, however, a class action launched by bondholders. See Gary Jacobson & Brendan Case, *Tom Leppert Had Front-Row Seats to Washington Mutual’s Collapse*, DALLAS MORNING NEWS, Mar. 1, 2009, http://www.dallasnews.com/sharedcontent/dws/bus/stories/DN-LeppertWamu_22bus.ART.State.Edition1.4aaca63.html.

Table 1**Securities Class Actions Filed During 2008 Against Companies Removed from the S&P 500 (in order of removal)**

Company	Industry	“At Risk”?	Date Filed	Allegations
The Bear Stearns Companies Inc.	Financials	Yes	Feb. 27, 2009	False and misleading statements concerning the company’s business and financial results.
Ambac Financial Group, Inc.	Financials	Yes	Aug. 25, 2008	False and misleading statements concerning the company’s business and financial results, with particular reference to insurance coverage of collateralized debt obligations.
Countrywide Financial Corporation	Financials	Yes	Jan. 7, 2009	False and misleading statements concerning the company’s business and financial results, with particular reference to the changing quality of the company’s mortgage loan portfolio.
Freddie Mac	Financials	Yes	Aug. 15, 2008	False and misleading statements concerning the company’s business and financial results, with particular reference to Freddie Mac’s loan portfolio and underwriting standards.
Fannie Mae	Financials	Yes	Sept. 8, 2008; Sept. 16, 2008	False and misleading statements concerning the company’s business and financial results, with one suit relating to secondary trading of Fannie Mae securities and the other to capital-raising.
Lehman Brothers	Financials	Yes	Oct. 27, 2008	False and misleading statements concerning the company’s business and financial results, with one suit relating to secondary trading of Lehman Brothers securities and the other to capital-raising.
Safeco Corporation	Financials	No	June 16, 2008	Directors pursuing their own interests at the expense of shareholders when negotiating a merger with Liberty Mutual.
MGIC Investment Corporation	Financials	Yes	May 26, 2008	False and misleading statements concerning the company’s business and financial results, with particular reference to MGIC’s investments in Credit-Based Asset Servicing and Securitization LLC.

Table 1
Securities Class Actions Filed During 2008 Against Companies Removed from the S&P 500 (in order of removal)

Company	Industry	“At Risk”?	Date Filed	Allegations
General Growth Properties Inc.	Financials	Yes	Oct. 31, 2008	False and misleading statements concerning the company’s access to finance.
Liz Claiborne Inc.	Consumer Discretionary	Yes	Apr. 28, 2009	False and misleading statements concerning the company’s business and financial results, particularly in relation to an alleged failure to disclose a sharp drop in orders.
Wachovia Corporation	Financials	Yes	June 6, 2008	Misleading investors with claims about the firm’s strict loan origination and underwriting practices.
National City Corporation	Financials	Yes	Jan. 24, 2008; Nov. 26, 2008	False and misleading statements concerning the company’s access to finance; breach of duty by directors in negotiating a merger with PNC, a bank. ¹⁵¹
Merrill Lynch & Co.	Financials	Yes	mid-October, 2008; Oct. 22, 2008	Merrill Lynch directors breached their duty of care by agreeing to an unduly hasty sale of the company to Bank of America; false and misleading statements pertaining to the sale of Merrill Lynch preferred stock and bonds.

151. Allegations that the directors of National City Corporation failed to maximize shareholder value in the merger with PNC provided the basis for two lawsuits alleging a breach of fiduciary duty. One, filed in Ohio, was primarily a securities law claim. See *Tharp v. Nat’l City Corp.*, No. 08-CV-02794 (N.D. Ohio filed Nov. 26, 2008), available at http://securities.stanford.edu/1041/NCC_01/20081126_f01c_0802794.pdf. The other, filed in Delaware, was based on corporate law. See Steve Wartenberg, *National City’s Old Options Are Part of Suit: Angry Shareholders Cite Board Minutes Telling of ‘08 Suitors*, COLUMBUS DISPATCH, May 31, 2009, at D1.

Source: Stanford Law School Securities Class Action Clearinghouse database; Factiva searches

reflecting the fact that the legal system gives executives wide authority to run businesses as they see fit even if they make terrible decisions honestly.¹⁵²

B. THE BOARD OF DIRECTORS

As part of what amounts to a corporate governance “industry,” various proxy research and advisory services rank the quality of public corporations’ corporate governance for clients making decisions about how to invest and how to vote their shares.¹⁵³ Despite all of the intellectual effort, commercial corporate governance indices have not yet proven to be reliable predictors of future stock returns, perhaps because what constitutes effective governance depends on each firm’s specific circumstances.¹⁵⁴ It follows in turn that in order to assess the quality of board governance in the companies removed from the S&P 500 in 2008, the most appropriate way to proceed is to focus on how matters worked out in practice rather than on the composition and structure of particular boards.

While in theory it is sensible to assess boards of the thirty-seven companies removed from the S&P 500 in terms of performance rather than structure, given that directors meet behind closed doors in confidential meetings, ascertaining how well they have done their job is a challenging task. The SEC has announced plans to investigate the performance of boards of banks and other financial firms leading up to the financial crisis, and this investigation should uncover valuable evidence on board performance.¹⁵⁵ With the sources available for this study, however, the only feasible method of proceeding was to focus on public indications of board shortcomings.

One public indication of board failure is criticism reported in the media and trade publications. Another is boardroom turnover, at least when doubts about the capabilities of incumbents prompt a change. The sources consulted for the purpose of this study offer evidence of both metrics of substandard board performance. The core finding, however, is a lack of things going awry. With a sizeable majority of companies removed from the S&P 500, there was no public criticism of the directors and no evidence of out-of-the-ordinary board turnover. It correspondingly appears that while directors were not a bulwark against the sharp decline in share prices that occurred in 2008, at least in the companies removed from the S&P 500, boards did not compound the problem.

Among the thirty-seven companies in question, with seven there was public criticism of the board (Table 2). In only one instance—brewer Anheuser Busch—was the company in question not in the “at risk” category and the Anheuser Busch

152. See Berman, *supra* note 140; Loren Steffy, *Law Can’t Stop Failure*, Hous. Chron., Mar. 21, 2008, at 1.

153. On the terminology, see generally Paul Rose, *The Corporate Governance Industry*, 32 J. Corp. L. 887 (2008). For an overview of the key commercial providers and the services they market, see *id.* at 898–906; Bhagat, Bolton & Romano, *supra* note 11, at 1824–26, 1872–76.

154. Bhagat, Bolton & Romano, *supra* note 11, at 1808, 1814, 1818, 1859.

155. See Zachary A. Goldfarb, *SEC to Examine Boards’ Role in Financial Crisis*, Wash. Post, Feb. 20, 2009, at D1.

Table 2
**Public Criticism of Boards Among Companies Removed from
the S&P 500, 2008 (in order of removal)**

Company	Industry	“At Risk”	Nature of Criticism
The Bear Stearns Companies Inc.	Financials	Yes	The board lacked sufficient financial expertise and failed to challenge sufficiently the company’s dominant CEO.
Countrywide Financial Corporation	Financials	Yes	The board failed to challenge sufficiently the company’s dominant CEO.
Lehman Brothers	Financials	Yes	The board lacked sufficient financial expertise and failed to challenge sufficiently the company’s dominant CEO.
Washington Mutual	Financials	Yes	The board failed to safeguard the company.
Dillard’s, Inc.	Consumer Discretionary	Yes	The board was too loyal to the Dillard family, founders of the company.
Anheuser-Busch	Consumer Staples	No	The board was too “clubby” and too loyal to the Busch family and CEO August Busch IV.
Merrill Lynch & Co.	Financials	Yes	Directors moved too hastily in agreeing to sell the company to Bank of America.

Source: Factiva Searches

board ultimately responded effectively to its critics when it secured a higher price for shareholders in a merger with Belgian brewer InBev by spurning InBev’s initial tender offer.¹⁵⁶

As for the boards of the “at risk” corporations that were subject to public criticism, all save one were financials. On a general level, directors of such companies stood accused of letting the good times roll rather than coming properly to grips with the risks management was taking.¹⁵⁷ Directors of particular companies were

¹⁵⁶ See Tim Barker, *Loyalty of A-B Board May Be Put to the Test*, ST. LOUIS POST-DISPATCH, June 20, 2008, at A1 (criticism of the board); David Nickalus, *In the End, A-B’s Board Stopped Bluffing and Took Care of Business*, ST. LOUIS POST-DISPATCH, July 14, 2008, at A1 (the board’s response).

¹⁵⁷ See Heineman, *supra* note 1; C.J. Prince, *Is Countrywide a Corporate Governance Train Wreck?*, CHIEF EXECUTIVE, June 2008, at 44.

also criticized on grounds of expertise, or lack thereof. For example, critics argued that the Bear Stearns board, which included among its twelve members two university presidents, a former toy company executive, a former law partner, and an oil company executive, lacked sufficient financial expertise to hold management properly accountable.¹⁵⁸ Another charge leveled against directors of certain financials was that they were dazzled by a free-wheeling, charismatic CEO and could not summon the courage to say “no” until it was too late. This allegedly was the pattern, for instance, at Bear Stearns with brassy, fast-talking CEO Jimmy Cayne, at Countrywide Financial with the charismatic Angelo Mozilo, and at Lehman Brothers, led by Dick Fuld, labeled “the text book example” of “the command-and-control CEO.”¹⁵⁹

With Dillard’s, the one non-financial “at risk” company where there was public criticism of the board, the discontent yielded tangible results in terms of board turnover. The Dillard family, which was entitled to select eight of Dillard’s twelve directors because it owned virtually all of the company’s super-voting class B shares, forestalled a proxy battle for the remaining four seats by agreeing to support the appointment of new independent directors endorsed by hedge fund activist shareholders.¹⁶⁰ None of the companies removed from the S&P 500 during 2008 experienced a fully fledged proxy fight where board seats were contested at the annual shareholder meeting.¹⁶¹ However, Circuit City and Unisys adopted the same approach as Dillard’s and consented to add directors selected by dissident shareholders so to as forestall a public confrontation (Table 3).

Among the companies removed from the S&P 500 during 2008 there were six additional firms that experienced publicized boardroom turnover (Table 3), making a total of nine. All were in the “at risk” category, which is what would be anticipated given that boardroom turnover is a logical corporate governance response when poor performance suggests a change of direction is in order. On the other hand, this was a rare instance where financials did not play an outsized role with corporate governance developments affecting the companies dropped from the S&P 500 in 2008, as only a minority of the companies that experienced board turnover were part of this sector.

Venerable shareholder activist Carl Icahn has said of the recent financial crisis, “[W]hile executives and regulators have justifiably taken the heat for this multifaceted debacle, board members have largely been let off the hook.”¹⁶² The absence

158. On Bear Stearns, see Gretchen Morgenson, *SEC Sends Investors to the Children’s Table*, N.Y. TIMES, Dec. 2, 2007, at 31; Paul Fain, *Two University Chiefs Caught Up in a Wall Street Meltdown*, CHRON. HIGHER EDUC., Nov. 7, 2008, at A17.

159. See Landon Thomas, Jr., *Not a Jolly Season for 2 Top Bankers*, N.Y. TIMES, Dec. 21, 2007, at C1 (Bear Stearns); Andrew Gowers, *Exposed: Dick Fuld, the Man Who Brought the World to its Knees*, SUNDAY TIMES, Dec. 14, 2008, at 1 (Countrywide, Lehman Brothers).

160. See *Dillard’s Side-Steps Proxy Fight*, KNOXVILLE NEWS-SENTINEL, Apr. 3, 2008, at 23; Toby Manthey, *Dillard’s Execs Got No 2007 Bonuses*, ARK. DEMOCRAT-GAZETTE, Apr. 23, 2008, at 27.

161. For a list of companies where a proxy fight occurred during 2008, see GEORGESON, 2008 ANNUAL REPORT, *supra* note 131, at 46–47.

162. Carl C. Icahn, *Corporate Boards that Do Their Job*, WASH. POST, Feb. 16, 2009, at A15. See also Francesco Guerrera & Peter Thal Larsen, *Gone by the Board? Why the Directors of Big Banks Failed to*

Table 3**Publicized Director Turnover Among Companies Removed from the S&P 500, 2008 (companies listed in order of removal from the index)**

Company	Industry	“At Risk”	Circumstances
Circuit City Stores Inc.	Consumer Discretionary	Yes	To fend off a fully fledged proxy fight, management consented to adding three nominees of an activist shareholder to its slate of nominated directors.
Ambac Financial Group, Inc.	Financials	Yes	Chairman of the board replaced, January 2008.
Brunswick Corporation	Consumer Discretionary	Yes	In July 2008, the board bolstered its ranks by appointing a director with expertise in downsizing.
OfficeMax, Inc.	Consumer Discretionary	Yes	The individual serving as chair of the committee of outside directors and as the lead independent director stepped down.
Washington Mutual	Financials	Yes	CEO was replaced as chairman of the board in response to a shareholder vote in favor of splitting the roles. Chair of finance committee replaced.
Dillard’s, Inc.	Consumer Discretionary	Yes	The company consented to the election of four directors selected by activist hedge funds to fend off a threatened proxy fight.
Unisys Corporation	IT	Yes	As part of a compromise to fend off a proxy fight, two directors selected by an activist hedge fund were added to the board.
General Growth Properties Inc.	Financials	Yes	After two independent directors took up executive posts with the company, a director who was also a senior executive resigned his board seat to ensure there remained a majority of independent directors.
Wachovia Corporation	Financials	Yes	CEO replaced as chairman of the board a few months before being dismissed as chief executive.

of a fully fledged proxy fight among the companies removed from the S&P 500 in 2008 lends credence to this charge, as does the fact that only four of the twelve financials in the “at risk” category experienced boardroom turnover. It cannot be taken for granted, however, that widespread boardroom dismissals were justified, even among the financials.

For instance, it may have been expecting too much of part-time external board members that they anticipate a looming financial meltdown that was not on the radar screen of full-time executives, regulators, or the financial press.¹⁶³ In addition, even those outside directors of financial institutions who were prescient enough to argue that a “go slow” approach made good sense likely would have been silenced by league tables and “gap analysis” indicating how their firm risked sacrificing market share and attendant revenue to dynamic competitors and by reassurances that sophisticated risk management models would provide ample warning of any serious problems.¹⁶⁴ As Jack Welch, former CEO and chairman of General Electric, has said, “Unfortunately, even boards with sound judgment didn’t stand much of a chance against the newfangled financial instruments that sparked the crisis.”¹⁶⁵ Finally, directors were perhaps doing their job properly, or at least an important aspect of it, by orchestrating merited managerial turnover. We turn to this issue next.

C. MANAGERIAL TURNOVER

When the board of a public company wants to execute a change in direction, the most direct method is to replace senior managerial personnel, in particular the chief executive officer. Given that various critics of U.S. corporate governance argue that public companies are afflicted by a counterproductive “CEO primacy,”¹⁶⁶ it might have been thought that chief executives could have ridden out the 2008 stock market storm without too much difficulty. That turned out not to be the case.

Factiva searches for the thirty-seven companies removed from the S&P 500 during 2008 reveal publicized CEO turnover in nine firms, publicized senior (but non-CEO) executive turnover in eight, and turnover of both sorts in four companies (Table 4).¹⁶⁷ The managerial turnover that occurred was not randomly distributed. Instead, all but two of the companies involved were financials and

Spot Credit Risks, FIN. TIMES, June 26, 2008, at 13; James Surowiecki, *Board Stiff*, NEW YORKER, June 1, 2009, at 34.

163. See Guerrero & Larsen, *supra* note 162; see also *supra* note 6 and accompanying text.

164. See William Rees-Mogg, *Good People + Impossible Task = Collapse*, TIMES ONLINE, Mar. 2, 2009, http://www.timesonline.co.uk/tol/comment/columnists/william_rees_mogg/article5827406.ece; *Rebuilding the Banks*, ECONOMIST, May 16, 2009, at 14.

165. Jack Welch & Suzy Welch, *How Much Blame Do Boards Deserve?*, BUS. WK. ONLINE, Jan. 14, 2009, http://www.businessweek.com/magazine/content/09_04/b4117102356265.htm.

166. See Steven A. Ramirez, *The Special Interest Race to CEO Primacy and the End of Corporate Governance Law*, 32 DEL. J. CORP. L. 345, 345–46 (2007) (endorsing the verdict offered by various observers).

167. This total does not include turnover occurring subsequent to an acquisition, where senior executives of the company being acquired will usually step down as a matter of course.

Table 4
Publicized Senior Executive Turnover Among Companies Removed from the S&P 500, 2008 (in order of removal)

Company	Industry	“At Risk”	CEO	Other Senior Executives	Circumstances
Circuit City Stores Inc.	Consumer Discretionary	Yes	Yes	Yes	CEO quit under pressure from shareholders. Sales executive vice president replaced. Executive vice president of merchandising and marketing resigned.
Commerce Bancorp	Financials	No	Yes	No	CEO and founder quit in late 2007 after self-dealing uncovered.
The Bear Stearns Companies Inc.	Financials	Yes	Yes	No	CEO stepped down but remained board chairman.
Ambac Financial Group, Inc.	Financials	Yes	Yes	No	CEO resigned; chairman of the board replaced him as interim CEO.
Fannie Mae	Financials	Yes	No	Yes	The CFO and two other senior executives were replaced a few weeks before Fannie Mae was put under government conservatorship.
Lehman Brothers	Financials	Yes	No	Yes	Due to investor worries about falling share prices, the chief operating officer and finance director were replaced.
Washington Mutual	Financials	Yes	Yes	No	The CEO, who had already been replaced as chairman of the board, was fired a few weeks before a rescue merger with JP Morgan.

Table 4
Publicized Senior Executive Turnover Among Companies Removed from the S&P 500, 2008 (in order of removal)

Company	Industry	“At Risk”	CEO	Other Senior Executives	Circumstances
Unisys Corporation	IT	Yes	Yes	No	Turnaround specialist brought in as CEO and chairman of the board.
General Growth Properties Inc.	Financials	Yes	Yes	Yes	With share prices falling dramatically, the CEO, a member of the founding family, quit and the CFO was replaced.
Liz Claiborne Inc.	Consumer Discretionary	Yes	No	Yes	In 2007 and 2008, ten senior executives departed as part of a shake-up orchestrated by a CEO hired in 2006.
Wachovia Corporation	Financials	Yes	Yes	Yes	CEO fired by the board. New CEO hired a new CFO.
National City Corporation	Financials	Yes	No	Yes	CFO departed at the same time the company raised capital from private equity investors. A new vice president was hired to handle risky loans.
Merrill Lynch & Co.	Financials	Yes	Yes	Yes	CEO replaced in December 2007 and the new CEO installed a fresh management team.

Source: Factiva Searches

the action focused almost exclusively on “at risk” companies. This is what would have been anticipated with well-functioning corporate governance, as experts on boardroom behavior say imposing discipline and providing fresh leadership is particularly important when corporations are afflicted by poor performance.¹⁶⁸ Commerce Bancorp was the only company in the sample affected by publicized managerial turnover that was not in the “at risk” category, and Vernon Hill, the chief executive in question, left due to scandal.¹⁶⁹

To put these figures into perspective, among the twenty “at risk” companies leaving the S&P 500 in 2008, 40 percent experienced CEO turnover and 40 percent experienced the publicized removal of other senior executives. This level of executive turnover greatly exceeds the norm, even in underperforming companies. According to Booz & Company, a management consulting firm, among the world’s largest 2,500 companies there was in a ten-year period ending in 2007 only a 2.1 percent chance of the CEO of a poorly performing company being dismissed in any given year, with the probability of termination increasing to only 5.7 percent among companies in the lowest decile of performance.¹⁷⁰

Boards of companies removed from the S&P 500 in 2008 were by no means flawless in their approach to selecting senior executives. The boards of various leading U.S. financials may well have failed to choose chief executives wisely, in the sense that the CEOs who were hired frequently pursued profits aggressively with highly leveraged strategies that ultimately wrought havoc.¹⁷¹

It is also possible that, for some firms, instability created by frequent managerial turnover made it more difficult to navigate through the crisis.¹⁷² Conversely, there were among the companies dropped from the S&P 500 in 2008 instances where, in retrospect, it was surprising the board stuck with the incumbent CEO as long as it did. For instance, Countrywide Financial’s board not only gave Angelo Mozilo a \$10 million bonus in 2006 to reward him for staying in office longer than planned, it remained loyal to him until the firm was sold to Bank of America even though the share price had fallen from \$37.95 to under \$4.¹⁷³ Similarly, the board of Lehman Brothers left Dick Fuld in charge right up to the time the investment bank filed for bankruptcy, notwithstanding that he passed on various decent chances to sell the firm before it was shut down and pushed the firm into the real estate field just as the boom the United States experienced during the mid-2000s began to go into reverse.¹⁷⁴ Still, while there were instances where

168. Sanjai Bhagat & Brian Bolton, *Corporate Governance and Firm Performance*, 14 J. CORP. FIN. 257, 269 (2008).

169. See *supra* note 146 and accompanying text.

170. Per-Ola Karlsson, Gary L. Neilson & Juan Carlos Webster, *CEO Succession 2007: The Performance Paradox*, STRATEGY + BUS., Summer 2008, at 1, 3.

171. See Heineman, *supra* note 1.

172. See Paul Davis, *Execs Come, Execs Go, Effects Stay*, AM. BANKER, June 18, 2009, at 1.

173. See James R. Hagerty, *Mozilo’s Pay Plunged 79%; He Still Made \$10.8 Million*, WALL ST. J., Apr. 25, 2008, at B1 (bonus for staying in office); Stephanie Hoops, *Countrywide Financial’s ‘Sad Day’: BofA Deal Approved*, VENTURA COUNTY STAR, June 26, 2008, <http://www.venturacountystar.com/news/2008/jun/26/countrywide-financials-sad-day-bofa-deal/> (share prices).

174. See Berman, *supra* note 140.

boards could no doubt have done better, among companies removed from the S&P 500 in 2008, corporate governance did function appropriately in the sense that, for top executives of firms in bad financial shape, there was a real risk they would pay with their jobs.

D. EXECUTIVE PAY

Executive compensation generated controversy at various junctures during the 1990s and the 2000s as increases in CEO pay dramatically outpaced inflation, the growth of the U.S. economy, and pay raises from which rank-and-file workers benefited.¹⁷⁵ However, in 2008, the economy’s downward spiral put the issue in the spotlight as never before, with feelings running high because of expectations that executives would “feel the pain” along with the shareholders experiencing dramatic declines in stock prices and employees losing their jobs.¹⁷⁶ Nevertheless, there was no random backlash among the thirty-seven companies removed from the S&P 500 in 2008, perhaps due partly to general trends concerning executive pay—median pay for CEOs of S&P 500 companies fell 6.8 percent in 2008.¹⁷⁷ A sizeable majority of the companies removed from the index (23) escaped any sort of public criticism of their executive compensation policies and controversies that arose seemed appropriately targeted.

Of the fourteen companies removed from the S&P 500 during 2008 where there was publicized criticism of executive pay, eleven were “at risk” companies (Table 5), implying critics specifically (and understandably) targeted executives who presided over a massive write-down in shareholder value. As for the other three companies, they were perhaps singled out because CEO pay comfortably exceeded the 2007 median for S&P 500 CEOs (\$8.4 million).¹⁷⁸ In addition, at one of the companies the CEO resigned due to a scandal (Commerce Bancorp) and at another (IAC/Interactive Corp.) the CEO had been paid an eye-catching total of \$295.1 million in 2006 (Table 5).

With the nine “at risk” companies where there was no executive pay controversy, the lack of a backlash may have been partly a result of the relatively modest pay of the CEO. In seven of the companies, CEO pay for 2007 was below the median for S&P 500 CEOs (again, \$8.4 million).¹⁷⁹ The only exceptions were

175. See, e.g., GRAEF S. CRYSTAL, *IN SEARCH OF EXCESS: THE OVERCOMPENSATION OF AMERICAN EXECUTIVES* 23–24 (1991); John C. Bogle, *The Executive Compensation System Is Broken*, 30 J. CORP. L. 761, 762–63 (2005); *Too Many Turkeys*, *ECONOMIST*, Nov. 26, 2005, at 75.

176. See Greg Farrell & Barbara Hansen, *Stocks May Fall, but Execs’ Pay Doesn’t*, *USA TODAY*, Apr. 10, 2008, at B1 (“the public is focusing on CEO compensation as never before”); Francesco Guerrera & Joanna Chung, *Fear of Falling*, *FIN. TIMES*, Jan. 6, 2009, at 7 (“The level of anger and incredulousness around the country is at record levels.” (quoting union leader Dan Pedrotty)).

177. See *Surviving the Slump*, *ECONOMIST*, May 28, 2009, at 3.

178. See Rachel Beck & Matthew Fordahl, *CEO Pay Higher in ’07 Despite Slow Economy*, *TULSA WORLD*, June 22, 2008, at E5.

179. The eight companies were, in order of removal from the S&P 500, Circuit City (\$6.5 million, CEO compensation as of 2006, all other figures are for 2007); Ambac Financial Group, Inc. (\$730,000); Brunswick Corporation (\$3.4 million); OfficeMax, Inc. (\$5.1 million); MGIC Investment (\$3.5 million); Unisys Corporation (\$1.9 million); Ashland, Inc. (\$4.4 million).

Table 5
CEO Pay Controversies Among Companies Removed from the S&P 500, 2008 (in order of removal)

Company	Industry	“At Risk”	CEO Pay (2007 unless otherwise indicated)	Nature of Controversy
Commerce Bancorp	Financials	No	\$24.9m (2006)	Vernon Hill, founder and CEO, was forced to resign in late 2007 due to problematic non-arm’s-length transactions.
The Bear Stearns Companies Inc.	Financials	Yes	\$38.3m (2006)	The lucrative compensation of top Bear Stearns executives drew much criticism, particularly when the company began to encounter serious financial difficulties.
Countrywide Financial Corporation	Financials	Yes	\$48.1m (2006)	There was much criticism of the severance package (worth up to \$115m) awarded to Countrywide’s CEO and founder as part of the firm’s merger with Bank of America. He announced prior to testifying before Congress on his role in the financial crisis that he would not take the package. He also took a 79 percent pay cut between 2006 and 2007.
IAC/InterActive Corporation	Consumer Discretionary	No	\$15.4m	Liberty Media, IAC/Interactive’s largest shareholder, was critical of the generous pay the CEO received and of excessive use of the company jet.
Electronic Data Systems	IT	No	\$15m	There was criticism of payment of bonuses paid to EDS executives after the firm agreed to merge with Hewlett-Packard.
Fannie Mae	Financials	Yes	\$11.7m	There was intense criticism of a golden parachute of c. \$10 million to be paid out to the CEO departing after the federal government in effect took over the firm.
Freddie Mac	Financials	Yes	\$18.3m	Same as for Fannie Mae.

Table 5
CEO Pay Controversies Among Companies Removed from the S&P 500, 2008 (in order of removal)

Company	Industry	“At Risk”	CEO Pay (2007 unless otherwise indicated)	Nature of Controversy
Lehman Brothers	Financials	Yes	\$34.4m	Corporate governance advisory services deemed executive pay to be too high and criticized the secretive process by which executive compensation was determined. There was also criticism of bonuses paid to executives immediately prior to Lehman Brothers’ bankruptcy.
Washington Mutual	Financials	Yes	\$5.3m (\$22.7m in 2006)	Due to shareholder pressure, the company reversed a decision to ignore mortgage losses when calculating performance bonuses for top executives.
Dillard’s, Inc.	Consumer Discretionary	Yes	\$2.8m	Shareholder activists pressed for full disclosure of executive perks. Senior executives received no bonuses in fiscal 2007.
General Growth Properties Inc.	Financials	Yes	\$0.24m	A family trust set up by the company’s founding family lent sizeable sums of money to two senior executives so they could meet margin calls arising from sizeable purchases of General Growth shares.
Liz Claiborne Inc.	Consumer Discretionary	Yes	\$6.3m	The CEO’s pay was criticized as being too high for a company that had recently cut 2,200 jobs.
National City Corporation	Financials	Yes	\$3.4m	There was criticism of \$50 million paid out as golden parachutes to executives departing after National City merged with PNC.
Merrill Lynch & Co.	Financials	Yes	\$24.3m	\$3.6 billion worth of bonuses were paid out hurriedly to Merrill Lynch executives before the firm merged with Bank of America.

Sources: Factiva Searches; AFL-CIO Executive Pay database; *Forbes* Executive Pay database (for CEO pay)

Terex, a manufacturer of heavy construction and mining equipment, and Wachovia, where controversy was likely stifled because the bank's CEO, who was only in the job a few months before the company was sold to Citigroup, suffered a \$14 million loss on the 1 million Wachovia shares he owned and received no severance package after the Citigroup merger.¹⁸⁰

Although during the stock market meltdown of 2008 public controversies concerning executive pay involved the sort of companies that would be anticipated from a corporate governance perspective, executive pay at major financial companies remained problematic. Various top executives at such firms took a sizeable financial hit as share prices plummeted.¹⁸¹ Nevertheless, the right incentives apparently were not in place, as executives opted to engage in aggressive deployment of capital to generate returns unjustified by the potential downside consequences. As the chief executive of a bank admitted to the *Economist*, "It was better to be an employee than a shareholder."¹⁸²

One explanation for the bravado of the financials was that the executives did not recognize the gambles they were taking, believing, like most commentators, that the financial system was stable and doing a good job of spreading risk.¹⁸³ Executive pay, however, likely was part of the problem, in that senior executives of major financial firms could become sufficiently rich when times were good to give them a license to make big bets that could increase the share price dramatically and generate stratospheric payouts but alternatively could jeopardize the future of the firm.¹⁸⁴ To take a high-profile example, while the market value of Lehman Brothers shares held by its CEO Richard Fuld had fallen from nearly \$600 million to nothing by the time Lehman Brothers went bankrupt, he had already pocketed an estimated \$363 million between 1993 and 2007 by cashing in share options.¹⁸⁵ The Treasury Department correspondingly was likely on the mark when, in a 2009 report outlining the Obama administration's plans for financial reform, it identified compensation practices as one of the significant causes of the financial crisis, saying, "In particular, incentives for short-term gains overwhelmed the checks and balances meant to mitigate against the risk of excess

180. See David J. Reynolds, *Wachovia CEO Steel Loses Big on Sale to Citigroup*, DOW JONES NEWSWIRES, Sept. 29, 2008.

181. See, e.g., Farrell & Hansen, *supra* note 176 (discussing losses suffered by Bear Stearns's chief executive James Cayne); Martha Graybow, *Lehman's Fuld Suffers Wealth Hit as Shares Fall*, REUTERS, Sept. 12, 2008, <http://www.reuters.com/article/idUKN1240760720080912> (discussing impact of Lehman Brothers' September 2008 bankruptcy on the CEO); Robert Frank & Kris Hudson, *Dark Days for Mall Dynasty*, WALL ST. J., Dec. 10, 2008, at A1 (discussing how senior executives of General Growth Properties had to borrow money from the firm's founding family to meet margin calls incurred buying the company's shares).

182. *The Revolution Within*, ECONOMIST, May 16, 2009, at 15.

183. See *The Bonus Racket*, ECONOMIST, Jan. 31, 2009, at 81.

184. See Alan S. Blinder, *Crazy Compensation and the Crisis*, WALL ST. J., May 28, 2009, at A15; *Attacking the Corporate Gravy Train*, ECONOMIST, May 30, 2009, at 71; ORG. FOR ECON. CO-OPERATION & DEV., CORPORATE GOVERNANCE AND THE FINANCIAL CRISIS: KEY FINDINGS AND MAIN MESSAGES 16-17 (2009), available at <http://www.oecd.org/dataoecd/3/10/43056196.pdf>.

185. See Graybow, *supra* note 181.

leverage.”¹⁸⁶ Hence, while in a majority of companies removed from the S&P 500 in 2008 executive pay was uncontroversial and the controversies that arose occurred in the “right” companies, executive pay likely deserves at least some of the blame for the 2008 stock market meltdown.

E. PRIVATE EQUITY

Private equity buyouts have a disciplinary dimension that arguably serves to improve managerial accountability in public companies.¹⁸⁷ However, with corporate governance facing its most robust challenge in modern times due to the 2008 stock market meltdown, private equity was barely a factor. The fall in stock market prices meant there should have been numerous bargains around.¹⁸⁸ Private equity firms could not capitalize, however.

Private equity firms typically carry out buyouts with capital raised by one of their buyout funds, supplemented with large amounts of bank debt. Capital-raising suffered during the financial turmoil of 2008, with the value of investments made in private equity funds falling 69.5 percent as compared to 2007.¹⁸⁹ More importantly, it became almost impossible to obtain debt finance for the sort of super-sized leveraged public-to-private deals that characterized the private equity boom of 2005–2007.¹⁹⁰ Correspondingly, the aggregate value of U.S. private equity buyouts fell 84 percent in 2008 as compared with 2007 and there was not a single deal larger than \$10 billion.¹⁹¹

The private equity “deep freeze” was readily apparent with the thirty-seven companies removed from the S&P 500 in 2008. Harrah’s Entertainment, a resort operator, and Clear Channel Communications, Inc., a radio broadcaster, were dropped from the index due to being taken private but both deals were initially struck in 2006.¹⁹² There were rumors about private equity bids for a number of other companies removed from the index (e.g., Circuit City and Wendy’s International)¹⁹³ but these came to nothing.

186. U.S. DEP’T OF THE TREASURY, FINANCIAL REGULATORY REFORM: A NEW FOUNDATION 29 (2009), available at http://www.financialstability.gov/docs/regs/FinalReport_web.pdf [hereinafter FINANCIAL REGULATORY REFORM].

187. See *supra* notes 74–77 and accompanying text.

188. See Thorold Barker, *Private Equity Could Yet Discover a Silver Lining*, FIN. TIMES, Mar. 15, 2008, at 33; *Loan Rangers*, ECONOMIST, Aug. 30, 2008, at 73.

189. See Martin Arnold, *Buy-out Bosses See Halcyon Days Fade Away*, FIN. TIMES, Jan. 3, 2009, at 17 (capital raised fell from \$765.2 billion to \$233.5 billion).

190. See Peter Lattman, *Lacking Leverage, Firms Embrace EBOs*, WALL ST. J., Mar. 12, 2009, at C1.

191. See Posting to Wall Street Journal Deal Blog, <http://blogs.wsj.com/deals/2009/01/07/final-2008-data-confirm-little-but-tumbleweeds-in-lbo-arena/> (Jan. 7, 2009, 11:32 EST) (“Final 2008 Data Confirm: ‘Little But Tumbleweeds’ in LBO Arena”) (discussing data compiled by data provider Dealogic).

192. See Heather Timmons, *The Year that Made Deal Makers Giddy*, N.Y. TIMES, Jan. 5, 2007, at C6.

193. See Pallavi Gogoi, *Is Circuit City Headed for a Blowout?*, BUS. WK. ONLINE, July 2, 2008, http://www.businessweek.com/bwdaily/dnflash/content/jul2008/db2008072_040726.htm?chan=top+news_top+news-index_news+%2B+analysis; Catherine R. Cobb, Sarah E. Lockyer & Peter Romeo, *Arby’s Parent Triarc to Acquire Wendy’s in \$2.34B Stock Swap*, NATION’S RESTAURANT NEWS, May 5, 2008, at 3.

Despite the public-to-private buyout “deep freeze,” private equity firms did play a cameo role with the banks that were at the epicenter of the meltdown. As the financial crisis intensified, there was speculation that private equity firms, which had more than \$400 billion to invest due to successful fund-raising during the buyout boom, would come to the rescue of troubled banks by injecting capital in return for sizeable minority stakes.¹⁹⁴ As matters transpired, private equity stuck largely to the sidelines, at least with respect to companies removed from the S&P 500. In April 2008, private equity firms TPG and Corsair Capital were the lead investors, respectively, in \$7 billion capital raisings by Washington Mutual and National City Corporation.¹⁹⁵ That, however, was it.

Regulation was one obstacle to private equity deal-making in the banking sector. By virtue of regulations issued pursuant to the Bank Holding Company Act of 1956,¹⁹⁶ private equity firms could not own more than 10 percent of the voting shares of a bank (increased to 15 percent in September 2008) without being deemed to be a bank holding company, which would expose the private equity firm to supervisory oversight by the Federal Reserve Board and a “source of strength” obligation that could require the private equity firm to inject further capital into the bank(s) in which it had invested.¹⁹⁷ The fate TPG suffered also likely discouraged other private equity firms from stepping forward.¹⁹⁸ Its \$1.35 billion investment vaporized when in September 2008 regulators declared Washington Mutual insolvent and sold the assets to J.P. Morgan Chase for \$1.9 billion.¹⁹⁹ Corsair managed to avoid a similar fate, with the saving grace being “downside protection provisions” negotiated with National City that guaranteed that in the event of a merger Corsair would receive no less than the \$5 per share it paid for its shares.²⁰⁰ This amount was more than double the \$2.23 per share PNC Financial Services Group, Inc., agreed to pay when it acquired National City in November 2008.²⁰¹

194. See *Loan Rangers*, *supra* note 187; Andrew Ross Sorkin, *New Path for Kings of Buyouts*, N.Y. TIMES, Apr. 8, 2008, at C6.

195. See *WaMu's Lesson for Private Equity*, N.Y. TIMES, Sept. 29, 2008, at C2 (Washington Mutual); Arielle Kass, *Details of Nat City, Corsair Deal Reveal Race for Capital*, CRAIN'S CLEV. BUS., July 7, 2008, at 1 (National City).

196. 12 U.S.C.A. § 1841–1850 (West 2001 & Supp. 2009).

197. See *Loan Rangers*, *supra* note 187; Ralph F. MacDonald III et al., *Private Equity Investments in Bank Holding Companies: The Fed Expands and Clarifies Opportunities*, JONES DAY COMMENTS, Sept. 2008, http://www.jonesday.com/pubs/pubs_detail.aspx?pubID=S5475; Bernard Condon & Nathan Vardi, *Toe in the Water*, FORBES, Mar. 2, 2009, at 32.

198. See Condon & Vardi, *supra* note 197; Jason Kelly & Jonathan Keehner, *Why Private-Equity Firms Won't Ride to Banks' Rescue*, HOUS. CHRON., Sept. 27, 2008, at 2.

199. See *WaMu's Lesson*, *supra* note 195; Peter Lattman, *WaMu Fall Crushes TPG*, WALL ST. J., Sept. 27, 2008, at B1.

200. See *Reporter's Notebook: Behind the News with Crain's Writers*, CRAIN'S CLEV. BUS., Nov. 24, 2008, at 19.

201. See *id.*

F. SHAREHOLDER ACTIVISM

Given the massive erosion of shareholder value that occurred during the stock market meltdown of 2008, it might have been anticipated that shareholders would have protested vocally and sought to orchestrate fundamental changes to improve matters. This did not occur with the thirty-seven companies removed from the S&P 500. Instead, shareholders generally proved reluctant to step forward and challenge management.

During the 1990s major institutional investors—mutual funds and pension funds—seemed poised to step up their efforts at activism so as to target underperforming companies, but expectations on this count proved ill-founded.²⁰² The stock market meltdown of 2008 did not alter the trend. Of the thirty-seven companies removed from the S&P 500, with only one—Washington Mutual—did complaints by mutual funds or pension funds generate significant publicity. In April 2008, Mary Pugh, chair of Washington Mutual’s finance committee during a disastrous plunge into subprime and adjustable-rate mortgages, resigned after a campaign by a coalition of union pension funds put into serious jeopardy her chances of being re-elected to the board.²⁰³ Two months later CEO Kerry Killinger gave up his post as chairman of the board in response to a 51 percent vote in support of an advisory resolution proposed by the Service Employees International Union Master Trust to split the CEO/chairman roles.²⁰⁴

While activism by mainstream institutional investors generated publicity only in the case of Washington Mutual, companies removed from the S&P 500 did not receive a completely free pass from this constituency. Instead, eight of the firms received requests from shareholders to put resolutions to a vote in the 2008 round of annual shareholder meetings, with the proponent typically being a union pension fund (Table 6). “At risk” companies were not targeted specifically, as three of the eight firms did not fall into this category. On the other hand, the only three resolutions that passed involved “at risk” companies, these being Ashland, Inc., a chemical company, Washington Mutual, and General Growth Properties.

The low profile institutional investors adopted in relation to the thirty-seven companies removed from the S&P 500 corresponded with general trends. Mutual funds, owners of about a quarter of the shares in U.S. public companies, were largely silent during the stock market meltdown. The founder of a proxy vote tracking firm attributed this to the fact that “[t]hey just don’t want to stick their necks out and ruffle management’s feathers.”²⁰⁵ More generally, as the crisis built up, shareholders increasingly prized stability and became less inclined to “rock

202. See *supra* note 80 and accompanying text.

203. See Kevin Dobbs, *Wamu Shareholder Criticizes Nominees*, AM. BANKER, Mar. 28, 2008, at 20; Francesco Guerrera & Ben White, *WaMu Director Forced to Quit*, FIN. TIMES, Apr. 16, 2008, at 16; David A. Katz & Laura McIntosh, *Shareholders Focused on Stability in Proxy Votes*, N.Y.L.J., Oct. 30, 2008, at 5 n.4.

204. See *Washington Mutual Separation of CEO, Chair*, PR NEWSWIRE, June 2, 2008.

205. Muralikumar Anantharaman, *In Crisis, Mutual Funds Fail to Speak Up*, REUTERS, Dec. 12, 2008, <http://www.reuters.com/article/ousiv/idUSTRE4BB51R20081212>.

Table 6

2008 Shareholder Proposals Among Companies Removed from the S&P 500, 2008 (in order of removal)

Company	Industry	“At Risk”?	Nature of Proposal(s) (ordered from lowest level of support to highest)	Type of Shareholder Making the Proposal(s)	Votes Cast in Favor (% range from the lowest to highest level of support if there was more than one proposal)
Clear Channel Communications, Inc.	Consumer Discretionary	No	Increase compensation committee independence; majority voting for directors; adoption of “say on pay”; anti “gross up” executive pay policy.	Union pension funds.	No votes due to private equity buyout.
Electronic Data Systems	IT	No	Adoption of “say on pay.”	Individual.	41%
Washington Mutual	Financials	Yes	Majority voting for directors; split CEO/chairman of the board.	Union pension funds.	42% to 51%
General Growth Properties Inc.	Financials	Yes	Repeal classified board.	Union pension fund.	76%
Ashland, Inc.	Materials	Yes	Majority voting for directors.	Union pension fund.	63%
Anheuser-Busch	Consumer Staples	No	Adoption of “say on pay”; right of shareholders to call meetings.	Individuals.	42% to 44%
Wachovia Corporation	Financials	Yes	Double the number of board nominees; adoption of “say on pay.”	Union pension fund (one); individual (one).	6% to 29%
Merrill Lynch & Co.	Financials	Yes	Establish buyback holding period (executive pay); introduce cumulative voting for directors; impose restrictions on directors having executive contracts; adoption of “say on pay.”	Union pension funds (three); individual (one).	9% to 36%

Source: Georgeson 2008 Annual Corporate Governance Review

the boat.”²⁰⁶ As a result, directors of public companies were typically re-elected in 2008 with 90 percent-plus support and the number of corporate governance proposals brought to a vote by shareholders fell as compared with 2007.²⁰⁷

The sort of “offensive” shareholder activism engaged in by hedge funds also proved to be the exception to the rule in companies removed from the S&P 500 in 2008, with only six of the thirty-seven firms experiencing publicized interventions of this nature. As share prices fell, there seemingly should have been numerous opportunities for savvy investors to profit by buying up shares at bargain prices and orchestrating value-enhancing changes.²⁰⁸ There were, however, various factors that simultaneously discouraged the sort of activism in which hedge funds specialize. One was that dismal returns led investors to withdraw their money rapidly from the hedge fund sector during 2008, thus reducing the financial firepower of hedge funds that included shareholder activism as part of their repertoire.²⁰⁹ Moreover, strategies popular with shareholder activists, such as pushing management to borrow to make a large cash payout or put the company up for sale, became harder to execute as the credit crunch deepened.²¹⁰ Finally, a sizeable proportion of interventions that occurred went badly when stock prices fell precipitously in the second half of 2008, and many formerly aggressive hedge fund managers responded by “hiding under their desks.”²¹¹

The small number of interventions by hedge fund activists meant this form of corporate governance did not perform a central corrective role among companies removed from the S&P 500 in 2008. On the other hand, when hedge funds did step forward, they were catalysts for change. In all three of the firms where management agreed to add new directors at the behest of dissident shareholders so as to forestall a proxy fight (Table 3), hedge funds had agitated for change (Barington Capital Group and Clinton Group at Dillard’s, MMI Investments in the case of Unisys, and Wattles Capital Management LLC with Circuit City).²¹² Wendy’s International, which gave Trian Partners, an investment fund run by activist investor Nelson Peltz, three board seats in 2006, was removed from the S&P 500

206. See Kristin Gribben, *Shareholder Democracy Is on Hold*, FIN. TIMES, July 7, 2008, at 9.

207. Katz & McIntosh, *supra* note 203.

208. See Long Live Activism: Investors Still Wield Influence in the Coming Downturn, FIN. TIMES, Nov. 5, 2008, at 8; Lina Saigol, *Activists Rise from the Ashes as Crisis Exposes Weaknesses*, FIN. TIMES, Nov. 14, 2008, at 28.

209. See Armour & Cheffins, *supra* note 82, at 33–34; Zachery Kouwe, *Among Activist Investors, a New Hesitancy*, N.Y. TIMES, Mar. 26, 2009, at SPG4; *Flight of the Locusts*, ECONOMIST, Apr. 11, 2009, at 63.

210. See Armour & Cheffins, *supra* note 82, at 31–32; *Activist Investors*, FIN. TIMES, Mar. 10, 2008, at 14.

211. Roben Farzad, *Shareholder Activists: Not So Active Anymore*, BUS. WK., Dec. 11, 2008, at 80.

212. On Dillard’s see *supra* note 160 and accompanying text. See also Maureen S. Malik, *Activist Fund Banks on IT Turnaround*, BARRON’S, Oct. 6, 2008, <http://online.barrons.com/article/SB122329241346007347.html> (Unisys); Louis Llovio, *Change for Circuit City: Retailer to Ask Shareholders to Add Board Seats, Diluting Gains by Dissident Company*, RICH. TIMES-DISPATCH, May 17, 2008, at B11 (Circuit City). At Dillard’s, Barington Capital Group and Clinton Group also lobbied for the dismissal of CEO William Dillard II and for the company to buy out the special class of shares that gave the Dillard family voting control but were rebuffed. See Rachel Dodes, *Hedge Funds Seek Ousters at Dillard’s*, WALL ST. J., Oct. 28, 2008, at B4.

when it was bought outright by Peltz-dominated Triarc Companies, Inc., which already owned the Arby's restaurant chain.²¹³ Applied Biosystems' June 2008 announcement that it was being bought by Invitrogen came two months after hedge fund S.A.C. Capital, a 5 percent shareholder, urged the company to explore a sale.²¹⁴ Finally, in late 2008, hedge fund Pershing Square Capital Management built up a 25 percent stake in troubled mall owner General Growth Properties and lobbied for the company to declare chapter 11 bankruptcy, which it in fact did in April 2009, and secured leverage for itself in the bankruptcy proceedings by providing \$375 million of "debtor-in-possession" financing.²¹⁵ Pershing Square's logic was that the market value of General Growth's malls comfortably exceeded its \$27 billion debt load, creating a potentially sizeable reorganization upside for shares Pershing Square bought on the cheap.²¹⁶ Given that the occurrences of offensive shareholder activism affecting companies removed from the S&P 500 generated results, even if activist hedge funds did not play a central corrective role during the stock market meltdown, they were by no means a complete sideshow.

G. SUMMARY

How did corporate governance function during the 2008 stock market meltdown? At least among the thirty-seven companies removed from the S&P 500, the answer is tolerably well. The news was certainly not all good. The fact that the dramatic decline in share prices occurred in the first place means all was not right with large U.S. corporations. Executive pay arrangements in place at major financials may well have prompted top management to gamble the future of their firms in a way that ultimately wrought havoc. In addition, aspects of the corporate governance system proved largely unresponsive as share prices dropped. Private equity involvement was minimal and activism by major institutional shareholders was a rarity.

There were, however, among the companies removed from the S&P 500 during 2008 various encouraging corporate governance trends. There was some offensive shareholder activism, as hedge funds successfully agitated for change in a number of underperforming firms. The apparent absence of fraud was also a bright spot. It likely was tempting for senior executives with incentive-laden compensation packages to "cook the books" or spin the facts to ensure they hit targets as share

213. See Monique Curet, *End of an Era*, COLUMBUS DISPATCH, Apr. 25, 2008, at 1A; *Triarc and Wendy's Sign Definitive Merger Agreement*, BUS. WIRE, Apr. 24, 2008, http://www.businesswire.com/portal/site/home/permalink?ndmViewId=news_view&newsId=20080424005640&newsLang=en; *Wendy's Takeover Completed*, WASH. POST, Sept. 30, 2008, at D2.

214. See Thomas Gryta, *Applied Biosys Holders Get Desired Deal, but Premium Lacking*, DOW JONES NEWSWIRES, June 12, 2008.

215. See Posting to New York Times DealBook Blog, <http://dealbook.blogs.nytimes.com/2008/12/10/ackman-raises-stake-in-general-growth/> (Dec. 10, 2008, 7:11 EST) ("Ackman Raises Stake in General Growth") (Pershing Square's ownership stake); James Covert, *Ackman's Mall Gamble*, N.Y. POST, Apr. 17, 2009, at 32 (other aspects).

216. See Covert, *supra* note 215.

prices fell. However, at least in the companies removed from the S&P 500, fraud of this sort was conspicuous by its absence.

Developments in the boardroom were also encouraging. This verdict at first seems perverse, given that directors presided over destruction of shareholder value unprecedented in modern times. On the other hand, public criticism of boards among the companies that left the S&P 500 was the exception to the rule, implying boardroom performance was at least tolerable. Moreover, blind deference to chief executives was generally lacking in “at risk” companies, as CEO turnover greatly exceeded the norm in public companies.

The treatment of executive pay also provided cause for optimism. With a majority of the companies removed from the S&P 500, there were no complaints about executive compensation arrangements. Moreover, in those instances where executive compensation was criticized, the criticism was apt in the sense that the companies were uniformly “at risk” firms that had typically paid their CEOs greater than the norm for the S&P 500. Hence, while crucial elements of executive pay policies that major financial firms adopted proved to be ill-judged, the approach taken to managerial remuneration otherwise seemed largely acceptable.

VI. POLICY IMPLICATIONS

Various observers have inferred from the stock market meltdown of 2008 that the U.S. system of corporate governance needs to be overhauled. As a *Washington Post* columnist argued in 2009 while pressing the case for the United States to take a cue from Germany and Scandinavia, “Wall Street’s capitalism is dying in disgrace. It is time for a better model.”²¹⁷ Developments concerning the thirty-seven companies removed from the S&P 500 during 2008 suggest a different lesson. Corporate governance by no means functioned optimally. However, the shareholder-oriented corporate governance system that began to take shape in the 1970s was responsive in various important ways to the challenges posed, which implies that the case in favor of dramatic reform has yet to be made out. This diagnosis presupposes, however, that firms operating in the financial sector will not be in a position to carry out the free-wheeling lending, speculative trading, and aggressive fund management that characterized the mid-2000s. We will canvass this point first.

A. THE FINANCIAL SECTOR

Though the economic pain associated with the stock market meltdown of 2008 was widespread, the sector labeled as “financials” in Standard & Poor’s U.S. stock indices was ground zero. As Part IV.B described, among companies comprising the S&P 500 index, the financials not only suffered the largest share price declines,

217. Harold Meyerson, *Building a Better Capitalism*, WASH. POST, Mar. 12, 2009, at A19. See also *supra* notes 1–4 and accompanying text.

they also dominated the roster of companies removed from the index, particularly with respect to the “at risk” category. Moreover, to the extent there was evidence of corporate governance problems among the companies removed from the S&P 500 during 2008, the financials were implicated to a disproportionate degree. As Parts V.A., V.B., and V.D. discussed, public criticism of boards, controversies concerning executive pay, and securities fraud litigation were restricted largely to this sector. The OECD argued in a 2009 report on corporate governance and the financial crisis, “It is important to take a wider corporate governance view since banks are not fundamentally different from other companies with respect to corporate governance”²¹⁸ At least in terms of corporate governance practice and outcomes, this was clearly not the case with companies removed from the S&P 500 during 2008. The financials were a breed apart.

The news was not all bad. Corporate governance was responsive in the financials as the financial crisis built, in the sense that boards commonly orchestrated managerial turnover and the executive pay arrangements at various firms were criticized. There also were sparks of institutional shareholder activism (Washington Mutual) and also some private equity intervention (Washington Mutual and National City).

Against this, to the extent that corporate governance shortcomings created problems at the financials, there were instances where, due to systemic risk, there were serious adverse collateral effects.²¹⁹ For example, investment banks Bear Stearns and Lehman Brothers apparently had less than optimal corporate governance and their travails generated a negative ripple effect due to strong connections to other major players in the financial system.²²⁰ Corporate governance problems also may have contributed to the downward spiral at crisis-ridden major financial companies that were not removed from the S&P 500 but likely would have ended up bankrupt, saddling trading partners with massive losses and unnerving markets, had they not been rescued by government bailouts. This likely occurred, for instance, with AIG and Citigroup, where boardroom deficiencies apparently contributed to the troubles afflicting these firms in the run-up to the financial crisis.²²¹

To the extent that size, complexity, and interconnectedness with the financial system imply that major financial companies might be “too big to fail,” systemic risk may justify policymakers and regulators imposing tougher corporate governance standards than would be appropriate for public companies generally. The logic involved is that such firms should meet exacting standards of risk manage-

218. ORG. FOR ECON. CO-OPERATION & DEV., *supra* note 184, at 12.

219. See Heather Landy, *Executives Took, but the Directors Gave*, N.Y. TIMES, Apr. 5, 2009, at BU1.

220. See Table 2 (criticism of board of directors); Table 5 (criticism of executive pay); *supra* notes 158 & 159 and accompanying text (governance problems at Bear Stearns and Lehman Brothers); John Cassidy, *Anatomy of a Meltdown*, NEW YORKER, Dec. 1, 2008, at 49 (Bear Stearns and systemic risk); Douglas W. Arner, *The Global Credit Crisis of 2008: Causes and Consequences*, 43 INT'L LAW. 91, 96, 113–14 (2009) (Lehman Brothers and systemic risk).

221. See *supra* note 119 and accompanying text.

ment so as to prevent a 2008-style calamity and to protect the implicit stake taxpayers have in financial stability due to the government being a de facto guarantor against bankruptcy.²²² Aspects of the Corporate and Financial Institution Compensation Fairness Act of 2009, passed by the House of Representatives in July 2009,²²³ could potentially be justified on this basis. The relevant measures, if they become law, would require creation of rules obliging financial institutions with assets exceeding \$1 billion to disclose the structure of all incentive-based compensation schemes to federal regulators and would authorize the regulators to prohibit such firms from adopting incentive-based payment arrangements that could have adverse effects on financial stability.²²⁴

While a plausible argument can be made that systemic risk justifies tougher corporate governance regulation for large financial institutions, a number of caveats are in order. One is that, given the *zeitgeist*, it is doubtful whether any set of corporate governance arrangements could have forestalled the financial bandwagon on the loose in the mid-2000s. Amidst an implicit consensus among investors, politicians, regulators, journalists, and even homebuyers that an overheating financial system was fundamentally sound, those preaching caution were marginalized.²²⁵ Correspondingly, major financial firms arguably might well have been laid low by the financial crisis of 2008 even if they had what was, by pre-crisis standards, state-of-the-art corporate governance.²²⁶

A second caveat is that the number of firms that are genuinely “too big to fail” may be very small, in the sense that their failure would pose a threat to financial stability due to the scale and complexity of their operations. Even though Washington Mutual had \$307 billion worth of assets, its business operations were largely self-contained and domestically based, so the Federal Deposit Insurance Corporation was able to unwind the bank’s operations in the fall of 2008 in a fairly straightforward manner.²²⁷ Hence, while the federal government implicitly signaled in the spring of 2009 that financial firms with \$100 billion in assets (19 in all) posed systemic risk by promising to provide them with enough capital to weather an economic downturn and concomitantly tested these firms under

222. See, e.g., Michael Schrage, *How to Sharpen Banks’ Corporate Governance*, FIN. TIMES (ASIA), Nov. 18, 2008, at 13; *Too Big to Fail or Too Big to Save? Examining the Systemic Threats to Large Financial Institutions: Hearing Before the Cong. Joint Econ. Comm’n.*, 111th Cong. (2009) (statement of Joseph E. Stiglitz, Prof., Columbia Univ.), http://jec.senate.gov/index.cfm?FuseAction=Hearings.HearingsCalendar&ContentRecord_id=c89b185b-5056-8059-7670-0ce56df64713.

223. Corporate and Financial Institution Compensation Fairness Act of 2009, H.R. 3269, 111th Cong., available at <http://thomas.loc.gov/cgi-bin/query/z?c111:H.R.3269>.

224. *Id.* § 4.

225. See *supra* note 6 and accompanying text; see also Daniel Gross, *Reining in Bubbles so They Won’t Pop*, NEWSWEEK, Mar. 9, 2009, at 44; Peter Tasker, *Bonuses Don’t Create Bubbles*, NEWSWEEK, Apr. 6, 2009, <http://www.newsweek.com/id/191512/page/1>.

226. See *CEOs and Market Woes: Is Poor Corporate Governance to Blame?*, KNOWLEDGE@WHARTON, Dec. 10, 2008, <http://knowledge.wharton.upenn.edu/article.cfm?articleid=2114> (quoting academics Thomas Gerrity and Wayne Guay).

227. See Joe Adler, *Stress Tests Complicate “Too Big to Fail” Debate*, AM. BANKER, May 18, 2009, at 1. But see Arner, *supra* note 220, at 116 (arguing that the collapse of Washington Mutual had systemic effects).

hypothetical adverse economic scenarios (“stress tests”), many (if not most) of the companies were likely not too big, too complex, or too intertwined with the financial system to mean their survival was economically imperative.²²⁸

Third, and finally, whatever systemic risks corporate governance deficiencies posed prior to the financial crisis of 2008, the governance challenges financial services firms pose are likely to be less potent going forward. This is because in the wake of the financial crisis, to quote Winston Churchill, we are likely to “see finance less proud.”²²⁹ Leading financial services firms are, on their own initiative, forsaking the free-wheeling pre-financial crisis business model as they reduce proprietary risk-taking, scale back high octane asset management, and draw upon the harsh lessons of 2008 to overhaul risk management strategies.²³⁰ Markets will also play a role, as investors traumatized by the financial crisis likely will give short shrift to the market practices and asset classes implicated in the meltdown.²³¹

Regulation could also be an important factor. A key theme in the 2009 report by the U.S. Treasury Department on federal government oversight of the financial system was that tougher regulation, primarily in the form of stricter capital, liquidity, and risk management standards, should be imposed on firms whose failure could pose a threat to financial stability.²³² Implementation of reforms along these lines should foster managerial conservatism on the part of executives running the firms in question. To the extent that internal reform, market pressure, and regulation combine to make U.S. major financial firms “boring,” at least by pre-financial crisis standards, the corporate governance challenges they will pose will be reduced. Since the corporate governance lapses that occurred among the companies removed from the S&P 500 during 2008 typically involved free-wheeling financials, a change of this sort would make the case in favor of radical corporate governance reform less compelling.

B. THE BOARD OF DIRECTORS

Carl Icahn, the prominent shareholder activist, claimed in a 2009 *Washington Post* column, “In this global meltdown we are seeing that many board members were demonstrably unqualified, abjectly remiss or simply too cozy with management.”²³³ His prescription was legal reform, with the subtext being “[c]learly, we must strengthen boards at public companies.”²³⁴ It is hard to argue against “better” boards. However, the stock market meltdown does not provide a decisive argument in favor of major legislative reform.

228. See Adler, *supra* note 227.

229. See Martin Wolf, *Seeds of Its Own Destruction*, FIN. TIMES, Mar. 9, 2009, at 7.

230. See *Rebuilding the Banks*, *supra* note 164, at 14–15; Jim Wexler, *New Era of Risk Control to Recruit All in Firm*, AM. BANKER, Apr. 24, 2009, at 9.

231. See Tasker, *supra* note 225.

232. FINANCIAL REGULATORY REFORM, *supra* note 186, at 21–22, 24–25.

233. Icahn, *supra* note 162.

234. *Id.*

As Parts V.B. and V.C. of this Article have discussed, among the companies removed from the S&P 500 during 2008—a sample one would anticipate would be biased in favor of board failure—boards apparently performed tolerably well. It is also unclear whether differently structured boards would have improved matters. For instance, one proposal Icahn made was that the role of chairman of the board and chief executive should be split, and the Shareholder Bill of Rights Act of 2009 introduced in the Senate by Charles Schumer and Maria Cantwell in May 2009, and the Shareholder Empowerment Act of 2009, introduced in the House of Representatives the following month by Gary Peters, both contain such a provision.²³⁵ The experience in the United Kingdom suggests it would have made little, if any, difference if this had been the law prior to the stock market meltdown in 2008.

U.K.-based companies quoted on the London Stock Exchange are required by subordinate legislation to organize their corporate governance in accordance with what is referred to as “the Combined Code.”²³⁶ The Combined Code stipulates the roles of chairman of the board and CEO should not be exercised by the same individual and that the chairman must qualify as “independent” from management.²³⁷ Quoted companies are expressly permitted to breach the Combined Code guidelines so long as they explain non-compliance,²³⁸ but during the mid-2000s, U.K. banks made a habit of complying fully with the Combined Code.²³⁹ Despite banks having the benefit of a separate chairman and CEO, the U.K. banking sector failed as profoundly as its U.S. counterpart in 2008, with the government ending up owning dominant stakes in a couple of Britain’s largest banks (HBOS/Lloyds TSB and the Royal Bank of Scotland) and buying up completely a couple of smaller failed banks (Bradford and Bingley and Northern Rock).²⁴⁰

While the stock market meltdown of 2008 does not provide convincing evidence that a regulatory overhaul of corporate boards is in order, it seems boardroom changes prompted by SOX had beneficial effects.²⁴¹ Based on the experience of companies removed from the S&P 500 during 2008, the major corporate

235. Shareholder Bill of Rights Act of 2009, *supra* note 4, § 5 (stipulating that a public company would have to have an independent chairman, thus implicitly prohibiting a single chairman/CEO); Shareholder Empowerment Act of 2009, H.R. 2861, 111th Cong. § 2, available at <http://www.govtrack.us/congress/billtext.xpd?bill=h111-2861> (same).

236. U.K. LISTING AUTHORITY, LR, ¶¶ 9.8.6(5), (6) (2009) (imposing an obligation on quoted companies to make disclosures in accordance with the Combined Code). The Listing Rules are available at <http://fsahandbook.info/FSA/html/handbook/D85> (last visited Sept. 10, 2009).

237. FINANCIAL REPORTING COUNCIL, COMBINED CODE ON CORPORATE GOVERNANCE A.2.1, A.2.2 (2008). The Combined Code is available at [http://www.frc.org.uk/documents/pagemanager/frc/Combined_Code_June_2008/Combined%20Code%20Web%20Optimized%20June%202008\(2\).pdf](http://www.frc.org.uk/documents/pagemanager/frc/Combined_Code_June_2008/Combined%20Code%20Web%20Optimized%20June%202008(2).pdf) (last visited Sept. 10, 2009).

238. *Id.* p.mbl. ¶¶ 4, 5.

239. Kit Bingham, *It’s the Board Stupid*, FIN. NEWS ONLINE, Oct. 27, 2008, <http://www.efinancial-news.com/assetmanagement/specialfeatures/content/3352296911>.

240. See John O’Doherty, *State to Own 43% of Merged Lloyds-HBOS*, FIN. TIMES (FT.COM), Jan. 12, 2009, <http://www.ft.com/cms/s/0/845e7956-e079-11dd-b0e8-000077b07658.html>.

241. See Thomas Olson, *Sarbanes-Oxley Law Eased Blow, Former Congressman Says at Duquesne*, PITT. TRIB.-REV., Apr. 22, 2009, http://www.pittsburghlive.com/x/pittsburghtrib/business/s_621691.html (quoting Paul Sarbanes, one of the sponsors of the legislation, as saying, “Had it not been for Sarbanes-Oxley, this could have been a lot worse.”).

failures that occurred were largely fraud-free.²⁴² Further testing is required to determine whether reforms SOX introduced in fact constituted a meaningful deterrent to managerial deceit, though the available evidence does suggest post-SOX boards had a stronger independent orientation than their pre-SOX predecessors and the workload of directors increased.²⁴³ It remains possible that the costs SOX imposed on firms (particularly smaller firms) outweighed the benefits.²⁴⁴ Still, overall the experience of the companies removed from the S&P 500 during 2008 weakens the case of those arguing that SOX should be dismantled or re-enacted as a set of default rules.²⁴⁵

C. EXECUTIVE PAY

Public indignation over executive pay mounted as the financial crisis grew, with the prospect of executives of financial firms bailed out by the federal government claiming promised bonuses helping to fuel the outrage.²⁴⁶ Congress responded to the furor in 2009 by enacting rules requiring companies that received money from the federal government's Troubled Asset Relief Program to give shareholders an annual advisory vote on executive compensation and refrain from paying their most highly paid staff bonuses that exceeded one-third of total annual compensation or took a form other than restricted stock.²⁴⁷ The outcry over executive pay may well soon foster reforms applicable to public companies generally. The type of reform that seems most likely is the introduction of rules requiring all public companies to offer their shareholders an annual advisory "say on pay." The Schumer/Cantwell Shareholder Rights Bill and the Corporate and Financial Institution Compensation Fairness Bill both contain a provision mandating yearly non-binding votes on how executives are paid, as does a legislative proposal the Obama administration issued in July 2009.²⁴⁸

While the stock market meltdown of 2008 helped to precipitate outrage over executive pay, the events of this traumatic year do not provide convincing evidence in favor of broad-based reform. The fact that executive compensation prompted

242. See *supra* note 145 and accompanying text.

243. See James S. Linck, Jeffrey M. Netter & Tina Yang, *The Effects and Unintended Consequences of the Sarbanes-Oxley Act on the Supply and Demand for Directors*, 22 REV. FIN. STUDIES 3287 (2009).

244. See Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1587-88 (2005).

245. For examples of those making this case, see *id.* at 1594-99; Larry E. Ribstein & Henry N. Butler, *Where Was SOX? Believers in Democracy Should Let Shareholders Opt Out of Expensive Regulation*, FORBES, Dec. 22, 2008, at 28.

246. See Robert H. Frank, *Should Congress Put a Cap on Executive Pay?*, N.Y. TIMES, Jan. 4, 2009, at BU5.

247. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, § 111, 122 Stat. 3765, 3776-77, amended by American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, § 7001, 123 Stat. 115, 516-20 (to be codified at 12 U.S.C. § 5221).

248. Shareholder Bill of Rights Act of 2009, *supra* note 4, § 3; Corporate and Financial Institution Compensation Fairness Bill, *supra* note 223, § 2; Investor Protection Act of 2009 § 941, http://www.treas.gov/press/releases/docs/tg_218IX.pdf (draft legislation delivered by the U.S. Department of the Treasury to the U.S. Congress on July 10, 2009). The Shareholder Empowerment Act of 2009, *supra* note 235, § 3, also provides for a non-binding annual vote on executive pay policy.

little controversy—“at risk” financials aside—among the thirty-seven companies removed from the S&P 500 implies that for the most part existing procedures worked tolerably well. This pattern corroborates the contention of a managing partner of a firm of compensation consultants who argued in a 2009 interview that most boards “try to do the right thing. You don’t hear about them; instead you hear about the ridiculous abuses of shareholder trust.”²⁴⁹

The experience in the United Kingdom, which has had an advisory “say on pay” rule in place for publicly listed companies since 2002,²⁵⁰ is also instructive. The available empirical evidence indicates that the rule has had only a modest impact, with executive compensation becoming somewhat more sensitive to poor performance but generally continuing to grow dramatically.²⁵¹ Also, “say on pay” apparently did little, if anything, to address the counterproductive aspects of executive compensation in the U.K. banking sector, which again suffered a crisis matching America’s.

As was the case in the U.S., executive compensation policies British banks had in place likely helped to precipitate the financial crisis. A 2009 report commissioned by U.K. government on the crisis said

it is likely that past remuneration policies . . . have created incentives for some executives and traders to take excessive risks and have resulted in large payments in reward for activities which seemed profit making at the time but subsequently proved harmful to the institution, and in some cases to the entire system.²⁵²

Nevertheless, executive pay policies adopted by U.K. banks were endorsed by shareholders uniformly year in and year out, with the level of dissent averaging a mere 9 percent prior to onset of the financial crisis.²⁵³ Up to April 2009, when the U.K. government, as holder of 58 percent of the shares of Royal Bank of Scotland, expressed its displeasure with a controversial pension payment to a departed CEO by voting against the bank’s executive pay policy,²⁵⁴ there were no banks among the small number of companies suffering a “no” vote on executive pay policy.²⁵⁵ Correspondingly, to the extent that policymakers in the United States are inclined to rely on “say on pay” as a check against the adoption of the sort of counterproductive incentives that helped to precipitate the recent financial crisis, their expectations are unlikely to be fulfilled.

249. Robert J. Grossman, *Executive Pay: Perception and Reality*, HR MAG., Apr. 2009, at 26 (quoting Gerry Miller, Managing Partner, DolmatConnell & Partners).

250. See Directors Remuneration Report Regulations 2002, S.I. 2002/1986 (U.K.); Companies Act, 2006, c. 46, § 439 (U.K.).

251. See Fabrizio Ferri & David Maber, *Say on Pay Votes and CEO Compensation: Evidence from the UK* 15, 19–21, 34 (2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1420394.

252. THE TURNER REVIEW, A REGULATORY RESPONSE TO THE GLOBAL BANKING CRISIS 80 (2009), available at http://www.fsa.gov.uk/pubs/other/turner_review.pdf.

253. See ORG. FOR ECON. CO-OPERATION & DEV., *supra* note 184, at 47 (citing research by Manifest).

254. See Jane Croft & Andrew Bolger, *Thumbs Down for RBS Pay Report*, FIN. TIMES, Apr. 4, 2009, at 12.

255. Up to July 2009, there were nine U.K. public companies where the shareholders cast majority votes against the annual remuneration report. These were Royal Bank of Scotland; GlaxoSmithKline, a pharmaceuticals company, see Neil Collins, *The Day Shareholders Finally Had Enough of Corporate*

D. PRIVATE EQUITY

The private equity buyout boom of the mid-2000s occurred in a congenial regulatory setting. Private equity firms had ample latitude to raise capital for their buyout funds without becoming subject to federal securities regulation.²⁵⁶ They could pile on debt with buyouts knowing interest payments would be deductible for tax purposes from the income of target companies.²⁵⁷ In addition, private equity firms could structure “carried interest”—the profits distributed by buyout funds to private equity partners—so income the partners received was taxed at the prevailing capital gains rate of 15 percent rather than the top rate of income tax.²⁵⁸

When the private equity boom was in full swing, these regulatory features became highly controversial as concerns grew about the potential negative side effects of public-to-private buyouts.²⁵⁹ The post-credit crunch collapse in buyout activity meant private equity largely fell off the regulatory radar screen.²⁶⁰ However, in April 2009 legislation was introduced in Congress that would tax carried interest as ordinary income rather than capital gains and in June the Obama administration, as part of its plan to overhaul the financial regulatory system, recommended that private equity firms be required to register with the SEC.²⁶¹ It remains to be seen to what extent regulatory change will affect private equity. However, given that private equity largely dropped off the radar screen during the stock market meltdown of 2008, if the introduction of new regulations deters public-to-private buyouts, the effects should be negligible in a future bear market of similar magnitude.

E. SHAREHOLDER RIGHTS

Prompted in part by a 2005 law review article by law professor Lucian Bebchuk titled *The Case for Increasing Shareholder Power*, over the past few years there has

Greed, TELEGRAPH, May 20, 2003, <http://www.telegraph.co.uk/comment/personal-view/3591536/The-day-shareholders-finally-had-enough-of-corporate-greed.html>; Aegis, a marketing services company, see Clay Harris, *Shareholders Reject Chief Executive's Pay Deal*, FIN. TIMES, May 27, 2004, at 21; Freeport, a property group, see *id.*; United Business Media, a business information provider, see *Remuneration Report Votes: UBM and MFI Reports Defeated*, MANIFEST-1, June 2, 2005, <http://www.manifest.co.uk/manifest-i/2005/0506%20June/050602remuneration.htm>; MFI Furniture, a furniture retailer, see *id.*; Bellway, a builder, see Kate Burgess, *Investors Up in Arms over Poor Governance*, FIN. TIMES, Feb. 3, 2009, at 19; Royal Dutch Shell, the petroleum giant, see Kate Burgess & Michael Steen, *Investors Rebel over Executive Pay at Shell*, FIN. TIMES, May 20, 2009, at 1; and Provident Financial, a mortgage lender, see Kate Burgess & Jane Croft, *Provident Bonuses Shot Down by Shareholders*, FIN. TIMES, May 7, 2009, at 21.

256. See Cheffins & Armour, *supra* note 66, at 9–11.

257. See *id.* at 57–58.

258. See *id.*

259. See *id.* at 55–59.

260. See Karen H. Wruck, *Private Equity, Corporate Governance, and the Reinvention of the Market for Corporate Control*, 20 J. APPLIED CORP. FIN. 8, 18 (2008).

261. See Press Release, Congressman Sandy Levin, Rep. Levin Reintroduces Carried Interest Tax Reform Legislation (Apr. 3, 2009), http://www.house.gov/apps/list/press/mi12_levin/PRO40309.shtml; FINANCIAL REGULATORY REFORM, *supra* note 186, at 37–38.

been extensive debate about whether U.S. corporate and securities law should be amended to fortify shareholder rights.²⁶² Proposed reforms include replacing the prevailing “plurality” system of board elections with a system where a nominee would fail to be elected if a majority of votes were cast against him or withheld, giving insurgent shareholders seeking board seats access to the corporate proxy machinery management can rely on, and providing shareholders with the power to initiate changes to the charter and bylaws.²⁶³ The stock market meltdown of 2008 provided advocates of greater shareholder power with the impetus to pursue their agenda with renewed vigor, as they could argue that boards that were more responsive to shareholder concerns would have done a better job of holding management accountable.²⁶⁴ Legislative proposals followed in turn. The Shareholder Rights Bill and the Shareholder Empowerment Bill both provide for majority voting with the election of directors, and the Shareholder Rights Bill stipulates that directors should face election annually, thus precluding entrenchment of incumbent directors by way of a “classified board” where directors have staggered terms.²⁶⁵ In June 2009, the SEC released proposed proxy access rules that would give shareholders owning a prescribed percentage of shares in a public company (1 percent in the case of companies with a market capitalization of \$700 million or more) the right to rely on the company’s proxy materials to propose candidates for election to the board, and the Shareholder Empowerment Bill provides similarly.²⁶⁶

The fact that shareholder activism was the exception to the rule among the thirty-seven companies removed from the S&P 500 during 2008 potentially fortifies the case in favor of reform. The argument could be made that investors were hamstrung by the limited powers available to them and would have done more to check the dramatic erosion of shareholder value if they had greater ability to intervene. As is the case with “say on pay,” however, events occurring in Britain provide a cautionary note.

U.K. company law is, in various respects, more “shareholder-friendly” than the equivalent regime in the United States, as U.K. shareholders have greater authority to call shareholder meetings, initiate changes to the corporate constitution, and dismiss directors.²⁶⁷ For instance, shareholders owning 5 percent or more of

262. Lucian Ayre Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005); see generally *Battling for Corporate America*, ECONOMIST, Mar. 11, 2006, at 69 (summarizing the debate).

263. See *Battling for Corporate America*, *supra* note 262; John Gapper, *The Votes of Investors Should Count*, FIN. TIMES, Apr. 17, 2006, at 13.

264. See, e.g., Carl C. Icahn, *The Economy Needs Corporate Governance Reform*, WALL ST. J., Jan. 23, 2009, at A13.

265. On majority voting, see Shareholder Empowerment Act of 2009, *supra* note 235, § 2; Shareholder Bill of Rights Act of 2009, *supra* note 4, § 5. On eliminating “classified” boards, see Shareholder Bill of Rights Act of 2009, *supra* note 4, § 5; JAMES D. COX, THOMAS LEE HAZEN & F. HODGE O’NEAL, CORPORATIONS § 13.30 (1999) (effect of classified board).

266. Press Release, U.S. Sec. & Exch. Comm’n, SEC Votes to Propose Rule Amendments to Facilitate Rights of Shareholders to Nominate Directors (May 20, 2009), <http://www.sec.gov/news/press/2009/2009-116.htm>; Shareholder Empowerment Act of 2009, *supra* note 235, § 2.

267. Bebchuk, *supra* note 262, at 847–50.

a company's voting shares have the right to call a shareholder meeting to dismiss any director by way of a majority vote, meaning wholesale changes can be made to the board at any time without regard for staggered terms.²⁶⁸ Regardless, it does not appear that banks were better managed in the United Kingdom than in the United States.²⁶⁹ Moreover, bank shareholders apparently made little use of the powers available to them. The chief executive of the U.K.'s financial markets regulator admonished major shareholders for being "too reliant and unchallenging" in the run up to the financial crisis.²⁷⁰ Lord Myners, Financial Services Secretary in the U.K. Treasury, similarly chastised institutional shareholders as being "absentee landlords."²⁷¹ The experience in Britain implies that even if shareholder rights are increased in the United States in the aftermath of the stock meltdown of 2008, there is no guarantee shareholders will use the powers made available to them to forestall a similar future assault on shareholder value.

VII. CONCLUSION

U.S. corporate governance has since the 1970s evolved away from managerial capitalism toward a shareholder value model. As part of this trend, independent directors have become an increasingly prominent feature of corporate boards, shareholder activism has become more common, and performance-oriented compensation has become a predominant feature of executive pay. The transformation of corporate governance has been market-driven in many respects, but SOX provided a legislative backstop by fortifying the status of independent directors on corporate boards and by introducing accounting and auditing reforms designed to counteract incentives that performance-driven executive compensation schemes create to manipulate earnings figures.

The stock market meltdown of 2008 constituted a major stress test for the shareholder-value corporate governance model. Many have argued that the system failed this test. This Article, based on case studies of the thirty-seven companies removed from the iconic S&P 500 index, offers a different verdict.

In 2008, U.S. stock markets had their worst year since the 1930s. Hence, the corporate governance mechanisms in place failed in the sense that they did not prevent a massive reduction in shareholder value. However, once a less exacting test of "failure" is adopted, this Article's analysis of corporate governance in the

268. Companies Act, 2006, c. 46, §§ 168, 303 (U.K.); Companies (Shareholders' Rights) Regulations 2009, S.I. 1632/2009, s. 4 (U.K.) (amending § 303(3) to reduce the threshold from 10 percent to 5 percent); see also John Armour, *Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Assessment*, in RATIONALITY IN COMPANY LAW: ESSAYS IN HONOUR OF D.D. PRENTICE 71, 105 (John Armour & Jennifer Payne eds., 2009).

269. See John Plender, *Shut Out*, FIN. TIMES, Oct. 17, 2008, at 11; *Changing Course*, ECONOMIST, May 2, 2009, at 73.

270. Jennifer Hughes, *FSA Chief Lambasts Uncritical Investors*, FIN. TIMES, Mar. 12, 2009, at 1 (quoting Hector Sants).

271. See Kate Burgess, *Myners Urges "Absentee Landlord" Shareholders to Be More Involved*, FIN. TIMES, Apr. 22, 2009, at 17; see also Burgess, *Investors Up in Arms*, supra note 255 (quoting Myners as saying "institutions should have been more challenging").

thirty-seven companies removed from the S&P 500 in 2008 suggests that in various key respects corporate governance operated satisfactorily.

Admittedly, activism by mainstream institutional investors and public-to-private buyouts were conspicuous by their absence. On the other hand, the corporate failures that occurred were largely fraud-free. Boards of directors generally performed satisfactorily enough to avoid public criticism, crisis-ridden financial corporations excepted. Moreover, with troubled companies the directors were far from complacent, as they orchestrated CEO turnover at a rate greatly exceeding the norm in publicly traded firms. As for executive pay, companies removed from the S&P 500 during 2008 had arrangements in place that failed to generate controversy, with the unsurprising exception of troubled financial firms that paid their chief executives more than the S&P 500 average. Finally, while hedge funds were operating in far from optimal conditions during the stock market meltdown, they did not entirely forsake their particular brand of activism.

“You never want a serious crisis to go to waste,” Rahm Emanuel, Barack Obama’s new chief of staff, said shortly after the 2008 presidential election.²⁷² For advocates of corporate governance reform, this implies that the stock market meltdown of 2008 created a first-rate opportunity to persuade lawmakers to introduce changes to strengthen corporate boards, address concerns about executive pay, and enhance shareholder rights. With the possible exception of large, complex firms in the financial services sector likely to impose major costs on taxpayers and the economy at large if they implode due to imprudence or mismanagement, events occurring during 2008 do not provide a convincing case for radical initiatives. As this study of companies removed from the S&P 500 during 2008 has revealed, “the financials” monopolized the bad news, which implies this is where regulatory attention should be focused. Moreover, though the U.S. system of corporate governance did not perform optimally during its 2008 stress test, along key dimensions it performed tolerably well under very difficult conditions. The case for fundamental reform is thus not yet made out.

272. Gerald F. Seib, *In Crisis, Opportunity for Obama*, WALL ST. J., Nov. 21, 2008, at A2.

APPENDIX

COMPANIES REMOVED FROM THE S&P 500, 2008 (IN ORDER OF REMOVAL)

Company	Date Removed (2008)	Sector	Sub-Industry	At Risk?	Removed due to low market value	Spin-off	Reincorp.	Bankrupt	Private Equity Buyout	Acquired by company (by type)	Acquired "under duress"
Harrah's Entertainment	Jan. 28	Consumer Discretionary	Casinos	No					Yes		
Circuit City Stores Inc.	Mar. 28	Consumer Discretionary	Computer Retailing	Yes	Yes						
Commerce Bancorp	Mar. 28	Financials	Regional Bank	No						Non S&P 500 public company	
The Bear Stearns Companies Inc.	June 2	Financials	Investment Banking	Yes						S&P 500	Yes
Trane Inc.	June 6	Industrials	Building Products	No		Yes					
Ambac Financial Group, Inc.	June 10	Financials	Insurance	Yes	Yes						
Brunswick Corporation	June 20	Consumer Discretionary	Leisure Manufacturing	Yes	Yes						
OfficeMax Inc.	June 20	Consumer Discretionary	Speciality Stores	Yes	Yes						
Countrywide Financial Corporation	June 30	Financials	Thrifts/Mortgages	Yes						S&P 500	Yes

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Company	Date Removed (2008)	Sector	Sub-Industry	At Risk?	Removed due to low market value	Spin-off	Reincorp.	Bankrupt	Private Equity Buyout	Acquired by company (by type)	Acquired "under duress"
E.W. Scripps	June 30	Consumer Discretionary	Broadcasting	No		Yes					
ACE Ltd.	June 30	Financials	Insurance	No			Yes				
Clear Channel Communications, Inc.	July 30	Consumer Discretionary	Broadcasting	No					Yes		
IAC/InterActive Corporation	Aug. 20	Consumer Discretionary	Internet Retailing	No		Yes					
Electronic Data Systems	Aug. 26	IT	Data Processing	No						S&P 500	
Federal Home Loan Mortgage Corporation	Sept. 10	Financials	Thrifths/Mortgages	Yes	Yes						
Federal National Mortgage Association	Sept. 10	Financials	Thrifths/Mortgages	Yes	Yes						
Lehman Brothers	Sept. 16	Financials	Investment Banking	Yes				Yes			

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Company	Date Removed (2008)	Sector	Sub-Industry	At Risk?	Removed due to low market value	Spin-off	Reincorp.	Bankrupt	Private Equity Buyout	Acquired by company (by type)	Acquired "under duress"
Safeco Corporation	Sept. 22	Financials	Insurance	No						Non S&P 500 public company	
Washington Mutual	Sept. 29	Financials	Thrifths/Mortgages	Yes						S&P 500	Yes
Wendy's International, Inc.	Sept. 29	Consumer Discretionary	Restaurants	No						Non S&P 500 public company	
Wm. Wrigley Junior Co.	Oct. 3	Consumer Staples	Packaged Foods	No						Private company	
Dillard's, Inc.	Oct. 21	Consumer Discretionary	Department Stores	Yes	Yes						
MGIC Investment Corporation	Oct. 30	Financials	Thrifths/Mortgages	Yes	Yes						
Terex Corporation	Nov. 5	Industrials	Construction/ Heavy Trucks	Yes	Yes						
Unisys Corporation	Nov. 10	IT	IT Consulting	Yes	Yes						
General Growth Properties Inc.	Nov. 12	Financials	REITs (Mall Owner)	Yes	Yes						
Ashland, Inc.	Nov. 13	Materials	Chemicals	Yes	Yes						

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COMPANIES REMOVED FROM THE S&P 500, 2008 (IN ORDER OF REMOVAL)

Company	Date Removed (2008)	Sector	Sub-Industry	At Risk?	Removed due to low market value	Spin-off	Reincorp.	Bankrupt	Private Equity Buyout	Acquired by company (by type)	Acquired "under duress"
Hercules Inc.	Nov. 13	Materials	Chemicals	No						Non S&P 500 public company	
Anheuser-Busch	Nov. 18	Consumer Staples	Brewing	No						Non S&P 500 public company	
Applied Biosystems Inc.	Nov. 21	Healthcare	Life Sciences	No						Non S&P 500 public company	
Liz Claiborne Inc.	Dec. 1	Consumer Discretionary	Apparel	Yes	Yes						
Allied Waste Industries, Inc.	Dec. 4	Industrials	Environmental	No						Acquirer moved into S&P 500	
Transocean Inc.	Dec. 18	Energy	Ocean Drilling	No			Yes				
Barr Pharmaceuticals, Inc.	Dec. 22	Healthcare	Pharma	No						Non S&P 500 public company	
Wachovia Corporation	Dec. 31	Financials	Diversified Banks	Yes						S&P 500	Yes
National City Corporation	Dec. 31	Financials	Regional Banks	Yes						Non S&P 500 public company	Yes
Merrill Lynch & Co.	Dec. 31	Financials	Investment Banking	Yes						S&P 500	Yes

Sources: Standard & Poor's web site; Factiva Searches

