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REVOLUTION IN THE BOARD ROOM?

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One of the most important things I learned during my career as a corporate secretary was not to interfere with the chairman's relationship with the members of the board of directors. As corporate secretary, I had good reason from time to time to talk with directors about the agenda or travel arrangements, and sometimes the conversation drifted to general corporate matters. It did not take long to realize that the chairman liked to be kept informed about his relationship with the board. After all, his authority depended on this relationship.

It must have been very disconcerting for some chief executives in the 1993 proxy season to find a third party interfering with this relationship. Big pension funds which are shareholders requested meetings with outside directors, in private, without the CEO present. Even more alarming is that the subject matter of these meetings was poor corporate performance[1] and the tenure of the chief executive officer. Finally, in the case of a few very large companies, the unexpected events included the early termination of the CEO. Suddenly, employees of IBM and Eastman Kodak found themselves with a new boss.[2]

What do these events signify? Do they mean that the balance of power between management and shareholders is shifting? Do they represent a revolution in corporate governance? Or do they simply reflect a slower evolution which has been underway for sometime? Finally, what is the attitude of the Clinton administration on these changes?

I would like to approach these questions from my own experience as Assistant Secretary of Labor and as head of the Pension

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* Former Assistant Secretary of Labor (1989-1993).

1 *See, e.g.*, John Holusha, *Eastman Kodak Chief is Ousted by Directors*, N.Y. TIMES, Aug. 7, 1993, at A37 (noting Kodak's poor performance); Steve Lohr, *I.B.M.'s New Leader; Task of Turning Around I.B.M. is Given to an Industry Outsider*, N.Y. TIMES, Mar. 27, 1993, at A1 (mentioning I.B.M.'s business woes). *See generally Bigger They Are, Harder They Fall*, PLAIN DEALER, Jan. 2, 1994 (describing trend, backed by institutional investors, of ousting CEOs).

2 *See* Jonathan Weber, *Kodak Puts Motorola's Chairman in the Picture*, L.A. TIMES, Oct. 28, 1993, at D1; Steve Lohr, *I.B.M.'s New Leader*, N.Y. TIMES, Mar. 27, 1993, at 1.

and Welfare Benefit Administration ("PWBA"). Under the Employee Retirement Income Securities Act of 1974 ("ERISA"),[3] the PWBA oversees the private pension system, which today has assets of over $2.3 trillion.[4] I would also like to draw on my experience as a corporate secretary running hundreds of board, committee, and shareholder meetings. These different perspectives have helped me appreciate the important role that pension plans have played and are playing in the development of corporate governance.

Today over fifty million Americans, approximately one-half of the work force, are participants in, or retirees under, private pension plans.[5] As of 1992, these plans in the aggregate owned equities worth $975 billion, or twenty percent of all outstanding equities.[6] In addition, public plans currently own equities worth several hundred billion dollars.[7]

As the percentage of the Standard & Poor's 500 companies' stock held by pension plans continues to grow, the so-called "Wall Street" rule,[8] that investment managers should either vote with management or sell the stock, is no longer economically feasible.[9] With the Wall Street rule rendered impractical, it seems that the managers of pension fund assets must pay attention to matters of corporate governance in order to maximize the value of their existing corporate holdings.

The PWBA has vigorously articulated both its legal and policy positions on corporate governance over the past few years. In a

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3 Pub. L. No. 93-406, 88 Stat. 829 (1974) (codified as amended at 29 U.S.C. §§ 1001-1461 (1988)).

4 *See Berg's Bully Pulpit*, PENSIONS & INVESTMENTS, Sept. 6, 1993, Opinion, at 10.

5 *See* Leslie Wayne, *Seeking Investment with Principle*, N.Y. TIMES, Aug. 10, 1993, at D1.

6 *See generally* Patrick W. Seburn, *Evolution of Employer-Provided Defined Benefit Pensions*, MONTHLY LAB. REV., Dec. 1991, at 16 (noting that by 1987, defined benefit pension plan assets reached nearly 900 billion); Susan E. Kuhn, *The New Perilous Stock Market*, FORTUNE, Dec. 27, 1993, at 48 (noting pension plans own approximately 26% of all stock).

7 *See* ROBERT A. MONKS & NEIL MINOW, POWER AND ACCOUNTABILITY 183 (1991) (noting that public plan equities reach up to several hundred billion dollars).

8 *See Labor Department Survey of Burke Finds Proxy Voting Policies in Good Order*, Pens. & Ben. Daily (BNA), Feb. 19, 1992; Stephen Labaton, *S.E.C. Will Require Fuller Disclosure of Executive Pay*, N.Y. TIMES, Oct. 15, 1992, at A1 (discussing "Wall Street" rule).

9 Labaton, *supra* note 8, at A1. "For too long, the Wall Street rule has been that if you don't like what's going on, sell out. That has made it difficult and expensive for shareholders.'" *Id.* (quoting S.E.C. Chairman Richard D. Breeden).

nutshell, the Agency's position[10] is: (1) that fiduciaries of employee benefit plans have a duty to manage plan assets solely in the interests of the participants and beneficiaries of the plans;[11] (2) that the ability to vote proxies is a plan asset;[12] and (3) that it would be a dereliction of duty if managers of plan assets did not vote, or voted without paying close attention to the implications of their vote concerning the ultimate value of the plan's holdings.[13]

It might be useful to share with you the underlying reasons for the Department's views on corporate governance, give you my impressions of what is happening in the field, and tell you a little about what I can see in my crystal ball.

First, it should be noted that the Department's attitude on corporate governance stems from the view, as Judge Friendly stated in *Donovan v. Bierwirth*,[14] that fiduciaries of pension funds have an obligation to manage their assets with an "eye single" to benefit the plan participants and beneficiaries.[15] This means, of course, that fiduciaries, when choosing between investments of equal risk, should choose the one that gives a greater return. Similarly, when choosing between investments yielding the same return, fiduciaries should choose those with the least risk. The obvious corollary of this proposition is that plan fiduciaries have a duty to manage plan assets so as to preserve or increase their

10 *See* 29 C.F.R. § 2550.404a-1 (1992) (describing fiduciary duties of plan manager); Labor Department Letter on Proxy Voting by Plan Fiduciaries (Feb. 23, 1988), *reprinted in* Joseph S. Schuchert, *Adequate Consideration Determinations in Leveraged ESOP Transactions*, 271 PLI/TAX 519, app. B (1988), *available in* WESTLAW, PLI database.

11 *See* 29 U.S.C. § 1104(a) (1993) (requiring "prudent man" standard of care). "[A] fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries." *Id.* § 1104(a)(1).

12 *See Corporate Governance: Ball Signals Continued Commitment to Proxy Voting Issues at Department*, Pens. & Ben. Daily (BNA), Jan. 29, 1990, at 207; *DOL Continues Initiatives on Proxy Voting, Ball Says*, Pens. & Ben. Daily (BNA), Sept. 24, 1990, at 1622.

13 John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM. L. REV. 1277, 1366 (1991) ("[T]he pension investment manager's strategy . . . should be to increase portfolio value . . . .").

14 680 F.2d 263 (2d Cir.), *cert. denied*, 459 U.S. 1069 (1982).

15 *Id.* at 271. Judge Friendly stated:

> Although officers of a corporation who are trustees of its pension plan do not violate their duties as trustees by taking action which, after careful and impartial investigation, they reasonably conclude best to promote the interests of participants and beneficiaries simply because it incidentally benefits the corporation or, indeed, themselves, their decisions must be made with an eye single to the interests of the participants and beneficiaries.

Id. (citations omitted).

value. Therefore, fiduciaries would be derelict in that duty if they did not vote plan shares on matters which might affect the value of the shares.

Although this is the legal underpinning for the Department's position on corporate governance, economic imperatives have had an equally great role in sensitizing pension fund managers and other institutional investors to the importance of corporate governance issues. A 1989 article in the *Harvard Business Review*[16] put forward the theory that institutional investors do not really need the liquidity the public market offers because they can project their cash needs well into the future.[17] It went on to note that trading is a tough, zero-sum game, and that large funds face "diseconomics" of scale in executing trades because it is difficult to trade large blocks of stock quickly.[18] Furthermore, the very act of trading such a block tends to move markets. Therefore, the article suggested that institutional investors will move toward taking larger positions in a smaller number of companies.[19] This would allow them to enhance the value of their investment by actively participating in the ownership and management of the underlying assets.[20]

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[16] Michael C. Jensen, *Eclipse of the Public Corporation*, HARV. BUS. REV., Sept.-Oct. 1989, at 61.

[17] *Id.*

> New organizations are emerging . . . organizations that are corporate in form but have no public shareholders and are not listed or traded on organized exchanges. These organizations use public and private debt rather than public equity, as their major source of capital. Their primary owners are not households but large institutions . . . . These transactions have inspired criticism, even outrage, among many business leaders and government officials . . . [but] this organizational innovation should be encouraged. By resolving the central weakness of the public corporation—the conflict between owners and managers over the control and use of corporate resources—these new organizations are making remarkable gains in operating efficiency, employee productivity, and shareholder value. Over the long term, they will enhance U.S. economic performance relative to our most formidable international competitor, Japan . . . .

Id.

[18] *See generally id.* (noting that "all told, institutional investors are remarkably powerless").

[19] *Id.* at 64. "The absence of effective monitoring led to such large inefficiencies that the new generation of active investors arose to recapture the lost value. These investors overcome the costs of the outmoded legal constraints by *purchasing entire companies*—and using debt and high equity ownership to force effective self-monitoring." *Id.* (emphasis added).

[20] *Id.*

A major inhibition of pension funds taking active positions on corporate governance, beyond merely voting on proposals set forth by others, were the SEC proxy rules, which required the filing of written proxy statements before the communication with other shareholders regarding proxy proposals. The Securities and Exchange Commission, reacting in part to the Department's position on corporate governance and to the new economic realities of institutional investment, adopted new proxy rules on October 15, 1992, which enable pension funds and large investors to communicate freely with other investors.[21] This was an important step in the evolution of corporate governance.

The new rules will have an impact on shareholder communication and executive compensation disclosure. Shareholders are no longer required to file proxy materials with the SEC if they wish to communicate orally with other shareholders on proxy voting matters,[22] unless they are seeking proxy authority. Now that investors can communicate freely with each other, they are in a stronger position to have a more active relationship with corporate management.

More active shareholder involvement in corporate governance as a way to create value is, in my view, inevitable. Quite aside from the fact that ERISA requires plan fiduciaries to cast their corporate proxy ballot knowledgeably,[23] it stands to reason that active institutional investors do not invest in corporations that they believe are fully valued against future expectations. Rather, they invest in corporations that they believe are undervalued against future expectations. Therefore, as fiduciaries on behalf of their participants and beneficiaries, pension fund managers should examine proxy proposals and corporate governance issues to determine whether they will add to or detract from the value of the corporation over the time frame of the investment, and vote accordingly.

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21 *See* David R. Sands, *S.E.C.'s 'Sunlight' Reforms Usher in 'New Era of Corporate Governance'*, WASH. TIMES, Apr. 15, 1993, at C1.

> The SEC changes, approved by the agency after heated debate, fall into two broad categories. Companies must clearly disclose how much money and other forms of compensation they gave their top executives last year. Also, the agency adopted rules designed to make it easier for shareholders to talk among themselves about their holdings.

Id.

22 *Id.*

23 *See* Donovan v. Bierwirth, 680 F.2d 263, 270-72 (2d Cir.), *cert. denied*, 459 U.S. 1069 (1982).

Actions designed to insulate corporate management from the discipline of the marketplace are, as a general matter, unhealthy for the corporation, its workers, and the economy at large. A corporate management that is insulated from the discipline of the marketplace is likely to become inefficient and fail to maximize value for shareholders. Moreover, it is unlikely to provide stable employment for its workers over the long term.

This is not to say that I advocate an adversarial relationship between pension plans and corporate management. Pension plans, which generally are accumulating funds for benefit payments in the future, are in a particularly good position to be patient, long-term investors. Just as plans do not necessarily gain by selling shares of stock every time they disagree with management, in general, it is preferable for plans that are large shareholders in companies to share their concerns with management and to try to resolve them before they get involved in tender offers or proxy contests to unseat management. Shareholders should be treated as partners in achieving a corporation's long-term goals.

Effective corporate governance would greatly reduce the pressure for hostile takeovers because management and shareholders would then more closely share the same goal. If American corporations desire patient capital to compete in today's global market, our corporate managers must listen to their shareholders' voices. Patient investing requires participation. Directors of companies that try to erect barriers to shareholder involvement in corporate governance will sooner or later face hostile takeovers or proxy fights, as shareholders seek to realize the underlying value of their shares.

Fortunately, there are signs that corporate management is listening. The 1993 proxy season provided evidence that management is increasingly sensitive to and willing to respond to large investors. The season itself was marked by quiet diplomacy by pension funds and investors, rather than ugly proxy solicitations and takeover battles. The 1994 proxy season promises to follow the same patterns. Several big public plans have said that they prefer to negotiate first before they announce which companies they are targeting. Both management and activists seem willing to discuss, in a nonconfrontational manner, critical issues such as executive compensation, poor performance, or lack of independent directors.

This strategy is a good example of "relationship investing."[24] Relationship investing seeks to decrease the number of companies in which a fund is invested and to boost its holdings in particular companies to as high as fifteen to twenty percent of the outstanding shares.[25] The strategy seeks to develop close, long-term relationships with the companies. The proponents of relationship investing hope that it will help break down an insulated culture at some companies and lead to more timely action at companies with poor performance.

What is the Clinton agenda for corporate governance? My successor, Olena Berg, has indicated that she intends to continue to devote a good amount of the limited resources of PWBA to corporate governance.[26] Recently, I served as chairman of a conference on corporate governance in New York City. One of the speakers was Susan P. Thomases,[27] who as you know was active in the 1992 presidential campaign and continues to serve as an informal advisor to both the President and the First Lady. She advocated a single ballot for the election of directors instead of the current practice which requires a separate ballot for each competing slate.

It seems to me that a single ballot for the election of directors is extremely unlikely at the present time. There is virtually no support for such a change in the marketplace. There are, however, other changes occurring which will continue the evolution of corporate governance.

At least three developments will be driven by more active shareholder involvement in corporate governance as a way to create value. These changes will reflect a growing sensitivity on the part of management to the shareholders.

I. More Meaningful Communication

The first development is a trend toward more meaningful communication. Pension funds want to talk directly to members

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24 *See* David A. Vise, *Shifting the Boardroom Balance of Power; Pension Funds Weigh Large-Strike, Long-Term 'Relationship Investing' in Firms*, WASH. POST, Mar. 6, 1993, at D1 (discussing "cutting-edge" concept of relationship investing).

25 *Id.* ("Those who promote relationship investing say that individual pension funds should direct some of their billions of dollars toward the purchase of large, long-term ownership stakes, perhaps as much as 15 percent to 20 percent, in a number of public companies.").

26 *See Berg's Bully Pulpit*, *supra* note 4, at 10 (characterizing Berg's position as "government meddling in investment management decisions").

27 Susan P. Thomases is presently a partner in the law firm Willkie Farr & Gallagher.

of the board, rather than have their views filtered through management. This is already happening, and of course, it has the potential to make management very nervous. Suddenly, the board of directors is in the investor relations business. Pension funds are seeking regular, periodic meetings with outside directors to discuss governance issues and particularly corporate performance. As a general matter, better communication will lead to changes in a company's strategy, which will add value.

Relatedly, there is a trend toward more meaningful communication with mutual funds, which are governed by the Investment Company Act[28] and not by ERISA. Fidelity funds, for example, now say that they are voting for control.[29] This frees them to communicate with other big holders as they seek to maximize value. Fidelity encourages portfolio managers to challenge corporate management on such issues as staggered terms for directors, compensation, and anti-takeover measures.[30]

Historically, private money managers have enjoyed regular access to corporate executives, although not usually to the chief executive officer or the board. In the future, we are likely to see corporate pension funds, insurance companies, and mutual funds become less reluctant to communicate their views. For instance, it has been reported that Alliance Capital Management, Putnam Management, and J.P. Morgan were active in connection with the installation of a new CEO at American Express.[31] In July 1993, Campbell Soup announced the establishment of proxy voting guidelines for its pension fund managers in order to communicate its views on specific issues related to corporate governance.[32] In October, TIAA-CREF, the giant pension fund for teachers, announced a corporate governance policy and mailed it to all 1500 companies in which it holds stock.[33] It is also significant that sev-

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[28] Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 - 80b-18 (1988 & Supp. IV 1992).

[29] *See generally* David G. Ball, *Where the Government Stands on Proxy Voting; Special Report: Pension Fund Management*, FIN. EXECUTIVE, July, 1990, at 31 (stating fidelity funds have changed stated goals to invest for control).

[30] *Id.*

[31] *See Bigger They Are, Harder They Fall, supra* note 1, at 1E (characterizing J.P. Morgan as institutional "rabble-rouser[ ]" in investor effort to remove American Express chairman).

[32] *See Campbell Soup's Proxy Guidelines Aim to Highlight Governance Issues*, Pens. & Ben. Rep. (BNA), July 19, 1993, at 1521.

[33] *See* Jim Connolly, *TIAA-CREF Asked to Take Its Own Advice on Salaries*, LIFE & HEALTH/FIN. SERVICES EDITION, Oct. 18, 1993, at 43.

eral large corporate pension funds have recently joined the Council of Institutional Investors.

II. More Outside Directors

The second development that I predicted in my crystal ball was a growing demand for more outside directors. When I first became a corporate secretary in 1969, insiders constituted a majority of most boards. According to a 1992 Korn/Ferry study, the average board now consists of nine outside directors and three inside directors.[34] The trend toward outside directors will continue. This is, in part, a reflection of increasing skepticism about management insulation and entrenchment. It is also a reflection of shareholder demands that the board take a more active role in managing companies. Pension plans are unlikely to put their own representatives on corporate boards because the restrictions on insider trading under section 16(b) of the Securities and Exchange Act of 1934 would make it difficult for the funds to buy or sell shares.[35] What they are likely to do is move toward relationship investing and rely on outside directors to represent their interests. Thus, Campbell Soup's strategy will be to tell its money managers to vote Campbell's proxies against companies that elect more than three inside directors.[36] TIAA-CREF's goal is to "sharpen the ac-

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[34] *See* Korn/Ferry International Board of Directors Nineteenth Annual Study 9 (1992).

[35] Securities and Exchange Act of 1934 § 16(b), 15 U.S.C. § 78(a) (1981). Section 16(b) provides:

> For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months . . . . This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

Id.

[36] *See Corporate Board Should Consist of Independent Directors, Pension Fund Says*, Pens. & Ben. Daily (BNA), Nov. 1, 1993, at 1.

countability of directors to shareholders."[37] This includes requiring directors to own common shares so that their interests match those of shareholders.

Pressure from outside directors is likely to intensify the sensitivity of management to the best interests of the shareholders. Shareholders will not settle for rubber stamp approval by directors of management actions. The recent departures of CEOs at General Motors, IBM, Westinghouse, and Eastman Kodak are attributable to the actions of institutional shareholders and outside directors.[38]

III. Independent Nominating Committees

The third development foreseen is increasing pressure for a nominating committee made up exclusively of outside directors.[39] This has already happened with audit committees as a result of a New York Stock Exchange rule.[40] Independent audit committees play an important role in assuring the integrity of corporate finances. Pressure for independent nominating committees may hit a nerve in terms of the traditional prerogative of the chief executive officer. There is no reason, however, why independent committees need to be perceived as threatening to a successful manager. Independent committees can function effectively with the CEO as an important participant, who can occasionally be excluded when the committees meet in executive session.

There is already some evidence that, under pressure from pension funds and institutional holders, boards have been limiting insiders' participation in choosing new directors. Thus, in 1993 the CEO stepped down from the nominating committee at both

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[37] *Id.* "The Teachers Insurance and Annuity Association-College Retirement Equities Fund said a corporate board should include audit, compensation, and nominating committees consisting entirely of independent directors." *Id.* TIAA-CREF believes that "the rights of shareholders should be balanced by 'need of the management and the board to direct the corporation's affairs free from distracting short-term pressures.'" *Id.*

[38] *See* Thomas A. Stewart, *The King is Dead*, FORTUNE, Jan. 11, 1993, at 34 (noting increased influence institutional investors have on corporate executives). "Executives . . . must let institutional investors into the tent or force damaging proxy fights or—perhaps worse—uncertain access to capital markets." *Id.*

[39] *See* Brigid McMenamin, *Help Wanted*, FORBES, Nov. 22, 1993, at 186. "Almost two-thirds of the firms that responded to a recent . . . survey said they now use independent nominating committees, compared with less than half ten years ago." *Id.*

[40] *See* John Curran, *SEC's Ruder Defends Stance on Audit Committees to Congress*, REUTER BUS. REP., May 2, 1988 ("Currently, the New York Stock Exchange requires all listed firms to have entirely independent audit committees.")

Sears[41] and Campbell Soup.[42] Recently, IBM established a new board committee of outside directors which will nominate directors, handle proposals from shareholders, and oversee the power structure of the board.[43] Previously, the nominating authority had been held by an insider-dominated executive committee.[44] Furthermore, in December 1992, Westinghouse formed a nominating committee of outside directors.[45]

At this point, I would like to comment on one change in governance that seems unlikely to occur. Some commentators have suggested a division of responsibilities at the top of a company in order to ensure a balance of power and authority. Massachusetts Representative Edward Markey has suggested that corporations be required to split the positions of chairman and chief executive officer.[46] This was proposed at the 1993 Sears, Roebuck & Co. annual meeting by the New York City Employees Retirement System and shareholder activists, and supported by over one-third of the votes cast.[47] Furthermore, in most British companies the chairman of the board is not the chief executive officer.[48] The

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41 *See Sears Board Grants Some Proposals at Request of Institutional Investors*, Pens. & Ben. Daily (BNA), June 22, 1992. As a result of pressure from institutional investors the board restricted membership on the nominating committee to outside directors, forcing Sears Chairman and CEO Edward Brennan from the committee. *Id.*

42 *See Campbell Soup's Proxy Guidelines Aim to Highlight Governance Issues*, Pens. & Ben. Daily (BNA), July 20, 1993. "President and [CEO] David W. Johnson, recently stepped down from the board's nominating committee, in part to advance good corporate governance principles." *Id.*

43 *See* McMenamin, *supra* note 39, at 186. I.B.M. recently appointed a new nominating committee that actually welcomes suggestions from shareholders. *Id.*

44 *See* Leslie Cauley, *Shareholders Demand IBM Make Changes*, USA TODAY, Jan. 25, 1993, at 1B (discussing demands United Shareholders made to IBM in January of 1993).

45 *See Westinghouse Adopts New Corporate Governance Provisions*, PR NEWSWIRE, Dec. 3, 1992, *available in* LEXIS, Nexis Library, Business File.

46 *See generally Executive Compensation; Corporate America's Most Powerful People*, FORBES, May 24, 1993, at 114 (noting leverage CEO who is also chairman has over board members).

47 *See* Steve Lohr, *Pulling Down the Corporate Clubhouse*, N.Y. TIMES, Apr. 12, 1992, § 3, at 1 (noting that two institutional investors, New York City Employees Retirement System and United Shareholders, are sponsoring proxy resolution sent to Sears, Roebuck and Co.'s 1000 largest shareholders, urging them to vote to split jobs of chairman and chief executive between two people); Ellen Neuborne & Michael Osborne, *Shareholder Revolt at Sears : Mutual Funds, Pensions Lead the Charge*, USA TODAY, May 15, 1992, Money, at 1B (noting that proposal to separate posts of chairman and chief executive received 27% of shareholder vote).

48 *See* Neville Nankivel, *Shaw Has Sweetest Job as Head of Tate & Lyle*, FIN. POST, June 26, 1993, § 5, at S14 (noting increasing pressure to separate jobs of chairman and chief executive to improve corporate performance); *Hanson to Name New*

chair sets the agenda for board meetings and presides at board and shareholder meetings. Frequently the chair will speak for the company. The chief executive officer manages the company.

Although some American companies do indeed divide responsibilities, it seems that such a separation is unnecessary and, in some cases, even undesirable. It could create the potential for rivalry which would lead to compromise and confusion. It would dilute the ability of the chief executive to provide effective leadership.

Furthermore, management's knowledge and experience with regard to the day to day operations of the company will almost always be greater than that of a nonexecutive chairman involved on a part-time basis. Effective corporate governance can be achieved without this artificial separation of powers; it simply is not necessary! The development of a strong and independent counterweight at the top level will occur as the natural result of the evolutionary process that is now occurring. The trend toward more outside directors, independent compensation, and nominating committees will improve management sensitivity and accountability. The trend will also enable outside directors to discharge their monitoring function properly, and thus help assure effective corporate governance.

When we assume positions of responsibility, we are all at risk of becoming surrounded by people who tell us what they think we want to hear, thereby insulating us from the interests and pressures of the everyday world. This is a risk for the President of the United States, and it is a risk for the chief executive officer of a large company. As pension fund giants are becoming involved in governance issues, they are beginning to challenge this insulation which has a profound effect on corporate America.

CONCLUSION

I have identified three developments that can be foreseen in corporate governance: more meaningful communications, more outside directors, and independent nominating committees. What

Chairman, REUTERS, Apr. 21, 1992, Financial Report, at 1 (identifying new appointment of CEO in British company as separate from role of executive chairman). "The fact that 76 percent of chairmen combine the role of chief executive may seem a touch unlikely to a U.K. audience. Since the publication of the Cadbury report on corporate governance in 1991, splitting the two jobs in big companies has become very much de rigueur." Tim Dickson, *Moving Toward Independence—The Changing Face of U.S. Boardrooms*, FIN. TIMES, Aug. 25, 1993, Management, at 9.

do they mean for corporate management? Their significance can be summed up in two words—greater accountability. As a general matter, management will become less insulated and more sensitive to the best interests of shareholders. The attention of chief executive officers will be increasingly focused on their accountability in the real world. As Dr. Samuel Johnson said: "Depend upon it, sir, when a man knows he is to be hanged in a fortnight, it concentrates his mind wonderfully."[49]

These three developments have been underway in the marketplace for some time. This is not a revolution; these changes will not mature overnight or all at once, although I believe they will be the norm within the next ten to fifteen years. Although in a small number of corporations management may resist the changes because the CEO feels threatened, such resistance is not really in the best interest of the shareholders. Sooner or later, with the support of pension funds and institutional investors, changes are going to happen. The process has already begun with the large high-profile companies at the center of economic activity, and over time they will gradually ripple throughout the marketplace to middle size and smaller companies.

The evolution will occur partly through proxy contests won by shareholders. However, it will also come through the heightened sensitivity of corporate management responding to demands of pension funds and institutional investors on issues of corporate governance. The evolutionary process will be driven by the marketplace. There is no need for legislation to mandate change, although perhaps one day the New York Stock Exchange will amend its listing agreement to require independent nominating committees. As institutional investors hold an ever increasing share of the Standard & Poor's 500 companies, corporate management will become increasingly responsive to these issues, and as a result, there will be fewer, rather than more, proxy contests over governance.

During my service as head of the Agency, some people asked me why the PWBA devoted a good amount of its limited resources to corporate governance, a field that is unlikely to yield massive recoveries even when violations are discovered. My answer was, and I believe that the answer of the Clinton administration is, that pension plan fiduciaries must act as owners of the companies

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49 *See* JAMES BOSWELL, LIFE OF JOHNSON (quoting a letter of Sept. 19, 1977, as quoted in JAMES BARTLETT, FAMILIAR QUOTATIONS 432a (14th ed. 1968)).

in which they hold shares. Fiduciaries must act both to protect the value of the shares that they own on behalf of plan participants, and in a broader sense, to assure that corporate management acts in the best interest of all shareholders. At the same time, management should treat shareholders, including pension plans, as partners and not adversaries. As Assistant Secretary I was proud of the fact that we identified these issues early on as matters of importance both to pension plans and to society generally. We not only brought significantly increased compliance in this area but also made a significant contribution to the evolution of corporate governance.