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Here and Now: Trends in the D&O World*

Frederick (Fritz) Reed, Lee McCorkle, and Bill Schorling

MR. REED: Thank you. We are, in fact, going in the opposite order of our introductions. And so, Bill, do you want to be our moderator?

MR. SCHORLING: Thank you, Fritz. Yes, it's our fault for not telling anybody else.

I'm going to use some terms and some of them you have heard already, but I thought I would explain them before we get into the discussion so rather than having jargon, it may be jargon you understand.

We'll talk about ISS.¹ ISS is a firm that advises people on how to vote on officers and directors in publicly traded corporations and on issues that appear in the proxy statements. It arose out of the obligation placed on pension advisors under ERISA² to make informed decisions on issues that they're to asked to vote on as shareholders.

Leo Strine, Vice Chancellor Strine of the Delaware Chancery Court—you've already heard a lot of discussion about Vice Chancellor Strine. I'll give you some additional background. Vice Chancellor Strine teaches a course at the University of Pennsylvania Law School on director and officer obligations. He's one of the foremost thinkers about to whom those obligations are owed. He also participates in the Institute for Law and Economics at the Wharton School and the University of Pennsylvania Law School. I participate in that, as well as does Judge Ambro.

Now you didn't hear Judge Ambro's name used much, but Judge Ambro wrote *CitX*,³ and he's written a number of other important opinions in the area. Judge Ambro sits on the Third Circuit. Judge Ambro was a practitioner in Delaware prior to joining the Third Circuit.

I am going to talk about Lynn LoPucki. Lynn LoPucki is a professor at the University of California at Los Angeles Law School. He has written extensively. He's probably the—or probably most notable for

* This is an edited version of the transcript from the third panel at the DEPAUL BUSINESS AND COMMERCIAL LAW JOURNAL SYMPOSIUM, *Corporate Governance: The Ins and Outs for Ds and Os*, held on April 19, 2007.

1. The full name of the firm is Institutional Shareholders Services.

2. Employee Retirement Income Security Act, 29 U.S.C. §§ 1001-1461 (2007).

3. *In re CitX Corp.*, 448 F.3d 672 (3d Cir. 2006).

his empirical work in bankruptcy. Most bankruptcy scholars owe a great deal to Professor LoPucki for his empirical work.

I don't agree with Professor LoPucki on everything he writes. I participated in panels with Professor LoPucki where I took the opposite view. But Professor LoPucki has, along with several other professors at UCLA, propounded a theory of corporate governance called the team production theory.⁴

I'm going to rely on that quite a bit. There's an unpublished manuscript in the materials that Professor LoPucki gave us permission to reproduce that talks about the team production theory.⁵ So that's Lynn LoPucki.

Judge Posner. Judge Posner is on the Seventh Circuit Court of Appeals. He is well-known for law and economics. Judge Posner also participates in the Institute for Law and Economics and has made some interesting comments on corporate governance.

So those are some of the shorthand—some background to some people I'm going to talk about in shorthand.

My own background, I'm a bankruptcy lawyer. I also represent directors and officers primarily in causes of action arising out of alleged breaches of fiduciary obligations in insolvent companies. I am admitted in Delaware. I practice in Delaware. I'm also admitted in Pennsylvania and practice there as well.

But I am—and I'll reveal my bias—I'm a proud Delaware lawyer. I believe that the Delaware Chancery Court is the foremost authority on obligations of directors and officers.

As my introduction noted, I did teach at Temple. I should warn you: I stopped when I decided I wasn't doing a very good job. So what I'm going to talk about is an overview of the trends that I think are emerging in the duties of directors and officers. It's not what the law is. It's what the law—where the law is going.

Of the students here, how many of you have had a corporations course? Business organizations course? Okay. For you, you're probably safe because you aren't going to be asked on a test what the obligations are of officers and directors. For those of you who may be taking the course in the future, don't cite me or talk about the principles I'm going to espouse. They're not the law yet. Okay. You can do it after you have set forth the law, but they're not the law yet.

4. Lynn LoPucki, *A Team Production Theory of Bankruptcy Reorganization* (Nov. 6, 2003) (unpublished manuscript, on file with the University of California, Los Angeles, School of Law), available at <http://ssrn.com/abstract=397801>.

5. *Id.*

Vice Chancellor Strine and Judge Ambro and Judge Posner have said a number of things. And gossip is always interesting, especially lawyers, otherwise the *American Lawyer* wouldn't exist. But, in addition, they have written a lot. I'm really going to try to limit my comments to their writings.

The one violation of that rule is I'm going to talk about Judge Posner. Many people think that boards of directors, especially those in publicly traded companies, are broken. It's pretty clear they're broken in a number of areas, but those that have received the most attention are executive compensation. And Judge Posner, in a lecture at the University of Pennsylvania, espoused the position that the market no longer works in the area of executive compensation, that the boards of directors are not exercising appropriate oversight, and that we probably need regulation. Coming from Judge Posner, that is an astounding statement. He is a free-market proponent.

Shareholder votes. Vice Chancellor Strine in a speech at the University of Iowa took the position that shareholder voting really wasn't working anymore, that it wasn't serving the corporate interest. He's skeptical of whether actions taken by short-term holders of securities, of stock, benefit the corporation in the longer term. I think it's reflected in some of his opinions. I'm going to talk about both *Trenwick*⁶ and *Production Resources*⁷ somewhat.

He thinks there are problems with ISS and similar providers. I think as you will hear, the panel has problems with ISS as well. But he expresses grave concerns about whether or not corporate governance is addressing the long-term interest of corporations.

Finally, there's been a lot of talk including from Lynn LoPucki on both the failure of Chapter Elevens⁸ to reorganize because of the significant number of Chapter Twenty-Twos⁹ that are occurring, for instance, the USAir Chapter Eleven. For those of you who are not bankruptcy lawyers, Chapter Twenty-Twos are repeat bankruptcies. Professor LoPucki is of the view that that evinces a failure of the first bankruptcy case.¹⁰ He ascribes that failure to the courts and the failure of the courts.¹¹ I think it's better described as a failure of the

6. *Trenwick Am. Litig. Trust v. Ernst & Young, L.L.P.*, 906 A.2d 168 (Del. Ch. 2006), *aff'd sub nom.* *Trenwick Am. Litig. Trust v. Billett*, No. 495, 2007 WL 2317768 (Del. Aug. 14, 2007).

7. *Prod. Res. Group, L.L.C. v. NCT Group, Inc.*, 863 A.2d 772 (Del. Ch. 2004).

8. 11 U.S.C. §§ 1101-74 (2006).

9. Chapter Twenty-Two is an unofficial term for a company that has filed for Chapter Eleven twice.

10. LYNN LOPUCKI, *COURTING FAILURE* (University of Michigan Press 2005).

11. *Id.*

boards of directors to properly address the duties and the constituencies to whom they owe those duties.

So we've got the three duties of directors and officers: duty of care, and that's the business judgment rule; duty of good faith; and the duty of loyalty. And many people conflate the duty of good faith and the duty of loyalty. We're going to be talking—I'm going to be talking about the duty of care. If the duty of good faith or the duty of loyalty is breached, that's a cause of action. And the boards are going to be liable for that; and that's primarily self-dealing.

So I'm going to be talking really in the area of the duty of care. It's process oriented. It looks to whether or not the board properly went through the process. It's a matter of public policy and encourages directors to serve on boards because their decisions aren't going to be second guessed if they exercised and went through the proper steps in reaching their decision.

The *Disney* decision¹² in Delaware arguably broadened the scope of the duty of care. In *Disney*, the Delaware Supreme Court said that where the allegation of the complaint was that the directors acted totally uninformed,¹³ that was a breach in the duty of care.¹⁴

I think prior to *Disney*,¹⁵ the courts hadn't gone that far. I'm not going to talk about this because I don't find that that interesting. I am going to talk about to whom the duty is owed and the implications of that on the permissible bounds of decision-making by directors and officers.

There are competing views. The primary view, and the long-held view, is that in a solvent corporation, the duties of officers and directors are owed to shareholders—that is, that they have to take the interest of the shareholders into account in reaching their decisions. The shareholders elect the board, and the board is answerable to the shareholders.

Some scholars have concluded that the election function doesn't work in the modern corporation, and I have a cite in my outline which is in your materials.¹⁶ The contrary view is the team production view. That's the one that Lynn LoPucki has espoused, Blair and Stout as well, primarily out of the University of California in Los Angeles.¹⁷ It

12. *In re The Walt Disney Co. Derivative Litig.*, 906 A.2d 27 (Del. 2006).

13. *Id.*

14. *Id.*

15. *Id.*

16. See Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999).

17. *Id.*

is based on director primacy.¹⁸ It creates a super group of directors whose interest it is to look out for all of the constituencies of the corporation.¹⁹

In the constituent groups, the team are those who have entered into a bargain with the corporation, and they don't look solely to contracts, but to all of the constituencies. It would include suppliers. It would include employees. It could include the community if the community has invested in infrastructure. But there's an implicit, if not explicit, quid pro quo that they will receive the benefits that the corporation has received. They'll receive their share of those benefits.

It's based on a lack of trust of the other team members because you could empower the other team members to make that decision, but no one entrusts someone who may seek to increase his or her stake in the benefits or the profits of the corporation at the expense of others, so that they entrust the decision to the board.

It is both a positive and a normative theory in that it is testable in the empirical data, and normative because you can predict or espouse an appropriate behavior.

The developments in the zone of insolvency in Chapter Eleven²⁰ corporations have supported this view. I'm going to look to *Trenwick*²¹ and *Production Resources*²² in particular because they start out on the issue in front of Vice Chancellor Strine as to who is the person on whose behalf the fiduciary obligations of directors and officers should be exercised. And he talks about creditors and he talks about shareholders.

But he begins in *Production Resources*,²³ actually to go all the way back to *Credit Lyonnais*²⁴ and Chancellor Allen, to find support where the classes of persons whose interests may be considered in exercising the directors duties have begun to expand. At least when they talk about to whom the duty is owed, they begin to expand beyond the constituencies of shareholders and creditors.

In *Credit Lyonnais*, the court said the board has an obligation to the community of interests that sustain the corporation to exercise judgment in an informed, good faith effort to maximize the corporation's

18. *See id.*

19. *See id.*

20. 11 U.S.C. §§ 1101-74 (2006).

21. *Trenwick Am. Litig. Trust v. Ernst & Young, L.L.P.*, 906 A.2d 168 (Del. Ch. 2006), *aff'd sub nom. Trenwick Am. Litig. Trust v. Billett*, No. 495, 2007 WL 2317768 (Del. Aug. 14, 2007).

22. *Prod. Res. Group, L.L.C.*, 863 A.2d at 772.

23. *Id.*

24. *Credit Lyonnais Bank Nederland, N.V. v. Pathe Commc'ns Corp.*, 1991 WL 277613 (Del. Ch. Dec. 30, 1991).

long-term wealth-creating capacity.²⁵ That goes significantly beyond shareholders.

Vice Chancellor Strine in *Production Resources* talks about, as the prior panel did, the fact that *Credit Lyonnais*²⁶ has been seized upon by courts as an affirmative weapon against the board, as opposed to a defensive weapon.²⁷ That is the position that *Credit Lyonnais* held—that the board did not owe a duty solely to shareholders.²⁸

In *Production Resources*, Vice Chancellor Strine speaks of maximizing corporation value to best satisfy the legitimate claims of all of its constituents.²⁹ He goes on to say in *Trenwick* that some scholars are critical of a jurisprudence that expresses the view that directors owe fiduciary duties to the corporation itself rather than a particular constituency of the corporation.³⁰ The Delaware Chancery Court does not share this concern.³¹

In *Trenwick*, Vice Chancellor Strine says that even in an insolvent corporation, directors are not prevented from making judgments about how generous or stingy to be to other corporate constituencies in areas where there is no concise legal obligation to those constituencies.³² So, again, the court is speaking of taking into account interests well beyond those of shareholders and creditors.

The problem with this view comes as to how you circumscribe the permissible exercise and the discretion if the board can take into account the interest of many other constituencies. Vice Chancellor Strine in *Trenwick*, while he talks about taking into account the other interests, says that the directors may do so if they believe that will improve the firm's value and return to its creditors.³³ So that, here, Vice Chancellor Strine is back to looking to the value of the firm in general.

In bankruptcy, the traditional views of corporate governance don't fit. In the traditional view of corporate governance, the board is elected by shareholders. In Chapter Eleven,³⁴ the board was initially, pre-petition, elected by the shareholders. Typically, there's no annual

25. *Id.*

26. *Id.*

27. 863 A.2d at 772.

28. 1991 WL 277613.

29. 863 A.2d at 772.

30. 906 A.2d at 168.

31. *Id.*

32. *Id.*

33. *Id.*

34. 11 U.S.C. §§ 1101-74 (2006).

meeting held. The board continues in perpetuity. It looks an awful lot like the team production theory.

Others in the area of bankruptcy have said that the interest of noneconomic constituents, noncontractual constituents should be taken into account. Professor Warren has taken that position.³⁵ Professor, now President, Gross has taken that position in terms supported by the legislative history.³⁶

There is opposing that view, a contractarian view, which is that corporations are just made up of a bunch of contracts. If you don't have a contract through the corporation, your interests don't deserve to be protected. That view, however, has started to fail; and that's a view that Professor Jackson³⁷ has espoused along with Professor Mooney³⁸ at Penn.

But then you get to the debtor-in-possession. That just doesn't fit a contractarian theory because the board of directors is exercising decision-making power on behalf of the debtor-in-possession, but the board is not appointed by the creditors. It is elected by the pre-petition shareholders and, as I said, begins to look like a permanent institution. He's not re-elected. They don't hold elections every year.

Indeed, when shareholders have tried to change the board, the courts have not—have enjoined that exercise where they believed that it would interfere with the reorganization. It goes back to a case like *Lifeguard Industries*,³⁹ which was decided by a court in Ohio; Fritz represented the bank and I represented the creditors' committee.

So the issue becomes, if we agree that we can take into account other interests, how do we circumscribe that discretion? Professor LoPucki says, in bankruptcy, we circumscribe it by the difference between the liquidation value and the going concern value; that difference can be allocated among various constituencies.⁴⁰ Query: How do you do it outside of bankruptcy? Also, query: Whether or not there should be a difference in how corporations are governed in and out of bankruptcy?

In summary, I think that the Delaware Chancery Court has indicated that it is heading this way. I think we can anticipate more deci-

35. Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336 (1993).

36. KAREN GROSS, *FAILURE AND FORGIVENESS* (Yale University Press 1997).

37. Thomas H. Jackson & Robert E. Scott, *An Essay on Bankruptcy Sharing and the Creditors' Bargain*, 75 VA. L. REV. 155 (1989).

38. Charles W. Mooney, *A Normative Theory of Bankruptcy Law: Bankruptcy as (is) Civil Procedure*, 61 WASH. & LEE L. REV. 931 (2004).

39. *In re Lifeguard Industries, Inc.*, 37 B.R. 3 (Bankr. D. Ohio 1983).

40. LoPucki, *supra* note 4, at 34.

sions. Hopefully the *Trenwick* supreme court decision⁴¹ will shed further light on it,⁴² but the team production theory does appear to be one answer as to how directors should exercise their discretion in the years ahead.

MR. REED: It is an interesting theory. We've heard a lot of discussion and certainly—for example, at noon today, we heard an impassioned plea that we should take a broader view than the statutory scheme.

Earlier today, somebody was making analogies, or being reminded of movies, and then it was *Monty Python*.⁴³ This theory reminds me of the *Pirates of the Caribbean*⁴⁴ where they said, you have to adhere to the code, and in this case, maybe the bankruptcy code, but a little later, we heard but the code really is just more guidelines.

That isn't what the code is. In a bankruptcy context, at least, it is a theory propounded by people who can't get the statute passed by Congress. The idea that you can—that you can ignore the statutory scheme set out specifically and say, well, it is found in the legislative history, admittedly, not in the statute, but in the legislative history; and then give it a different result or a different—a different, in the case of all the arguments, priority than the statute allows is not something that I think is going to get traction in the bankruptcy court.

I don't think it ought to outside either, but the policing of it is much more difficult in a solvent corporation where there the penalty for directors ignoring the more traditional definitions of to whom the duty is owed is a function of shareholder vote.

MR. SCHORLING: I don't think you can get away with it as easily just to say it's the code and you have to follow the code because the code doesn't give all the answers. The board has to propose a plan of reorganization which has to take into account myriad interests.

MR. REED: Absolutely.

MR. SCHORLING: One. Number two, you have got Sections 1113⁴⁵ and 1114,⁴⁶ and you heard about it at lunch. There is no stan-

41. *Trenwick Am. Litig. Trust v. Ernst & Young, L.L.P.*, 906 A.2d 168 (Del. Ch. 2006), *aff'd sub nom. Trenwick Am. Litig. Trust v. Billett*, No. 495, 2007 WL 2317768 (Del. Aug. 14, 2007).

42. After the Symposium, the Delaware Supreme Court affirmed both the holding and reasoning of the Court of Chancery in *Trenwick*. *Trenwick Am. Litig. Trust v. Billett*, No. 495, 2007 WL 2317768 (Del. Aug. 14, 2007).

43. *MONTY PYTHON AND THE HOLY GRAIL* (Michael White Productions 1975).

44. *PIRATES OF THE CARIBBEAN: THE CURSE OF THE BLACK PEARL* (Walt Disney Pictures 2003).

45. 11 U.S.C. § 1113 (2006).

46. *Id.* § 1114.

dard in Sections 1113⁴⁷ and 1114⁴⁸ other than equitable. And so I've got some hypotheticals that are attached to my materials that raise issues as to how you would advise the board. While they are couched as hypotheticals, they actually come from real cases.

MR. McCORKLE: Don't you, in bankruptcy context, always have the fallback of the decisions of the bankruptcy judge, who often starts with, this is a court of equity, not of law. And so there's a fair amount of security in looking for a novel approach that I wonder—I wonder if that security exists in playing with a solvent corporation?

MR. SCHORLING: Well, what happens if I just go back to Vice Chancellor Strine's statement in *Trenwick* that you can take these other interests into account so long as it's consistent with the long-term economic benefit of the corporation?⁴⁹

MR. McCORKLE: Well, let's leave the long-term, short-term for a minute because I'm going to get into that. At least I think it's worth talking about. But I think that the citation that says you can take the other interests into account still flies in the face of a good deal of history saying that the duty of the directors is to the shareholders. There are some statutory exceptions to that, I know.

MR. SCHORLING: But isn't the question: what's in the interest of the shareholders? Is it long-term interest? Is it short-term interest?

MR. McCORKLE: Well, that's one question. I think the other question as you raised it, and that is, to what extent are the directors permitted to consider the interest of other stakeholders, business partners, employees, those who support the activities of the enterprise?

You are smiling at me as if you have won your case.

MR. SCHORLING: No, I am not. I don't have an answer.

MR. McCORKLE: I don't think there is an answer. But one of the concerns we run obviously is trying to provide some predictability in an uncertain world. And the mistakes that we make today are what this seminar will be talking about five years from now in the courts' written opinions about it.

MR. SCHORLING: I guess where I come out of it is that you can't explain it all with the contractarian theory. You just can't. And given that there are too many—there are exceptions to the contractarian theory, is there a better theory? And does a team production theory better reflect reality?

47. *Id.* § 1113.

48. *Id.* § 1114.

49. 906 A.2d 168.

MR. McCORKLE: And if it did, the implementation would be legislative, presumably.

MR. SCHORLING: Vice Chancellor Strine doesn't seem to think that it needs to be legislative. In his opinions, he's indicated that he thinks we can take those into account.

MR. REED: Most of the rhetoric, though, around additional interests are not defined, or are often not defined in terms of what's best for the corporation, but what is best for the constituency that somebody is putting forward. And to the extent that it is that, that's where I get cross-wise with it.

In a solvent corporation where the board of directors is sitting there trying to decide how the accommodation of additional constituencies, besides shareholders, creditors, and—or traditional shareholders and creditors to include employees, the city, if you want, because they invested in the streets system or gave them a tax break or whatever, all of those things to the extent that it is in the context of trying to decide what the long-term value increase is in the company I think is fine.

To the extent that it is a pretext for simply advancing the cause of a specific group, then you lose it; and that's—and the idea that it is put in the context of a team theory when that isn't the purpose is—

MR. McCORKLE: Even if whatever the concession is enhances the value to the corporation provided by that group?

MR. REED: No. I think if it enhances the value of the corporation, because you have done that, you have met the test. The fact that you say that's what you're doing when you're doing something else is where I have the problem.

MR. McCORKLE: Of course.

MR. SCHORLING: Fritz, do you want to—

MR. REED: We're going to bore you with *Disney*.⁵⁰

MR. McCORKLE: *Disney*⁵¹ has no interest to Bill, which I won't talk about a great deal, but I do have a framed copy of it over my bed; and I'm happy to cite it for the proposition that directors can do just about anything as long as they follow the right process.

MR. SCHORLING: We're going to have to consider the six-month trial.

MR. McCORKLE: Sure. And that, I want to say, is probably the law. It says, as we provide—try to provide—some measure of predictability in what is an unsettled and an uncertain world, at least from my view point; and that may make it worth saying two things.

50. *In re* The Walt Disney Co. Derivative Litig., 906 A.2d 27 (Del. 2006).

51. *Id.*

If you listened to my biography, I am a general counsel of a publicly traded company.⁵² So you will at least understand, if not forgive, my paranoia.

Second, I hope that none of you, should you ever meet my mother, would let her know that you saw me sitting between two insolvency lawyers.

Let me do a little contrast here. I just want to read some materials. The great strength of Delaware's corporation law, including the business judgment rule, is that corporate fiduciaries, even though subject to high standards in fulfilling their stewardship over the assets of others, have wide latitude in their efforts to maximize shareholder investments, so long as they act faithfully and honestly on behalf of those whose interests they represent. That is a generalized statement and one in which I take a great deal of comfort.

This morning, we talked about Sarbanes-Oxley.⁵³ Consider the difference in approach. Whatever the Sarbanes-Oxley objectives are, it has resulted in what can be described easily as a feeding-frenzy of checklists. Its approach is detailed regulations; minutia required; specific, detailed requirements; and an intent—actually a disregard of intent in some instances, maybe even criminalized activity without scienter. It has resulted in, I think, and will continue to result in, a homogenization of generally accepted accounting principles, both out of fear by the remaining four major firms, and also because of the government's intrusion over the accounting-standards people by virtue of the public accounting board.

It has generated tons of SEC writings, almost all staff; and all of that is directed to specific activity without reference to the rush to judgment.

Now if you look at—if you look at the *Disney* case,⁵⁴ which I think is worth reading even if I'm interested in only a couple of points or perspectives. A board cares about enhancing shareholder value and can, almost certainly in today's law, consider other values or other interests as well. But it cares practically for the integrity of its actions; that is, that its actions will stick.

A CEO is interested in as much freedom as she can get; and, for her, *Disney*⁵⁵ may be a win. For the general counsel, it's a loss. You law students who decide to get into in-house work will learn that, like

52. Wendy's International, Inc.

53. Sarbanes-Oxley Act of 2002, Pub. L. 107-204, 116 Stat. 745 (codified in scattered sections of 15 U.S.C. and 18 U.S.C.).

54. *Disney*, 906 A.2d at 27.

55. *Id.*

“the dog ate my homework,” the first thing out of anybody’s mouth when there’s a problem is, “but I ran it by the lawyers.” Now that might have been a run by at six thirty on the thirteenth tee, but whatever.

As Bill intimated, getting the suit and not getting out of it on a summary judgment is really a loss. There were thirty-seven days of testimony in *Disney*.⁵⁶ There is the element of *Disney*⁵⁷ that you ought to think about, though, and Professor Gold mentioned it this morning, and that is whether there is anything unique or different about the Delaware General Corporation Code at 102(b)(7)⁵⁸ where it uses the term “good faith.” Is that part of the duty of the care, part of the duty of loyalty, or is it something else? And is an absence of good faith the same thing as bad faith? Or are they different? That’s a problem I haven’t been able to solve over a long time.

We know good faith. Bad faith isn’t necessarily gross negligence or failure of the duty of care. And where you find the really egregious circumstance, like self-dealing or fraud on the part of the director, it’s not a problem, but there’s a lot of other latitude.

Now as I’m sure Bill would remind me, in *Disney*⁵⁹ neither the compensation committee, nor management in the form of the CEO, nor probably the general counsel, if he had any say in it, and certainly not management, followed what are called “best practices.”

Anyhow, the result is right in *Disney*,⁶⁰ but there was certainly a failure to follow best practices. Let me leave for a minute what they are. The flurry of all the people in this world who can talk about best practices is one of the by-products of Sarbanes-Oxley or the environment that spawned Sarbanes-Oxley.⁶¹ And just imagine a camel galloping wildly across the desert spreading sand, vegetation, and less pleasant materials. That’s some of the stuff that comes along with Sarbanes.⁶²

But should we follow best practices? Probably. And the way I have expressed it to many, including some who are on my board of directors, is that if you are a fish in a school, if you’re an individual fish, your desire is to be in the middle of the school. You don’t want to be behind it; you don’t want to be ahead of it, with the barracudas and

56. *Id.*

57. *Id.*

58. DEL. CODE ANN. tit. 8, § 102(b)(7) (2006).

59. 906 A.2d at 27.

60. *Id.*

61. Sarbanes-Oxley Act of 2002, Pub. L. 107-204, 116 Stat. 745 (codified in scattered sections of 15 U.S.C. and 18 U.S.C.).

62. *Id.*

the sharks. Your chances of survival are better in the middle. Now Warren Buffett hasn't used that analogy, but he has talked about how compensation committees want all kinds of comparative data so that they can look like everybody else and not be attacked.

Another benefit of best practices certainly is in dealing with the regulators. The regulators love checklists. They may be complex to put together, but so long as they are easy to look at, that's fine; and then, of course, there are the advisory services, ISS, Glass Lewis, some institutions, TIAA-CREF, and others who do their best to tell us how our business ought to be run. And, in general, it seems to me those things tend to be one size fits all. Fritz is getting ready to jab me because he thinks I'm now on a rant.

There are some potential drawbacks, however; and practical advice says to you take some care before you just adopt or recommend the adoption of best practices.

One of them is that they can have serious distraction effects. One of the things you heard this morning with respect to Sarbanes-Oxley,⁶³ for example—and we've all talked about—is the extent to which it serves as a distraction to a board and a management team that otherwise might have more productive things on its mind. I don't say that is universally true, but in part, that's true.

Another thing is that if you adopt practices, you are adopting “gotchas”; because if you're familiar with the codes, your directors' guidelines, and your charters for your committees, which provide for the way certain things ought to be done, then it's pretty easy for somebody to prove that they have not done those things. Another concern with the drawbacks of these things is one-size-fits-all.

ISS may—no, I won't say ISS. A particular commentator may say the offices of the chairman of the board and the chief executive officer should be separated. Maybe because they do it in England, maybe because somebody at the Harvard Business School said those corporations do better, I don't know. But the question is, does that one size fit all?

I think that particular fad is fading at this point. The city of New York, to the extent it is an investor by virtue of pension funds, has taken a universal position, as far as I know, with respect to certain personnel items that may fit well in New York or Los Angeles. They might fit well in Detroit. They may not play in Peoria or in Resume Speed, Arkansas, and so on and so on.

63. *Id.*

And then finally, at least one recommendation with respect to best practices: One must think about the methodology one wants to use; that is, what's the objective in adopting the methodology?

Now some advice that's consistent, I hope, with what you have heard before. One of the things I will conclude with is that we're in a fishbowl with corporations; and if you advise corporations, I think you're in a fishbowl today, paranoid as that thought may be. Independence is critical. Independence by management of some decisions, independence of the boards, independence of the external experts, and maybe, to some extent, the internal experts.

Group-inclusive deliberations are important. And I think deliberating long enough, if you can get it, for the board to achieve unanimity on a particular decision is extremely important. Boards ought to be fingers in—I mean, nose in, fingers out, so on and so forth. And then, as you heard in the last presentation, you want to be able to prove these things with some details, some care, and some follow-up.

Remember, of course, that records, like board-meeting minutes, can be too specific. So it's more of a balance than just deciding how long you can read a set of minutes.

So what's happening now? First, I think from the point of view of the cases five years from now, I think there's an attitude that corporations have to be watched with suspicion. I find that disheartening because I think that it is not true with 99.9 percent of them, but maybe.

Second, I don't see any abatement in litigation against boards for second-guessing the decisions they make. And I see and listen to—I thought I listened to, in the last presentation, a nice evolution of theories of liability. I don't see regulatory actions abating. I think they will continue to increase at least up to some point.

And then, as a substantive matter, (and my colleagues may want to talk about it, but it bothers me, particularly in light of the discussions that we had this morning with respect to objectives of hedge funds, i.e. should short-term shareholders be permitted to vote and the like) it can be a quandary for directors today as to whether the historic language about what is in the best long-term interest of the corporation still has the same effect that it used to have. There's a short-term focus now. Are there legitimate short-term objectives advanced by shareholders?

And, finally, how to deal with those things. The best advice I can provide today is process. Process is God, if there is one; information, information flow, integrity of information, deliberation by everybody including the guy who sweeps the floors, independence of particular

matters, and a willingness and a desire and an ability to go back and prove that all those things occurred. Let me take a breath.

MR. SCHORLING: Lee, you talked about independent directors, and that's the buzz word and the watch word for publicly traded companies now. What impact does—do the independent evaluation firms have on behavior of independent directors, many of whom also sit on other boards?

MR. McCORKLE: Sure. I think directors care in the same way that you care about the reputation of the law firm; I care about the reputation of the company. They care that, to some extent, the ratings for governance principles are good. They care that their company is seen as one that is socially responsible.

I obviously can't answer—I can't answer in detail because you haven't asked me in detail—but my impression is that directors generally pay attention to those ratings and care about them.

Now I know that there are directors—there are companies in Ohio, for example, who are downgraded by most rating agencies because they have staggered boards; and the boards have said that's a downgrade they will live with. But I know others have paid attention to the separation of the chief executive officer and the chair of the board.

MR. SCHORLING: Let's go to something with a little more guts to it. How about—there is a proposal by a hedge fund that the board incur debt to pay a dividend to shareholders in order to improve the return of shareholders and ISS comes out in favor of that provision? Do you think that that affects how independent directors will vote?

MR. McCORKLE: No, but I believe that if they vote in the affirmative, they will certainly consider that ISS supports it. It appears that there are a number of institutions, investors, and perhaps others, who pay attention to ISS, Glass Lewis, and GMI, and other rating agencies with respect to shareholder proposals; and, as you put it, I think it cuts back on the responsibility. ISS has become very successful.

MR. SCHORLING: Should that be the case if the directors form the view or are you of the opinion that by incurring that debt, they will decrease the amount of capital the company can use within the business because they have to pay that debt long-term and the hedge funds will sell out once the value of the stock spikes because there was a perceived benefit to short-term holders from the distribution?

MR. McCORKLE: You almost answered the question in the way you ask it. But it does raise very clearly the question of if that action were taken, and if it were to cause a departure of certain elements in the shareholder population, would that work to the long-term benefit of the company? I think on more facts and more deliberation I can

answer the question in either direction, but I would certainly be—I would want to have the process to support that decision.

MR. SCHORLING: Do you have an opinion as to whether or not it's having an impact on transactions generally in the market?

MR. McCORKLE: It being ISS?

MR. SCHORLING: ISS, yes.

MR. McCORKLE: No, I'm not competent to form—to answer that. I doubt it, but I don't know.

MR. SCHORLING: Fritz?

MR. REED: I think it does have an impact because I think boards are aware that—or maybe take a holistic view of what ISS's positions will be that are not issue by issue. If you sort of fork their goal in this issue, they will take positions with respect to director votes or a variety of other things that concern them. And, how it plays out in a case-by-case basis—I don't have either any empirical evidence or even anecdotal evidence—but I know they think about it; and if they think about it, it's having some effect.

MR. McCORKLE: I'm not aware of any example by any of the rating agencies in which they have taken positions unique to specific corporations; that is to say, if they were to support separation of CEO and chair of the board, they take that with respect to everybody. They don't say it's all right for GM to combine them, but GE to separate them; and, therefore, they're not advocates for specific actions by specific corporations.

MR. SCHORLING: By what standards are they judged?

MR. McCORKLE: As far as I know, none.

MR. SCHORLING: Is that a problem?

MR. McCORKLE: Well, if their services are hired, it seems to me that people do pay attention to their services and pay attention to the source. I don't—I could hardly be excused for hiring an incompetent lawyer and never looking at her credentials.

A board—you would say, I think, that if a board were considering a specific action and it got advice from an investment banker or accounting board, independent lawyer, or any other advice that, to some extent, the board has a duty, at least in the first instance, to get that advice from somebody reliable. I don't know what examination, institutional or otherwise, shareholders give to their sources—GMI, ISS, whether they want to follow TIAA-CREF in particular, I have no idea.

MR. REED: I want to ask one more question before we move on to the last topic, and it is: Do you guys think that the board function is

being sapped very badly by what we heard described in the Sarbanes-Oxley discussion and what we're describing here as a sort of over-blown focus on process?

If the board and the audit committee are spending all of their time listening to a parade of people report on compliance, 404 compliance under Sarbanes⁶⁴ and other compliance, and every time they make a decision, if what they are doing is running around documenting it so that the business judgment rule can be justified in case they're sued, they're not spending that time doing what they're supposed to be doing, which is considering the business plan, the prospects, and the best interest of the corporation as experienced people bringing their own independent judgment to bear. Maybe they are doing that some, but they are definitely doing it less if they're doing all these other things that are aimed purely at process and covering their butts.

MR. McCORKLE: I think it would be—I think it would be not complete to say they're focusing only on process and covering their butts.

MR. REED: Exaggeration never hurt anybody.

MR. McCORKLE: That's all right. You wanted to charge me up.

One of the things that the board cares about in responsibly fulfilling its duties is that the actions that it takes have the integrity to stick. Boards, in general, aren't out looking to get sued or do things that aren't going to hold on. So part of what—I would say that covering their butts is a little bit pejorative. Also I make my living with that kind of coverage I guess. That's the answer.

MR. SCHORLING: Do you think the markets—I am going to pose a different question. Do you think that the markets' focus on short-term recoveries and the hedge funds participation as active shareholders has affected the decisions of boards of directors?

MR. REED: It has to. I mean, they have the voting power to put directors on the board whose sole instruction from the people who elected them is to put through the programs of the hedge fund. Absolutely, it's doing that.

MR. SCHORLING: Is that a good thing or bad thing?

MR. REED: Well, it was—that's sort of a social view as to whether or not the hedge funds are appropriate, or whether or not they're kind of greedy and blood thirsty.

It is an interesting juxtaposition, I guess, that you started the discussion in this group by saying that the first theory was that one of the

64. *Id.*

reasons that you need the team theory is because voting doesn't work. It clearly does work. It's just that you don't like the result.

MR. SCHORLING: By not work, I'm saying that from an economic standpoint it may not maximize economic values.

MR. REED: Because to the extent that they have enough power, and they do, they are able to put through programs that are to their specific benefit; and, when they do that, I think it's detrimental to the corporation.

MR. SCHORLING: Okay. The only place where I can point to empirical evidence of that is in Chapter Twenty-Two where I think there's evidence that the short-term claim holders are forcing the re-organized companies to come out with too much debt and, as a result, the companies are failing; and it's my view that these boards are not exercising their discretion appropriately to say no to that, and they're putting at risk the long-term viability of their companies.

MR. McCORKLE: With the empirical evidence that exists today, I think it's certainly money around; and, by all indications, you got to make this pretty strong and living on it. What we may not know, we may not know the impact until some pretty fundamental changes have happened that we haven't gotten in front of. One hopes we don't have a disaster so that the cow is gone, horse, both sheep, all the rabbits, and even the raiding rats have gotten out of the barn, and then Congress shows up with an incredibly overpowering and detailed piece of legislation; not that that's ever happened before, but I think that we might have. I just don't think the answer to the question—I believe there's an impact, but I'm not sure what it is.

MR. SCHORLING: Fritz, are you ready?

MR. REED: Yes, I guess I'm back to the *Monty Python* quotes: "Now for something completely different."⁶⁵ That is from *Monty Python*.⁶⁶

The two prior presentations on the subject matter of the two prior presentations dealt with general overviews. Certainly the question of to whom the overall duties of a board of directors are due is a general theory. The idea of what the standard of care should be is a general theory.

I want to talk about something significantly more specific. It is executive compensation and what is happening in that area. It is last not because it's best, but because it's got good stuff in it. It's got greed and

65. AND NOW FOR SOMETHING COMPLETELY DIFFERENT (Columbia Pictures Corporation 1971).

66. *Id.*

it's got envy and it's got ridiculous legislative and other responses, looting of corporations and that kind of stuff, and so it's easier to talk about that if you're last on the agenda.

It's a mixed bag as we talk about it. We want to talk about it in 1) the context of public companies that are not in bankruptcy, 2) a little bit about what's happening in a bankruptcy context, 3) the overlap of what the drivers are that cause this to be a public concern right now between nonbankruptcy and bankruptcy stuff, and 4) what those legislative and regulatory responses to this are. That is, especially in the time left, probably enough.

The drivers themselves I think are ones that you have all seen. There's a little bit in the materials that are summaries of the news items that have gotten public attention and the general, interest of the public and, therefore, legislatures. It's abuse. The kind of abuse that we're talking about are the reworking of bonus targets for executives after they miss them, to go back and redefine the targets so that you can give them a big bonus. Backdating of options is always a nice topic and the people who have been doing that. Simple big payments to CEOs and other named executives in down times as well as in good times; that is, a corporation has falling profits, cash and stock prices, and the bonus and the compensation for the CEO, among others, goes up.

Big numbers simply by themselves are—a guy named Nardelli, who is now the departed CEO of Home Depot, got 210 million bucks as a severance package. It's not exactly on point, but Dick Grasso's 140 million severance for the New York Stock Exchange—it probably is a little on point because the people on the board who approved that are CEOs of all these other corporations. And when they are doing numbers like that, you sit up and take notice as to what's happening with boards and with CEOs.

Just perks by themselves are the kind of things that make great news. The use of the corporate plane has been the big one—you know, private use for CEOs and their families. Club memberships are big and are dying now because of disclosure requirements. Financial counseling is one of my favorites. The financial counseling that the corporation pays the CEO because they're paying him so much money he can't figure out what to do with it himself is a circularity that is great for newspapers and for legislators to get their hands on.

One of my personal favorites on the perk list is the guy who was making eight figures, and the first one wasn't a one, and he had the corporation buy his Book of the Month Club membership. That kind

of stuff is the kind of stuff that has resulted in a reaction not just from shareholders, but from regulators.

In the nonbankruptcy public company context, we have a variety of things going on. What has happened are new SEC disclosures rules.⁶⁷ And we are in proxy—we are in proxy time right now with the new disclosure rules coming out really for the first time. And it's interesting to see what the reaction will be at annual meetings of shareholders when the new numbers and the new disclosures are put together.

MR. McCORKLE: As a footnote, I might say that, as I recall, that was five pages from the Securities Exchange Commission and 373 pages by the staff.

MR. REED: Yes, and it's certainly a bunch of pages of everybody's proxy statement now because, among other things—

MR. McCORKLE: Printing costs alone.

MR. REED: —it can't be understood particularly well.

The things that are driving or that drove that, we talked a little bit about the drivers, you know, the absolute pay has been a problem certainly. One of the political drivers of it is the continuing increase in disparity between CEO, or all executive pay, and average worker pay. You see that twenty-six years ago the average comparison between the average worker and the CEO's pay was ten bucks for the CEO for each buck for the average worker. Now twenty-six years later, the average is 436 to one instead of ten to one; the kind of number, if it's true, that will get everybody's attention. Even if it's not true, it's close enough to true, that the numbers—there are certainly—there are a lot of mitigating factors as well that you don't see. That kind of statistic is always—I think it was Benjamin Disraeli, some people think Mark Twain, but I think Benjamin Disraeli said there are three kinds of lies: there are lies, there are damn lies, and there are statistics.⁶⁸

MR. SCHORLING: Disraeli.

MR. REED: Yeah, I think it was Disraeli.

These statistics are impressive on their face. You don't usually see the other side.

The poster boy I think for corporate extravagance in terms of—or at least the current poster boy is a guy named William McGuire, who is the departing CEO of United Health. And I don't remember—he had accumulated stock options when he finally left that were 1.2—it

67. Executive Compensation and Related Person Disclosure, 17 C.F.R. §§ 228, 229, 232, 239, 240, 245, 249, 274 (2006).

68. See QuoteWorld.org, <http://www.quoteworld.org/quotes/3776> (last visited September 17, 2007) (quoting Benjamin “Dizzy” Disraeli).

was more than a billion dollars. It was a lot of money. I was reading in preparation for talking a little bit about this, and I was just interested to see what the increase in the stock value was during his tenure while he was accumulating these things over ten years. And I don't know whether or not—actually I think I do know. It doesn't get me to paying the guy a billion two, but the increase in the stock value was, in fact, eleven thousand percent. So I thought he did okay.

And, indeed, some of the reasons his options were as valuable as they were is he substantially outstripped the expectations of the company who granted him the options to begin with. Yes, sir?

MR. LOU ROBIN: I heard recently that there were a few CEOs taking one dollar compensation but taking huge stock options of stock.

MR. REED: There are people who are taking, as direct pay, one dollar; or, in some cases, Steve Jobs takes zero, and then they take options. There are people who assumed their position by virtue of owning a big chunk of the corporation, and they're simply taking it on stock appreciation. And those kinds of things happen.

MR. LOU ROBIN: But my question is, I heard recently that one reason they take just these stock options, i.e., the stock as compensation instead of a salary, is to avoid the Medicare tax, which I heard for million dollars would be like thirty-five thousand dollars. Have you heard that?

MR. REED: That may be true in some cases. I mean, the guy for Tyco who tried to save eight dollars and something on—I think it was more than eight bucks, but it wasn't enough more for what he was paying.

MR. SCHORLING: Sales tax.

MR. REED: Yeah, the sales tax on art, those kinds of things. It sounds to me frankly more like no good deed goes unpunished. This is a rich guy and we don't like him so we're finding a reason why even taking zero is bad. But, maybe they're doing it for that reason.

MR. SCHORLING: One of my side lines has been representing senior executives in the negotiation of their compensation, and I think when I have represented people like that, the driver was twofold.

One, it was caused by their extreme confidence in how good they were. And, two, it was driven by the fact that given the results they thought they were going to produce, there's no way a board could approve that compensation up front because it would be so large as to shock the conscience. And so some of them were, in fact, quite successful and were paid a lot of money. But that was what was driving it.

MR. LOU ROBIN: Are you saying stock options and the stock or taking these little nickel and dimes—

MR. SCHORLING: No, no, stock options. They were paid a dollar and taking the stock options because if you paid them what they thought they were worth up front, it would shock the conscience. The board couldn't justify that to the shareholders. So they wanted to take the stock options because they thought they were going to make the upside and make that much more money.

MR. McCORKLE: It would be interesting to see what the new disclosure rules do to some of these arrangements. I hate to say it that I like having to write longer proxy statements, but, in this case, I might actually buy in.

There is the element, however, which is this: If you show me and a hundred others somebody who makes more money than we do, we're going to be satisfied that that person is overpaid.

There is—Fritz has given some real unreasonable examples, and it's hard to justify. I wouldn't intend to. But there is the factor of what the board thinks it needs when it hires the CEO and how competitive that market is. As Fritz said, if I had owned stock with the company that increased its value eleven thousand times, all power to him. I'm happy. I made money, too.

MR. REED: Assuming that's the constituency you want to benefit.

MR. McCORKLE: Myself, I'm talking about.

MR. JOE MARINO: But you're talking about the board approving these incredibly huge payments or formulas when you see that they were scammed in many ways where the CEO comes in and says, look, I won't take—I will take a dollar the first year, dollar the second year, and then I will take twenty percent of the profits the third year. And the first two years he's front-loading prepayment expenses, so in the last year they doubled or tripled. It just seems to me that the board lacks sophistication to deal with a con man scheme like that.

Are these companies so difficult to run that there are only five or six people who can hold them up for these outlandish compensation packages?

MR. REED: Well, I think that to the extent that what you say is they're being paid too much and it's shocking, it's hard to disagree with that. To say that they were scammed or that they didn't understand is, I think, not true. They have advisors.

Now I'm not saying it doesn't happen in small, middle-market companies, but that's not where these numbers happen. You're talking about a board and a compensation committee that have expert advi-

sors who make projections as to what they say a home run will be in terms of—in terms of incremental value in their stock. They set options that, if those things are met, the options will be worth a certain number, and then, in the case, for example, it gets outstripped by the performance twenty or thirty times. John Reed, from Citicorp talking on exactly this subject, says that when that happens, what the board, if it had any guts, as he said, would do, is make sure that when they give options later they take into consideration the fact that the guy has been paid more than they thought.

I will tell you that as I read that, that's a guy who's talking to the press because it makes no sense to me. What you do when you take that position is to say, look, I wanted an increase that was a hundred bucks. How dare you give me one that was ten thousand? I'll punish you for that. Never let that happen again.

What is it that says we made a projection that we thought was a home run. You didn't hit a home run. You hit a grand slam and you did it in consecutive innings, and now I'm going to punish you for that.

That still doesn't get me to a billion, two. I understand that. But there is something wrong with the concept that says when you very meticulously set it towards the goal and then the goal gets blown away by the performance that that's a punishable offense.

MR. JOE MARINO: It would seem to me that, lawyers are paid when we take a contingency fee, and it's on a sliding scale due to the size so that there's a larger percentage, the lower the dollars, and then the percentage goes down as the number comes up. I mean, it wouldn't make any difference if somebody said to them something very similar that they would have a compensation and then, if it exceeds that it would be less because, look, we're going to give you ten percent of the earnings if you make a million dollars; but, if you make ten million, we're not going to give you ten percent.

MR. REED: But that's not what they're doing. They're using stock options and they're saying we're giving you fifteen shares. Everybody else got increasingly richer who owned those shares, too.

I mean, this isn't cash. This is equity that has increased in value along with the equity of the rest of the company.

MR. JOE MARINO: Yeah, but the benefit of the stock is that—well, obviously, if they get the shares of stock then that's income to them even though it's not cash, so the option—

MR. REED: It is when they cash them.

MR. JOE MARINO: Until the option is exercised. But if you pay somebody a million shares of stock and the stock is a dollar a share, that day he has a taxable event of a million dollars.

MR. SCHORLING: Talking about stock options, one of the hypos that I had in my materials is that the management discloses that the corporation set aside fifteen percent of its equity for the stock option program for management. That's the United Airlines plan of reorganization. Yes. Fifteen percent of the equity. Makes you wonder who's managing what.

MR. REED: I know you all would rather drink than talk to me and it's coming in a few minutes.

MR. McCORKLE: Boy, I'll buy into that, man.

MR. REED: Let me talk quickly about the responses that have happened. We've talked about the fact that the SEC has these disclosure requirements. They are out now. It's proxy season.

In the materials there, it gives you chapter and verse on what the detail is, and I wouldn't purport to go through that now anyway. But the one number that's important that didn't used to be there is at the end of the summary table. There is now what's called the "wow number," which is the total when they add it all up; and that's where shareholders will start to see things for the first time. It is already clearly cutting into perks because people who are embarrassed by the perks they were taking, which weren't quite disclosed that way, are now cutting them down. That's in the SEC nonbankruptcy situation.

Section 503 of the Bankruptcy Code⁶⁹ is dealing with it, sort of, as it relates to—as to bankruptcy, and there are very different drivers there. The question of job security, or pay as compared to retention from the standpoint of the company, is what that's about; and, by and large, Congress in Section 503⁷⁰ has said, if it's a retention program, you can't do it. The verbiage is a little bit different from that, but that's ultimately what it means. So you have these legislative responses and we're about to see what the effect is.

Both in bankruptcy and in the SEC, there is additional stuff going on right now. There is a bill that has been considered—I guess it will be considered—Cathy, help me—tomorrow—

MS. CATHY VANCE: The bill on allowing shareholders to vote issue was considered on the House floor yesterday.⁷¹ Business was un-

69. 11 U.S.C. § 503 (2006).

70. *Id.*

71. See 153 CONG. REC. H3499-01, H3508-02, H3529-05 (daily ed. Apr. 18, 2007).

finished. It's due to be taken up again tomorrow morning where a vote is expected.

MR. REED: That bill is not—that bill is a vote that is an advisory, not a binding vote by shareholders, that is on two things.⁷² One is on compensation of named executives, which tend to be the top five reporting officers or the highest paid, and on golden parachutes.⁷³ Again, it's an advisory vote.

The House Judiciary Committee is also starting up—and this was just in the news this morning—a consideration of total compensation for CEOs in bankruptcy as compared to outside bankruptcy brought under the title, their title, which is *How Much is Too Much*; and they are considering trying to legislate specific limitations on executive compensation, not just retention, but the compensation of any kind in bankruptcy.⁷⁴

The principal kind of news releases that they're doing in that regard deal almost exclusively with comparisons between CEO pay and average worker pay, and that is—you will see that echoed in Section 503 of the Bankruptcy Code as well.⁷⁵

But those are the kinds of things that are happening.

MR. SCHORLING: Cathy, when's the hearing on that? Tuesday?

MS. CATHY VANCE: I believe it was Tuesday and it was before the Judiciary Committee's Subcommittee on Commercial and Administrative Law.⁷⁶

MR. SCHORLING: Of the House?

MS. CATHY VANCE: Yes, sorry.

MR. McCORKLE: This is more federal corporate governance law.

MR. REED: It's simple compensation limitation because people are shocked; and, in many cases, they deserve to be shocked. There are big numbers out there.

That's sort of the thumbnail of what's going on in the compensation area, a little bit of why and, at least, the structure of the legislative and regulatory responses that some of the numbers that have been banded about—some of the actions, not just the numbers, but the way they got there by screwing around with the dating stock options and

72. H.R. 1257, 110th Cong. (1st Sess. 2007).

73. *Id.*

74. *Executive Compensation in Chapter 11 Bankruptcy Cases: How Much is Too Much?: Hearing Before Subcomm. on Com. and Admin. Law of the H. Comm. on the Judiciary*, 110th Cong. 1 (2007).

75. 11 U.S.C. § 503 (2006).

76. *Id.*

backdating targets and revising targets and revising the strike points for options for a variety of things that had been solely for purposes—

MR. McCORKLE: How prevailing is that?

MR. REED: I don't think it's all that common, but it is abusive when it happens, and that's the thing which the great statutes are made of.

MR. SCHORLING: Fritz, what do you think the impact of disclosing compensation will be on going private?

MR. REED: From the CEO standpoint, the biggest part of the compensation total requires liquidity and the ability to get rid of the options. If you go private and you got a public company, the ability to cash it out is—

MR. SCHORLING: But you know that in the going private transaction, they're going to offer the chief executive more equity in the company than they have right now.

MR. REED: They will, but it's more liquid.

MR. SCHORLING: It is until they go public. You don't have to deal with all the disclosure anymore.

MR. REED: And that will be the deposit. The lesson is, if it's harder to sell, it doesn't spend as well. So it will be a mixed bag.

MR. SCHORLING: Just to piggyback on what Fritz said. I have been—I was in Congress along with Lou about, what, two, three weeks ago, Lou? I would say the only two things that really had traction in the legislative arena were executive compensation and corporate governance.

MR. LOU ROBIN: Prime loans, too. Subprime loans.

MR. SCHORLING: Those are the areas in which Congress has an interest. Whether they'll pass any legislation on it, who knows. Thank you.