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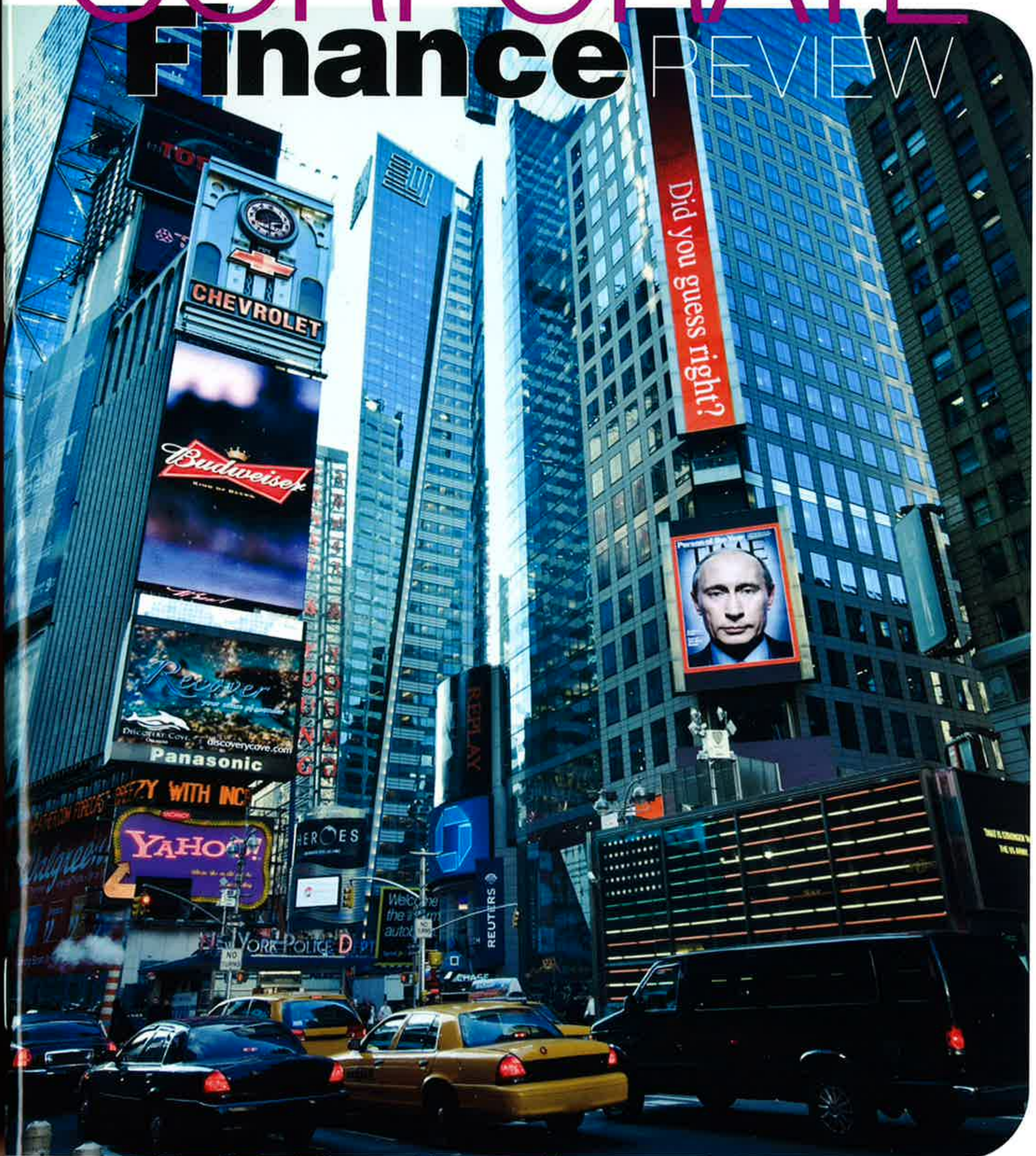

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HANK BOERNER

CORPORATE PROXY SEASONS: PROXIES FOR THE DEBATE ABOUT WHOSE INTERESTS ARE SERVED — "OWNERS" OR MANAGERS AND BOARDS "IN CONTROL"

The Baseball Hall of Fame recognized the career accomplishments of the long-time New York Yankee player Lawrence "Yogi" Berra for his on-field accomplishments (1946–63), and later as a team coach and manager, a broadcaster, and overall as an outstanding member of professional baseball. Over time Yogi has also won wide recognition for his witty and often convoluted quips, his aphorisms that reek of common man wisdom. One that comes to mind is from the 1960s as he watched Mickey Mantle and Roger Maris hit back-to-back home runs: *It's like déjà vu all over again*. This might apply to today's corporate proxy seasons as perennial issues are raised by activist investors, and as government (and citizens) take a closer look at the societal dynamics between big business and the American society-at-large.

The societal issues play out in numerous proxy campaigns. As summer turns to autumn, the new business year gets underway for many. For companies with a Fiscal Year following the calendar year, this means that senior management and board, as well as shareholders and analysts, are focused on the fourth quarter/year end results. But come September and October, other groups are also focusing on the approach of the new calendar year and the start of the annual corporate proxy season process. These include investor activists, and social issue advocates, often now working in coalitions and networks to assert pressure in support of their issues in the annual proxy arena.

As we have observed in this commentary in the past, to use a metaphor, two powerful streams of thought have over the recent decades converged into a great river of thought and action. Investors who have traditionally focused on corporate governance issues are now more closely aligned with, or are working with, investors who may be focused on both corporate governance and a wide range of environmental and social or societal issues. The social activists use governance issues as a lever, an effective means of exerting pressure on the public companies in their portfolios to effect change on a wide range of social issues, or environmental management issues (such as company actions and disclosure on climate change issues, or supply chain issues).

The converging issues are blending into a package of demands and expectations (especially for large-cap corporations and brand-name companies) that make for lively campaigns around proxy votes and for advocate-corporate engagement when executives recognize the potential damage to corporate reputation and valuations caused by bruising confrontation. The proxy season activities also bring into focus the public dialogue about the corporation and its role (an influence) in the American Society.

What proxy season is about

For some companies, the proxy seasons are *déjà vu all over again* as shareholders return to press their demands for

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expanded disclosure and changes in corporate behavior in a public venue. And as is the case in many elections, boards and managers often ignore even sizable supporting votes for the advocates' positions. The usual proxy vote on issues is "advisory" for most companies; the outcome is a measure of shareholder sentiment and is not binding. This is all about affecting voting outcomes—but also about embarrassing companies and managements and boards in very public ways.

The language of the proxy season activities often shapes the debate—about issues during the proxy season, of course, and also about the rights of shareholders within the proxy process itself. Should there be "corporate democracy?" Of course there is sharp disagreement on these matters and very often the U.S. courts side with board and management. But lately the debate is broadening to include examination of the role of the large corporation in American life and rights and responsibilities of the corporation—and these are becoming part of the proxy season dialogue as well, and as potential content material for authors, film producers, journalists, broadcasters, and others beyond the activist shareholder community.

The recurring questions about the role of the corporation

This second *déjà vu all over again* is the current dialogue on the role that large public companies play in the American society of the 21st century—a dialogue that spans three centuries, back to the "Robber Baron" days in the 19th century. As the first mega-cap public companies emerged—United States Steel was the first billion dollar public corporation, fashioned by J.P. Morgan and other Wall Street leaders out of Andrew Carnegie's private holdings at the start of the 20th century—President Theodore Roosevelt focused the nation's attention on large businesses. Besides U.S. Steel there were other enterprises of similar scope and scale with broadening ownership base in the early 20th century—General Motors, General Foods, Pennsylvania Railroad, the Chicago meat packers, and the spinoff "oil sisters" from the Rockefeller oil trust (such as Standard Oil of New Jersey, and Standard of NY, now recombined in the present ExxonMobil).

President Roosevelt ("TR") as soon as he was in office called for regulatory oversight of these and other large companies, proposing a "Bureau of Corporations," which Congress never rallied around. "Teddy" was a trust-buster, setting in motion initiatives to regulate railroads, steel, food, stock trading, banking, and other industrial activities. President Roosevelt's successor, William Howard Taft made even greater contributions to trust busting, and as the [brief] Progressive Era continued, his successor, President Woodrow Wilson, continued the public sector focus on big business (until illness sidelined him after World War I.)

In the Progressive Era many social reforms were enacted but others—such as comprehensive oversight of Wall Street and banking—were left for action by a TR cousin, President Franklin D. Roosevelt. "FDR" was able to bring comprehensive oversight to financial businesses and the industrial sector after the disastrous stock market crash of October 1929 and the economic decline of the ensuing Great Depression. President FD Roosevelt shepherded the 1933 and 1934 banking and securities industry proposals to enacted law in his first two years in office.

Still, with all the regulation there was continuing debate about corporate oversight and the 1933 and 1934 [and subsequent] Acts were steadily expanded over the next seven decades both through modification and the regulation first enabled by the 1930s legislation.

After the dramatic corporate scandals as represented by Enron, Arthur Andersen, WorldCom *et al.*, the U.S. Congress passed the comprehensive package of new laws we know as *Sarbanes-Oxley* (signed into law by President George W. Bush). That proved to be a minor speed bump for a number of large-cap and Wall Street firms when the 2007-2008 financial crisis occurred; it seemed to be *déjà vu all over again* in the late 2000s. And so more legislation was passed in 2010 in the form of the *Dodd-Frank Act.* At this writing the process of adopting reg-

PROXY SEASONS IN THE 21ST CENTURY

The traditional corporate governance issues that are in focus for investors usually include:

- **Say on Pay (advisory vote by shareholders on executive compensation schemes)**
- **The presence of independent directors on boards (the majority directors for large-caps)**
- **The independence [actions and behaviors] of directors (a subjective view).**
- **The separation of chair and chief executive officer (the momentum is shifting to the side that favors separation).**
- **Elimination of classified / staggered term boards.**
- **Elimination of anti-takeover mechanisms.**
- **Reporting relationships–board oversight of management.**
- **Board–shareholder communication, director availability to investors (an emerging issue).**

Note that in 2009 and 2010 the Securities & Exchange Commission addressed some of these issues; for example, US companies must begin reporting the rationale for individual directors' service on the board, including those already elected and those standing for elections. The *Dodd-Frank Act* addressed the thorny questions surrounding shareholder input to the proxy process and the 2012 proxy season will likely be the first to be affected by the new rules.

SUSTAINABILITY ESG ISSUES IN PROXY SEASONS

In recent seasons the governance issues raised have been expanded to include environmental management and social / societal concerns, including:

- **Supply chain, sourcing and logistical policies and actions.**
- **Corporate relationships with despotic foreign regimes (especially for oil and gas and extractive industries).**
- **Climate change policies and disclosure of risks and opportunities.**
- **Energy conservation and management.**
- **Treatment of small growers and farmers by large companies (especially in the coffee and cocao industries).**
- **De-forestation and removal or old growth and tropical forests destruction.**

For a growing number of shareowners these policies are a reflection of past history in the debate and bring into focus several important inflection points in history.

ulatory rules for implementation is well underway. The *Dodd-Frank Act* implementation is so sweeping that it requires more than 500 new rules, 81 studies, and 93 congressional studies! (Note: The major changes that will affect corporate proxy voting will probably be in place for the 2012 campaigns.)

And in that comprehensive and wide-ranging public policy process once again the role of the large corporation in the American Society and beyond the U.S. borders is a matter of growing public debate. The U.S. Supreme Court in a recent landmark decision *(Citizens United vs. Federal Elections Commission)*[1] ruled that a corporation has the same rights as the individual in terms of free speech. (The case resulted from a dispute over whether or not a not-for-profit corporation, Citizens United, could broadcast a film that criticized a presidential candidate which was apparently a violation of federal campaign reform laws.)

One immediate impact of these is the ability of a corporation to advertise and otherwise directly promote a political point-of-view with relative freedom. Given the frequent *left-right, conservative-liberal, Republican-Democrat* divide in today's public policy debates, the *cultural wars* are carried over to the corporate proxy seasons as well.

And just what is "corporate democracy?" Is this a form of representative democracy for shareholders, especially in proxy voting, or is shareholder advocacy a meddling, an interference in ordinary business matters, and obstacle to management and board "doing what we know best" for the shareholder and enterprises? (The writer recalls an exchange with a *Fortune 50* CEO about "shareowner rights" in an upcoming election. Said the CEO: "They are not owners, they are renters and I treat them that way.")

Other people's money at work

In his book, *Other People's Money,* a collection of essays published from 1914–1915, the well-known attorney Louis Brandeis examined the emergence of large corporations and looked back at the battling of monopolies by the federal government.[2] His essays on corporate power were published at the height of the Progressive Era and dealt with the power of J.P. Morgan and his company, the Rockefeller oil interests, the Andrew Carnegie interests, trusts, corporate corruption of the political process at the state and federal level, and more. Lawyer Brandeis was the "champion of the little guy." Wall Street and banks were predators to be closely watched, he believed.

Regulation of big business was a campaign issue in the presidential election 1916, pitting [New Jersey] Governor Woodrow Wilson, the former president of Princeton University, against [President] William Howard Taft. Both were often on the same side of the arguments to regulate big business—the difference was in the approach. Governor Wilson campaigned to destroy the big business trusts—and advisor Louis Brandeis shaped Wilson's position to regulate and remove certain privileges (such as tariff protectionism). Brandeis also helped to shape the new Federal Reserve System, the USA's central banker.

After Woodrow Wilson was elected Louis Brandeis was named to the U.S. Supreme Court 1916—and his nomination was opposed by no less than a former U.S. president, a former U.S. attorney general, a former secretary of state, and the American Bar Association! Why? He was thought to be a peril to the "existing system" because of his "socialist" views. No dissent allowed!

Among the reasons were Brandeis's views as expressed in *Other People's Money.* This little book has helped to shape over the passing years important views on banking, investment, the stock market, relationships with big business, and big business's relationship with the American Society. (The title is a popular shorthand for Wall Street—OPM.)

Justice Brandeis in his essays observed that *"the great monopoly in this country is the money monopoly. The growth of the nation is in the hands of a few men . . . who control the business of America . . . the dominant element in our financial oligarchy is the investment banker . . . "* And because of this, the shareholder [of that day] was very limited in their influence in the companies they invested in. Part of the reason was the dispersed nature of shareholding in the large corporations that came in the early years of the 20th century. Brandeis survived the nomination battle.

Crash of 1929: Big business again in focus

It was only a relatively short time later that big business was again in focus by influential authors whose work would have lasting effect. Following the October 1929 stock market crash and the ensuing economic collapse, two Columbia University professors—Adolf A. Berle, Jr. (Faculty of Law) and Gardiner C. Means (economist)—working on the Columbia Law School project published *The Modern Corporation and Private Property.*[3] The Berle-Means work is still in print and is generally considered to have set in place a number of concepts about large American corporations whose stockholding is widely dispersed. (West Law Company published the collected *Cases and Materials in the Law of Corporation Finance* in 1930; these were prepared under the auspices of the Columbia University Council for Social Research acting on behalf of the Social Science Research Council of America.)

Berle–Means: Important observations about big business

Among the most important of these observations:

- "It is the essence of revolutions of the more silent sort that they are unrecognized until they are far advanced. This was the case with the Industrial Revolution and is the case with the corporate revolution through which we are at present passing."
- Two-thirds of economic organization of the American society was now big business; this was the authors' statistical projection of the "transfer of industrial wealth of the US from private ownership to ownership by large, publicly-financed corporations vitally changes the lives of property owners, the lives of workers and the method of property tenure . . . "
- They asked: What would the state of relations be with government (business vs. the state) should the state dominate business? To regulate business? Or to follow a *laissez faire* approach?
- This was the work of a lifetime, the authors posited, to be able to examine the relationship of the corporation to ownership of property.
- On control of the corporation: "In the corporate system the owner of industrial wealth is left with a mere symbol of ownership, while the power, the responsibility and the substance which have been an integral part of ownership in the past are being transferred to a separate group in whose hands lies control."

The importance of control

Berle–Means saw five kinds of control of the corporate enterprise which were complete ownership; majority ownership; legal devices without majority ownership; minority control; and management control. On management control: enterprise ownership was by 1928 so widely distributed that by that time no individual or small group could dominate the company. Because of this, the authors observed: *"The owners' personal vote will count for very little or nothing at all unless he has a very large block of stock; the stockholder is reduced to the alternative of not voting at all or handing over his vote to individuals over whom he has no control and in whose selection he did not participate."*

Control was in the hands of those who managed the proxy process. *"Managers can be self-perpetuating; they can choose the boards and the boards can choose management. Possession of the corporation levers of control means management and the board control."*

At that time, with stock markets still relatively immature, the authors said that the stockholder—stripped of his power of control—could only look to the *public capital market as an agency,* to be compensated through dividends and appreciation of the share price. The public market was seen to be the liquidator and valuator of the stockholder interests [in the corporation].

Looking at what Berle–Means called "the traditional logic of property," the shifts in the relationship of "property" and "enterprise" (the corporation) issue—the important question was raised as to whom should receive the benefits of industrial wealth. They saw a major societal question to be addressed in the coming years: *"How to insure that companies would operate in the best interests of the owners or in the interests of those in control."* We are still visiting that question from time to time, and especially in periods when things seem to be out of control (i.e., the recent financial crisis).

And so to 2010 and into proxy season 2011, the dialogue on corporate power following the Supreme Court decision,the rules flowing out of the *Dodd-Frank Act* regulation implementation, the SEC rules and interpretations on corporate disclosure—all will affect the 2011 and 2012 proxy seasons and help to shape the rising debate on the role of the big corporation in America.

Another Yogi Berra aphorism comes to mind, a quick line with a wealth of information behind it: *It ain't over 'till it's over*. The debate about corporate democracy and corporate power is building as proxy season 2011 grows near. ■

NOTES:

1 U.S. Supreme Court, *Citizens United v. Federal Election Commission*, 558 *U.S. 50* (2010 decision).

2 L. D. Brandeis, *Other People's Money: and How the Bankers Use It* (Washington DC: National Home Library Foundation, 1915, 1933). In the editor's note to the 1933 edition, editor Sherman F. Mittel writes: *If these truths had been heeded 20 years ago, we should today have been spared great unhappiness and grief.*

3 A.A. Berle, Jr., and G. C. Means, *The Modern Corporation and Private Property* (New York: The MacMillan Company, 1932). (updated versions are available through William S. Hein & Co. Inc.)