
Hedge Funds: The Missing Link in Executive Pay Reform

By Robert C. Illig

As part of its bank rescue plan, the Obama administration has sought to enlist hedge funds to participate in so-called public-private partnerships.¹ Surprisingly, however, these often misunderstood entities may have an even more important role to play in connection with executive pay reform. Indeed, though their reputation with the general public probably ranks just above that of the AIG financial products unit, hedge funds are exemplars of good corporate governance. This is because their managers, unlike many of their peers in corporate America and on Wall Street, are in most cases rewarded *only* when they produce tangible profits.²

When considered soberly, it is clear that recent criticism of AIG and Wall Street bonuses is based on more than their raw size. Indeed, many less-reviled Americans bring home much larger paychecks. Among these are movie stars and professional athletes. The difference between the public's general embrace of these individuals and its fury at those at AIG lies in the fact that Americans expect pay to be tied to performance.³ So long as business leaders actually perform in a manner that is deemed worthy, we do not begrudge them their wealth. As a nation, we venerate entrepreneurship and business success, but only when each is based in reality.

Stated in the language of economics, tying pay to performance reduces agency costs because it aligns the interests of managers and investors. When managers pay themselves excessive salaries, fail to diligently pursue profits, or place their own interests ahead of the corporation's, waste is produced and both investors and society suffer.⁴ The problem with the increasingly

infamous bonuses on Wall Street—and with executive pay in general—is that they do not appear to be tied to any genuine measure of success.

As a result, the incentives created by existing pay structures are misaligned. In fact, the dirty little secret of executive pay is that stock options and other performance-based measures provide no penalty for managers who take on excessive risk, exactly the kind of risk that lies at the heart of the nation's recent credit meltdown. No matter how well designed, rewards tied only to high achievement provide no protection against the downside risk of over-speculation.⁵ Corporate America needs a stick as well as a carrot.

Under the current system, if an executive is able to increase the value of the company's stock in the short term, her options (or bonus or other form of stock-based compensation) will become valuable and she will be entitled to a potentially large payday, depending upon the size of the increase. But what if her company's performance lags? If the value of the stock drops to near or below the strike price of her options, her incentives change. For her, a small loss is the same as a large loss because her options provide a reward in the event of a gain but no penalty (other than a lost opportunity) in the event of failure. Thus, her incentive is to swing for the fences—to take on increased risk in the hope that she might get lucky and return her company to profitability. At this point, moral hazard comes into play because she is, quite literally, gambling with other people's money.

This is not what happens at hedge funds, however. Though largely unregulated, the industry has developed a fairly standard compensation scheme. Even more so than stock options, the structure of hedge fund compensation typically results in extremely large rewards for managers who produce tangible profits, but essentially nothing for managers for whom profits prove elusive.⁶

More importantly, however, hedge fund compensation also provides protection against downside risk.

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Managers, due to a combination of custom and market forces, generally invest a material portion of their personal wealth in their funds.⁷ The amount is not set, but it must be enough to cause the manager to feel real pain as losses begin to mount. Moreover, as a practical matter, such monies must remain at risk for as long as the hedge fund remains in business.⁸

What this means is that the hedge-fund model of compensation reduces agency costs by effectively linking the fortunes of managers with the fortunes of investors. If they produce profits, hedge fund managers are in for a potentially significant reward. If they produce nothing, their return is essentially zero—in theory, at least, only their costs are covered by a comparatively modest management fee.⁹ Finally, if they produce a loss, the managers share directly and proportionately in the loss alongside their investors. As a result, they are incentivized to perform well, but their incentive to take on excessive risk is minimized. Their interests thus fully aligned, hedge fund managers want exactly what their investors want.

If policymakers are serious about executive pay reform and not merely interested in beating up AIG and Wall Street executives for political gain, they should take a hard look at the hedge fund model. Rather than merely sanction the *granting* of stock options, as is currently the case, Congress should require that executives use their personal wealth and earnings to *purchase* stock in the companies they manage, thereby putting their own wealth at risk alongside the wealth of their investors. Moreover, they should make it impossible for managers to cash out their positions over the short term. What we need, in other words, is an incentive mechanism for corporate America that both rewards true performance *and* penalizes managers who take on unnecessary risk. If corporate America's executives are going to be paid to behave like entrepreneurs, they should also be required to internalize the hazards associated with entrepreneurial risk-taking.¹⁰

To better understand the limitations inherent in existing forms of executive compensation, as well as the potency of the hedge fund model, this essay compares the compensation structure of corporate executives and hedge fund managers. Its goal is to identify a model of compensation reform that both incentivizes managers to aggressively pursue investor interests and minimizes the likelihood that managers will take on excessive levels

of risk. With a few caveats, most notably an unnecessary and counterproductive management fee, hedge fund compensation embodies exactly that ideal.

Executive Pay and Stock Options

Prior to the 1980s, corporate managers were rewarded primarily on the basis of rank. Status within the corporate hierarchy, rather than actual financial performance, determined career success. As a result, the interests of managers overlapped only indirectly with those of their shareholders.¹¹ Rather than selflessly pursue higher stock prices, managers were incentivized to engage in empire-building and other stratagems aimed at enhancing their perceived importance.¹² Predictably, stock prices languished while executive compensation and M&A activity ballooned.¹³

Beginning around 1990, however, performance-based pay became part of the national agenda. It was then that Michael Jensen and Kevin Murphy published their provocative work claiming that American business leaders were behaving like bureaucrats because they were paid like bureaucrats.¹⁴ The size of executive pay was not the issue, they argued. Rather, the problem was that compensation had become unmoored from any significant measure of performance.¹⁵ Thus, if corporate executives could only be made to own substantial amounts of company stock, they would be incentivized to help American businesses remain profitable in the face of increased competition from Europe and Asia.¹⁶ Jensen and Murphy, in other words, were attempting to superimpose the model of the Silicon Valley entrepreneur onto mainstream corporate managers.

Important political support for pay for performance came in 1992, when Bill Clinton made it a major theme in his first run at the Presidency.¹⁷ Once in office, he enacted an excise tax on executive pay to the extent that it exceeds \$1 million, but exempted compensation that, like stock options, is tied to performance.¹⁸ Meanwhile, until 2006, public companies were not required to record the value of most stock option grants on their income statements.¹⁹ As a result, compensation in the form of options was given preferential accounting treatment in that such grants—no matter how large—had no impact on reported earnings.

Such favored tax and accounting treatment led predictably to an explosion in the use of stock options

and other stock-based awards.²⁰ Eighty percent of American senior executives now receive stock option grants, up from 50 percent in the 1960s and less than 20 percent in the 1950s.²¹ More significantly, however, the size of option grants has increased at an even faster pace. During the 1990s, for example, the average value of management stock options rose at the rate of 32 percent, such that more than half of the value of executive compensation now takes the form of gains from stock options.²²

Perhaps the best recent exemplar of this trend is Steve Jobs, the CEO of Apple, who limited himself to an annual salary of only \$1.²³ With Jobs at the helm, Apple's stock tripled in value over three years, thereby handsomely rewarding its shareholders.²⁴ As a result of stock-based awards, however, Jobs received \$650 million in incentive compensation in 2006, an amount sufficient to win him the title of America's highest paid corporate executive.²⁵

Clearly, then, American pay practices have improved the underlying alignment of interests between managers and shareholders. Indeed, although it has recently and spectacularly stumbled, the United States economy had experienced a near-continuous bull market since moving to a pay-for-performance system in the early 1990s.²⁶ At first blush, then, executive compensation appears to have achieved its stated goal of incentivizing corporate managers to more diligently pursue shareholder wealth maximization. Managers no longer behave like staid bureaucrats. Instead, they frequently behave like hungry entrepreneurs.

Perverse Incentives and Downside Risk

The true impact of stock options on corporate America, however, has been both muted and perverse. In the first place, stock options, as currently structured, frequently fail to create strong incentives for high-quality performance. Because it is unusual for an option's strike price to be tied to market indices, for example, most options reward managers whenever the company's market sector improves even if the company in question lags its competitors.²⁷ There is also evidence that the size of most option grants is largely unrelated to any measure of past or future performance.²⁸ In practice then, and despite the best hopes of Jensen and Murphy, stock options appear unlikely to incentivize American executives to truly become "value-maximizing entrepreneurs."²⁹

Even worse, however, to the extent that stock options do create incentives, they are often perverse.³⁰ For example, opportunities abound for fraud and accounting manipulation through the selective or timely disclosure of information.³¹ An obvious example of this phenomenon was the almost universal backdating of option grants among Silicon Valley technology companies during the late 1990s.³² Meanwhile, vesting schedules accentuate management's near-religious focus on short-term success.³³ In fact, on one level, much of the blame for the fraud that occurred at companies like Enron and WorldCom can be attributed to management's intense desire to maintain and enhance quarterly earnings.³⁴ Additionally, as the Black-Scholes model of option pricing demonstrates, stock options are most valuable when a company's stock is most erratic.³⁵ Management is therefore potentially rewarded less for consistency in long-term earnings growth than for pursuing a boom-and-bust mentality.

Finally, and most relevant to the ongoing credit crisis, corporate compensation packages are often structured in a way that provides little downside risk for managers who underperform. Thus, for example, when a company's stock price deteriorates significantly, it is common for the board to reset the strike price downward, thereby promising rich rewards for managers who simply return the company to its former level.³⁶

News accounts are similarly rife with stories of failed executives departing with epic paydays.³⁷ Robert Nardelli, for example, left Home Depot in 2007 with a \$210 million severance package, even though the company's stock actually fell during his tenure as chief executive.³⁸ Likewise, GM's long-term chairman, Rick Wagoner, departed only after being forced out by the Obama Administration, despite the fact that GM lost more than \$30 billion in 2008.³⁹ In fact, although GM's stock fell on his watch from more than \$82 per share in 2000, the year he became chairman, to its current price of just less than \$2, Wagoner received more than \$10 million in compensation in 2006 and more than \$14 million in 2007.⁴⁰

Meanwhile, compensation tied to stock options and other rewards for superior performance typically fail to differentiate between significant failures and minor ones. In other words, for a manager whose stock price is falling, a large loss is no different than a small

loss. In either case, her options are out-of-the-money and thus worthless over the short term. As a result, as performance begins to deteriorate, incentives are created for managers to increase their level of risk in the hope, however improbable or unlikely, that they can return the company to profitability. Indeed, the worse the manager's performance, the greater the likelihood of excessive risk. Thus, arguably at least, it is the worst of America's managers who are taking on the greatest level of risk. The extensive use of other forms of non-performance-based compensation, including retirement benefits and deferred compensation, further mute the downside impact of options by providing large guaranteed minimum salaries.⁴¹

Perhaps surprisingly, however, the underlying cause of these defects has never been much of a mystery—executive pay simply isn't negotiated at arm's length. A typical CEO's compensation is set by board members who are nominated and maintained in office by the CEO.⁴² Meanwhile, the compensation consultants that most large companies use to justify management pay scales are themselves hired by the very executives whose salaries they review.⁴³ Management, in other words, negotiates its compensation package with individuals who are financially beholden to their largesse.⁴⁴

Nor is management's compensation subject to any significant outside review. Unlike in Britain, for example, shareholders do not regularly vote on management's compensation practices.⁴⁵ Indeed, until quite recently, substantial portions of an executive's pay were exempt from federal disclosure requirements, and the Securities and Exchange Commission (SEC) remains quite concerned about the quality of compensation disclosures.⁴⁶ Legal and practical barriers similarly make it unlikely that outside investors will find it cost effective to challenge management pay in a proxy contest.⁴⁷ As a result, markets provide little in the way of discipline.⁴⁸

Prevailing compensation practices can thus be best understood as having been co-opted by management. As Lucian Bebchuk and Jesse Fried detail in their book, *Pay Without Performance*, the underlying problem is power.⁴⁹ Managers are often able to exploit their control over the corporation's purse and day-to-day affairs to insulate themselves from outside influence and so blunt any attempts to hold them accountable for poor

performance.⁵⁰ Indeed, as William Bratton brings to light, there is surprising consensus among scholars of all political stripes on this point.⁵¹ Though incentive-compensation schemes show promise, political realities are such that management has been able to subvert their impact. Rather than discipline underperforming managers, options in fact reward all managers and encourage them to manipulate their financial results. Moreover, as a final insult, they create a veneer of justification, camouflaging the truth with a narrative of hard-working executives who earn—and thus deserve—their outsized pay.⁵²

As foretold by Berle and Means, managerial interests thus remain distinct from, and in many respects opposed to, the interests of shareholders.⁵³ As a result, corporate agency costs flourish, excessive risk-taking proliferates, and an opportunity to focus the attention of executives in a socially and economically desirable direction is squandered.

Hedge Fund Compensation and the Magic of the “Carried Interest”

In contrast to corporate executives, the managers of hedge funds are compensated almost exclusively on the basis of their performance. Moreover, unrelated third parties determine compensation through the mechanism of a market for investment dollars. As a result, agency costs are reduced while opportunities for abuse are muted. Most importantly, however, the structure of most hedge funds is such that managers share the pain of their investors when they suffer losses due to an excess of risk. In fact, the stated goal of hedge fund governance is to align the interests of fund managers with those of their investors.⁵⁴

What makes hedge fund compensation unique, however, is not only its ability to align the interests of fund managers with the interests of their investors but also the fact that it is solely a creation of the market. There is no legal regulation or other outside influence that requires or rewards the scheme described below, as there is with corporate stock options and other forms of pay.⁵⁵ Rather, the scheme developed organically as a result of repeated—and unregulated—arm's-length negotiations between fund managers and prospective investors. Moreover, it is essentially an American creation, being used primarily by US-based hedge funds, private equity funds, and venture capital funds.

The centerpiece of hedge fund compensation is the so-called “carried interest.”⁵⁶ The term is industry shorthand for a scheme whereby any profits are split between fund investors and fund managers, typically at the ratio of 80/20.⁵⁷ Thus, once the fund investors have been allocated the entirety of their initial contribution, such that any remaining monies constitute pure profit, all future allocations are made at the rate of 80 percent for the investors and 20 percent for the managers.⁵⁸

In practice, this means that if a fund manager fails to generate investment profits during any given period, she is not paid for her (failed) efforts.⁵⁹ If, on the other hand, the manager’s investment strategy generates significant returns, she will be rewarded handsomely with a large share of the profits.⁶⁰ As a result, the manager’s incentives are focused entirely on increasing the value of the fund’s investment portfolio.

As an additional benefit, because the manager’s ability to share in the profits never dissipates, no matter how successful the fund, neither do the incentives.⁶¹ This is in contrast to a typical bonus, which incentivizes potential recipients to strive to achieve a certain threshold result, but then fails to incentivize further efforts. In a hedge fund, every single dollar of profit is shared 80/20, meaning that extra effort is always rewarded.

Thus, to the extent that a fund’s investors also seek capital appreciation, their interests will be aligned and agency costs will abate. Indirect proof that this structure is working can be found in the fact that highly sophisticated investors, who could easily choose to entrust their monies elsewhere, have poured more than \$1.8 trillion into hedge fund and private equity markets during the past decade.⁶²

The structure of hedge fund compensation, in addition to aligning the interests of fund managers and their investors, also reduces opportunities for manipulation and abuse.⁶³ This is because, unlike corporate managers, hedge fund managers have their fees set by outside investors as part of a comparatively well-functioning market for investment dollars.⁶⁴ The market, however, arises not because of federal disclosure obligations or frequent trading in the securities of any one fund, but because hedge fund managers compete to raise money from many of the same investors as other fund managers. As a result, the individuals who review any given

fund’s fees in anticipation of making an investment are well aware of what other funds are charging and how their compensation is structured. Moreover, their awareness is heightened because the recurring and frequently illiquid nature of private equity investing means that such managers must continually raise money to replenish their coffers.⁶⁵ Consequently, fund managers cannot charge significantly off-market terms without running the risk that they will fail to raise sufficient capital. Indeed, the take-it-or-leave-it nature of most fund offerings is such that managers find themselves negotiating against themselves when preparing proposed deal terms.⁶⁶

On a similar note, hedge fund compensation is also superior to that of corporate executives in addressing the potential for fund managers to benefit from general market movements. To the extent that a particular market sector is deemed to be hot, it is often the case that even the weakest players in that sector will see their share prices increase.⁶⁷ Thus, a fund manager who invests in such companies will be rewarded less for the quality of her performance than as a result of fortune’s grace (and the same is true of the managers of such corporations).

However, hedge fund compensation provides two answers to this potential misalignment of interests. First, fund managers generally seek to achieve high *absolute* returns (on a risk-adjusted basis), rather than relative returns.⁶⁸ Their goal is therefore not to outperform any particular market index or other stated benchmark, but to achieve positive results regardless of the business environment.⁶⁹ For governance purposes, this means that the compensation of hedge fund managers has less correlation to general market movements than would be the case if they sought merely to beat the market.

Second, many of the best fund managers charge a carried interest only to the extent that fund profits exceed a so-called “hurdle rate” or “priority return.”⁷⁰ Although there is a great deal of variation in how such hurdles are defined, they are frequently tied to bond market indices, such as the London Interbank Offered Rate or the yield on 12-month treasury bills, or to other appropriate financial benchmarks or market indicators.⁷¹ In such cases, the fund managers receive their carried interest only to the extent that they are able to produce profits that exceed the pre-determined minimum level of performance. As a result, the portion of the fund’s

success that is attributable to the underlying health of the economy or other factors beyond the managers' control is factored out of the equation.⁷² Properly constructed to include hurdle rates, the carried interest therefore rewards only exceptional performance.

As far as current market turmoil is concerned, however, the true magic of hedge fund compensation lies in its ability to minimize the downside risk associated with an underperforming fund. As we have seen, for a manager who is paid only in the presence of a profit, a large loss is the same as a small one.⁷³ Thus, the concern is that a straight carried interest—like stock options—could encourage excessive risk-taking whenever a fund's activities are yielding a loss. Indeed, as losses accrue, the risk increases that a fund manager would engage in unwarranted speculation in the hope that the fund could be returned to profitability.⁷⁴ Thus, the manager of a losing fund may find her interests diverging from those of her investors.

To address this possibility, fund managers have typically been required by their limited partners to invest a significant portion of their personal wealth in their funds alongside other investors.⁷⁵ Eddie Lampert, for example, the lead principal of ESL Investments, personally contributed almost half of the \$11.5 billion that ESL (until recently) had under management.⁷⁶ Although this practice began as a way to finesse a quirk in early partnership statutes, it has developed into a means for penalizing fund managers who gamble with their investors' dollars.⁷⁷ In a similar development, fund managers frequently co-invest in portfolio companies alongside their fund, thereby placing even more of their personal wealth at risk.⁷⁸ Thus, the typical hedge fund compensation structure already accounts for the downside risk of over-speculation by giving managers something to lose.⁷⁹ The fund managers are themselves investors with their own capital in jeopardy.

The Problem of Management Fees

This basic scheme is not without flaws, however. Particularly problematic is the continued existence of a management fee. Historically, to offset high operating costs, hedge funds and private equity funds have charged a management fee of around 2 percent in addition to the carried interest.⁸⁰ As initially conceived, such fees were intended to cover only reasonable operating expenses and thus to have a neutral impact

on the fundamental alignment of interests between fund managers and fund investors. Indeed, many funds are structured such that the fund's advisers must return the management fees to their investors, in addition to the investors' capital contributions, before taking their carried interest.⁸¹ Such fees were also designed to provide private equity managers a source of income during extended periods of non-liquidity.

Contrary to their intended purpose, however, management fees have steadily risen.⁸² Were such fees truly limited to offsetting expenses, we would expect to see the stated percentages falling at the same time that the average size of funds has been increasing. In other words, due to the savings that come from economies of scale, the doubling of a fund's assets should not require a doubling of its management fee. Recall, for example, that mutual fund fees have declined by more than half during the past two decades.⁸³ Fund management fees, however, have remained steady at about 2 percent.⁸⁴

By continuing to charge a fixed *percentage* of assets under management, even as the average-sized fund has grown, managers appear to be masking the fact that the absolute size of their non-performance-based compensation has ballooned. Thus, a fund with \$1 billion in assets now receives an annual management fee of \$20 million regardless of its performance.⁸⁵ Although its expenses may be significant, at least a portion of this amount is probably being treated as profit or used as insurance against a down year. Given that management fees lack any direct relation to profits, their growth undoubtedly serves to undercut a fund's overall alignment of interests.⁸⁶

In something of an ironic twist, however, it should be noted that current market turmoil has the potential to have positive effect on management fees. As stock and bond markets have tumbled, investors have put increased pressure on fund managers. As a result, at least a few funds have responded by reducing their management fees in order to retain their investors, while others are considering such a move.⁸⁷ Over the long term, then, concern over the negative impact of high management fees may prove to be overstated.

More importantly, as we search for a new model of executive compensation, there is no reason why management fees cannot simply be omitted from any

attempts at reform. Management fees, after all, are add-ons and thus are not integral to the overall scheme of hedge fund pay. Indeed, when considering executive pay reform, Congress could heed the warning implicit in the management fee and act to discourage or prohibit similar downside protections for corporate managers, including deferred compensation and option repricings. Thus, the management fee, though clearly detrimental to an otherwise elegant alignment of interests, should have little negative impact on compensation reform.

Overall, hedge fund compensation constitutes a proven (and, indeed, American) model whereby incentive compensation causes managers to strive for results that are untarnished by inside dealing and that minimize excessive risk-taking. Operating free from legal restrictions or management exploitation, hedge fund markets have developed a sophisticated mechanism for aligning the interests of managers and investors. Unlike the compensation of corporate executives, the carried interest—when subject to a hurdle rate—rewards hedge fund managers only for superior performance. Meanwhile, a direct investment by the fund managers penalizes them in direct proportion to their level of failure. The structure of hedge funds therefore recommends them as a superb model for executive pay reform.

Conclusion

Returning to this article's original question, the above analysis suggests that the clues for how to improve corporate pay are already present in the structure of hedge fund compensation. Indeed, although the industry as a whole has suffered in the wake of the ongoing credit crisis, many hedge funds have avoided excessive risk-taking and continued to outperform the market, once again proving the continued viability of their internal governance structure.⁸⁸ An agenda for corporate compensation reform is therefore clear.

First, Congress should consider methods of requiring corporate executives to put their own wealth at risk, alongside the wealth of their investors. Thus, for example, stock options should not be *granted*, but *sold*. In this way, managers can be discouraged from taking unnecessary or excessive risks because, like real entrepreneurs, their personal wealth will be on the line alongside that of their investors. Likewise, executives should be required to maintain an investment in the corporations they manage for an extended time, thereby minimizing

the temptation to privilege short-term gains over long-term success.

Second, aspects of compensation that interfere with the alignment of interests between managers and investors should be discouraged or eliminated. These include deferred compensation, option repricings, and option reloads. At the same time, a hurdle rate should also be required for all tax-preferred options and option-like rewards so that managers benefit only from truly exceptional performance.

Ultimately, the goal of executive compensation should be to accurately and tightly align the interests of managers and investors. In this respect, compensation reform represents an opportunity, not merely to increase fairness but also to improve efficiency and the overall success of the US economy. Interestingly enough, the hedge fund model is the product of both a uniquely American culture and a largely unregulated industry. Perhaps surprisingly, perhaps not, it is this model of compensation that represents our best prospect for once again making corporate America a leading force in worldwide corporate governance, risk-management and economic efficiency.

Notes

1. See Deborah Solomon, "Geithner Banks on Private Cash," *Wall St. J.*, Mar. 23, 2009, at A1.
2. The one major exception to this phenomenon is the 2 percent management fee charged by most hedge funds and private equity funds. See *infra* text accompanying nn.80-87.
3. See Jonathan Weisman, Sudeep Reddy & Liam Plevin, "Political Heat Sears AIG," *Wall St. J.*, Mar. 17, 2009, at A1.
4. Stephen M. Bainbridge, Corporation Law and Economics 35-36 (2002) ("Agency costs are defined as the sum of the monitoring and bonding costs, plus any residual loss, incurred to prevent shirking by agents. In turn, shirking is defined to include any action by a member of a production team that diverges from the interests of the team as a whole. As such, shirking includes not only culpable cheating, but also negligence, oversight, incapacity, and even honest mistakes.").
5. Robert C. Illig, "What Hedge Funds Can Teach Corporate America: A Roadmap for Achieving Institutional Investor Oversight," 57 *Am. U. L. Rev.* 225, 284 (2007).
6. Dow Jones, Private Equity Partnership Terms & Conditions 39 (2007) [hereinafter Private Equity Terms & Conditions] (this so-called "carried interest" is generally calculated as 20 percent of profits net of the investors' initial contributions).
7. See *id.* at 23 (reporting that the mean contribution by general partners in the survey was 3.25 percent for buyout funds and 2.1 percent for venture capital funds).

8. *Id.*
9. *Id.* at 30. See also *infra* text accompanying nn.80-87.
10. See generally David Skeel, *Icarus in the Boardroom: The Fundamental Flaws in Corporate America and Where They Came From* 5 (2006) (“When a would-be innovator with a visionary idea puts every dollar he or she has or can borrow into an Internet innovation, but the dream collapses, it isn’t headline news. Even if the entrepreneur loses everything, the failure may not ripple much further than a few family and friends. Put Icarus in the boardroom and everything changes An Icarus executive who takes excessive or fraudulent risks with a large corporation may jeopardize the financial lives of thousands of employees, investors, and suppliers of the business.”).
11. See Michael C. Jensen & Kevin J. Murphy, “CEO Incentives—It’s Not How Much You Pay, But How,” *Harv. Bus. Rev.*, May-June 1990, at 138, 139-140. Although managers were granted stock options prior to the 1990s, the value of such options did not constitute a significant part of their overall compensation package. See *id.*
12. See *id.* at 140.
13. See Lucian Bebchuk & Jesse Fried, *Pay Without Performance: The Unfulfilled Promise of Executive Compensation* 16 (2004) (describing the managerial tendency toward empire-building in order to justify a larger salary and additional perks); Patrick A. Gaughan, *Mergers, Acquisitions, and Corporate Restructurings* 296 (3d ed. 2002) (noting that firm managers may engage in leveraged buyouts based on the belief that “they could more easily justify higher salaries and other perks if the company were larger”). With regard to stock prices, see Roger Lowenstein, *Origins of the Crash: The Great Bubble and Its Undoing* 1-2 (2004) (“Indeed, in 1976, the market was no higher than its level of *eleven years* before. Adjusted for inflation, the picture was far worse: the purchasing power of the average stock had fallen by two-thirds.”).
14. See Jensen & Murphy, *supra* n.11, at 138; see also Michael C. Jensen & William H. Meckling, “Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure,” 3 *J. Fin. Econ.* 305, 308 (1976) (arguing in favor of incentive-based compensation for corporate managers); Charles M. Elson, “Director Compensation and the Management-Captured Board—The History of a Symptom and a Cure,” 50 *SMU L. Rev.* 127, 127-131 (1996) (extending this argument to corporate directors).
15. See Jensen & Murphy, *supra* n.11, at 139.
16. See *id.* at 141, 145, 149.
17. See, e.g., Jeffrey H. Birnbaum, “Campaign ’92: From Quayle to Clinton, Politicians Are Pouncing on the Hot Issue of Top Executives’ Hefty Salaries,” *Wall St. J.*, Jan. 15, 1992, at A14.
18. Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, 107 Stat. 312 (1993) (current version at I.R.C. § 162(m) (2000)) (imposing an excise tax on compensation paid to certain “covered employees” to the extent it exceeds \$1 million, other than “remuneration payable solely on account of the attainment of one or more performance goals” including stock options).
19. See generally Financial Accounting Standards Board, *Statement of Financial Accounting Standards No. 123R, Share-Based Payment*, Dec. 2004, available at <http://www.fasb.org/pdf/fas123r.pdf> (requiring that the fair value of stock options be recorded as an expense).
Although FAS 123R was originally scheduled to go into effect in 2005, its application to most companies was later postponed by up to six months. See Floyd Norris, “Audit Board Delays Rule On Options As Expenses,” *N.Y. Times*, Oct. 14, 2004, at C1 (reporting that FASB had acted under pressure from the SEC).
20. Although stock options are the best-known form of incentive compensation, the same or similar financial results can be achieved through grants of restricted stock, stock appreciation rights, phantom stock, and other awards. For convenience, however, I use the term “stock options” in this article as shorthand for all forms of stock-based compensation. For an overview of these forms of compensation, see generally Donald P. Delves, *Stock Options & the New Rules of Corporate Accountability: Measuring, Managing, and Rewarding Executive Performance* (2004).
21. Carola Frydman & Raven E. Saks, “Historical Trends in Executive Compensation 1936-2003,” at 20 (Nov. 15, 2005) (unpublished working paper, on file with the University of Chicago Graduate School of Business), available at <http://www.chicagogsb.edu/research/workshops/AppliedEcon/archive/WebArchive20052006/FrydmanSecondPaper.pdf>.
22. *Id.* at 18, 20; see also Delves, *supra* n.20, at 7 figs.1 & 2; David I. Walker, “The Manager’s Share,” 47 *Wm. & Mary L. Rev.* 587, 661 (2005) (pointing out that, for any one given executive, an overwhelming proportion of her compensation is typically paid in the form of incentive-based awards).
23. See Jordan Robertson, “Apple CEO Takes \$1 Salary in 2007,” *Assoc. Press*, Jan. 24, 2008, [http://www.thefreelibrary.com/Apple+C EO+takes+\\$1+salary+in+2007-a0161087462](http://www.thefreelibrary.com/Apple+C EO+takes+$1+salary+in+2007-a0161087462).
24. According to Apple’s three-year financial history summary, shares of its common stock traded as high as \$155 in 2007, as compared to a peak of \$53.20 in 2005. Apple Inc., *Three-Year Financial History*, http://media.corporate-ir.net/media_files/irol/10/107357/AAPL_3YR_Q407.pdf (last visited Oct. 27, 2008).
25. According to Apple’s 2007 proxy statement, Jobs was granted 10 million shares of restricted stock in March 2003. Apple Inc., *Proxy Statement (Form 14A)*, at 41 (April 16, 2007). All 10 million shares vested in March 2006, netting Jobs a profit of close to \$650 million. See Scott Decarlo, “Big Paychecks,” *Forbes*, May 21, 2007, at 112. In 2007, Jobs exercised 120,000 stock options, valued by Apple at \$14.6 million. See Robertson, *supra* n.23.
26. Notably, growth in the United States during the period from 1992 to 2000 outpaced that experienced by Italy, France, Britain, Germany, and Japan. See William W. Bratton, “The Academic Tournament over Executive Compensation,” 93 *Cal. L. Rev.* 1557, 1576 (2005) (reviewing Lucian Bebchuk & Jesse Fried, *Pay Without Performance: The Unfulfilled Promise of Executive Compensation* (2004)).
27. See *id.* at 139-142, 160.
28. See Rakesh Khurana, *Searching for a Corporate Savior: The Irrational Quest for Charismatic CEOs* 46-47, 245 n.54 (2002). One almost poetic example of this phenomenon is former AT&T CEO Edward Whitacre. After his company’s stock had fallen to 67 percent of its value, the incentive-based portion of his compensation was likewise reduced to 67 percent of its potential value. Though this might appear even-handed on its

- face, the result was that Whitacre received two-thirds of his incentive pay, while stockholders lost one-third of their investment. See Alan Murray, "CEOs of the World, Unite? When Executive Pay Can Be Truly Excessive," *Wall St. J.*, Apr. 26, 2006, at A2 (announcing the entrants to his annual "pay-for-nonperformance Hall of Shame"). The disconnect between performance and the level of option grants can also be seen in the common practice of "reloading"—automatically granting new options each time the manager exercises an existing option. See Bebchuk & Fried, *supra* n.13, at 169-170.
29. Jensen & Murphy, *supra* n.11, at 138.
 30. See, e.g., Saul Levmore, "Puzzling Stock Options and Compensation Norms," 149 *U. Pa. L. Rev.* 1901, 1930 (2001); Roger L. Martin, "Taking Stock," *Harv. Bus. Rev.*, Jan. 2003, at 19, 19 ("Motivating managers with company stock can do damage on a grand scale, encouraging them to pursue strategies that fatten their wallets at shareholders' expense."); Mark A. Sargent, "Lawyers in the Perfect Storm," 43 *Washburn L.J.* 1, 9 (2003) ("[S]tock option programs not only failed to meet their avowed goal of aligning managerial and shareholder interests, they created perverse incentives for abusing shareholders.").
 31. See, e.g., Bebchuk & Fried, *supra* n.13, at 174-183, 191; Bengt Holmström & Steven N. Kaplan, "The State of U.S. Corporate Governance: What's Right and What's Wrong?," 12-14, 16-17 (Eur. Corp. Governance Inst., Finance Working Paper No. 23/2003), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=441100.
 32. See, e.g., M. P. Narayanan, Cindy A. Schipani & H. Nejat Seyhun, "The Economic Impact of Backdating of Executive Stock Options," 105 *Mich. L. Rev.* 1597, 1605-1606 (2007) (noting that when a manager participates in backdating, "shareholders may be misled into believing that management's interests are firmly aligned with theirs through the compensation package, when in fact executives can receive additional compensation without stock prices rising"). For a spectacular example of options backdating fraud, see Vanessa Fuhrmans & James Bandler, "Ex-CEO Forfeits \$620 Million in Options Cases," *Wall St. J.*, Dec. 7, 2007, at A1, which describes what is believed to be the largest giveback ever in a shareholder derivative action.
 33. See Bebchuk & Fried, *supra* n.13, at 148, 155-156.
 34. See Walter M. Cadette, "How Stock Options Lead to Scandal," *N.Y. Times*, July 12, 2002, at A19.
 35. James C. Van Horne, *Financial Management and Policy* 107 (12th ed. 2001) ("Usually the most important factor in the valuation of options is the price volatility of the associated security. More specifically, the greater the possibility of extreme outcomes, the greater the value of the option to the holder, all other things being the same."); see also Fischer Black & Myron Scholes, "The Pricing of Options and Corporate Liabilities," 81 *J. Pol. Econ.* 637, 640-645 (1973) (first describing their formula for options pricing).
 36. See Mark Maremont & Charles Forelle, "Bosses' Pay: How Stock Options Became Part of the Problem," *Wall St. J.*, Dec. 27, 2006, at A1.
 37. See, e.g., David Carey, "Deliver and You Get Paid," *Corp. Dealmaker*, July-Aug. 2007, at 26, available at http://www.thedeal.com/corporatedealmaker/2007/08/deliver_and_you_get_paid.php (reporting that Carly Fiorina left Hewlett-Packard in disgrace with a \$180 million severance package, while Hank McKinnell left a failing Pfizer with \$200 million). See generally Eric Dash, "Has the Exit Sign Ever Looked So Good?," *N.Y. Times*, Apr. 8, 2007, § 3, at 6 (reporting that "the 35 chief executives who were ousted [in 2006] were handed more than \$799 million on their way out the door").
 38. Stephen Taub, "Nardelli Resigns from Home Depot," *CFO.com*, Jan. 3, 2007, <http://www.cfo.com/article.cfm/8486274?f=search>.
 39. See Sheryl Gay Stolberg & Bill Vlasic, "U.S. Lays Down Terms for Auto Bailout," *N.Y. Times*, Mar. 30, 2009, at A1.
 40. General Motors Corp., Proxy Statement (Form 14A), at 36 (April 25, 2008) (Summary Compensation Table). For the details of the changes in GM's stock price over time, see Yahoo! Finance, available at <http://finance.yahoo.com/q/bc?s=GM&t=my&1=on&z=m&q=1&c=>.
 41. See Bebchuk & Fried, *supra* n.13, at 95-99, 102-105 (describing the use of various non-incentive-based forms of compensation, including retirement programs and deferred compensation).
 42. *Id.* at 23-27.
 43. See *id.* at 37-39, 70-71; see also Gretchen Morgenson, "House Panel Finds Conflicts in Executive Pay Consulting," *N.Y. Times*, Dec. 6, 2007, at C1.
 44. See Bebchuk & Fried, *supra* n.13, at 18-20 (framing their inquiry around the question: "What would characterize an executive compensation arrangement produced by arm's-length bargaining between the executive and a board seeking to maximize shareholder value?").
 45. Rules promulgated in 2002 under the Companies Act, 1985, c. 6 (Eng.), engage shareholders in an annual vote on management compensation. The votes, however, are merely advisory in nature and thus do not bind the company so much as they serve as a means for shareholders to publicly express their outrage. As a result, the true impact of the rule remains to be seen. See generally Jesse Eisinger, "'No Excessive Pay, We're British,'" *Wall St. J.*, Feb. 8, 2006, at C1.
 46. See Executive Compensation and Related Party Disclosure, Exchange Act Release Nos. 33,8655, 34,53185, 71 Fed. Reg. 6542, 6543, 6545 (proposed Feb. 8, 2006). The prior disclosure rules had been adopted in 1992 in the wake of significant outcry regarding perceived excesses in executive compensation. See Susan Lorde Martin, "Executive Compensation: Reining in Runaway Abuses—Again," 41 *U.S.F. L. Rev.* 147, 148-153 (2006); Randall S. Thomas & Kenneth J. Martin, "The Effect of Shareholder Proposals on Executive Compensation," 67 *U. Cin. L. Rev.* 1021, 1069-1072 (1999) (finding that, despite rule changes in 1992, shareholders who seek to reform executive compensation face significant structural hurdles). Indeed, the SEC remains concerned that disclosure of executive compensation is too opaque. See Kara Scannell & Joann S. Lublin, "SEC Unhappy with Answers on Executive Pay," *Wall St. J.*, Jan. 29, 2008, at B1 (reporting that the SEC had sent letters to 350 companies critiquing the quality of their disclosures).
 47. See Bebchuk & Fried, *supra* n.13, at 25-27. Indeed, one study found that mutual funds generally oppose shareholder attempts

- to limit executive pay. Jennifer Levitz, "Do Mutual Funds Back CEO Pay?," *Wall St. J.*, Mar. 28, 2006, at C1 (reporting on the results of a study sponsored by AFSCME and the Corporate Library).
48. See Bebchuk & Fried, *supra* n.13, at 53-58 (arguing that market constraints work only against larger, higher-profile wealth transfers).
49. See *id.* at 61-117 (discussing the "managerial power perspective" and how that power is often abused).
50. *Id.* at 80-86.
51. See Bratton, *supra* n.26, at 1560-1561, 1583.
52. See Bebchuk & Fried, *supra* n.13, at 145 (asserting that executive compensation is structured to minimize the influence of "outrage costs"—expressions of disapproval by influential outsiders—by means of camouflaging its true impact).
53. See Bratton, *supra* n.26, at 1558 (noting that, according to Bebchuk and Fried, "current executive compensation practice demonstrates that the separation of ownership and control identified by Berle and Means more than seven decades ago still hobbles shareholder capitalism") (footnote omitted).
54. See James M. Schell, Private Equity Funds: Business Structure and Operations § 1.03[3], at 1-14 (2007) ("The concept of alignment of interest can provide an important element of consistency to the consideration of the numerous financial and other terms embedded in the contracts governing the organization and operation of a private equity fund. It can also provide a basis for identifying economic and other terms that, even if widely accepted as 'market,' should be resisted when possible."); Private Equity Terms & Conditions, *supra* n.6, at 7 ("Private equity finance derives its strength from an organizational characteristic that sets it apart from most other types of finance: It is structured so that the entrepreneurs, the investment managers, and the providers of capital all benefit in very material ways from the success of the businesses receiving financing. This alignment of interest ensures, at least in theory, that all decisions are made in a way that is likely to maximize the success of the business being financed.").
55. See Robert C. Illig, "The Promise of Hedge Fund Governance: How Incentive Compensation can Enhance Institutional Investor Monitoring," 60 *Ala. L. Rev.* 41, 64-67 (2008) (describing the legal restraints impacting mutual fund and pension fund compensation).
56. This is sometimes also referred to as a "promote," "promoted interest," or "override." Schell, *supra* n.54, § 2.02, at 2-6. For a general discussion of the carried interest, see William M Mercer, Inc., Key Terms and Conditions for Private Equity Investing 4, 16-18 (1996) [hereinafter Mercer Report].
57. Increasingly, some funds also vary the percentage payable to the fund advisers depending on the fund's performance. For example, a firm might charge a 20 percent carried interest if the internal rate of return is below 20 percent, but a 25 percent carried interest if performance exceeds the 20 percent level. Private Equity Terms & Conditions, *supra* n.6, at 39.
58. See Schell, *supra* n.54, § 2.02[1], at 2-6 to -9. In fact, the actual percentage may, in many cases, be far higher, as it is industry practice for the fund managers to invest a portion of their own net worth in the funds they manage. *Id.* § 3.02[2], at 3-21 to -23. Thus, not only are they likely to receive their 20 percent share of the profits, but they are also likely to receive an additional 80 percent share with respect to any capital that they invested.
59. Occasionally, this structure leads to complicated timing questions, especially in funds where an early investment might pay off quickly while others die a slower death. The result is that fund managers and investors have developed a complicated set of provisions, including so-called "clawbacks," that ensure that the economics of the fund balance correctly over its life, even if one party or another is inadvertently paid too much at one time or another. See Schell, *supra* n.54, § 2.04, at 2-21 to -27. Thus, private equity fund managers who oversee a loss are typically not rewarded for returning the fund to its prior level, as are corporate managers whose options are re-priced. See *supra* n.36 and accompanying text. Rather, they receive a carried interest only to the extent that profits exceed prior benchmarks. See Mercer Report, *supra* n.56, at 31.
60. These incentives can be quite large in practice. Witness the incredible pay packages for the top hedge fund managers. See Stephen Taub, "The Top 25 Moneymakers: The New Tycoons," *Alpha*, Apr. 2007, at 39, 41-42 (reporting that the top 25 hedge fund managers each individually earned more than \$240 million in 2006).
61. This is partly a function of the fact that for most funds, once a certain level of profit has been achieved, the managers are not entitled to any additional incentive fees until (and unless) the fund's performance exceeds this new "high water mark," at which point the standard is again adjusted upward. For a mathematical example of how such fees are calculated, see Henry Ordower, "Demystifying Hedge Funds: A Design Primer," 7 *U.C. Davis Bus. L.J.* 323, 347-348 (2007).
62. See Private Equity Terms & Conditions, *supra* n.6, at 30-34. Because private equity funds have a finite term, after which they are wound up and liquidated, it is difficult to measure the total assets under management at any given time. Thus, because the term of most funds is 10 years or less, the best gauge of the industry's size may be the amount of funds raised over a rolling 10-year period.
63. That being said, as with any commercial endeavor, there is always the potential for outright theft or fraud in clear violation of legal dictates. A prominent example of this may have occurred when the principals of Bayou Group disappeared in 2005 with approximately \$300 million of their investors' funds. See Ian McDonald, "Bayou Drained Accounts in '04 of \$161 Million," *Wall St. J.*, Sept. 1, 2005, at C1 (tracing Bayou's transfers of funds to and among banks around the world); Ian McDonald, John R. Emshwiller & Ianthe Jeanne Dugan, "Bayou Transfers Set off Alarms," *Wall St. J.*, Sept. 12, 2005, at C1 (explaining that the fraud scheme operated by tricking low-level bank employees into accepting funds by confusing them with technical financial language); Gretchen Morgenson, "What Really Happened at Bayou," *N.Y. Times*, Sept. 17, 2005, at C1 (detailing the unraveling of fraud).
64. See Schell, *supra* n.54, § 1.02, at 1-9 (noting that the relationship between investors and fund managers in private equity funds is

- characterized by voluntary agreement, rather than dictated by regulation, and so is the result of negotiations that take place within a market for pooled investments). For a discussion of the exemptions used by private equity funds to avoid most securities law disclosure requirements, see Illig, *supra* n.5, at 277-278.
65. See Paul Gompers & Josh Lerner, *The Venture Capital Cycle* 23 (2d ed. 2004) (describing the impact of the fact that most private equity funds are “self-liquidating”); Thomas Meyer & Pierre-Yves Mathonet, *Beyond the J-Curve: Managing a Portfolio of Venture Capital and Private Equity Funds* 24 (2005) (“To maintain continuous investment in portfolio companies, general partners need to raise new funds as soon as the capital from the existing partnership is fully invested, i.e. about once every 3-5 years.”).
66. See Mercer Report, *supra* n.56, at 82 (“The basic premise underlying our [study] was that general partners will attempt to negotiate terms and conditions that the market will bear.”).
67. See Bebchuk & Fried, *supra* n.13, at 139, 143.
68. Scott J. Lederman, *Hedge Fund Regulation* § 1.3, at 1-17 to -20 (2007).
69. See David Einhorn, *Fooling Some of the People All of the Time: A Long Short Story* 17-18 (2008).
70. See *Private Equity Terms & Conditions*, *supra* n.6, at 41-42 (reporting that 88.2 percent of buyout funds and 42.3 percent of venture capital funds in the survey provided for the payment of priority returns before the advisers earned their carried interest); see also Mercer Report, *supra* n.56, at 31-32. *But see* Victor Fleischer, “The Missing Preferred Return,” 31 *J. Corp. L.* 77, 82-86 (2005) (noting that venture capital funds, unlike leveraged buyout funds, typically do not calculate fund manager compensation by reference to a preferred return).
71. Schell, *supra* n.54, § 2.03[2], at 2-17 to -18. For example, many funds use a market index, such as the S&P 500, or simply a fixed rate of return in the range of 6 percent to 8 percent. *See id.*
72. Thus, for example, if a \$10 million fund generated \$5 million in profits during its first year (so that it now held \$15 million in capital) and if the hurdle rate were set at 5 percent, then the first \$10 million would be allocated to the investors as repayment of their initial capital, as would a return of 5 percent of their \$10 million investment (or \$500,000). The remaining \$4.5 million, which is attributable to the effort and skill of the fund managers, would then be split 80/20 between the fund investors and the fund managers. At the end of the day, then, the investors would be allocated \$14.1 million (\$10 million plus \$500,000 plus \$3.6 million), while the fund managers would receive \$900,000. Note, however, that most funds that provide for priority returns also adjust the calculation of the carried interest to permit the fund advisers to “catch up” once they have satisfied the priority amount. *See, e.g., Private Equity Terms & Conditions*, *supra* n.6, at 42 (providing a detailed mathematical example).
73. See Schell, *supra* n.54, § 3.02[2], at 3-21 to -23.
74. *See id.*
75. *See, e.g., Private Equity Terms & Conditions*, *supra* n.6, at 23 (reporting that the mean contribution by general partners in the survey was 3.25 percent for buyout funds and 2.1 percent for venture capital funds); Mercer Report, *supra* n.56, at 12-14. For a \$1 billion fund, this means an investment by the managers of around \$30 million.
76. Gretchen Morgenson, “Saving Sears Doesn’t Look Easy Anymore,” *N.Y. Times*, Jan. 27, 2008, § 3, at 1.
77. See Schell, *supra* n.54, § 3.02[2], at 3-21 to -23.
78. See *Private Equity Terms & Conditions*, *supra* n.6, at 24-25 (reporting that 30 percent of buyout fund general partners and almost 16 percent of venture capital fund general partners retain the option of co-investing).
79. See Schell, *supra* n.54, § 3.02[2], at 3-21 to -23.
80. *Id.* at 30; see also Mercer Report, *supra* n.56, at 16-19, 25-30; Schell, *supra* n.54, § 2.05[1], at 2-28 to -31. Management fees are generally in the range of one percent to 3 percent, with smaller funds charging the largest percentage fees, and a 2 percent fee being the most common. *See, e.g., Private Equity Terms & Conditions*, *supra* n.6, at 30-31 (noting that Blackstone Group’s newest fund will charge a management fee of 1.5 percent for the first \$6 billion and 1 percent for the remainder of the fund).
81. See *Private Equity Terms & Conditions*, *supra* n.6, at 38 (noting that 86.8 percent of funds surveyed calculated the carried interest net of management fees and other expenses).
82. Note, by contrast, that private equity markets have tackled a similar problem with non-incentive based compensation in the past. The managers of leveraged buyout and other private equity funds are frequently in a position to charge their portfolio companies any number of fees that are not performance based, including investment banking fees, arrangement fees, consulting fees, and break-up fees for transactions that are never consummated. *See Private Equity Terms & Conditions*, *supra* n.6, at 35. Until the early 1990s, fund managers generally retained the entire amount of such fees, thereby disrupting their alignment of interests with investors. *Id.* More recently, however, fund investors have begun to claim as much as 80 percent of such fees so as to minimize their disparate impact by mirroring the structure of the carried interest. *Id.* at 36.
83. Investment Company Institute, *2007 Investment Company Fact Book* 47 (47th ed. 2007) (reporting that total mutual fees, including ongoing expenses plus an annualized portion of any sales loads, declined from an average of 2.3 percent of fund assets in 1980 to only 1.1 percent of fund assets in 2006).
84. *Compare Private Equity Terms & Conditions*, *supra* n.6, at 30-31, with Mercer Report, *supra* n.56, at 25-30.
85. Of course, if performance were to lag too much, investors would presumably withdraw their capital.
86. A similar disalignment occurs as the result of front-end transaction fees earned by managers in connection with leveraged buyouts. *See* Michael C. Jensen, “Eclipse of the Public Corporation,” *Harv. Bus. Rev.*, Sept.-Oct. 1989, at 61, 74.
87. *See, e.g.,* Stephen Taub, *Alpha*, Oct. 2008, at 41; Louise Story, “Hedge Fund Glory Days Fading Fast,” *N.Y. Times*, Sept. 12, 2008, at C1, C7.
88. *See* Zachery Kouwe, “Hedge Fund Investors See Returns of 5 to 10%,” *N.Y. Times*, Mar. 23, 2009, at B3; *see also* Louise Story, “Top Hedge Fund Managers Do Well in a Down Year,” *N.Y. Times*, Mar. 24, 2009, at B1.

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