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STAY TUNED ...
To Corporate
Democracy —
The Ballot Box
Is the Proxy

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STAY TUNED ... To Corporate Democracy — The Ballot Box Is the Proxy

In politics, vital decisions are often swift and, at times, merciless. Incumbents and challengers stand for election, citizens enter the voting booth, and when the votes are tallied, one person wins, and another loses. On Election Day, careers begin and end. Power shifts. In our participatory democracy, key matters of public governance are decided once The People have spoken.

We don't yet have this kind of direct electoral influence or control over corporate sector governance, with power traditionally delegated by the owners (voters) to the board, who then pick senior managers to run the company. The shareholders do elect the board, but often without being able to name the candidates (as in political primary contests). But one important characteristic of the corporate governance revolution under way today is the spread of electoral influence — call it *corporate democracy* — with real encouragement of shareholder (political) activists by new laws, rules and regulations.

The 2003 proxy season will be taking place in a much-changed arena, with voting contests presenting real challenges for some IROs, senior managers and boards. As this goes to press, almost 900 shareholder resolutions have been filed this year (compared with 802 in all of 2002).

Traditional corporate governance resolutions account for 57% of this total, and the season is just getting under way.

In addition, New York Stock Exchange- and Nasdaq-listed companies will soon have to submit stock option plans to shareholders for direct vote (yea or nay) as a condition of their listing. (Note that Sarbanes-Oxley legislation stopped just short of requiring this, leaving it to the authorized Self-Regulating Organization, like the NYSE, to enact rules.)

Stay Tuned to investor proxy voting as a key barometer of the revolutionary changes under way in how companies are governed. As we have described in previous columns, two streams of thought have now converged in the corporate governance revolution. The first is traditional shareholder

activism, with demands for voting equality, fairness in board/investor or manager/investor dealings, and a say in how a corporation is governed. These activists focus on the electoral process (one share = one vote), board behavior, CEO accountability and, often, the undemocratic way (in their view) in which the corporation is managed.

The second set of activists often start out as stakeholders, focused on societal issues (sweatshop or child labor, protection of human rights, sale of tobacco, manufacture of guns, sale of baby formula abroad, pharmaceuticals pricing) and then discover the power of the corporate ballot box to change corporate behavior. The two streams have merged and are making the proxy season a time of greater anxiety. To balance the scale, forward-thinking boards and management at some companies are dealing forthrightly with the issues raised by all types of shareholder activists, and winning praise in the process.

Proxy Activists, Movers & Shakers

Let's look at some of the potential critics, adversaries or new stakeholders whom your company could well be engaged by (or with) in this and coming proxy seasons.

Stay Tuned to the Shareholder Action Network, a clearinghouse for information and analysis for shareholder advocates and, especially, socially responsible investors. The SAN links institutional investors and financial advisers with activists (faith-based investors, social justice advocates, labor unions, environmental organizations, etc.). Allies and partners include social investment mutual funds, denominational investors, grassroots activists and money managers for institutions and high-wealth individuals.

SAN's issues at proxy time will typically include corporate policies on global warming and renewable energy, predatory lending (and, at times, executive compensation policies of accused lenders), global vendor or sourcing standards, global protection of human rights, manufacture or marketing of genetically modified foods, tobacco sales and sexual and gender discrimination within companies.

One of the most prominent groups associated with SAN is the New York-based Interfaith Center on Corporate Responsibility, a coalition of almost 300 faith-based investor groups with total equity investments of more than \$100 billion. ICCR is a group whose actions clearly demonstrate the confluence of the two major streams of corporate governance and social accountability. Over the years, ICCR issues were often isolated, but now, with the demand for greater corporate governance and accountability, they have become more visible to investors and corporations.

Stay Tuned to the critical issues that are the focus of ICCR activism: elimination of sweatshops, global warming, ending racially offending images used in logos and advertising, pharmaceutical and healthcare availability and pricing, an end to tobacco product advertising, debt forgiveness for the poorest nations, and equal opportunity for capital allocation and employment.

Stay Tuned to important changes in mutual fund proxy voting. The SEC has adopted a new rule (effective April 14) that orders mutual fund advisers to disclose their guidelines and procedures for casting proxy votes and the actual votes cast. The rules are intended to make fund advisers more accountable to their investors and to provide transparency of proxy voting by mutual funds, which account for about 20% of all U.S. investment in publicly traded companies and cast proxy votes for 90 million individual investors. The new rule has the support of the AFL-CIO and International Brotherhood of Teamsters, among others.

In 1999, Domini Social Equity Fund was the first fund to disclose its proxy votes. California Public Employees Retirement System soon followed, and now others, including Calvert Group, Pax World Funds, the University of Wisconsin and Walden Asset Management, are getting on the bandwagon.

Stay Tuned to federal regulators: As the mutual fund community was reacting to the new disclosure rules, a key federal bank regulatory agency was considering new rules to require bank trust departments to disclose how they vote their proxies, especially those cast on behalf of clients whose money is managed in investment pools.

As with the investment company community (mutual fund managers), the U.S. banking community is not thrilled with the prospect of greater transparency of proxy voting. But investor and consumer groups may have momentum on their side — it is about investor trust, they argue, and

avoiding conflicts of interest. (Trusts control about 5% of equity proxy votes.)

Stay Tuned to major attitudinal shifts on the part of investors and board members as a closer relationship between the two evolves. Ira Milstein, partner in the law firm Weil Gotshal & Manges and an influential authority on corporate governance, spoke recently to the Directors Roundtable. He described possible scenarios as investors become more involved in proxy voting, and as boards react to events such as adoption of NYSE rules, Sarbanes-Oxley and SEC rulemaking.

“We will likely see the emergence of a ‘presiding director’ or ‘lead director,’ and the separation of the posts of chairman and CEO,” said Milstein. This generation of CEOs will not embrace these changes eagerly, but Milstein believes it will evolve to a chairman governing the board and a CEO presiding over the daily affairs of the company. “A more independent board will pay greater attention to the voice of shareholders,” he added.

Columbia University law professor John Coffee, speaking at the same forum, observed that shareholder-initiated reforms — primarily led by institutions — are becoming more aggressive in seeking to place issues on the agenda for a shareholder vote. “We are seeing measures calling for

minimum holding periods for options, minimum periods of retention of shares by officers and directors and more restrictions for auditing firms,” he said. “The institutions are well organized and are seeking SEC cooperation for developing shareholder proxy voting reforms.”

Coffee noted that the SEC generally opposes shareholder-to-shareholder communication, which could cause frustrated investors to shift to the courtroom to settle disputes. Coffee sees a litigation crisis as a strong possibility in the future:

“Addressing shareholder restrictions would appear to be a more intelligent course of action than letting litigation decide issues, or elements of the proxy proposal process. We urge institutional investors to apply the very important tools of the proxy process, and to discuss reforms with SEC.”

Stay Tuned to media focus on CEO pay. Finally, as you gear up for the proxy season, one of the crusaders to keep an eye on is the omnipresent Graef Crystal, who as a compensation consultant put together many of the plans that boards use to determine CEO and senior manager pay schemes. But Crystal “got religion,” and became an outspoken critic of overpaid CEOs more than a decade ago. Many shareholder activists have focused on the ratio of CEO-to-employee pay.

Crystal is peddling a new ratio to describe the gap, and it is catching on with journalists. He calls it the “CEO-to-CEO Pay Gap” — the difference between what one CEO is paid vs. others. As an extreme example, Crystal cites Warren Buffett’s \$350,000 annual salary with Sandy Weill’s Citigroup pay of \$127 million. Crystal is circulating his recent study of companies with more than \$8 billion in revenues — and a list of their saints and sinners.

So **Stay Tuned** to this year’s proxy season. It’s bound to be interesting. **IRU**

Hank Boerner is managing director-NY for Rowan & Blewitt, a counseling organization. The views expressed are his own. He welcomes comments at hank@pb.net.

RESOURCES

Interfaith Center on Corporate Responsibility: www.iccr.org — you can request its 2003 proxy roundup.

Domini Social Equity Fund: www.domini.com — the fund posts detailed guidelines covering 90 corporate governance, social and environmental issues, as well as its proxy voting record.

SEC Final Rule requiring disclosure by funds of proxy voting policies and records: www.sec.gov/rules/final/33-8188.htm.