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Did Corporate Governance "Fail" During the 2008 Stock Market Meltdown? The Case of the S&P 500

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Abstract

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 paper argues generally "no", based on a study of a sample of companies at "ground zero" of the stock market meltdown, namely the 37 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. The fact that corporate governance functioned tolerably well in companies removed from the S&P 500 implies that the case is not yet made out for fundamental reform of current arrangements.

Keywords: corporate governance, financial crisis, board of directors, executive pay, shareholder rights

JEL Classifications: G01, G30, G38, K22

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INTRODUCTION

Corporate America experienced in 2008 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). The commercial banking sector had to be propped up by governmental rescue schemes but industry leaders such as Washington Mutual and Wachovia disappeared nonetheless.

A striking aspect of the stock market meltdown of 2008 is that it occurred despite U.S. corporate governance having been strengthened over the past few decades and re-oriented towards the promotion of shareholder value. As the 20th 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 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 there was a prompt legislative response in the form of the Sarbanes-Oxley Act of 2002 that 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 the purpose. "Boards Fail – Again", a 2008 piece in *BusinessWeek*, 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 Organization 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] A 2009 article in *Management Today* entitled "Corporate Apocalypse" claimed similarly "today's doctrines of shareholder primacy and managerial self-interest have brought many companies to the brink of self-destruction."[4]

This paper 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 37 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 capitalization 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.

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[1] Ben W. Heineman, *Boards Fail – Again*, BUSINESSWEEK, Sept. 26, 2008.

[2] Anne Simpson, *America's Governance Revolution Must Not Be Ducked*, FIN. TIMES, May 26, 2009.

[3] Grant Kilpatrick, *The Corporate Governance Lessons from the Financial Crisis*, (2009) FIN. MKT. TRENDS, issue #1, 1, 2. The report was published under the auspices of the OECD Steering Group on Corporate Governance.

[4] *Corporate Apocalypse*, MANAGEMENT TODAY, January 2009, 50.

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 what were far from optimal 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 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 coming down the pike."[5] Based, however, on what occurred at the 37 companies removed from the S&P 500, lawmakers would be 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 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] All 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 as and when it burst. Given the underlying consensus, a stock market crisis likely would have been on 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 scope under corporate law to exercise influence over how their companies are run than their American counterparts. Nevertheless, stock prices fell faster in Britain during the 2008 than they did in the U.S.,[7] underpinned by a banking crisis every bit as serious as America's.

The verdicts this paper 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 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, the paper does not attempt to assess corporate

[5] Quoted *id*.

[6] Thomas Frank, *Financial Journalists Fail Upward*, WALL STREET J., March 18, 2009.

[7] Standard & Poor's, *Monthly Report: World by Numbers*, December 2008, 4 (indicating stock prices in the U.K. fell 50.9% as compared with 38.7% for the U.S.).

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 paper – again 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 paper 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 within this sector there is a sub-set 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 knock-on effects for the economy at large will be minimal.[9] However, within the financial sector there can be firms for which bankruptcy can result in trading partners and counter-parties being saddled with huge 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 likely "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.

The paper is structured as follows. Part II 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 paper 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 which forms the core of the paper, 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 policy implications. 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 manner 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 to be addressed and the logic underlying the "fixes" that evolved. Only a succinct summary is necessary for present purposes; detailed historical analysis is available elsewhere.[10]

Economists Sanjai Bhaghat and Brian Bolton and law professor Roberta Romano have said "The key focus of U.S. corporate law and corporate governance systems is what is referred to as an agency problem: an organizational 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

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[8] *The Sensible Giants*, ECONOMIST, May 2, 2009.

[9] Joe Nocera, *Geithner's Plan on Pay Falls Short*, NEW YORK TIMES, June 13, 2009.

[10] See, for example, Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 STANFORD L. REV. 1465 (2007); MARY O'SULLIVAN, CONTESTS FOR CORPORATE CONTROL: CORPORATE GOVERNANCE AND ECONOMIC PERFORMANCE IN THE UNITED STATES AND GERMANY 105-7 (2000).

[11] Sanjai Bhaghat, Brian Bolton and Roberta Romano, *The Promise and Peril of Corporate Governance Indices*,

seemingly mattered little whether there were mechanisms in place to ensure managers were properly accountable to shareholders. With the U.S. being the world's dominant economy and experiencing a prolonged post-war economic boom, 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 pre-supposition 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, US Steel and Alcoa becoming not merely household names but worldwide prototypes of managerial capitalism, the manager-oriented model of the corporation was pre-eminent.[16] However, the fact executives lacked potent incentives to focus on shareholder returns became increasingly evident.[17] CEO pay 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. Growth by acquisition, however, was frequently not good news for shareholders.

One problem was that numerous deals failed to live up to expectations and ended up destroying shareholder value.[19] Moreover, executives struggled to maintain control over their sprawling corporate empires. Penn Central, a railway company which had diversified into pipelines, hotels, industrial parks and commercial real estate, collapsed in 1970 amidst personality clashes, mismanagement and lax board oversight.[20] International Telephone and Telegraph, another sprawling conglomerate, was wracked in the early 1970s by allegations 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.[21] Subsequently, dozens of public companies, prompted by the threat of prosecution, admitted having made bribes, kickbacks or other illicit corporate payments abroad and in the United States.[22] 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.[23]

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108 COLUMBIA L. REV. 1803, 1809 (2008).

[12] O'SULLIVAN, *supra* note 10, 105-7; 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, for example, A.A. BERLE, THE TWENTIETH CENTURY CAPITALIST REVOLUTION (1954).

[14] Joel Seligman, *A Sheep in Wolf's Clothing: The American Law Institute Principles of Corporate Governance Project*, 55 GEORGE WASHINGTON L. REV. 325, 330-32 (1987); Bengt Holmstrom and Steven N. Kaplan, *Corporate Governance and Merger Activity in the United States: Making Sense of the 1980s and 1990s*, 15 J. ECON. PERSPECTIVES 121, 129 (2001).

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

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

[17] Holmstrom and Kaplan, *supra* note 14, at 123.

[18] Frank Dobbin and Dirk Zorn, *Corporate Malfeasance and the Myth of Shareholder Value*, 17 POLITICAL POWER & SOCIAL THEORY 179, 183 (2005).

[19] *Id.*

[20] Gordon, *supra* note 10, at 1515; ROBERT SOBEL, THE RISE AND FALL OF THE CONGLOMERATE KINGS 171, 175-76 (1984).

[21] SOBEL, *supra* note 20, at 186-87.

[22] Gordon, *supra* note 10, at 1516.

[23] Seligman, *supra* note 14, at 335-36; Fredrick Andrews, *Management – Changing America's Executive Climate*, NEW YORK TIMES, June 3, 1977, 43 (discussing bribes and kickbacks by Lockheed).

B. The Corporate Governance Counter-Reaction

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 should proactively exercise independent oversight so as to enhance managerial accountability. In 1977, the New York Stock Exchange (NYSE), at the request of the federal Securities and Exchange Commission (SEC), amended its listing requirements to require each listed company to maintain an audit committee composed of independent directors.[24] 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.[25] Even before the NYSE amended its listing rules to provide for the establishment of audit committees, nearly 90% of the largest corporations in the U.S. had taken this step.[26] Likewise, a 1978 report on corporate accountability based on interviews with companies in 17 countries referred to the United States as a "cauldron of experimentation", with the basic shift being toward more active and independent boards.[27]

By the early 1980s, there was a growing consensus "the 'outside' director has won."[28] Legal reforms sealed the victory. During the 1980s, Delaware court decisions involving derivative litigation and the invocation of takeover defences indicated judicial acceptance of decisions taken to sidetrack derivative suits and 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.[29] In 1993 Congress endorsed the idea that executive pay should be dealt with by independent directors, stipulating that performance-based executive remuneration could only be exempted from a new $1 million deductibility cap under the Internal Revenue Code if a compensation committee made up entirely of outside directors approved the relevant arrangements.[30]

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.[31] Correspondingly, by the 1990s boards increasingly evaluated managerial performance by reference to shareholder value and became more willing to fire underperforming chief executives.[32] 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), who 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.[33] 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.[34] During the 1980s and 1990s institutional investors began shifting away from this purely reactive approach in favor of challenging management to create value for shareholders.[35] They did this from a position of strength, as the proportion of shares in U.S. public companies held by

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24 Seligman, *supra* note 14, at 338.

25 Thomas B. Hubbard, *Company Boards Don't Need Uncle Sam*, NEW YORK TIMES, June 24, 1979, F14.

26 Seligman, *supra* note 14, at 338.

27 Ann Crittenden, *World's Companies Changed by Moves for Accountability*, NEW YORK TIMES, January 4, 1978, D7 (discussing a report by Business International Corporation).

28 Thomas C. Hayes, *Board "Outsiders" Win Favor*, NEW YORK TIMES, March 31, 1980, D1.

29 Gordon, *supra* note 10, at 1481, 1522-26; Zapata Corp. v. Maldonado 430 A.2d. 779 (Del. 1981) (derivative litigation); Unocal Corp. v. Mesa Petroleum *Co.* 493 A.2d 946 (Del. 1985) (takeovers); Moran v. Household International Inc. 500 A.2d 1346 (Del. 1985) (*ditto*).

30 26 U.S.C. § 162(m), added as part of the Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, § 13211, 107 Stat. 312.

31 Millstein, *supra* note 12, at 278.

32 Gordon, *supra* note 10, at 1531-33.

33 Holmstrom and Kaplan, *supra* note 14, at 134; Dobbin and Zorn, *supra* note 18, at 188.

34 Dobbin and Zorn, *supra* note 18, at 188; ROBERT A.G. MONKS AND NELL MINOW, CORPORATE GOVERNANCE 107 (1995).

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

households and domestic institutional investors respectively shifted from 84%/14% in 1965 to 49%/45% in 1985.[36]

Institutional shareholders, in their new activist mode, initially focused on fighting anti-takeover initiatives.[37] The 1980s was known as "the Deal Decade", exemplified by bidders relying on aggressive, innovative financial techniques to engineer daring takeover bids.[38] Executives reacted defensively and sought to introduce management entrenchment devices such as the poison pill. 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.[39]

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.[40] Institutional investors also pressured companies to overhaul existing executive pay arrangements to replace the traditional bias towards "pay-for-size" in favor of pay-for-performance.[41] The message got through, as a dramatic increase in equity-based compensation – most prominently the awarding of stock options -- served to increase pay-to-performance sensitivity tenfold for CEOs between 1980 and 1998.[42]

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 corporate governance than existed up to the early 1980s is here to stay."[43] Moreover, with corporate governance reform coinciding with strong economic growth in the U.S., ideological and market-driven momentum built up for companies elsewhere to converge towards a U.S.-style shareholder oriented corporate governance model.[44] 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."[45]

C. Then Came Enron

While Holmstrom and Kaplan strongly endorsed U.S. corporate governance in 2001, they conceded a mere four years later "To a casual observer, the United States corporate governance system must seem to be in terrible shape."[46] 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 fell 36% between January 2000 and September 2002 and the S&P 500 dropped 48% between March 2000 and

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

[37] BRANCATO, *supra* note 35, at 84.

[38] O'SULLIVAN, *supra* note 10, at 161; BRUCE WASSERSTEIN, BIG DEAL: 2000 AND BEYOND 167-68 (2000).

[39] O'SULLIVAN, *supra* note 10, at 176; Holmstrom and Kaplan, *supra* note 14, at 132; BRANCATO, *supra* note 35, at 84.

[40] BRANCATO, *supra* note 35, at 84-85.

[41] Dobbin and Zorn, *supra* note 18, at 189; JOHN C. COFFEE, *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 *et al.* eds., 2006).

[42] Holmstrom and Kaplan, *supra* note 14, at 133; see also JOHN C. COFFEE, GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE 62 (2006).

[43] Holmstrom and Kaplan, *supra* note 14, at 140.

[44] See, for example, Hansmann and Kraakman, *supra* note 16.

[45] Holmstrom and Kaplan, *supra* note 14, at 141.

[46] Bengt Holmstrom and 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 and Stuart L. Gillan eds., 2005).

September 2002.[47] 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.[48]

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.[49] Others, while prepared to acknowledge the scandals revealed various imperfections that should be addressed by regulatory intervention, argued any sort of fundamental overhaul would be unwise because the U.S. system of market-oriented capitalism had proved itself as successful in creating growth and prosperity exceeding that of all other countries.[50] The latter view ultimately prevailed, as public officials moved quickly to introduce the federal Sarbanes-Oxley Act of 2002 (SOX)[51] 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"[52] and the legislation was highly controversial when it was enacted. Sarbanes-Oxley did impose various new requirements on public companies and their executives and directors.[53] Generally, however, the Act did not constitute a radical departure from past practice, building instead on existing federal regulations, state laws, accounting practices and corporate governance conventions.[54] As a result, SOX was part 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, has said "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 into must. And it worked."[55]

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. 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".[56]

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.[57] 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

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[47] 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 (derived from historical charts available on websites for NYSE and NASDAQ on Yahoo! Finance: http://finance.yahoo.com/ (accessed March 29, 2009).

[48] On the pre- and post-scandal market capitalization of these companies, see ZABIHOLLAH REZAEE, CORPORATE GOVERNANCE POST-SARBANES-OXLEY 28-29 (2007).

[49] See, for example, Simon Deakin and 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 and Joseph A. McCahery eds., 2006).

[50] See, for example, Holmstrom and Kaplan, *supra* note 46; ROY C. SMITH AND INGO WALTER, GOVERNING THE MODERN CORPORATION: CAPITAL MARKETS, CORPORATE CONTROL AND ECONOMIC PERFORMANCE 21-22 (2006).

[51] Pub.L. 107-204, 116 Stat. 745.

[52] Quoted in SMITH AND WALTER, *supra* note 50, at 245.

[53] For a succinct summary of the changes SOX introduced, see REZAEE, *supra* note 48, at 37-38.

[54] *Id.,* 36, 247; SMITH AND WALTER, *supra* note 50, at 245.

[55] Quoted in REZAEE, *supra* note 48, at 36.

[56] 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 and Bala G. Dharan eds., 2004).

[57] REZAEE, *supra* note 48, at 37-38.

more fraud, as senior executives have powerful financial incentives to manipulate earnings to maximize pay-outs available from exercising the options.[58] 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.[59] 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. Sarbanes-Oxley in effect aimed to redress the balance without displacing the ability of public companies to seek to motivate their executives with performance-oriented compensation.[60]

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 for corporate control."[61] 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.[62] 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.[63]

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.[64] A tightening of credit markets also made it much more difficult to orchestrate public-to-private buyouts.[65] Holmstrom and Kaplan argued in their 2001 survey of corporate governance that this sort of transaction was obsolete anyway. 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.[66] In fact, a revival of the public-to-private deal was just around the corner.[67]

LBO associations – rechristened private equity firms -- had great success through much of the 2000s securing backing for the investment funds they launched amid general enthusiasm for "alternative" investment strategies among pension funds, endowments and wealthy private investors frustrated by uneven results the stock market delivered. 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. Correspondingly, in 2006, the value of "public-to-private" buyouts surged to a record $120 billion, or about 1.5% of G.D.P., up from just over $70 billion in 2005.

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.[68] Private equity bidders prefer to work in co-operation with incumbent

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[58] COFFEE, *supra* note 42, at 62-64.

[59] *Id.*, 15.

[60] Gordon, *supra* note 10, at 1536; Ronald J. Gilson, *Catalysing Corporate Governance: The Evolution of the United States System in the 1980s and 1990s*, 24 CORP. & SEC. L.J. 143, 156-57 (2006).

[61] JONATHAN MACEY, CORPORATE GOVERNANCE: PROMISES KEPT, PROMISES BROKEN 118 (2008).

[62] FRANK H. EASTERBROOK AND DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 172-73 (1991).

[63] Holmstrom and Kaplan, *supra* note 14, at 124; Brian Cheffins and John Armour, *The Eclipse of Private Equity*, 33 DEL. J. CORP. L. 1, 18-19 (2008).

[64] O'Sullivan, *supra* note 10, at 167; Holmstrom and Kaplan, *supra* note 14, at 126-27; MACEY, *supra* note 61, at 122-26.

[65] Cheffins and Armour, *supra* note 63, at 21.

[66] Holmstrom and Kaplan, *supra* note 14, at 132-36.

[67] The discussion which follows is based on Cheffins and Armour, *supra* note 63, at 2-4, 22-24.

[68] For an overview of the points raised here, see BRIAN R CHEFFINS, CORPORATE OWNERSHIP AND CONTROL:

executives rather than make "hostile" bids. Nevertheless, in buyout negotiations the bargaining position of the incumbent management team will be strengthened if the company is well-run, and underperforming executives could easily find themselves on the outside looking in of a private equity restructuring. Private equity thus potentially has a disciplinary effect on public companies something akin to an old-style hostile takeover bid.[69] As economist Irwin Stelzer said in 2007:

> "We might just 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."[70]

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 this leverage to lobby for changes intended to increase shareholder value.[71] 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.[72] 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.[73] A key obstacle was that these investors emphasized diversification as an investment philosophy.[74] Since improved returns in a particular company were only likely to have 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.

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. The typical tactic was to build up quietly a sizeable position in the targeted company and 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.[75] For the hedge funds, the lure was the prospect of selling out at a sizeable profit after value-enhancing changes had taken place. 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 10 days after the acquisition of 5% or more of a public company's shares.[76]

Activist hedge funds are generally less likely to target big companies than small firms because a

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BRITISH BUSINESS TRANSFORMED 397-98, 403 (2008).

[69] William W. Bratton, *Private Equity's Three Lessons for Agency Theory*, 3 BROOK. J. CORP. FIN. & COM. L. 1, 9-10 (2008).

[70] Irwin Stelzer, *Don't Close Gate on Private Equity "Barbarians"*, SUNDAY TIMES, May 13, 2007. See also Paul Rogers, Tom Holland and Dan Haas, *Private Equity Disciplines for the Corporation*, J. PRIVATE EQUITY, Winter 2002, 6, 8.

[71] On the notion of "offensive" shareholder activism, see CHEFFINS, *supra* note 68, at 392-93.

[72] BRANCATO, *supra* note 35, at 82, 85.

[73] Iman Anabtawi and Lynn Stout, *Fiduciary Duties for Activist Shareholders*, 60 STANFORD L. REV. 1255, 1277-78 (2008); Stephen J. Choi and Jill E. Fisch, *On Beyond CalPERS: Survey Evidence on the Developing Role of Public Pension Funds in Corporate Governance*, 61 VAND. L. REV. 315 (2008); Marcel Kahan and Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1028, 1043-45 (2007).

[74] Anabtawi and Stout, *supra* note 73, at 1278.

[75] MACEY, *supra* note 61, at 245; Anabtawi and Stout, *supra* note 73, at 1279.

[76] Section 13(d) of the Securities Exchange Act of 1934, 15 USC § 78m(d) (2009), provides the statutory foundation for this requirement.

large amount of capital is required to acquire a sufficiently sizeable voting block to make offensive activism worthwhile.[77] However, with assets under management by hedge funds growing substantially during the 2000s and with derivatives being available that permitted the hedging away of the economic interest in shares, hedge fund managers with a shareholder activism mandate could and did challenge management at very large firms.[78] This meant, according to law professors Marcel Kahan and Ed Rock, that "Hedge funds (had) become critical players in…corporate governance."[79] The *New York Times* put the point more strongly in 2007, saying "activists have captured the center ring and are directing the main event."[80] A *Wall Street Journal* columnist observed similarly in 2008 "Like a rebel politician declaring victory, shareholders can declare their revolution nearly complete."[81]

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 harm it, over the long haul.[82] 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."[83]

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."[84] He argues that the benefits do not extend merely to companies hedge funds targeted. 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."[85]

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

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[77] Alon Brav, Wei Jiang, Frank Partnoy and Randall Thomas, *Hedge Fund Activism, Corporate Governance and Firm Performance*, 68 J. FIN. 1733, 1752 (2008).

[78] Anabtawi and Stout, *supra* note 73, at 1279-80; Susan Chandler, *Hedge Funds Put the Pressure On*, CHICAGO TRIBUNE, January 27, 2006. Examples of companies targeted included Circuit City, General Motors, H.J. Heinz, McDonalds and Time Warner: William W. Bratton, *Hedge Funds and Governance Targets*, 95 GEORGETOWN L.J. 1375, 1429-32 (2007); THE CONFERENCE BOARD, HEDGE FUND ACTIVISM: FINDINGS AND RECOMMENDATIONS FOR CORPORATIONS AND INVESTORS 14 (2008).

[79] Kahan and Rock, *supra* note 73, at 1024.

[80] Charles Duhigg, *Gadflies Get Respect, and Not Just at Home Depot*, NEW YORK TIMES, January 5, 2007, C1.

[81] Dennis K. Berman, *Activist Holders Sit Pretty, For Now*, WALL STREET J., July 8, 2008.

[82] Anabtawi and Stout, *supra* note 73, 1290-91.

[83] Brav *et al., supra* note 77, at 1739. See also David Haarmeyer, *The Revolution in Active Investing: Creating Wealth and Better Governance*, 19 J. APPLIED CORP. FIN. 25 (2007).

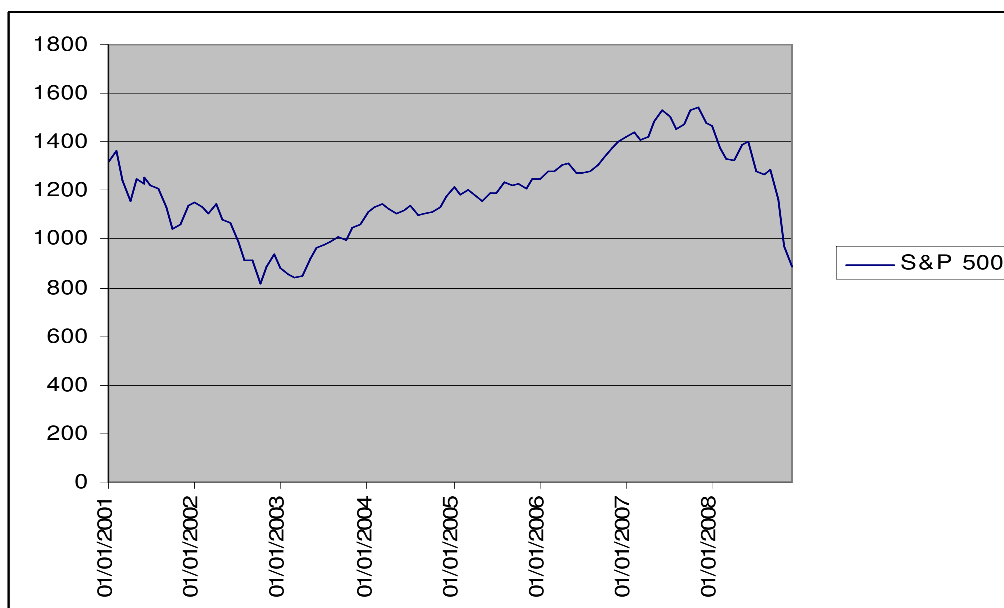
[84] MACEY, *supra* note 61, at 241.

[85] *Id.*, at 250 (emphasis in original).

reporting is more reliable and transparent. Auditor oversight is significantly improved."[86]

Improved confidence in corporate governance coincided with a robust stock market recovery. During early October 2007, the Dow Jones Industrial Average hit its all-time high of 14,280, a 90% jump since September 2002. Likewise, the S&P 500 peaked in early October 2007 at 1576, a 97% improvement over the same period (Fig. 1). The stock market even took in stride during 2007 rising oil prices and a late summer "credit crunch" precipitated by pressures surging mortgage defaults were imposing on banks and investors.[87]

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

By the end of 2007, the stock market had dropped moderately from the October 2007 peak, with the Dow Jones Industrial Average 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.[88] Then the bottom fell out (Fig. 1).

At the close of trading on December 31, 2008 the Dow Jones Industrial Average was 8,776, a drop of 33.8% over the year, and the S&P 500 average was 903, representing a 38.5% annual decline. 2008 was the worst year for the S&P 500 since 1937 and the worst for the Dow Jones since 1931.[89] Across all U.S. stock markets, an estimated $6.9 trillion in market value was wiped out.[90] Moreover, the decline affected all types of companies. Financials were particularly hard hit, but all sectors within the S&P 500 suffered major price declines (Fig. 2).

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[86] Quoted in REZAEE, *supra* note 48, at 36.

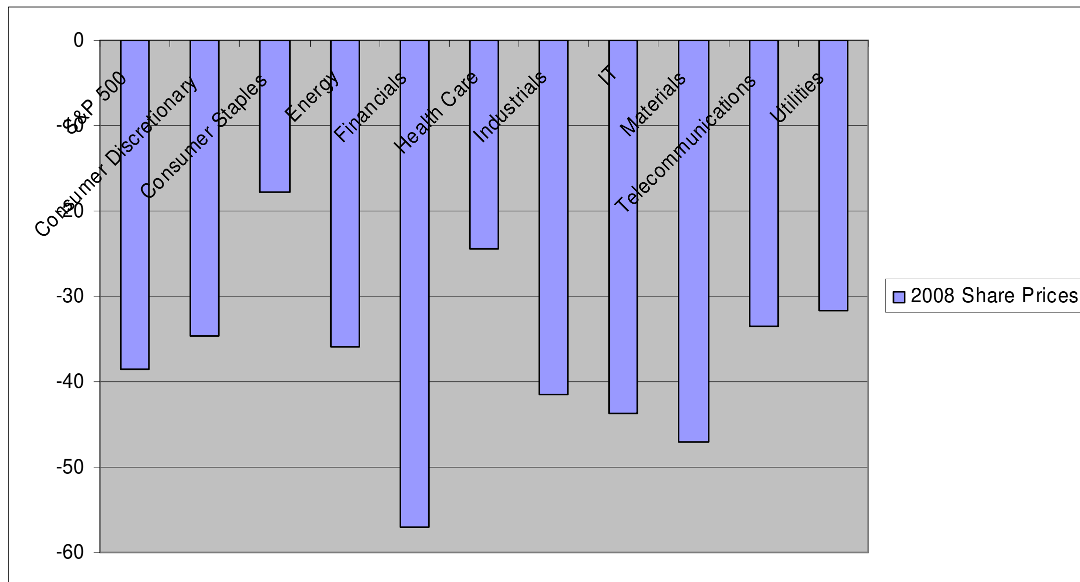
[87] Dean Calbreath, *Market Proves Resilient*, SAN DIEGO UNION-TRIBUNE, January 2, 2008, C1.

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

[89] Matt Krantz, *Markets' Fall was Worst in Seven Decades*, USA TODAY, January 2, 2009, B1. The index officially reported by S&P for 1926 to 1956 contained only 90 stocks. The modern version of the S&P 500 index, with 500 stocks, was launched in 1957. *See* Jack W. Wilson and 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, 507-8, 512, 514 (2002).

[90] Krantz, *supra* note 89.

FIGURE 2: SHARE PRICE PERFORMANCE S&P 500 SECTORS, 2008



Source: Compiled using data from Standard & Poor's, *Monthly Report: World by Numbers*, December 2008

The sharp decline in stock prices suggested that something was seriously amiss with the shareholder value-oriented system of corporate governance system 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."[91] 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 bailouts of numerous major financial firms around the globe. Nevertheless, a system of corporate governance checks and balances oriented around the promotion of shareholder value had seemingly failed to deliver what had been implicitly promised. The breakdown allegedly was particularly acute at the U.S. financial institutions at ground zero of the market crisis. As a *BusinessWeek* columnist observed,

> "regulators, 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 behaviour and ultimately to devastation."[92]

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 academic testing of the hypothesis that good corporate governance improves corporate financial performance has yielded inconclusive results.[93] It therefore is possible corporate governance in public companies generally operated

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[91] *Shareholder Value*, FIN. TIMES, February 4, 2009.

[92] Heineman, *supra* note 1.

[93] See, for example, 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 and Hans-Christoph Hirt, *Corporate Governance and Performance: the Missing Links*, in THE BUSINESS CASE FOR CORPORATE GOVERNANCE 201 (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).

satisfactorily amidst general market trends that inexorably drove share prices downwards. 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 the paper constitutes a pioneering effort to address this gap in our understanding, with the approach adopted being to examine corporate governance in the 37 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. Since there are around 17,000 such firms in the U.S.,[94] 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 index, which is composed of 500 leading U.S. public companies, covers approximately 75% of the total value of the U.S. equities market, illustrates the point.[95]

Even studying the operation of corporate governance for all companies in 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 sub-set 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 findings from the sample extrapolate reliably to the population at large.[96] In this particular context, however, much of the story may well be lost by adopting this methodology, since troubled companies are likely be 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 position in a self-serving manner. Even absent a scandal, a plunging share price can throw into sharp relief corporate governance deficiencies, such as lax boardroom oversight and executive incompetence. 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 and 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 which are removed from the index. The S&P Index committee, made up of Standard & Poor's economists and index analysts,[97] will automatically remove companies from the S&P 500 that have been acquired or have gone bankrupt. The committee also can remove a company on the basis that it fails to meet the criteria for inclusion. To be eligible for the S&P 500 a company must typically be based in the U.S., 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% or more of its outstanding shares publicly traded.[98]

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[94] On the number of public companies, see http://www.uschamber.com/press/speeches/2003/030714tjd_hitachi.htm (accessed March 30, 2009).

[95] Standard & Poor's, *S&P 500*, available at http://www2.standardandpoors.com/spf/pdf/index/SP_500_Factsheet.pdf (accessed March 30, 2009).

[96] Charles H. Feinstein and Mark Thomas, Making History Count: A Primer in Quantitative Methods for Historians 10-11 (2002).

[97] Standard & Poor's, *S&P 500*, *supra* note 95.

[98] *Id*. The market capitalization threshold was increased from $3 billion to $4 billion in 2008: Standard & Poor's, *Standard & Poor's Announces Update to the U.S. Market Cap Guidelines and Changes to U.S. Indices*, September 25, 2008 (available at http://www2.standardandpoors.com/portal/site/sp/en/us/page.topic/indices_500/2,3,2,2,0,0,0,0,0,3,1,0,0,0,0,0.html , accessed March 30, 2009).

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. 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.[99]

The S&P index committee strives to minimize unnecessary turnover with the S&P 500, which is reflected by the fact that continued index membership is not conditional upon a company continuing to fulfil all guidelines for inclusion.[100] 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 Co. (a.k.a. "Freddie Mac") was only removed from the S&P 500 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.[101] Companies therefore are typically not dropped from the index unless they are in conspicuous financial trouble or "disappear" in an acquisition.[102] Removal, moreover, is a fate an S&P 500 company will want to avoid (absent a merger) because when this occurs its share price typically falls further as fund managers of index-tracking funds sell out.[103]

The upshot is that companies removed from the S&P 500 index should provide an instructive sample for assessing corporate governance responses to the "stress test" posed by 2008's dramatic fall in shares prices. This is borne out by the fact that most of the 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. Notable exceptions were AIG, an insurance/asset management conglomerate with $860 billion worth of assets of the end of 2008, and Citigroup, a diversified financial service company holding company with assets of $1.94 trillion, which retained their positions on the S&P 500 in large measure because of highly publicized government bailouts.[104]

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.

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, health care, information technology,

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[99] See http://en.wikipedia.org/wiki/S&P_500 (accessed March 30, 2009).

[100] Standard & Poor's, *S&P 500*, *supra* note 95.

[101] Standard & Poor's, *Standard & Poor's Announces Changes to U.S. Indices*, (September 9, 2008); Standard & Poor's, *Standard & Poor's Announces Changes to U.S. Indices* (November 11, 2008).

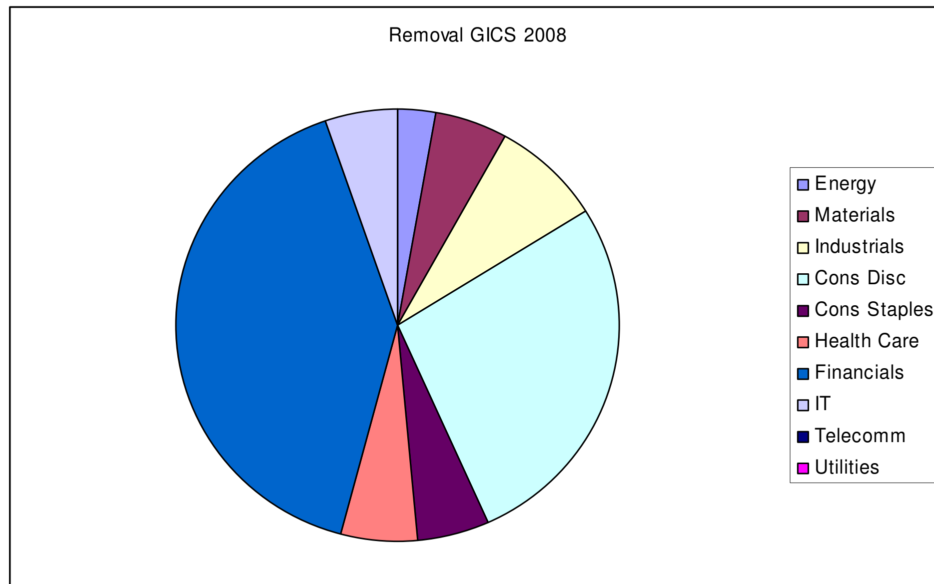
[102] GARY L. GASTINEAU, THE EXCHANGE TRADED FUNDS MANUAL 148 (2002).

[103] *Id.* See also *New IAC Poised To Get Cheaper After Break-Up*, DOW JONES NEWSWIRES (August 19, 2008) (discussing the share price impact of IAC/InterActive Corp.'s exit from the S&P 500).

[104] On AIG, see the company's 2008 annual report on Form 10-K, filed with the Securities and Exchange Commission, 6-8, 36, (available at http://idea.sec.gov/Archives/edgar/data/5272/000095012309003734/y74794e10vk.htm accessed June 22, 2009). On Citigroup, see the company's 2008 annual report on Form 10-K, filed with the Securities and Exchange Commission, 2, 4 (available at http://idea.sec.gov/Archives/edgar/data/831001/000119312509041237/d10k.htm ; accessed June 22, 2009).

telecommunications services and utilities.[105] More than two-thirds of the 37 removals from the S&P 500 during 2008 were in the financials (15) and consumer discretionary (10) sectors (Fig. 3, Appendix), disproportionately large numbers given the composition of the S&P 500 as of the end of 2007, both in terms of the number of companies (Fig. 4) and market capitalization (Fig. 5).[106] The sizeable number of financials on the list is not surprising, given that that the share price performance of this sector was considerably worse than it was for the other nine sectors (Fig. 1), but the consumer discretionary sector performed better than the S&P 500 overall (Fig. 1).

FIGURE 3: NUMBER OF COMPANIES REMOVED FROM S&P 500 IN 2008, BY GICS

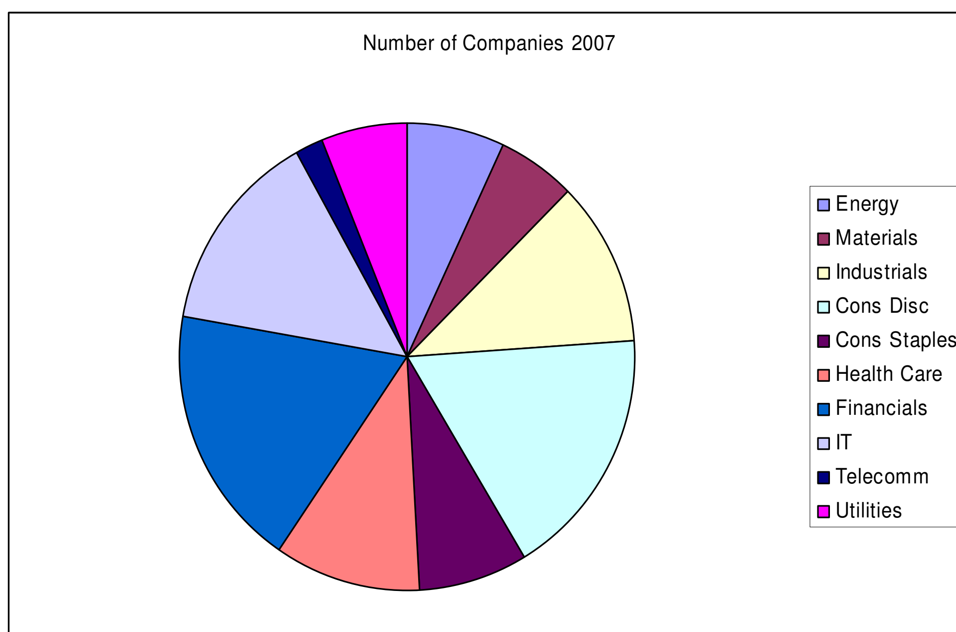


Source: Appendix, this paper.

[105] On categories within the GICS sectors, see http://www2.standardandpoors.com/spf/pdf/index/GICSIndexDocument.PDF?vregion=us&vlang=en (accessed March 30, 2009).

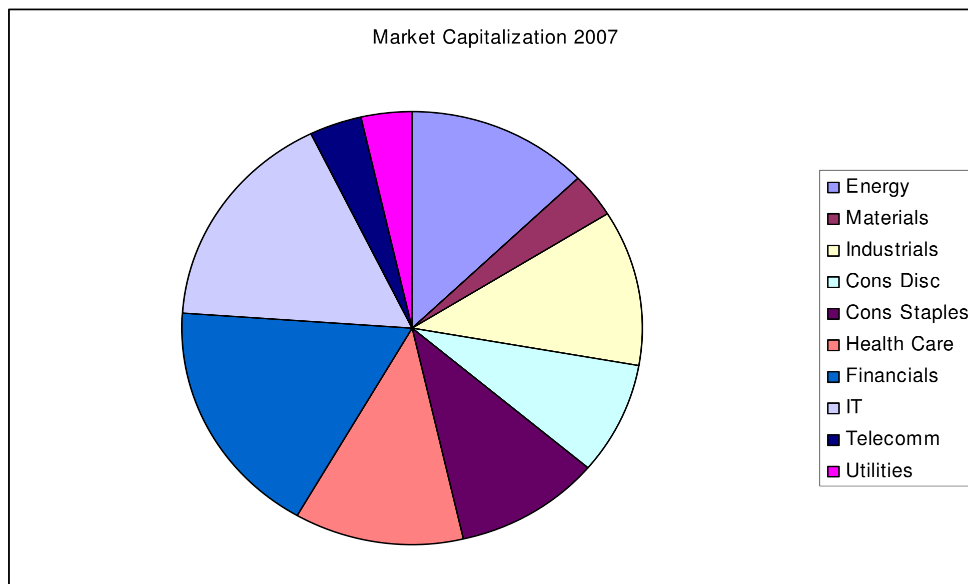
[106] A sector-by-sector breakdown of companies that make up the S&P 500 as of a particular date is available on an interactive chart set out at http://www2.standardandpoors.com/portal/site/sp/en/us/page.topic/indices_500/2,3,2,2,0,0,0,0,0,0,0,0,0,0,0,0.html (accessed March 30, 2009).

FIGURE 4: S&P 500 SECTOR-BY-SECTOR BREAKDOWN, NUMBER OF COMPANIES, DEC. 31, 2007



Source: Compiled from interactive chart available on S&P website

FIGURE 5: S&P 500 SECTOR-BY-SECTOR BREAKDOWN, MARKET CAPITALIZATION, DEC. 31, 2007



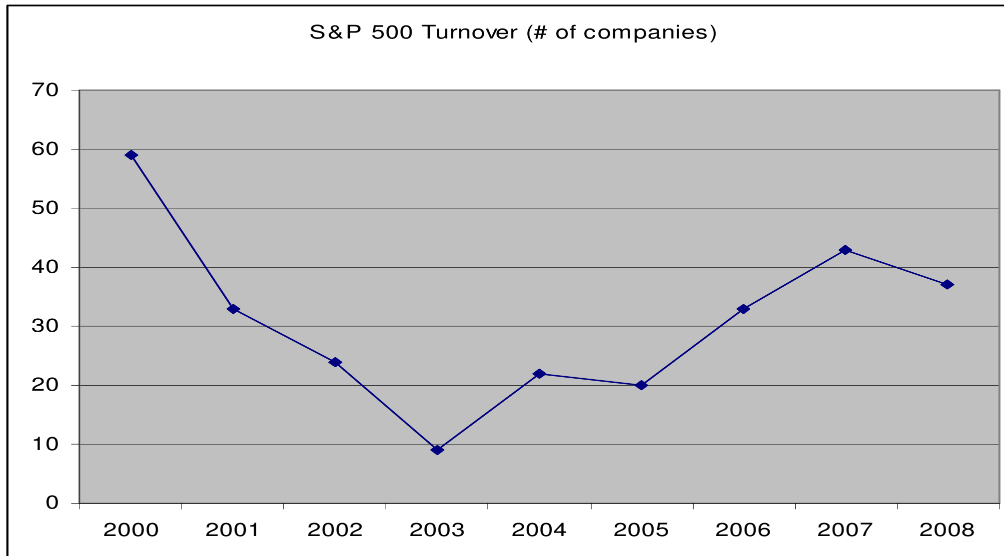
Source: Compiled from interactive chart available on S&P website

Given the stock market turmoil of 2008, it might have been anticipated that S&P 500 turnover would have been higher than average. This was in fact the case (Fig. 6).[107] However, turnover was not

[107] A list of all companies removed from and added to the S&P 500 since 2000 is available at http://www2.standardandpoors.com/portal/site/sp/en/us/page.topic/indices_500/2,3,2,2,0,0,0,0,0,4,1,0,0,0,0,0.html

as rapid as in 2000 and 2007, likely because acquisitions of S&P 500 companies necessitate removal from the index and M&A activity was modest in 2008 in comparison with these years.[108]

FIGURE 6: S&P 500 TURNOVER, 2000-2008



Source: Compiled from S&P website

Among the 37 companies removed from the S&P 500 in 2008, as the Appendix to this paper indicates, a total of 13 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.[109] Sixteen companies were dropped from the index after being acquired by another company (see Appendix). Half of the time the acquirer was another S&P 500 company,[110] 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 Junior Co. being bought by Mars Inc.) the acquirer was a private company. In six of the 16 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 due to spinning off key operations, though in one instance (E.W. Scripps/Scripps Networks Interactive) the spin-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

(accessed March 31, 2009).

[108] Standard & Poor's, *Standard & Poor's Announces Changes to U.S. Indices* (June 12, 2008) (explaining how Standard & Poor's had greater scope in 2008 to readjust its indices on the basis of market values of companies because M&A activity was modest as compared with other years).

[109] Standard & Poor's, in the press releases it issues to announce the reconfiguration of the S&P 500, typically gives the reasons for removal. 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 (Asia ed.), March 1, 2008, 9 (indicating Circuit City's share price had fallen by more than 70% in the past year). Barr Pharmaceuticals was removed because it was acquired by Teva Pharmaceutical Industries Limited, an Israeli company. See *Teva; Barr*, CORP. COUNSEL, November 2008, 31).

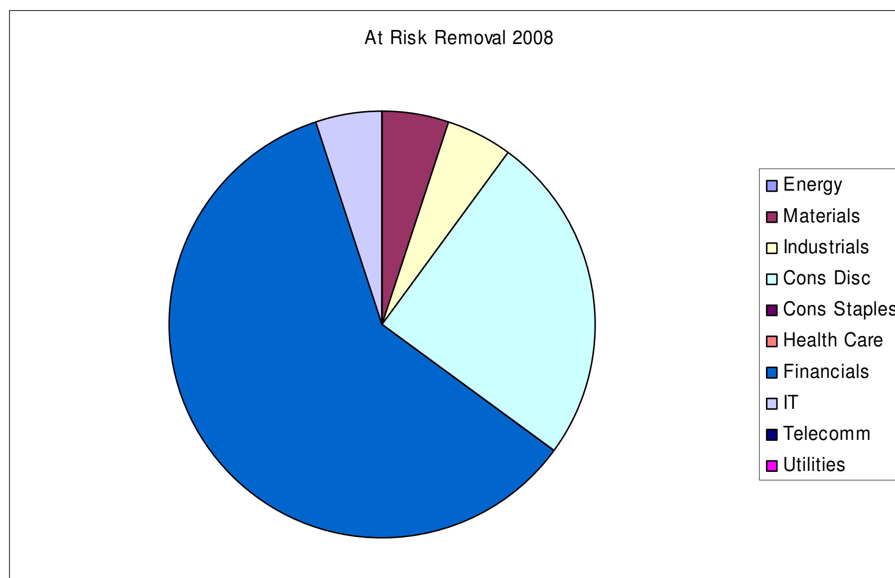
[110] Republic Services Inc. has been included in this category because its acquisition of Allied Waste Industries meant Republic Services Inc. took Allied Waste's place in the S&P 500. See Standard & Poor's, *Standard & Poor's Announces Changes to U.S. Indices* (November 26, 2008).

they re-domiciled in Europe to reduce tax liabilities.[111] Finally, one company -- Lehman Brothers -- was dropped because it filed for bankruptcy.

Of the 37 sample companies, a total of 20 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 13 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 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)[112] and one of the companies taken private would have faced difficult choices if the buyout had fallen through (Clear Channel Communications Inc.),[113] 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, with the other 10 instances where a merger precipitated an exit from the S&P 500 only three of the companies were from this sector.

FIGURE 7: S&P 500 "AT RISK" REMOVALS, SECTOR-BY-SECTOR BREAKDOWN



Source: Appendix, this paper.

C. Search Strategy

In order to assess the operation of corporate governance in the 37 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

[111] *Tax Moves May See Index Shake-ups*, MARKETWATCH, December 23, 2008 (discussing ACE Ltd. and Transocean Inc.).

[112] By August 2008, IAC/Interactive shares were trading at $17.75, well off a 2008 high of $80: *New IAC, supra* note xx; *Mogul v Mogul*, ECONOMIST, March 15, 2008.

[113] *Clear Channel's Outlook is Cloudy as Buyout Flops*, WALL STREET J., March 31, 2008.

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.[114] 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.[115] 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.

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. Nevertheless, the Factiva searches were supplemented in various ways. First, Georgeson's *2008 Annual Corporate Governance Review*[116] was referenced to find instances of shareholder activism 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.[117] 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 from January 2008 through to 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 website on executive pay, were consulted to find out how the sample companies stood in relation to peers in the S&P 500.[118] A *Forbes* website providing data on 2006 was used to collect data on the small handful of companies for which 2007 figures were unavailable.[119]

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 sub-divided 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 *etc.* in the early 2000s. Was the dishonest behaviour that characterized these scandals a feature of the stock market turmoil of 2008? As for board issues, reform has been a hallmark of corporate governance since the 1970s.[120] 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 managerial remuneration did too little

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[114] On Factiva's content, see http://factiva.com/sources/contentwatch.asp?node=menuElem1522 (accessed March 31, 2009).

[115] 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.

[116] Georgeson, 2008 Annual Corporate Governance Review: Annual Meetings, Shareholder Initiatives, Proxy Contests (2009).

[117] See http://securities.stanford.edu/fmi/xsl/SCACPUDB/findrecords.xsl?-view (last accessed June 19, 2009).

[118] *Executive Pay Watch*, available at http://www.aflcio.org/corporatewatch/paywatch/ (accessed April 2, 2009).

[119] *Special Report: Executive Compensation*, available at http://www.forbes.com/2007/05/03/highest-paid-ceos-lead-07ceo-cz_sd_0503ceo_land.html (accessed April 2, 2009).

[120] *Supra* notes 24 to 32, 56 and accompanying text.

to promote shareholder value,[121] 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 the overall promotion of shareholder value.[122] 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.[123] 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

The Sarbanes-Oxley Act of 2002 was enacted in response to the corporate scandals occurring at Enron, WorldCom and assorted other major public companies at the beginning of the 2000s.[124] 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."[125] 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 Sarbanes Oxley passed this admittedly basic test. As the *Economist* said of the financial crisis in a 2009 survey of U.S. business, "…swindles were not typical. The crisis owed more to incompetence than criminality."[126] Developments at the 37 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 37 companies.[127] This could be the case, for example, with an investigation the New York attorney general has launched into $3.6 billion worth of bonuses investment bank Merrill Lynch hastily granted to executives before the culmination of its rescue merger with the Bank of America in December 2008.[128] The situation could be the same with mortgage lender Countrywide Financial Corp., with the Securities and Exchange Commission filing in June 2009 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.[129] Future revelations could also arise with various "at risk" financials removed

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[121] *Supra* note 41 and related discussion.

[122] See, for example, LUCIAN BEBCHUK AND JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION (2004).

[123] *Supra* note 8 and related discussion.

[124] *Supra* notes 51 to 57 and accompanying text.

[125] Dennis K. Berman, *Enron Lessons are Thin*, WALL STREET J., October 29, 2008, 24. See also Michael Skapinker, *Every Fool Knows It Is a Job for Government*, FIN. TIMES, November 18, 2008.

[126] *Surviving the Slump: A Special Report on Business in America*, ECONOMIST, May 30, 2009, 15.

[127] Roger Parloff, *Wall Street: It's Payback Time*, FORTUNE, January 19, 2009, 56; Paul M. Thompson, *White Collar Crime; Investigating the Economic "Villains"*, NATIONAL L.J., March 9, 2009, S1 (discussing congressional committees).

[128] Greg Farrell and Henny Sender, *The Shaming of John Thain*, FIN. TIMES (U.K edition), FT Weekend, March 14/15, 2009, 20, 24-25.

[129] Gretchen Morgenson, *SEC Accuses Countrywide's Former Chief of Fraud*,New YorkTIMES, June 5, 2009; Kara Scannell and John R. Emshwiller, *Countrywide Chiefs Charged with Fraud*, WALL ST. J., June 5, 2009.

from the S&P 500 in 2008 that were reportedly under criminal investigation as of early 2009[130] and with the S.E.C.'s enforcement director saying in June 2009 the Commission had made it a priority "to pursue cases at the root of the financial crisis."[131]

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.[132] Also, in those instances where intentional managerial misconduct came to light at one of the 37 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.[133] 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 sub-prime-loan holdings but these were filed against two of the firm's fund managers rather than against senior executives.[134] Similarly, with Wachovia Corp., removed from the index in December 2008 after a rescue merger by Wells Fargo & Co., 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.[135]

While unambiguous, intentional wrongdoing by executives apparently did not afflict the companies exiting the S&P 500 in 2008, there may well 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 13 of the 37 companies removed from the S&P 500 in 2008 (Table 1).[136] All of these were financials, save for retailer Liz Claiborne, and eleven fell into the "at risk" category. At the time of writing, outcomes in the suits remained pending. The remaining 24 companies apparently escaped securities lawsuits despite 2008's dramatic drop in share prices.[137]

TABLE 1 – SECURITIES CLASS ACTIONS FILED DURING 2008 AGAINST COMPANIES REMOVED FROM S&P 500 (IN ORDER OF REMOVAL)

Company	**Industry**	**"At Risk"?**	**Date Filed**	**Allegations**
Bear Stearns	Financials	Yes	Feb. 27, 2009	False and misleading statements concerning the company's business

[130] Parloff, *supra* note 127 (naming Countrywide, Fannie Mae, Freddie Mac, Lehman Brothers and Washington Mutual).

[131] Morgenson, *supra* note 129.

[132] *Id*.

[133] Holly Sraeel, *Vernon Hill's Magic as CEO Was Also His Downfall*, US BANKER, August 2008, 8; *TD Earns Kudos for Bold Southern Foray*, TORONTO STAR, October 8, 2007, B03.

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

[135] Jennifer Levitz, *Wells Fargo, BofA Pay to Settle Claims,* WALL ST. J., June 10, 2009. 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 U. CONN. L. REV. 963, 1044 (2009).

[136] To avoid unnecessary clutter, pinpoint cites have not been provided for propositions advanced in Table 1 and other tables in paper. Microsoft Word files containing the relevant newspaper stories, journal articles and newswire reports, organized by reference to the months when companies were removed and sub-divided on a company-by-company basis, are available on request from the BUSINESS LAWYER.

[137] Washington Mutual and its (former) directors did face, however, a class action launched by bondholders. See *Leppert Witnessed WaMu's Collapse From Seat on Bank's Board*, ASSOCIATED PRESS NEWSWIRES, March 2, 2009).

				and financial results.
Ambac Financial Group	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	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	Financials	No	June 16, 2008	Directors pursuing their own interests at the expense of shareholders when negotiating a merger with Liberty Mutual.
MGIC Investment Corp.	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.
General Growth Properties	Financials	Yes	Oct. 31, 2008	False and misleading statements concerning the company's access to finance.
Liz Claiborne	Consumer Discretionary	Yes	April 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	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.[138]
Merrill Lynch	Financials	Yes	mid-October, 2008, Oct. 22, 2008	Merrill Lynch directors breached their duty of care by agreeing to hasty sale of the company to Bank of America; false and misleading statements pertaining to the sale of Merrill Lynch preferred stock and bonds.

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

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. Sarbanes-Oxley 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, reflecting the fact that the legal system gives executives wide scope to run businesses as they see fit even if they make terrible decisions honestly.[139]

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.[140] Despite all of the intellectual effort, commercial corporate governance indices have not yet proved to be reliable predictors of future stock returns, perhaps because what constitutes effective governance depends on each firm's specific circumstances.[141] 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 37 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

[138] Allegations that the directors of National City Corp. 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 (*Tharp et al. v. National City Corp.*, filed Nov. 24, 2008, Docket No. 08-CV-02794). The other, filed in Delaware, was based on corporate law (Steve Wartenberg, *National City's Old Options are Part of Suit*, COLUMBUS DISPATCH, May 31, 2009, D1).

[139] Berman, *supra* note 125; Loren Steffy, *Law Can't Stop Failure*, HOUSTON CHRONICLE, March 21, 2008.

[140] On the terminology, see 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.*, 898-906; Bhaghat, Bolton and Romano, *supra* note 11, at 1824-26, 1872-76.

[141] Bhagat, Bolton and Romano, *supra* note 11, at 1808, 1814, 1818, 1859.

leading up to the financial crisis, and this investigation should uncover valuable evidence on board performance.[142] 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 sub-standard 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 37 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 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.[143]

TABLE 2: PUBLIC CRITICISM OF BOARDS AMONG COMPANIES REMOVED FROM S&P 500, 2008 (IN ORDER OF REMOVAL)

Company	**Industry**	**"At Risk"**	**Nature of Criticism**
Bear Stearns	Financials	Yes	The board lacked sufficient financial expertise and failed to challenge sufficiently the company's dominant CEO.
Countrywide Financial Corp.	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	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	Financials	Yes	Directors moved too hastily in agreeing to sell the company to Bank of

[142] Zachary A. Goldfarb, *SEC to Examine Boards' Role in Financial Crisis*, WASHINGTON POST, February 20, 2009, D1.

[143] Tim Barker, *Loyalty of A-B Board May be Put to the Test*, ST. LOUIS POST-DISPATCH, June 20, 2008, 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, A1 (the board's response).

			America.

Source: Factiva Searches

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 firms companies stood accused of letting the good times roll rather than coming properly to grips with the risks management was taking.[144] Directors of particular companies were also criticized on grounds of expertise, or lack thereof. For example, critics argued 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 wherewithal to hold management properly accountable.[145] Another charge levelled against directors of certain financials was that they were dazzled by a free-wheeling, charismatic CEO and couldn't 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, labelled "the text book example" of "the command-and-control CEO."[146]

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 by virtue of owning 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.[147] 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.[148] 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 boardroom turnover is a logical corporate governance response when poor performance implies 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.

TABLE 3: PUBLICIZED DIRECTOR TURNOVER AMONG COMPANIES REMOVED FROM S&P 500, 2008
(COMPANIES LISTED IN ORDER OF REMOVAL FROM THE INDEX)

Company	**Industry**	**"At Risk"**	**Circumstances**
Circuit City	Consumer Discretionary	Yes	To fend off a fully fledged proxy fight, management consented to adding three nominees of an activist shareholder to its slate

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

[145] On Bear Stearns, see Gretchen Morgenson, *SEC Sends Investors to the Children's Table*, NEW YORK TIMES, December 2, 2007, 1; Paul Fain, *Two University Chiefs Caught Up in Wall Street Meltdown*, CHRONICLE OF HIGHER EDUCATION, November 7, 2008, A17.

[146] Landon Thomas, *Not a Jolly Season for Top 2 Bankers*, NEW YORK TIMES, December 21, 2007, 1 (Bear Stearns); Andrew Gowers, *The Man Who Brought the World to its Knees*, SUNDAY TIMES, December 14, 2008, 1 (Countrywide, Lehman Brothers).

[147] *Dillard's Side-Steps Proxy Fight*, KNOXVILLE NEWS-SENTINEL, April 3, 2008, 23; Toby Manthey, *Dillard's Execs Got No 2007 Bonuses*, ARKANSAS DEMOCRAT-GAZETTE, April 23, 2008, 27;

[148] For a list of companies where a proxy fight occurred during 2008, see GEORGESON, 2008 ANNUAL, *supra* note 116, at 46-47.

			of nominated directors.
Ambac Financial Group. Inc.	Financials	Yes	Chairman of the board replaced, January 2008.
Brunswick Corp.	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 director 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	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	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, a director who was also a senior executive resigned his board seat to ensure there remained a majority of independent directors.
Wachovia Corp.	Financials	Yes	CEO replaced as chairman of the board a few months before being dismissed as chief executive.

Source: Factiva Searches

Venerable shareholder activist Carl Icahn has said of the recent financial crisis "while executives and regulators have justifiably taken the heat for this multifaceted debacle, board members have largely been let off the hook."[149] The absence of a fully fledged proxy fight among the companies removed from the S&P 500 in 2008 companies lends credence to this charge, as does the fact that only four of the 12 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.[150] 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

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[149] Carl. C. Icahn, *Corporate Boards That Do Their Job*, WASHINGTON POST, February 16, 2009, A15. See also Francesco Guerrera and Peter Thal Larsen, *Gone by the Board?*, FIN. TIMES, June 26, 2008; James Surowiecki, *Board Stiff*, NEW YORKER, June 1, 2009, 34.

[150] Guerrera and Larsen, *supra* note 149; see also *supra* note 6 and related discussion.

management models would provide ample warning of any serious problems.[151] 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."[152] 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 will be 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",[153] it might have been thought that chief executives could have ridden out the 2008 stock market storm without too much difficulty. This turned out not be the case.

Discounting managerial turnover occurring subsequent to an acquisition, which is standard operating procedure, Factiva searches for the 37 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). The managerial turnover that occurred was not randomly distributed. Instead, all but two of the companies involved were financials and 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.[154] 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.[155]

TABLE 4: PUBLICIZED SENIOR EXECUTIVE TURNOVER 2008, COMPANIES REMOVED FROM S&P 500 (IN ORDER OF REMOVAL)

Company	**Industry**	**"At Risk"**	**CEO**	**Other Senior Executives**	**Circumstances**
Circuit City	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.
Bear Stearns	Financials	Yes	Yes	No	CEO stepped down but remained board chairman.

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[151] William Rees-Mogg, *Good People + Impossible Task = Collapse*, TIMES, March 2, 2009; *Rebuilding the Banks: A Special Report on International Banking*, ECONOMIST, May 16, 2009, 14.

[152] Jack Welch and Suzy Welch, *How Much Blame Do Boards Deserve?*, BUSINESSWEEK, January 14, 2009.

[153] 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).

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

[155] See *supra* note 133 and related discussion.

Ambac Financial Group	Financials	Yes	Yes	No	CEO resigned; chairman of the board replaced him as interim CEO.
Fannie Mae	Financials	Yes	No	Yes	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.
Unisys Corp.	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 Corp.	Financials	Yes	Yes	Yes	CEO fired by the board. New CEO hired a new chief financial officer.
National City Corp.	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

To put these figures into perspective, among the 20 "at risk" companies leaving the S&P 500 in 2008, 40% experienced CEO turnover and 40% experienced the publicized removal of other senior executives. This level of executive turnover greatly exceeds the norm, even in underperforming companies. According to Booz & Co., a management consultancy, among the world's largest 2,500 companies there was in a ten-year period ending in 2007 only a 2.1% chance of the CEO being dismissed for poor performance in any given year, with the probability of termination only increasing

to 5.7% among companies in the lowest decile of performance.[156]

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 that were hired frequently pursued profits aggressively with highly leveraged strategies that ultimately wrought havoc.[157] It is also possible that for some firms instability created by frequent managerial turnover made it more difficult to navigate through the crisis.[158] 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.[159] 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 U.S. experienced during the mid-2000s began to go into reverse.[160] Still, while there were instances where boards could have no doubt 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 and the growth in pay of rank-and-file workers.[161] However, in 2008, the economy's downwards spiral put the issue in the spotlight as never before, with feelings running high due to expectations that executives would "feel the pain" along with the shareholders experiencing dramatic declines in stock prices and employees losing their jobs.[162] Nevertheless, there was no random backlash among the 37 companies removed from the S&P 2008, perhaps due partly to general trends concerning executive pay -- median pay for CEOs of S&P 500 companies fell 6.8% in 2008.[163] 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 14 companies removed from the S&P 500 during 2008 where there was publicized criticism of executive pay, 11 were at risk companies (Table 5), implying critics specifically (and sensibly) 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).[164] 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).

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[156] Per-Ola Karlsson, Gary L. Neilson and Juan Carlos Webster, *CEO Succession 2007: The Performance Paradox*, STRATEGY + BUSINESS, Summer 2008, 1, 3.

[157] Henieman, *supra* note 1.

[158] Paul Davis, *Execs Come, Execs Go, Effects Stay*, AMERICAN BANKER, June 18, 2009, 1.

[159] James R. Hagerty, *Mozilo's Pay Plunged 79%*, WALL STREET J., April 25, 2008, B1 (bonus for staying in office); *Countrywide Financial's Sad Day*, VENTURA COUNTY STAR, June 26, 2008 (share prices).

[160] Berman, *supra* note 125.

[161] See, for example, BEBCHUK AND FRIED, *supra* note 122; GRAEF S. CRYSTAL, IN SEARCH OF EXCESS: THE OVERCOMPENSATION OF AMERICAN EXECUTIVES (1991); *Too Many Turkeys*, ECONOMIST, November 26, 2005.

[162] Greg Farrell and Barbara Hansen, *Stocks May Fall, But Pay Doesn't*, USA TODAY, April 10, 2008, B1 ("…the public is focusing on CEO compensation as never before"); Francesca Guerrera and Joanna Chung, *Fear of Falling*, FIN. TIMES, January 6, 2009, 11 ("The level of anger and incredulousness around the country is at record levels").

[163] *Surviving the Slump, supra* note 126, at 3.

[164] *CEO Pay Higher in '07 Despite Slow Economy*, TULSA WORLD, June 22, 2008, E5.

TABLE 5: CEO PAY CONTROVERSIES 2008 AMONG COMPANIES REMOVED FROM S&P 500 (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.
Bear Stearns	Financials	Yes	$38.3m (2006)	The lucrative compensation of top Bear Stearns executives drew much criticism, particularly as the company encountered financial difficulties.
Countrywide Financial Corp.	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 up the package. He also took a 79% pay cut between 2006 and 2007.
IAC/InterActive Corp.	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.
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 bankruptcy.
Washington Mutual	Financials	Yes	$5.3m ($22.7m in	Due to shareholder pressure, the company reversed a decision to ignore mortgage

			2006)	losses when calculating performance bonuses for top executives.
Dillard's	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 controversially lent money to two senior executives so they could meet margin calls arising from sizeable purchases of General Growth shares.
Liz Claiborne	Consumer Discretionary	Yes	$6.3m	The CEO's pay was criticized as being too high for a company that cut 2,200 jobs.
National City Corp.	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	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)

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).[165] The only exceptions were 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 one million Wachovia shares he owned and received no severance package after the Citigroup merger.[166]

Though 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.[167] 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

[165] 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 ($730,000); Brunswick Corp. ($3.4 million); OfficeMax Inc. ($5.1 million); MGIC Investment ($3.5 million); Unisys Corp. ($1.9 million); Ashland Inc. ($4.4 million).

[166] *Wachovia CEO Steel Loses Big On Sale To Citigroup*, DOW JONES NEWSWIRES, September 29, 2008.

[167] See, for example, Farrell and Hansen, *supra* note 161 (discussing losses suffered by Bear Stearns' chief executive James Cayne); *Lehman's Fuld Suffers Wealth Hit as Shares Fall*, REUTERS, September 12, 2008 (discussing impact of Lehman Brothers' September 2008 bankruptcy on the CEO); Robert Frank and Kris Hudson, *The Fallen: Bucksbaum Family*, WALL STREET J, December 10, 2008, 1 (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).

admitted to the *Economist*, "It was better to be an employee than a shareholder."[168]

Part of the explanation for the pattern likely 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.[169] 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 licence to make big bets that could dramatically increase the share price and generate stratospheric payouts but alternatively could jeopardize the future of the firm.[170] 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.[171] 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 leverage."[172] 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.

D. Private Equity

Private equity buyouts have a disciplinary dimension that arguably serves to improve managerial accountability in public companies.[173] However, with corporate governance facing its most robust challenge in modern times due to the 2008 stock market meltdown, private equity went AWOL. The fall in stock market prices meant there should have been numerous bargains around.[174] Private equity firms could not capitalize, however.

Private equity firms typically carry out buyouts with capital they have raised for buyout funds they have established, 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% as compared to 2007.[175] 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 2005-07.[176] Correspondingly, the aggregate value of U.S. private equity buyouts fell 84% in 2008 as compared with 2007 and there was not a single deal larger than $10 billion.[177]

The private equity "deep freeze" was readily apparent with the 37 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.[178] There were rumours about private equity bids for a number of other

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[168] *Rebuilding the Banks, supra* note 151, at 15.

[169] *The Bonus Racket*, ECONOMIST, January 31, 2009.

[170] Alan S. Blinder, *Crazy Compensation and the Crisis*, WALL STREET J., May 28, 2009, A15; *Attacking the Corporate Gravy Train*, ECONOMIST, May 30, 2009; OECD, CORPORATE GOVERNANCE AND THE FINANCIAL CRISIS 16-17 (2009).

[171] *Lehman's Fuld*, *supra* note 167.

[172] TREASURY DEPARTMENT, FINANCIAL REGULATORY REFORM: A NEW FOUNDATION (2009) (available at http://www.financialstability.gov/docs/regs/FinalReport_web.pdf , accessed June 19, 2009).

[173] *Supra* notes 68 to 70 and related discussion.

[174] Thorold Barker, *Private Equity Could Yet Discover a Silver Lining*, FIN. TIMES, March 15/16, 2008, 33; *Loan Rangers*, ECONOMIST, August 30, 2008.

[175] Martin Arnold, *Buy-out Bosses See Halcyon Days Fade Away*, FIN. TIMES, January 3/4, 2009, 17 (capital raised fell from $765.2 billion to $233.5 billion).

[176] Peter Lattman, *Lacking Leverage, Firms Embrace EBOs*, WALL STREET J., March 12, 2009.

[177] *"Little But Tumbleweeds" In LBO In '08*, WSJ BLOG/DEAL JOURNAL, January 7, 2009 (discussing data compiled by data provider Dealogic).

[178] Heather Timmons, *The Year That Made Deal Makers Giddy*, NEW YORK TIMES, January 5, 2007.

companies removed from the index (e.g. Circuit City and Wendy's International)[179] but these came to nothing.

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.[180] 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.[181] 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,[182] private equity firms could not own more than 10% of the voting shares of a bank (increased to 15% 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 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.[183] The fate TPG suffered also likely discouraged other private equity firms from stepping forward.[184] 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.[185] Corsair managed to avoid a similar fate, with the saving grace being "downside protection provisions" negotiated with National City which guaranteed that in the event of a merger Corsair would receive no less than the $5 per share it paid for its shares. 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.[186]

E. 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 37 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.[187] The stock market meltdown of 2008 did not alter the trend. Of the 37 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 sub-prime and adjustable-rate

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[179] Pallavi Gogoi, *Is Circuit City Headed for a Blowout?*, BUSINESSWEEK.COM, July 3, 2008; Catherine R. Cobb, Sarah E. Lockyer and Peter Romeo, *Arby's Parent Triarc to Acquire Wendy's in $2.34B Stock Swap*, NATION'S RESTAURANT NEWS, May 5, 2008.

[180] *Loan Rangers*, *supra* note 174; Andrew Ross Sorkin, *New Path for Kings of Buyouts*, NEW YORK TIMES, April 8, 2008.

[181] Breakingviews.com, *WaMu's Lesson for Private Equity*, NEW YORK TIMES, September 29, 2008 (Washington Mutual); *Details of Nat City, Corsair Deal Reveal Race for Capital*, CRAIN'S CLEVELAND BUSINESS, July 7, 2008 (National City).

[182] 12 U.S.C. § 1841, *et seq*.

[183] *Loan Rangers*, *supra* note 174; Jones Day, *Private Equity Investments in Bank Holding Companies: The Fed Expands and Clarifies Opportunities*, September 2008 (available at http://www.jonesday.com/pubs/pubs_detail.aspx?pubID=S5475; accessed June 17, 2009); *Toe in the Water*, FORBES, March 2, 2009, 32.

[184] *Toe in the Water, supra* note 183; *Why Private-Equity Firms Won't Ride to Banks' Rescue*, HOUSTON CHRONICLE, September 27, 2008.

[185] Breakingviews.com, *supra* note 181; Peter Lattman, *TPG Takes Big WaMu Hit*, WALL STREET J. ASIA, September 25, 2008.

[186] *Behind the News With Crain's Writers*, CRAIN'S CLEVELAND BUSINESS, November 24, 2008.

[187] *Supra* note 73 and related discussion.

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.[188] Two months later CEO Kerry Killinger gave up his post as chairman of the board in response to a 51% vote in support of an advisory resolution proposed by the Service Employees International Union Master Trust to split the CEO/chairman roles.[189]

While activism by institutional investors only generated publicity 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.

TABLE 6: 2008 SHAREHOLDER PROPOSALS AMONG COMPANIES REMOVED FROM 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** (%s 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% - 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%

188 Kevin Dobbs, *Wamu Shareholder Criticizes Nominees*, AMERICAN BANKER, March 20, 2008, 20; Francesco Guerrera and Ben White, *WaMu Director Forced to Quit*, FIN. TIMES, April 16, 2008, 16; David A. Katz and Laura McIntosh, *Shareholders Focused on Stability in Proxy Votes*, NAT'L L.J., October 30, 2008, 5, n. 4.

189 *Washington Mutual Separation of CEO, Chair*, PR NEWSWIRE, June 2, 2009.

Anheuser-Busch	Consumer Staples	No	Adoption of “say on pay”; right of shareholders to call meetings.	Individuals.	42% - 44%
Wachovia Corp.	Financials	Yes	Double the number of board nominees; adoption of “say on pay”.	Union pension fund (one); individual (one).	6% - 29%
Merrill Lynch	Financials	Yes	Establish buyback holding period (executive pay); cumulative voting for directors; restrictions on directors having executive contracts; adoption of “say on pay”.	Union pension funds (three); individual (one).	9% - 36%

Source: Georgeson 2008 Annual Corporate Governance Review

The low profile institutional investors adopted in relation to the 37 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 “They just don’t want to stick their necks out and ruffle management’s feathers.”[190] More generally, as the crisis built up, shareholders increasingly prized stability and became less inclined to “rock the boat”.[191] As a result, directors of public companies were typically re-elected in 2008 with 90%-plus support and the number of corporate governance proposals brought to a vote by shareholders fell as compared with 2007.[192]

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 37 firms experiencing publicized interventions of this nature. 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).[193] 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 when it was bought outright by Peltz-dominated Triarc Companies Inc., which already owned the Arby’s restaurant chain.[194] Applied Biosystems’ June 2008 announcement that it was being bought by Invitrogen came two months after hedge fund S.A.C.

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[190] *In Crisis, Mutual Funds Fail to Speak Up*, AFX ASIA, December 12, 2008.

[191] Kristin Gribben, *Shareholder Democracy is on Hold*, FIN. TIMES, July 7, 2008, FT fm, 9.

[192] Katz and McIntosh, *supra* note 188.

[193] On Dillard’s see *supra* note 147 and related discussion. Otherwise, see *Activist Funds Banks on IT Turnaround*, BARRON’S ONLINE, October 6, 2008 (Unisys); *Change for Circuit City*, RICHMOND TIMES-DISPATCH, May 17, 2008, 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: Rachel Dodes, *Hedge Funds Seek Ousters at Dillard’s*, WALL STREET J., October 28, 2008, B4.

[194] Monique Curet, *End of an Era*, COLUMBUS POST-DISPATCH, April 25, 2008, 1A; *Triarc and Wendy’s Sign Definitive Merger Agreement*, BUS. WIRE, April 24, 2008; *Wendy’s Takeover Completed*, WASHINGTON POST, September 30, 2008, D2.

Capital, a 5% shareholder, urged the company to explore a sale.[195] Finally, in late 2008 hedge fund Pershing Square Capital Management built up a 25% 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.[196] 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 it bought on the cheap.[197]

While the occurrences of offensive shareholder activism generated results, the small number of interventions meant this form of corporate governance did not perform a central corrective role among companies removed from the S&P 500 in 2008. The lack of activism among this cohort was consistent with general patterns, as activist campaigns in U.S. public companies fell from 61 in 2007 to 34 in 2008, with just two interventions occurring during the final quarter of 2008.[198] The paucity of activism is particularly striking because theoretically the rapid decline in share prices in 2008 provided a congenial platform for intervention. 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.[199] There were, however, various factors that simultaneously discouraged the sort of activism in which hedge funds specialized.

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.[200] 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.[201] Finally, a sizeable proportion of interventions that occurred went badly wrong when stock prices fell precipitously in the second half of 2008, and many formerly aggressive hedge fund managers responded by "hiding under their desks."[202] The upshot is that while activist hedge funds were not completely sidelined during the stock market meltdown of 2008, they did remain a corporate governance sideshow among those companies removed from the S&P 500.

E. Summary

How did corporate governance function during the 2008 stock market meltdown? At least among the 37 companies removed from the S&P 500, the answer is tolerably well. The news was certainly not all good. The fact the dramatic decline in share prices occurred in the first place means all was clearly 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 went AWOL and activism by major institutional shareholders was also conspicuous by its absence.

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 few underperforming firms. The apparent absence of fraud was also a bright spot. It likely was tempting for senior executives with incentive-laden compensation

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195 *Applied Biosys Hldrs Get Desired Deal, But Premium Lacking*, DOW JONES NEWSWIRES, June 12, 2008.

196 *Ackman Raises Stake in General Growth*, NEW YORK TIMES, Dealbook, December 10, 2008 (Pershing Square's ownership stake); James Covert, *Ackman's Mall Gamble*, NEW YORK POST, April 17, 2009, 32 (other aspects).

197 Covert, *supra* note 196.

198 *Flight of the Locusts*, ECONOMIST, April 11, 2009 (citing data compiled by Thomson Reuters).

199 *Long Live Activism*, FIN. TIMES, November 5, 2008, 12; Lina Saigol, *Activists Rise From the Ashes as Crisis Exposes Weaknesses*, FIN. TIMES, November 14, 2008, 28.

200 *Flight*, *supra* note 198; Zachery Kouwe, *Among Activist Investors, a New Hesitancy*, NEW YORK TIMES, March 26, 2009.

201 *Activist Investors*, FIN. TIMES, March 10, 2008, 18.

202 *The Deactivated Activists*, BUSINESSWEEK, December 30, 2008, 80.

packages to "cook the books" or spin the facts to ensure they hit targets as share 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, there was a conspicuous absence of blind deference to chief executives 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 how matters worked. Moreover, in those the instances where executive compensation was criticized, the targeting was apt in the sense 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 major financial firms adopted proved to be ill-judged, otherwise the approach taken to managerial remuneration 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 U.S. to take a cue from Germany and Scandinavia, "Wall Street's capitalism is dying in disgrace. It is time for a better model."[203] Developments concerning the 37 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 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 labelled as "financials" in Standard & Poor's U.S. stock indices was ground zero. As Part IV.B of the paper has described, among companies comprising the S&P 500 index, the financials not only suffered the largest share price declines, 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."[204] 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 executive pay arrangements were criticized. There also were sparks of institutional shareholder activism (Washington Mutual) and also some private equity intervention (Washington Mutual again and

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[203] Harold Meyerson, *Building a Better Capitalism*, WASHINGTON POST, March 12, 2009, A19. See also *supra* notes 1 to 4 and accompanying text.

[204] OECD, *supra* note 170, at 12.

National City).

Against this, to the extent that corporate governance created problems at the financials, there were instances where there were serious adverse knock-on effects due to systemic risk.[205] For instance, 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.[206] Corporate governance problems may have also contributed to the downward spiral at crisis-ridden major financial companies that were not removed from the S&P 500 but would have saddled trading partners with massive losses and unnerved markets had they not been rescued by government bailouts. This likely was the case with Citigroup, where the board reputedly lacked sufficient objectivity due to over-representation by current and former executives, and with AIG, where the board allegedly collectively had insufficient expertise to understand AIG's multi-faceted and often risky businesses and senior management stood accused of failing to exercise proper oversight of key parts of AIG's far-flung empire.[207]

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 management 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.[208] A number of caveats, however, 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.[209] 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.[210]

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 Co. was able to unwind the bank's operations in the fall of 2008 in a fairly straightforward manner.[211] Hence, while the federal government implicitly signalled 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 hypothetical adverse economic scenarios ("stress tests"), many (if not most) of the companies were likely not too big, too

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[205] Heather Landy, *Executives Took, But the Directors Gave*, NEW YORK TIMES, April 5, 2009.

[206] See Table 2 (criticism of board of directors), Table 5 (criticism of executive pay); *supra* notes 145 and 146 and related discussion (governance problems at Bear Stearns and Lehman Brothers); John Cassidy, *Anatomy of a Meltdown*, NEW YORKER, December 1, 2008, 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).

[207] Stevenson Jacobs and Tom Krusher, *What if Washington Bailed Out of Bailouts?*, BUSINESSWEEK.COM, March 25, 2009 (explaining why Citigroup and AIG likely qualified as "too big to fail"); *Proposed Split Leaves Pandit's Role in Question*, FIN. TIMES, January 15, 2009 (Citigroup board); Terence Corcoran, *Guess Who Killed AIG,* NATIONAL POST, September 18, 2009 (AIG board); *Greenberg, Whistleblower Both Fault AIG Internal Controls*, BEST'S INS. NEWS, October 8, 2008 (AIG oversight).

[208] See for example, Michael Schrage, *How to Sharpen Banks' Corporate Governance*, FIN. TIMES (Asia ed.), November 18, 2008, 13; Joseph E. Stiglitz, *Testimony to the Joint Economic Committee*, CG CAPITAL TRANSCRIPTS, April 21, 2009.

[209] *See supra* note 6 and related discussion as well as Daniel Gross, *Reining in Bubbles So They Won't Pop*, NEWSWEEK, March 9, 2009, 44; Peter Tasker, *Bonuses Don't Create Bubbles*, NEWSWEEK, April 6, 2009.

[210] *CEOs and Market Woes: Is Poor Corporate Governance to Blame?*, KNOWLEDGE@WHARTON, December 10, 2008 (available at http://knowledge.wharton.upenn.edu/article.cfm?articleid=2114 , accessed June 22, 2009) (quoting academics Thomas Gerrity and Wayne Guay).

[211] Joe Adler, *Stress Tests Complicate "Too Big to Fail" Debate*, AMER. BANKER, May 18, 2009, 1. See, however, Arner, "Global", *supra* note xx, 116 (arguing that the collapse of Washington Mutual had systemic effects).

complex or too intertwined with the financial system to mean their survival was economically imperative.[212]

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."[213] 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.[214] Markets will also play a role, as investors traumatized by the financial crisis will give short shrift to the market practices and asset classes implicated in the meltdown.[215]

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.[216] 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."[217] His prescription was legal reform, with the subtext being "Clearly, we must strengthen boards at public companies."[218] 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.

As Parts V.B and V.C. of the paper 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, a bill introduced to the Senate by Charles Schumer in May 2009, contains a provision that would introduce such a rule.[219] The experience in the U.K. 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".[220] The Combined Code stipulates the roles of chairman of the board and CEO

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[212] Adler, *supra* note 211.

[213] Quoted in Martin Wolf, *Seeds of Its Own Destruction*, FIN. TIMES, March 9, 2009, 13.

[214] *Rebuilding the Banks, supra* note 151, at 14-15; Jim Wexler, *New Era of Risk Control To Recruit All in Firm*, AMERICAN BANKER, April 24, 2009, 9.

[215] Tasker, *supra* note 209.

[216] TREASURY DEPARTMENT, *supra* note 172, at 21-22, 24-25.

[217] Icahn, *supra* note 149.

[218] *Id.*

[219] Shareholder Bill of Rights Act of 2009, § 5, available at http://www.corpfinblog.com/uploads/file/bill-text-shareholders-bill-of-rights-act-of-2009(2).pdf (accessed June 19, 2009) (stipulating that a public company would have to have an independent chairman, thus implicitly prohibiting a single chairman/CEO).

[220] U.K. Listing Authority, *Listing Rules*, ¶¶ 9.8.6(5), (6) (imposing an obligation on quoted companies to make

should not be exercised by the same individual and that the chairman must qualify as "independent" from management.[221] Quoted companies are expressly permitted to breach the Combined Code guidelines so long as they explain non-compliance,[222] but during the mid-2000s U.K. banks made a habit of complying fully with the Combined Code.[223] 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/Lloyd's TSB and the Royal Bank of Scotland) and buying up completely a couple of smaller failed banks (Bradford and Bingley and Northern Rock).[224]

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 the Sarbanes-Oxley Act of 2002 had beneficial effects.[225] Based on the experience of companies removed from the S&P 500 during 2008, the major corporate failures that occurred were largely fraud-free.[226] 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.[227] It remains possible the costs Sarbanes-Oxley imposed on firms (particularly smaller firms) outweighed the benefits.[228] 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.[229]

C. Executive Pay

Public indignation over executive pay has been mounting recently, with the prospect that executives of financial firms bailed out by the federal government claiming promised bonuses helping to fuel the outrage.[230] Congress responded to the furore in 2009 by enacting rules meaning companies that received money from the federal government's Troubled Asset Relief Program had to give shareholders an annual advisory vote on executive compensation and could not pay their most highly paid staff bonuses that were more than one-third of total annual compensation or took a form other than restricted stock.[231] The public outcry could yet foster reforms intended to limit executive compensation that apply 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 Shareholder Rights Bill contains a provision mandating yearly non-binding votes on how

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disclosures in accordance with the Combined Code). The Listing Rules are available at http://fsahandbook.info/FSA/html/handbook/D85 (accessed June 23, 2009).

[221] Financial Reporting Council, Combined Code, Code Provisions 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 (accessed June 23, 2009).

[222] Combined Code, Preamble, ¶¶ 4, 5.

[223] Kit Bingham, *It's the Board Stupid*, FIN. NEWS, October 27, 2008.

[224] John O'Doherty, *State to Own 43% of Merged Lloyds-HBOS*, FIN. TIMES, January 12, 2009.

[225] See Thomas Olson, *Sarbanes-Oxley Eased Blow, Former Congressman Says at Duquesne*, PITTSBURGH TRIBUNE REV., April 22, 2009 (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").

[226] *Supra* note 132 and related discussion.

[227] James S. Linck, Jeffry M. Netter and Tina Yang, *The Effects and Unintended Consequences of the Sarbanes-Oxley Act on the Supply and Demand for Directors*, REV. FIN. STUDIES (forthcoming, 2009).

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

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

[230] Robert H. Frank, *Should Congress Put a Cap on Executive Pay?*, NEW YORK TIMES, January 4, 2009.

[231] Emergency Economic Stabilization Act of 2008, 12 U.S.C. 5221, § 111, as amended by American Recovery and Reinvestment Act of 2009, Pub. L. 111-5, § 7001.

executives are paid and the Obama administration has given its backing to efforts in Congress to require companies to submit pay policies to an annual vote.[232]

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 broadly-based reform. The fact executive compensation prompted little controversy -- at risk financials aside -- among the 37 companies removed from the S&P 500 implies that for the most part existing procedures worked tolerably well. This pattern chimes with the contention of a managing partner of a pay consultancy who argued in a 2009 interview most boards "try to do the right thing. You don't hear about them; instead you hear about the ridiculous abuses of shareholder trust."[233]

The experience in the U.K., which has had a "say on pay" rule in place for publicly listed companies since 2002,[234] is also instructive. The available empirical evidence indicates that the rule has had at best a modest impact, with executive compensation becoming somewhat more sensitive to poor performance but generally continuing to grow dramatically.[235] Also, say on pay apparently did little, if anything, to address the counterproductive aspects of executive compensation in the banking sector, which again suffered a crisis matching America's. A 2009 report commissioned by U.K. government on the financial crisis says "it is likely that 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."[236] Nevertheless, executive pay policies U.K. banks adopted were endorsed by shareholders uniformly year in and year out, with the level of dissent averaging a mere 9% prior to onset of the financial crisis.[237] Up to April 2009, when the U.K. government, as holder of 58% of the shares of Royal Bank of Scotland, expressed its displeasure with a controversial pension payment to a departed CEO by voting down the bank's executive pay policy,[238] there were no banks among the small number of companies suffering a "no" vote on executive pay policy.[239] Correspondingly, to the extent that policymakers in the U.S. are minded to rely on say on pay as a check against the adoption of the sort of counter-productive incentives that helped to precipitate the recent financial crisis, their expectations are unlikely to be fulfilled.

D. Private Equity

The private equity buyout boom of the mid-2000s occurred in a congenial regulatory setting.[240] Private equity firms had ample scope to raise capital for their buyout funds without becoming subject to federal securities regulation. They could pile on debt with buyouts knowing interest payments would be deductible for tax purposes from the income of target companies. In addition, private equity firms could structure "carried interest" – the profits distributed by buyout funds to private equity partners –

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[232] Shareholder Bill of Rights Act of 2009, § 3; *Principles, Not Pitchforks*, ECONOMIST, June 13, 2009.

[233] Gerry Miller of DolmatConnell & Partners, quoted in Robert J. Grossman, *Executive Pay: Perception and Reality*, HR MAGAZINE, April 2009.

[234] The Directors Remuneration Report Regulations 2002, S.I. 2002/1986. See now Companies Act 2006 (U.K.), c. 46, s. 439.

[235] Fabrizio Ferri and David Maber, *Say on Pay Vote and CEO Compensation: Evidence from the UK*, unpublished working paper, (2008).

[236] LORD TURNER OF ECCHINSWELL, 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 (accessed April 7, 2009).

[237] OECD, *supra* note 170, at 47 (citing research by Manifest).

[238] Jane Croft and Andrew Bolger, *Thumbs Down for RBS Pay Report*, FIN. TIMES, April 4/5, 2009, 12.

[239] Up to July 2009, there were eight 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 (Neil Collins, *The Day Shareholders Finally Had Enough of Corporate Greed*, TELEGRAPH, May 20, 2003); Aegis, a marketing services company (Clay Harris, *Aegis Shareholders Reject Chief's Deal*, FIN. TIMES, May 27, 2004); Freeport, a property group (Harris, "Aegis", *op. cit.*); United Business Media, a business information provider (*UBM and MFI Reports Defeated*, MANIFEST-I, June 2, 2005); MFI Furniture, a furniture retailer ("UBM", *op. cit.*); Bellway, a builder (*Areas for Reform*, FIN. TIMES, February 3, 2009, 19) and Royal Dutch Shell, the petroleum giant (Kate Burgess and Michael Steen, *Investors Rebel Over Executive Pay at Shell*, FIN. TIMES, May 20, 2009).

[240] Cheffins and Armour, *supra* note 63, at 9-11, 57-58.

so income the partners received was taxed at the prevailing capital gains rate of 15% rather than the top rate of income tax.

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.[241] The post-credit crunch collapse in buyout activity meant private equity largely fell off the regulatory radar screen.[242] However, in April 2009 legislation was introduced to Congress which 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 S.E.C.[243] It remains to be seen to what extent regulatory change impacts on private equity. However, given that private equity went AWOL 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 entitled "The Case for Increasing Shareholder Power", there has over the past few years been extensive debate about whether corporate and securities law should be amended to fortify shareholder rights.[244] Reforms proposed 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.[245] The stock market meltdown of 2008 provided advocates of greater shareholder power with the impetus to pursue their agenda with renewed vigour, as they could argue that boards that were more responsive to shareholder concerns would have done a better job of holding management accountable.[246] Legislative proposals followed in turn. The Schumer shareholder rights bill stipulated that directors should face election annually, thus precluding entrenchment of incumbent directors by way of a "classified board" where directors have staggered terms.[247] In May 2009 the S.E.C. announced it was contemplating introducing new rules that would give shareholders owning a prescribed percentage of shares in a public company (1% 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.[248]

The fact that shareholder activism was the exception to the rule among the 37 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 there had been greater scope 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 U.S., as U.K. shareholders have greater scope to call shareholder meetings, initiate changes to the

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[241] *Id.*, 55-59.

[242] Karen H. Wruck, *Private Equity, Corporate Governance, and the Reinvention of the Market for Corporate Control*, 20 J. APPLIED CORP. FIN., #3, 8, 18 (2008).

[243] *Rep. Levin Reintroduces Carried Interest Tax Reform Legislation*, U.S. FED NEWS, April 4, 2009; TREASURY DEPARTMENT, *supra* note 172, at 37-38.

[244] Lucian Ayre Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005); *Battling for Corporate America*, ECONOMIST, March 11, 2006 (summarizing the debate).

[245] *Battling For*, *supra* note 244; John Gapper, *The Votes of Investors Should Count*, FIN. TIMES, April 17, 2006.

[246] See, for example, Carl C. Icahn, *The Economy Needs Corporate Governance Reform*, WALL STREET J., January 23, 2009.

[247] Shareholder Bill of Rights Act of 2009, § 5; JAMES D. COX, THOMAS LEE HAZEN & F. HODGE O'NEAL, CORPORATIONS § 13.30 (1999) (effect of classified board).

[248] Securities and Exchange Commission, *SEC Votes to Propose Rule Amendments to Facilitate Rights of Shareholders to Nominate Directors*, SEC Release 2009-116 (available at http://www.sec.gov/news/press/2009/2009-116.htm , accessed June 18, 2009).

corporate constitution and dismiss directors.[249] For instance, shareholders owning 10% or more of the 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.[250] Regardless, it does not appear that banks were better managed in the U.K. than in the U.S.[251] 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 financial crisis.[252] Lord Myners, Financial Services Secretary in the U.K. Treasury, similarly chastised institutional shareholders as being "absentee landlords".[253] The experience in Britain implies that even if shareholder rights are increased in the U.S. 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 towards 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 the Sarbanes-Oxley Act of 2002 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 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 paper, based on case studies of the 37 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 paper's analysis of corporate governance in the 37 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.[254] For advocates of corporate governance reform, this implies the stock market meltdown of 2008 provides a first-rate opportunity to persuade lawmakers to introduce changes to strengthen corporate boards, address concerns about executive pay

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[249] Bebchuk, *supra* note 244, at 847-50.

[250] Companies Act 2006, §§ 168, 303; John Armour, *Enforcement Strategies in UK Company Law: A Roadmap and Empirical Assessment*, RATIONALITY IN COMPANY LAW: ESSAYS IN HONOUR OF D.D. PRENTICE 71, 105 (John Armour & Jennifer Payne, eds., 2009).

[251] John Plender, *Shut Out*, FIN. TIMES, October 17, 2008, 11; *Changing Course*, ECONOMIST, May 2, 2009.

[252] Jennifer Hughes, *FSA Chief Lambasts Uncritical Investors*, FIN. TIMES, March 12, 2009, 1 (quoting Hector Sants).

[253] Kate Burgess, *Myners Urges "Absentee Landlord" Shareholders to be More Involved*, FIN. TIMES, April 22, 2009, 17. See also Kate Burgess, *Investors Up in Arms Over Poor Governance*, FIN. TIMES, February 3, 2009 (quoting Myners as saying "institutions should have been more challenging.")

[254] Gerald F. Seib, *In Crisis, Opportunity for Obama*, WALL STREET J., November 21, 2008, A2.

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 in 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.

APPENDIX

COMPANIES REMOVED FROM 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.	March 28	Consumer Discretionary	Computer Retailing	Yes	Yes						
Commerce Bancorp	March 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	June 20	Consumer	Leisure	Yes	Yes						

Corp.		Discretionary	Manufacturing								
OfficeMax Inc.	June 20	Consumer Discretionary	Speciality Stores	Yes	Yes						
Countrywide Financial Corp.	June 30	Financials	Thrifts/ Mortgages	Yes						S&P 500	Yes
E.W. Scripps	June 30	Consumer Discretionary	Broadcasting	No		Yes					
ACE Ltd.	June 30	Financials	Insurance	No			Yes				
Clear Channel Comm. Ltd.	July 30	Consumer Discretionary	Broadcasting	No					Yes		
IAC/ InterActive	Aug. 20	Consumer Discretionary	Internet Retailing	No		Yes					
Electronic Data Systems	Aug. 26	IT	Data Processing	No						S&P 500	
Federal Home Loan Mortgage Corp.	Sept. 10	Financials	Thrifts/ Mortgages	Yes	Yes						
Federal National Mortgage Association	Sept. 10	Financials	Thrifts/ Mortgages	Yes	Yes						
Lehman Brothers	Sept. 16	Financials	Investment Banking	Yes				Yes			

Safeco Corp.	Sept. 22	Financials	Insurance	No						Non S&P 500 public company	
Washington Mutual	Sept. 29	Financials	Thrifts/ 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 Corp.	Oct. 30	Financials	Thrifts/ Mortgages	Yes	Yes						
Terex Corp.	Nov. 5	Industrials	Construction/ Heavy Trucks	Yes	Yes						
Unisys Corp.	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						
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	Health Care	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	Environ-mental	No						Acquirer moved into S&P 500	
Transocean Inc.	Dec. 18	Energy	Ocean Drilling	No			Yes				
Barr Pharmaceuticals Inc.	Dec. 22	Health Care	Pharma	No						Non S&P 500 public company	
Wachovia Corp.	Dec. 31	Financials	Diversified Banks	Yes						S&P 500	Yes
National City Corp.	Dec. 31	Financials	Regional Banks	Yes						Non S&P 500 public company	Yes
Merrill Lynch	Dec. 31	Financials	Investment Banking	Yes						S&P 500	Yes

Sources: Standard & Poor's website; Factiva Searches

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