VIEW from the COMMON

DEDICATED TO THE PURSUIT OF FINANCIAL RETURN AND SOCIAL CHANGE

BOSTON COMMON ASSET MANAGEMENT, LLC — SPRING 2011

Responsible Shareholder Capitalism

Geeta Aiyer

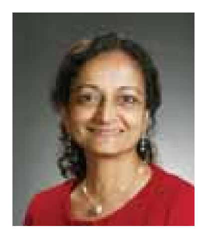
As socially aware investors, we want to take long-term stakes in corporations, become engaged in their development, and empower long-term thinking by management. We're often disturbed by the systemic barriers to this purpose. In most cases, shareholders' assets are managed by professional intermediaries acting in a fiduciary role, who may feel restricted from taking such an expansive view. Stakes in public corporations tend to be highly fragmented among many shareholders, leaving no single owner with a strong voice. And the legal framework of the corporation restricts minority shareholders' ability to reign in a corporation's board and management or petition for changes in its policy. The corporations we own play an expansive role in our economy, our communities, even our political process, and yet we are compromised in our ability to guide their missions and modes of operating.

In response to these challenges, we present a graphic depiction of corporate evolution and five voices seeking to redefine the historical role of the corporation and provide new paradigms for its future functioning. We invite you to join these authors in rethinking the framework of a responsible shareholder capitalism and to continue with us in the coalition of owners seeking to realize it.

World Markets: Clients of Small Enterprise Foundation, a Shared Interest beneficiary, meet biweekly to save and borrow at the Motopa Kgomo Village Center in South Africa. For information visit www.sharedinterest.org.

Inside:

Many thanks to Jonas Clark, Dawn Wolfe, Kristin Jenko and Nathan Foley-Mendelssohn for their contributions.



■ ***Geeta Aiyer*** *is the founder of Boston Common Asset Management and a portfolio manager for institutions and individuals, allowing her to combine her commitment to sustainability with her experience in investment theory and finance. Geeta serves on the boards of the Worldwatch Institute and the New England Foundation for the Arts.*

About Boston Common

Boston Common Asset Management is an investment manager and a leader in global sustainability initiatives. We specialize in long-only equity and balanced strategies and pursue long-term capital appreciation by seeking to invest in diversified portfolios of high quality, socially responsible stocks. Boston Common managed over $1.4 billion including subadvised assets as of December 31, 2010. Boston Common is independent, globally focused, employee-owned, and fields a seasoned team of professionals.

The Challenge of Corporate Board Reform

Nell Minow

In *The Big Short*, Michael Lewis gives us a brilliant inside look at the financial crisis from the perspective of the few who saw it coming, those sensible investors who realized that subprime loans and the derivatives they were based on were doomed to collapse. As the story unfolds, of course, we learn more than we ever thought we could about the infamous credit default swaps, collateralized debt obligations, and other tools of financial wizardry that obscured massive, systemic risk. Yet the most telling part of Lewis' entire work, the most important fact of all, comes at the end, a single sentence eight pages from the story's finish. Lewis put it almost gently, though I'm going to be less so and put it in italics:

The people on the short side of the subprime mortgage market had gambled with the odds in their favor. The people on the other side – the entire financial system, essentially – had gambled with the odds against them. Up to this point, the story of the big short could not be simpler. *What's strange and complicated about it, however, is that pretty much all the important people on both sides of the gamble left the table rich*. (emphasis added)

As Lewis points out, it makes perfect sense that those who bet against subprime – those few contrarians who withstood the ridicule and contempt of the Masters of the Universe on Wall Street when they questioned whether such loans were as "risk-proof" as everyone said – made tens of millions of dollars.

What makes no sense, however, is that those who foolishly bet that there was such a thing as "risk-proof" made enormous sums as well. "Howie Hubler lost more money than any single trader in the history of Wall Street," Lewis tells us, "and yet he was permitted to keep the tens of millions of dollars he had made." The CEOs who either ran their companies into bankruptcy or were saved from bankruptcy by the U.S. taxpayers, Lewis notes, "all got rich, too."

In the end, the billions of dollars of losses and the near-collapse of our economy is far less important than the damage to the very credibility of the American system of capitalism. How can we get managers to care as vitally about the money provided from outsiders as though it is their own? The answer has to be by ensuring that there are meaningful consequences for failure. The market cannot work without market tests with real upsides and downsides.

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Congress can pass laws and regulatory agencies can enforce them, but only investors can solve such a critical problem. Sarbanes-Oxley and the massive new financial reform legislation can begin to undo the business-supported loopholes and protections that made legal almost all of the externalization of risk in the subprime era. Regulators can investigate but the consequences of even a successful enforcement action are not necessarily meaningful. The headlines say that Goldman

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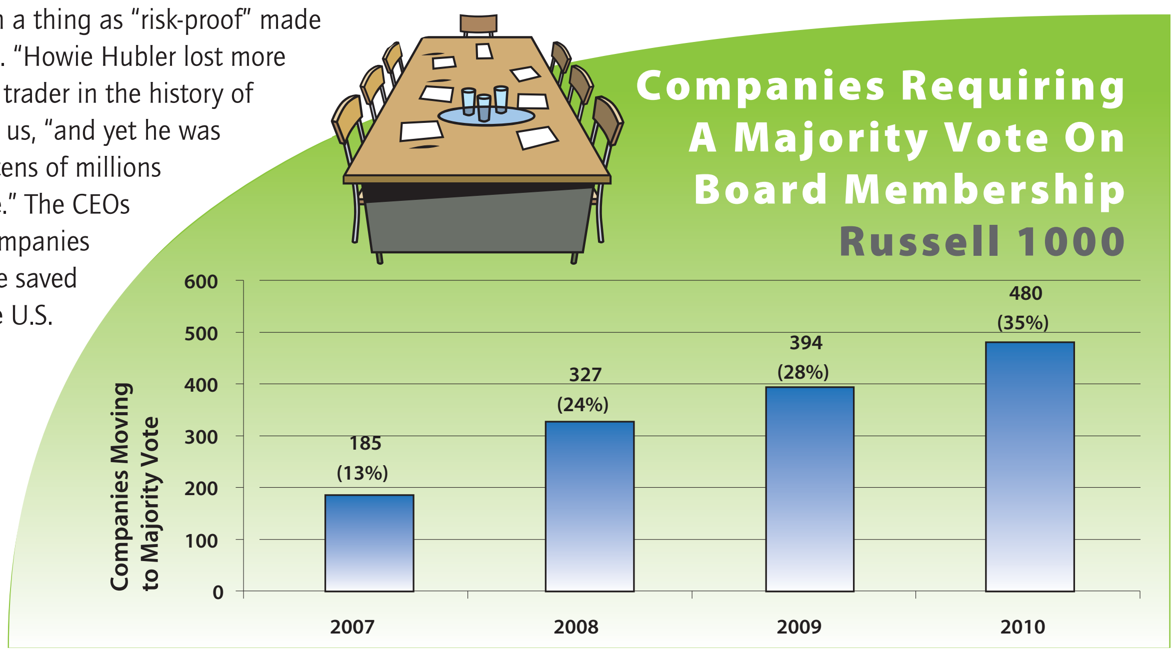
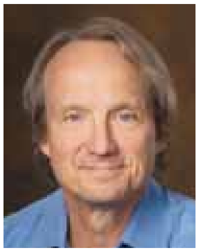


Source: The Corporate Library

Fiduciary Duty: Challenges To The Traditional View

Jay Youndahl



Adapted from a speech presented to Harvard Law School Program for Advanced Trustee Studies July 28, 2010.

Assume you are the average trustee for a pension or endowment. What do you do? You go to meetings of your board, serve on sub-committees, and sit in on innumerable conference calls. You listen to presentations by men and women, smartly dressed, who have flown in from the financial capitals of our country. They are articulate, well-scrubbed, and carry glossy binders with mind-numbing charts and information. These financial professionals say they have your best interests at heart. The subtext is that they are experts; you are not. Such professionals functionally run many pension funds in this country. Part of the reason for this state of affairs is the fear that many trustees have of being successfully sued by participants for bad investment decisions.

There are few places in our society where people have as much at stake with as little appreciation or compensation for their hard work and personal risk as trustees do. And yet many say that the recent crisis should have taught trustees that they haven't been doing enough. In spite of the long-term time horizon of required benefit payouts, trustees tended to choose investment strategies that pursued quarterly or annual returns at the expense of long-term thinking. Many sought to juice short-term returns by employing financial tricks marketed by Wall Street folks, which happen to generate Midas-like fees for Wall Street.

In the recent financial crisis, nearly all of these genius strategies failed. Many argue that they contributed to the credit bubble and the market crash. Nearly all public fund portfolios suffered drastic losses, which have jeopardized the ability of public workers to enjoy a retirement after a life of service to the citizens of their communities.

If there is any silver lining to this well-known narrative, it's that the time is ripe for a new discussion of whether, along with all of the myriad reforms that the crisis has prompted, the traditional understanding of a trustee's fiduciary duty ought to be reexamined. Specifically, we should recognize that investment strategies that pursue short-term alpha by exporting social and systemic risks don't benefit the pension or endowment as a whole. The recent crisis demands a "sustainable capitalism," which seeks to maximize long term value creation, which honestly looks at risks and opportunities, and which explicitly incorporates "ESG" concerns – environmental, social, and governance factors.

Pensions and endowments today are major players in the ownership and control of the modern corporation. This is a relatively new phenomenon. At the beginning of the twentieth century, the typical owners of corporations were the founders and a small group of shareholders. Around the 1920s, a new form of control came about, managerial capitalism, in which larger groups of individual shareholders hired professional managers, resulting in a separation of ownership and control. We are now in a third phase in which large institutions, and in particular pensions and endowments, are the largest players, along with the mutual fund industry. Thus, the separation between ownership and control is even more pronounced.

Pensions and endowments serve as crucial providers of capital for the U.S. and global economies. They implicitly control a significant proportion of global economic activity. For liquidity and diversification, they spread their wealth broadly across the economy, effectively becoming "universal owners" of all manner of financial assets. Responsible trusteeship for such a broad pool of assets means understanding the role the fund plays in the success of the economy during the long time horizon over which it makes payouts to beneficiaries. Trustees must ask: how do we invest so that our capital helps the overall economy grow and positions our funds to earn long-term, sus-

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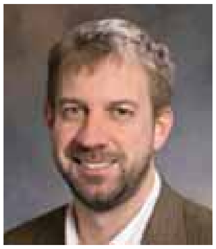
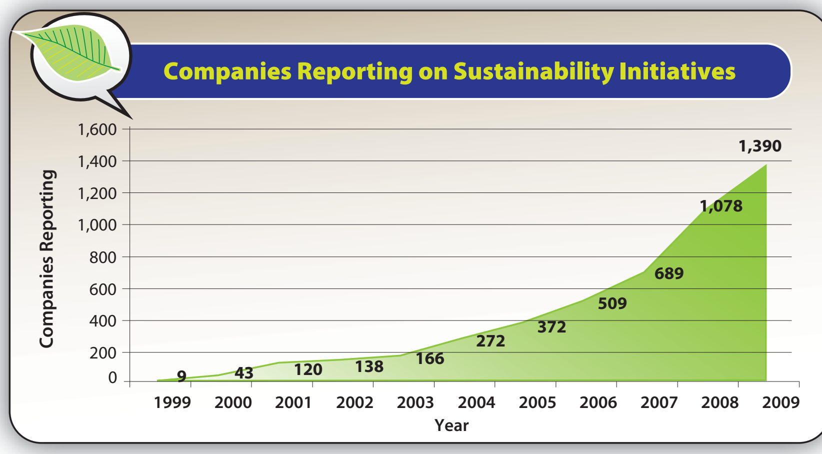
Corporate Disclosure and the Promise of Social Investment

David Wood



It's pretty widely accepted that markets need good information to allocate investments efficiently, an assertion that has also led social investors to vigorously promote corporate disclosure. The reason? Markets that do not take into account the long-term costs of things like despoiling the environment or violating labor rights won't be properly directed towards long-term wealth creation. And what's the point of investing if not to produce sustainable wealth?



We tend to link this insight about disclosure to the future prospects of our investments by pointing to the costs associated with certain externalities. After all, corporations can't push the costs of things like oil spills, or environmentally induced lung disease, onto society forever. Someone has to pay for them, and as costs rebound back to their source, those corporations with superior environmental and social performance will outperform over time.

The other tricky part, of course, is that we also need good information – rich enough to evaluate corporate performance, consistent enough to compare corporations to each other, and concise enough to allow stakeholders to process effectively. Fortunately, the past decade has seen great progress on this score. The Global Reporting Initiative now counts over 1,300 corporations reporting and has set the standard for how corporations should report on material impacts. In the United States, advocates working through groups such as the Social Investment Forum, the Interfaith Center for Corporate Responsibility, Ceres, and others have made inroads towards mandatory integration of environmental and social reporting into traditional accounting standards. Last year's SEC guidance on corporate reporting on climate risk is rightfully seen as both a major success and a step along the path towards mandatory reporting.

> **"Enhanced disclosure may remain nothing more than a better tool to document the distance between corporate profit and the social good. Here is one place where social investment shows enormous promise."**

The Initiative for Responsible Investment, where I work, recently published our own contribution to the conversation on how best to design a mandatory disclosure regime, a white paper called "From Transparency to Performance: Industry-Based Sustainability Reporting on Key Issues." My co-authors, Steve Lydenberg of Domini Social Investments and Jean Rogers of Arup, and I used this project as way to think out loud about how best to set a minimum floor for sustainability reporting. We looked for a process built on three principles: simplicity, materiality, and transparency. The result was a scoring system, built on the Global Reporting Initiative's pathbreaking work, which would identify a smaller set of industry specific performance indicators that would give not only investors, but also communities, advocates, public agencies, and other stakeholders a tool for evaluating corporate performance and holding corporations accountable. We hope the white paper furthers discussion and debate over mandatory sustainability reporting, which we view as a natural and necessary step towards a market system that rewards long-term wealth creation.

But this is only a necessary step, not a sufficient one. As the last few years should have taught us, the market cannot be trusted to reward good outcomes on its own. Investors, corporations, and other stakeholders can find plenty of reasons and can invent plenty of justifications for favoring short-term gain with little regard for long-term consequences. Mandatory reporting may create a level playing field, but how can we be sure anybody will show up to

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After *Citizens United*: Q & A with Massachusetts Congressman Mike Capuano

The January 2010 Supreme Court ruling in *Citizens United v. Federal Election Commission* expanded the first amendment free speech rights of corporations. Looking back one year later, we asked Congressman Capuano about the impact of the decision that allows corporations to spend freely and directly out of the treasury on political election campaigns.

BCAM: What has been the impact of the *Citizens* decision thus far? How do you see it affecting the political landscape in the long run?

MC: The impact on the most recent election cycle was clearly significant, with corporations spending large sums of money on races all over the country. The amounts of money spent on television advertising and other types of outreach were really staggering last year. According to the Center for Responsive Politics, corporations and businesses spent over $1.3 billion in the 2010 elections. The House passed the DISCLOSE Act in 2010 as a response to the Supreme Court decision; it did not pass the Senate, so the legislation had no impact on last year's elections. I am still hopeful that the long-term impact on the political landscape can be addressed through legislation, whether it's through the DISCLOSE Act or some other measure. Congress cannot ignore the Supreme Court's decision, but it can certainly take steps to increase transparency and accountability when it comes to corporate political expenditures.

BCAM: You have recently called for a shareholder protection act. What is this exactly, and what does it entail? What do investors stand to gain from this?

MC: My legislation, The Shareholder Protection Act, simply requires an annual shareholder vote before corporate general treasury funds can be used for political expenditures. It gives shareholders an opportunity to exercise their free speech rights by voting on a company's political budget. If corporations can spend unlimited funds on elections, their shareholders should have an opportunity to weigh in on the use of those funds. After all, it is their money. My legislation passed in Committee last year but was not brought for a full House vote. I plan on re-filing it this year, but given the changes in the House and Senate, it seems unlikely the bill will be considered this Congress.

BCAM: Going forward, what actions can people who opposed the decision take to minimize its impact?

MC: Voters can be as informed as possible before casting their ballots, and can pay particular attention to the political messages that blanket the airwaves. Where is the message coming from? What is the agenda behind the message? Voters can also contact their federal elected officials and express support for legislative action to address the Supreme Court decision.

BCAM: Ideally, what sort of relationship do you envision work-

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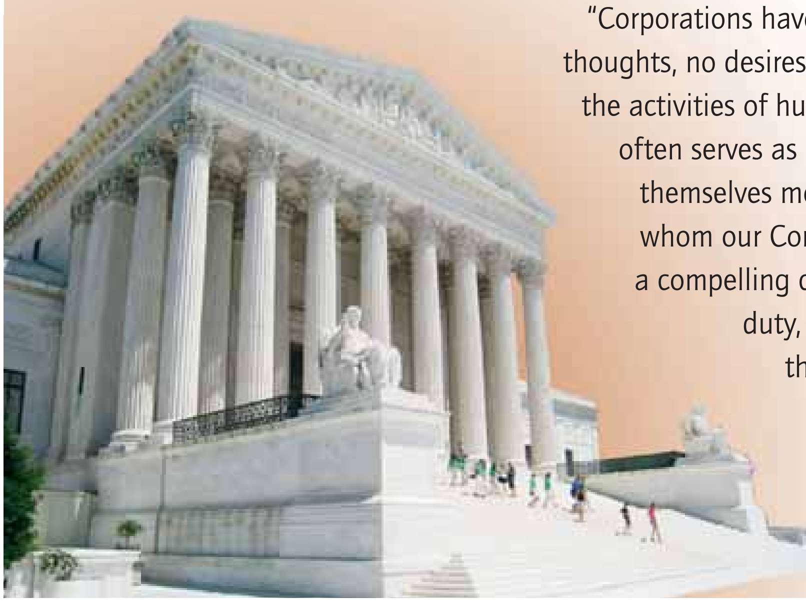
Dissenting Opinion



"Corporations have no consciences, no beliefs, no feelings, no thoughts, no desires. Corporations help structure and facilitate the activities of human beings, to be sure, and their 'personhood' often serves as a useful legal fiction. But they are not themselves members of 'We the People' by whom and for whom our Constitution was established...Our lawmakers have a compelling constitutional basis, if not also a democratic duty, to take measures designed to guard against the potentially deleterious effects of corporate spending in local and national races."

– Justice John Paul Stevens, dissenting opinion joined by Justices Ginsburg, Breyer, and Sotomayor in the 5-4 ruling.

A Brief History of the Corporation

1600 - 1700s

Creation of the Joint Stock Company

Creation of royally-chartered, limited liability joint stock companies as instruments of European colonial trade policy, most notably the ***Dutch and British East India companies.*** The structure derived from Genoese and even Roman precursors.

1800 - 1850s

Enlarged Business Associations and Demand for Incorporation

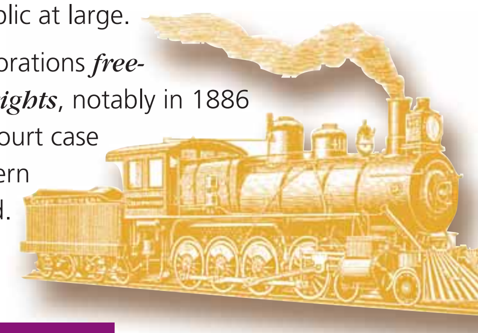
Growth, primarily in Britain, of ***business associations with thousands of members*** to finance large-scale industrialization. Western countries adopt new laws to help these associations function administratively: incorporation, ***transferable share ownership, and limited liability*** without royal charter.

1860 - 1890s

Grant of Freestanding Legal Rights

U.S. and European railways, needing huge amounts of capital, choose incorporation to access a broader ownership base. Corporations typically remain under the majority control of banks or founding families rather than the public at large.

Courts grant corporations ***freestanding legal rights***, notably in 1886 U.S. Supreme Court case Santa Clara v. Southern Railroad.



1900 - 1920s

Rise of the Public Corporation and Dispersion of Ownership

Large, public corporations such as Ford and General Electric lead global economic boom. Corporation replaces partnership as dominant business form. Economic activity grows more concentrated in hands of largest firms.

Progressive-era legislation curbs monopolies, regulates product safety, and tries to limit political contributions.

Share ownership becomes widespread in U.S. and Britain, leaving ***no single owner with firm control***. In Continental Europe, smaller firms with few owners are the norm.

1930 - 1940s

Regulatory Framework and Rethink of Purpose

Following market crash, introduction of ***securities regulation***, financial disclosure, and accounting standards in Britain and the U.S.

In Western democracies, launch of ***national social welfare systems*** and greater role for the labor movement.

Landmark 1931-1932 ***Berle and Dodd debate*** on whether corporations are responsible only to shareholders (later termed ***"Shareholder Primacy"***) or have broader social obligations (later ***"Stakeholder Capitalism"***).

1950 - 1970s

Managerial Capitalism and Worker Representation

Britain and the U.S. practice "managerial capitalism": ***corporate managers govern*** in place of a ***dispersed and voiceless shareholder base***. In Continental Europe and Japan, family groups and oligarchs control public firms by cross-holding shares among banks and interrelated corporations.

Union participation peaks in developed economies. In Continental Europe, laws mandate worker participation in corporate governance via supervisory boards or councils.

1970s-era legislation regulates ***environmental impact of business operations*** and seeks to enforce limits on political contributions.

1980 - 1990s

Ascendance of the Multinational and Return of Shareholder Primacy

Western corporations increasingly operate in ***emerging economies with weaker political and civil institutions***. Unions decline in developed economies. ***Anti-globalization movement*** takes shape.

Shareholders seek to take back control of the corporation. ***Corporate raiders*** take concentrated positions to break the hold of entrenched managers. Institutional shareholders use ***proxy ballot*** to press for increased disclosure and ***independent boards***.

2000 - forward

Prospect of "Enlightened Shareholder Value" and Global Role for Emerging Market Firms

Corporate social responsibility movement gains traction. Voluntary initiatives and European legislation promote corporate ***disclosure on environmental and social factors***. European pensions and endowments consider ***stakeholder issues in investment decisions***.

Emerging market-domiciled corporations with differing norms and governance take on global importance.

The Rise of the Benefit Corporation

Andrew Kassoy

Recent events have made it clear our old way of doing business isn't working. The traditional corporation, focused on the bottom line and making short-sighted decisions based on profit alone, is no longer acceptable. Current corporate structure demands profits be maximized at all costs and that directors are legally obligated to consider shareholders first and foremost. It is no surprise, then, that we are now seeing the dangerous results of this system. With the spill in the Gulf, the problems with Goldman Sachs, and the financial downturn, consumer trust has all but disappeared.

It is possible to rebuild trust in business but only if corporations clearly demonstrate that they're worthy of such trust. Transparency and high standards of performance are necessary. Corporate behavior impacts the environment, employees, and consumers. These stakeholders must therefore be included in the decision making process. Aside from being good business, consumers demand it. Fortunately there are a growing number of corporations showing the way.

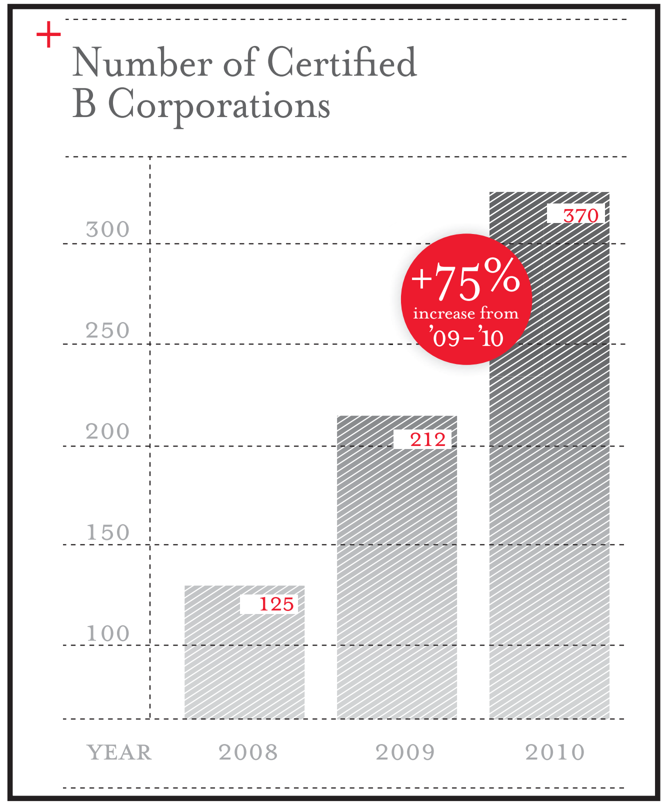
Certified B Corporations are businesses working to solve social and environmental problems. They meet rigorous standards of social and environmental performance, legally expand their corporate responsibilities to include consideration of the interests of workers, community, and the environment, and build a collective voice through the unifying B Corporation brand. For these organizations, business is more than just financial profit. They have a wider definition in which financial profit is part of a complex dynamic that includes all stakeholders, from the community to the employees.

B Corp Quick Facts

B Corporations are a new kind of company that uses the power of business to solve social and environmental problems.

Certified Benefit Corporations:

1. meet transparent and comprehensive standards of social and environmental performance
2. legally expand their corporate responsibilities to include consideration of stakeholder interests
3. amplify the voice of sustainable business and for-profit social enterprise through the power of the unifying B Corporation brand



At the close of 2010, there are 364 Certified B Corporations from 54 industries. B Corporations include well-known companies like Seventh Generation and King Arthur Flour, as well as new and innovative ones that enjoy turning business models upside down. Emerge offers a low interest alternative to payday loans for employees living paycheck to paycheck. Hydrovolts generates affordable, local, renewable energy from water currents in canals and channels. Atyne of Maine converts trash into high performance athletic gear. Because B Corporations take a comprehensive B Impact Assessment, consumers can be confident that they are more than just good marketing. These organizations have made their programs transparent and prove that they actually practice what they preach. B Corporations must achieve a high baseline score on an exhaustive survey of their practices and agree to random on-site auditing.

Furthermore, the legal expansion of corporate responsibilities expands fiduciary duty beyond shareholders. This holds B Corporations accountable to continue to consider all stakeholders in the decision-making process. All B Corporations must submit a copy of their company's governing documents amended with the B Corp Legal Framework within a year of certification. This requires B Corps to obtain approval from the company's board of directors and to re-file the amended articles with the Secretary of

How would businesses you frequent score on the B Corp Impact Assessment?

Test it out with this sampling from B Corp's comprehensive benchmarking questionnaire.

Section 1: Accountability

- Has the company explicitly integrated a commitment to social impact or environmental stewardship into its written corporate mission?
- Does the company have a Board of Directors or other governing or advisory body?

Section 2: Employees

- What multiple is the highest compensated individual paid as compared to the lowest paid full-time worker?
- Is health insurance offered to all full-time employees and their families and what percent of premiums are paid by the company?

Section 3: Consumers

- Does the product or service promote economic equality, preserve the environment, improve health, advance knowledge, or increases the flow of capital to purpose-driven enterprises?

Section 4: Community

- Does the company share its social and environmental mission with suppliers?
- What is the total number of volunteer hours donated for last year?

Section 5: Environment

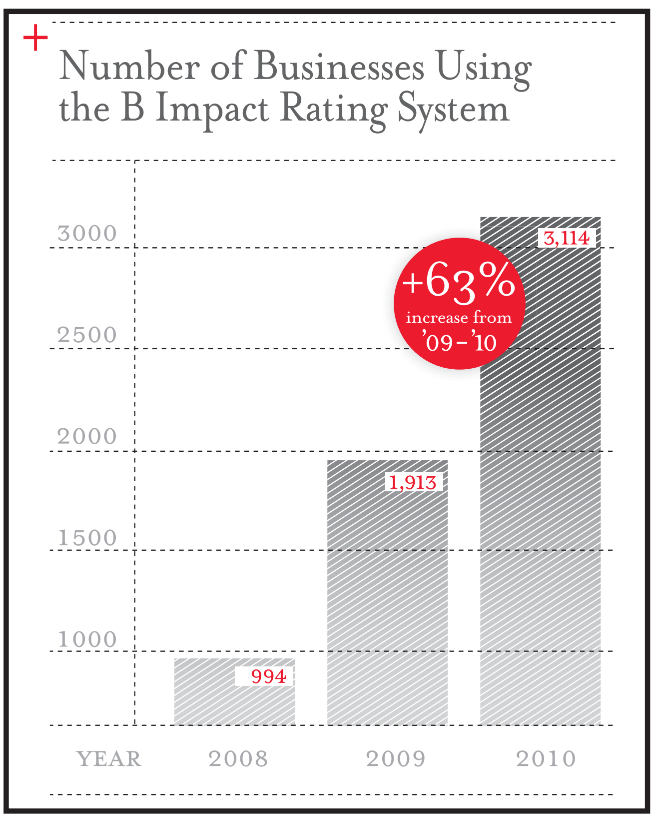
- Has the company conducted an environmental audit or review of company activities in the last three years?
- Is an annual carbon inventory of company activities conducted?

Section 6: Beneficial Business Models

- Is the company a community-based business, focused on serving your local economy?
- Is the company's business model designed to generate charitable giving?

State. Social and environmental values are built into their DNA, demonstrating a new way of doing business.

The growing community of Certified B Corporations has led to the most important corporate reform since the financial crisis, turning their legal innovations into law. Maryland and Vermont have passed legislation to recognize Benefit Corporations. Distinct from B Corporations, Benefit Corporation legislation expands fiduciary duty by requiring a company to create a material, positive impact on society and the environment and meet higher stands of accountability and transparency. By the end of 2011, seven other states may follow. Another large step forward is the first tax break for certified sustainable businesses in the city of Philadelphia. Optimistically, this policy will spread to other cities and eventually reach the federal level. This will not only allow, but also demand, that corporations serve more than just shareholders.



Despite recent accomplishments, there is still work to be done. It is our ultimate vision that B Corporations will be recognized by all states, receive tax preferences from the IRS, and be valued above all others by investors and consumers alike. For this to happen, we must all hold corporations accountable and demand that they change how they do business. We must also hold ourselves responsible to support those corporations and Benefit Corporation legislation in our home states.

By practicing transparency and holding corporations to high standards of behavior, we can rebuild consumer trust. By harnessing the scale and talent of our business community and looking beyond short-term profit, we can rebuild local, living economies, restore the environment, alleviate poverty and create better working environments. Corporations that are purpose-driven and benefit all stakeholders, not just shareholders, are the key to a better, more sustainable future. We must now support the necessary changes to make such corporations possible.

*Before leaving the private sector to form B Lab with two long-time friends, **Andrew Kassoy** spent 16 years in the private equity business.*

Fiduciary Duty: Challenges To The Traditional View

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tainable returns that come from solid economic growth?

In Europe, ESG-informed investing is becoming an integral part of benefit fund strategy. But it has been slower to catch on in the U.S. ESG-informed investing often has been viewed here as an attempt to inject non-economic or political considerations into something that should be return-oriented and value-neutral. The U.S. Department of Labor, the federal agency with jurisdictional rights over ERISA funds, has issued contradictory guidance as to whether trustees are permitted to make such considerations. The effect of this regulatory uncertainty, along with pushback from the corporate sector and an unwillingness of investment advisors to strongly support this approach, has meant that trustees in the United States, who must always consider potential personal liability for breaches of their fiduciary duties in their investing function, have been slow to consider ESG issues.

But a change is possible. The 1959 Prudent Man rule required trustees to invest trust assets as a prudent man would invest his own estate. Subsequent guidance has supported the notion that the concept of Fiduciary Duty should evolve to accommodate changing investment management practice. Now is the time for a change to a revised definition of fiduciary duty that seeks to maximize long term value creation by supporting sustainable capitalism. This approach would look thoroughly at risks of all types and explicitly include ESG factors. Doing so would lead to a more sustainable economy and a sustainable investment landscape, supporting employee pension costs over the long term.

■ ***Jay Youngdahl*** *is a writer and lawyer who represents several labor-affiliated benefit funds. He is an Independent Trustee on the Middletown Works VEBA that provides health insurance to approximately 5,000 retired steel workers and their families. He is also a member of the Small Funds Steering Committee of the UNPRI.*

Congressman Mike Capuano

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ing best between the public and private spheres? How involved should government be in regulating corporations and how involved should they be in affecting the public political process?

MC: The level of government involvement should depend on circumstances. If government involvement seems necessary and appropriate, then action should be taken. In this particular case, Congress does not seek to prohibit the ability of corporations to become involved in elections. Rather, Congress seeks to increase transparency and accountability in that process, which will provide more information and benefit the average voter in the long run.

Corporate Disclosure

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play? Advocates for enhanced disclosure sometimes sound as if they think that good information alone will move markets – that investors will follow new information and capital will flow towards positive outcomes once we know environmental and social costs. But with no mechanism to internalize externalities, there is no reason for investors to change their behavior. Enhanced disclosure may remain nothing more than a better tool to document the distance between corporate profit and the social good.

Here is one place where social investment, as an investment discipline, shows enormous promise. Social investment is predicated on the idea that investors can play an active role in improving corporate social performance. Social investors raise important issues in public awareness, and work directly with corporations to improve performance. Engagement and advocacy with corporations, public officials, advocates, and so on, are all part of what it means to be a social investor – to do it right, you have to put information to work not just in analyzing investments, but also in shaping the investment ecosystem. When its put to work, enhanced sustainability disclosure, in conjunction with these tools, can help shape markets so they reward more positive social outcomes.

In other words, social investment builds on the obvious but too often ignored insight that markets are made by people and that people can make them better. The goal of enhanced disclosure is not an end in itself but part of the larger process of rebuilding markets so that efficient allocation of capital supports the long term common good.

■ ***David Wood*** *is the Director of the Initiative for Responsible Investment at Harvard's Hauser Center for Nonprofit Organizations.*

Corporate Board Reform

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Sachs paid a record-breaking $550 million to settle the SEC's fraud charges relating to the marketing of some securities. But where does that money come from? The answer: from shareholders. But the people who marketed those securities were the primary beneficiaries and they neither paid a fine nor lost their jobs. Astoundingly, the board of directors the day after the settlement was the same as the day before, including many members who were responsible for the entire subprime fiasco.

Ultimately, there's only one way to make meaningful change, and that is to change the board. Whereas past reforms in this area have focused on improving director "independence," over 200 academic studies have been unable to link "independent" directors to either enhanced returns or reduced risk. This isn't because independence is insignificant; it is because "resumé independence," in order to meet the requirements of the exchanges, the SEC, and various "best practices" standards, are easily overrun by the fundamental conflicts of a system that still gives management control over who serves on the board.

The law says that except in the very rare case of a contested election – less than a fraction of one percent of director elections each year – even one vote in favor is enough to secure a seat on the board. More than 80 directors are continuing to serve even though a majority of the shareholders voted against them. Six directors received no more than a third of the vote, including three at one company. What's more, absent personal corruption, it is almost unheard of for a director to pay even a penny out of his own bank account, even in a $550 million fraud settlement like the one at Goldman Sachs. We cannot be surprised, then, that directors forget that it's shareholders to whom they owe their duties of care and loyalty.

Fortunately, there are some significant changes that will have a greater impact on the election of individual directors than at any time since the development of the modern public corporation. The first is the adoption, under shareholder pressure, of voluntary "majority vote" provisions. While a key provision was dropped from an earlier version of the financial reform legislation, one that would have imposed a majority vote requirement on all companies, most of the largest companies have already agreed that they will not allow directors to serve unless more than half of the shareholders want them to. This past spring, for example, CalPERS announced that it would ask 58 of the top U.S. companies in its global equity portfolio to voluntarily adopt the majority vote standard in uncontested elections for corporate directors.

Because of these efforts, it will become increasingly difficult

for companies to insist on keeping directors that shareholders do not want. Furthermore, director and officer liability insurers may become reluctant to insure them; why should the courts defer to the business judgment of people who explicitly have not been delegated authority from the company's owners?

It will also become increasingly more difficult for shareholders to routinely vote in favor of all management-sponsored board candidates. The New York Stock Exchange rules have been revised so that the election of even uncontested directors is no longer considered "routine." Investors, especially large institutional investors, recognize that they have been enablers for bad boards; most notably, re-electing an actress and a theatrical producer to the board of Lehman Brothers, or the boards that put in place outrageous executive compensation at Countrywide Indymac, Bear Stearns, and others. Ultimately, investors should give as much thought to the board as they do to financial and analyst reports.

Despite the best efforts of corporate lobbyists to expunge or defang reform, the "proxy access" provision was included in the final version of the reform legislation. The SEC has now developed rules that will permit investors to nominate their own candidates for the board and have them included in the proxy materials distributed to all shareholders by management. These changes will put directors for the first time to a genuine market test. And as any fan of capitalism knows, real, vigorous competition is the way to ensure not just real, meaningful independence, but also the kind of rigorous oversight that is the best guarantee of a robust and sustainable economy.

■ ***Nell Minow*** *is editor and co-founder of The Corporate Library and a frequent commentator on issues of corporate governance. Ms. Minow was named one of the 20 most influential people in corporate governance by Directorship magazine in 2007. She has served as President of Institutional Shareholder Services and as an attorney at the U.S. Environmental Protection Agency, the Office of Management and Budget, and the Department of Justice. Ms. Minow is also known as the "Movie Mom" critic for Beliefnet.*

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