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Giving Voice to Shareholder Choice

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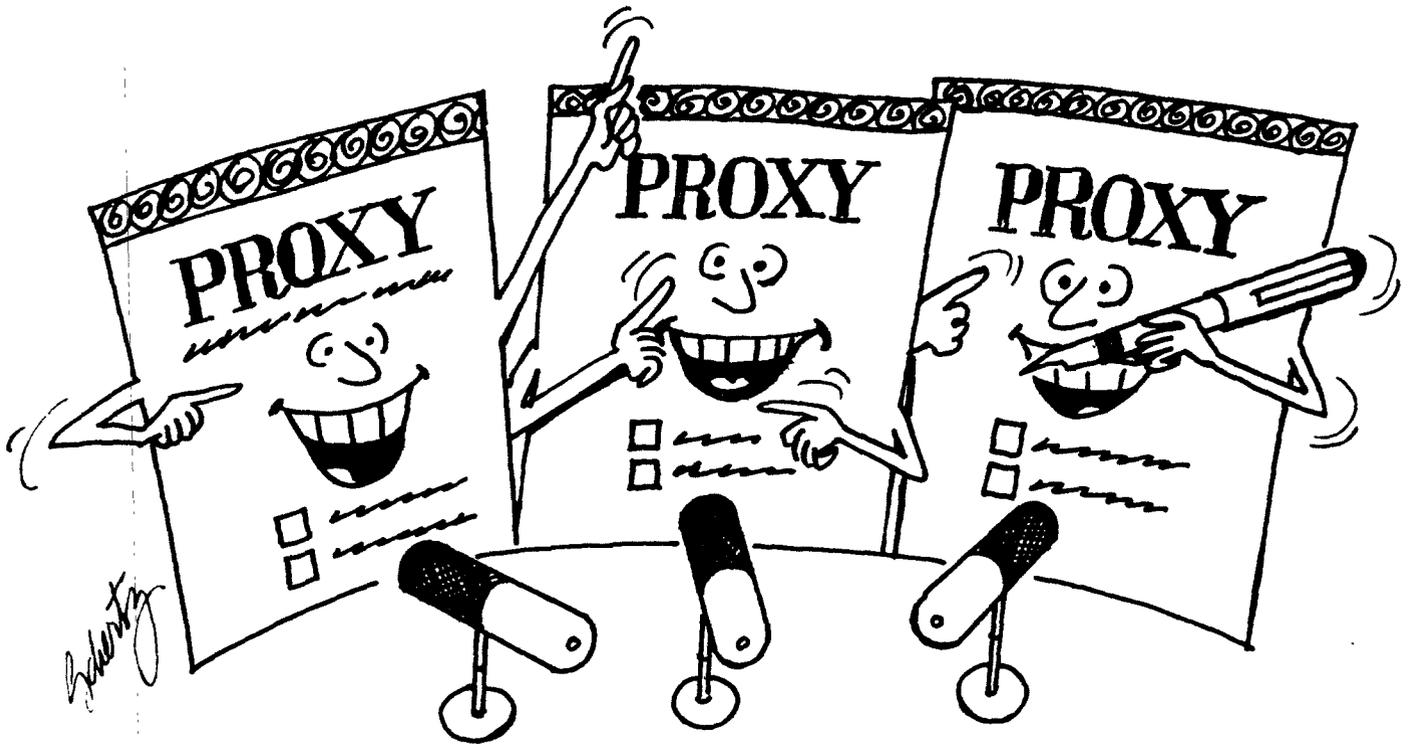
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The drive for corporate democracy.

Giving Voice to Shareholder Choice



by JAYNE W. BARNARD

IN NEW YORK, in order to get on the ballot as a candidate for statewide office, one needs only to pay a nominal filing fee and gather up 20,000 voter signatures, which is usually an easy task. Once that threshold is met, the cost of printing and distributing ballots is borne by the government.

In that same state, unless selected by incumbent managers, the only way to be elected as a director of a publicly owned company is to launch a full-scale proxy contest. This involves printing and mailing

thousands of proxy disclosure documents and ballots (prepared by a securities specialist at the standard hourly rate) at one's own expense.

Given these rules, it is no wonder that there is almost always a contest for even the most minor public office whereas elections for positions on corporate boards only rarely involve a proxy fight. In 1989, according to the Investor Responsibility Research Center, out of more than 15,000 public companies, there were only a dozen proxy contests for positions on corporate boards.

Many critics have been asking why it is so costly for a capable investor or other interested individual to seek election to a corporate board. Every publicly

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held corporation must send out a proxy statement each year in advance of the annual shareholder meeting. Since the proxy statements always list the candidates nominated by incumbent management, why not require these companies also to include candidates independently nominated by nonmanagement shareholders? Eligibility to make nominations could be limited to those who own (or could compile the support of others who collectively own) a substantial amount of stock, say \$500,000, or enough to represent some percentage of the total, say 3 percent. Other safeguards could be imposed to ensure that gadflies, "flakes," and takeover artists do not take advantage of this simple, though valuable, nomination privilege.

"Shareholder access to the proxy has been an issue since the federal securities laws were enacted."

Noted academics like Louis Lowenstein of Columbia Law School and Melvin Eisenberg of the University of California have advanced proposals to provide shareholders access to the proxy statement to permit them to nominate directorial candidates. Savvy practitioners like Martin Lipton have argued that direct access to the proxy would correct the existing imbalance of power between incumbent management and outside investors and might even curb the takeover binge. Ralph Nader has endorsed shareholder access to the proxy. Congressmen and senators on both the left and the right have submitted bills that would provide shareholder access. To date these bills have been defeated.

As it stands now, the typical shareholder receives a ballot each year containing a single slate of nominees hand-selected by incumbent management. For example, ten candidates would be nominated for ten board positions. There are no other choices and, because proxies have been submitted to management and tallied in advance, the process of nominating from the floor at the annual meeting is invariably futile. Thus, as one observer has noted, the typical Third World dictatorship often enjoys more "democracy" than do American shareholders.

AGITATING FOR ACTION

Now a new group of activists has come along seeking a greater voice in the selection of those men and women who run America's big corporations. Some, like oil industry analyst Kurt Wulff, have attempted to

gain access to the proxy one corporation at a time. Others, like T. Boone Pickens and his United Shareholders Association, have been seeking a legislative solution to the access problem. Big institutional investors, notably the California Public Employee Retirement System (CalPERS), have been agitating for any effective means by which major shareholders can have a voice in directorial selection and long-range corporate planning. The SEC, which considered adopting access rules in the past, before abandoning the effort during the Reagan administration, has remained silent on the growing access debate.

Corporate managers dismiss access efforts, arguing that there is ample opportunity for serious shareholders to play a role in choosing board members. Invitations to "write to our nominating committees" are often included in the annual proxy statement. Shareholders are asked to "give us your ideas for an improved board of directors, and we will carefully consider them." However, in a survey of 300 public companies conducted by The Conference Board, the futility of making suggestions to board nominating committees became apparent.

SURVEY SAYS

Nominating committee respondents were asked where they first learned of their ultimate board nominees. Fully nine out of ten identified the chief executive officer as the prime source of nominees. Shareholders, on the other hand, significantly influenced the nomination of candidates in only a handful of companies. Indeed, more than eight out of ten survey respondents did not find shareholders to be a useful source or even a source at all in the search for board candidate nominees.

"The SEC has remained silent on the growing access debate."

Recently, more and more corporations have created board nominating committees, often made up exclusively of outside directors. A recent survey suggests that as many as 70 percent of the Standard & Poor's 500 companies now have some form of nominating committee. But that development has been accompanied by an increasing resistance to shareholder nominations. Many companies have adopted stringent bylaws or operating procedures to dictate the form that shareholder nominations must conform to for consideration by the board. Many require a full biog-

raphy and financial information such as eventually would be required by the SEC if the nomination were submitted to the shareholders. Some even require a signed consent by the candidate before a shareholder's suggestion will even be presented to the nominating committee.

Shareholders — particularly holders of large blocks of stock — argue that the will of dissatisfied investors should not be frustrated by these nominating committee "gatekeepers" appointed by management.

"The typical Third World dictatorship often enjoys more democracy than do shareholders of American corporations."

Shareholders are guaranteed by law the right to elect corporate directors; that should include the right to nominate directorial candidates as well. In practice and tradition, however, the right to nominate exists only for those who are present at the annual meeting or those willing to undertake their own independent proxy solicitation. The right to nominate does not include those unwilling to bear the cost of a separate mailing but merely hope to be free riders on the corporate proxy statement.

In the political world, the U.S. Supreme Court has ruled that the right to vote must include an effective voice in the nomination process. Thus, black voters excluded from participating in all-white Democratic Party primaries were found to have been denied their constitutional rights and the exclusionary primary system was dismantled. Alas, there are no constitutional rights on which shareholders may rely. Thus, shareholder activists have turned to Congress to give them a real voice in the selection of corporate boards.

The Senate has before it the Corporate Takeover Reform Act, a bipartisan bill that provides for any shareholder or group of shareholders representing at least 3 percent of a company's voting shares to nominate directorial candidates. Biographical information would be included in the management proxy, where they are given "equal space, coverage, and treatment," as are management's candidates.

PROXY MOXIE

The need for this reform was highlighted last year when the Delaware Supreme Court protected Time, Inc.'s decision to merge with Warner Communications notwithstanding the overwhelming desire of shareholders instead to sell their shares to Paramount, Inc.,

at a substantial premium. The court's ruling was based on the express proposition that "corporation law does not [require] directors . . . to follow the wishes of a majority of shares."

Assume a majority of Time's shareholders now wish to express their dissatisfaction with the Warner transaction in the only way left to them: by replacing the incumbent board (or at least some of its members). In the absence of an access provision, their only means of doing so would be through the prohibitively expensive mechanism of a proxy fight that as a practical matter is only likely to be pursued by a raider seeking a change in management for his own profit. Access to the proxy would permit an alternative means of expression, at a minimal cost to shareholders as a group.

What would be the long-term impact of the Senate's access proposal? Some corporate executives fear it would encourage corporate raiders or result in a board unable to make effective decisions and transfixed by short-term considerations. Others concede it would be sparingly used and seldom effective in actually replacing a board member because of the high costs of follow-up solicitation necessary, even where the ballots would be circulated at corporate expense. They acknowledge, though, that the mere existence of access rights would stimulate more interchange between management and institutional investors who now own over 50 percent and sometimes as much as 90 percent of the stock in many major corporations in this country.

"The futility of making suggestions to nominating committees became apparent."

Shareholder access to the proxy has been an issue since the federal securities laws were enacted in the 1930s. Its vitality has risen and fallen with political and economic tides. Whereas most corporate managers today, as they did in 1934, reject the notion that shareholders have any contribution to make to the process of corporate governance, their most sophisticated investors feel otherwise. Some investment managers now control portfolios ranging into the billions of dollars, and are increasingly insisting that their views be heard.

As the composition of shareholder ownership in public companies changes from large numbers of individual investors with small holdings to a much smaller concentration of institutional investors with large holdings, access to the proxy will be increasingly an issue to watch. □