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# INSTITUTIONAL INVESTORS AND THE NEW CORPORATE GOVERNANCE

JAYNE W. BARNARD\*

*During the last decade, American capital markets have experienced a marked shift from a constituency made up primarily of household investors to one made up primarily of institutional investors. Institutional investors are fiduciary bodies such as pension funds, mutual funds, and employee stock ownership plans, representing large numbers of beneficiaries. As collective entities, institutional investors often amass billions of dollars in assets, thus giving them the potential for substantial influence on the companies in which they invest. In recent years, some institutional investors have sought to use this influence to challenge traditional patterns of corporate governance, claiming that new patterns of decisionmaking will result in enhanced corporate performance.*

*In this Article, Professor Jayne Barnard examines the most commonly-advanced institutional proposal for change—the shareholders' advisory committee—as well as the larger question of the appropriate role of institutional investors in corporate governance. After analyzing the changing role of institutional investors, Professor Barnard considers some of the policy questions raised by increased shareholder activism and explores some of the positive and negative consequences which may follow from this trend. She concludes that while institutional participation in corporate governance may have some beneficial impact on management, institutions should abandon the redundant shareholders' advisory committee, and focus instead on the composition and processes of the corporate board itself.*

[M]anagement quite naturally is the source of pressure for a totally compatible, comfortable, and supportive board. We need to create a countervailing force that works against that tendency toward comfort.<sup>1</sup>

The Board is most likely to perform its functions well when important stockholders are holding a prod to its collective back.<sup>2</sup>

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1. Williams, *Corporate Accountability: The Board of Directors*, 44 VITAL SPEECHES OF THE DAY, no. 15, May 15, 1978, at 468, 471, reprinted in BUSINESS ETHICS: READINGS AND CASES IN CORPORATE MORALITY, at 202 (W. Hoffman & J. Moore eds. 1984) (Harold M. Williams was Chairman of the SEC when he made this speech.).

2. Johnson, *Making the Board of Directors Function in the Age of Pension Capitalism*, in 21ST

Most companies are very wary. They regard any large shareholder not as an asset but as a liability. We can't even get them to return our phone calls.<sup>3</sup>

During the 1990 spring proxy season, the California Public Employees Retirement System (CalPERS), a fiduciary body currently managing \$58 billion in assets, submitted three identical shareholder proposals—to the managements of Avon Products Corporation, TRW Corporation, and Occidental Petroleum Corporation—seeking to establish a “shareholder’s advisory committee” as a supplemental body to those companies’ existing boards of directors.<sup>4</sup> During the same season, Harold C. Simmons, an insurgent seeking control of Lockheed Corporation in a vigorously contested proxy fight, won the support of key institutional investors (though ultimately not the proxy fight itself) by promising that, if victorious, he would create a shareholders’ advisory committee to counsel Lockheed’s board.<sup>5</sup>

This concept of a dual governance structure, which has its roots both in the West German corporate model<sup>6</sup> and the American tradition of an equity security holders’ committee in bankruptcy,<sup>7</sup> is just one of a number of proposals cur-

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ANNUAL INSTITUTE ON SECURITIES REGULATION 607 (C. Nathan, H. Pitt & S. Volk eds. 1989) (Elmer W. Johnson is former General Counsel and board member of General Motors Corporation).

3. Bartlett, *Big Funds Pressing for Voice in Management of Companies*, N.Y. Times, Feb. 23, 1990, at D5, col. 5 (quoting Roland M. Machhold, director of New Jersey public pension funds).

4. In each case, the proposal read as follows:

RESOLVED, that the Company shall have

a Shareholder’s Advisory Committee to advise the Board of Directors on the interests of shareholders. The Board of Directors shall ensure the formation and effective operation of this Committee and shall give due consideration to such advice and proposals as shall be reported by this Committee to the Board. Members of the Committee shall serve without costs to the Company, except that the Committee shall be reimbursed for normal travel and operating expenses. The Committee shall be composed of at least nine members and shall be reconstituted on an annual basis. The Board shall establish appropriate procedures for selection of members, provided that (i) each member is a beneficial owner of at least 1,000 shares of the company’s voting stock for the entire period of membership, (ii) no member has any affiliation with the Company other than as a shareholder, and (iii) at least five members are selected from the 50 largest beneficial owners of the Company’s voting shares. No member may serve more than two consecutive terms.

Letter from Kayla J. Gillan, Assistant General Counsel of CalPERS, to the author (April 5, 1990).

After the SEC staff declined to issue a No Action letter excluding this proposal from the ballot at TRW, CalPERS withdrew the TRW proposal, as well as the one at Occidental, because TRW “agreed to meet with [the fund] to discuss the concept of increased shareholder participation,” and Occidental “agreed to conduct semi-annual meetings between institutional shareholders and certain members . . . of the board of directors.” *Id.* The Avon proposal went forward and was voted on at the company’s May 3, 1990 annual meeting. See *infra* text accompanying note 139.

5. McCartney, *New Takeover Tactic: Ballots Instead of Bonds*, Wash. Post, Apr. 8, 1990, at H10, col. 4. Management also can use the advisory committee as an instrument for currying favor with institutional investors. In the spring of 1990, AmBase, Inc., confronted with widespread claims of mismanagement, voluntarily offered to assemble a shareholders’ advisory board. Galen, *AmBase’s Shareholders Don’t Think It Shared Enough*, BUS. WK., May 14, 1990, at 41-42. Later that year, Healthco International’s management assembled a shareholders’ advisory committee in response to a proxy challenge. Schultz, *Shareholder Activism Breaks New Ground with Healthco*, 16 CORP. FIN. WK., Oct. 8, 1990, at 1.

6. See *infra* notes 73-78 and accompanying text.

7. Upon the filing of a petition for reorganization under Chapter 11 of the Bankruptcy Code, the United States Trustee may appoint a committee of equity security holders to participate in the formulation of the reorganization plan. 11 U.S.C. § 1102(a)(1) (1988). Membership in the commit-



rently being considered by institutional investors, who are looking not only to improve the process of corporate decisionmaking but also to expand their role in corporate governance. That role, once essentially passive, in the last three years has become markedly more active. Institutional investors increasingly have been advancing shareholder proposals under SEC Rule 14a-8,<sup>8</sup> joining together to thwart management-proposed antitakeover strategies,<sup>9</sup> extracting significant concessions from contestants in proxy fights,<sup>10</sup> pressuring management for desirable reforms,<sup>11</sup> intervening in shareholders' rights litigation,<sup>12</sup> and taking high-profile positions on corporate governance issues generally.<sup>13</sup>

Today some institutional investors are seeking a more regularized role in corporate governance. In support of their efforts, they argue that they have expertise to contribute to the governance process. Moreover, they claim that institutional investors must have new incentives, in the form of participation opportunities, to ensure their loyalty and long-term investment presence in the American capital markets. Pointing to the fact that institutions unsentimentally cashed out many of their equity investments during the takeover binge of the late 1980s, some organizations now suggest—at least by inference—that they may feel as free to move their capital to other equity markets (such as the Euro-

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tee "shall ordinarily consist of the persons, willing to serve, that hold the seven largest amounts of equity securities . . . of the kinds represented on such committee." *Id.* § 1102(b)(2) (1988).

8. See Hanson, *Proxy Season: Victories Without Majorities*, PENSIONS & INVESTMENT AGE, July 23, 1990, at 16 (noting proposals by the Florida Board of Administration, Connecticut Retirement and Trust Funds, Massachusetts Pension Reserves Investment Management Board, and Houston Firemen's Relief and Retirement Fund); Parker, *Funds Gird for Proxy Season*, PENSIONS & INVESTMENT AGE, Nov. 13, 1989, at 92 (describing shareholder proposals submitted by TIAA-CREF, CalPERS, California State Teachers Group (CalSTRS), the State of Wisconsin Investment Board, and the Connecticut Trust Funds). During the 1990 proxy season, institutional investors advanced 98 shareholder proposals, of which 13 won a plurality of the shareholder vote. Fromson, *The Big Owners Roar*, FORTUNE, July 30, 1990, at 67. See generally Ryan, *Rule 14a-8, Institutional Shareholder Proposals, and Corporate Democracy*, 23 GA. L. REV. 97, 158-59 (1988) (describing institutional experiences in 1987 and 1988 using the shareholder proposal rule).

9. See *infra* notes 121-24 and accompanying text.

10. In the Lockheed proxy fight mentioned in the text, see *supra* text accompanying note 5, institutional investors were able to secure three seats on Lockheed's board as the price of their support for incumbent management. Stevenson, *Lockheed's Moves in Proxy Fight*, N.Y. Times, Apr. 5, 1990, at D2, col. 1.

11. *Big Stockholders May Put Pressure on First Interstate*, Wall St. J., Dec. 5, 1990, at A8, col. 3 (Institutional manager asserts that "if performance doesn't improve at the Los Angeles multibank holding company, he wouldn't hesitate to join with other big investors to force a breakup or sale to another banking company.").

12. CalPERS has intervened in suits challenging UA Corp. (for authorizing payment of \$76 million in investment banking fees to a management group whose LBO efforts failed) and Occidental Petroleum (for authorizing over \$70 million to construct and maintain the Armand Hammer Museum of Art). See *CalPERS Irate Over UAL Merger Fees*, MONEY MGMT. LETTER, Apr. 30, 1990, at 4; Grover, *What's Good for Armand Hammer May Not Be So Good for Oxy*, BUS. WK., Mar. 26, 1990, at 35.

13. In November 1989, CalPERS was the first group to file a petition with the SEC seeking comprehensive proxy reform. Letter from Richard H. Koppes, General Counsel, California Public Employees Retirement System, to Linda C. Quinn, Director, Division of Corporation Finance, Securities and Exchange Commission (Nov. 3, 1989). Since then, the American Bar Association, the United Shareholders Association, the American Society of Corporate Secretaries, and the Business Roundtable have joined in the reform efforts, though many of these groups disagree on just what "reform" is required.



pean Community) that will afford them the participation opportunities they seek.<sup>14</sup>

This Article examines the idea of shareholders' advisory committees and the larger question of the appropriate role of institutional investors in corporate governance. After tracing the origins of the advisory committee proposal, the Article will consider the traditional role of American institutional investors as non-participatory providers of capital. It then will examine the very practical reasons why this model and its operant counterpart, the "Wall Street Rule,"<sup>15</sup> have become obsolete. The Article then will explore the policy implications of institutional investor demands for significant, rather than cosmetic, participation in governance matters, and consider some of the hazards which such participation may generate. Finally, the Article will look at some possible advantages of institutional participation in corporate governance, especially the role institutions may play in curbing the tendency toward managerial "groupthink." The Article concludes by recommending that institutions abandon the shareholders' advisory committee and focus instead on the composition and processes of the corporate board itself.

#### I. THE ORIGINS OF THE SHAREHOLDERS' ADVISORY COMMITTEE

The idea of a representative group of institutional shareholders, whose function is to represent shareholders' interests generally and to monitor management on behalf of other shareholders, is not new: Adolph Berle in 1928 urged that banks holding depositors' shares in trust act as a "permanent protective committee" to negotiate for then unavailable financial disclosure and to represent shareholder interests in the face of managerial abuses.<sup>16</sup> Berle's idea was to authorize these banks to accept shares in custodian accounts,

thereby gathering many small holdings into an institution commanding a block so large that protection was worth while, and [also providing] themselves with power to represent the depositors of stock. Such institutions could easily keep themselves informed as to the affairs of the corporation whose stock was deposited with them and, as representing their clients, could take the action necessary to prevent or rectify violations of property rights where they occurred.<sup>17</sup>

Current proposals for shareholders' advisory committees differ from Berle's in several ways. Under the current view, shareholders' advisory committees would be comprised of several members, rather than relying on a sole monitor.

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14. CalPERS already has moved approximately \$9 billion, or more than 15% of its assets, to overseas investments. White & Sesit, *U.S. Funds Are Rushing Overseas Despite Foreign Market Slump*, Wall St. J., Dec. 5, 1990, at C1, col. 4. "[N]early half of all American pension funds, foundations and endowments have put money abroad or plan to do so." *Id.* Many overseas companies are now actively courting foreign capital by making their governance rules more attractive to international investors. Price, *German Vote Curbs Under Fire*, PENSIONS & INVESTMENT AGE, Apr. 16, 1990, at 19 (German companies are considering abandoning rules prohibiting shareholders with more than five or ten percent of a company's equity from voting the excess over that percentage).

15. See *infra* note 94 and accompanying text.

16. A. BERLE, *STUDIES IN THE LAW OF CORPORATION FINANCE* 39 (1928).

17. *Id.*

These committees would be established on a company-by-company basis, only when poor performance suggests the need to change governance practices. Committees would be firm-specific, typically comprised of the nine or ten largest shareholders willing to serve.<sup>18</sup> Committee members would be reimbursed their actual expenses by the company, thus spreading the cost among all shareholders.<sup>19</sup> The purpose of the committees would be to provide a forum through which shareholders could communicate with board members and "[to] institutionalize a procedure for developing and communicating shareholder input."<sup>20</sup>

Shareholders' advisory committees by definition would impose costs on corporations and thereby deplete assets otherwise available for reinvestment or for distribution to investors.<sup>21</sup> Further, many observers consider them unnecessary and duplicative at a time when directors themselves, through compensation schemes featuring equity—rather than cash—payments, are aligning their interests more closely with those of their constituents,<sup>22</sup> and thus may be assumed to be moving toward a more effective governance role. Some economists argue that the confluence of the capital market, the market for managerial labor, and the market for corporate control stimulate corporate managers to optimum performance, rendering additional monitoring mechanisms unnecessary.<sup>23</sup> Indeed, some scholars even argue that the board of directors has become superfluous.<sup>24</sup>

Business executives, too, generally disfavor efforts to establish shareholders' advisory committees. They claim to worry about the inhibiting effects of "governance by referendum."<sup>25</sup> They also argue that advisory committees are likely to be comprised primarily of investors with "special interests or motives contrary to the interests of the stockholders in general."<sup>26</sup>

How is it then, that a structure which would be at least minimally costly and might impair the ability of corporate managers to take appropriate risks seems to be gathering shareholder support?<sup>27</sup> And how, more broadly, does it happen that an increasing number of institutional investors are expressing some

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18. See, e.g., the "Texaco proposal," *infra* note 63.

19. See, e.g., the "Avon proposal," *supra* note 4.

20. AVON PRODUCTS, INC., PROXY 25 (Mar. 30, 1990) (statement supporting shareholder proposal).

21. See *infra* note 203 and accompanying text.

22. KORN/FERRY INTERNATIONAL, SEVENTEENTH ANNUAL BOARD OF DIRECTORS STUDY 9 (1990) ("In 1989, 24 percent of all respondents provided stock options for their outside directors, up from 16 percent in 1988 and three percent five years ago.").

23. See, e.g., Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 NW. U.L. REV. 913, 919 (1982); Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259, 1263-64 (1982) [hereinafter *Corporate Governance*].

24. See, e.g., Axworthy, *Corporate Directors—Who Needs Them?*, 51 MOD. L. REV. 273 (1988).

25. THE BUSINESS ROUNDTABLE, CORPORATE GOVERNANCE AND AMERICAN COMPETITIVENESS 16 (1990). As one critic has pointed out: "The inclination of corporate executives to make wealth-maximizing but risky decisions might not be improved much by the introduction of a class of professional kibitzers who answer to financial intermediaries." Comment, *Wimpy Directors Likely Result of Proxy Reform*, Wall St. J., Dec. 4, 1990, at A18, col. 3.

26. AVON PRODUCTS, INC., PROXY 28 (Mar. 30, 1990) (statement opposing shareholder proposal).

27. See *infra* notes 71-72 and accompanying text.



interest in expanding their governance role? The answer may be found in the changing demographics of institutional investors as a group.

*A. Institutions in Their Economic and Political Context*

Four major trends define the behavior of American institutional investors over the past five years. First is the asset growth of institutional investors in absolute terms. Pension fund assets grew from \$1.59 trillion in 1985 to \$2.47 trillion in 1989,<sup>28</sup> a fifty-five percent increase; retail mutual fund assets grew from \$495.5 billion in 1985 to \$982.0 billion in 1989,<sup>29</sup> a ninety-eight percent increase. Second, particularly in the case of pension funds, is the increasing allocation of those assets away from traditional debt instruments to higher-risk equity investments,<sup>30</sup> often on an indexed, rather than on a selective, basis.<sup>31</sup> Third is the intense concentration of institutions' assets in specific companies, typically the blue chip companies. For example, the twenty biggest pension funds collectively now own more than nine percent of IBM and more than ten percent of General Motors.<sup>32</sup> The top twenty pension funds plus the ten largest United States money managers now hold more than sixteen percent of the shares in the ten largest United States corporations.<sup>33</sup> Experts speculate that by the year 2000, the ownership of the ten largest corporations by these thirty shareholders will range somewhere between twenty-two percent and twenty-nine percent.<sup>34</sup> Fourth is the development of a professional cadre of portfolio management professionals and associated proxy-voting advisors.<sup>35</sup> All of these trends, reflecting the expanded presence of institutions in the equity markets, help to explain why institutions are seeking a larger voice in governance matters.

In considering the changing role of institutional investors, one must look to several different categories of these investors: public pension funds, corporate pension funds, union pension funds, retail mutual funds, banks and thrifts, in-

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28. White, *Giant Pension Funds' Explosive Growth Concentrates Economic Assets and Power*, Wall St. J., June 28, 1990, at C1, col. 3. All institutions now control assets worth \$6 trillion, more than the GNP of the United States. Taylor, *Can Big Owners Make a Big Difference?*, HARV. BUS. REV., Sept.-Oct. 1990, at 70.

29. INVESTMENT COMPANY INSTITUTE, MUTUAL FUND FACT BOOK 2 (30th ed. 1990).

30. White, *supra* note 28, at col. 4 (in 1970, stocks equalled less than 17% of the assets of state and local pension funds; by 1988, stockholdings had increased to 37% of their portfolios). There has been a countervailing shift in private pension plans from defined benefit pension plans to defined contribution pension plans, which characteristically include a high percentage of fixed-income securities and a low percentage of equities. *Special Report: The New Breed of Pensions That May Leave Retirees Poorer*, BUS. WK., Nov. 6, 1989, at 164.

31. Of the \$40 billion in equities owned by the New York State retirement funds, \$30 billion are in indexed portfolios. Taylor, *supra* note 28, at 72. Overall, approximately 30% of all pension fund assets now are held in indexed accounts. Alder, *Are Indexed Funds Un-American?*, J. PORTFOLIO MGMT., Fall, 1990, at 94.

32. White, *supra* note 28, at col. 3.

33. Taylor, *supra* note 28, at 71.

34. Millstein, *The Institutional Investor Project at Columbia University—Progress to Date and Future Direction, Remarks to the Corporate Governance Workshop at Wharton (May 23, 1990)*, in 22ND ANNUAL INSTITUTE ON SECURITIES REGULATION 407, 413 (H. Pitt, C. Nathan & S. Volk eds. 1990).

35. Consulting firms such as Institutional Shareholder Services, Inc., Analysis Group, Inc., and Institutional Voting Research Service, have all come into existence during the last five years.



surance and annuity companies, and private foundations. Collectively, the first five categories now represent over forty percent of the equity market.<sup>36</sup> Thus, the focus here will be on them.

While decisionmakers within each of these categories are fiduciaries, and each of these entities is to some degree regulated, the economic motivations of each type of fund and the political context in which each operates may be quite different. For example, all pension funds presumably are interested in long-term growth and actuarially predictable payouts rather than in short-term performance or liquidity. Elected officials often oversee public pension funds, and may use the proxy arena as a bully pulpit in which to gain public attention.<sup>37</sup> Corporate pension funds, by contrast, generally are overseen by corporate executives, who serve as the "named fiduciary," and by middle-management technocrats, whose highest aspirations may be anonymity. Union pension funds under the Taft-Hartley Act<sup>38</sup> (those established under collective bargaining agreements) are administered jointly by management and labor representatives, while non-Taft-Hartley union funds (those which are funded by union dues) are administered by officials selected from union leadership. In all four types of pension funds, both the trustees and their in-house fund administrators enjoy job security largely unrelated to fund performance.

Because of their social and organizational loyalties, most corporate pension fund fiduciaries and the management-appointed trustees who oversee Taft-Hartley union funds have parallel interests with managers of other corporations, and in the event of a contest are likely to identify more with management's, than with shareholders', concerns. Because they are not themselves corporate managers, this is less likely to be true of public pension fund trustees and union-based trustees. The latter, however, may have "other constituency" biases which can inhibit an unflinching commitment to shareholder wealth. For example, public pension fund trustees sometimes must consider the possibility of lost jobs, and lost tax revenues, which may result from the exercise of their shareholder franchise.<sup>39</sup> Union fund trustees similarly may consider the interests of

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36. W. CARY & M. EISENBERG, *CORPORATIONS CASES AND MATERIALS* 144 (concise 6th ed. 1988).

37. Examples may include Harrison "Jay" Goldin, formerly Comptroller of the City of New York, a founder of the Council of Institutional Investors, and a recent candidate for Mayor of the City of New York; and Gray Davis, California Controller, member of the CalPERS and CalSTRS boards of trustees, co-chair of the Council of Institutional Investors, and an aspirant candidate for higher office. Both men have gotten political mileage out of their stands on corporate environmental policies and social issues. Alpert, *The Shareholders Who Roared*, *FORTUNE*, June 19, 1989, at 161 (persuading Exxon to put an environmentalist on its board); Bucio & Preston, *Koch Sells His Controversial Stock Holdings*, *Newsday*, Jul. 12, 1989 at 6 (doing business in South Africa).

38. 29 U.S.C. § 141 (1988).

39. The State of Wisconsin Investment Board (SWIB) discovered this in 1987, after it had submitted a critical shareholder proposal at General Motors Corp. and summoned GM's top executives to account for their recent activity. One observer stated:

The action shook up [GM] Chairman Roger Smith, who agreed to go to Madison and meet with the state board. The head of the investment board told Governor Tommy Thompson of Smith's impending visit. Thompson had just been elected on a campaign pledge of more jobs and a better business environment. Smith happened to be considering expanding a truck plant in Janesville, Wisconsin.

Perry, *Who Runs Your Company Anyway?*, *FORTUNE*, Sept. 12, 1988. After a pre-meeting off-the-

current union members as well as their constituent retirees.

Most pension funds, regardless of type, contract out a substantial amount of the investment decisionmaking and related governance obligations to hired fund managers. These fund managers operate in a highly competitive atmosphere in which their performance necessarily may be judged on a short-term basis, as management contracts come up for renewal. Their continuing employment is based entirely upon performance—if not on a quarterly basis, then certainly over time. Managers who consistently underperform the median of all fund managers, for example, are not likely to survive. They are not judged, or rewarded, on the basis of their “citizenship” or success in corporate governance.<sup>40</sup>

Fund managers operate at the sufferance of the sponsoring funds’ trustees and administrators, who may interfere with the exercise of fund proxy voting power either by seizing the vote directly or by influencing their fund managers indirectly. For example, at least one commentator has alleged that fund sponsors often discourage corporate pension fund managers from taking an active governance role, threatening them with discontinuation of their contracts.<sup>41</sup>

The Department of Labor, as the oversight agency for ERISA employee benefit plans, which include corporate pension plans and all union plans, has expressed substantial concern in this area.<sup>42</sup> In any event, it is not surprising that corporate pension funds, as distinguished from public pension funds, have not participated at all in the “corporate governance movement.”

Retail mutual funds operate in a very different atmosphere. Unlike pension fund beneficiaries, who have a long-term investment horizon, many mutual fund investors move freely in and out of their funds. Thus, retail mutual funds must have a far higher percentage of liquid assets than pension funds. Because of the competitive and highly liquid nature of the industry, mutual fund customers are also likely to focus on quarterly or annual results.

Mutual fund managers are compensated on the basis of prenegotiated annual management fees, generally based on a percentage of the fund’s net assets. Spending resources on governance matters necessarily will reduce their net management fee. Thus, most retail mutual fund managers have declined to seek an active role in corporate governance matters, often citing the unrecoverable costs

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record dinner at the Governor’s mansion, Smith met with SWIB officials and shortly thereafter, the fund announced it was reconsidering its position. Burr, *Meeting Eased Concerns; Wisconsin Might Not Co-Sponsor GM Resolution*, PENSIONS & INVESTMENT AGE, Jan. 26, 1987, at 94.

40. L. LOWENSTEIN, WHAT’S WRONG WITH WALL STREET: SHORT-TERM GAIN AND THE ABSENTEE SHAREHOLDER 206 (1988).

41. Fromson, *supra* note 8 (investment manager Dean LeBaron claims he has lost clients because of his outspoken opposition to antitakeover devices); see also SECURITIES AND EXCHANGE COMMISSION, STAFF REPORT ON CORPORATE ACCOUNTABILITY 397 (1990) Banking, Housing and Urban Affairs, U.S. Senate, 96th Cong., 2d Sess. (1980) [hereinafter SEC STAFF REPORT ON CORPORATE ACCOUNTABILITY] (recounting institutional concerns about customer dissatisfaction were they actively to exercise their proxy powers).

42. See Letter from Alan Lebowitz, Deputy Assistant Secretary of Labor to Helmuth Fandl, Avon Products, Inc., 15 PENS. REP. (BNA) 391 (1988) (the “Avon letter”) (reminding ERISA fiduciaries to vote shares solely for the benefit of plan beneficiaries).



involved.<sup>43</sup> Because of special conflict of interest considerations and the adverse nature of creditors' rights laws,<sup>44</sup> banks, too, have been reluctant to engage in high-profile governance pursuits.

As a consequence of these patterns, until recently, only a handful of institutions have taken an active role in corporate governance matters. Virtually all of the activists have been public pension funds headed by salaried executives.<sup>45</sup> That pattern, however, may be changing. Fidelity Investments, which manages some \$40 billion in equity mutual fund assets, recently changed its investment policy restrictions to permit it to participate more actively in proxy contests.<sup>46</sup> Fidelity and the Vanguard Group, Inc., representing \$20 billion in equity mutual fund assets, both lobbied against Pennsylvania's aggressive new antitakeover law in the spring of 1990.<sup>47</sup>

Some private fund managers are said to be considering participation in a "corporate governance fund," in which investors will pool their resources to acquire significant stakes in targeted corporations and then demand a significant governance role.<sup>48</sup> All things considered, however, corporate pension funds, and most retail mutual fund managers, remain reluctant to become involved in governance matters. To date, only four union pension funds<sup>49</sup> and a dozen or so public pension funds out of the thousands in existence have taken an out-front role in governance matters.<sup>50</sup> The most outspoken of those taking the lead has

43. Ring, *Mutual Fund Activism Unlikely*, PENSIONS & INVESTMENT AGE, Jan. 22, 1990, at 75.

44. See J. NORTON & W. BAGGETT, LENDER LIABILITY LAW AND LITIGATION *passim* (1990) (describing numerous theories under which lenders may be held liable for borrower's conduct).

45. Cf. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 606 (1990) ("All major institutions have significant conflicts of interest; all but public pension funds have incentives to keep corporate managers happy."). The occasional exception to this statement may be found in union pension funds. For example, the United Mine Workers Union in 1989 sponsored three shareholder proposals at the Pittston Company, where mine workers had been on strike since April 1988. Forming a group called the Pittston Independent Shareholders Committee, comprised of mine workers who owned Pittston shares, the UMW sought shareholder approval of proposals challenging Pittston's poison pill and advocating confidential proxy voting and the establishment of a committee to explore opportunities for restructuring, all typical shareholders' rights proposals. The UMW's real goal, however, was to gain leverage in its labor dispute. See Parker, *Miners Lead Proxy Bid: Claim Fight is Unrelated to Labor Dispute*, PENSIONS & INVESTMENT AGE, May 1, 1989, at 1. The United Brotherhood of Carpenters and Joiners of America, the International Brotherhood of Electrical Workers, and the Paperworkers Union have also ventured into the world of shareholder activism, albeit on a limited basis.

46. Ring, *supra* note 43, at 75.

47. Marr, *Anti-takeover Bill Threatens Shareholders*, PENSIONS & INVESTMENT AGE, Mar. 5, 1990, at 14.

48. Rosenbaum & Korens, *Institutional Shareholder Activism and Related Proposals for Legislative and Regulatory Changes to Corporate Governance Rules*, in PROXY CONTESTS, INSTITUTIONAL INVESTOR INITIATIVES AND MANAGEMENT RESPONSES 1990, at 628 (K. Eppler & T. Gilroy eds.). CalPERS may be ahead of the private funds in this regard. It already has placed two directors on the board of Santa Fe Pacific Realty, of which it owns 19.9%. Hemmerick, *A Test for California Fund—Officials to Get Hand in Directing Company's Fortune*, PENSIONS & INVESTMENT AGE, June 11, 1990, at 36.

49. See *supra* note 45.

50. The following public pension funds have submitted shareholder proposals on corporate governance issues to date—CalPERS, the California State Teachers Retirement System, the State of Connecticut Retirement and Trust Funds, the Florida State Board of Administration, the New York City Employees' Retirement System, the New York City Fire Department Pension Fund, the New York City Police Department Pension Fund, the New York City Teachers' Retirement System, the



been the California Public Employees Retirement System.

*B. The CalPERS Agenda*

CalPERS has been active in corporate governance issues since 1984, when then-state Treasurer Jesse M. Unruh, an influential member of the CalPERS board, discovered greenmail. In an often-told story, Unruh one day read that Texaco's management had just paid \$1.3 billion—representing a premium of \$40 million over market—to buy back two million of its shares that recently had been purchased by the Bass brothers.<sup>51</sup> Inasmuch as CalPERS was the largest single Texaco shareholder, Unruh convened his staff to question the transaction:

"Do you mean these people can elect to buy out one class of shareholder at \$55 and leave the rest of us in at \$35?" Unruh asked the CalPERS staff. Yes, they can, they told him. "Like hell!" said Unruh.<sup>52</sup>

Other episodes, such as the greenmail payment by Walt Disney Productions to Saul Steinberg in 1984, led Unruh to convene the Council of Institutional Investors.<sup>53</sup> Unruh later demanded dialogue between major shareholders and the managements of poorly performing companies, such as General Motors, and lobbied in favor of statutory one share/one vote guarantees.<sup>54</sup> Unruh's recurring theme was "if [shareholders] don't show some activity, they are going to get screwed,"<sup>55</sup> or, equally graphic, "Right now, it's like we're getting raped and we can't fight back."<sup>56</sup>

The specific impetus toward shareholders' advisory committees traces to the lawsuit filed by Pennzoil Co. against Texaco, Inc. in 1984, arising out of Pennzoil's aborted purchase of Getty Oil Co.<sup>57</sup> Pennzoil ultimately secured a judgment against Texaco for \$10.3 billion, and Texaco, unable to post a supersedeas bond to pursue its appellate rights, filed for protection under Chapter 11 of the Bankruptcy Code in April 1987.<sup>58</sup>

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Pennsylvania Public School Employees' Retirement System, and the State of Wisconsin Investment Board. J. BIRSACH, VOTING BY INSTITUTIONAL INVESTORS ON CORPORATE GOVERNANCE ISSUES IN THE 1990 PROXY SEASON app. B (1990); L. KRASNOW, VOTING BY INSTITUTIONAL INVESTORS ON CORPORATE GOVERNANCE ISSUES IN THE 1989 PROXY SEASON app. A (1989). In addition, TIAA/CREF, which represents many public as well as private university employees, has submitted shareholder proposals.

51. Perry, *supra* note 39, at 141.

52. *Id.*

53. *Council of Institutional Investors is Becoming a Force to be Reckoned With in Corporate Takeover Plotting*, AM. BANKER, Oct. 29, 1985, at 40. CII now has more than 60 members, representing \$300 billion in assets. The story of the greenmail payments in the Disney case is recounted in J. TAYLOR, STORMING THE MAGIC KINGDOM—WALL STREET, THE RAIDERS, AND THE BATTLE FOR DISNEY (1987).

54. Power, *Shareholders Aren't Just Rolling Over Anymore*, BUS. WK., Apr. 27, 1987, at 32, 33.

55. *Id.*

56. *A Move to Make Institutions Start Using Their Stockholder Clout*, BUS. WK., Aug. 6, 1984, at 70.

57. *Texaco, Inc. v. Pennzoil Co.*, 729 S.W.2d 768 (Tex. Civ. App. 1987), *cert. dismissed*, 485 U.S. 994 (1988).

58. *In re Texaco, Inc.*, 77 Bankr. 433, 435 (Bankr. S.D.N.Y. 1987). The Pennzoil case ultimately was settled in 1988 for \$3 billion.

As authorized by Chapter 11, the Bankruptcy Judge appointed both a creditors' committee and an equity security holders' committee to participate in the structuring of Texaco's reorganization plan. Several institutional investors, though eligible to serve on the equity security holders' committee, declined for fear of insider trading liability in the event they were to trade while serving.<sup>59</sup> CalPERS, by contrast, sought committee membership but was thwarted by a bankruptcy statute that excludes governmental entities from serving on committees.<sup>60</sup> Nevertheless, CalPERS and its rust-belt counterpart, the Pennsylvania Public School Employees' Retirement System, ultimately were authorized by the bankruptcy court to serve as non-voting members of the equity security holders' committee and later played an instrumental role in crafting Texaco's ultimate settlement with Pennzoil and the company's emergence from Chapter 11.<sup>61</sup>

During these events, CalPERS's officials saw the potential for shareholders' advisory committees outside of bankruptcy. The issue that stimulated the fund's interest was director selection. During the summer of 1988, CalPERS and the New York State & Local Retirement Systems approached Texaco seeking a role for institutional investors in the nomination of director candidates to be elected at the 1989 shareholders' meeting.<sup>62</sup> When discussions on this issue collapsed in December, CalPERS submitted a shareholder proposal that would have established a permanent shareholders' advisory committee upon the dissolution of the equity security holders' committee in bankruptcy.<sup>63</sup> The proposed committee would have as its primary responsibility a specific role in directoral selection and

59. Burr, *New Fund Activism: Two Play Role in Texaco Settlement*, PENSIONS & INVESTMENT AGE, Mar. 7, 1988, at 1, 38.

60. See 11 U.S.C. §§ 101(35) (" 'person' . . . does not include governmental unit"); 1102(b)(2) ("A committee of equity security holders . . . shall ordinarily consist of . . . persons.") (1988).

61. Burr, *supra* note 59, at 1.

62. Parker, *Institutions Rethinking Board Seat at Texaco*, PENSIONS & INVESTMENT AGE, July 25, 1988, at 2.

63. Parker, *Texaco Impasse: Plan for Permanent Committee on Table*, PENSIONS & INVESTMENT AGE, Dec. 12, 1988, at 1. The text of this proposal read:

The Company shall have a Stockholders' Advisory Committee to advise the Board of Directors on the views and interests of stockholders. The Board of Directors, through the Chairman of the Board, shall ensure the formation and effective of the Committee. The Committee shall adopt such bylaws as it deems appropriate. The annual operating expenses of the Committee, which shall not exceed the annual operating expenses of the Board of Directors, shall be borne by the Company.

The Committee shall be composed of nine members, and shall be reconstituted on an annual basis. No member may serve more than three consecutive terms. The members of the Committee shall include (a) the five eligible stockholders who beneficially own the greatest number of shares of the Company's common (determined annually as of the record date for the annual meeting of stockholders) (the "Ranking Stockholders") and who nominate themselves by submitting their names and proof of beneficial ownership in writing to the Secretary of the Company within 30 days after each annual meeting of stockholders, and (b) four persons elected by a majority vote of the Ranking Stockholders from among stockholders who similarly nominate themselves ("At Large Stockholders"), provided that each At Large Stockholder must be the beneficial owner of at least 1,000 shares of the Company's common stock, and further provided that no At Large Stockholder may be an officer, director or affiliate of the Company. If a member of the Committee ceases to be a beneficial owner of the common stock of the Company, such member shall no longer be eligible to serve on the Committee.

Letter from Richard H. Koppes, CalPERS Chief Counsel, to the author (August 22, 1989).



a broader, ongoing role in other governance matters.<sup>64</sup> Texaco quickly diffused this proposal by placing a CalPERS-recommended nominee—New York University president John Brademas—on the company's official board slate, and by responding to other concerns expressed by CalPERS and the equity security holders' committee, notably those related to criteria for the selection of future board members and the retention of Texaco's poison pill.<sup>65</sup> Satisfied with its achievements, CalPERS withdrew its advisory committee proposal<sup>66</sup> and, with the close of the bankruptcy case, the Texaco equity security holders' committee was disbanded. CalPERS continued, however, to search its portfolio for other poorly-performing companies and those it regarded as "insensitive" to shareholders' interests.<sup>67</sup> By the end of 1989, it had focused on Avon, TRW and Occidental, and at each of these firms resurrected the advisory committee idea.<sup>68</sup>

Some observers might argue that CalPERS's focal role in these events marks both the beginning and the end of the "movement" toward shareholders' advisory committees. CalPERS frequently has taken the lead on issues related to shareholder activism and found itself with few followers.<sup>69</sup> Its current chief executive officer, Dale Hanson, has become something of a "guru" in the shareholders' rights movement.<sup>70</sup> Some may claim that the idea of shareholders' advisory committees represents little more than one man's preoccupation.

Assume, however, as the evidence suggests, that institutional support for advisory committees goes beyond the boundaries of California, and is shared by a range of institutions, including many institutions other than public pension funds. When institutional investors were asked in 1990 whether they supported the idea of shareholders' advisory committees, 44.7 percent of the respondents answered yes, "at least at those companies that are troubled."<sup>71</sup> In another 1990 survey, fifty-five percent of the responding institutions expressed a willingness to support shareholders' advisory committees, at least on a case-by-case basis.<sup>72</sup> This support may be motivated by the belief that institutional involvement in corporate governance can improve corporate performance as it has in other cul-

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64. *Id.*

65. Business Wire Inc., CalPERS and Texaco reach accord, CalPERS press release, Feb. 9, 1989 (on file with the author).

66. *Id.*

67. Koppes & Gillan, *The Role of Pension Fund Investors in the Election of Corporate Directors*, INSIGHTS, Dec. 1988, at 11, 13.

68. See *supra* note 4.

69. For example, CalPERS is one of only a handful of shareholder sponsors of the "Valdez Principles," a package of environmental practices being urged on pollution-prone companies, primarily by environmentalist groups. See Barnard, *Exxon Collides with the "Valdez Principles"*, 74 BUS. & SOC'Y REV. 32 (Summer 1990).

70. In 1989, Fortune Magazine asserted that "Dale Hanson has become to shareholders what Joan of Arc was to France." *The Year's 25 Most Fascinating Business People*, FORTUNE, Jan. 2, 1989, at 32, 37.

71. *Pensionforum: Speaking Out*, INSTITUTIONAL INVESTOR, July, 1990, at 203. Sixty-four percent of the public funds polled favored this view, as did 35 percent of the corporate respondents. *Id.*

72. J. BIRSACH, *supra* note 50, at 54. In a similar survey of institutional investors conducted in late 1989, 50% of the respondents indicated they would consider on a case by case basis voting in favor of a shareholders' advisory committee. L. KRASNOW, *supra* note 50, at 28.



tures, notably Germany, the United Kingdom, and Japan, as described in the next section of this Article.

### C. *The German Dual-Governance Model*

An essential model for the shareholders' advisory committee is the German *Aktiengesellschaft* (AG), or public company, which is governed not by a unitary board of directors, as in the United States, but by two separate and distinct bodies: the *Vorstand*, or management board, and the *Aufsichtsrat*, or supervisory board. The relationship between these bodies is both collegial and hierarchical:

The Vorstand runs the company. It is responsible for the performance of the company and represents the company to the public, whereas the Aufsichtsrat supervises the activities of the Vorstand. The Aufsichtsrat is not allowed to interfere in the policymaking of the Vorstand. This organizational structure was chosen in order to have a clear division of responsibilities between the Vorstand and the Aufsichtsrat.

In addition to the supervisory function, two other prime tasks of the Aufsichtsrat are to hire the members of the Vorstand and to approve the yearly balance sheet and profit statement.<sup>73</sup>

Certain decisions, such as those related to investment and financing, typically are initiated by the *Vorstand*, but statutorily are allocated to the *Aufsichtsrat*.<sup>74</sup>

Because of the tradition of codetermination, and the consequent presence on the *Aufsichtsrat* of a substantial contingent (up to fifty percent) of labor representatives,<sup>75</sup> the *Aufsichtsrat* is not a perfect model for an American shareholders' advisory committee. The role of the *shareholders' representatives* on the *Aufsichtsrat*, however, does illuminate the ways in which a shareholders' advisory committee might function.

Shareholders' representatives on the *Aufsichtsrat* are generally "bankers, businessmen or representatives of the public."<sup>76</sup> Bankers play an especially prominent role because their employers often serve as trustees or assignees of publicly-owned shares, and therefore have a large percentage of the votes at their command.<sup>77</sup> Moreover, banks themselves maintain significant stock positions in a number of companies—a fact traceable in part to the small universe of available investments: there are fewer than 500 publicly-traded German companies.<sup>78</sup>

73. J. BACON & J. BROWN, *THE BOARD OF DIRECTORS: PERSPECTIVES AND PRACTICES IN NINE COUNTRIES* 28 (1977).

74. *Id.*

75. See generally Conard, *The Supervision of Corporate Management: A Comparison of Developments in European Community and United States Law*, 82 MICH. L. REV. 1459, 1483-85 (1984) (describing the role of worker representatives on the German *Aufsichtsrat*).

76. J. BACON & J. BROWN, *supra* note 73, at 28.

77. *Id.* One observer has asserted that, "[a]t the general meetings of widely-held corporations, these portfolio-managing banks account for over 90% of the voting rights, because of the rights transferred to them by their clients." Kalfass, *The American Corporation and the Institutional Investor: Are There Lessons from Abroad? The German Experience*, 1988 COLUM. BUS. L. REV. 775, 782. As significant is the fact that 45% of all privately-held shares are voted by just three banks—Deutsche Bank, Dresdner Bank, and Commerzbank. *Id.* at 783.

78. Givant, *U.S. Urged to Follow Europe*, PENSIONS & INVESTMENT AGE, May 30, 1988, at 6.

The banks whose employees are represented on the *Aufsichtsrat* are often, of course, lenders to the company as well, with access to a wealth of operating data.

Due largely to the dominance and expertise of these bankers, German supervisory boards have become very effective in monitoring management, and, unlike American boards, are often the chief executives' "fiercest critics".<sup>79</sup>

As so often in business affairs, the supervisory boards have become quite the opposite of what softhearted reformers intended. Conceived by the Allied occupiers after World War II, [the German] supervisory board composed of representatives of labor, the company's bankers, and society as a whole was set apart from the executive board. . . . Its purpose was to force companies to take into account the views of various constituencies besides the stockholders.

As it turned out, the Germans have made their supervisory boards the most stringent possible watchdogs for stockholders. . . . A representative of a large German bank is likely to be the dominant figure on a big company's supervisory board. The bankers compare the company's record with what is happening to other companies under their bank's wing. Given the banker's expertise, the other directors generally follow his lead in keeping management on a tight leash.<sup>80</sup>

The monitoring role played by conservative German bankers is said to emphasize long-term, rather than short-term, shareholder gain.<sup>81</sup> This may be an easy preference in a culture in which uninvited takeovers "simply do not exist."<sup>82</sup> Additionally, however, the practice of aggressive, comparative, and informed oversight apparently has proven effective in maximizing shareholder wealth<sup>83</sup> as well as positioning German companies for international competitiveness.

Similar, though less formal, dual-governance formulae have emerged in Japan and, to a lesser degree, in the United Kingdom. In Japan, for example, significant blocks of shares in many companies are held by *antei kabunushi*, or "stable stockholders," which typically include the companies' primary banks, suppliers and customers. "[B]anks and other corporate entities own more than sixty percent of the combined stock of the firms listed on Japan's stock exchanges."<sup>84</sup> These shareholders are well-integrated into corporate decisionmaking. For example, CEOs representing corporate owners meet regularly "to discuss matters of common concern and to coordinate their business strategies."<sup>85</sup> Even though they are prohibited by law from owning any more than five percent of the shares of any company, bank shareholders "exercise a virtual

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79. Macrae, *Wanted: Blue Blood for American Boards*, BUS. MONTH, Apr., 1990, at 16.

80. *Id.*

81. Kallfass, *supra* note 77, at 790.

82. *Id.* at 776.

83. See Dorfman, *Investing in a West German Stock Boom*, WALL ST. J., Dec. 12, 1989, C1, col. 3 (describing vitality of West German equity markets prior to reunification).

84. Hiroshi, *The Closed Nature of Japanese Intercompany Relations*, in INSIDE THE JAPANESE SYSTEM 61 (D. Okimoto & T. Rohlen eds. 1988).

85. Wright, *Networking—Japanese Style*, BUS. Q., Autumn 1989, at 20, 21.



veto power over management decisions.”<sup>86</sup> Institutional owners are regularly, albeit subtly, consulted on executive succession issues.<sup>87</sup>

In the U.K. the “Pro-Ned” organization (Promotion of Non-Executive Directors), formed in 1982 by a consortium headed by the Bank of England, the Stock Exchange, and institutional investors, has created and trained a group of nearly 400 professional, full-time, independent corporate directors, and has facilitated their placement on listed company boards. Pro-Ned coordinates these directors’ activities on corporate governance issues and lobbies on their behalf in Parliament. In addition, four industry associations representing member institutions (insurance companies, pension funds, trusts, and investment companies) have combined to act on behalf of their members in emergency situations requiring shareholder action, such as negotiating to minimize greenmail payments.<sup>88</sup>

In each of these cultures, corporate executives have accommodated institutional investors as important participants in the governance process. In the United States, to date, they have not.

#### D. *The Demise of the “Wall Street Rule”*

The conventional wisdom, repeatedly delivered since Berle and Means published *The Modern Corporation and Private Property*<sup>89</sup> in 1932 has been that, in the absence of a control position, equity investors—even those with substantial holdings—are essentially powerless to influence corporate policies. Their individual votes count for “little or nothing,”<sup>90</sup> and consequently are rarely used as an “instrument of democratic control.”<sup>91</sup>

The explanation for this phenomenon has been simple—dispersed shareholders suffer from the same problems of collective action as other politically disenfranchised people: (1) The cost of individual action is high and unlikely to result in a commensurate reward, and (2) the incentives toward collective action are inadequate. In other words,

because no compulsory cost-sharing mechanism exists [for shareholders wishing to oppose a management policy], and because no single shareholder can capture the whole gain to shareholders generally from the proposal’s defeat, there will be insufficient incentive to organize opposition.<sup>92</sup>

86. *Id.* at 21, 23.

87. Anderson, *Corporate Directors in Japan*, HARV. BUS. REV., May-June 1984, at 30, 31.

88. See Lowenstein & Millstein, *The American Corporation and the Institutional Investor: Are There Lessons from Abroad? Introduction*, 1988 COLUM. BUS. L. REV. 739, 748. Overall, “in [the] U.K. there is significantly greater interaction [than in the U.S.] between institutional investors and the corporations that they hold stakes in.” *Id.*

89. A. BERLE & G. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932).

90. *Id.* at 86.

91. *Id.* at 89. Thirty-five years after his book’s initial publication, Berle reiterated this view: The stockholders’ right to vote “is of diminishing importance as the number of shareholders in each corporation increases—diminishing in fact to negligible importance as the corporations become giants.” A. BERLE & G. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* xix (rev. ed. 1968).

92. Fischel, *Corporate Governance*, *supra* note 23, at 1277; Gordon, *Ties That Bind: Dual Class*



In addition to this "free rider" explanation for shareholder passivity, commentators have offered another explanation: investor deference to managerial expertise.

[N]o reason exists why investors, who provide the firm with capital in anticipation of receiving a certain rate of return generated by the firm's assets, should have any input into the firm's decisionmaking processes. On the contrary, investors are willing to supply capital, as opposed to starting and operating the enterprise themselves, precisely because they trust the expertise of professional managers. Moreover, the rational (risk-averse) shareholder may well attempt to diversify his portfolio by investing in many firms or in a mutual fund. The investor who holds securities in multiple firms is unlikely to have the interest or expertise to participate in running any particular firm. . . . Shareholders would be hurt rather than helped if they were given more power, which no doubt explains why they show no enthusiasm for the constant proposals to increase their role.<sup>93</sup>

These descriptions of shareholder behavior typically have been accompanied by a prescription, commonly known as the "Wall Street Rule." This rule defines appropriate shareholder action in the event a corporation's performance declines: "If a shareholder is dissatisfied, the more logical course in most cases is simply to sell one's shares."<sup>94</sup> In other words, the assumption has been that shareholders are best off when they remain rationally ignorant of the details of a firm's operations, inform themselves only by reference to the firm's market price, and sell when that price becomes unsatisfactory given their overall investment objectives. The apotheosis of this view emerged when academics recently called for the abolition of the New York Stock Exchange's one (common) share/one vote rule.<sup>95</sup>

Although the behavioral assumptions explaining shareholder passivity are compelling with regard to individual shareholders with small holdings, for whom the mere mechanics of voting are often so burdensome that they return their proxies signed but unmarked, or fail to return them at all, these assumptions apply as well to institutional investors. As Professors Easterbrook and Fischel pointed out in 1983, "professional money managers operate in a highly competitive industry where the liquidity of assets makes it relatively easy to assess managers' performance and shift from one investment to another. . . . [In-

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*Common Stock and the Problem of Shareholder Choice*, 76 CALIF. L. REV. 1, 44 (1988); Levmore, *Monitors and Freeriders in Commercial and Corporate Settings*, 92 YALE L.J. 49, 60 (1982).

93. Fischel, *Corporate Governance*, *supra* note 23, at 1276-77. Other explanations have been given for shareholder passivity, most recently in Black, *supra* note 45, at 530-60 (arguing that shareholder passivity is attributable not to economic factors, but to artificially imposed legal impediments to shareholder voting, such as the federal proxy rules, ERISA constraints on trustee behavior, and state anti-takeover statutes).

94. Fischel, *Corporate Governance*, *supra* note 23, at 1277; see also Easterbrook & Fischel, *Voting in Corporate Law*, 26 J. LAW & ECON. 395, 396-97 (1983) (shareholders express their views by buying and selling shares; because they lack information, they should not attempt to influence corporate managers by other means).

95. See, e.g., Fischel, *Organized Exchanges and the Regulation of Dual Class Common Stock*, 54 U. CHI. L. REV. 119, 135-42 (1987) (citing the advantages in eliminating the one share-one vote rule).

stitutions'] perceived unwillingness to [expend scarce resources on information-gathering and voting] is no doubt rational behavior."<sup>96</sup>

Easterbrook and Fischel's position may have been correct in 1983.<sup>97</sup> Now, however, many pension funds and large mutual funds have grown to the point where the aggregate size of their holdings and the amount invested in a given corporation's stock are so large as to preclude reliance on the Wall Street Rule.<sup>98</sup>

Consider the situation of a large state employees' pension fund (Fund) that grows by hundreds of millions of dollars in a given year. Last year, Fund acquired 250,000 of the common shares of Bigco, a blue chip, big board stock. Say the purchase was at forty dollars per share, and the 250,000 shares represent one percent of Bigco's equity. (Like many funds, Fund is limited by its charter to acquiring no more than five percent of any single company's shares.) Now, two years later, Fund is dissatisfied with Bigco's languor in the market: the shares now trade at thirty five dollars. Even with negotiated commission rates, the transaction costs to Fund of bailing out of Bigco are likely to be substantial.<sup>99</sup> Even worse, if Fund unloads its Bigco common stock all at once, the price may be depressed below thirty five dollars, further increasing Fund's loss.<sup>100</sup> Fund will also have to bear the cost of finding a substitute investment. Consequently, it is not difficult to see that Fund may be better off working to improve Bigco's performance than (in the absence of a takeover premium) selling out Bigco.<sup>101</sup>

This scenario assumes that Fund acquired its Bigco shares on a "managed

96. Easterbrook & Fischel, *supra* note 94, at 426.

97. *But see* SEC STAFF REPORT ON CORPORATE ACCOUNTABILITY, *supra* note 41, at 393-94 (describing the inability in 1979 of some institutional investors to divest their individual holdings without depressing market price).

98. OUR MONEY'S WORTH, THE REPORT OF THE GOVERNOR'S TASK FORCE ON PENSION FUND INVESTMENT 37 (1989) [hereinafter CUOMO COMMISSION REPORT]:

[L]arge pension funds have found that the individual investor/exit response model is not always practical, nor is it consistent with the special qualities of large pension funds. While severe underperformers and big winners may be sold, pension systems increasingly cannot "vote with their feet" because their assets are too large and the duty to diversify too important to rely upon a strategy that says "sell" every time an investment under-performs. The universe of quality investments is just not big enough for large permanent investors to regularly move in and out of individual stocks or bonds.

99. Institutions' transaction costs now run between two and eight cents per share. Welles, *The Future of Wall Street*, BUS. WK., Nov. 5, 1990, at 119.

100. The loss may be exacerbated if other funds decide to sell their Bigco shares at the same time Fund is looking for a buyer. *See* Dent, *Toward Unifying Ownership and Control in the Public Corporation*, 1989 WIS. L. REV. 881, 922-23.

101. Professors Gilson and Kraakman argue that institutional focus on only certain companies may be self defeating.

Many improvements affecting the value of one company in an indexed portfolio come only at the expense of other companies in the portfolio. For example, the institutional investor does not gain when one of its portfolio companies simply acquires market share at the expense of another. From the portfolio holder's point of view, this improvement merely transfers money from one pocket to another, both in the same pair of pants.

Gilson & Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863, 866 (forthcoming 1991). While it may be true, this observation does not take into account the fact that businesses may increase value other than by raiding a competitor's market share. Businesses may create new markets, either by creating new products for which there are no current competitors or by entering new geographic areas with existing products.



fund" basis; that is, Fund made a considered decision to buy Bigco, as opposed to other stocks, and has the resources to locate a substitute. Fund's dilemma may be exacerbated if instead it acquired its Bigco shares as part of a basket of shares or an "indexed fund." Indexing assumes that an investor is diversified throughout an entire community of shares (for example, an indexed portfolio organized around the Standard & Poor's 500 will have shares in each of the S&P 500 companies); and that, over time, the performance of the entire index, left untouched, will outperform managed funds. Indexing permits an investor to eliminate research costs and transaction costs attendant to selective trading.

If Fund is indexing properly, it effectively is trapped in its Bigco shares. If it were to follow the Wall Street Rule, not only would it take a loss on its sale and incur substitution costs but more importantly, the act of selling and reinvesting out of the index (or redeploying the cash to other shares within the index, *excluding* Bigco) would distort the whole point of indexing. Thus, indexed funds by definition will have little if any turnover; even managed funds now are endeavoring to minimize their turnover and attendant transaction costs.<sup>102</sup>

With the embrace by institutions of indexing,<sup>103</sup> the Wall Street Rule has been replaced by the notion that these shareholders, rather than selling their shares, should use their resources to improve those shares' performance. Often referred to as the "voice," rather than the "exit," option,<sup>104</sup> this preference, together with the demographic patterns discussed above, has led to an entirely new persona for institutional investors—as "patient capitalists"<sup>105</sup> who demand that their governance views be heard.

## II. THE TILT TOWARD PARTICIPATION

While few voting statistics are available predating 1985, when the Investor Responsibility Research Center began maintaining market-wide proxy voting records, there is evidence that shareholder participation in governance, like shareholder selling and buying, for decades looked as one would have predicted—characterized by low voter turnout, infrequent resistance to management proposals, and very few shareholder proposals other than those brought by individuals or religious groups seeking social reform.<sup>106</sup> As late as 1988, the Department of Labor, which oversees ERISA employee benefit plans, was expressing concern that many pension fund managers were ignoring their fiduciary duty to engage in considered shareholder voting, either by succumbing to undue influence from management or by failing to vote altogether.<sup>107</sup>

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102. Welles, *supra* note 99, at 119.

103. See *supra* note 31.

104. The term derives from A. HIRSCHMAN, *EXIT, VOICE AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES* 4-5 (1970).

105. This term was coined in the CUOMO COMMISSION REPORT, *supra* note 98.

106. See AMERICAN SOCIETY OF CORPORATE SECRETARIES, INC., *REPORT ON SHAREHOLDER PROPOSALS* (1975-1989).

107. Department of Labor Pension & Welfare Benefits Administration Press Release 88-241, *PWBA Announces Enforcement Project to Monitor Investment Managers Voting Proxies of Employee Benefit Plan*, May 11, 1988.

Throughout the early 1980s, management-initiated proposals—including share-depressing antitakeover proposals—rarely were defeated and shareholder-initiated proposals on significant economic (as opposed to social) issues virtually never passed or, indeed, received more than a token vote of approval. Institutional proposals were rare.<sup>108</sup>

By 1987, however, the tide had begun to turn. During the 1987 proxy season, the College Retirement Equities Fund (CREF), then representing over \$30 billion in pension fund assets, the California State Teachers' Retirement System and the State of Wisconsin Investment Board—all loosely organized through the Council of Institutional Investors—undertook a series of shareholder proposals aimed at challenging the poison pills of forty American companies.<sup>109</sup> At last, these institutions had discovered an issue on which they were prepared to initiate some action.

Adoption of a poison pill has a negative impact on share value.<sup>110</sup> The shareholder proponents in 1987 argued that shareholders had the right to be consulted about, and indeed to ratify or reject, management's desire to adopt a poison pill.<sup>111</sup> More than fifty anti-pill proposals were submitted in 1987, and the overall average shareholder vote on these proposals was 27.4 percent.<sup>112</sup> The following year, the average vote on shareholder-initiated anti-pill proposals increased to 38.7 percent<sup>113</sup> and by 1990, the average vote was 42.7 percent.<sup>114</sup> The runaway takeover market of the 1980s, and the sophisticated ways in which managers resisted that market, had created the occasion for institutional investors to rethink their passive role.

The situation was simple—many public companies were revealed as having been undervalued substantially. Changing their governance structure by privatizing them in leveraged buyouts had liberated billions of dollars for shareholders. Some companies commanded more than a fifty percent premium over market.<sup>115</sup> Management interference with the market for corporate control was an issue over which even the most lethargic of institutions could get involved, and a particularly astute handful of them did just that, with the result that, in 1991, shareholder behavior looks quite different from that predicted by traditional theories of collective action.

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108. During the 1986 proxy season, only 33 proposals on any topic were submitted by institutional shareholders. AMERICAN SOCIETY OF CORPORATE SECRETARIES, INC., REPORT ON SHAREHOLDER PROPOSALS JULY 1, 1988 - JUNE 30, 1989, at 3 (1989).

109. Nussbaum, *The Battle for Corporate Control*, BUS. WK., May 18, 1987, at 102; Power, *supra* note 54, at 32. In 1987 institutions submitted 167 shareholder proposals. AMERICAN SOCIETY OF CORPORATE SECRETARIES, INC., *supra* note 108, at 3.

110. See SECURITIES & EXCHANGE COMMISSION, OFFICE OF THE CHIEF ECONOMIST, THE EFFECTS OF POISON PILLS ON THE WEALTH OF TARGET SHAREHOLDERS (1986); Choi, Kamma & Weintrop, *The Delaware Courts, Poison Pills, and Shareholder Wealth*, 5 J. LAW ECON. & ORG. 375, 376 (1989); Ryngaert, *The Effect of Poison Pill Securities on Shareholder Wealth*, 20 J. FIN. ECON. 377, 385 (1988).

111. Ryan, *supra* note 8, at 158-59.

112. *Id.* at 159.

113. *Id.*

114. *Both Shareholders, Management Rack Up Proxy Wins*, 7 IRRS CORP. GOVERNANCE BULL., July-Aug. 1990, at 90.

115. Jensen, *The Eclipse of the Public Corporation*, HARV. BUS. REV., Sept.-Oct. 1989, at 61, 64.



First, as I have noted elsewhere, shareholders now vote in surprisingly large numbers given the issues generally at stake; more importantly, they vote with a high level of discrimination among the issues presented to them for a vote.<sup>116</sup> Thus, even in situations not involving contests for control, shareholders are becoming increasingly active in their voting behavior.<sup>117</sup> Moreover, as they vote, shareholders are increasingly resistant to the knee-jerk tendency to support management under all circumstances.

Second, shareholders are engaging in more and more collective action. Substantial evidence illustrates that, since 1988, shareholders generally and institutional investors in particular have been acting successfully in concert, by, for example, organizing resistance to unacceptable managerial conduct,<sup>118</sup> organizing affirmative campaigns to effectuate corporate reforms<sup>119</sup> and seizing the moral high ground on such corporate governance issues as golden parachutes, greenmail, and confidential voting.<sup>120</sup>

The most successful collective action to date occurred during the 1989 proxy season, when investor Richard Rainwater, CalPERS, and the Pennsylvania Public Schools Employees' Retirement System joined together to defeat two antitakeover proposals that management at Honeywell, Inc. had submitted to its shareholders. Although the California and Pennsylvania funds collectively represented less than five percent of Honeywell's shares, Rainwater, CalPERS, and the Pennsylvania Public Schools Employees' Retirement System organized a campaign among other institutional investors to defeat these proposals.<sup>121</sup> Their efforts included hiring a proxy solicitor and engaging the support of a prominent proxy-voting consulting firm, Institutional Shareholder Services, Inc. Both antitakeover proposals were defeated<sup>122</sup> and Honeywell's share price rose from seventy dollars per share at the beginning of the campaign to seventy-nine dol-

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116. Barnard, *Shareholder Access to the Proxy Revisited*, 40 CATH. U. L. REV. 37, App. A at 104-05 (1990) (noting voting statistics from the 1989 proxy season).

117. Several factors may account for this increase in voting activity, including the growing insistence of regulators that ERISA fiduciaries and others maintain records of their voting behavior, and the emergence of a cottage industry of proxy-voting consultants. The SEC, through its oversight of the proxy voting process, has also stimulated more timely circulation of proxy materials to shareholders whose stock is held in street name.

118. Examples of organized "revolt" among institutional investors may be found in connection with General Motors' redemption of Ross Perot's shares for \$742 million in November 1987 and in connection with the Exxon Valdez incident in March 1989. In the former case, six institutions co-sponsored a shareholder resolution protesting the buy-back and seeking amendments to the company's bylaws. Clowes, *GM Stock Up; Fight Continues*, PENSIONS & INVESTMENT AGE, Jan. 26, 1987, at 1. In the latter case, several institutions met with Exxon's management, demanding the appointment of an environmentalist to the company's board. *Pension Power and the Big Spill*, N.Y. Times, May 19, 1989, at A34, col. 1.

119. Recently, CalPERS and the New York State Common Retirement Fund led the efforts to persuade General Motors to adopt a bylaw ensuring that future GM boards would be comprised of a majority of independent, outside directors. See *infra* note 235.

120. For the history of institutional activity in 1987 and 1988, see Ryan, *supra* note 8, at 158-60. For more current history, see *infra* notes 131-37 and accompanying text.

121. *Honeywell: The Value of Shareholder Activism*, 4 U.S.A. ADVOCATE No. 9, at 3 (Sept. 1989) [hereinafter *Honeywell*].

122. The vote in favor of a classified board was 46.6% for and 29.5% against; the vote in favor of the abolition of shareholder action by written consent was 43.4% for and 32.6% against. L. KRASNOW, *supra* note 50, at app. 79.

lars per share three weeks later, when the vote tally had been completed.<sup>123</sup> Several weeks following the vote, the company was restructured, stimulating a rise in share price to eighty-nine dollars per share. The restructuring, long resisted by Honeywell's management, was attributed as much to the influence of institutional investors as it was to Honeywell's continuing exposure to takeover.<sup>124</sup>

In addition to organizing collective action to resist management-initiated, value-reducing proposals like Honeywell's,<sup>125</sup> there have been a number of shareholder-initiated, value-enhancing proposals. As noted above,<sup>126</sup> institutional investors since 1987 have been advancing proposals concerning poison pills. During the 1990 proxy season, ten institutional investors submitted thirty proposals that would require companies either to redeem their poison pills or to put them to a shareholder vote.<sup>127</sup> Four of these proposals—at Armco, Avon Products, Champion International and K-Mart—received a majority of the votes cast.<sup>128</sup> Institutions were also instrumental in encouraging more than seventy Pennsylvania companies to opt out of the 1990 Pennsylvania antitakeover law that, like poison pills, imposes a substantial negative impact on share value.<sup>129</sup>

Other issues have caught and sustained institutions' interest in the last three years. While confidential voting has been institutions' "major initiative,"<sup>130</sup> other recurring issues on which institutions have taken the lead have included proposals to require shareholder approval of targeted-share placements,<sup>131</sup> proposals to opt out of the Delaware antitakeover law,<sup>132</sup> antigreenmail proposals,<sup>133</sup> and proposals to require shareholder approval of all golden parachute contracts.<sup>134</sup> All of these initiatives, perhaps save the secret ballot, have been aimed at disencumbering the market for corporate control and facilitating uninvited takeovers. More generally, the goal of the proposals has been to maximize share value or, at least, to create an atmosphere conducive to maximization.

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123. *Honeywell*, *supra* note 121.

124. *Id.*

125. Another example of institutional resistance to management proposals is the rejection in 1990 of a proposed amendment to the Articles of Incorporation of Alleghany Corp. that would have disenfranchised shareholders holding as much as 15% of the company's shares. *Alleghany Holders Defeat Plan for Takeover Defense*, Wall. St. J., May 7, 1990, at B3, col. 3.

126. *See supra* note 111.

127. J. BIRSACH, *supra* note 50, at app. 79-97.

128. *Id.*

129. *See* Pamepinto, *Studies Agree: Pennsylvania Law Lowers Share Value*, IRRRC CORP. GOVERNANCE BULL., Sept.-Oct. 1990, at 6 (describing studies of investment managers at Wilshire Associates and economists at Drexel University which show that the new law depressed collective share prices by \$3.6 and \$4.0 billion, respectively); *Both Sides See Victory as Companies Opt Out or Remain Under Pa. Statute*, 22 SEC. REG. & L. R. No. 32 (BNA), Aug. 10, 1990, at 1177; Anand, *Institutions Get Tough With Corporate Managements*, Investor's Daily, July 31, 1990.

130. L. KRASNOW, *supra* note 50, at 9.

131. PFIZER, INC., PROXY 19 (Mar. 8, 1990) (proposal by CREF).

132. BOEING, CO., PROXY 22 (Mar. 20, 1990) (proposal of NYCERS); KIMBERLY-CLARK CORP., PROXY 15 (Mar. 13, 1990) (same).

133. J.C. PENNEY CORP., PROXY 37 (Apr. 13, 1989) (proposal of CalSTRS).

134. RYDER SYSTEM, INC., PROXY 24 (Mar. 28, 1990) (proposal of CalSTRS).



Institutional investors continue to submit governance-related shareholder proposals, approaching the process with increasing precision.<sup>135</sup> Consequently, more shareholder proposals passed in 1990 than in the entire history of shareholder proposals prior to 1990.<sup>136</sup> At least twenty shareholder proposals received majority votes (seven of these had been submitted by institutions) and the average support for all major proposals ran well above the 1989 level.<sup>137</sup> Clearly the behavior of institutional investors—both the initiators like CalPERS and the followers who supported their actions—had in the span of four proxy-voting seasons changed substantially in character. Many institutions are no longer content to view themselves as mere “residual claimants,” but now regard themselves as active contributors to the corporate governance process.

### III. IMPLICATIONS OF THE NEW INSTITUTIONAL BEHAVIOR

One of the institution-initiated proposals characteristic of the new institutional behavior was the shareholders’ advisory committee proposal submitted by CalPERS at Avon in 1990.<sup>138</sup> Although the proposal did not receive a majority, it did receive forty-five percent of the votes cast—a remarkably high figure for a first-time proposal—and thirty-two percent of the total shares outstanding.<sup>139</sup> This Article will now address whether similar proposals, if submitted in the future,<sup>140</sup> should be encouraged and whether the shareholders’ advisory committee is likely to perform the function that institutional investors anticipate.

#### A. Patterns of Influence

In one model of the shareholders’ advisory committee, only those shareholders with the largest holdings (and willing to serve) would be eligible to participate.<sup>141</sup> The Avon proposal<sup>142</sup> required that five out of nine members of the shareholders’ advisory committee be selected from the company’s fifty largest shareholders. It is important to consider who these shareholders are likely to be. Appendix A identifies those institutions that would be the initial candidates to

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135. Institutional proposals fell to 98 in 1990, Fromson, *supra* note 4.

136. *Face the Facts*, 5 U.S.A. ADVOCATE No. 7, at 1 (July 1990).

137. O’Hara, *Both Shareholders, Management Rack Up Proxy Wins*, IRRP CORP. GOVERNANCE BULL., July-Aug. 1990, at 90; O’Hara, *Shareholders Score Unprecedented Victories in 1990*, IRRP CORP. GOVERNANCE BULL., May-June 1990, at 54.

138. See *supra* note 4 and accompanying text.

139. Telephone conversation with Marilyn Reynolds, Avon Products Corp. Shareholder Relations Office (Sept. 18, 1990). The vote was 19,071,650 shares FOR the proposal; 22,983,085 shares AGAINST the proposal and 17,086,854 shares ABSTAINING. The abstentions are believed to be comprised primarily of institutional investors who were not ready to commit on the issue that year.

140. CalPERS again proposed shareholders’ advisory committees during the 1991 proxy season, at Avon once again, and at Sears, Roebuck & Co. Parker, *Looking Over the Shoulder—Sears, Avon the Targets of Fund’s Governance Efforts*, PENSIONS & INVESTMENTS, Nov. 26, 1990, at 3. The Sears proposal was later withdrawn and a modified version of the Avon proposal ultimately was accepted by management. Parker, *GM Bylaw Revision Hailed as a Victory*, PENSIONS & INVESTMENTS, Feb. 4, 1991, at 6; Star, *Avon, Shareholders Agree*, PENSIONS & INVESTMENTS, Apr. 1, 1991, at 3. CalPERS has also undertaken to persuade 30 public companies to create shareholders’ advisory committees voluntarily.

141. See the “Texaco proposal,” *supra* note 63.

142. See *supra* note 4.

serve on the advisory committees of those companies comprising the "Top 50" of the 1990 Fortune 500.

This listing of the ten largest equity holders in the Top 50 companies suggests a number of patterns which in turn raise a number of possible concerns specifically regarding advisory committees and more generally regarding institutional involvement in corporate governance: (1) what significance, if any, attaches to the fact that so many of the institutions are commercial banks; (2) what is to be made of the fact that some of these commercial banks hypothetically could serve on a large number of committees across a wide range of economic sectors; (3) what significance, if any, attaches to the fact that *many* institutional investors, including but not limited to commercial banks, might sit on multiple advisory committees, including the advisory committees of competitive companies or companies in vertical trade relationships with one another; (4) should one be concerned that many of the institutions eligible to sit on advisory committees may themselves be competitors of other eligible institutions; and (5) what, if anything, is the appropriate role in managerial oversight for Employee Stock Ownership Plans?

#### 1. The Revival of Bank Domination

Early twentieth-century capitalism was characterized by a handful of powerful banks that largely were able to determine how and where capital would be employed throughout the American economy.<sup>143</sup> The largest of these banks, of course, was the House of Morgan, whose partners held seats, at the time of Morgan's greatest strength, on the boards of 112 public companies.<sup>144</sup>

Apprehension about bank domination of corporate decisionmaking has surfaced with some regularity since the House of Morgan days. For example, in 1938 New Deal policymakers assembled the Temporary National Economic Committee (TNEC), which examined the effects of bank control over national corporations as part of a larger study on the causes of the Great Depression. In 1968, Congressman Wright Patman, chairman of the House Banking Committee, expressed concern that "the American economy of today is in the greatest danger of being dominated by a handful of corporations in a single industry as it has been since the great money trusts of the early 1900s,"<sup>145</sup> and commissioned a comprehensive study of commercial bank trust departments and the way in which they used their influence.<sup>146</sup>

In his 1978 book, *Bank Control of Large Corporations in the United States*,

143. M. MIZRUCHI, *THE AMERICAN CORPORATE NETWORK, 1904-1974*, at 25 (1982).

144. R. CHERNOW, *THE HOUSE OF MORGAN—AN AMERICAN BANKING DYNASTY AND THE RISE OF MODERN FINANCE* 152 (1990). "In this era of relationship banking, board seats often meant a monopoly on a company's business. During the previous decade, the House of Morgan had floated almost \$2 billion in securities—an astronomical figure for the time." *Id.* Morgan's influence and that of Kuhn, Loeb & Co. on the American economy were the focus of the 1912 hearings of the "Pujo Committee," a congressional committee headed by Rep. Arsene Pujo (D-La.). *Id.* at 150-56.

145. STAFF OF HOUSE SUBCOMM. ON DOMESTIC FINANCE COMM. ON BANKING AND CURRENCY, 90th Cong., 2d Sess., *COMMERCIAL BANKS AND THEIR TRUST ACTIVITIES: EMERGING INFLUENCE ON THE AMERICAN ECONOMY* iii (Comm. Print 1968).

146. *Id.*



David Kotz reexamined Congressman Patman's data and argued that since the 1960s, public companies had come increasingly under the control of American money center banks.<sup>147</sup> Kotz asserted that this trend portended several potentially adverse consequences, including a tendency to take on excessive debt, a reduction of intra-industry competition, less-than-optimal pricing policies vis-a-vis bank-controlled suppliers and customers, and a tendency toward conglomeratization.<sup>148</sup> Kotz also argued that bank-controlled companies are more risk-averse than comparable non-bank-controlled companies, due to the banks' conflicting roles as both equity- and debt-holder.<sup>149</sup>

Some sociologists have rejected Kotz's findings, arguing that the so-called "control" of corporations by banks—especially insofar as that "control" is evidenced by bank presence on corporate boards—is in fact something quite different. Under these theories, corporate managers invite bankers to sit on their boards in order to *co-opt* them, *not* as a signal of capitulation to their power.<sup>150</sup> Others have pointed out that so-called bank-controlled corporations generally pay higher dividends than those that are not bank-controlled, so that bank control, if it exists, in fact may be beneficial to shareholders.<sup>151</sup>

This debate has value with regard to the question whether bank participation—even multiple bank participation—on shareholders' advisory committees poses any risk to shareholder interests. Many corporations already have bank representatives on their boards.<sup>152</sup> Even assuming this presence is infiltrative on the part of the banks, rather than deliberately co-optive on management's part, these banker/directors seldom have much, if any, direct impact on corporate operating policies.<sup>153</sup> Given the way in which upper level management structures corporate boards and controls their agendas, individual directors have very little opportunity to influence a corporation's day-to-day operations or decisions about borrowing, pricing, or strategic planning.<sup>154</sup> By contrast, the CEO has enormous power.<sup>155</sup>

This is not to say that CEOs do not nurture important banking relation-

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147. D. KOTZ, *BANK CONTROL OF LARGE CORPORATIONS IN THE UNITED STATES* (1978).

148. *Id.* at 130-40.

149. *Id.* at 141-44. Note that banks themselves cannot own common stock, although bank holdings companies may. Bank equity holdings are maintained solely in a fiduciary capacity through bank trust departments.

150. See Caswell, *An Institutional Perspective on Corporate Control and the Network of Interlocking Directorates*, XVIII J. ECON. ISSUES 619, 622-24 (1984); Palmer, *Broken Ties: Interlocking Directorates and Intercorporate Coordination*, 28 ADMIN. SCI. Q. 40, 45-46 (1983) (describing the competing theories); Richardson, *Directorship Interlocks and Corporate Profitability*, 32 ADMIN. SCI. Q. 367, 368-71 (1987).

151. Kerbo & Della Fave, *Corporate Linkage and Control of the Corporate Economy: New Evidence and a Reinterpretation*, 24 Soc. Q. 201, 210 (1983).

152. This practice is declining, however. According to Korn/Ferry International, 54.1% of companies responding to its annual survey in 1974 reported having a commercial banker on their boards. In 1990, only 23% of those responding reported a commercial banker on their boards. Yovovich, *More Than Ever, CEOs Lean on Directors*, CRAIN'S CHICAGO BUS., Oct. 8, 1990, at 18.

153. Sociologists refer to this view as "the null hypothesis." Caswell, *supra* note 150, at 622.

154. See J. LORSCH, *PAWNS OR POTENTATES—THE REALITY OF AMERICA'S CORPORATE BOARDS* 75-96 (1989).

155. *Id.*

ships; they do, especially in times of tight money. They are, however, unlikely to do so in ways that disregard competitive alternatives over time. Moreover, most public companies today enjoy multiple banking relationships<sup>156</sup> and have available to them many non-bank sources of capital,<sup>157</sup> thus reducing their dependence on banks whose representatives may sit on their boards.

Just as fears of bank control cannot be supported solely on the basis of bank presence on corporate boards, the same fears should not be premised on the power of a bank's shareholder vote held in trust.<sup>158</sup> While that vote may have great value in contested control settings, it has scant influence otherwise. Borrowing and pricing issues, for example, are excluded expressly from those issues that may be considered by shareholders at the annual shareholders' meeting.<sup>159</sup> Moreover, banks holding shares in trust are supposed to cast their votes in a fiduciary capacity, and to observe a "Chinese wall" between trust and lending functions.<sup>160</sup>

If bank domination of business exists, it is most likely because of the risk-reducing terms of specific banks' commercial lending agreements, not because of any status based on ownership. Thus, the creation of shareholders' advisory committees in which banks may play a prominent role would be unlikely to increase any single bank's influence significantly beyond that which it already has. Moreover, because of the hazards of emerging doctrines of lender liability,<sup>161</sup> most banks are seeking to have less, rather than more, direct impact on corporate governance. Thus, even recognizing their special fiduciary status, banks might eschew an advisory committee role.

Assume, however, that commercial banks agree to serve on shareholders' advisory committees in the approximate order of their eligibility, and thus, in combination, enjoy substantial influence. The real risk of bank domination in corporate governance is that banks often have shown themselves to be poor value producers.<sup>162</sup> That is, if the end result of any movement toward shareholder advisory committees is to make non-financial companies perform more like their bank owners, then shareholders could be the losers. That outcome, however, is unlikely for three reasons: (1) it would be the rare advisory committee that would be comprised of a majority of bank representatives; (2) the presence of competitive bank representatives on any given committee would minimize favoritism toward any one of them; and (3) even if banks collectively

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156. Luke, *Rivalry Intensifies in California Market*, AM. BANKER, June 15, 1988, at 23 (average number of banking relationships is 3.1 nationally).

157. The private placement market, for example, made up almost entirely of debt placed with insurance companies, increased from \$59 billion in 1985 to \$168 billion in 1989. Jereski, *If in Doubt, Downgrade It!*, FORBES, Jan. 7, 1991, at 52.

158. Banks as trustee currently hold legal title to approximately 15.3% of all corporate stock. W. CARY & M. EISENBERG, *supra* note 36, at 144.

159. 17 C.F.R. § 240.14a-8(c)(7) (1990).

160. B. KRIKORIAN, *FIDUCIARY STANDARDS IN PENSION AND TRUST FUND MANAGEMENT* 242-46 (1989).

161. See *supra* note 44.

162. See Byron, *The Bad-News Banks*, NEW YORK, Oct. 8, 1990, at 16 (describing recent bank stock decline); Weberman, *Bank Debt Play*, FORBES, Sept. 17, 1990, at 235 (same); Weiss, *Bottom-Fishers Are Eyeing the Banks*, BUS. WK., Nov. 12, 1990, at 119 (same).



played a dominant role in an advisory committee, any industry-wide bias would be mitigated by the other members of the committee and by non-bank members of the board.

Finally, a word must be said about concerns that banks, as well as other institutions—because of their substantial multiple holdings—might sit simultaneously on a number of advisory committees, including those of competitive enterprises and those of companies in vertical trade relationships. One might fairly ask if the resultant interlocks among these companies might impair the corporate performance of any or all of them. The initial response to this concern is that this kind of impairment is unlikely to occur because shareholders' advisory committees only rarely would be established and then, only for the most poorly performing companies. No one envisions hundreds, or even dozens of such committees ever existing simultaneously.<sup>163</sup> Nonetheless, because the possibility of interlock does, at least theoretically, exist, it merits separate consideration.

## 2. The Problem of Advisory Interlock

The sociological literature is profuse with studies of interlocking corporate directorates and their alleged pernicious influence both on corporate performance and larger issues of societal concern.<sup>164</sup> For some, interlocking directorates<sup>165</sup> stimulate ominous conspiracy theorizing:

[A]mong the largest national corporations (and for that matter among the largest companies within a region), personal interlocks between business leaders may lead to a concentration of economic or fiscal control in a few hands. There is in this the danger of a business elite, an ingrown group, impervious to outside forces, intolerant of dissent, and protective of the status quo, charting the direction of [industry].<sup>166</sup>

163. Telephone conversation with Nell Minow, President, Institutional Shareholders Services, Inc. (Dec. 31, 1990).

164. See, e.g., R. BURT, *CORPORATE PROFITS AND COOPTATION—NETWORKS OF MARKET CONSTRAINTS AND DIRECTORATE TIES IN THE AMERICAN ECONOMY* (1983); M. MIZRUCHI, *supra* note 143; J. PENNINGS, *INTERLOCKING DIRECTORATES—ORIGINS AND CONSEQUENCES OF CONNECTIONS AMONG ORGANIZATIONS' BOARDS OF DIRECTORS* (1980).

165. Scholars recognize two types of interlocks among companies. "Direct interlocks" occur when a single director sits on the board of two or more companies. In these cases, the "receiving" companies are said to be interlocked. Direct interlocks between competitors, as when X sits on the boards of both Ford and Chrysler, are prohibited by section 8 of the Clayton Act. 15 U.S.C.A. § 19 (West Supp. 1990). "Indirect interlocks" occur when two companies each have a director on the board of a third. In these cases, the "sending" companies are said to be interlocked.

166. SENATE COMM. ON GOVERNMENTAL AFFAIRS, SUBCOMM. ON REPORTS, ACCOUNTING AND MANAGEMENT, *INTERLOCKING DIRECTORATES AMONG THE MAJOR U.S. CORPORATIONS*, S. Doc. No. 107, 95th Cong., 2d Sess. (1978). This report also articulates some of the specific abuses which interlocking directorates supposedly invite:

Second, interlocks between actual or potential competitors, whether direct or indirect, provide a linkage for communication and discussion which can result in common action (with or without agreement) and a consequent elimination of competition. . . .

Third, there may be directorate interconnections between companies, which, although not directly competitive, are in the same or closely related industries. Such liaison relationships may result in corporate policies which discourage expansion and diversification into competitive areas, or the development of completely new business fields. . . .

Fourth, vertical interlocks—where a common director links two or more companies

For others, the existence of widespread interlocking directorates promotes efficiency by encouraging uniform practices or coordinating distribution. Interlocks may also reduce the costs of doing business, for example by facilitating the transmission of information from a corporation's suppliers or customers. All of these theories, like those concerned with "bank domination," are premised on an inflated view of the director's role at the center of the interlock.<sup>167</sup>

Directors generally act according to a number of unstated but understood and shared behavioral norms.<sup>168</sup> Today these norms prohibit directors from conferring with one another outside of board or board committee meetings,<sup>169</sup> and from initiating discussions with upper or middle managers without specific direction from the CEO. Directors, themselves busy men and women, occasionally meet with these managers in structured settings in connection with scheduled board meetings,<sup>170</sup> but rarely have occasion to converse with them otherwise.

Board meetings do not afford much opportunity for the sorts of informal exchange that would facilitate the transmission of "inside" information from director to director or from director to in-house manager. At such meetings, according to Bayless Manning (who has attended many of them),

[f]ully three quarters of the board's time will be devoted to reports by the management and board committees, routine housekeeping resolutions passed unanimously with little or no discussion, and information responding to specific questions that had earlier been put to the management by directors about a wide range of topics sometimes accompanied by suggestions from the board members, usually procedural in character. Perhaps the remaining one quarter of the meeting time will be addressed to a decision, typically unanimous, on one or two specific different business items, such as the sale of a subsidiary or the establishment of a compensation plan.<sup>171</sup>

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having actual or potential dealings with each other at different levels of business activity—are also potentially dangerous. Such interlocks can reach backward to various states of supply or forward through various levels of distribution and consumption. In either case, the close relationship may lead to preferential treatment to the detriment of other suppliers or consumers.

*Id.* at 6-7. Louis Brandeis described concerns about interlocking directorates in a 1915 speech:

[Interlocking directorates] are an obstacle to knowledge of fundamental facts, because the existence of the interlocking robs an enterprise of those conditions which under the general laws of business ordinarily lead to the ascertainment of true values. Ordinarily in business the value of a thing or service is determined through the agreement reached by an intelligent seller and an intelligent purchaser—each looking out for his own interest to the best of his ability. Where interlocking directorates or other conflicting interests exist, this protection is lost.

L. BRANDEIS, *BUSINESS—A PROFESSION* 323 (1933).

167. Others have argued in a similar vein. See M. MIZRUCHI, *supra* note 143, at 35 (citing J. GALBRAITH, *THE NEW INDUSTRIAL STATE* (1967); M. MACE, *DIRECTORS: MYTH AND REALITY* (1971); G. STIGLER, *THE ORGANIZATION OF INDUSTRY* (1968)).

168. J. LORSCH, *supra* note 154, at 91-95.

169. *Id.* at 93.

170. *Id.* at 60.

171. Manning, *The Business Judgment Rule and the Director's Duty of Attention: Time for Reality*, 39 BUS. LAW. 1477, 1483 (1984). Elmer Johnson, a former member of the General Motors board, has noted that often board meetings are little more than "slide shows or theatricals carefully



The meetings themselves last only three to six hours.<sup>172</sup> In short, and notwithstanding the quite compelling logic of social network theories, contemporary board members seldom get the chance to influence operating decisions which could, over time, be harmful to shareholder interests.<sup>173</sup> Thus, if shareholders' advisory committees are otherwise a sound idea, concerns that they may replicate and even exacerbate existing interlocks at the directoral level should not present a serious impediment to their adoption.<sup>174</sup>

### 3. Threats to Institutional Competitiveness

Consider a "typical" shareholders' advisory committee comprised of ten members—three banks, four mutual fund management companies, two public pension funds, and CREF. One could imagine that such proximity might lead to diminished intra-industry competition among the committee members themselves. Like concerns about bank domination or the consequences of advisory interlocks, this is a baseless concern. Public pension funds (and corporate pension funds) are not in competition with one another for beneficiaries, and the mutual funds or banks which might participate on advisory committees are already members of trade associations, where anticompetitive conduct—if it is to occur—is more likely to occur than in the context of collective efforts to improve a portfolio company's performance.

### 4. The Role of Employee Stock Ownership Plans

Over ten thousand companies now offer some type of Employee Stock Ownership Plan (ESOP)<sup>175</sup> by which corporate employees may acquire equity ownership in their employer. Some two thousand public companies have ESOPs. Most of these plans hold less than fifteen percent of the sponsoring company's equity.<sup>176</sup>

ESOPs typically are managed by plan trustees who are selected and compensated by management. Many public companies' plans, however, confer "pass-through" voting rights, enabling participating workers to vote on

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scripted by the chairman." Johnson, *An Insider's Call for Outside Direction*, HARV. BUS. REV., Mar.-Apr. 1990, at 47.

172. J. LORSCH, *supra* note 154, at 87.

173. In one view, board service can be seen not as cementing a relationship between specific firms, "but as a diffuse set of social relations that facilitates formation of group consensus and socializes new members of the [upper] class." Caswell, *supra* note 150, at 622-23.

174. The possibility of Clayton Act-type interlocks at the advisory level may present a different, and larger, problem. Occasions conceivably could arise in which an institutional investor would be eligible and would like to place a representative on the advisory committees of, say, both Ford and Chrysler. Institutions could minimize, but not eliminate, this problem by placing a different representative on each committee. They could eliminate the problem voluntarily by disqualifying themselves from one of the committees or, more broadly, by excluding from eligibility for committee membership any shareholder who is represented on the board or an advisory committee of a competitive enterprise.

175. Hansmann, *When Does Worker Ownership Work? ESOPs, Law Firms, Codetermination, and Economic Democracy*, 99 YALE L. J. 1749, 1752 (1990).

176. M. QUARREY, J. BLASI & C. ROSEN, *TAKING STOCK—EMPLOYEE OWNERSHIP AT WORK* viii (1986).

directorial candidates and other issues submitted for shareholder vote.<sup>177</sup>

Studies generally have shown that the presence of an ESOP has no positive impact on firm productivity or profitability;<sup>178</sup> indeed, some studies have shown that ESOPs often have a negative impact on share value.<sup>179</sup> At best the evidence is inconclusive.<sup>180</sup> Any correlation between ESOP ownership and corporate performance that could be proven, however, likely would derive from enhanced management-labor relations arising out of the creation of the ESOP and not from any special expertise on the part of worker/owners in their capacity as shareholder/voters. Moreover, studies have shown that ESOP participants overwhelmingly favor management when voting, even where that vote may be adverse to their ownership interests.<sup>181</sup> For example, during the 1980s many companies strategically established ESOPs as a tool to thwart uninvited takeovers.<sup>182</sup> In recent proxy contests at these companies, employees' pass-through votes largely have been cast in favor of incumbent management and against insurgent board candidates.<sup>183</sup> Thus, there is little reason to believe that the presence of an ESOP representative on a shareholders' advisory committee would make an appreciable difference in a company's governance choices, particularly if the assigned ESOP representative is the management-controlled ESOP trustee. For this reason, advocates of shareholders' advisory committees by definition might exclude corporate ESOPs, even where their holdings otherwise would render them eligible to serve.<sup>184</sup>

### B. Institutional Skills and Value Preferences

Some commentators have suggested that an increased institutional role in corporate governance would result in impaired financial performance directly attributable to institutional values and skills. For example, in a recent commentary, Boston College business professors Samuel Graves and Sandra Waddock argue that institutional investors involved in the active oversight of a number of enterprises would be "forced to use simple, quantifiable, and perhaps naive, performance measures" to keep track of them.<sup>185</sup>

177. Hansmann, *supra* note 175, at 1797-99.

178. See J. BLASI, *EMPLOYEE OWNERSHIP—REVOLUTION OR RIPOFF?* (1988).

179. One study suggests that establishment of the ESOP itself may depress share value as much as 4.5%. *ESOPs' Impact Studied: Plans Seen Insulating Management from Takeovers*, PENSIONS & INVESTMENT AGE, July 10, 1989, at 33.

180. See C. ROSEN, K. KLEIN & K. YOUNG, *EMPLOYEE OWNERSHIP IN AMERICA* 2 (1986).

181. See J. BLASI, *supra* note 178, at 166.

182. See, e.g., *Shamrock Holdings, Inc. v. Polaroid Corp.*, 559 A.2d 278 (Del. 1989) (upholding defensive creation of an ESOP holding 14% of the target's equity).

183. In the 1990 proxy fight at Lockheed Corp., approximately 70% of the participating employee/shareholders voted their pass-through shares with more than 90% of the shares cast in favor of incumbent management. Stroud, *Lockheed Wins Proxy Fight, But At a Cost*, *Investor's Daily*, Apr. 11, 1990, at 1. But see Ring, *ESOP Fiduciaries Target of Suit*, PENSIONS & INVESTMENT AGE, May 28, 1990, at 26 (70% of ESOP shares at South Bend Lathe, Inc. were voted against the reelection of three members of the incumbent board).

184. Cf. the "Avon proposal," *supra* note 4 (eligibility for membership on Advisory Committee required beneficial ownership of company's voting stock as sole affiliation with the company).

185. Graves & Waddock, *Ownership at a Distance: Implications of Activist Institutional Investors*, BUS. IN THE CONTEMP. WORLD, Spring 1990, at 86.



These measures may fail to account for the subtleties and ambiguities which actually exist at the operating level. . . . This kind of management may dampen innovation by "relying too heavily on short-term financial measures—a sort of managerial remote control . . . ."<sup>186</sup>

Drawing the analogy to classic corporate conglomerates, in which decisionmakers lacked operating knowledge and were "structurally distant" from the people actually responsible for, and knowledgeable about, production, design, and marketing, Graves and Waddock suggest that "very large scale institutional holdings accompanied by active institutional participation in corporate governance [may] yield the same [poor] results as traditional conglomeration."<sup>187</sup>

These concerns appear to confuse the "hands on" managerial role of conglomerateurs with the "advisory" role of institutional investors who, by definition, would be two steps removed from any "hands on" position. It may be true that conglomerates failed because key decisionmakers lacked sufficient knowledge concerning diverse divisions' strengths and needs to generate an appropriate operational plan. But directors, and certainly outside directors, are understood not to have intimate knowledge of corporate affairs.<sup>188</sup> There is no reason to expect that institutional investors serving as advisors to the board would have any greater access to information than do outside directors, nor that their lack of information would impair corporate performance.

Nonetheless, there is a legitimate concern that advisors (like the directors they advise) may judge corporate performance by artificial methods suited to their particular skills and applicable to all corporations, rather than by measures tailored to an individual corporation's characteristics. For example, a number of institutions and their consultants currently are working on computerized programs whose purpose is to identify "weak" corporations.<sup>189</sup> Because they are designed to be applied market-wide, and are unlikely to accommodate idiosyncracies, these programs may tend to encourage formulaic solutions to complex corporate problems. Using such approaches, institutional advisors may rigidify, rather than improve, a corporation's governance plan.

Other concerns may be raised about institutions' value preferences. For example, conflicts of interest may influence governance priorities: Will the State of Wisconsin Investment Board work to stem plant closures in that state?<sup>190</sup> Will retail mutual funds, concerned about their own quarterly results and their

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186. *Id.*

187. *Id.*

188. See J. LORSCH, *supra* note 154, at 80-81. Lorsch states:

In the boardroom, the CEO is the acknowledged expert. Outside directors are part-timers, while the CEO not only spends most of the time leading the company, he or she has usually been involved with it for his or her whole career. . . . [O]utside directors are keenly aware of the limitations of their own information and understanding.

*Id.*

189. See, e.g., Terhaar, *PERS Devises New Rating System*, Sacramento Bee, Apr. 3, 1990, at F1 (describing system developed by Analysis Group, Inc., which permits intra-industry comparisons among companies. Such factors as short- and long-term stock returns, five-year return on assets, operating margins, asset turnover, and cash flow/asset ratios will be included in the system).

190. See *supra* note 39.

position in mutual fund performance rankings, encourage the manipulation of corporate financial activities to impact on short term share pricing? Will risk-averse banks encourage corporate behavior conducive to reliable loan repayment? "Such pressure could result in abandonment of products or services requiring significant risk-taking."<sup>191</sup> Some observers have expressed concern that institutional investors will focus on self-serving and "winnable" reforms, such as confidential voting, rather than addressing more significant performance-related issues.<sup>192</sup>

All of these concerns are legitimate, but probably not significant. For example, the conflicts of interest of individual advisors can be diffused by the diversity of the advisory committee. Thus, regional biases can be offset by non-regional biases and short-term preferences by long-term preferences. Risk takers can balance the risk avoiders. The "shareholders' rights" zealots are likely to be outnumbered where they cannot show that their agenda has a demonstrable impact on value.

### C. Institutional Expertise

Perhaps the greatest concern about the changing role of institutional investors is whether institutions have the competence necessary to play an effective governance role. In a recent *Harvard Business Review* article, William Taylor points out that most public pension fund trustees are either politicians or public employees, not trained business managers.<sup>193</sup> Similarly, corporate pension fund trustees, union pension fund trustees, and mutual fund executives are seldom themselves experts in corporate strategic planning. Their hired money managers may be "experts in when to buy and sell stocks, bonds and options [but they are] not [experts] in how to reinvigorate a global industrial empire like GM."<sup>194</sup>

Taylor concedes that this deficiency can be compensated for by hiring agents with appropriate expertise.<sup>195</sup> One may fairly ask, however, whether agents selected by institutional investors to represent their interests on a shareholders' advisory committee are likely to be any more capable than outside directors selected by incumbent management or by a nominating committee for a position on the corporate board.<sup>196</sup> Even if these agents are "accountable" to their nominators more than to incumbent management, they still will face problems relating to lack of time, staff and resources. Moreover, the universe of

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191. Graves & Waddock, *supra* note 185, at 87.

192. Taylor, *supra* note 28, at 78 ("A company with an eroding position in world markets does not improve its position by eliminating a poison pill or by adopting confidential voting.").

193. *Id.* at 72-74.

194. *Id.* at 74. See also DeMott, *Assessing Investors' Long-Term Commitment*, *LEGAL TIMES*, Apr. 24, 1989, at 27 ("Unfortunately, the skills and perspectives necessary to manage an investment portfolio . . . may not match the skills and perspectives required to run other types of businesses.").

195. Hundreds of companies already have engaged in strategic restructuring, with the result that many corporate executives are now high on the knowledge curve of mechanisms that can create shareholder value. See Rappaport, *The Staying Power of the Public Corporation*, *HARV. BUS. REV.*, Jan.-Feb. 1990, at 96-100.

196. Many observers have asserted that even the best qualified directors are likely to be ineffective monitors, given the "tools placed at their disposal [and] the process by which they are nominated." Levmore, *supra* note 92, at 62.



available candidates for these positions is limited, even if one considers not only experienced chief executive officers (the typical candidate field), but also academics, lawyers, and financial experts.<sup>197</sup>

Public companies already are experiencing difficulty keeping competent men and women on their corporate boards.<sup>198</sup> How will institutions find candidates to represent them on advisory committees (a position of less prestige and direct influence than membership on the board itself) when corporate managers are finding it difficult to fill board vacancies?<sup>199</sup> Any desirable candidate for an advisory committee position is likely to be pursued for board positions as well. In light of the likely differential in compensation for the two positions, few with a choice would choose the advisory role. Consequently, those willing to accept advisory committee positions are likely to be less competent than those whose directoral performance they would be expected to review.

#### D. *The Advisory Committee's Agenda*

The question of competence ultimately must turn on what, precisely, shareholders' advisory committees would be expected to do that is not already being done by the traditional board of directors. Some proponents of shareholders' advisory committees suggest that the committees' agendas should include only a few items: executive compensation and the occasional issue that pits management against shareholders, such as the adoption of antitakeover devices or major changes in strategic direction.<sup>200</sup> Other institutional activists favor a broader agenda, which would include the entire panoply of issues traditionally allocated to the corporate board. Apart from specifics, shareholders' advisory committees could serve four possible functions: (1) initiation, (2) consultation, (3) monitoring, and (4) communication.

No one envisions that shareholders' advisory committees would initiate corporate strategic plans. Boards do not do so now, and for very good reasons—they have neither the necessary access to detailed operating information nor a staff to develop such plans. Advisory committee members would be one step further removed from information and similarly unsupported by a professional staff. Moreover, advisory committee members presumably would spend less time per company on governance matters than do board members because advisors, unlike directors, will not, under current law, risk legal liability for failure to exercise due care.

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197. J. LORSCH, *supra* note 154, at 19 (currently there "aren't enough CEOs to go around"—as many as 60% of CEOs invited to join a corporate board now decline).

198. KORN/FERRY INTERNATIONAL, *supra* note 22, at 11 (twenty-five percent of corporate respondents reported the resignation of outside directors within the past year, with the highest incidence of resignations occurring in the retail and banking sectors).

199. *Id.* at 12. "Twenty-five percent of the responding companies reported that prospective board directors declined invitations to serve on their boards in the past year, up from 23 percent in 1988 and 20 percent in 1985. Of the total respondents, 62 percent experienced one refusal, 32 percent had two, and six percent reported three or more. At 29 percent, billion dollar corporations and insurance firms most frequently experienced refusals." *Id.*

200. Dobrzynski, *A Shareholder's Place is in the Boardroom—Sometimes*, BUS. WK., Jan. 22, 1990, at 30 (quoting Nell Minow, then General Counsel of Institutional Shareholder Services, Inc.)

It is more reasonable to expect that advisory committees would provide a consultative function—reviewing proposals in their formative stages and massaging those proposals to achieve consensus with the directors. This model, however, presents an obvious risk of inefficiency. The typical corporate board already must consider the views and prejudices of ten to eighteen board members.<sup>201</sup> Adding an additional nine or ten advisors inevitably would retard the decisionmaking process, with no assurance that the decisions reached would be any better in terms of shareholder wealth than had no advisors been consulted. This phenomenon would be most apparent if advisory committees become populated largely by director-clones, or if the committees adopt a combative approach to their advisory tasks.

Advisory committees also might be expected to monitor management—both in the specific sense of tracking performance against pre-established performance criteria, and in the more general sense of ensuring against managerial shirking and disloyalty. Again, this would invite duplication of the efforts of the traditional board and its various committees. Moreover, if one assumes that the board has immediate access to sources of information while the committee would receive only that information that has been filtered through the board, the advisory committee's monitoring would be at best derivative, and in any case less efficient than the monitoring conducted by the board.

The least that can be expected of shareholders' advisory committees is that they would become transmitters of information to and from the board and the committees' institutional constituents. This role can be likened to that of the indenture trustee, who performs a "passive and essentially ministerial role."<sup>202</sup> Although this role would be harmless, it would not be costless, and therefore only could be justified if the communication provided were appreciably more valuable to big shareholders than that already provided through existing shareholder relations channels.

The question whether under any of these scenarios shareholders would be "better off" with an advisory committee than they would be under the status quo remains problematical. Even if advisory committees were limited to the critical issue of executive compensation, there is no assurance that committee views of an appropriate incentive formula would lead to better corporate performance than now exists.

#### *E. Costs and Compensation*

Whatever the precise charge of the shareholders' advisory committee, its existence necessarily would involve costs to the corporation, if no more than committee members' "actual expenses."<sup>203</sup> Of more interest are the additional costs, represented by committee members' time, which must be borne, one assumes, either by the members themselves or by the institutions whose interests

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201. KORN/FERRY INTERNATIONAL, *supra* note 22, at 14.

202. Comment, *The Washington Public Power Supply System Bond Default: Expanding the Preventive Role of the Indenture Trustee*, 34 EMORY L.J. 157, 161, 198 (1985).

203. See the "Avon proposal," *supra* note 4.



they represent. If a committee member is a salaried employee of the institution she represents, compensation will be handled as part of the institution's overhead. But if, as is more likely, institutional investors engage experts, those experts will demand to be paid. This fact effectively will exclude many institutional investors who cannot or will not bear the costs of representation. In turn, this may serve to minimize the diversity of the advisory committee, supposedly one of the idea's strengths.<sup>204</sup> It also will create free rider problems.

#### IV. THE VALUE OF INSTITUTIONAL ACTIVISM

The foregoing discussion suggests that, even though many of the critics' concerns about shareholders' advisory committees may be misplaced, there are several reasons why shareholders' advisory committees are an inadvisable solution to institutions' desires to participate more effectively in corporate governance: committees are likely to lack expertise, they are likely to duplicate the efforts of incumbent outside directors, and they are unlikely to perform well any unique function which would warrant the costs involved.

There may be other reasons why creation of shareholders' advisory committees may be an unwise response to poor corporate performance. Acquiring a stake in governance by participation in advisory committees may stimulate institutions to prefer equity investments when their capital might better be allocated to other types of investments. And, curiously, establishing a shareholders' advisory committee might serve to *strengthen* management's control rather than to diffuse it. That is, investors who participate in shareholders' advisory committees may, by the process of co-optation,<sup>205</sup> become less capable of monitoring management than they would be as pure outsiders.

Most important, reliance on a shareholders' advisory committee draws attention away from the proper locus of managerial oversight—the board of directors itself. After all, it is the board, not the shareholders, that is charged with making the corporation perform.<sup>206</sup> Rather than creating a "shadow cabinet," comprised of shareholders or their representatives, that is supposed to monitor the board and stimulate it to more effective decisionmaking, institutions can achieve the same result, with greater effect and at less cost, by putting institutional representatives on the board itself. Board representation for institutional investors may be achieved either by setting aside board positions, as Professor Lowenstein has suggested,<sup>207</sup> or by permitting institutions direct access to the ballot to compete for available board positions, as I, and others, have advocated elsewhere.<sup>208</sup> One commentator has even advanced the unlikely proposal that

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204. In a recent survey of institutional investors, 53% of the respondents indicated that they would not consider participating in a shareholders' advisory committee, even if such things existed. J. BIRSACH, *supra* note 50, at 9. This compares to 41% who oppose the creation of shareholders' advisory committees. *Id.* at 54.

205. See Dent, *supra* note 100, at 909 (describing the co-optation process as it applies to outside directors on corporate boards).

206. See, e.g., REV. MODEL BUSINESS CORP. ACT § 8.01 (1984).

207. L. LOWENSTEIN, *supra* note 40, at 209-10.

208. Barnard, *supra* note 116, at 98 and commentators cited therein at 54-61.

corporations cede the entire process of board selection to institutional investors.<sup>209</sup>

I do not discount, nor do I discuss here, the many existing impediments, and perceived impediments, to placing institutional investors or their representatives on a corporate board.<sup>210</sup> The critical question in this context is how changing the composition of a corporation's board of directors to include institutional investors or their representatives might make a corporation stronger. Many studies have suggested that the presence of "independent" directors on a board makes little difference in the way the board functions and has no positive impact on the company's performance.<sup>211</sup> Professors Gilson and Kraakman argue that only "professional outside directors," serving full time as corporate vigilantes, have any hope of breathing new life into the traditional corporate board.<sup>212</sup> Their scheme involves the creation of a tripartite board, composed of "inside directors," "outside directors" selected by management, and "professional directors"—primarily academics and consultants—nominated by institutions and elected in groups sufficient to command a substantial board voice.<sup>213</sup>

Merely changing board composition to decrease the percentage of corporate CEOs,<sup>214</sup> or to include directors whose nomination originated outside of the executive suite, is not enough, although it is a necessary precondition to effective governance reform. In advocating institutional participation on corporate boards, one must also address the way in which boards currently operate.

Specifically, at the same time institutions seek representation on corporate boards through the direct nomination process, they should also advocate a rigorous review of traditional board practices. Studies of organizational behavior and recent findings concerning the conditions that lead to the "best" group decisions should guide these efforts. Those conditions include: non-directive leader-

209. Dent, *supra* note 100, at 907-08.

210. For a discussion of some of these problems, see Black, *supra* note 45, at 530-60; Conard, *Beyond Managerialism: Investor Capitalism?*, 22 MICH. J. L. REFORM 117, 152-62 (1988); Gilson & Kraakman, *supra* note 101.

211. See, e.g., Brudney, *The Independent Director—Heavenly City or Potemkin Village?*, 95 HARV. L. REV. 597, 611-13 (1982) (independent directors do not monitor effectively because they share cultural values with management, lack resources, and lack adequate incentives to perform this task); Conard, *supra* note 210, at 129 ("Independent" directors are not really independent—"[e]xecutives can easily find directors who are neither subordinates, relatives, nor suppliers, who will support almost anything that the executives propose, and who will resign in extreme cases rather than oppose the executives who have invited them to the board."); Solomon, *Restructuring the Corporate Board of Directors: Fond Hope—Faint Promise*, 76 MICH. L. REV. 581, 600 (1978) (empirical review of performance of corporate boards after a court-ordered change in composition indicates "imperceptible" change in directors' behavior or approach to governance). But see Baysinger & Butler, *Corporate Governance and the Board of Directors: Performance Effects of Changes in Board Composition*, 1 J. L., ECON. & ORG. 101, 104 (1985) (finding that "board composition, in terms of the proportion of outside independent directors, has a mild [positive] effect on organizational performance, but that the effect is lagged."); Kesner & Johnson, *An Investigation of the Relationship Between Board Composition and Stockholder Suits*, 11 STRATEGIC MGMT. J. 327, 333 (1990) (boards sued for breach of fiduciary duties tend to have a greater percentage of insiders than those not sued).

212. Gilson & Kraakman, *supra* note 101.

213. *Id.*

214. Sixty three percent of public company board members are themselves chief executives of other public companies. "These directors are unlikely to monitor more energetically than they believe they should be monitored by their own boards." *Id.*



ship;<sup>215</sup> active, questioning participants;<sup>216</sup> an array of choices from which decisions are to be selected; assigned evaluative roles; and small task groups.<sup>217</sup>

While it is not the purpose of this Article fully to explore these ideas, it is important to note that social scientists who have probed the group decisionmaking process and the behavioral patterns that may influence group decisions have concluded that *changing the process can improve the outcome*. They agree, for example, that some level of stress within a decisionmaking group is a positive force for sound decisionmaking.<sup>218</sup> Involving "outsiders" in the discussion of complex matters, encouraging group members to caucus with other knowledgeable people away from the decisionmaking group, and convening "second chance" meetings to review decisions previously reached are all characteristic of well-conceived "quality decisions."<sup>219</sup>

The late Irving Janis, a social psychologist at Yale, prescribed nine specific practices for optimum group decisionmaking, derived from studies of public policy choices but each equally applicable to the work of a corporate board:

1. The leader of a policy-forming group should assign the role of critical evaluator to each member, encouraging the group to give high priority to airing objections and doubts. This practice needs to be reinforced by the leader's acceptance of criticism of his or her own judgments in order to discourage the members from soft-pedaling their disagreements.
2. The leaders in an organization's hierarchy, when assigning a policy-planning mission to a group, should be impartial instead of stating preferences and expectations at the outset. This practice requires each leader to limit his or her briefings to unbiased statements about the scope of the problem and the limitations of available resources, without advocating specific proposals he or she would like to see adopted. This allows the conferees the opportunity to develop an atmosphere of open inquiry and to explore impartially a wide range of policy alternatives.
3. The organization should routinely follow the administrative practice of setting up several independent policy-planning and evaluation

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215. Leana, *A Partial Test of Janis' Groupthink Model: Effects of Group Cohesiveness and Leader Behavior on Defective Decision Making*, 11 J. MGMT. 5, 15 (1985).

216. Callaway, Marriott & Esser, *Effects of Dominance on Group Decision Making: Toward a Stress-Reduction Explanation of Groupthink*, 49 J. PERS. AND SOC. PSYCH. 949 (1985) (groups whose members are "dominant"—having a predisposition to argue for their own points of view—are likely to reach high-quality decisions).

217. Mann & Janis, *Decisional Conflict in Organizations*, in PRODUCTIVE CONFLICT MANAGEMENT: PERSPECTIVES FOR ORGANIZATIONS 29, 32 (D. Tjosvold & D. Johnson eds. 1983); see also I. JANIS & L. MANN, *DECISION MAKING: A PSYCHOLOGICAL ANALYSIS OF CONFLICT, CHOICE, AND COMMITMENT* 11 (1977). Other characteristics associated with high-quality decisions include a collaborative, rather than competitive, process of conflict resolution, Wall, Galanes & Love, *Small, Task-Oriented Groups: Conflict, Conflict Management, Satisfaction, and Decision Quality*, 18 SMALL GROUP BEHAV. 31, 34 (1987), and the presence of vigilance, frequent second-guessing, accurate information processing and the absence of improbable fantasy chains. Hirokawa, *Why Informed Groups Make Faulty Decisions: An Investigation of Possible Interaction-Based Explanations*, 18 SMALL GROUP BEHAV. 3, 9 (1987).

218. Mann & Janis, *supra* note 217, at 21, 37-38.

219. *Id.* at 34.

groups to work on the same policy question, each carrying out its deliberations under a different leader.

4. Throughout the period when the feasibility and effectiveness of policy alternatives are being surveyed, the policy-making group should from time to time divide into two or more subgroups to meet separately, under different chairpersons, and then come together to hammer out their differences.

5. Each member of the policy-making group should discuss periodically the group's deliberations with trusted associates in his or her own unit of the organization and report back their reactions.

6. One or more outside experts or qualified colleagues within the organization who are not core members of the policy-making group should be invited to each meeting on a staggered basis and should be encouraged to challenge the views of the core members.

7. At every meeting devoted to evaluating policy alternatives, at least one member should be assigned the role of devil's advocate.

8. Whenever the policy issue involves relations with a rival nation or organization, a sizeable block of time (perhaps an entire session) should be spent surveying all warning signals from the rivals and constructing alternative scenarios of the rivals' intentions.

9. After reaching a preliminary consensus about what seems to be the best policy alternative, the policy-making group should hold a "second chance" meeting at which the members are expected to express as vividly as they can all their residual doubts and to rethink the entire issue before making a definitive choice.<sup>220</sup>

Most of these practices do not occur within the self-selecting board of directors today.<sup>221</sup> Rather, as noted earlier,<sup>222</sup> traditional boards often are characterized by social cohesion,<sup>223</sup> restrictive cultural norms, and conventions of discourse that tend (1) to overvalue the views of the chairman, (2) to exclude consideration of alternative options, and (3) to minimize expression of challenging views. Consequently, boards of directors, like other elite groups, are often subject to the psychological process known as "groupthink,"<sup>224</sup> which has been defined as: "a mode of thinking that people engage in when they are deeply involved in a cohesive in-group, when the members' strivings for unanimity override their motivation to appraise realistically alternative courses of action."<sup>225</sup>

220. I. JANIS, *GROUPTHINK: PSYCHOLOGICAL STUDIES OF POLICY DECISIONS AND FIASCOES* 262-271 (2d. ed. 1983).

221. See generally J. LORSCH, *supra* note 154, at 55-74 (describing typical board practices).

222. See *supra* notes 168-69 and accompanying text.

223. Elmer Johnson refers to this as the "club ethos" among board members. Johnson, *An Insider's Call for Outside Direction*, HARV. BUS. REV., Mar.-Apr. 1990, at 47; see also C. MILLS, *THE POWER ELITE* 11-12, 122-30 (1963) (describing the common social origins and practices of most business leaders).

224. See generally Swap, *Destructive Effects of Groups on Individuals*, in *GROUP DECISION MAKING* 69-95 (W. Swap ed. 1984) (discussing the powerful but detrimental influence a group has over its members: social loafing, deindividuating effects, and pressure on members to arrive at a consensual decision that may not be fully developed).

225. I. JANIS, *supra* note 220, at 9.



Many observers have noted that groupthink often occurs in the boardroom.<sup>226</sup> In their deliberations, "[board] members may be[come] so concerned with maintaining positive interpersonal relations and reducing conflict that they lose the ability or willingness to critically evaluate the risks and advantages of decision alternatives."<sup>227</sup> Because of the structure of the board, and the way in which it conducts its business, there is seldom opportunity for any real "give and take on the issues."<sup>228</sup>

A shareholders' advisory committee, which by definition is not part of the in-group, might alter this pattern of decisionmaking. A free-standing committee would avoid the problems of co-optation that may characterize even the most "independent" of corporate boards.<sup>229</sup> However, as noted earlier,<sup>230</sup> free-standing advisory committees have many shortcomings. The better option for institutional investors would be to focus their reformational energies on the board itself and to seek structural means of minimizing the groupthink phenomenon.

A preliminary prescription for changing board practices might include a number of strategies adopted from the group psychology literature. "New boards" could (1) encourage the addition of "untraditional" directors to corporate boards to reduce the nearly-exclusive reliance on corporate CEOs; (2) encourage the use of an outside director as chairman of the board;<sup>231</sup> (3) encourage wider use of multiple directoral subcommittees, with diverse leaders, to explore common issues, and then come together as a group to resolve differences of opinion;<sup>232</sup> (4) encourage board members to give high priority to airing their objections and doubts in the boardroom; (5) encourage CEOs to recognize the value of opinion diversity and to develop a discriminating compensation scheme for directors that rewards contributions to the governance process; and (6) recognize that board service as redefined will require a greater commitment than has been expected of board members in recent years, and will command substantially greater rewards.

Adopting such practices need not invite decisional paralysis. Obviously, boards and their chairmen must be selective and discriminating in assembling

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226. Cox & Munsinger, *Bias in the Boardroom: Psychological Foundations and Legal Implications of Corporate Cohesion*, LAW & CONTEMP. PROBS., Summer 1985, at 99-104; Dent, *supra* note 100, at 899 & n.102; Haft, *Business Decisions by the New Board: Behavioral Science and Corporate Law*, 80 MICH. L. REV. 1, 35-39 (1981).

227. Swap, *supra* note 224, at 83.

228. Johnson, *supra* note 223, at 47.

229. See Cox & Munsinger, *supra* note 226, at 114-31; Dent, *supra* note 100, at 909.

230. See *supra* notes 185-99 and accompanying text.

231. Cf. Knowlton & Millstein, *Can the Board of Directors Help the American Corporation Earn the Immortality It Holds So Dear?*, in J. MEYER & J. GUSTAFSON, THE U.S. BUSINESS CORPORATION—AN INSTITUTION IN TRANSITION 184 (1988) (recommending that one of the outside directors, rather than the CEO, routinely serve as board chair). Currently, only about 21% of American public companies assign someone other than the CEO to the position of chairman. KORN/FERRY INTERNATIONAL, *supra* note 22, at 14.

232. Peter Drucker tells a story which illustrates the views of Alfred Sloan, former Chairman of General Motors, on the value of debate in decisionmaking. At an executive meeting, called to consider a major decision, Sloan concluded: "Gentlemen, I take it we are all in complete agreement on the decision here . . . . Then I propose we postpone further discussion until our next meeting to give ourselves time to develop disagreement and perhaps gain some understanding of what the decision is all about." P. DRUCKER, MANAGEMENT, TASKS & RESPONSIBILITIES 472 (1974).

information and choosing among alternative strategies; otherwise they would waste irrecoverable resources in "a fruitless quest for an elusive, faultless alternative."<sup>233</sup> Board decisions by definition involve risk and will always be premised on intangible business judgments, perceptions about timing, and unverifiable assumptions about consumer, competitive, and regulatory behavior. Nor are such practices inconsistent with the notion of a monitoring board. Insisting that directors become more directly and intensely engaged in the determination of corporate policy is not the same as asking them to micro-manage the enterprise.

The point is that corporate boards may be able to improve their decisional performance and, by extension, their companies' financial performance, if they are willing to depart materially from traditional patterns of board composition and process. At the very least, in the face of intense international competitive pressures, corporate managers should be willing to give these ideas a try.

This kind of transformation will not come easily. Many business leaders pride themselves on their resistance to the advice of scholars. In a more narrow sense, shareholders in many companies are having difficulty securing even a significant number of outside directors, conventionally selected,<sup>234</sup> let alone trying to transform boards' longstanding decisionmaking styles. Business executives are understandably reluctant, especially in a time of economic uncertainty, to undertake major structural changes in their boards. That is precisely what they must try to do, however, because, unless they can create and exploit a "properly functioning board," public companies will become an "endangered species."<sup>235</sup> Better corporate governance does not require the creation of a new supervisory body such as that being promoted by CalPERS, but it does require a sensitized, diversified, and participatory board.

#### CONCLUSION

The new-found willingness of many institutional investors to consider schemes such as the shareholders' advisory committee and other mechanisms of empowerment suggest both a narrow and a broader conclusion. The narrow conclusion is that over half of all institutional investors are willing to give serious thought to the notion of a shareholders' advisory committee on a case-by-case basis.<sup>236</sup> The broader conclusion is that a substantial number of influential institutional investors, frustrated by what they perceive as management insensitivity to shareholders' concerns, and often inhibited by the volume of their holdings (or by indexing practices) from profitably selling their shares, are willing to

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233. I. JANIS & L. MANN, *supra* note 217, at 13.

234. See Durgin, *Fighting for Independence: Proxy Proposals Seeking Directors Without Company Ties*, PENSIONS & INVESTMENT AGE, Feb. 18, 1991, at 1, 50; Parker, *Funds Shift Target for Proxy Season: New Focus Put on Directors*, PENSIONS & INVESTMENT AGE, Oct. 29, 1990, at 1 (listing shareholders' proposals for 1991, the purpose of which is to ensure a majority of outside directors on corporate boards). Note that in January, at CalPERS' urging, General Motors voluntarily amended its bylaws to require a majority of outside directors. Parker, *supra* note 140, at 6.

235. Johnson, *supra*, note 171, at 46.

236. See *supra* notes 117-21 and accompanying text.



entertain quite radical ideas, including an entirely new model of corporate governance, to stimulate better long-term corporate performance.

This Article has examined only one of these ideas, and concludes that, although the concept of a shareholders' advisory committee is intriguing, shareholders' advisory committees are not the best available response to a growing concern about declining corporate performance and declining national competitiveness. The need for an alternative governance structure that involves institutional investors nevertheless remains for two reasons. The first is that shareholders generally and institutional shareholders specifically require some reassurance that their concerns are still paramount, if no longer exclusive, in the governance equation. These shareholders' sense of security understandably has been damaged, both with the increase in statutory accommodations for "other constituencies,"<sup>237</sup> and with the increase in judicial tolerance for schemes that disenfranchise them.<sup>238</sup> The second reason is that the existing governance form does not work as well as it might, given the current state of our knowledge about collegial decisionmaking.

Institutional investors and corporate managers together must continue to examine how boards work and how they can work more effectively. Territorial defensiveness and sloganeering<sup>239</sup> will not facilitate these discussions. Rather, managers and their institutional owners must seek common ground, including a deeper understanding of how their traditional arms-length relationships and seemingly immutable board practices may be inhibiting corporate success.

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237. See ABA Committee on Corporate Laws, *Other Constituencies Statutes: Potential for Confusion*, 45 BUS. LAW. 2253 (1990). See generally Coffee, *Unstable Coalitions: Corporate Governance As a Multi-Player Game*, 78 GEO. L. J. 1495 (1990) (discussing the new role of stakeholders in corporate governance); Johnson, *The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law*, 68 TEX. L. REV. 865 (1990) (urging recognition of stakeholder interests in corporate policymaking).

238. See, e.g., *Business Roundtable v. SEC*, 905 F.2d 406 (D.C. Cir. 1990) (striking down Commission's mandatory one share-one vote rule, thus permitting public companies to submit dual-class recapitalization proposals to their shareholders, notwithstanding known collective action problems); *Paramount Communications, Inc. v. Time, Inc.*, 571 A.2d 1140 (Del. 1990) (upholding corporate defense strategy that deprived shareholders of opportunity to participate in a cash tender offer which featured a \$75 per share premium over market).

239. See Comment, *supra* note 25.

## APPENDIX A

The 10 Largest Equityholders in the  
FORTUNE 500 COMPANIES Top 50\*

## GENERAL MOTORS

General Motors Savings Trust  
Sanford C. Bernstein & Co.  
Wellington Mgmt.  
Wells Fargo Bank  
Michigan State Treasurer  
Mellon Bank  
CREF  
Bankers Trust  
Rosenberg Inst. Eq. Mgmt.  
NYS Common Retirement

## FORD MOTOR

Manufacturers National Corp./Detroit/Trustee  
[Employee Savings & Stock Investment Plan]  
Wellington Mgmt.  
Sarofim Faye  
Wells Fargo Bank  
Bankers Trust  
Mellon Bank  
Michigan State Treasurer  
Capital Research & Mgmt.  
Sanford C. Bernstein & Co.  
Capital Guardian Trust

## EXXON

Wells Fargo Bank  
Bankers Trust  
Mellon Bank  
CREF  
Chemical Bank  
NYS Common Retirement  
PNC Financial Corp.  
J.P. Morgan  
Chase Manhattan  
CalPERS

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\* The Fortune 500 is comprised of the largest U.S. industrial corporations, based upon sales. This list was published by Fortune Magazine on April 23, 1990.

The listing of these companies' 10 largest shareholders was derived from Compact Disclosure figures as of 12/31/89. Where necessary, clarifying information was secured from the companies' most recent proxy statements.



## INTERNATIONAL BUSINESS MACHINES

Wells Fargo Bank  
Bankers Trust  
Sanford C. Bernstein & Co.  
Mellon Bank  
Michigan State Treasurer  
J.P. Morgan  
Delaware Mgmt. Co.  
Capital Research & Mgmt.  
NYS Common Retirement  
CalPERS

## GENERAL ELECTRIC

Wells Fargo Bank  
Bankers Trust  
Mellon Bank  
Sarofim Fayez  
Alliance Capital Mgmt.  
First Security Corp./Utah  
NYS Common Retirement  
FMR Corp.  
CREF  
University of California

## MOBIL

Employees' Savings Plan  
Mellon Bank  
Wells Fargo Bank  
NYS Common Retirement  
Delaware Mgmt. Co.  
Lord Abbett & Co.  
Bankers Trust  
Sarofim Fayez  
Rosenberg Inst. Eq. Mgmt.  
Newbolds Asset Mgmt.

## PHILIP MORRIS

Sarofim Fayez  
Alliance Capital Mgmt.  
Wells Fargo Bank  
CREF  
Bankers Trust  
Capital Research & Mgmt.  
Lazard Freres & Co.  
Mellon Bank  
Sanford C. Bernstein & Co.  
FMR Corp.

**CHRYSLER**

Wellington Mgmt.  
Windsor Fund  
Sanford C. Bernstein & Co.  
Michigan State Treasurer  
Dreman Value Mgmt. Co.  
Wells Fargo Bank  
TCW Asset Mgmt.  
Barrow Hanley Mewhinney  
Trinity Investment Mgmt.

**E.I. DUPONT DE NEMOURS**

JES Developments [Seagram Co.]  
Wilmington Trust Co.  
Mellon Bank  
Wells Fargo Bank  
Delaware Mgmt. Co.  
Bankers Trust  
Loomis Sayles & Co.  
Sarofim Faye  
NYS Common Retirement  
PNC Financial Corp.

**TEXACO**

Icahn Group  
Manufacturers Hanover  
J.P. Morgan  
Capital Research & Mgmt.  
FMR Corp.  
Delaware Mgmt. Co.  
Lazard Freres & Co.  
NYS Common Retirement  
Barrow Hanley Mewhinney  
Oppenheimer & Co.

**CHEVRON**

Chevron Corp. Employee Profit Sharing/Savings Plan  
Pennzoil Co.  
Sarofim Faye  
Wells Fargo Bank  
NYS Common Retirement  
Mellon Bank  
Bankers Trust  
Chase Manhattan  
CREF  
Rosenberg Inst. Eq. Mgmt.



## AMOCO

First National Bank/Chicago/Trustee  
[Employee Savings Plan]  
Wells Fargo Bank  
Bankers Trust  
Mellon Bank  
Invesco Capital Mgmt.  
NYS Common Retirement  
Delaware Mgmt. Co.  
Sarafim Fayeze  
CalPERS  
Alliance Capital Mgmt.  
NYS Teachers Retirement

## SHELL OIL N/A

## PROCTER &amp; GAMBLE

Procter & Gamble Profit Sharing Trust  
Procter & Gamble ESOP  
PNC Financial Corp.  
Wells Fargo Bank  
University of California  
Bankers Trust  
Mellon Bank  
Fifth Third Bank/Cincinnati  
Sarafim Fayeze  
NYS Common Retirement

## BOEING

Alliance Capital Mgmt.  
CREF  
Capital Guardian Trust  
Wells Fargo Bank  
IDS Financial Mgmt.  
Bankers Trust  
Miller Anderson & Sherrerd  
Jennison Assoc. Capital  
Loomis Sayles & Co.  
Kemper Financial Services

## OCCIDENTAL PETROLEUM

Manufacturers Hanover  
Wells Fargo Bank  
Bankers Trust  
Batterymarch Financial Mgmt.  
Delaware Mgmt. Co.  
CREF  
Mellon Bank  
NYS Common Retirement  
Dewey Square Investors  
CalPERS

## UNITED TECHNOLOGIES

FMR Corp.  
Newbolds Asset Mgmt.  
Capital Research & Mgmt.  
Batterymarch Financial Mgmt.  
Loomis Sayles & Co.  
Invesco Capital Mgmt.  
Putnam Mgmt. Co.  
Lehman Ark Mgmt.  
Capital Guardian Trust  
Wells Fargo Bank

## EASTMAN KODAK

Delaware Mgmt. Co.  
Wells Fargo Bank  
University of California  
Sarofim Fayeze  
Bankers Trust  
CREF  
Templeton Galbraith & Hans  
Mellon Bank  
Chase Manhattan  
Lehman Ark Mgmt.

## USX

Icahn Capital Corp.  
U.S. Steel & Carnegie Pension Fund  
Delaware Mgmt. Co.  
Barberry Corp.  
FMR Corp.  
Lord Abbett & Co.  
Bankers Trust  
Wells Fargo Bank  
National City Bank/Cleveland  
Putnam Mgmt. Co.

## DOW CHEMICAL

Wells Fargo Bank  
Sarofim Fayeze  
Rosenberg Inst. Eq. Mgmt.  
Bankers Trust  
University of California  
Mellon Bank  
CREF  
Wellington Mgmt.  
NYS Common Retirement  
Capital Research & Mgmt.



## XEROX

State Street Bank/Boston/Trustee  
[Employee Stock Option Plan]  
Delaware Mgmt. Co.  
Barrow Hanley Mewhinney  
FMR Corp.  
United Banks of Colorado  
University of California  
Pioneering Mgmt. Corp.  
Texas Teacher Retirement System  
Wells Fargo Bank  
Bankers Trust

## ATLANTIC RICHFIELD

Wells Fargo Bank  
J.P. Morgan  
Bankers Trust  
Mellon Bank  
University of California  
Aetna Life & Casualty  
NYS Common Retirement  
Harris Bankcorp  
RCM Capital Mgmt.  
Michigan State Treasurer

## PEPSICO

Sarofim Fayez  
CREF  
Wells Fargo Bank  
Mellon Bank  
Bankers Trust  
Alliance Capital Mgmt.  
State Street Boston Corp.  
State Street Research & Mgmt.  
Lincoln Capital Mgmt.  
NYS Common Retirement

## RJR NABISCO HOLDINGS (N/A)

## McDONNELL DOUGLAS

Bankers Trust/Trustee  
[Employee Savings, Investment and Thrift Plan; MDC ESOP]  
Batterymarch Financial Mgmt.  
James F. McDonnell III  
Ivesco Capital Mgmt.  
Sanford C. Bernstein & Co.  
Bankers Trust  
John F. McDonnell  
Trinity Investment Mgmt.  
Wells Fargo Bank  
FMR Corp.

## TENNECO

Delaware Mgmt. Co.  
FMR Corp.  
Putnam Mgmt. Co.  
Prudential Insurance Co.  
Bankers Trust  
Wells Fargo Bank  
CREF  
Mellon Bank  
Alliance Capital Mgmt.  
NYS Common Retirement

## DIGITAL EQUIPMENT

Sanford C. Bernstein & Co.  
Shawmut Corp.  
Michigan State Treasurer  
Rosenberg Inst. Eq. Mgmt.  
Capital Research & Mgmt.  
Kenneth H. Olsen  
University of California  
Oppenheimer & Co.  
Wells Fargo Bank  
Capital Guardian Trust

## WESTINGHOUSE ELECTRIC

Barrow Hanley Mewhiney  
FMR Corp.  
Wells Fargo Bank  
Mellon Bank  
Capital Research & Mgmt.  
Bankers Trust  
Capital Guardian Trust  
CREF  
Shearson Lehman Hutton  
Loomis Sayles & Co.

## ROCKWELL INTERNATIONAL

First Interstate Bankcorp/Trustee  
[Employee Savings Plan]  
Wells Fargo Bank  
Bankers Trust  
Mellon Bank  
Trinity Investment Mgmt.  
Batterymarch Financial Mgmt.  
CREF  
Texas Teacher Retirement System  
NYS Common Retirement  
CalPERS



## PHILLIPS PETROLEUM

Phillips Petroleum Thrift Plan  
Phillips Petroleum Stock Savings Plan  
Batterymarch Financial Mgmt.  
Wells Fargo Bank  
Rosenberg Inst. Eq. Mgmt.  
Mellon Bank  
J.P. Morgan  
Bankers Trust  
TCW Asset Mgmt.  
Harris Associates

## ALLIED-SIGNAL

State Street Bank/Boston/Trustee  
[Allied-Signal Savings Plan]  
State Street Boston Corp.  
Delaware Mgmt. Co.  
Barrow Hanley Mewhinney  
Bankers Trust  
Wells Fargo Bank  
Newbolds Asset Mgmt.  
CREF  
Independent Investment Assoc.  
E.I. DuPont de Nemours

## MINNESOTA MINING &amp; MFG.

First Bank System  
State Street Boston Corp.  
University of California  
Wells Fargo Bank  
Sarofim Faye  
Bankers Trust  
Invesco Capital Mgmt.  
NYS Common Retirement  
Miller Anderson & Sherrerd  
Lord Abbett & Co.

## HEWLETT-PACKARD

David Packard  
William and Flora Hewlett Foundation  
Wells Fargo Bank  
Invesco Capital Mgmt.  
Sanford C. Bernstein & Co.  
University of California  
Lincoln Capital Mgmt.  
Bankers Trust  
State Farm Mutual Auto Ins.  
Mellon Bank

## SARA LEE

Mellon Bank  
Wells Fargo Bank  
Alliance Capital Mgmt.  
Capital Supervisors  
First Manhattan Co.  
Chancellor Capital Mgmt.  
CREF  
Bankers Trust  
National City Bank/Cleveland  
NYS Common Retirement

## INTERNATIONAL PAPER

Bankers Trust/Trustee  
[Employee Savings, Thrift and ESOP Plans]  
Manning & Napier Advisory  
Oppenheimer & Co.  
CREF  
Miller Anderson & Sherrerd  
NYS Common Retirement  
Wells Fargo Bank  
Dodge & Cox  
Mellon Bank  
Harris Bankcorp

## CONAGRA

Fidelity International Ltd./FMR Corp.  
First Bank System  
Mellon Bank  
Wells Fargo Bank  
E.I. DuPont de Nemours  
IDS Financial Corp.  
Bankers Trust  
CREF  
Independent Investors Ass'n  
U.S. Trust

## ALUMINUM CO. OF AMERICA

Wellington Mgmt.  
Michael H. Steinhardt  
Mellon Bank  
Alcoa Savings Plan  
Sanford C. Bernstein & Co.  
Batterymarch Financial Mgmt.  
Lord Abbett & Co.  
Wells Fargo Bank  
Loomis Sayles & Co.  
NYS Common Retirement



## CATERPILLAR

Capital Research & Mgmt.  
Lord Abbett & Co.  
Sanford C. Bernstein & Co.  
United Banks of Colorado  
Newbolds Asset Mgmt.  
Alliance Capital Mgmt.  
Shearson Lehman Hutton  
Dodge & Cox  
Michael H. Steinhardt  
Wells Fargo Bank

## GOODYEAR TIRE &amp; RUBBER

Sanford C. Bernstein & Co.  
FMR Corp.  
Batterymarch Financial Mgmt.  
Loomis Sayles & Co.  
Trinity Investment Mgmt.  
Capital Research & Mgmt.  
Hotchkiss and Wiley  
J.P. Morgan  
Bankers Trust  
Wellington Mgmt. Co.

## UNOCAL

Security Pacific Corp./Trustee  
[Unocal Profit Sharing Plan and ESOP]  
Alliance Capital Mgmt.  
Lazard Freres & Co.  
Wells Fargo Bank  
TCW Asset Mgmt.  
Bankers Trust  
Loomis Sayles & Co.  
RCM Capital Mgmt.  
FMR Corp.  
Ohio State Teachers Retirement

## GEORGIA-PACIFIC

University of California  
CREF  
Harris Bankcorp  
Manning & Napier Advisory  
Wells Fargo Bank  
Trinity Investment Mgmt.  
Rosenberg Inst. Eq. Mgmt.  
Bankers Trust  
Templeton Galbraith  
Texas Teacher Retirement System

## WEYERHAEUSER

Delaware Mgmt. Co.  
Wells Fargo Bank  
Capital Research & Mgmt.  
Bankers Trust  
Bank of California  
Miller Anderson & Sherrerd  
Pioneering Mgmt. Corp.  
Dodge & Cox  
First Bank System  
CREF

## UNISYS

FMR Corp.  
Cahsman Farrell & Assoc.  
Trinity Investment Mgmt.  
Texas Teacher Retirement System  
Lehman Ark Mgmt.  
Wells Fargo Bank  
Wilmington Capital Mgmt.  
Loomis Sayles & Co.  
Bankers Trust  
J.P. Morgan

## GENERAL DYNAMICS

Lester Crown and James S. Crown  
Batterymarch Financial Mgmt.  
Trinity Investment Mgmt.  
Invesco Capital Mgmt.  
Boston Co.  
C.H. Dean & Assoc.  
Bankers Trust  
Wells Fargo Bank  
J.P. Morgan  
Sanford C. Bernstein & Co.

## LOCKHEED

U.S. Trust of California/Trustee  
[Lockheed ESOP Feature Trust]  
Invesco Capital Mgmt.  
Sanford C. Bernstein & Co.  
Trinity Investment Mgmt.  
Loomis Sayles & Co.  
N.L. Industries Inc.  
Wells Fargo Bank  
Heine Securities  
E.I. DuPont de Nemours  
Boston Co.

## SUN

Glenmede Trust Co./Trustee

[Pew Memorial Trust and other trusts and estates]

Mellon Bank

Delaware Mgmt. Co.

Wells Fargo Bank

Bankers Trust

CREF

NYS Common Retirement

NYS Teachers Retirement

Philadelphia National Bank

CalPERS

## JOHNSON &amp; JOHNSON

Robert Wood Johnson Foundation

Wells Fargo Bank

Bankers Trust

State Farm Mutual Auto Ins.

University of California

Mellon Bank

PNC Financial Corp.

Shearson Lehman Hutton

Wilmington Trust Co.

NYS Common Retirement

## MOTOROLA

Robert W. Galvin

Harris Bankcorp

Capital Research & Mgmt.

Wells Fargo Bank

Capital Guardian Trust

Lord Abbett & Co.

Alliance Capital Mgmt.

Bankers Trust

Kemper Financial Services

Investors Research Corp.

## ANHEUSER-BUSCH

Boatmen's Bancshares

Mercantile Banc/Missouri

Sarofim Faye

Lazard Freres & Co.

Bankers Trust

Wells Fargo Bank

Capital Research & Mgmt.

CREF

J.P. Morgan



**BRISTOL-MYERS SQUIBB**

Bankers Trust  
Delaware Mgmt. Co.  
PNC Financial Corp.  
Boston Co.  
Wells Fargo Bank  
Boatmen's Bancshares  
CREF  
NYS Common Retirement  
Alliance Capital Mgmt.  
Mellon Bank