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The Mechanisms of Board Independence

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The debates about corporate governance have been ongoing for a generation. Wouldn't you think that everything that needs to be said, or that could be said, has already been said? The interesting thing is that this is not the case. There are at least two important factors have make the corporate governance questions as urgent as ever. First is the contemporary consensus, virtually worldwide, in favor of organizing economies through shareholder-owned firms that respond in significant measure to marketplace signals. Second is the increased globalization of commerce, which means that firms compete internationally for both capital and market share. Both of these developments make corporate governance vital, for two distinct reasons.

First, the devolution of power inherent in an economy organized by shareholder-owned firms rather than the state creates a legitimacy deficit. The problem is most acute in the case of diffusely-owned firms, such as the US, but exists everywhere. The paramount concern expressed in Berle and Means' classic work on the separation of ownership and control was not about the efficiency losses from what we have come to

describe as the principal-agent problem, but rather the problem of managerial aggrandizement -- that unless the managers' activity was firmly tied to the welfare of shareholders, they would accumulate unaccountable power. This strand appears in the midst of the takeover jurisprudence in the United States, as courts have resisted managers' distortions of the election machinery in the effort to insulate themselves from replacement by shareholders.¹ It also prominently figures in debates over the firm's objective function: should the corporation maximize shareholder value even at the expense of stakeholder value? Except on strong assumptions about perfect markets, it is not clear whether telling managers to maximize shareholder value would in fact maximize the surplus associated with all the inputs to the firm. This efficiency claim -- which is normatively attractive in ways that simple shareholder wealth maximization is not -- is an empirical question that needs to be tested.² Yet if managers were given a mixed objective function, we are back to Berle's problem: How can we disaggregate well-considered balancing of diverse interests from managerial aggrandizement, since diverse, sometimes conflicting, stakeholder interests will make it harder to judge managerial performance. Corporate governance has struggled with the problem of managerial power and control, but the legitimacy questions will inevitably recur.

The second critical element, worldwide economic integration and competition, itself has two governance entailments. First, national governance systems are increasingly judged on an efficiency standard, because of associations between the

¹ See, e.g., *NM Companies, Inc., v. Liquid Audio, Inc.*, 813 A.2d 1118 (Del. S.Ct 2003); *Blasius Indus., Inc., v. Atlas Corp.*, 564 A.2d 651 (Del.Ch. 1988)

² See generally, Jeffrey N. Gordon, *The Shareholder Wealth Maximization Hypothesis: An Empirical Test Using an Airline Industry Example* (work in progress).

success of a nation's firms and the economic welfare of its people. As rents are competed away in the international competition, it becomes harder for the government or business elites to abide obvious dysfunction. But at the same time, no country has the luxury of inventing a corporate governance system from scratch. It must start with the ownership structure, the legal system, and the financial intermediaries and capital markets that are already in place.

Comparative corporate governance scholarship has taught us two, sometimes inconsistent, lessons: First, there are indeed conditions that favor financial market development and pathologies that retard it, and there is a set of mechanisms and strategies that can address particular problems. This increases the pressure to transplant institutions from one society to another, pushing us toward convergence, almost a pathway of reforms. Yet at the same time we have also learned about the importance of path dependencies and complementary institutions that make it very likely that diversity in many specific governance choices will persist, both because of embedded rents and because of efficiencies.³ The embedded rents are of two kinds: economic and political. Controllers who enjoy a flow of private benefits will not willingly move to an alternative regime that reduces those benefits unless the gains are so substantial as to make their smaller slice of the bigger pie larger than their bigger slice of a smaller pie. Moreover, the controllers may also be able to translate their private benefits into political power, deployable in way that can retard the adoption of rent-reducing legal and institutional change even if there would be substantial systemic gains. But the persistence story is not

³ These themes are developed in Jeffrey N. Gordon & Mark J. Roe, eds., *Convergence and Persistence in Corporate Governance* 2004.

all dark side: Governance differences may persist because different systems have created different sets of interlocking institutions that solve core problems of managerial monitoring and efficient capital market allocation. Piecemeal change could in fact be inefficient, because of lost complementarities. Yet the switching costs of widespread institutional change could be quite substantial. To make the point in a somewhat different way: the economic success associated with the diffuse equity ownership pattern in the US -- despite the many avenues for managerial and other opportunism -- depends upon a complicated set of legal constraints and regulatory mandates at state and federal levels, a well-functioning court system and litigation rules that facilitate private policing of applicable norms, strong stock exchanges, and various robust financial intermediaries themselves subject to regulatory regimes. These institutional features are not easily replicated in fact or in function.

So the first entailment of the heightened global competition is the importance of efficiency to a country's governance system. The second entailment is that the existing governance arrangements may be put through intense stress tests, in which their limitations and pathologies become all too apparent. Germany discovered this in the 1980s with some notorious failures of *hausbank* monitoring.⁴ Korea discovered this in the midst of the Asian financial crisis in the late 1990s, as it became apparent that the *chaebol* had operated without effective monitoring by financial institutions, despite their heavy reliance on dollar-denominated debt finance.⁵ And the United States came to a

⁴ See ,e.g., Jeffrey N. Gordon, Deutsche Telekom, German Corporate Governance, and the Transition Costs of Capitalism, 1998 Colum. Bus. L. Rev. 185.

⁵ Bernard Black et al,

similar discovery with the corporate governance failures associated with Enron et al that became manifest in 2001-02.⁶

This paper will develop these themes in the context of one of the key governance institutions, the board of directors. Part One will use the US example to show how our understanding of board function has evolved in response to historical contingency; in particular, how the weight assigned to various functions has shifted so as to privilege board independence. Part Two will elaborate on five distinct mechanisms to create board independence: categorical (categorizing connections that undercut director independence); relational (describing the relationships that undercut independence); functional (assigning functions to the board's exclusive prerogative); structural (creating board committees with specific responsibilities); and genealogical (director nomination or election methods that reduce management's role in director selection). Mechanisms one and two aim to exclude inherently compromised directors from board service. Mechanisms three and four aim to isolate certain elements of board activity from management's influence. Mechanism five aims to buttress a director's sense of accountability to shareholders. The SEC's recent proposal calling for constrained shareholder access to the management proxy for director nomination purposes is an innovative genealogical approach to the enhancement of director independence.

Part three will explore the comparative value of board independence as conditional on stockholding patterns, namely, whether ownership is concentrated or

⁶ See, e.g., Jeffrey N. Gordon, What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections, 69 U.Chi. L. Rev. 1233 (2002).

diffuse. The key comparative insight is this: Differences in ownership structure affect the agency problem that boards must solve, so that the appropriate board composition and structure may conceivably differ across firms and, more generally, across national regimes. In the typical US firm, for example, the pattern of diffuse ownership means that the managerial agency problem looms large, meaning the divergence of managerial from shareholder interests. In some US firms, however (think Adelphia), and in the typical public firms throughout much of the rest of the world, there is a contrary pattern of concentrated ownership. Especially where there are family-mediated structures in which control rights diverge from cash flow rights, the controlling shareholder agency problem is paramount, requiring the control of private benefits obtained by the controller.

This has significance for board structure: In the typical US firm, the role of independent directors on the board may well have been overstated as a virtue (except for key functions such as the audit committee and perhaps the compensation committee), because of the effectiveness of "hard" and "soft" control markets in limiting the scope of managerial agency costs. In controlled US firms, by contrast, and in firms elsewhere in the world, board independence may be more important, even critical. To some extent this depends on the strength of the substitute mechanisms for the control of controlling shareholder agency costs. The control market is obviously an ineffective disciplinary mechanism against controlling shareholders. The effectiveness of alternative disciplinary legal mechanisms may vary. In the US, for example, overreaching by controllers is somewhat limited by the interacting systems of mandatory disclosure of

related party transactions, explicit judicial standards regarding such transactions, and system of derivative litigation in which attorneys who are compensated on a contingent basis bear the plaintiffs' costs. But if such systems do not function well -- which perhaps can be inferred from the large minority discount in many countries for publicly traded firms -- then the invigoration of director independence could be crucial in protecting minority shareholders from the controllers. So on this view, board independence, and effective criteria for judging the independence in fact of directors, if important in the US, may be far more important outside the US.

Part IV concludes.

Part I -- Some History

Boards are obviously not a creation of the late 20th century. Adam Smith addressed the role of boards in the joint stock company and the difficulty in getting directors to monitor appropriately, in 1776. Nevertheless the post-World War II period is an especially dynamic period in our understanding of boards because of the heightened competitive pressures that led to rapid evolution in our conception of the board's role. So the recent history is useful both because it makes us aware of different potential board functions, not all of which might have been conceived of by Adam Smith, and because of the changing weights of the different functions in our conception of the well-functioning board.

The history, is also valuable because it makes us aware that many aspects of board function are jointly determined with corporate purpose. For example, a corporation that evaluates managerial performance almost exclusively in terms of shareholder value will inevitably produce a board in composition and function quite different from a corporation in which managers are charged with trying to balance and in some way maximize total stakeholder value. The normative part of the paper is based on the assumption that in competitive global capital and product markets, the shareholder value objective is likely to be of greater importance and therefore will drive the conception of the board. This thumbnail sketch of the relevant history can be broken down into 5 periods, each focusing on a characteristic view of the corporation's objective function and the board's corresponding function.

The 1950s. The 1950s conception of the corporation and the board reflects what was the post-World War II high-water mark of stakeholder capitalism in the United States. The political climate favored such a conception of the corporation, and the dominant economic position of the United States in the immediate post-war period permitted it. The shared sacrifice of World War II produced a strong national feeling that the fruits of post-war prosperity should be shared as well. Organized labor was never stronger and the demands for employee sharing in enterprise rents enjoyed strong social legitimacy. "Pluralism" was the innovation in the political science debate, and the idea of log-rolling-as-sharing (vs. creating deadweight loss) enjoyed currency. Notwithstanding the inevitable battling over the appropriate employee share, managers of large public firms did not reject outright such stakeholder claims. In part this was because of

managers' identification with the ideological contest with communism over which system could provide a better life for the "workers." Moreover, the strong global position of United States firms-- which had avoided physical and economic devastation during the war -- was a source of rents that managers could allocate away from shareholders without harsh capital market punishment. Thus 1961 a Harvard Business Review survey of 1700 executives revealed that approximately 85 percent of the respondents agreed that "For corporation executives to act in the interests of shareholders alone, and not also in the interests of employees and consumers, is unethical."¹⁴

World War II and the socialist competition influenced the firm in other ways. The war was waged and won by huge centralized bureaucracies that were able to surmount logistical and planning challenges. These lessons could be applied to the private firm in shaping and managing its environment. Moreover, serious intellectual effects were dedicated to showing how a centralized planned economy -- socialism -- might successfully function and the advantages that such a system might have over an economy of discrete firms. Once again the lesson was that bureaucratic rationality could shape and manage a complex economic environment.

The 1950s is famously the high water mark of managerialism in US corporate governance, in which boards were largely passive instruments of the CEO, chosen by him and strongly disinclined to challenge his decisions or authority. But this conception -- much derided in hindsight -- has some fit with reigning ideas of corporate function and

¹⁴"How Ethical Are Businessmen?" 39 Harvard Business Review 7, 10 (July-August 1961).
[Discuss more generally essays from the Harvard Business Review in the period for these propositions]

managerial capacity. Managers were perceived as having two tasks: anticipating and controlling supplier and customer market conditions and allocating enterprise rents among the various potential claimants on the firm. Boards played their role as a managerial sounding board and participant in finding the right balance to the corporation's mission statement. A critical account of board behavior during the period may not do justice to the underlying tradeoffs, which can be put in terms of choice over the CEO's information revelation and candor to an "advising" board vs. a "monitoring board." The 1950s board may have had strength as a sounding board for the CEO, precisely because candid discussion of the firm's problems with a "kitchen cabinet" that the CEO had assembled could lead to better decisions. Candor with a monitoring board, one of whose main functions would be to decide on CEO tenure, would increase the CEO's vulnerability. In other words, depending on the relative quality of decisionmaking under each board type, it was conceivable that the advisory board dominated the monitoring board, at least given the firm's mission statement and the presumption about the capacities of bureaucratic rationality. The board nomination mechanism followed upon this conception of the board's role. If the CEO was looking for trusted advisors, then it followed that the CEO would play a large role in director selection.

1970s The 1970s were characterized by a double disillusionment about corporate performance, and the passivity of directors that contributed to it. The shocks were first, the unexpected collapse of Penn Central in 1970 – which resonated in its day like the fall of Enron – and the Watergate-related illegal domestic campaign contributions and

questionable payments, that is, bribes, to foreign government officials. The Penn Central debacle revealed the failure of the 1950s board conception, since it became apparent that the board had little inkling of the financial troubles facing the railroad and that these directors (and directors more generally) had been neither advisors nor monitors, but figureheads. These failures spurred a wave of board reform aimed at enhancing the board's monitoring role over general management performance and specifically, its role in monitoring corporate law compliance. Nevertheless the conception of the monitoring board was circumscribed by a continuing elite consensus [see Business Roundtable report] that the corporate purpose was more accurately described in stakeholder than strictly shareholder value terms. Indeed, significant impetus for corporate governance reform came from the corporate social responsibility movement.⁷ By contrast, Milton Friedman's 1970 essay, *The Social Responsibility of Business Is to Increase Its Profits*⁸, was a *scandale* because of its unvarnished emphasis on the shareholder value as virtually the sole criterion by which corporate performance should be judged.

1980s. The 1980s were marked by the dual development of shareholder value as the ultimate measure of corporate success and by the rise of the monitoring board composed of independent directors. This development was fostered by a change in a real economic variable: for the first time it seemed that firms modeled on US-style governance were out-competed on the world stage. This perception of under-performance helped legitimate the hostile tender offer, which in turn gave business elites a reason to promote the monitoring board and buttress the role of independent directors.

⁷ Donald Schwartz, Campaign GM.

⁸ N.Y. Times Magazine, Sept. 13, 1970.

The goal was two fold: First, business elites needed a credible board-centered governance mechanism to address performance problems in substitution for the market-centered approach associated with the hostile tender offer. Independent directors were an indispensable part of mechanism.⁹ Second, independent directors also provided legal cover under the applicable Delaware fiduciary standards to target managers who were resisting a hostile bid.

1990s. By the 1990s, the triumph of shareholder value was nearly complete. Yet business elites had successfully persuaded the Delaware courts to validate a virtual board veto over hostile takeover bids, and, in any event, many were looking for a lower cost mechanism to align shareholder and managerial interests than the hostile market in corporate control. This led boards to focus on the markets in managerial services, especially CEO services, including the crafting of contracts that would give managers high powered incentives to promote shareholder value, particularly in the form of stock options. This linked the board's monitoring role to the stock markets in two critical respects. First, the board could evaluate CEO performance with respect to shareholder returns, particularly as compared to industry benchmarks . Second, the board could tie CEO compensation directly to the performance measure. This, in turn, produced two immediately visible developments: first, the shortest average CEO tenure in recent US business history, and second, the highest level of CEO compensation.

2000s. Enron, WorldCom, and similar but less catastrophic disclosure failures vividly demonstrated the weakness of the board governance system produced by the

⁹ Eg, Ira Milstein, The Certifying Board.

1990s, both in terms of board function and in board composition. In a system that depended heavily on market-based determinants of managerial success to determine both tenure and payoffs, the quality of the firm's disclosure was both critical and yet threatened by managerial self-interest. It became immediately apparent that a critical board function must be in the oversight of the integrity of the firm's financial controls and financial reporting; this role had been insufficiently protected, at enormous private and social cost. Not only did bad disclosure lead to poor monitoring at the firm in question, but led to the misallocation of real resources at other firms whose investment decisions were guided in part by the apparent rents earned by the mis-disclosers.

There had also been a failure of compensation design; the purported shareholder alignment was miscalibrated in contracts that appeared to give managers too great an incentive to take these financial reporting risks and otherwise make too-aggressive bets. Many thought this was the result of board failure, namely the lack of arm's length bargaining by compensation committees with the management team, which resulted from insufficiently independent compensation committees

What this brief, potted history reveals is a shifting, expanding role for the board, or rather, many roles: advisor, strategic planner, monitor of managerial law compliance, monitor of managerial performance, monitor of internal controls and financial reporting, master of executive compensation and tenure. And the history also reveals increasing call for "independent" directors, increasing reliance on the role of the independent director, and yet also increasing skepticism about the independence-in-fact of directors

who serve on corporate boards.

Part II

Conceptions of board independence

1. Categorical (NYSE examples – the effort to find formal categories that seem to rule out independence in fact.)
2. Relational (especially the avoidance of “low visibility” ties that undermine independence, for example, the consulting contract.)
3. Functional -- distinct role for the board. For example, in the case of a management buyout, the independent directors constitutes itself an organ separate from management. The hope is that irrespective of prior relationships that led to an “independent” director’s selection, the bargaining agent function will force independence in fact on the board. This will be enhanced if the board hires independent legal and financial advisors, who help to create a independent directors’ “team” in opposition to the management team.
4. Structural: the creation of board committees (structures) that have a distinct functional role. So service on distinct audit, executive compensation, and nomination committees may buttress the sense of independence, especially if independent directors are the only members of these committees. It’s the interaction of structure and function that creates the behavioral distance from the managers.

5. Geneological: focusing on the routes by which a director comes to the board.

Traditionally the CEO has played the dominant role in vetting, if not recruiting, directors to the board. A director selected by a CEO is likely to feel ties of obligation and loyalty in evaluating that CEO's performance and compensation. By contrast, a director who is nominated by an outside shareholder group is likely to feel detached from that sense of obligation and loyalty to the CEO. The conception of director independence has been under-theorized and under-appreciated. In a sense the first geneological inquiry should be whether the CEO hired the director or vice versa – for example, a case where the board recruited a new CEO; theory would predict more independence-in-fact in the second case.

For the public corporation, there has been one historically important geneological mechanism – cumulative voting; one mechanism used in rare circumstances – the self-perpetuating board or director class;¹⁰ and now a new mechanism that is the subject of an SEC proposal to provide some access to the management proxy for the shareholder nomination of directors.

1. Cumulative voting

Under the corporate laws of most states, shareholders have the right to nominate directors, providing an avenue for the election of geneologically independent directors. As a practical matter this right has been illusory because of the costs entailed in mounting a proxy solicitation in the large diffusely owned firm and the reimbursement rules, or rather, the non-reimbursement rules relating to even successful election contests, at least those not in the context of a battle for control.

One possible vehicle for addressing this problem is cumulative voting, an invention of US corporate law. Mandatory cumulative voting was adopted first in Illinois in 1870 as an application of proportional representation in the corporate setting, to protect minorities against overreaching by a majority particularly where access to information was a necessary part of minority protection. Cumulative voting operates in two distinct settings. First, a single shareholder with a large enough block can automatically elect a director to the board. But second, cumulative voting lowers the cost of mobilizing diffuse shareholders, because electoral success – in the sense of placing a nominee on the board – requires much less than 50 percent. For example, in the case of a 10 person board elected annually, a nomination proponent need rally only 10 percent of the shareholders to put a director on the board. So it looks like cumulative voting offers significant potential for the election of structurally independent directors.

The cumulative voting idea spread rather rapidly, leading to the addition of mandatory cumulative voting to the corporate laws of nearly half the states by the turn of the century, a pattern that persisted for nearly 60 years. Things began to turnaround rapidly as well after 1960, and by 1990, only six states had mandatory cumulative voting.

What happened? The proxy contests of the 1950s mobilized managerial efforts to eliminate a potential vehicle to challenge incumbent control, and the hostile takeovers of the 1980s brought a further wave of managerial efforts. But there is a weakness in the cumulative voting idea itself, in its double effect. Yes, it strengthens the hand of

¹⁰ Note that this is commonly used by not-for-profit corporations.

relatively diffuse shareholders whose votes can be coordinated in a low cost way – institutional investors. But it also gives bargaining leverage to a single shareholder who can acquire a sufficiently large block to elect a director by him/herself, and who can use that position to threaten a control challenge or to disrupt the board, potentially as a way of extracting greenmail or other private benefits.

2. Self-perpetuating directors

“Public” directors of United Air Lines under the employee buyout.

3. Current SEC proposal

[Describe]

The SEC’s shareholder proxy access rule can be seen as a substitute for cumulative voting that preserves its desirable attributes while reducing the risks of the undesirable ones. That is, the rule provides institutional shareholders with a low-cost way to obtain board representation while screening out use by a potential greenmailer. Thus it offers an innovative approach to genealogical independence.

There are 4 critical elements. First, the rule provides access to the corporation’s proxy for both the purpose of the triggering resolutions as well as the subsequent nominations, meaning a low cost mechanism of soliciting shareholders. Yet second, the rule generally requires action by majority shareholder vote, certainly to elect a director, which dramatically reduces the threat of a potential greenmailer. This is different from cumulative voting, obviously. Third, the rule significantly insulates shareholder-nominated directors from the nominating shareholders themselves by forbidding explicit

or implicit agreements. And fourth, but hardly least, the rule limits the number of directors who can be elected in this way, to approximately one-ninth of the board, looking to representation rather than control and thus also reducing the nominator's threat point.

So the SEC's rule can be seen as reviving a tradition that would enable shareholders to have a low cost mechanism for obtaining board representation and in that way strengthen the genealogical independence of directors.

[There are two strong reasons to endorse this proposal. The first is that it is a minimally appropriate response to the management's "grab" of governance power from shareholders in the 1980s through the institution of the poison pill, particularly on the top of other defensive measures whose power was unexpectedly magnified by the pill. A host of shark repellent charter amendments were adopted in the 1980s in large part because they seemed to promise some protection against abusive takeover tactics but did not in turn provide management with a genuine showstopper. The poison pill, especially the flip-in, especially in its post- Time-Warner incarnation, radically changed the calculus. Suddenly the definition of a "preclusive" defensive measure shifted from a failure to redeem the pill to impermissible interference with the shareholder franchise in the resisting the bidder's effort to replace the board. This really poison pill, added to the previously relatively harmless classified board, now made for a showstopper. So if you think the hydraulics of corporate governance benefit from a certain level of outside pressure, then the SEC proposal can be seen as a way of partially restoring a certain balance that had been undermined.

More functionally, the SEC access proposal will strengthen the structural independence of directors. First, the potential for shareholder action is likely to encourage nominating committees to make fuller use of their new autonomy and new disclosure obligations. The nominating committee would presumably prefer to avoid a challenge to a nominee; this threat would at least partly offset the implicit pressure still wielded by the CEO. Moreover, a committee nominee would know that his/her position was a result of both vectors, not just CEO preference. Second, a director nominated by a shareholder group would of course understand his/her independence in fact from management. Because of the stringent requirements on the nominating shareholders – they must be long term holders without a control motive – and because of the bar on explicit or implicit agreements between these shareholders and the nominees, the shareholder nominees will enjoy significant independence from their nominators.]

Part III: Has Director Independence Been Oversold?

1. Perhaps it has been oversold: the general case

a. Lack of evidence between measures of board independence and performance.

[Discuss]

1. Functional explanation: Perhaps independence creates costs as well as benefits: more monitoring but less useful service in advisory and strategizing roles because less useful information and less incentive to expend effort. (and the board composition rules tend to

be uniform across firms, rather than tailorable, so it's easy to imagine that endogenously (ie, efficiently) chosen board composition will vary from the standard form.

2. . more generally, is there an irreducible level of managerial agency costs conditional on a certain ownership structure and shareholder coordination costs? Examples: Arlen's claim about management's selecting "embedded" defenses in response to greater exposure to hostile bids; the radical shortening of CEO tenure coincident with the radical increase in CEO compensation

b. Perhaps director independence has been insufficiently targeted.

Where is it really important? For the oversight of internal controls and financial reporting; for the negotiation of executive compensation contracts.

-- Director independence is especially important in the internal controls/ financial reporting domain because of the role of disclosure in internal monitoring and capital allocation

-- Director independence especially important in executive compensation because of the potential for low visibility conflicts, the way badly designed executive compensation can corrupt controls and reporting, and because of the legitimacy issues associated with executive compensation.

-- So boards director independence should be buttressed where it matters (through composition, through special skills (which may produce heightened reputational capital), and though different compensation schemes – no issuer stock, for example). Otherwise firms should be permitted greater freedom to play a mixed strategy of rigorously independent directors and “gray” and insider directors.

-- Additional way to strengthen the independence of the board committees is to require a distinct public function thus heightening the sense of accountability. For executive compensation, for example, the committee could be required to provide a detailed account of the compensation actually provided to the 5 senior officers for whom disclosure is required. So in addition to the current statement of compensation principles, the committee would be responsible for marshalling the information about salary, bonus, option grants, deferred compensation, retirement benefits, and the like that now appear in several places in the proxy statement. This would force the committee to take responsibility for what it has approved and enhances functional independence. (I would favor shareholder bylaw proposals requiring this committee role, but not the UK system of a shareholder vote on the actual compensation package.)

c. Director independence reconsidered: the difference between managerial agency costs and controlling shareholder agency costs.

-- Even where market and other constraints assist in managerial monitoring, internal controls/financial reporting and executive compensation should still be remitted to

independent directors, because markets need good information to make that judgment.

-- But in general director independence will be particularly important in reviewing related transactions in the controlled firm and the pervasive ways that controllers can shift value.

IV Conclusion

[To come]