

I am the William D. Warren Distinguished Professor of Law at the UCLA School of Law, where I teach corporate and securities law. (This affiliation information is provided solely for purposes of identification. No implication that UCLA or the School of Law approves of or agrees with these comments is intended.)

I have written over a dozen books on these topics, including *Corporate Governance After the Financial Crisis* (Oxford University Press 2012); *Business Associations: Cases and Materials on Agency, Partnerships, and Corporations* (8th ed. 2012) (with Klein and Ramseyer); *Agency, Partnerships, and Limited Liability Entities: Cases and Materials on Unincorporated Business Associations* (3d ed. 2012) (with Klein and Ramseyer); *Mergers and Acquisitions* (3d ed. 2012); and *The New Corporate Governance in Theory and Practice* (Oxford University Press 2008). I have also written over 90 law review articles which have appeared in such leading journals as the *Harvard Law Review*, *Virginia Law Review*, *Northwestern University Law Review*, *Cornell Law Review*, *Stanford Law Review*, and *Vanderbilt Law Review*. In 2008, 2011, and 2012, I was named by the National Association of Corporate Directors' Directorship magazine to its list of the 100 most influential people in the field of corporate governance.

I write to oppose the proposed changes<<https://www.issgovernance.com/file/publications/independent-chair-shareholder-proposals-us.pdf>> to the ISS policy with respect to independent chair shareholder proposals. At present, the ISS policy is to recommend approval of such proposals unless the company meets an extremely restrictive set of criteria. The new policy would be even more restrictive, by adding "add new factors that are not considered under the current policy including the absence/presence of an executive chair, recent board and executive leadership transitions at the company, director/CEO tenure, and a longer (five-year) TSR performance period." The effect of this change would be to make it even more difficult for companies to obtain an ISS recommendation against such proposals.

In my view, this change moves the ISS in the wrong direction. Instead, the ISS should adopt a policy of generally opposing such proposals. Neither the empirical data nor corporate governance theory support requiring companies to have a non-executive chairman.

A study by Olubunmi Faleye finds support for the hypothesis that firms actively weigh the costs and benefits of alternative leadership structures in their unique circumstances and concludes that requiring a one size fits all model separating the CEO and Chairman positions may be counterproductive.[1] A study by James Brickley, Jeffrey Coles, and Gregg A. Jarrell found little evidence that combining or separating the two titles affected corporate performance.[2] A subsequent study by the same authors found "preliminary support for the hypothesis that the costs of separation are larger than the benefits for most firms." [3]

As John Coates summarizes the field, the evidence is mixed, at best:

At least 34 separate studies of the differences in the performance of companies with split vs. unified chair/CEO positions have been conducted over the last 20 years, including two "meta-studies." ... The only clear lesson from these studies is that there has been no long-term trend or convergence on a split chair/CEO structure, and that variation in board leadership structure has persisted for decades, even in the UK, where a split chair/CEO structure is the norm.[4]

Although Coates concludes that splitting the CEO and Chairman positions by legislation “may well be a good idea for larger companies,” he further concludes that mandating such a split “is not clearly a good idea for all public companies.”[5]

Proponents of a mandatory non-executive Chairman of the Board thus have overstated the benefits of splitting the positions, while understating or even ignoring the costs of doing so. Michael Jensen identified the potential benefits in his 1993 Presidential Address to the American Finance Association, arguing that: “The function of the chairman is to run the board meetings and oversee the process of hiring, firing, evaluation, and compensating the CEO. ... Therefore, for the board to be effective, it is important to separate the CEO and Chairman positions.”[6] In fact, however, overseeing the “hiring, firing, evaluation, and compensating the CEO,” is the job of the board of directors as a whole, not just the Chairman of the Board.

To be sure, in many corporations, the Chairman of the Board is given unique powers to call special meetings, set the board agenda, and the like.[7] In such companies, a dual CEO-Chairman does wield powers that may impede board oversight of his or her performance. Yet, in such companies, the problem is not that one person holds both posts; the problem is that the independent members of the board of directors have delegated too much power to the Chairman. The solution is to adopt bylaws that allow the independent board members to call special meetings, require them to meet periodically outside the presence of managers, and the like.

Indeed, the influence of an executive chairman may not even be a problem. Brickley, Coles, and Jarrell concluded that the separation and combination of titles is part of the natural succession process. A successful CEO receives a variety of rewards from the company, one of which may be a fancier title. If the power that comes with the combined title came as a reward for sustained high performance, that power may actually redound to the company’s benefit.

Turning from the benefit side to the cost side of the equation, even if splitting the posts makes it easier for the board to monitor the CEO, the board now has the new problem of monitoring a powerful non-executive Chairman. The board now must expend effort to ensure that such a Chairman does not use the position to extract rents from the company and, moreover, that the Chairman expends the effort necessary to carry out the post’s duties effectively. The board also must ensure that a dysfunctional rivalry does not arise between the Chairman and the CEO, both of whom presumably will be ambitious and highly capable individuals. In other words, if the problem is “who watches the watchers?,” splitting the two posts simply creates a second watcher who also must be watched.

In addition, a non-executive Chairman inevitably will be less well informed than a CEO. Such a Chairman therefore will be less able to lead the board in performing its advisory and networking roles. Likewise, such a Chairman will be less effective in leading the board’s in monitoring top managers below the CEO, because the Chairman will not know those managers as intimately as the CEO.

Accordingly, I urge the ISS to reject the proposal changes and, in addition, to change the current policy to adopt a presumption against recommending approval of independent chairman shareholder proposals.

[1] Olubunmi Faleye, Does One Hat fit All? The Case of Corporate Leadership Structure (January 2003).

[2] James A. Brickley et al., Leadership Structure: Separating the CEO and Chairman of the Board, 3 J. Corp. Fin. 189 (1997).

[3] James A. Brickley et al., Corporate Leadership Structure: On the Separation of the Positions of CEO and Chairman of the Board, Simon School of Business Working Paper FR 95-02 (Aug. 29, 2000), <http://ssrn.com/abstract=6124>.

[4] John Coates, Protecting Shareholders and Enhancing Public Confidence through Corporate Governance (July 30, 2009), <http://blogs.law.harvard.edu/corpgov/2009/07/30/protecting-shareholders-and-enhancing-public-confidence-through-corporate-governance/>.

[5] Id.

[6] Michael C. Jensen, Presidential Address: The Modern Industrial Revolution, Exit and the Failure of Internal Control Systems, 48 J. of Fin. 831, 866 (1993).

[7] James Verdonik and Kirby Happer, Role of the Chairman of the Board 2 (explaining that “one of the duties of the Chairman is to call meetings of the Board of Directors and the shareholders. ... Chairmen often set the agenda for Board meetings”), [www.directorsforum.com/role-of-the-chairman-verdonik-happer.pdf](http://www.directorsforum.com/role-of-the-chairman-verdonik-happer.pdf).

---

Stephen M. Bainbridge

William D. Warren Distinguished Professor of Law UCLA School of Law

405 Hilgard Avenue

Box 951476

Los Angeles, CA 90095-1476

310.206.1599 (office)

213.453.1393(cell)

<mailto:bainbridge@law.ucla.edu>

Strange errors are probably the result of undetected errors by my voice recognition/dictation software.

Weblog: [www.professorbainbridge.com](http://www.professorbainbridge.com)<<http://www.professorbainbridge.com>>

Twitter: <http://twitter.com/ProfBainbridge> Working papers on-line:

<http://papers.ssrn.com/author=016596>

Skype: stevebainbridge

NOTICE: This communication may contain privileged or other confidential information. If you have received it in error, please advise the sender by reply email and immediately delete the message and any attachments without copying or disclosing the contents. Thank you.