

## Chapter 1

# THE CHANGING WORLD OF BOARD GOVERNANCE

## *How We Got Here*

### What's in This Chapter?

- How and Why Boards Have Changed
- A Barometer for CEO Compensation
- Why Pay Ratios Have Changed Radically
- A Board Governance Tipping Point
- Impact of the 2008 Financial Meltdown
- Chapter Summary and What's Next

One of the principle tenets of our consulting work is that every board is operationally and culturally unique. It is this simple fact that makes constructing a single, all-inclusive set of board governance best practices an impossible task. Therefore, the guidance in this book is not positioned as a set of “hard and fast” rules or universally applied “must have” characteristics. Rather, the guidance is based on a flexible framework approach that allows boards to meet their fiduciary and governance duties while remaining

responsive to the real cultural dynamics that directly influence the quality and consistency of decision making.

A framework approach also has a second advantage: it allows boards to respond appropriately to an ever-changing external socio-economic and political landscape. This is an important point, since society's swiftly moving cultural currents, along with the ebb and flow of an economy's strength, has a profound impact on the performance expectations of corporate boards. Of course, this is no grand revelation to anyone reading this book, but we believe these concepts are important to keep in mind as context for the board governance recommendations made in the pages that follow.

## **HOW AND WHY BOARDS HAVE CHANGED**

If you were asked to make a list of the most important game-changing events or trends that have profoundly impacted the U.S. economy and culture in the last sixty-five years, the list that you would make would likely include at least the following:

- A move away from a manufacturing economy to a service economy following decades of dominance in the post-Second World War global economy.
- Improvements in automation and the manufacturing process of the 1970s and 1980s. It was a trend that further undermined the manufacturing sector over the years as computer-driven machinery and tools (robotics, CAD-CAM design tools, etc.) replaced individual workers. Global competition also slowly eroded the U.S. manufacturing base as more and more manufacturing jobs moved to countries outside U.S. borders with lower labor costs.
- The diminishing influence and power of organized labor's ability to guarantee members a lifetime of a steady, living wage and a fully funded, secure pension upon retirement.
- The "creative destruction" of industries in the 1980s brought about by the world of leveraged buyouts and a ruthless cadre of "corporate raiders" who broke up many marquee old-line companies and sold off the divisions to score huge profits for themselves.

- The dot-com bubble that began its rise in the early 1990s and continued throughout the decade until it popped, to a devastating effect, in 2001. Investment strategy at the time was a race toward unrealistic valuation. Investors were willing to fund nearly any technological start-up venture even if it lacked a viable business plan. It is interesting to note that this investment setback did little to cloud the financial community's continued unrealistic economic outlook. In fact, this unsound enthusiasm in the marketplace was encouraged in large part by favorable economic policies of the federal government, supported by a period of low inflation due largely to lower cost of goods from China and a continuing worldwide technological revolution.
- The impact of blatant corporate malfeasance in 2001, exemplified by three highly visible corporations at the time: WorldCom, Enron, and Tyco. It was a revelation that rocked both the investment community and individual stockholders. Again, high-flying investors and shareholders lost millions of dollars when these companies declared bankruptcy (Enron Corporation declared bankruptcy in December of 2001), a singular action that further exposed an underbelly of lies and deceit that had pervaded these organizations at the very top and eventually put thousands of ordinary workers out on the street without jobs or their life savings.
- Finally, the 2008 huge financial meltdown and the economic panic that followed. It was a time of fear and shock as we watched once powerful brokerage houses as well as large banks and old-line industrial giants teeter on the brink of declaring bankruptcy. It took massive, last-minute, stopgap federal cash infusions to save the world's economy and to shore up institutions that were deemed "too big to fail."

## **WHY THESE EVENTS ARE IMPORTANT**

The reason for noting these historical and societal events is twofold. First, it demonstrates how past events impact the current expectations placed on corporate boards; and second, it establishes the contextual "waters" for the operational strategies, policies, and



**Figure 1.1** History of CEO Pay

Source: Peter Browning Partners

procedures that most boards follow today. This chapter will focus on two specific trends that grew out of these economic and social gyrations:

- Ever-increasing chief executive officer (CEO) compensation (see Figure 1.1).
- The impact of a 2002 change to the New York Stock Exchange (NYSE) Listed Company Manual that required “non-management directors to meet at regularly scheduled executive sessions without management.” While this change to the NYSE Listed Company Manual (303A.03) occurred during the same time period as the passage of the 2002 Sarbanes-Oxley Act (Congress’s response to public outrage over Enron’s corporate malfeasance and greed), the fact that the two actions occurred at the same time is a coincidence of timing. The fact is, as important as the Sarbanes-Oxley legislation has been to curbing illegal corporate activities, we would argue that the NYSE Listed Company Manual change has ultimately produced the most far-reaching impact on board governance, performance, and effectiveness.

## **A BAROMETER FOR CEO COMPENSATION**

According to Carola Frydman and Raven E. Saks, authors of “Historical Trends in Executive Compensation 1936–2003,” CEO compensation experienced three distinct phases over the last seventy-five years: World War II, the mid-1940s to the 1970s, and the 1980s through the 1990s.<sup>1</sup>

Prior to World War II, the median executive compensation was about fifty-six times higher than average wages, although CEO compensation did decline sharply during World War II. After the war the U.S. economy experienced a period of unfettered growth and development. This expansion created a rapidly growing middle class that was confident about lifelong careers with the same company, steadily rising wages, and opportunities for career advancement. All of this confidence brought with it a predictable stream of disposable cash to buy American products.

Interestingly, executive salaries during this period of expansion remained relatively low and, in fact, slowly fell until 1970, when they reached a low point of twenty-five times average wages. During this period organizations promoted their most senior and capable executives to the CEO spot and then compensated them with a salary, cash bonuses, and limited stock options. As a rule, these groomed CEOs kept their jobs until retirement.

### **Global Competition Brings Change**

Global competition in the 1970s imposed new economic pressures on corporate America. Nations previously ravaged by war, especially Japan, took full advantage of industrial redevelopment support from the United States. Soon these countries began to compete directly with their benefactor, especially in the car and consumer electronics markets. This competition resulted in the closing of many U.S. manufacturing plants, and once thriving towns, cities, and communities, and even whole regions, were economically decimated. All of this upheaval and uncertainty in the manufacturing sector from mid-1970 to the end of the 1980s resulted in a 2,000 percent increase in merger and acquisition activity (as compared to previous years) as companies struggled to

keep control of their organizations and to avoid the ravages of a hostile corporate takeover (Gladwell, 2009).<sup>2</sup>

## **The Impact of Strategic Planning**

Beginning in the early 1980s, CEO compensation policy began to radically change as U.S. corporations switched their focus to long-term strategic planning models and away from more traditional, short-term business planning approaches. This was a change in thinking that directly impacted corporate board management and its priorities.

A key proponent of this long-term strategic planning approach was Bruce Doolin Henderson, who in 1963 founded the Boston Consulting Group. Corporate leaders, including General Electric's CEO Jack Welch, became disciples of the approach in the early 1980s, as did many university business schools and scores of consultants who were eager for the business opportunity created by Henderson's ideas.

In his 2010 book, *The Lords of Strategy: The Secret Intellectual History of the New Corporate World*, which is about Henderson's influence on business practices worldwide, author Walter Kiechel notes that Henderson literally "changed the world." "Few people," Kiechel says, "have had as much impact on international business in the second half of the twentieth century." (A complete account of this industry-changing consulting group can be found in *The Lords of Strategy: The Secret Intellectual History of the New Corporate World*.)<sup>3</sup>

## **The Impact of Long-Term Incentives**

The shift to corporate strategic-planning practices not only created a multibillion-dollar consulting industry but also set the groundwork for a new way to compensate CEOs and other top corporate executives. Now, instead of traditional compensation packages (i.e., salary, cash bonuses, and limited stock options), corporate boards had a range of pay strategies that mirrored these emerging long-term business planning strategies. CEO pay packages soon included long-term incentives (LTI) that tied a CEO's overall pay to the long-term performance of the company (typically, three years).

These changes to the traditional rubric used to calculate CEO compensation occurred just as investors and other financial community movers and shakers began to demand that companies produce higher profits within ever-shorter time lines. The pressure behind these short-term profit demands resulted in great measure from the dissolution of traditional pension plans and the significant expansion of mutual funds. These various funds competed with one another for shorter-term performance increases.

According to a recent article in *Foreign Affairs* magazine by Jerry Z. Muller, a history professor at The Catholic University of America, the hypercompetitive 1980s resulted in “companies (as well as various public-sector organizations) attempt[ing] to shift the risk by putting their pension funds into the hands of professional money managers, who were expected to generate significant profits.” The result of this strategy, according to Muller, was that “retirement income for employees [was] now depend[ent] . . . on the fate of [the employee’s] pension funds. “The change had the practical result of putting even more “pressure on corporate executives to produce short-term performance results.”<sup>4</sup>

The shorter time line to increase profits also had an unfortunate downside: it created a temptation among fund managers, corporate CEOs, and others at the corporate top to boost immediate profits at the expense of longer-term investments, such as research and development or improving workforce skills.

### **Phase Three—The Results of Uncertainty**

The final phase of Frydman and Saks’s executive compensation development framework extended through the 1990s. It was a time when many CEOs lost their jobs because the company’s promised performance failed to square with the company’s earnings reality or because of increased merger and acquisition activity. The employment uncertainty led boards to offer highly sought after CEOs and their teams a “change of control agreement” (also known as a “golden parachute”) in their employment contracts. This practice grew to such a degree that the Internal Revenue Service (IRS) responded in 1984 with new rules that capped these payments at

2.99 times the average of the last five Form 1099 income filings by the CEOs. Any income in excess of this amount would now be subject to a nondeductible 20 percent excise tax.<sup>5</sup>

By the late 1980s, companies began offering stock options (LTIs) stock options in lieu of cash for LTI payments as public sentiment (and pressure) believed these rewards would be more aligned with shareholder value.

Soon, the stock benefit alone began to make up almost half of high-level managerial pay (Frydman and Saks, 2007), a state of affairs that only served to increase the CEO/worker wage gap as stock values soared during the period's bull market. As noted even in Graef Crystal's 1991 book, *In Search of Excess: The Overcompensation of American Executives*, the preceding twenty years had seen CEO pay increase by more than 400 percent while the typical American worker's wages remained stagnant.<sup>6</sup>

In 1993, in response to investor complaints, Congress enacted Internal Revenue Code Section 162(m), which caps a public company's corporate income tax deduction at \$1 million per year for each of its top executives. The provision did, however, include an important exception in the case of preapproved, performance-based compensation plans, a "loophole" that allowed the continued growth of long-term executive pay and bonuses. Clearly, this was not the original law's intention. Nor was it the lawmaker's intention to allow the value of stock option grants to CEOs of the S&P 500 firms to leap by 45 percent on average (during the law's first year in effect) and then to nearly double over the next two years. As the chairman of the Securities and Exchange Commission (SEC), Christopher Cox noted in an article by Mark Maremont and Charles Forelle in the December 27, 2006 edition of the *Wall Street Journal*, that the 1993 law "deserves pride of place in the Museum of Unintended Consequences."<sup>7</sup>

Even the end of the great 1990s dot-com bubble did nothing to slow the rise of executive compensation. By 2005 the gap between executives and workers expanded even further, and by 2005 an executive in our study earned 110 times an average worker's earnings—about twice the corresponding ratio prior to World War II. Due to the generous use of stock options as compensation,



some top executives would eventually earn more than 700 times the pay of an average worker (Frydman and Saks, 2007).<sup>8</sup>

## **2002—A BOARD GOVERNANCE TIPPING POINT**

Interestingly, a pivotal change in board governance occurred during the market upheaval of the post-dot-com era. In 2001 employees at communications firm WorldCom, electronics and home security company Tyco, and energy giant Enron Corporation all were caught up in an episode of unparalleled corporate malfeasance. Enron's criminality was particularly egregious in the behavior of employees of certain prominent business partners—in particular, employees of the Chicago-based accounting firm, Arthur Andersen. At the time Arthur Andersen was one of the five largest audit and accountancy partnerships in the world.

Despite a one-hundred-year record of service and its business community prestige, the “Enron scandal” destroyed the venerable accounting firm. Arthur Andersen lost its Certified Public Accountant license in 2002 and quickly disappeared from the scene. Enron filed for bankruptcy in 2001, and many of its top executives were charged, convicted, and served prison time for their role in the scandal.

The fallout from these highly publicized events was a great deal of public and private scrutiny on boards of directors serving in publicly traded companies. In 2002 Congress enacted a new law, Sarbanes-Oxley (also known as the Corporate and Auditing Accountability and Responsibility Act), designed to address future corporate accounting integrity breaches.

### **KEY PROVISIONS OF THE SARBANES-OXLEY ACT**

Each of the eleven titles (or sections) of the Sarbanes-Oxley Act (SOX) mandates specific financial reporting requirements that

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are intended to curb financial fraud and to increase financial reporting transparency.

SOX legislation was a direct response to revelations in the early 2000s of accounting fraud that was perpetrated by Enron, Tyco, and WorldCom.

Five of the eleven Sarbanes-Oxley provisions are associated with major points that we make in this book, including the following:

- Section 320 focuses on statutory reports to include certifications.
- Section 401 focuses on the accuracy of financial statements.
- Section 404 is associated with the adequacy of internal control structure and procedures.
- Section 409 concerns public disclosure of significant changes in a company's financial condition.
- Section 802 outlines penalties for destroying or falsifying records to obstruct or impede an investigation.

The law's intent was to strengthen the integrity of internal reporting by requiring top management to personally certify the accuracy of key financial information and by imposing severe penalties for fraudulent activity. The Sarbanes-Oxley Act also increased the independence of the outside auditors who review the accuracy of corporate financial statements and increased the oversight role of boards of directors.

## **The Most Impactful Governance Change**

While some would suggest that our current board governance environment is a result of the Sarbanes-Oxley Act, that assertion would be only partially true. Certainly, the Sarbanes-Oxley Act has had a profound impact on the internal reporting requirements of

corporations. In particular, there are five key sections of the legislation that are associated with the major points that we make in this book. The first is Section 320, which is focused on statutory reports to include certifications; the second, Section 401, is focused on the accuracy of financial statements published by issuers and requires that they be presented in a manner that does not contain incorrect statements or admit to stating material information. The third, Section 404, is concerned with requirements for issuers to publish information in their annual reports concerning the scope and adequacy of internal control structure and procedures. The fourth section, Section 409, requires issuers to disclose to the public, on an urgent basis, information on material changes in their financial condition or operations. Finally, Section 802 is a provision that imposes penalties or fines and/or up to twenty years' imprisonment for altering, destroying, mutilating, concealing, and falsifying records to obstruct or impede an investigation.

However, the pivotal change that would forever change the landscape of corporate boards took place on August 1, 2002. That's when the NYSE Board of Directors approved and submitted to the SEC for approval a revision to their Listed Company Manual that recommended, among others, the following corporate board guidelines:

- A majority of corporate board members must be independent; that is, they cannot have any material interest in the corporation.
- Independent directors are the only voting members of the board.
- Boards must have a minimum of three standing committees: audit, compensation, and governance/nominating.
- Boards must conducting annual assessments of the CEO, the board itself, and each of the three standing committees.
- Independent directors must meet periodically in executive session without company management being present.

Of all the Listed Company Manual changes approved by the NYSE, the last one requiring the independent directors to meet without the CEO represents a sea change in the world of board

governance. Prior to this change, CEOs never would have allowed this meeting to take place, and with good reason; you never knew what might be discussed in the meeting, including a CEO's performance and compensation. We discuss this important change in more detail in Chapter 3, "Key Board Leadership Roles," along with the many implications that this change has had on board governance activities.

## **Other Important Governance Changes**

Another important change to the world of board governance occurred in April 2003, when the SEC implemented rule 30b1-4 that required registered management investment companies to disclose their proxy voting policies and voting records. Although this ruling might appear to be fairly straightforward, the practical impact of implementing it certainly was not. At the time of the ruling, mutual funds represented 18 percent of all publically traded U.S. corporate equity (about \$2 trillion of value). Suddenly, those who managed these large funds were required to vote on every proxy matter. This meant that the managers would have to understand hundreds, if not thousands, of proxy votes and cast votes appropriately.

The solution to this dilemma was essentially to outsource this work to proxy advisory firms, principally to Institutional Shareholder Services (ISS), a firm founded in 1985 by shareholder activists Robert Monks and Neil Minnow. The purpose of ISS originally had been to promote good governance and to raise the level of active and informed proxy voting among institutional investors. However, by 2006 opinions about ISS on proxy votes began to have considerable influence on the final outcomes of proxy voting. A 2006 article by Robert D. Hershey Jr. in the *New York Times*, titled "A Little Industry with a Lot of Sway on Proxy Votes," provided good evidence of this influence. The article noted that by the firm's own estimate ISS opinions affect the governance decisions of a cadre of professional investor's controlling \$25 trillion in assets, a figure that encompasses half the value of the world's common stocks.<sup>9</sup> As aptly characterized by David W. Smith, president of the Society of Corporate Secretaries and Governance Professionals, "the influence these advisors wield is extraordinary."<sup>10</sup>

## KEY PROVISIONS OF THE DODD-FRANK ACT

Dodd-Frank (or The Dodd-Frank Wall Street Reform and Consumer Protection Act) was passed by the Obama administration in 2010 in response to the 2008 financial crisis. It is a complex piece of legislation that is intended to prevent the particular set of circumstances that nearly crashed the world economy in 2008.

The act covers sixteen major areas of reform, ranging from consumer protection, to preventing abusive lending and mortgage practices by banks, to ensuring that financial institutions will never again be “too big to fail.”

Dodd-Frank, named after its sponsors, Senator Christopher J. Dodd (D-CT) and U.S. Representative Barney Frank (D-MA), also created various councils and oversight agencies that are charged with ensuring that the aims of the legislation are realized. Since these mechanisms are complex and often controversial, many of them are still being implemented. Here are some of the major provisions of the legislation:

- Creation of the Financial Stability Oversight Council (FSOC) to monitor the overall risks in the financial industry (including hedge funds). The council’s members include the Federal Reserve, the SEC, and a newly formed agency called the Consumer Financial Protection Bureau (CFPB) that is intended to protect consumers from “unscrupulous” business practices by banks.
- Dodd-Frank also mandated that the riskiest of investment instruments, such as credit default swaps, be regulated by the SEC or the Commodity Futures Trading Commission (CFTC). Insurance companies were also targeted by the legislation, and a new Federal Insurance Office (FIO) was set up to determine if the largest of these companies might be a potential risk to the system. Insurance underwriter AIG

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needed an \$85 billion federal bailout to stay in business in 2008.

- An Office of Credit Rating was created at the SEC to ensure that credit ratings agencies such as Moody's and Standard & Poor's do a better job of monitoring and recommending investment tools.

On June 30, 2014, the SEC, responding to a rising chorus of complaints about the outsized influence of ISS and other proxy voting entities such as Glass Lewis, published a ruling entitled "Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms." Specifically, the ruling noted that "the proxy Voting Rule does not require that investment advisers and clients agree that the investment adviser will undertake all of the proxy voting responsibilities."<sup>11</sup>

The ruling has pushed large institutional investors to develop their own capabilities for the determination of what votes to cast on a particular proxy matter. For example, BlackRock, the largest manager of money, just recently published its own 2015 proxy voting guide.

## **IMPACT OF THE 2008 FINANCIAL MELTDOWN**

The financial crisis of 2007–2008 was the worst financial crisis since the Great Depression in 1929, and it threatened to completely collapse the American banking system. In large measure the collapse was caused by a housing bubble that peaked in 2006 as a complex system of subprime mortgages and questionable trading practices was revealed and the whole house of cards quickly crumbled.

One of the most notable events was the failure of Lehman Brothers. Before declaring bankruptcy in 2008, Lehman Brothers was the fourth largest investment bank in the United States. A court-

appointed examiner later found that the bank had moved \$50 billion of bad investments off its balance sheet each quarter to hide its actual financial condition. Like the Enron scandal, Lehman Brothers' fall was seen by stockholders as another example of corporate America's failure to monitor itself.

As if the country needed another example of financial malfeasance, the Bernie Madoff scandal also surfaced in 2008. Madoff was the founder of a Wall Street investment firm, Bernard L. Madoff Investment Securities. Madoff eventually admitted that his Ponzi scheme had defrauded thousands of individual and institutional investors out of more than \$64 billion. Madoff is now serving a 150-year prison sentence for his crimes.

## **Federal Bailout**

As a result of these scandals and associated regulatory failures, the economy spiraled dangerously toward economic depression, and trust in the stock market and in big business plummeted as quickly as unemployment rose. Finally, the U.S. government played the only hand that it had in the game and pumped more than \$750 billion into the largest "too big to fail" financial institutions through the Troubled Asset Relief Program (TARP). The government also loaned about \$110 billion to the auto industry to keep it afloat, with a majority of the relief going to General Motors and Chrysler.

Multiple factors contributed to the 2008 financial crisis. The U.S. Senate's Levin–Coburn Report, the product of a two-year bipartisan investigation by the U.S. Senate Permanent Subcommittee on Investigations into the origins of the 2008 financial crisis, noted that the crisis was the result of "high risk, complex financial products; undisclosed conflicts of interest; the failure of regulators, the credit rating agencies, and the market itself to rein in the excesses of Wall Street." Others would argue that the 2008 financial crisis was another example of corporate greed and a failure of corporate boards to control excessive executive compensation.

While there might be debate about the causes of the financial crisis, the Dodd-Frank Act (named after Senator Christopher Dodd and U.S. Representative Barney Frank), which was signed into

federal law by President Barack Obama in July 2010, was very clear about the legislation's intention in its preamble. The act states that its purpose is to "promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail,' to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes."

The Dodd-Frank legislation brought about the most significant changes to financial regulation since the financial reforms enacted following the Great Depression. In addition to curbs on the types of trading activities that financial institutions would be allowed to practice, the legislation gave additional powers to shareholders. The changes represented a seismic shift in this fundamental relationship. Among other provisions, the SEC was asked to grant shareholders the right to provide a nonbinding advisory vote, a "say on pay" for executive compensation.

Although the vote is not binding, directors are now required to regularly (annually, biannually, or triennially) submit to shareholders an advisory vote on the prior year compensation for the NEOs (named executive officers). If the affirming vote is less than 70 percent, then it may indicate that a problem exists in the correlation between the CEO's pay and the Total Shareholder Return (TSR) ratio of the company. This score is also a metric that ISS and other proxy services track and use in their evaluation of individual companies. Although the number of negative votes remains quite low, it does keep attention focused on this issue.

The other significant outcome from the Dodd-Frank Act is just beginning to unfold. The legislation called for changes aimed at better shareholder access. Specifically, it asked for a process to provide shareholders the ability to place candidates beyond those proposed by the board on the company's annual proxy list of candidates.

Although the regulation proffered by the SEC was contested and eventually dropped, no resolution is at hand. Shareholders are still asking for such a proviso to be placed on the proxy list for a shareholders' vote. Some companies, such as GE and Bank of America (among others), changed their bylaws to add this feature while others are dealing with it in their annual meeting. For example, the May 18,



2015 issue of the corporate board publication *Agenda* noted that “the most popular shareholder proposal topic this year has been proxy access, increasing fourfold from last year.”<sup>12</sup>

## CHAPTER SUMMARY

This chapter supports the board governance recommendations that we make later in this book by highlighting the major social, economic regulatory changes that contribute to today’s board culture and practices. Specifically, this chapter makes the following key points.

CEO compensation continues to increase, despite increasing public attention to the gap between average worker and CEO compensation. This wage gap has increased from a low of twenty-five times that of an average wages to many multiples of that ratio, although the average gap generally caps at about 350 percent that of an average worker’s wages in the company.

Clearly, this is an issue that will not disappear anytime soon. At the same time, the emphasis on pay for performance is showing results. In May 2009 *Forbes* published an article by Emily Lambert titled “The Right Way to Pay,” highlighting a move toward “pay packages that reward long term performance rather than short term greed.” Importantly, 3,422 companies held “say on pay votes” in 2014, in which only 66 companies failed (1.9 percent).<sup>13</sup>

As a May 17, 2015 article, “It’s (Still) Their Party,” by David Gelles in the *New York Times* said about this issue on their annual survey of CEO compensation, “this apparent satisfaction with pay may be a result of the rising stock market. Shareholder dissent, when it does crop up, typically occurs at companies that have awarded lush compensation even as their performance has lagged. Investors watching their shares go up are less likely to be outraged by a sizeable bonus or stuck grant.”<sup>14</sup>

Although the most visible legislative result of the “Enron scandal” is the Sarbanes-Oxley Act, aimed at the accounting abuses at the root of Enron’s corporate malfeasance, the most important rule change impacting board governance occurred in 2002, when the NYSE Board of Directors approved and submitted to the SEC for approval

a revision to their Listed Company Manual, recommending that independent directors must meet periodically in executive session without company management being present.

Of all the Listing Company Manual changes approved by the NYSE, this is the most important action taken, and it represents a sea change in the world of board governance.

The Dodd-Frank Act is a consumer protection act signed into federal law by President Barack Obama in July 2010, which restricts the types of trading activities that financial institutions are allowed to practice. The law was enacted in response to the 2008 financial meltdown that nearly sent the United States and the world into a 1929-type depression. The Dodd-Frank legislation, among other consumer protections, gave shareholders the right to provide a nonbinding advisory vote, or a “say on pay,” for executive compensation.

## **WHAT'S NEXT?**

Chapter 2, “Role of the Board,” offers some guiding principles for effective board governance. The chapter uses the story of the rise and fall of former Home Depot CEO Bob Nardelli to illustrate a cautionary tale for boards considering going outside the company to hire their next CEO. The story also supports two key principles: first, boards do not run companies; second, there are serious consequences in making the wrong choice of a CEO, and there is transformative power in making the right choice of a CEO.