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The Tenth Annual Albert A. DeStefano Lecture On Corporate, Securities & Financial Law. Corporate Accountability: Governance And Compensation Issues

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THE NEW YORK TIMES 1.

LECTURE

THE TENTH ANNUAL ALBERT A. DESTEFANO LECTURE ON CORPORATE, SECURITIES & FINANCIAL LAW[1]

CORPORATE ACCOUNTABILITY: GOVERNANCE AND COMPENSATION ISSUES

WELCOME
DEAN WILLIAM MICHAEL TREANOR
FORDHAM UNIVERSITY SCHOOL OF LAW

OPENING REMARKS
CONSTANTINE N. KATSORIS
FORDHAM UNIVERSITY SCHOOL OF LAW

MODERATOR
THE HONORABLE STANLEY SPORKIN

PANELISTS
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1. The panel discussion herein was held at Fordham University School of Law on March 8, 2010. It has been edited to remove minor cadences of speech that appear awkward in writing.

WELCOME

DEAN TREANOR: Good evening, everyone. My name is Bill Treanor. I am the Dean of Fordham Law School. It's my pleasure to welcome you to our program tonight, *Corporate Accountability: Governance and Compensation Issues*.

I'll be turning matters over to Professor Gus Katsoris in a minute, but I want to make a few welcoming remarks.

I have to say this is an amazing panel. Our Corporate Law Center does great event after great event, but even within the history of our Corporate Law Center, this is really a standout event.

At Fordham Law, we take business law very seriously. It's really at the core of what we do, and we have an amazing business law faculty, and we're joined by some of them tonight. I'd like to recognize Professor Martin Gelter, Professor Richard Squire, and Professor Gus Katsoris, who are all mainstays of our great program.

We have a phenomenal Corporate Law Center, which was created in 2001 and since that time has done an amazing job of strengthening the business law program at Fordham. The Chair of the Corporate Law Center Board of Advisors is Paul Soden, who joins us, as well as two Board Members, Pamela Chepiga and Bob Hollweg.

The Director of the Corporate Law Center, Ann Rakoff, really worked long and hard and did so much to put together this fabulous program. She was assisted by Zach Slates, who is our Corporate Law Center Fellow, and by Jeanne Rosendale, who really did so much to help bring this evening together.

I'd like to express the Law School's great gratitude to the Becker Ross firm for their generosity in establishing the DeStefano Lecture Series. We're delighted to have Howard Justvig and his wife Flora with us tonight.

We also have, from the Pace School of Business, Professor John James, who has brought a dozen students from his MBA class in comparative corporate governance.

I just want to make you aware that we have other great programs coming up. This Friday, March12, we'll be having an all-day academic conference on *New Ideas for Limiting Bank Size*. And then, on March 31, there will be a lecture by Ken Feinberg, TARP Special Master for Executive Compensation.

And, as we do all of these things, we work very closely with our great *Fordham Journal of Corporate & Financial Law*, which has been cited by the Supreme Court. It's one of the top five corporate law journals in the country. It has fabulous leadership. Thank you very much.

Without any further ado, let me turn matters over to our legendary business law faculty member, Constantine "Gus" Katsoris.

OPENING REMARKS

PROF. KATSORIS: Good evening, ladies and gentlemen.

On behalf of the DeStefano family, I'd like to welcome you here tonight. Unfortunately, they could not be with us, but they send their regrets and their best wishes.

For those of you who have never met Al DeStefano, let me briefly describe him to you. He started at Fordham Law School as an evening student, worked during the day, still managed to make the Law Review, and graduated at the top of his class. He then went on to become a partner in the Becker firm, specializing in corporate matters, particularly mergers and acquisitions. In his spare time, he devoted himself to numerous charitable endeavors and, as an adjunct professor on our faculty, shared his enormous knowledge and experience with our students.

In short, Al DeStefano was a symbol of what Fordham Law School was in the past, he is a symbol of what Fordham Law School still is, and he will remain a symbol of what Fordham Law School will be in the future.

Since its inception less than a decade ago, the DeStefano Lectures have covered a wide range of timely and diverse topics, such as: the need for market regulation, the demise of Enron and its auditor Arthur Andersen, strengthening the protection for investors, making our capital markets more transparent and, last year, the subprime mortgage meltdown. Sadly, the effects of that meltdown still linger, resulting in what many call the Great Recession.

Interestingly, everybody is busy blaming everybody else for the meltdown. The truth is many must share the blame, starting with the mortgage brokers; the loan reviewers who applied few, if any, standards;

there were also the lenders and investment bankers, who indiscriminately packaged subprime mortgages into securities and sold them throughout the world; there were the insurance, securities, and bank regulators, who seemed oblivious to the risks; and finally, the rating agencies that overrated the safety of these products. Ironically, many of the politicians who now seek reforms or reelection must also bear some of the responsibility for either creating or fostering some of the programs that inflated the bubble, or by simply ignoring many of the warning signals along the way.

In short, to borrow a phrase from the past describing a different economic crisis, "where were the professionals when these improper transactions were being consummated?" These words appeared in an opinion issued by Judge Sporkin in upholding the federal seizure of the Lincoln Savings & Loan Association some thirty years ago. They were appropriate then and they are still relevant today.

Shareholders are also to be faulted for not taking a more active interest in the companies they owned, instead of relying upon the self-serving rhetoric of their CEOs that "shareholder value" was being created, only to be subsequently shocked when the enormous retirement packages were paid to executives as they were exiting and leaving their companies in shambles.

There is no question that a major contributing factor to the Great Recession was greed — greed that sought short-term gain regardless of the long-term consequences, greed that often assumed risk could be passed on to counterparties, ignoring the fact that the risk did not go away and remained in the financial system.

Sadly, this game of Russian roulette was engaged in not only by speculators, but also by regulated banks and insurance companies.

Feeding this greed that led to our present dilemma was the method by which we compensated corporate executives, by encouraging them to engage in this enormous risk-taking — not with their own money, but with that of the shareholders and others. This is one of the topics our panel will discuss tonight, excessive executive compensation.

About six months ago, we were privileged to host a special lecture in this very room by William Dudley, President of the New York Federal Reserve, who eloquently discussed the financial meltdown as of last year. It was a few days after Ken Lewis had announced his retirement as Chairman of Bank of America and a search committee had been formed. Ken Feinberg had already become the "salary czar."

At the end of the lecture, in the question-and-answer period, I pointed out that although some governmental oversight was clearly understandable, it should not be "penny wise and pound foolish" so as to be counterproductive in the search to get a competent CEO for a very difficult job. I then asked the question, that if he, Mr. Dudley, and I were on the Bank of America search committee, where would we look for a successor, what type of person would we look for, what type of compensation would be necessary to induce the proper person to take the job, and to what extent should the government influence the process?

That was six months ago. A lot has happened since then in the board rooms of companies like AIG, GMAC, General Motors, Bank of America, and even with companies like Goldman Sachs and Morgan Stanley, as they reformulated their compensation packages in seeking to avoid public wrath and indignation regarding executive compensation.

Tonight, we are privileged to have with us an extraordinary panel of experts. On behalf of corporate America, as it looks to the future and as it looks for guidance, I ask the same question of the panel tonight: if you and I were on such a search committee, where would you look, who would you look for, how much would you pay, and what form would that compensation take, and, in the process, what input should you expect from the government?

I would now like to say a few words about tonight's moderator, our chairman of the panel, Judge Sporkin, and then he will introduce the rest of the panel.

After graduating from Yale Law School in 1957 — which, incidentally, was the year I graduated from Fordham Law School — he worked in private practice for a few years, and in 1961 he became a staff attorney at the SEC. In 1974, he became Chief of the Enforcement Division, where he served for eight years in that capacity. Thereafter, he served as General Counsel to the CIA for five years, until he was appointed to the U.S. District Court for the District of Columbia by President Reagan, where he presided over many notable and high-profile cases. Upon retirement from the bench, he returned to private practice.

Throughout his career, he has always championed the public interest and relentlessly sought the pursuit of justice. In short, Stanley Sporkin is no shrinking violet. Indeed, he is a no-nonsense, two-fisted public servant.

On the other hand, I can also personally attest to his softer side. As you know, in academia we have a saying: "publish or perish." Thus, out of necessity, in order to survive in academia, from time to time I was forced to publish various articles, which I distributed to a select captive audience. They are captive because once you are on the list you never get off until one of us dies. Judge Sporkin is on that list.

More often than not, like a bill collector who sends out overdue statements, I rarely hear from this select group once they receive one of my articles. But not Judge Sporkin. He would take the time out to courteously acknowledge receipt and graciously encourage me to write again. Most importantly, he has never asked to be taken off that list.

Ladies and gentlemen, it is with great pleasure that I introduce to you The Honorable Stanley Sporkin.

PANEL DISCUSSION

JUDGE SPORKIN: That was terrific. Great introduction.

I didn't know I was going to be offered a job as the head of the Bank of America today. I seem to fit that bill. I don't know if my wife would like living in North Carolina.

I see a number of old friends in the audience here today. Of course, Jeanne Rosendale, Ann Rakoff, and Judge Rakoff are here today, and we are very grateful to have them. I see Simon Lorne, Jim Buck, Ed Fleischman, and many good old friends here.

We're going to discuss a number of subjects. But the first thing I want to do is give short introductions and offer no jobs to the panel. I don't have any to offer.

Todd Lang is an old associate of mine, really one of the great people in the legal profession. While I could go through and say he graduated from Yale Law School and all that other stuff, what I really admire about him is he, along with Ira Millstein and Harvey Miller, in effect started their own firm in the late 1950s or early 1960s. Would you believe, that firm started by these three people is now in competition with the best in the world — not the best in America, the best in the world? Anybody that can do that is really an outstanding lawyer.

Gary Naftalis beat you, Todd, because his law firm, Kramer Levin, has his name in the firm. You need to get your name in the firm. Gary and I go back again — what do you figure, sixty years? — and we've been friends ever since. He is not only a great lawyer, but he is a decent human being. Our friendship has shown that. He, of course, graduated from Columbia Law School and Brown University.

The other two people are just as distinguished.

Jeffrey Sonnenfeld has a tremendous record at Yale. *Business Week* called Mr. Sonnenfeld one of the world's ten most influential business school professors, and *Directorship* magazine listed him among the hundred most influential figures in corporate governance. He is now the Lester Crown Professor of Management Practice at the Yale School of Management — for which I take my hat off to him, because when I was at Yale they didn't want to get involved in any of this financial stuff; they thought it was too much like plumbing.

Then we have Louise Story, who writes for *The New York Times*. She graduated from Yale and Columbia University. Again, she is going to be one of the great writers. In addition to being a publicist for Judge Rakoff, she has done some very great work on her own. And he needs no publicist, believe me.

Let me just quickly start out.

We keep looking at what has happened in this great meltdown. We look at it in the terms that we know — the financial upheaval, the fact that we went from a problem in connection with a real estate problem and turned it into a financial problem.

Well, the problem there was we've had real estate problems in the past. They never became a financial problem. They became a financial problem when we took the wall down. We securitized the real estate, and of course when the real estate collapsed, so began the financial collapse.

But let me take you a step back. It's my contention — and it's something that I spoke on years ago, before the current administration said, "Hey, we think the problem is jobs." Of course it's jobs. We screwed this country up so badly over the years that when I now look back, I cannot believe it.

Did we see what was going to happen when we let all our jobs from this nation go overseas? And now we're saying, "people can't pay for the real estate." Of course they can't.

I just read in the newspaper a little while back — a person was describing a town in Massachusetts called Palmer. This is what the article said:

> In this once prosperous, now depressed, former mill town in western Massachusetts, residents casually rattle off the names of all the factories that shut down long ago and of the businesses getting ready to leave. 'Everything is closing down,' said Robin Moriarty, who has worked here in her father's corner grocery store since she was in high school. The video place wants to close; Comcast closed; there was a fruit company across the street, they left; the taxi company wants to close; there was a flower shop across the street, she's gone. That's what's happened. It's a ghost town. We allowed these jobs to go. Where did they go? They went to countries based upon the fact that they're not paying competitive wages, slave labor.

And everybody's to blame. I even place some of the blame on the unions. Somebody, when I was talking about this to a union person, said, "How dare you?"

I said, "What you did is you gave cover to the business people to leave this country."

That's what happened. Unless we deal with that problem, we're never going to get out of this mess. And it's a very, very difficult problem to start bringing back these jobs.

Now, the governor of Massachusetts had a solution for the problem in Palmer.

Does anybody know who is going to bring back industry to Palmer? Does anybody know what the industry was going to be? Can you guess how they're going to resurrect this little mill town?

Gambling. So those are the jobs we're going to create. You can see what that's all about.

But really, to start blaming jobs and the financial markets we would be dealing with judgments and not the root cause. The financial markets certainly do not get any glory out of what happened. Surely they could have done a much better job, but you've still got to get to the root cause in order to solve the problem. I hope we can get better economists now who can help us and stop talking in slogans — "free trade," "free this" and "free that." It isn't going to work.

We've really got to drill down and go right back to the basics and start creating and bringing in jobs, creating real companies. We don't even have — if we were in a national security crisis matter — the wherewithal to create implements of war. Where are we going to go? Indeed, recently we had to go to a French company to build some of the airplanes needed by the Air Force.

Sure, I was in favor of bailing out General Motors, because we need General Motors if we have a national security threat and have to build heavy duty tanks and artillery. We can't strip this country of things of that kind.

At this time I'm going to ask Todd to get back into the real world of finance and talk a little bit about the proxy issues.

Go ahead, Todd.

MR. LANG: Okay.

For me, talking about proxy access is the "seven-year itch." The reason is that about seven years ago the SEC initially put out a concept release on the subject, and it then proposed a rule. I won't burden you with all the intervening details, but this has been live action up to this past June, when the SEC made a proxy access proposal.

It consists of 250 pages and propounds over 500 questions. The subject matter is complex and it is very controversial.

The proxy access regime will apply to more than 10,000 publicly held corporations, each with its own capital and voting structure, and other relevant arrangements that may be affected by the creation of an access right.

A clear definition of the purpose of the creation of that right is key to establish the parameters of access and avoid its use for other purposes.

The SEC in its Proposing Release asserts there are two purposes to the access rulemaking initiative which it had undertaken. The first is "to remove an impediment to the ability of shareholders to nominate and elect directors." The second is "to enable long-term holders of a meaningful number of shares of a corporation to use the corporation's proxy materials to nominate a limited number of candidates for election as directors, but with no control, intent, or effect." That is very important.

Thus, the category of eligible shareholder is for the most part institutions and others who exercise their governance rights but who do not have a control or other comparable agenda or planned activity.

If the access rulemaking occurs, there will be no impediment. So the purpose would primarily be to that other category of shareholder which I mentioned.

Final rulemaking will provide criteria for the eligibility of a proponent shareholder or group of shareholders, as well as the maximum number of access directors who may be elected annually and in the aggregate. Candidates will likely be independent of the corporation under the objective director independence rules of the stock exchanges with, at least as proposed, no independence requirement in relation to the sponsor. That is a highly contentious issue.

There will be numerous other provisions, including the means of establishing priority in the situation where there is more than one eligible shareholder who seeks to exercise the right in a specific election.

There also will be modification or elimination of the director election exclusion under Rule 14a-8, the shareholder proposal rule.

The SEC's proposal establishes an access right by means of what is called a prescriptive rule. Thus, primary terms of access are established by the SEC and can only be modified by a rule change or interpreted through an advisory opinion under the SEC's no-action process.

It seems as if such a prescriptive rule would preempt governance structures and arrangements of individual corporations. This raises a federal-state issue in terms of jurisdiction in such matters of corporate governance.

One practical effect of a prescriptive rule is that it could limit the ability of the corporation and its shareholders to adapt the access right to the existing corporate structure and arrangements, and deal with future opportunities and needs.

In passing, note there is a longstanding question as to the authority of the SEC to adopt such a rule, but legislation is pending in Congress which seeks to provide that authority.

Access does not exist under state law, except in North Dakota. Under state law generally, bylaws would be the customary means of providing a right of access, taking into account the individual corporate structure and governance arrangements. There is, therefore, a tension between enabling corporations to adopt such bylaws and the desirability and right of the federal agency to prescribe such rules.

In addition, a matter of considerable concern is the workability of the prescriptive rule. It seems clear that private ordering would be a preferable vehicle to establish an access right for the defined purpose and, among other advantages, to avoid workability concerns.

Final rulemaking may take some or all of this into account and make some provision for private ordering. It also may enable shareholders — not directors — to vote to opt out of an access regime or, in the alternative, to opt into one. Another possibility is the SEC will adopt a default rule establishing a prescriptive right of access after a transition period for those corporations who have not adopted and maintained an appropriate access bylaw.

It is anticipated that final rulemaking will be achieved soon. But there is no firm deadline. We've heard this before and the date for final rulemaking continues to be extended.

It is also anticipated that there is going to be an extensive transition period after adoption, to enable corporations and their shareholders to adjust to the new rule and to comply with newly created disclosure and filing requirements.

I was asked to define access in a nutshell, meaning five minutes. I probably have adhered to that, sort of. But I've only given you the highlights. There is a great deal more.

In this case, the devil may well be in the details. Let's all stay tuned, because this initiative is likely to enter a new active phase in the very near future.

JUDGE SPORKIN: Todd, let me ask you this question. Can corporate democracy really work? Can there be a democratic way for the shareholders to vote and elect management that would carry out their wishes?

MR. LANG: Let me answer it this way. The whole voting system is under reconsideration, because there are a lot of problems with it. It hasn't kept up with technology; votes are not accurately counted all the time; shareholders are not the record owners of shares and often don't vote themselves since intermediaries vote their interests in the complex voting process; and proxy advisors have significant influence on how shares are voted. And so the answer is that "democracy" is a political term, not descriptive of the actual corporate voting system.

I think you can have a greater participation by shareholders in the process through a variety of means, and many people are working on that project. The SEC has an education group working on trying to communicate with shareholders in plain English so they will be better able to exercise their voting rights.

When you talk about shareholders, who are they? I mean shareholders' stock is often voted by others — it used to be brokers, not as much anymore. Their financial interest is often voted by pension trusts, unions, and other intermediaries and investment vehicles. Hedge funds know how to vote their own shares and they have their own money to back it up. In reality, the individual retail shareholder does a limited amount of voting of his or her shares directly. To compound the problem, proxy materials are complex and often difficult to understand, which in turn poses a difficulty for shareholders in terms of making informed voting decisions.

So I think the objective is to protect the voting franchise, and educate shareholders with respect to voting matters. This should enhance the democratic features of the voting system.

JUDGE SPORKIN: Louise, we're going to have this wonderful proxy system. What about the pay involved in these? In other words, when I become the CEO of Bank of America, how shall I determine how much I should be paid?

MS. STORY: Pay has been one of the major controversies of this crisis. It is one of the issues that everyone can understand. We and the rest of the media have written about it a lot.

What I find interesting is that now we are not that far away on pay than we were a year ago. If you remember, in January 2009, President Obama called the Wall Street bonuses "shameful." He was talking then about the 2008 bonuses, but it was January 2009, and he called the 2008 bonuses "shameful." We're back now with pay going up.

So one of the things that a lot of people in the government have said is that shareholders, through voting and the proxy and things like "say on pay," might help rein pay in. But I think that is going to have limited effect because shareholders would only vote on the very top executive pay. The vote is often not binding, and the companies don't have to follow it. And then, the really unique thing about Wall Street pay is that people 100 deep in the company, or even 1,000 deep in the company, are often making millions of dollars and taking on big risks for the companies. So on Wall Street it may bear fruit for the government to think more about pay at a far deeper level than shareholders typically vote on.

So I am a little skeptical that the proxy initiatives “say on pay” are going to change Wall Street pay in a big way.

JUDGE SPORKIN: What do you think? If you were going to design a system involving your government, how far can the government go in telling these people how much they should be paid under our system?

MS. STORY: Well, the problem is that they appointed this Compensation Special Master, Ken Feinberg, who will be speaking here soon, so you all can put questions to him. But the problem is he was only appointed to oversee pay at companies that still had an exceptional amount of bailout money. And so by the time he got going, Goldman Sachs, Morgan Stanley, so many of the companies, had returned their money and he was only really overseeing Bank of America and Citigroup as for the big banks. He will not oversee Bank of America and Citigroup this year. They have already returned most of their money, in the case of Citigroup, and Bank of America has returned it all.

So I think that one thing the government should rethink is, even though these companies are no longer beholden to the government for bailout money, given that there is this implicit “too big to fail” belief now, does that mean that there should be someone other than shareholders that have a say? Because you know that if companies take big risks and we’re going to bail them out again, there may be some lasting role that the government should play in pay, which is a break from the past if they were to do it.

JUDGE SPORKIN: Is there anybody that thinks that under our form of government that we could really tell a private company how much they can pay their executives? Todd or anybody join in. Is there a theory, other than if they are taking federal money? But if there is no reliance on federal money? Can we — I guess we could do it through the taxing system, can’t we?

MR. LANG: I don’t think so. I mean we had a war. We had price controls and wage controls. We had a Wage Stabilization Board, and they set all the rules and so forth. But you have to have that kind of crisis to justify that.

JUDGE SPORKIN: But isn't there a rule that talks about if somebody gets over $1 million in pay?

MR. LANG: It is Section 162(m) of the Internal Revenue Code.

JUDGE SPORKIN: What does that say? You've got to familiarize us.

MR. LANG: The corporation cannot deduct more than $1 million in compensation for defined executives unless it has earned it in a particular way, and satisfying that test has gotten tougher.

JUDGE SPORKIN: So you can't deduct it?

MR. LANG: The deduction is limited as I indicated.

JUDGE SPORKIN: So in other words, under the taxing power, what you are saying is there is a limited way of the federal government to involve itself in pay, right? They could do it that way. They could assess a surtax. They could do a lot of things, couldn't they?

MR. LANG: Stanley, it hasn't worked.

JUDGE SPORKIN: I'm not saying whether it's going to work. I'm trying to find out whether they have the ability to do it. You're probably right. Believe me, I'm not here suggesting it.

MR. LANG: Just let me say this. The tax law has been used a few times, including golden parachutes, but people have negotiated around it, and there are exceptions because Congress had a limit as to what it wanted to do.

So the question now is: under present circumstances, with the public mood being what it is, are there other things that can be done other than saying, "we're going to have good practices, more disclosure, and we are going to try to limit compensation on a sensible basis rather than legislate it"? That's the issue.

JUDGE SPORKIN: Louise, would you have any other suggestions?

MS. STORY: Yes. I think that in this "too big to fail" legislation that is in Congress, it is possible the government could create a new rationale for a government rule on pay, because it is not enough to say that they can regulate pay once a company takes bailouts. Companies now have an implicit guarantee that the government will bail them out. So I think it is possible that they could develop a new rationale based on that.

JUDGE SPORKIN: Very interesting.

All right. Let's talk to the Dean. Dean Sonnenfeld, what do you have to say about the latest in corporate governance?

PROFESSOR SONNENFELD: Well, that's a big question. It's almost as big as Ricardo's Theory of Comparative Advantage you opened with. There's a lot to master in one panel.

I think that this is something which really stands out in corporate governance that might be a little bit contrarian with the direction of the panel so far. I don't know where Gary is going to come out, but I kind of feel like the mosquito in a nudist colony. I hardly know where to strike first here, Judge.

I think there are real limits to the law in this whole debate. Whether or not it is compensation or the larger governance arenas, the law is a tool, a largely inadequate and clumsy tool, to get to something that is our objective. We are looking at personal accountability of our leaders. Corporate accountability is a byproduct of that. We want smart, informed, hardworking, long-term-oriented folks that are responsive to their shareholders and their communities, and with some personal integrity.

Louise, I'd differ with you a little bit about what the results of Ken Feinberg's interventions are, because it speaks again to the limits of the law. You're right; legally he is constrained to just over 100 executives. And yet, I think he has had an enormous effect in bringing in a kind of personal accountability to this, because there is a cultural issue.

If you take a look at what Jeff Immelt said in a speech recently, or what he did as CEO of GE, to forgo his bonus, that's a big deal. He just said:

> We are at the end of a difficult generation of business leadership, and maybe leadership in general. Tough-mindedness, a good trait, was replaced by meanness and greed - terrible traits. As a result, the bottom 25% of America is poorer than they were twenty-five years ago, and that's just plain wrong. Rewards became perverted. The richest people made the most mistakes with the least accountability. In too many situations, leaders divided us instead of bringing us together.

What has happened as a result, I think in part, of the model that Ken Feinberg has set, as limited as he was to those people, is we see Jeff Kindler at Pfizer forgoing much of his bonus; we see at Morgan Stanley the outgoing CEO and the incoming CEO taking the same path; at Citigroup somebody I've been very critical of — I have to admit he has grown a lot in office — has been taking $1.00 a year, forgoing his bonuses; the CEO of Coke — and it goes on and on and on. We didn't see this before. Many of the titans of industry have been deciding that shame and accountability matter. It is not going to be legislated or litigated. It is a sense of responsibility.

The boards are picking up on this little by little. I thought that when the WorldCom board and the Enron board were found to be accountable and liable — it was very limited you could say in that same case — all other directors got scared.

I think Delaware badly mishandled the Eisner/Ovitz situation and the board got away with perhaps being inept. But it scared directors everywhere.

Their law was very limited, but it put — was it Samuel Johnson who said, "Nothing so focuses the mind like the prospect of a hanging"? You know, the law's limits, rather than the law's reach, often is where some of the biggest things happen. Shame and accountability — I think that's the danger that we are seeing.

One of the problems with boards is groupthink — not how independent they are. You know, the fact that everybody on this panel has a strong Yale connection doesn't invalidate us. Groupthink, do we think the same way? I don't think we do. Do you have bystander apathy? Do you have obedience to authority, although we do respect the Judge? Is that cowardice or courage?

I think that's what the *Bank of America* decision brings out for us. Some people may be disappointed that we couldn't see ultimately slapping down the Bank of America for trying to — the SEC didn't find individuals personally accountable. But the message came out, if you will, from the Judge — I won't even look your way, so you don't have to even acknowledge — is that a message went out that personal accountability matters.

I went off and took a look at forest products industry executives in 1978. They were the same companies. In some cases, some of the same individuals went to prison for fixing prices in multi-wall bags and corrugated containers and folding cartons. The same companies were hit again and again. Why? There was just a little slap on the wrist of the company. There was no personal accountability.

Two CEOs back in Xerox in this post-Sarbanes-Oxley era. The CEO and the president violated — egregious financial fraud issues. Who was responsible? The shareholders paid the price, and nobody else.

That stuff has got to end. Personal accountability — even when it doesn't happen legally, the shareholders and CEOs are more and more getting the message. So I think that is the big change.

JUDGE SPORKIN: Let me ask you something. If we have this great democracy and you have people elected to the board whose interests are contrary to the workings of the company and to what it stands for, under corporate governance, how does a company deal with that? It's almost like the Hewlett-Packard situation. That's why the question I asked Todd before: does democracy really work? Suppose you have people fighting on the board; is that going to be good for the corporation?

PROFESSOR SONNENFELD: I think that's a great question. Dissent is a good thing. Dissent is not necessarily disloyalty. In that particular situation, the dissent was, surprisingly, the chairwoman herself, Patty Dunn, who had the temerity to lead an investigation that the full board had asked for, but then when they surfaced who the bad guy was, supposedly somebody named Jay Keyworth, another director ran cover for him and tried to suppress the whole thing. But the fact is the dissent itself was a good thing. The bad thing was that confidential discussions were being leaked to the outside. So I think on that part, dissent is good.

But the other side is, Judge, if you will, that what worries some about the kinds of things that Todd is pursuing — and I completely applaud Todd — nonetheless, people are worried about dissent when it comes to the campaign for office. People don't want to be part of a competitive slate of rival candidacies. If the board becomes parallel to a municipal city council meeting or a student council meeting, you are going to see quality people run for the hills the way we, sadly, sometimes do in public office.

JUDGE SPORKIN: All right. Gary?

MR. LANG: Could I make one point?

JUDGE SPORKIN: Sure.

MR. LANG: The model for a well-run board comes from private equity. People are smart. They have money. They take control of a company. They assist management because they know what they are doing and ultimately they will sell out because exiting is part of their strategy. But that is considered to be a role model of what a company ought to have — smart directors, people who know what they are doing, with money on the line for themselves.

This approximates what Bob Pozen said in his book. What he is saying is financial institutions should have a few super-directors who give three to four days a month to this work and who are experienced in financial matters. That's the way we ought to be running some of these kinds of companies since expertise is combined with the dedication of a substantial time to the task. I think there is a lot to that.

PROF. SONNENFELD: And they have real risk there. It isn't other people's money. That's why they become billionaires. It's their own money at risk, and we applaud it. We don't want limits on that.

JUDGE SPORKIN: Gary, let me ask you this question. The SEC over the years brings a lot of consent decrees. Up until recent times, they would take it to a judge and the judge would agree to it. Then we find in a recent case that a judge says he's not going to be a rubber stamp. There used to be a judge who, one time when the government came to him with a consent decree, asked whether he could use his own pen to sign the decree. What do you think of this new thing of the courts substituting their judgment for a regulatory agency? Have you thought about it? Have you been involved in it?

MR. NAFTALIS: Yes, I've thought about what this development means for the system.

I think the question you raised, Stan, is an interesting one. Historically, at least based on my anecdotal memory, I don't ever remember a single SEC consent decree that was negotiated by both sides being the subject of any particular judicial scrutiny. The lawyers would present the document to the Court, it would be entered, and that would be it.

Indeed, the pattern was really not dissimilar to that of private civil litigation, where judges really generally don't get involved. If I sue somebody and we decide to settle our dispute, the judge is happy to have the case removed from his or her calendar — save for the class action area and a few others, where the fairness of the settlement had to be appraised by the Court.

I think what we have here may well be a dramatic change in how judges exercise their power with regard to consent decrees. The law says — and I think Judge Rakoff referred to it in both of his opinions — that when you are dealing with a public agency, before you approve a consent decree which implicates the contempt power of the federal court — that is, if somebody violates the injunction, they can be held in contempt — you are supposed to find that the settlement is fair, that it is adequate, that it is reasonable, and that it is in the public interest.

That was the justification for Judge Rakoff's decision not to approve the initial Bank of America settlement. The Court's opinion turned for the most part on the fact that the Court was concerned — assuming there was a nondisclosure, and assuming the nondisclosure was actionable under the securities laws — that the settlement was being paid for by the victims. The shareholders themselves, who had not received the information, were the ones who were paying the fine. That struck the Court as neither appropriate nor in the public interest. Judge Rakoff did rely on a legal authority I had never heard of before, Oscar

Wilde, quoting his famous definition of a cynic – someone "who knows the price of everything and the value of nothing." I had read some of Wilde's work before, but not in the legal setting. In any event, Judge Rakoff sent the parties out to either go to trial or to come back with a settlement that would pass muster under the applicable standards.

The parties did come back several months later, just last month, with a new settlement that the Court approved. Judge Rakoff changed legal authorities though. He no longer was willing to rely on Oscar Wilde. He relied instead on a saying of the legal philosopher Yogi Berra, "I wish I had an answer to that because I'm getting tired of answering that question." Apparently, Yogi is pro-settlement while Oscar is anti-settlement.

What I think is interesting is the Court's analysis in the second *Bank of America* case. In addition to relying on the standards that this settlement had to be fair, adequate, reasonable, and in the public interest, Judge Rakoff said, "the law requires the Court to give substantial deference to the SEC as the regulatory body having primary responsibility for policing securities markets, especially with matters of transparency. While such deference can never be absolute, since the judgment ultimately entered is the Court's and is enforceable by the Court's contempt power" — which in fact he had noted in the first opinion — "the Court will fail in its duty if it did not give considerable weight to the SEC's position."

The Judge, in determining the fairness of the settlement, actually looked at the evidentiary materials and agreed with the SEC's position that the nondisclosure was the product of negligence, and was a reasonable, well-grounded position. The Court agreed that, as a matter of deference, it would approve the settlement, which at that point included two nondisclosure violations: (1) the bonuses paid to Merrill executives; and (2) that Merrill was suffering historically great losses in the fourth quarter of 2008.

The Court also pointed out that considerations of judicial restraint require that Federal judges have to defer, if in fact the settlement is fair, reasonable, adequate, and in the public interest.

What's interesting is that the parties came back with a series of prophylactic measures which were not in the first settlement. One was the retention of an independent auditor to review the bank's controls, which reminded me, Judge Sporkin, of the old days when we used to put all that stuff in the old SEC consents. Another was requiring the retention of independent disclosure counsel. As to both measures, the Court convinced the parties that if the SEC and Bank of America didn't agree on who would be retained, that the Court would have the final say.

As to a third prophylactic measure, the retention of a compensation consultant, Bank of America indicated that they thought that was appropriately a matter of their own corporate governance and who would be selected should not be the SEC's call, nor should it be determined by the Court.

The question that now remains: to what extent are courts now going to give enhanced scrutiny to SEC consent decrees? I think Professor Coffee of Columbia has indicated he thought that this will open the door to much greater scrutiny. Certainly, in issues where companies have received TARP funds, that opens the door to greater scrutiny.

A countervailing point is that individuals as well as corporations do settle SEC cases all the time. Even though they may not necessarily be guilty of the offense, they may not have the economic wherewithal to fight the case. They also may not have the emotional wherewithal to fight the case. People just want to get on with their lives. So there is that other countervailing dynamic in the settlement process.

PROF. SONNENFELD: Are we certain this is right? As one of the two non-lawyers on the panel, I am just amazed. Judge, you obviously were a pioneer, and it made a huge difference to raise the questions you did. I am in awe of what Judge Rakoff has done following in your wake.

And yet, you know, I have a Philadelphia lawyer in the room, my brother Mark — but antitrust settlements, all the time, have come before judicial review. I can come up with half-a-dozen antitrust settlements, and I'm not a lawyer — Food & Drug Administration reviews. NHTSA right now, the National Highway Traffic Safety Administration's settlement with Toyota is coming up for judicial review. What's so unusual? Is there something about securities law that is so godly we can't challenge it the way every other law can be challenged by judicial review? Mark, am I wrong?

JUDGE SPORKIN: In the *Microsoft* case, I didn't approve the settlement. They appealed me and I got reversed. The Court of Appeals said I didn't have a right to go as far as I did.

I had a little stronger support, I think, than even Judge Rakoff, because I had a law called the Tunney Act, in which the judge was supposed to be the gatekeeper. It came out of a matter involving government corruption. Congress said, "we're not going to trust the Antitrust Division anymore. Judges have got to be the gatekeepers."

So, reading the law the way I read it, I turned down the settlement. They appealed. They reversed me. And guess what happened? I'll bet you nobody here knows what happened. Does anybody know what happened after that case, after they reversed me?

Where are the students here? Can anybody tell me what happened?

PROF. SONNENFELD: Constantine might know.

JUDGE SPORKIN: Anybody know? Do you know what happened?

What happened is, Congress passed a law that said, "we meant what we said." The Court of Appeals was wrong, the District Court has pursuant authority to review antitrust consent decrees where the DOJ is involved.

Jed, did you come up against that? Did you see that in your research?

JUDGE RAKOFF[2]: How could I have missed it?

JUDGE SPORKIN: Which made me feel very good, that the Congress can reverse the courts, which I thought was — I used to have a lot of trouble with my Court of Appeals, but that's another thing.

In any event, I think he's dead-on. I mean, just think of a judge who is asked to put his signature on something. It's got to mean something. If the judge feels that it isn't right and he is uncomfortable, by golly, I don't know how you can force him to sign that thing. I don't know. That's why I couldn't understand my Court of Appeals. I said, "I need more information. I don't have enough information."

But in any event, there is another area, which Judge Rakoff

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[2] Judge Jed S. Rakoff, United States District Court for the Southern District of New York, participated in the Lecture as a member of the audience.

realized, that agencies need deference, parties need to have certainty. There are a number of judges now that I am aware of that are taking Judge Rakoff's viewpoint and being very careful in these settlements and are looking at them very closely. I think it is probably a good trend, except if he wants to try the case. I won a lunch on that. I said he was going to approve it, based upon my own view, saying if I were he I would not want to try that case. Maybe that was not the reason. In any event, the case has been settled.

What will happen, though, if there is too much interference, the SEC probably has enough ability to do its own thing. For example, it has virtual injunctive power through its cease-and-desist powers. So they will be able to do quite a bit on their own if they feel that it is necessary. So there is going to be a little bit of tension, I think, that is going to occur here.

I'm going to open it up. For any member of the panel, any questions on anything that we have said here? Go ahead.

QUESTION: We hear a lot about best practices versus other countries. How is our corporate governance, the cost of it, and our cost of managerialism in America versus Scandinavian countries?

JUDGE SPORKIN: Anybody know the answer to that question?

PROF. SONNENFELD: Well, I'll tell you, what never comes out in governance discussions, for a lot of reasons that might be obvious given who finances our country these days, is we have an imperfect governance system, but it is so much better than many of our major trading partners today.

If we were to take a look at the average major Chinese company, we are not even looking at anything close. Who represents a minority interest, because the government is the majority interest on most Chinese companies? Who are those? A minority person on a board, a director, is not representing the general corporation. Nothing that we think about in terms of governance would apply in China.

We look at South Korea, where several hundred top executives were rounded up — not only indicted, amazingly, in that judicial system, but actually convicted. It was all overturned, they were pardoned, because they said, "Gee, we need these people to run the country."

I think we do have to work on improving our governance, but it worries me that we use a pretty good system as the foil to flagellate ourselves. Again, we have to do better. I think *Bank of America* was terrible.

We need to do better, but we should somehow get a voice of criticism. I'm so glad you asked a comparative question about what is happening internationally. Whether it's the OECD or China, they use the United States as a whipping boy, as a scapegoat.

MR. LANG: I think they do. We borrow from mainly the western nations, not China, a great deal, and we study it, and often it is cited to support various governance reforms that people seek to impose.

For example, in London there is a "comply or explain" test which is generally used. It's a sensible system. It has been tried here, not too successfully, but it is something that we can put in.

The SEC here, for example, sometimes regulates through disclosure. You don't have to have a governance committee or a nominating committee, but if you don't, you've got to say in your proxy statement why. So that's the kind of thing that has crept in. Some of that comes from overseas.

Also, one other point. Things are different over there culturally. There is a working understanding between institutions and companies and so forth. We are different here. We are spread out. We have a hybrid system between states and the federal government and so forth. So I'm not sure most of their rules really apply to us. We have to fashion our own.

JUDGE SPORKIN: Let me tell you a little bit about Germany, which I happen to know a little bit about. They have two boards. One is a board of the people that run the company, of the management. The other is a super-board. I have found that the problem there is that on the super-board are representatives from the workers through their union. At times, management wants to keep from the union things that they don't want the union to know about. So it's a very difficult situation and one which is not very smoothly run.

That is the kind of thing we are talking about here. How much dissent do you want in your company if it is running well? You know, someone is going to say, "Okay, instead of being an apple picker, we'll turn it into a grape picker," or something like that. That's why these things are very difficult to deal with.

PROF. SONNENFELD: Another image we often see, Judge, of course, is the separation of roles, which is *de rigueur* in much of Europe, and, Todd, of course in the United Kingdom, if you think about it.

One of your favorite colleagues, one of my close colleagues who was a colleague of yours, argues passionately on the separation of roles needing to occur here. And yet, it has not been preventive on any of their governance scandals there. Nor, if you look at Enron and WorldCom, we had the separation of chairman and CEO when the most horrendous things were happening. It hasn't been in any way a panacea.

In fact, when scandals have hit at Royal Dutch Shell or other places, there was total confusion as to who was speaking for the company. There were so many different people who claimed that they were the boss.

JUDGE SPORKIN: You had two years ago — it has not been that long — well, I contend we have the best regulatory system in the world. I don't think there's anything like the one we have. Whatever anyone says about the SEC or whatnot, it's still the best.

But two years ago some of our top people in government, including Secretary Paulson, were against tough regulation. They were telling us that if we continued with SEC-type regulation and went to the prudential regulation of the banking organizations, all our financial business would go overseas. In effect, there was competition as to who could be the least effective regulator.

But you see, all of a sudden that thing blows up and everybody says, "What happened to all the regulators? We need more regulation." It really boggles one's mind when I see some of these things.

We were told, for example, a couple months ago that if we didn't bail out AIG that the world was going to come to an end — and not only bail them out, but we had to pay everybody a hundred cents on the dollar.

Then we get some hearings in Washington where Geithner testifies. He says, "Who, me? I recused myself from that decision because I was going to become the Secretary."

Then they go to Paulson. Paulson said, "I had nothing to do with it." This is documented, what I am telling you. He said, "I had nothing to do with it. I depended upon the Fed."

Then they go to Bernanke. He said, "I had nothing to do with it."

All I want to know is who made those decisions. Who made the decision to pay people a hundred cents on the dollar? If somebody would answer that question, I would love to have the answer.

Can anybody here confirm what I'm saying? You didn't hear the same thing? I watch C-SPAN. That's where I get my information. *Bloomberg* also reported this. You can't ask for anything better than *Bloomberg,* can you?

MS. STORY: It's true. I was watching the hearings. You're right. I'll vouch for you. It's true. I was watching the hearings also.

JUDGE SPORKIN: Am I right?

MS. STORY: Correct.

JUDGE SPORKIN: Geithner said he had nothing to do with it.

MS. STORY: You're correct. They all said that they didn't make the decision.

JUDGE SPORKIN: It reminds me of these three drunks who are in a car and they crack up and they all fall out. The cop says, "Who was driving?" "None of us. We were all sitting in the back seat." These guys were all sitting in the back seat when the country was going down the tubes. Gee, I couldn't believe it.

PROF. SONNENFELD: Your prior point about the overregulation issues is something that really hasn't come back to be sufficiently accountable. You might lay the Goldman decision or other things at the feet of Secretary Paulson, and people have issues that have come up once the dam burst as to how Paulson did or didn't respond. He did some things very well, some things not so well.

I think his missed moment was what you were talking about. He created, under great pressure from corporate America to take a look at these long-term issues that you opened with, Judge, about the loss of U.S. competitiveness, and instead it got hijacked, I think in part by a

Harvard Law School professor, to become an ideological rant that your friend, Harvey Goldschmid, your colleague, would say it was a canard, and he is right. The loss of IPOs to other markets didn't happen — we didn't lose any domestic companies. There were some international ones. We are trying to create strong financial markets in Russia. Rosneft, the energy company, opened in the Moscow market. We wanted that. In the past it would have been here. When the Bank of China opened in Hong Kong, it was a great thing. But somehow, this commission under Paulson was criticizing these things, when there is in fact explicit U.S. policy to encourage that.

And U.S.-originated business still happened here. But the difference was we charge 7% commissions and it's 2% and 1% internationally. It was a lot cheaper to do business elsewhere. It was a real canard to use this regulatory rant, and they have not been held accountable for it, because that was the moment we could have taken a look at the mismanagement of risk and the mispricing of risk instead of creating this nonsense about over-regulation driving business away.

MR. LANG: Jeff, isn't that what regulatory reform is all about, that this was all crisis response? Nobody wanted to be responsible. Everybody is to blame.

The question is: can you have a system which anticipates this sort of thing, and that has people in power to act with full disclosure and transparency, so that we don't run into this again? I think that is the object — I hope — and that is the big lesson we have learned.

JUDGE SPORKIN: You know what I also love? There are two other things that are interesting in what we are going to do now. We are going to now regulate the environment through cap-and-trade. If you like credit default swaps, you're going to love cap-and-trade.

Can you imagine giving this to the financial markets to regulate? And by the way, it's not new here. This has been used overseas. We didn't create it.

The other thing I love is that we are going to give systemic regulation to the Fed. But what happens when you bring in one of these economists, like they had in the past, who do not believe in regulation? What are you going to do? I don't know if I would give it to the Fed, I'll tell you that.

All right. Some more questions from the audience. Go ahead, sir.

QUESTION: The story that made one of the points that I found most interesting is in regard to the individuals not being able to be contained by the governance and regulations that they are trying to impose. The issue that I have been thinking about while listening to you is that, even if the individual boards were able to find some type of way to control the compensation packages, wouldn't that just allow the best of the best to go to other firms? They'll be stealing the labor and going someplace else to work. Greenhill and Lazard for the last year have been capturing a whole lot of new capital in that regard.

Then, the question I have is: if that is the case, if the regulations do go into effect, wouldn't that start a serious problem in the market, because if we didn't have this big blowup, nobody would be crying about Wall Street? It was a means for a lot of businesses to go out and to develop and to start up businesses for people to make huge amounts of money. But it seemed to be good for the companies, and now that we have these problems, they say it's not. So what would happen if you started to regulate that and what would happen with liquidity in the markets?

JUDGE SPORKIN: I don't think you can. I would agree with that question that you raise, and I assume the answer that you gave. But I'll let Ms. Story talk about that. I don't think you can regulate. That would really destroy — as much as our system can be criticized, but criticizing it on the kinds of things that I am talking about, where it doesn't make sense — but to destroy our whole free enterprise system where people ought to be able to make — you know, their worth ought to be determined by what their value is and whatnot.

What do you folks think?

MR. NAFTALIS: Let me sound a slightly different note. With all the oversized expectations and hoopla out there, what seems to be getting lost a little bit is that most people who sit on corporate boards of public companies are honorable people trying to do the right thing.

We should consider why do we have corporations and why do we have businesses? In a capitalist system, they make products or perform services and make money for the owners of the business, the shareholders. That is a reason why you want good people to serve on these boards. It is in the public interest that people who serve on corporate boards are dedicated to fulfill their fiduciary duties and enhance shareholder value. We want people who are not going to be concerned about whether they are going to be unfairly criticized because they are not conforming to the passing view of how much money people should be paid.

Jeff mentioned the *Disney* case as being wrongly decided. I think it was rightly decided, since I tried it. The *Disney* case is a good example of the gulf between reality and perception. The Walt Disney Company had hired Michael Ovitz as President. He didn't succeed in this job and was paid a lot of money when he was terminated. Everybody thought, "oh my God, the board was corrupt, the CEO was corrupt. They just gave all this money to this guy for no good reason." That was the public perception, and that was the perception when we went tried the case.

Except the facts really were different. The facts were that there was a very good business reason why Ovitz was hired. Michael Eisner, who I was privileged to represent in the trial, was the CEO of Disney and had had a phenomenal track record and had saved the company. He then had a quadruple bypass and his number two at Disney, Frank Wells, died in a helicopter crash. There was no potential successor to Eisner in the company and one was needed.

Ovitz was considered to be magic in Hollywood at this time. He was making a fortune running his talent agency, $20–25 million a year. So to get Ovitz to come to Disney, you had to offer him a compensation package where he wouldn't lose money by making the move. Nobody ever expected him to fail.

So what we did in trying the case was to show that the directors properly exercised their fiduciary duties, made a rational business judgment in hiring Ovitz, and were properly informed both in hiring him and later in firing him. That is how you want your boards to function.

PROF. SONNENFELD: Just don't pay him the protection money if he's fired for cause, as your client properly did, for egregious poor performance. He had no defenders in there. But don't pay him $120 million to leave.

MR. NAFTALIS: But, see, that's the problem of the misperception of the case. He wasn't fired for cause. The reason he wasn't fired for cause was because the general counsel, Sandy Litvack, a very distinguished lawyer, formerly Assistant Attorney General in Charge of the Antitrust Division, opined, "we can't fire him for cause." We put in evidence that Eisner had had endless conversations with Litvack saying, "can't we find a way to fire him for cause? I don't want to pay this guy." But it was concluded by the general counsel that there were no legal grounds to terminate Ovitz for cause. After all, they were in California, where the law is favorable for the employee.

PROF. SONNENFELD: But that is not necessarily the final answer. That was Litvack's conclusion. But the fact that he wasn't showing up for work, that he had this polarizing effect on virtually every project — everything about him — there was nobody defending his conduct in there. He just didn't happen to kill anybody on the job. But there wasn't anybody who was defending his performance. If he couldn't be fired for cause, nobody can be fired for cause.

MS. STORY: I think that's a great point. I think Ovitz is a lot like a Wall Street trader. This is where I think people have acknowledged some of the problems with Wall Street pay. You can have a Wall Street trader who comes in, and you think he's a sure-fire winner, like Ovitz looked great for Walt Disney when they hired him, and so no one thinks he is going to make a bad trade, and blow the place up.

The problem on Wall Street is that the upside for people who work there is infinite.

PROF. SONNENFELD: It's not just Wall Street. Carly Fiorina at HP, she cut her shareholder wealth in half and walked away with $75 million. Bob Nardelli cut his shareholder wealth in half and got twice as much at Home Depot. It's not just Wall Street. It's the failure of board backbone, and again, back to accountability.

MR. NAFTALIS: Let me just finish one thing on Ovitz. The reason Ovitz walked away with this package was that was what his contract provided, and he was the beneficiary of a "perfect storm." Ovitz was not a great success as president, and most of the time when the CEO or the COO does a lousy job, the stock price goes down.

That's normally how the world works.

In spite of Ovitz's performance, Disney's stock went up 25% during the fourteen months he served as president. Why he made most of his money was not because of the fixed salary or severance payouts in his contract. It was because the increased stock prices made his stock options very, very valuable. He was in the right place at the right time.

PROF. SONNENFELD: If shareholder price was the determinant, we wouldn't need courts and juries and judges and this whole building and the people here, because certainly you look at a lot of companies with soaring performance that had, say, options back-dating. You could use your argument and say, "gee, let's not police any of those prominent name-brand CEOs at United Healthcare or things like that, because look how well the shareholders are doing. Why hurt them?" But in fact they broke the law. Isn't the law superior to the shareholder performance?

MR. LANG: But not the contract. Term contracts are customarily terminable for cause which is defined, but realistically results in a limited termination right. The term does not depend on the performance of a corporation or the individual executive, and legal violations as cause are limited by definition. Stock price is often more directly related to compensation than the termination of the employment agreement.

PROF. SONNENFELD: By the way, I was going to congratulate you on having so efficiently captured the notion of the nobility of so many board directors stepping in there, until you went down that Disney path. You of course know more than I, but I have opinions anyway. I actually love the way you phrased it, Gary. You said it much more eloquently than I would have.

JUDGE SPORKIN: Any more questions?

Yes, there's a gentleman in the rear.

QUESTION: I worked at Citibank for twenty years before it lost its ethical balance. I'd like to just share an anecdote with you.

About thirty years ago, Citibank bought a large German bank, and we really, I must say, didn't know all we should have when we bought the bank. But it turned out that in order to put somebody on the board of supervisors, that person had to take personal financial responsibility for any bank failure.

The lawyers searched around and searched around, and if the bank guaranteed it, then it violated the rule. It was only when a very, very competent and very self-confident manager at the bank said, "I'll step up and do it and I'll take the responsibility," that we were able to put somebody on. I remember the anecdote. It's very funny.

I just want to make a very quick observation. When discussions of compensation come up, somehow we never talk about the real driving function behind compensation, which is earnings. We are obviously manic about earnings.

Now, it's a little bit out of the box, but maybe our current definition of earnings is a little out of date. We define earnings almost the way you would define how much a candy store makes. But we don't take into account all of the other factors that a corporation deals with as part of our society. It's a little bit out of the box, but —

PROF. SONNENFELD: No. A lot of the things that should come out of even Goldman Sachs, and JP Morgan and others now, at least have multiyear clawbacks and things, so that if the performance fails — I know you were talking about much more in terms of social impact, community, and the rest, but at least in terms of sustained performance after they get their cash, that can be recovered if the place fails afterwards, if the deals collapse afterwards. These are some major voluntary changes that even Wall Street has been bringing in. So you're right, I think it was too narrowly focused on the short term.

QUESTIONER: I just want to make one more observation about how accounting is not keeping up with where we are. It has been observed that when Microsoft calculates its assets, those assets are the buildings and computers that it owns. Well, those are the least important assets in the company. We have walked away from dealing with the problem of real assets, which is the knowledge base they have put together. That is just an example of where perhaps it is the accountants that are failing us right now.

PROF. SONNENFELD: Well, if the accountants took on this panel with me off of it, they would depreciate by age, and wouldn't that be a mistake?

JUDGE SPORKIN: Any further questions we have? Have we spent our time? Are we over our time?

VOICE: We’re over.

JUDGE SPORKIN: Well, thank you for coming.