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The Hampel Committee Report: A Transatlantic Critique

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To an American observer, the activities of the Cadbury, Greenbury and Hampel Committees are impressive, if only because so few lawyers seem to be involved. Unlike the US, where improvements in corporate governance can usually be traced to legislation or litigation, British efforts at self-governance offer an attractive, alternative model. The Hampel Report is disappointing, however, in three respects: the report lacks concrete models; its reliance on the AGM as a mechanism of reform is misplaced; and its failure to recognise internal monitoring programmes as an essential element of good corporate governance is shortsighted.

Introduction

As an American, I have observed with considerable awe and respect the resources that have been devoted to improving corporate governance in Britain. Since the creation of PRO-

NED in the 1980s, some of the most interesting innovations in this area seem to have come from Britain. In addition, the process by which British businesses have addressed the problems of governance have a singularly appealing character.

Let me be more specific. While in the United States most improvements in corporate governance have arisen in response to the actions of lawyers, in Britain, it seems, improvements in corporate governance have arisen largely because business leaders have tried to address business problems by employing a businesslike approach: (1) identify the problem; (2) gather information from all available sources; (3) consider possible solutions; (4) set a course of action; and (5) implement the programme. The motivation behind these actions may well have been to avoid more regulation by the state. But the process of corporate-governance reform in Britain seems very different from, and more sensible than, the lawyer-driven approach to corporate governance we have become accustomed to in the US.

The composition of the Cadbury Committee, for example, was remarkable to me in its variety and the degree of power it represented. The same applies to the Greenbury and Hampel Committees.[1] The *sponsorship* of these committees was itself a revelation. To bring together the resources of the Stock Exchange, the CBI, the Institute of Directors, leading institutional investors and accountants—all for the purpose of trying to improve the quality of corporate governance and accountability—makes a statement of shared commitment that would be unimaginable—though probably quite desirable—in the United States.[2] We seem instead to have entrusted most of our corporate-governance discussions to the membership of the American Law Institute.[3]

Though I am a member of the ALI, I don't believe that lawyers (or judges or even legal scholars) are necessarily the greatest source of wisdom into how to make complex enterprises work well, prosper and grow, and generate wealth for all concerned. Certainly, devising corporate-governance rules as a product of contentious, high-stakes litigation, as has occurred repeatedly in the US,[4] is not the ideal scenario for nuanced, careful thinking on the issue. Thus, the inclusive, proactive approach that I have observed in Britain seems to me far preferable to the American model.

A related phenomenon is the apparent belief among UK business leaders that self-regulation—frequently the resort of those about to be regulated—may actually work. This belief may, of course, be a function of the power of the parties who have leant their support to, and the broad consultative process that goes into, the creation of a self-governance programme. But my experience in America is that blue-ribbon panels—however distinguished—and codes of best practices—however carefully designed—seldom generate behavioural change in a consistent, dependable way. Rather, whatever true reform in American corporate-governance practices has come about in the last 20 years has occurred because: (1) the Securities and Exchange Commission has required that the change occur;[5] (2) the Delaware Supreme Court has ruled that failure to make such a change may expose directors to personal liability;[6] (3) a United States federal district court has either required or prohibited specific governance behaviour (typically related to disclosure);[7] (4) the company in question has been castigated by the very aggressive American business press for failing to make the change;[8] or (5) a core group of independent directors has forced the change over the objection of company managers.[9] The motivation for change has typically been fear or shame. Aspirational notions of simply trying to do things better seldom are part of the mix.

Stated another way, the processes by which American public companies (slowly) came to have a majority of outside directors on their boards; by which the nominating process for new directors (slowly) migrated from exclusive CEO control to shared control with outside directors; by which serious intervention into the management of poorly performing companies—including removal of the CEO and other top executives—(slowly) became a real option for thoughtful, proactive boards of directors; or by which the value of designating a lead director (if not in fact dividing the roles of chairman and chief executive) (slowly) is becoming recognised by American public companies—all can be traced either to a fear of litigation or fear of an exposé in the *Wall Street Journal*, not to any organised effort at self-regulation.[10]

1 One thing that did strike me, of course, was the fact that all three of these committees were comprised exclusively of men. It surprised me that no one could identify even a single woman of sufficient professional credentials—either in the business or academic worlds—to merit an appointment to any of these committees.

2 The closest we have come in the US to this kind of shared commitment to improved corporate governance is the project undertaken by the Working Group on Corporate Governance, comprised of three corporate executives (all lawyers), two prominent attorneys in private practice and three representatives of institutional investors. See 'A New Compact for Owners and Directors' (1991) 141 *Harvard Business Review*, July/August.

3 The ALI is comprised of 3,000 or so lawyers, judges and law professors and was the sponsor of the Principles of Corporate Governance project, completed in 1992.

4 See, eg, *Unocal Corp v Mesa Petroleum Co* 493 A 2d 946 (Del 1985) (holding that a board may invoke defence mechanisms in the face of a hostile takeover bid, but only so long as the defence is proportionate to the threat posed); *Revlon Inc v MacAndrews & Forbes Holdings Inc* 506 A 2d 173 (Del 1986) (holding that, at some point, a board must terminate its efforts to avoid a takeover and put the company up for auction); *Paramount Communications Inc v Time Inc* 571 A 2d 1140 (Del 1989) (holding that a company confronted with a cash takeover bid may resist that bid, if directors can point to a long-term business plan that they believe presents a better opportunity for the company); *Paramount Communications Inc v QVC Network Inc* 637 A 2d 34 (Del 1994) (holding that when a company undertakes a transaction leading to a change in corporate control, the directors' obligation is to obtain the best value reasonably available to the stockholders).

5 See, eg, SEC Exchange Act Release 34-31327 (Executive Compensation Disclosure) (1992) (describing in detail how executive compensation decisions are to be communicated to shareholders).

6 See, eg, *Smith v van Gorkom* 488 A 2d 858 (Del 1985) (holding that directors may be held personally liable if they fail to devote adequate time to determining the fair price for a sale of the company); *Re Caremark International Inc Derivative Litigation* 698 A 2d 959 (Del Ch 1996) (holding that directors may be held personally liable for failure to ensure that an appropriate information and reporting system is in place within the company).

7 See, eg, *Irving Bank Corp v Bank of New York Co Inc* 692 F Supp 163 (SDNY 1988) (tender offeror prohibited from going forward, unless substantial additional disclosure is provided by means of a supplemental prospectus); *American Carriers Inc v Baytree Investors Inc* 685 F Supp 800 (D Kan 1988) (same); and *Kaufman v Cooper Companies Inc* 719 F Supp 174 (SDNY 1989) (annual meeting is enjoined and all proxies voided, so that both parties to a proxy contest may provide accurate disclosure to shareholders).

8 See, eg, John A Byrne, 'The Best and Worst Boards' (1997) 90 *Business Week*, 8 December (identifying and discussing companies with the worst corporate-governance scores—this is an annual exercise).

9 See, eg, Robert AG Monks and Nell Minow, *Corporate Governance* (1995), 360–8 (describing the 'palace coup' by non-executive directors at General Motors Corp in 1992).

10 Even with all this progress, 'it is safe to say that American boards today are still only marginally more effective than they were ten years ago. On a scale of 1 to 10, they may collectively have moved from, say 2 or 3 to maybe 4 or 5. So there is plenty of scope for significant further improvement.' Robert AG Monks and Nell Minow, *Watching the Watchers: Corporate Governance*

Similarly, the improvements that have occurred in the setting of executive compensation in the United States have been energised, in turn, by (1) intense press scrutiny of overpaid executives;[11] (2) a directive by the SEC requiring detailed annual disclosure of the compensation paid to directors and the five most highly paid executives of each public company;[12] and (3) legislation by the US Congress, withholding the corporate tax deduction for any compensation paid in excess of $1m, unless that compensation is 'performance based'.[13] American financial disclosure requirements are imposed by legislation and monitored carefully by the SEC.

By contrast, substantial progress has been achieved in Britain in several areas of corporate-governance practice just since the publication of the Cadbury Report in 1992, without the intervention of the government and (apparently) without the threat of litigation. The Report on Compliance with the [Cadbury Committee's] Code of Best Practice[14] details measurable improvements by listed companies in the nominating process, the determination of executive compensation and the identification of lead directors. According to the *Financial Times*, there have been other 'clear changes for the better in UK corporate-governance practices' since Cadbury.[15] I take these changes to include better financial controls, better communications with shareholders and a more thoughtful approach to corporate-governance issues generally.

This is a remarkable record of progress in a very short period of time and is all the more remarkable in light of the fact that British investors lack two of the 'big sticks' which are available in the United States to reinforce shareholder demands: the shareholder class action lawsuit; and auditor liability to third parties. Without those tools (both of which have been criticised and both of which recently have been curtailed in the United States),[16] many of the corporate-governance reforms Americans now look to as models, simply would not have come about. Without the further 'big stick' of the SEC (and judges who enforce its rules), the current high quality of disclosure in the United States—financial disclosure generally and disclosure of executive compensation specifically—would never have been achieved.

Thus, to see British business leaders pursuing these objectives voluntarily—or at least to be moving in the right direction—is impressive and seems almost Victorian in its uprightness. Though some may doubt the sincerity of these efforts,[17] few can doubt that the Cadbury Report was bold, clear-headed and shrewd in its approach to shaping corporate behaviour; that the Greenbury Report tackled an issue that many would have preferred to leave unexamined and issued a code of best practices that was both sensible and exacting; and that the Hampel Committee Report, though less innovative than the other two, has moved the discussion forward and promises to consolidate in one place the current understanding of achievable corporate-governance practices.

A third impressive feature of the UK's recent corporate-governance activities, from my perspective, has been the refusal of all three committees to be lured too deeply into the 'other constituencies' debate. This debate, of course, has been going on for decades.[18] It surfaces periodically, especially when a constituency wants to advance its position. Sometimes the agitator is a consumer group;[19] sometimes it is an employee group;[20] sometimes, as in the case of environmental grievances, it is a more broadly based group. These groups almost always have a valid claim against a particular company or industry. None has ever yet, however, presented a claim sufficient to persuade policy-makers either in Britain or the United States that the profit-maximising norms of classic corporate law should be amended in its favour.[21] Therefore, it would not have been a productive use of these committees' resources to trudge down the 'other constituencies' road again.[22]

In a nutshell, then, the Cadbury, Greenbury and Hampel Committees all appear to have done an impressive job of keeping focused on the most important issues surrounding corporate-governance concerns: (1) identifying those practices that help boards of directors function and lead most effectively; (2) encouraging useful communications with investors and the public; and (3) empowering (and admonishing) all of the company's constituents to play the role they are best suited to play in the complex task of stimulating corporate growth and performance. They have done so with alacrity,[23] and produced three high-quality work products. I question some of the results, however, and it is to these areas that I now turn.

Focusing on the Hampel Committee Report, three specific items captured my attention: (1) the Committee's failure to provide models for the behaviour they prescribe; (2) the Committee's professed belief that any significant change can be accomplished in the context of the AGM; and (3) the Committee's failure of nerve in recognising that in-house compliance programmes can provide important support for the board's monitoring role, but declining to recommend that every public company adopt such a programme, specifically tailored to its needs.

for the 21st Century (1996), 295.

11 See, eg, John A Byrne, 'That Eye-Popping Executive Pay: Is Anybody Worth This Much?' (1994) *Business Week*, 25 April at 52; James W Michaels, 'Should Anyone Earn $25,000 a Day?' (1992) *Forbes*, 25 May; Shawn Tully, 'What CEOs Really Make' (1992) *Fortune*, 15 June; Dana Wechsler, 'Would Adam Smith Pay Them So Much?' (1990) *Forbes*, 28 May.

12 See note 5 *above*.

13 Internal Revenue Code, s 162(m).

14 24 May 1995.

15 Editorial, 'Governance' *Financial Times*, 29 January 1998.

16 The Private Securities Litigation Reform Act of 1995 significantly raised the requirements for shareholders wishing to sue companies for disclosure violations in federal courts. A decision by the United States Supreme Court in 1994 held that shareholders cannot employ an aiding-and-abetting theory to sue companies' auditors in federal courts.

17 See Robert Bruce, 'Hampel Offers Up a Big Serving of Fudge' *The Times*, 5 February 1998.

18 See, eg, AA Berle, Jr, 'Corporate Powers as Powers in Trust' (1931) 44 *Harvard Law Review* 1049; E Merrick Dodd, Jr, 'For Whom Are Corporate Managers Trustees?' (1932) 45 *Harvard Law Review* 1145; AA Berle, Jr, 'For Whom Corporate Managers Are Trustees' (1932) 45 *Harvard Law Review* 1365; and E Merrick Dodd, Jr, 'Is Effective Enforcement of the Fiduciary Duties of Corporate Managers Practicable?' (1935) 2 *University of Chicago Law Review* 194.

19 See, eg, Ralph Nader, *Taming the Giant Corporation* (1976); and Ralph Nader, *The Consumer and Corporate Accountability* (1973).

20 See, eg, *Your Stake at Work: TUC Proposals for a Stakeholder Economy* (1996), 23–4 (proposing that company law be amended to include required compliance with both the Cadbury and Greenbury Codes and also proposing that directors' duties should include specific obligations to stakeholders other than shareholders).

21 The 'other constituency' statutes that have been passed in the United States do not alter the primary objective of profit-maximisation. They simply give express permission for (and in the state of Connecticut require) boards to consider the interests of other stakeholders when considering strategic options. Section 309 of the Companies Act, dealing with employees, similarly does not alter a company's primary duty to its shareholders.

22 I understand the Labour government has been giving serious thought as to how an other-constituencies perspective might be implemented. See 'Beckett Urges Modernisation of Company Law' *Financial Times*, 5 March 1998. One should feel greatly comforted that the government is approaching this question with caution.

23 By contrast, the ALI Principles of Corporate Governance project took 14

Modelling good behaviour

When it comes to disclosure, American companies have little doubt about what information they are obliged to deliver, and how they are supposed to deliver it. The SEC has set out in meticulous detail both the content and format for disclosures relating to directors' past history and current activities, conflicts of interest, legal and financial entanglements, attendance at meetings, committee assignments, etc.[24] It also prescribes very specifically the way in which executive compensation is to be disclosed,[25] the way in which a company's short-term and long-term financial performance in relation to its competitors is to be disclosed,[26] the items to be addressed in the management's discussion and analysis of the past year's performance and future prospects,[27] and a number of other items that are identified as important in the Hampel Committee Report. There is nothing magical about the SEC-imposed model, and I am not suggesting that Hampel failed by not embracing that particular model or any other. But giving company executives a clearer idea of what good behaviour and good disclosure look like *in detail*—where possible by using excerpts from recent company reports but where no 'real' models yet exist, by creating simulated examples in several alternative formats—would have made the Hampel Committee report more immediately useable by those at whom it was aimed.[28]

Reliance on the AGM as a mechanism of true accountability

In most American companies—and most British ones, too, I suspect—the annual shareholders' meeting is a mostly scripted event full of self-congratulation, promises for the future, gratitude to those present and assurances that the management team is vigilant and forward-thinking. Only rarely—if ever—does the meeting have a measurable impact on the operations of the company or on the company's constituents.

Occasionally, a meeting erupts into spectacle, with a handful of critics seeking to commandeer the proceedings, complaining about how much money the executives are making, or hurling demands for the CEO's immediate resignation. This is not an ideal way to ensure that best practices are achieved.

Some reformers have advocated making more out of the AGM, to include consideration of detailed budgets and a line-by-line review of the preceding year's performance.[29] Others advocate turning the AGM into a truly 'public occasion' with debates featuring 'chosen representatives of the workers, consumers and the community'.[30] My suggestion is just the opposite—that shareholders' meetings as we know them should be abolished, except where some threshold number of investors—say 12–20 percent of the total—is in agreement that a meeting is necessary and appropriate.[31] The threshold could easily be met by institutional investors, and it would not be impossible even for private investors to initiate the process, especially when the issues involved are significant. This proposal would save a lot of time on pageantry; it would also make such meetings as occur truly useful ones, for which investors and their advisors would carefully prepare and at which serious performance-related issues (however 'performance' may be defined) could be examined in depth. Merely the convening of a meeting would be a noteworthy event and would signal a level of concern about a company that would command the management's attention.

I recognise the idea of abandoning the in-person AGM may reflect a cultural difference between our countries.[32] In the United States, much of the hard work of *corrective* corporate governance (which is usually what shareholders are concerned about) now often takes place in closed rooms, where institutional investors—alone or in groups—meet with uncomfortable top executives and ask them very pointed, very specific questions.[33]

Often this work takes place very publicly, too—when institutional investors publish lists of underperforming targets for their activities, when there are 'leaks' of discussions aimed at identifying and correcting a company's biggest problems, and (sometimes especially) when the business press becomes involved and prints its own critiques of a company's strategic choices, the management's claims of progress or even individuals' management styles.

My point is that, in a highly developed economy, there are far more effective ways to monitor and correct executive behaviour—whether it be shirking, self-dealing, lack of vision or incompetence—than to entrust these important issues to the psychodrama of the AGM. For the Hampel Committee to have given so much credibility to the AGM, therefore, was surprising. For the Committee to state expressly that its intention was to make the AGM 'a more meaningful and interesting occasion for [the] participants'[34] and to avoid stifling 'debate'[35] was especially disappointing.

It may be that concerns about the Insider Dealing Act—or simply inertia—deters institutions in Britain from playing a significant behind-the-scenes role in corporate oversight.[36] Or that companies are not yet comfortable in providing

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years (from 1978 to 1992) to complete.

24 Regulation S-K, items 401 and 404.

25 *Ibid*, item 402.

26 *Ibid*, item 201.

27 *Ibid*, item 303.

28 I understand that there exists a Stock Exchange and Chartered Accountants Annual Award for Published Accounts. While this is a laudable exercise, it does not include circulation to listed companies of the 'winning' reports. More importantly, the criteria for winning entries gives only sparse guidance on the way in which corporate-governance issues should be treated ('good disclosure on corporate governance' is required).

29 Godfrey Rehaag, *The Limited Company: Replacing the Victorian Steam Engine* (1994), 53–4. Rehaag would have the assembled body consider whether the company had achieved its goals regarding 'improving quality, reducing staff turnover, increasing productivity ... even reducing the corporation's environmental footprint'.

30 DG Goyder, *The Just Enterprise* (1987), 77–9.

31 In those years when actual meetings are not convened, routine matters requiring shareholder votes would be handled exclusively by proxy voting.

32 I understand, for example, that at a recent AGM of British Gas more than 5,000 shareholders showed up. That kind of turnout is unheard of in the United States, though some shareholders' meetings do draw several hundred participants. Often these meetings draw demonstrators and picketers, too.

33 Recent studies show that the collective result of these activities, known as the 'CalPERS effect', has been significantly to enhance investment returns. Constance E Bagley and Richard H Koppes, 'Leader of the Pack: A Proposal for Disclosure of Board Leadership Structure' (1997) 34 *San Diego Law Review* 149, note 9 and accompanying text.

34 Hampel Committee Report, para 5.13.

35 *Ibid*, para 5.14.

36 John Plender makes the case that British institutions, with a handful of exceptions, have (at worst) been disinterested and (at best) been ineffective in their behind-the-scenes dealings with British plcs: John Plender, *A Stake in the Future* (1997), 134–7. Professor Stapledon paints a somewhat richer picture of some institutions' behind-the-scenes influence, especially in their dealings with non-executive directors: GP Stapledon, *Institutional Shareholders and Corporate Governance* (1996), 77–8, 120–9 and 146–9.

access to investors to explore their concerns.[37] If that is the case, then investors—both large and small—may feel that they have no other option than to use the AGM to make their points. (Also, the AGM unquestionably provides an opportunity for investors seeking publicity to command the press's attention, and they may value this attention more than they value real change.)

Either way, the next step in corporate governance, it seems to me, will be to recognise the AGM for what it is—an artefact of the days when companies at best had a handful of owners. The AGM provides an illusion of participatory democracy that really makes little sense in today's more complex world.

Looking to in-house compliance programmes as an essential feature of effective corporate governance

The Hampel Committee Report in its section on internal controls wisely notes that good corporate governance goes beyond the boundaries of the Cadbury Committee's recommendations. Ensuring that adequate *financial* controls are in place is only a first step in building a truly successful, accountable company. As the Hampel Report recognises, internal controls must also extend to 'controls to ensure effective and efficient operations and compliance with laws and regulations'.[38] That being said, however, the Report then declines to include the creation of internal monitoring programmes (or even a modest internal audit function) in its menu of recommended company best practices.[39] That choice may prove to be a costly mistake.

In the United States, in-house monitoring programmes have been designed primarily to avert serious failures of compliance with the law. They also, however, have profound implications for the protection of investors and other corporate constituencies. For this reason, the Delaware Chancery Court recently held that where there is a significant risk (based on past experience, recent practices or otherwise) that a company will violate the law (environmental regulations, for example) or engage in fraud (for example, in government contracting)—either of which can result in gargantuan losses to the shareholders—a board of directors has an obligation to ensure that the company employs information and reporting systems that will detect and deter these problems, including a mechanism to get information about noncompliance *directly into the hands of the board*.[40] '[F]ailure to do so under some circumstances may, in theory at least, render a director liable for losses caused by non-compliance with applicable legal standards.'[41]

It may be that British companies haven't faced the kinds of huge fines and damage awards that American companies have faced in recent years[42] and that the risk of exposure of this sort seems remote. (It may also be that a reasonable scepticism about the utility of internal monitoring programmes prevails. It is true that vast resources might be spent in perfecting a compliance programme that turns out not to detect those practices that put a company in peril. It is also true that compliance professionals—like other staff professionals—may seek to build their empires by stressing the urgency of their task, while contributing little to the bottom line.)

Nevertheless, a well-designed internal monitoring programme can be central not only to avoiding criminal and civil liability, but also to averting insolvency. Internal audit programmes and other compliance programmes (including those designed to monitor compliance with a company's or industry's ethical guidelines) provide an important mechanism for ensuring that companies are spending their money wisely, conducting their business legally and participating in the marketplace in a manner designed to achieve responsible, long-term success.

Thus, for the Hampel Committee to minimise the importance of internal monitoring programmes and to say that 'directors and management must always have the main responsibility for an effective system of controls',[43] without noting that any such system will require human and financial resources, leadership, influence and access to the board to be truly effective, reflects more confidence in directors' abilities than is prudent.

The irony of corporate governance is that corporate managers and their boards constantly have to navigate between underperformance (due to timidity and mismanagement) and overperformance (due to fraud and overreaching). The Hampel Report suggests that sometimes directors are so concerned about avoiding the latter that they fail to devote sufficient energies to avoiding the former.[44] The Committee may be right, of course, but its failure to give adequate emphasis to the need for internal monitoring—tailored to a company's unique situation—seems extremely shortsighted to me.

Three other issues referred to in the Hampel Committee Report have generated some vocal criticism: (1) the question of which outside directors ought to be considered 'independent' and who is to decide in close cases; (2) the question whether institutional investors should be required to participate in voting; and (3) the question whether shareholders ought to be empowered to vote on individual compensation packages.

The question of independence

On the first question, regarding independence, one response would be to suggest that the answer is unimportant. A recent study of US companies found that the presence of independent directors on a board 'has no consistent effect on market-adjusted stock price performance'.[45] A more constructive response would be to concede that no definition will cover every situation and that traditional measures of independence (lack of a paid relationship to the company, for example, or manner of selection) cannot capture those situations where even those directors who appear to be independent may not be because of social ties, a desire to be a team player

37 In the United States, every public company has a shareholder-relations function that is designed to respond to shareholder inquiries, to facilitate meetings with institutional investors and generally to make sure that the company's investors feel that their concerns are being attended to. A good description of both the reactive and proactive practices of shareholder-relations professionals appears in Michael Useem, *Executive Defence: Shareholder Power and Corporate Reorganization* (1993), 131–6.

38 Hampel Committee Report, para 6.13.

39 *Ibid*, para 6.14.

40 *Re Caremark International Inc Derivative Litigation* 698 A 2d 959 (1996).

41 *Ibid* at 970.

42 The *Caremark* case arose out of criminal proceedings in which the company was fined $250m for multiple acts of Medicare fraud. The shareholders sought to recover some or all of these losses from Caremark's directors, alleging failure of oversight. In 1996, Archer Daniels Midland Co (ADM) was fined $100m for US antitrust violations. Shareholders recently settled a derivative suit against ADM's directors, employing a similar theory, for $8m.

43 Hampel Committee Report, para 6.15.

44 *Ibid*, para 3.7.

45 Sanjai Bhagat and Bernard Black, 'Do Independent Directors Matter?' (Columbia University Working Paper). Two American companies most often attacked for their boards' lack of independence, Walt Disney Co and HJ Heinz Co, have each been top performers in recent years.

or simple passivity.

The Hampel Report is correct in suggesting that it is probably not practicable to lay down a precise definition of 'independence'.[46] A number of American groups have attempted to do so, as did the Cadbury Committee and, more recently, PIRC. And while this exercise may be useful as a guideline, trying to distinguish between directors who are or are not 'independent'—in order to meet some arbitrary goal—misses the point.[47] What a company wants is a *good* director—one who does her homework, asks penetrating questions and provides real leadership both in moving the company forward and in keeping it out of trouble. The obsession—on both sides of the Atlantic—with further categorisation is not, frankly, all that productive.[48] What is productive is ensuring that outside directors are carefully selected, well-trained, provided with staff when necessary, well-counseled by their lawyers, evaluated periodically for effectiveness by their colleagues, open to dialogue with institutional investors, compensated in a manner designed to stimulate strong long-term performance and replaced when they become complacent. Hampel made most of these points.

Compulsory voting for institutions

On the question of whether institutional investors should be required to vote, I am comfortable—based on the American experience—in suggesting that the answer should be 'yes', at least for those institutions that hold their shares as fiduciaries for others.[49] I am further comfortable in suggesting that institutions holding shares in a fiduciary capacity should devise voting principles on recurring issues that can be provided upon demand to the institution's beneficiaries. The US teachers' pension fund, TIAA-CREF, provides one excellent example of a voting policy[50] but there are also many others that one could look to as a model. There are two reasons for such policies—one is transparency; the other is cost containment.

When American pension fund managers first came to appreciate, in the mid-1980s, that they were expected to exercise their proxy-voting powers, the learning curve at first was admittedly steep. Now, proxy voting has become quite manageable—certainly there is little difficulty in voting on the routine matters that come up every year. Voting policies minimise the cost of making decisions on most other issues and cost-sharing (*via* the use of consultancies) is available for responding to truly unique situations. Compulsory voting, should it be enacted in Britain, is nothing to be feared.

Voting on remuneration

The final question—regarding shareholder ratification of executives' compensation awards—is the least problematic for me. In the US, companies must submit to their shareholders the names of individual nominees for each directorial vacancy and certain proposals advanced by shareholders. If an executive compensation plan requires shareholder approval (a determination based primarily on the regulations of the Internal Revenue Service defining which plans are entitled to preferable tax treatment), detailed information must be supplied (including information about the impact of the plan on the five most highly paid executives and on others—like NEDs—by category).[51] It is not true, however, as some critics believe, that American investors pass judgment on each top executive's paycheque, or on the annual overall compensation package for directors and officers as a group. Only stock-based compensation plans may be subject to shareholder approval, and not all such plans are.

In other words, in spite of the impenetrable, densely worded resolutions that periodically appear on American proxy solicitations seeking approval for specific incentive compensation plans, there is no 'heckler's veto' for a company's yearly compensation figures, nor should there be. At least four arguments support this position: (1) shareholder disapproval of executive compensation awards could lead to unwanted discontinuities and disruption of valuable leadership; (2) the costs of compensation would likely go up under such a regime, rather than down; (3) the need to monitor compensation issues in detail (that is, executive-by-executive) would increase the burden assumed by institutions, with no compensating benefit; and (4) most shareholders would vote without adequate information, and their own self-interest (untempered by any fiduciary obligation to others) may give rise to destructive opportunism.

Requiring shareholder approval of a company's annual compensation package is, moreover, unnecessary. When a company's performance and its directors' compensation are significantly out of alignment, it is usually pretty obvious and that is the time for action, whether it be a 'just-say-no' vote against the directors, back-room negotiating by institutions and others, criticisms by the business press, or some combination of all three. To involve shareholders in the routine compensation decisions of every public company every year—regardless of that company's or its executives' performance—would be inefficient, costly and unwise.

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46 Hampel Committee Report, para 3.9.

47 The US Business Roundtable shares this view. In its Statement on Corporate Governance, issued in August 1997, the Roundtable argued that independence should be judged with respect to each director's circumstances, rather than through the 'mechanical application of rigid criteria'.

48 I concede that the situations in Britain and the US are quite different as regards the impact of outside directors. The most recent study of American boards of directors indicates that the average board is now made up of two inside directors and nine outside directors: *Korn/Ferry International 24th Annual Board of Directors Study* (1997). In these circumstances, the question of who is truly 'independent' may be less urgent than when the proportion of non-executive directors is much lower.

49 Of course an institutional shareholder, like any shareholder, should be permitted to abstain where, in the shareholder's considered judgment, that is the proper course of action. Confidential voting is useful in minimising abstentions.

50 The policy provides, *inter alia*, that TIAA-CREF will vote in favour of resolutions proposing confidential voting, against resolutions to create multiple classes of stock with disparate voting rights, in favour of 'fair price' provisions that preclude selective stock repurchases, against proposals that would impose any super-majority voting requirements and against proposed actions that would serve to eliminate shareholders' appraisal rights. See 'Excerpts from the TIAA-CREF Policy Statement on Corporate Governance' (1994) *Corporate Governance Advisor*, May/June; 'TIAA-CREF Guidelines for Voting Proxies on Executive Compensation' (1994) *Corporate Governance Advisor*, September/October.

51 SEC Exchange Act, Sched 14A, item 10.