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Are There Too Many Cooks in the Corporate Kitchen?

Jill Fisch

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FORDHAM FIN. SEC. TAX LAW FORUM

PANEL DISCUSSION:

REFORM: ARE THERE TOO MANY COOKS IN THE CORPORATE KITCHEN?*

*Professor Jill Fisch, Moderator***

Ms. MORROW: I would like to introduce Professor Jill Fisch, who will be the moderator of the panel discussion entitled "Reform: Are There Too Many Cooks in the Corporate Kitchen?" Professor Fisch has been at Fordham since 1989. She teaches in the areas of corporate and securities law and has written many articles. Her most recent work addressed proxy regulation, relationship investing, and the role of institutional investors.¹

PROF. FISCH: I should acknowledge the hardy souls that have managed to endure until the panel discussion, and particularly the members of the panel, who have had to sit patiently by watching all of these remarks without the opportunity to respond. I want to give them that opportunity now. But first, I want to introduce the additional members of the panel that you have not yet met.

On my far left, Reverend Dr. Andy Smith, who is the Director of the Social and Ethical Responsibility in Investments Program of National Ministries of the American Baptist Churches USA ("National Ministries"). National Ministries is involved in activist investing in accordance with various social and ethical criteria, and Rev. Smith's responsibilities include initiating dialogue with corporate executives concerning corporate policy, filing shareholder resolutions, and taking other actions to oversee the interests of the securities funds they manage in various types of socially responsible investments.²

To his right, Joseph Geoghan, an alumnus of Fordham Law School and a member of the Corporate Law Department at Union Carbide Corporation ("Union Carbide"). Joe has been with Union Carbide

* This panel discussion was part of a symposium held at Fordham University School of Law on March 13, 1997 entitled *Reshaping Corporate Governance & Shareholder Activism for the 21st Century*.

** Jill Fisch, in addition to being a professor at Fordham University School of Law, serves as chair of the Committee on Corporate Law of the Association of the Bar of the City of New York and on the faculty of the New York City Law Department's Civil Trial Advocacy Workshop.

¹ Jill Fisch, *The Buffet Board and Governance Reform*, 21 *DIRECTORS & BOARDS* 22 (1997).

² In addition to his work at the National Ministries, Rev. Andy Smith chaired the board of the Interfaith Center on Corporate Responsibility from 1992-94, is a founding member of the Board of the Coalition for Environmentally Responsible Economies and serves on the National Citizens Advisory Panel for the Responsible Care Program of the Chemical Manufacturers Association.

since 1957, he is currently General Counsel, Secretary, and Vice President, and in 1990 was elected a director of the corporation.³

To my far right, Richard Schlefer, Assistant Vice President with Teachers Insurance and Annuity Association - College Retirement Equities Fund ("TIAA-CREF" or "CREF"), received a B.A. from Harvard University and an M.B.A. from Columbia Business School. He will shortly be receiving a J.D. from Fordham Law School as well. TIAA-CREF is the world's largest pension company, and Richard's responsibilities include supervising a staff that analyzes and votes the proxies of some 4,000 foreign and domestic companies in CREF's equity portfolios. He is heavily involved in carrying out the shareholder activism that we have been hearing about.⁴

Now I want to give the new members of the panel a chance to offer a different and broader perspective. In particular, we have heard a great deal tonight about corporations responding to the concern of institutional investors that "shareholder value be maximized," and, in particular, the discussion has focused on profit maximization.

I think Rev. Smith offers a somewhat different perspective in both his definition of shareholder value and the appropriate ways for corporations to maximize shareholder value. Let me ask you to say a few words on that.

REV. SMITH: Thank you.

We heard earlier from Marty Lipton that the corporate governance side of institutional investor shareholder activism began about ten years ago.⁵ In fact, the churches began their activism over twenty-

³ Joseph Geoghan is a member of various bar associations including the American Bar Association, the New York City and State Bar Associations, the Association of General Counsel and is President of The Corporate Bar Association of Westchester and Fairfield, Inc.

⁴ Richard Schlefer is also a Chartered Financial Analyst and a member of both the New York Society of Security Analysts and the Association for Investment Management and Research.

⁵ Martin Lipton, *Corporate Governance: Does It Make A Difference?*, 2 FORDHAM FIN. SEC. TAX L.F. 41 (1997).

five years ago; I think we were the first institutional investors to begin doing shareholder proposals.⁶ This began in 1971, when the presiding Bishop of the Episcopal Church presented a shareholder proposal at the annual shareholder meeting of General Motors calling on them to withdraw from South Africa.⁷

The churches have been very active players on a great number of issues for the past twenty-five years, most of which have not been talked about tonight. The principle reason for this is our understanding that maximization of shareholder value is not simply financial value, but that it is related to how the corporation sees its role within society.

One of the things that has happened with the creation of a market society and a market economy over the past two centuries, beginning with the growth of the factories which we can probably trace back to England, was the commoditization of certain things that really were not commodities.⁸

There is a very interesting book, *The Great Transformation*, by Karl Polanyi, that was written over fifty years ago.⁹ Polanyi talks about this transformation from the role that the economy had within the society to a role that was really a driving one for society, the transformation to a market economy. He talks particularly about the transformation in terms of three things that were made into commodities: labor, land and money.¹⁰

A commodity is something that is produced for sale, and that is what you have in markets, an exchange of these commodities. And yet, if you look at labor, it acts as if it is a commodity, but is really human beings, so we have the commoditization of human beings. And land, when it is seen as a commodity, the land is really the natural environment within which we all exist, so we have the commoditization of

⁶ See Daniel H. Pink, *The Valdez Principles: Is What's Good for America Good for General Motors*, YALE L. & POL'Y REV. 180, 181 (1990) (noting that Rev. Leon Sullivan, a Baptist minister and member of GM's Board presented a resolution in 1971 for the company to divest from South Africa, in doing so he began the involvement of the churches in corporate activism; also Sullivan's principles reviewed); Thomas Gilroy, *The Proxy Machinery: Solutions and Contests Involving Corporate Control Issues (Shareholder Proposals: Recent Developments)*, 617 PLI/CORP. 839, 844-45 (1988) (reviewing some of the Interfaith Center on Corporate Responsibility's corporate activism and summary of issues raised during the 1988 proxy season).

⁷ See Pink, *supra* note 6.

⁸ KARL POLANYI, *THE GREAT TRANSFORMATION* (1957, c. 1944) (Polanyi discusses the changes that have occurred in society as a result of the industrial revolution).

⁹ *Id.*

¹⁰ *Id.* (discussing how the industrialization of society has transformed land, labor and money from being elements of nature and society into economic goods and articles of commerce).

nature and the natural environment. Money is simply a token of purchasing power, yet we have the commoditization of that, and it has a very important role within the market economy. So we have these fictitious entities that operate in the economy.

It seems that as we look toward the twenty-first century, we need to rethink the role of the corporation and of the economy as it relates to these entities and also to society. This is before we had a market economy we had the economy operating within the larger society and serving a larger set of needs than simply financial needs. We also had a shift toward an emphasis in earning profit and maximization of shareholder value, that is often what we hear, and yet that was a transformation, as Karl Polanyi refers to it — “a great transformation.”

It seems to me we need a great transformation as we look to the twenty-first century, where the economy is no longer the driving force of society, but operates within a society with a large array of needs, including human needs, human values, and protection of the environment. If we do not have those values present, then the economy basically becomes self-destructive. It destroys human communities where we have workers, because it commoditizes workers, human beings, into labor; and it commoditizes the natural environment and uses it as a resource rather than seeing the economy operating within the larger ecological sphere.

So the issues that the churches have addressed over these twenty-five years have related to a different set of values, but a very important and key set of values that has to do with the operation of society as an ecological community and as a human community. It seems to me that it is a very important role for corporations to play, and that means that the corporations need to have accountability, not simply to shareholders, but to the society.

Every corporation has that accountability ultimately, because every corporation is chartered by a state government, and that charter is a public trust given to the corporation.¹¹ So if we look only at maximization of profit, we are getting far away from the public trust that is given to the corporation to

¹¹ Thomas Linzey, *Awakening a Sleeping Giant: Creating a Quasi-Private Cause of Action for Revoking Corporate Charters in Response to Environmental Violations*, 13 PACE ENVTL. L. REV. 219, 278 (1995) (discussing corporate charter as a public trust and advocating its revocation when that trust is violated).

serve a particular need. The charters that were given to corporations actually were given for only a limited amount of time when they were first given, and when the corporation served the purpose for which it was meant, then the assets were divided up among the shareholders.¹² Now we do not have that happening. Instead, we have perpetual maximization of profit.¹³

I believe that one of the key issues here is the whole question of accountability to the larger society, and that is one of the issues that we within the network of the Interfaith Center on Corporate Responsibility ("ICCR") and the church shareholders are very much concerned with, a very large array of issues.

PROF. FISCH: National Ministries, of course, has been very important in raising public awareness of corporate social responsibility and bringing social, moral, and ethical proposals to the forefront.¹⁴ But there are those who say that these are not issues on which corporations are competent decision makers, that achieving social objectives, achieving moral ends, should be left to the legal system, philanthropic associations, and so forth; and that corporations are specialized in the business of making money.¹⁵ Milton Friedman, for example, has expressed that position.¹⁶

Let me put Joe [Geoghan] on the spot here and ask whether you feel that Union Carbide is really in a position to decide issues of social policy. Of course, corporations are doing more all the time. Corporations are making billions of dollars of charitable contributions, putting social programs into place, and so forth.¹⁷ Do you think that is a good thing for corporations to be involved in?

¹² Herbert Hovenkamp, *The Classical Corporations In American Legal Thought*, 76 GEO. L.J. 1593, 1616 (1988) (discussing the history of American corporate law, in particular, reviewing statutory reservation clauses).

¹³ See Milton Friedman, *The Social Responsibility of Business is to Increase It's Profits*, N.Y. TIMES MAGAZINE, Sept. 13, 1970, at 125 (expounding the principle that a corporations' only duty is to maximize profits).

¹⁴ Susan DeFord, *Challenging The Corporate Conscience; Religious Investors Gaining Clout*, WASH. POST, July 6, 1996, at B07 (reviewing the history, successes and guidelines of the religious investors and activist movement and noting that 9 percent of the total U.S. investment market is managed using guidelines that judge company practices beyond financial returns).

¹⁵ Friedman, *supra* note 13, at 125 (a corporation's duty is to maximize profits); see also Rogene A. Buchholz, *Corporate Responsibility and the Good Society: From Economics to Ecology*, BUS. HORIZONS, July 1, 1991, at 19 (discussing several different views of corporate responsibility, including Milton Friedman's view); *contra* Thomas F. Roeser, *What's Good for the Consumer is Good for Business*, CHI TRIB., May 19, 1997, at 11 (rejecting Friedman's thesis and positing that corporations have broad social responsibilities).

¹⁶ Friedman, *supra* note 13, at 125.

¹⁷ See Faith Stevelman Kah, *Pandora's's Box: Managerial Discretion and the Problem of Corporate Philanthropy*, 44 UCLA L. REV. 579, 587-89 (1997) (describing recent increased volume of corporate philanthropy).

MR. GEOGHAN: Yes, I really do, Jill [Fisch]. I might say, by way of a moment's background, if I may, that I have known Andy [Smith] for many years. I first met his associate, Tim Smith,¹⁸ who is the Executive Director of the Interfaith Center on Corporate Responsibility, some twenty years ago, in connection with a proposal they were then making to Union Carbide concerning our investments in Rhodesia (now Zimbabwe) and South Africa.

First off, I think, the social and religious activists, along with the institutional activists who are focused more on the creation of pure shareholder value, have been generally constructive forces. I come from a school that believes, and perhaps it is partly due to my Fordham education, I might add, that corporations have a duty that extends today beyond shareholders; they have a duty to stakeholders.¹⁹

Stakeholders exist in a variety of different forms.²⁰ They exist in your employees, they exist in the communities in which you operate, they exist in the countries in which you do business.²¹ I think each one of these needs to be addressed by responsible corporate management today.

What I believe the institutional investors, as well as the social investors, have done is focus more intensely, or force corporations to focus more intensely, on obligations beyond the shareholders to include stakeholders. Now, this stakeholder concept is recognized to some extent in the legislation of many states.²²

So, by and large, I believe this has been a very healthy tension over the years; that is not to say in the

¹⁸ DeFord *supra* note 14, at B07 (discussing Tim Smith, the executive director of the Interfaith Center on Corporate Responsibility, and his activities as a religious and social investor).

¹⁹ Robert A. Prentice and John H. Langmore, *Shareholder Alternatives to Hostile Takeovers: Restructuring, Auctions, and MacMillan II*, 20 SETON HALL L. REV. 4, 65-70 (1989) (considering non-shareholder interests and other stakeholder concepts); *see also* Roeser, *supra* note 15, at 11 (stating that corporations have broad social responsibilities and should provide benefits to the society as a whole).

²⁰ Prentice, *supra* note 19, at 65-70 (discussing different stakeholder concepts).

²¹ *Id.*

²² *See Corporations and Unincorporated Associations: Fiduciary Duty and Indemnification*, 15 PA. CODE § 515 (1996); *see also Good Business*, FIN. TIMES, Jan. 21, 1997, at 19 (considering the British stakeholder model of corporate governance); Vineeta Anand, *Governance Code Ripe for Import*, PENSIONS & INVESTMENTS, Dec. 9, 1996, at 44 (discussing the stakeholder oriented corporate governance models in the United Kingdom and Canada, which are similar to CalPERS' proposal, and advocating the importation of those principles to the United States); J. Richard Finlay, *Bringing the Boardroom into the 21st Century*, FIN. POST, May 18, 1996, at 23 (discussing the Canadian stakeholder theory of corporate governance); *see generally* Roberta S. Karmel, *Implications of the Stakeholder Model*, 61 GEO. WASH. L. REV. 1156, 1175-76 (1993) (concluding that the numerous state adopted stakeholder statutes represent a new "corporate governance model").

least that we have always agreed. Andy [Smith] and I have had many discussions over the last twelve or fifteen years in particular; these discussions have been, let me say that the discussions have been vigorous. But they have been very civil and very cordial, and we have clearly understood and respected each other's position.

I consider, on balance, this tension that exists to be very healthy for corporate America. I think it has reached something of a stage of equilibrium today, where there is a balance between the pressures that can be exerted by the shareholder activists and the corporate world.

This equilibrium is reflected in the poison pill.²³ When the poison pill was first adopted, there was a tremendous negative reaction by the institutional shareholders, moderated I believe in part by a series of court decisions that have made it very clear that the poison pill must be used in furtherance of shareholder value.²⁴ It is not a tool, as initially believed, for management entrenchment.

I think that the efforts of our legislatures, the court system, and the focus that has been brought by the institutional and social activist investment community, has resulted in a very healthy tension.

MR. GALLAGHER:²⁵ As the other corporate representative here, I should note that the stakeholder concept Joe [Geoghan] mentioned is clearly something which is being discussed and debated in corporate governance circles here and abroad.²⁶

The British Labor Party, for example, has taken on a theme of creating a stakeholder society in

²³ BLACK'S LAW DICTIONARY 1156 (6th ed. 1990). A *poison pill* is "a defense tactic used by a company that is a target of an unwanted takeover to make its shares or financial condition less attractive to an acquirer. For instance, a firm may issue a new series of preferred shares that give shareholders the right to compel their redemption at a premium price after a takeover." *Id.*

²⁴ See generally William A. Klein and John C. Coffee, Jr., BUSINESS ORGANIZATION AND FINANCE: LEGAL AND ECONOMIC PRINCIPLES, 101-6, 250 (4th ed. 1990) (reviews how poison pills work); Anthony Augliera, *Shareholder Rights Plans: Saying No To Inadequate Tender Offers*, 57 FORD. L. REV. 830 (1989) (provides a general discussion of poison pills).

²⁵ Terence Gallagher is Vice President - Corporate Governance with Pfizer, Inc. and is secretary of the corporation. Previously, he was chairman of the New York State Corporate Counsel section of the New York State Bar Association and currently serves on the Executive Committee of that Section.

²⁶ Margaret M. Blair, *Ownership and Control: Rethinking Corporate Governance for the Twenty-first Century*, The Brookings Institute, Washington, D.C. (1995), at 15-16, 230-32; see also *Good Business*, *supra* note 22, at 19 (discussing how the British corporate governance model allows for considerations of stakeholders when decisions are being made); Anand, *supra* note 22, at 44 (discussing the stakeholder oriented corporate governance models in the United Kingdom and Canada, which are similar to CalPERS proposal, and allow for consideration of the stakeholders in the decision making process); Finlay, *supra* note 22, at 23 (discussing how the Canadian corporate governance model allows for consideration of stakeholders when boards make decisions).

which the corporation would to some extent substitute for domestic socialist programs in Britain and become the source of social aid for the community.²⁷ I am not sure whether that goes too far. It is, however, something that we should look at. To date, it has been proposed on a theoretical basis, but it has not been really put in place and may not be put in place. Perhaps, when, and if, the Labor Party comes into power in Britain, such a stakeholder society may be implemented.²⁸

In the United States, there is a continuing discussion on these concepts. It is something that, I think, every corporation recognizes. I believe corporations appreciate that there is a community in which they live, that they are corporate citizens of that community and they owe a great deal to people, beyond the shareholders of the company. Most reputable companies have done a great deal in terms of helping out in the communities and among the stakeholders of the company.

In her first book, which Pfizer, Inc. ("Pfizer") supported, Margaret Blair, an economist at the Brookings Institution, put forth a theory which is not universally accepted. She posited that there is a true stakeholder concept of labor in the company, a capital stake in the company by the worker.²⁹ She is further developing her ideas and working on a second book now. She bases her theory on studies indicating that when an employee leaves a company, they lose the "firm-specific capital" they accumulated during their tenure at that company. As a result, when a person moves on to another employer, they cannot earn as much or use their firm-specific capital at that next corporation.³⁰ The theory is being discussed among academics at the moment.

The stakeholder concept is evolving, but I can see that the church groups would certainly be interested in having the stakeholder concept assume a formal position in companies. I think this is coming. It is now present in an informal sense. Blair's theory must be further considered; it needs to be talked about,

²⁷ *The Election: Radical Centre: 'A New Wave Forward,'* THE GUARDIAN, Apr. 25, 1997, at 15 (extract from Tony Blair's speech to a Labor Party Press Conference on April 24, 1997, discussing stakeholders); E.J. Dionne, Jr., *Hands Across The Atlantic (Editorial)* WASH. POST, Apr. 19, 1996, at 25 (discussing the stakeholder society in United Kingdom); Barry Reilly, *Shareholders Gain an Edge Over Stakeholders*, FIN. TIMES, Jan. 1, 1996, at 25 (discussing shifts in British corporate governance).

²⁸ *Id.*

²⁹ Blair, *supra* note 26, at 230.

³⁰ *Id.*

and it should be formulated into something more definitive than what exists presently. Some of the laws on the books which talk about a company's duty to maximize the return to its shareholders need to be sorted out to see where they fit into a different society.

The response in a country that has had a government social program that is now being cut back may be different. Most of the European countries are finding that they can no longer support the social programs that they put in place years ago, as a result of increasing populations and people living longer and getting more in terms of social benefits.³¹

So there is a big debate and an important discussion going on, but I think it needs to be sorted out with the church and other groups over the next five to ten years.

MR. SCHLEFER: I would like to jump in, Professor Fisch, on this stakeholder concept. I think everybody would agree that a company will not be able to prosper long term and can not create wealth for its shareholders long term if it is constantly facing strikes by its unions, if it is polluting its water supply, and so forth.³²

I think a problem with the stakeholder concept, though, is that by being accountable to everybody, in a sense you are not accountable to anybody.

We see an example of this in the Pennsylvania directors' duty statute, Section 15, which was involved in the three-way contest for Consolidated Rail Corporation ("Conrail") that Marty Lipton spoke

³¹ See Thomas Kamm and Cacilie Rohwedder, *Continental Divide: Many Europeans Fear Cuts in Social Benefits in One-Currency Plan*, WALL ST. J., July 30, 1996, at A1 (discussion of the fear of many European workers that the adoption of a single European currency may lead to the reduction of their generous social benefits system); Joan Warner, Paula Dwyer, John Rossant and John Templeman, *Clinging to the Safety Net*, BUS. WK., Mar. 11, 1996, at 62 (discussion of the "much wider social safety net" that is found in European and Japanese corporations); Daniel Benjamin, *Giant Under Stress: With Unemployment Climbing in Germany, So Are Social Tensions*, WALL. ST. J., Nov. 4, 1993, at A1 (noting that Germany, as a result of recession, was forced to cut many of the generous benefits workers had become accustomed to).

³² Morey W. McDaniel, *Stockholders and Shareholders*, 21 STETSON L. REV. 121, 127-30 (1991) (discussing corporate externalities and their costs and how they effect stakeholders, as well as, concepts of efficiency).

about.³³ The Pennsylvania directors' duty statute says that, even in a takeover context, the directors of a company can take into account various stakeholder interests (e.g., employees, suppliers, the community, and shareholders), but they do not necessarily have to put shareholders interests first.³⁴

Directors can use the freedom that is given to them by the legislature to say, "Well, in this situation we really want to favor our employees" and "in that situation we really want to favor our suppliers."³⁵ On the other hand, the advantage of the traditional concept that the Board's duty is to the shareholders is that you always know where the duty lies.³⁶

As to social responsibility, I am not sure that the company's proxy statement is really the best place to determine what kind of society we should have. Professor Fisch alluded to the fact that maybe that is the kind of political decision that a democracy makes through its legislature. TIAA-CREF, for example, the world's largest pension fund, manages money for about 1.8 million academics.³⁷ I do not think that the Fordham Law School faculty can always agree on everything, much less could 1.8 million academics agree on what kind of society TIAA-CREF should vote for.

PROF. FISCH: I am at a loss, I do not know how to respond to that. But I am glad you jumped in, because I was going to ask you that question. In fact, I was going to go further, because I think that

³³ Lipton, *supra* note 5; 15 PA. CODE § 515; *see also Good Business, supra* note 22, at 19 (discussing how the British corporate governance model allows for considerations of the stakeholders when decisions are being made); Anand, *supra* note 22, at 44 (discussing the stakeholder-oriented corporate governance models in the United Kingdom and Canada, which are similar to CalPERS's proposal, and allow for consideration of the stakeholders in the decision making process); Finlay, *supra* note 22, at 23 (discussing how the Canadian corporate governance model allows for consideration of stakeholders when boards make decisions); *see generally* Karmel, *supra* note 22, at 1175-76 (concluding that the numerous state adopted stakeholder statutes represent a new "corporate governance model"); Nell Minow, *Shareholders, Stakeholders, and Boards of Directors*, 21 STETSON L. REV. 197, 197-205 (1991) (dealing with the fiduciary duties and accountability within corporations).

³⁴ 15 PA. CODE § 515.

³⁵ *Id.* *See also* Karmel, *supra* note 22, at 1175-76 (concluding that state adopted stakeholder statutes allow corporations to consider more parties when making decisions); Minow, *supra* note 33, 197-205 (discussing the fiduciary duties within corporations and which parties should be considered when management makes decisions).

³⁶ *See* Minow, *supra* note 33, at 197-205 (dealing with the fiduciary duties within corporations); *see also* Susan A. Barrett, *Fiduciary Duties and Stock Warrants: A Fine Distinction Between Shareholders Rights and Contract Rights*, 21 STETSON L. REV. 253, 257 (1991) (providing a historical overview of fiduciary duty).

³⁷ Neil Stewart, *Fund Management Profile - TIAA-CREF*, INVESTOR REL., May 1, 1996 (providing background information on TIAA-CREF which manages \$160 billion in assets for 1.8 million academics and maintains a "philosophy of responsible investors").

Margaret Blair's view of employee rights goes beyond viewing employees as stakeholders.³⁸ She argues that, based on their contributions to the corporation, we should, in fact, characterize employees as owners, rather than granting stockholders exclusive rights as owners.³⁹ I take it your response to that kind of characterization would be that even if we acknowledge employees' contributions, treating employees as owners leaves directors in a decisional morass.

MR. SCHLEFER: Perhaps before we recognize employees as owners, we should recognize them as assets to the company rather than as an expense item. Our accounting system is not set up to recognize the value of training, the value of experience the company has invested in over the years through its seasoned employees.⁴⁰ Maybe the first step we have to take is to find a way to value employees as assets rather than as expenses or, in some sense, liabilities.

In some countries, when there are major layoffs necessitated by management decisions in prior years, management takes a hit as well as the employees.⁴¹ That is not always the case in the United States. Maybe that is another way to start looking at long-term corporate performance. Perhaps it is not always right to reward executives for downsizing a company to the same extent you reward them for building jobs and for making the company grow.

PROF. FISCH: Richard [Schlefer] makes a good point.

³⁸ Blair, *supra* note 26, at 230-32; see also Richard J. Hunter, Jr. *Ownership and Control: Rethinking Corporate Governance for the Twenty-first Century* (book review), MID-ATLANTIC J. BUS., Mar. 1, 1996, at 69 (considering various points of Blair's book and praising the principles discussed); Frederic S. Lee, *Ownership and Control: Rethinking Corporate Governance for the Twenty-first Century* (book review), J. ECON. ISSUES, Dec. 1, 1996, at 1193, (consideration of Blair's work with some reservation and criticism).

³⁹ Blair, *supra* note 26, at 15-16, 230-232.

⁴⁰ See Matthew A. Melone, *The Information Revolution: Organizational Knowledge and the Capital Expenditure Question*, 50 TAX LAW 73, 96 (1996) (criticizing traditional systems for not taking into account organization's human resources); George Mundstock, *Taxation of Business Intangible Capital*, 135 U. PA. L. REV. 1179, 1185-92 (1987) (extensive discussion of the intangible capital, including employees); see also MERTENS LAW OF FEDERAL INCOME TAXATION, Chapter 23A (noting that an assembled workforce is not an asset separate from the going-concern value of the business).

⁴¹ See Fred R. Bleakley, *Over Half of Europe's Big Firms Are Planning Work Force Cuts — Downsizing in Next 2 Years Is Expected to Surpass Rate of Moves in U.S.*, WALL ST. J., Sept. 21, 1993, at A19 (noting that some of Europe's largest corporations were planning major cuts in their work forces, including many management positions); Stephen Franklin, *Layoff Lesson: Here to Stay - Companies Play By Different Rules in Era of Downsizing*, CH. TRIB., Jan. 2, 1996, at 1 (finding that U.S. companies are tending toward including management in their downsizing); John Bussey, Clay Chandler and Michael Williams, *The Other Shoe: Japanese Recession Prompts Corporations To Take Radical Steps*, WALL ST. J., Feb. 1993, at A1 (discussing the large cut backs in some of Japan's largest companies, which included management positions and some senior managers).

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Jon [Lukomnik], if our emphasis is on corporate performance, why are we so focused on these principles of good governance, these models that are supposed to deal with emergency situations, transition problems, through policing? Most of what goes on in a corporation is not policing, it is everyday business decisions, things like executive compensation, research and development, training of employees. Those seem to be fundamental corporate governance issues that are not addressed by the proposals that institutional investors seem to be advocating. Why is that?

MR. LUKOMNIK:⁴² That requires about an eight-hour answer.

First off, just to comment on Dick [Schlefer]'s point. I do not know if you saw this, Dick, we did. There is a proxy coming up, which you will probably see, which says that management and directors should not be able to exercise options within six months of announcing downsizing. So this proposal gets to your point about the perverse incentive, since their options get into the money because of the announcement of a downsizing even if it has a longer term perverse effect. By the way, our recommendation was to vote for that.

But to get more to your question, there are a number of answers. The first answer is because it is the only tool we have. The shareholder proposal process has been shoehorned into doing lots of different things. What everyone really wants to do is to walk into, not Pfizer because they are a good performing company, but whatever your horror story of the day is; for example, Archer Daniels Midland Company ("ADM")⁴³ and say: "Here is a proxy proposal. It says 'perform better.'" Well, that does not happen.

PROF. FISCH: That is sort of like the balanced budget amendments.⁴⁴

MR. LUKOMNIK: So you have to try and grab for bits and pieces of that "magic bullet." I actually agree with one part of what Marty [Lipton] said before, he left before the cross-examination, that the "best performing companies are just those that have good management and you can not create a structure that

⁴² Jon Lukomnik oversees nearly \$70 billion in pension fund assets as the Deputy Comptroller for Pensions for the City of New York. He also serves as a trustee for four major defined benefit pension systems, one major defined contribution system and several smaller systems, with assets of more than \$80 billion. He is co-author of *ALPHA: THE POSITIVE SIDE OF RISK* (Investors Press, 1996) and has written articles in *Directorship* and *Global Investor*.

⁴³ Sharon Walsh, *Battling Bloodlines on ADM's Board; Agribusiness Giant Seeks to End Its Corporate Cronyism*, WASH. POST, Jan. 21, 1996, at H01 (discussing the myriad of problems at ADM, and focusing on the lack of outsiders on its board).

⁴⁴ Milton Friedman, *Balanced Budget: Amendment Must Put Limit on Taxes*, WALL ST. J., Jan. 4, 1995, at A12 (general discussion of balanced budget amendment proposals and what is needed for it to actually be effective).

will guarantee that.”⁴⁵ So what you try to do is you try to work around the edges, to enhance the probability that good management will happen, or, as Marty said, “to devise a failsafe way.” So you try to look at the compensation packages. You try to look at the board structures. But they are very poor proxies for, “We want you to perform better.”

Something else that was raised, by Dick [Schlefer], is the accounting system of the United States, modern double-entry accounting in use for the last 200 years. I just want to mention it because it actually ties together what Andy [Smith] and others have said. Our accounting system does not work today. We know that.

I know most of you have not noticed this, but to give real flesh and bone to what Dick [Schlefer] said, if Bill Gates left Microsoft Corporation [“Microsoft”] tomorrow and went to Pfizer, most of us would think Pfizer’s stock would go up and Microsoft’s would go down. And yet, the only place you will see Bill Gates on Microsoft’s balance sheet is as a liability; accrued pension benefits, stock options that may come due, and perhaps a life insurance policy.

So what happens is, actually in my mind, it is the harmonizing factor between the stakeholder view and the shareholder view, that corporations manage and Wall Street manages what is measurable. What is measurable in our accounting system are not intangible assets, such as Bill Gate’s creativity, more worker training, or not degrading the environment. All of us would agree conceptually that there is a linkage to those items and a well performing corporation over time, but it does not show up in the financial statement of a company.

And so really to harmonize maximization of shareholder value and the holistic view, if you will, of a corporation is what your time frame is and how willing are you to look at things that can not be quantified for the next quarter?

One of the reasons that we are viewed by much of the world as crazy social investors is, that we actually support many of the things that Andy [Smith] and Tim Smith propose. This is because of a term we have not mentioned here yet today. Not maximizing assets or shareholder value, but liabilities. This great pool of money exists for a reason. The pool of money exists to fund liabilities. Our liabilities are

⁴⁵ Lipton, *supra* note 5.

employee benefits that are thirty years out.

So we have the option of looking at things that Andy [Smith] is talking about because the truth is, despite what Marty Lipton said, we do not want a short-term pop in a takeover situation. We saw this in the case of Chrysler Corporation's management against Kirk Kerkorian. What we need is a large capitalization situation, preferable many large capitalization situations, that will earn a real rate of return above the rate of inflation forever, not "Gee, if it is out there tomorrow, I am going to grab it."

So when Andy [Smith] says something like "do not degrade the environment," Andy and the New York City Comptroller's Office agree. We are two of the founding members of the major environmental lobbying effort in this area. This is because we have initiated a meeting of the minds. Our concerns are not about next quarter; we want these corporations to succeed virtually forever.

MR. GALLAGHER: One of the things I might mention is that The Conference Board, specifically Carolyn Brancato, has been struggling for the last couple of years with a working group to try to define some non-financial measure of performance that might influence investors.⁴⁶ It has been, and continues to be, a difficult chore. But, there is at least some thinking about how to convey to investors the non-financial performance measures that distinguish companies which are responsive to various stakeholders. The hope is that this will make such companies more attractive to investors, those companies that do exhibit that kind of measure of performance.

PROF. FISCH: Jon [Lukomnik]'s criticism of accounting standards makes a pretty convincing case for why the effort to develop corporate governance guidelines, focuses on is the percentage or the number of independent directors.⁴⁷ These numbers are relatively easy to measure.⁴⁸

⁴⁶ *Executive Update: CEO Brief*, INVESTOR'S BUS. DAILY, Aug. 16, 1995, at A3 (noting a July 1995 study by the Conference Board of New York of companies' non-financial performance measurement initiatives).

⁴⁷ Patricia A. Vlahakis, *Directors Under the Spotlight: Corporate Governance Update*, 907 PLI/CORP. 489, 492 (1995) (advocating independent directors as a principle means of "promoting 'good governance'"); see also Barry D. Baysinger and Henry N. Butler, *Revolution Versus Evolution in Corporation Law: The ALI's Project and the Independent Director*, 52 GEO. WASH. L. REV. 557, 580-81 (1984) (considering the policy implications of independent directors and their effectiveness in leading toward corporate governance reform); Victor Brudney, *The Independent Director - Heavenly City or Potemkin Village?*, 95 HARV. L. REV. 597, 598 (1982) (discussion of the strategy of improving corporate governance through the introduction of independent directors and consideration of who independent directors are and the effectiveness of this strategy).

⁴⁸ *Id.* See also *Responsible Investor*, INVESTOR REL., May 1, 1996 (comments on TIAA-CREF's guidelines which include determination of director independence).

We have heard a lot of defense tonight of independent directors. I wonder if there is not another side to it. Joe [Geoghan], could I ask you: What about inside directors; is there a place for them anymore?

MR. GEOGHAN: I hope so. I am one of them. You will not get an argument from me on the need to have a predominance or a preponderance of independent directors. In our company we now have twelve directors.⁴⁹ There are two inside directors, the CEO and myself.⁵⁰ Our Corporate Governance Principles expressly provided that there will be a majority of independent directors on the board, and I think that has to be.

I think the days in the 1950s and 1960s, when boards were run by cronyism, are rapidly fading, and I think they are fading because independent directors are becoming more and more assertive.⁵¹ The definition of corporate governance can get somewhat twisted when management appoints the board and, in effect, it becomes all one big happy family. We absolutely applaud outside directors. It is a very positive force.

I would like, if I may, Jill [Fisch], while I have this microphone, to come back for a moment to the stakeholders issue, because I think there is an important nuance here that Jon [Lukomnik] touched on, and I would like to make very clear.

The interest of stakeholders other than shareholders is not in derogation of the rights and the primacy of the shareholder value issue. Today, it is more a reflection of what I would characterize as modern corporate philosophy, if you will, that in the context of maximizing long-term shareholder value, one cannot escape and one must pay very close attention to the societal obligations of the corporation to those other stakeholders.⁵²

⁴⁹ UNION CARBIDE CORP., 1996 ANNUAL REPORT 44 (1997); see also *Who's News: Union Carbide Corporation*, WALL ST. J., Jan. 7, 1997, at B9 (discussing recently elected members of Union Carbide's Board of Directors).

⁵⁰ UNION CARBIDE, *supra* note 49, at 44.

⁵¹ See Hugh Parker, *Re-Empowering the Board*, DIRECTORS & BOARDS, Jan. 1, 1996, at 6 (reviewing independent boards and advocating increasing board independence by 'professionalizing' it); Sharon Walsh, *supra* note 43 (noting that perennially nepotistic and insular ADM is moving toward an outside board of directors); see also Rod Meguen, *In the Line of Fire (3 part series)*, FIN. POST, May 11, 1996, at 6 (finding that boards are becoming more diverse as a result of a large number of retirements, some 25% of all sitting directors are set to retire in the next five years); *contra* Cyrus F. Freidheim, Jr., *New World Order in the Boardroom*, DIRECTORS & BOARDS, June 1, 1996, at 6 (questioning the increase of independence of boards, despite the decreasing number of insiders sitting on them).

⁵² Blair, *supra* note 26, at 230.

To my mind, it is not an issue of being able to find final accountability. Clearly, the final accountability is through the board to the shareholders.⁵³ But, I think, there has been an evolution in the concept of duties of corporations to society that recognizes the existence of other stakeholders and acknowledges a specific responsibility to those stakeholders, where in past years that acknowledgment has been absent. I believe that is a very positive development that has basically occurred in the last fifteen years.

REV. SMITH: There is another side of the independent director issue that we in the churches have been very much involved with, and I think it came very much to the forefront in the recent revelations about Texaco, Incorporated ("Texaco"),⁵⁴ and that is the whole question of board diversity.⁵⁵ The question is not simply one of independence, but also of diversity.⁵⁶ We have been looking particularly to have women, African Americas, Hispanic Americans, and other people of under-represented groups on boards of directors.

As I looked at our panel tonight, I found it very interesting that we are all white males. Our moderator and Kim [Morrow] are women, but otherwise everybody speaking tonight is a white male. This is not very diverse and not very representative. Certainly not the kind of board that we in the churches like to see as the governing body of a corporation. We think that diversity adds something to shareholder value ultimately because it reflects what our society is about and it brings in a different perspective that often is

⁵³ Michael A. Miles, *Should Directors Meet with Shareholders?*, DIRECTORS & BOARDS, Jan. 1, 1996 ("shareholders are, after all the owners of the company and are the 'bosses' to whom the directors are accountable."); Matthew Greco, *NACD Offers Board Guidelines*, INVESTOR REL. BUS., Nov. 25, 1996 (agreeing that boards, and management indirectly, are accountable to shareholders and should work toward independence); see Dennis J. Block and Jonathan M. Hoff, *Mergers and Acquisitions: Corporate Governance and Institutional Activism*, N.Y.L.J., Jan. 18, 1996, at 5 (noting that because institutional investors hold 50% of the stock of large U.S. public companies, they have great sway over boards who find themselves accountable to these major shareholders); Hobson Brown, Jr., *What do Institutional Investors Really Want?*, CORP. BOARD, May 15, 1996 (noting great power of institutional investors).

⁵⁴ Allanna Sullivan and Peter Fritsch, *Texaco Punishes Officials Over Racist Epithets*, WALL ST. J., Nov. 7, 1996, at A2 (reviewing actions taken by Texaco in the wake of the racism scandal); Courtland Milloy, *Texaco Taps a Deep Well of Racism*, WASH. POST, Nov. 10, 1996, at B01 (discussing racist comment of top executives at Texaco and investigation of the Equal Employment Opportunity Commission).

⁵⁵ *A Diverse Assault on Bias*, ST. PETERSBURG TIMES, Nov. 24, 1996, at 1H (advocating increased diversity within corporations); Robert Keefe, *A Diverse Assault on Bias: Texaco Case Sends Loud Message*, ST. PETERSBURG TIMES, Nov. 24, 1996, at 1H (further review of Texaco case and advocacy for increased diversity within corporations); Joann S. Lublin, *Management: Texaco Case Causes a Stir in Boardrooms*, WALL ST. J., Nov. 22, 1996, at B1 (finding that the Texaco scandal has lead boards of directors to look closer at diversity both within corporations and boardrooms); Joann S. Lublin, *Focus on the U.S.: Texaco Case Causes a Stir in Boardrooms*, WALL ST. J. EUR., Nov. 25, 1996, at 5 (noting that the Texaco scandal had lead boards of directors to view diversity as a "bottom-lone" issue and has lead them to scrutinize management's efforts).

very helpful in the management of the corporation. Many corporations lack that, when they simply go by the “good old boy network,” and we do have many corporations that still do that.

MR. SCHLEFER: Professor Fisch, could I just get back to the question of independence? You said that it is very easy to determine who are independent directors, and I would say it is almost impossible. If you take a look at the Walt Disney Company (“Disney”) example that was alluded to, there have been reports of personal ties between Disney’s chairman and some of the Company’s directors.⁵⁷ These are ties that could call into question a director’s ability to act independently, and yet they are not disclosed in the proxy statement.

PROF. FISCH: And, of course, TIAA-CREF has one of the strictest policies in terms of defining director independence.⁵⁸ But there are those that say that business relationships between non-employee directors and the company can actually help a board function, that the board can be more effective in formulating that strategic plan if the directors are involved in related industries or involved in supplier or customer companies and so forth.⁵⁹

MR. SCHLEFER: The problem we face is that we own shares in 4,000 companies around the world, half of them in the United States.⁶⁰ We are not a fly on the board room wall, and we really have no way of knowing which directors have courage, integrity, intelligence, or independence. We can read their résumés as they appear in the proxy statement, but in terms of real independence, of being capable of standing up to a Chief Executive Officer if there is a crisis and saying “wait just a minute, there is a problem here,” we really have no way of knowing. That is why we certainly can not use apparent independence as the only measure to identify companies that need some special attention from us.

⁵⁶ *Id.*

⁵⁷ Bruce Orwall, *If a Company Prospers, Should It’s Directors Behave By The Book?*, WALL ST. J., Feb. 24, 1997, at A1 (discussing the achievements of Michael Eisner at Disney and considering whether, considering the Company’s great success, it is acceptable that the Disney board is not independent); Bruce Orwall and Joanne S. Lublin, *Disney’s Eisner Shoots Back at Critics Who Say Board Isn’t Truly Independent*, WALL ST. J., Feb. 24, 1997, at A1 (illustrating Michael Eisner’s, Disney’s Chief Executive Officer, view of the Company’s Board of Directors); see also Walsh, *supra* note 43 (discussing how to determine if directors are independent or not).

⁵⁸ See *Responsible Investor*, *supra* note 48 (comments on TIAA-CREF’s guidelines which include determination of director independence).

⁵⁹ See Brudney, *supra* note 47, at 598 (taking the position that some relationships between businesses and the boards of directors of different businesses may be beneficial).

⁶⁰ Stewart, *supra* note 37 (extensive discussion of TIAA-CREF).

PROF. FISCH: Patrick [Speeckaert] has been sitting here very quietly. I know that one of the things that is on all of our minds is, if we move to adopt these sorts of corporate governance principles, in particular, if we embrace a broader stakeholder-oriented model of the corporation, how will that affect us in global competition? How is that going to position United States business in the increasingly international marketplace?

MR. SPEECKAERT:⁶¹ First, the concept of the two-tier board, I think, has been looked into very deeply in the United States. Some think that it could be a better model of governance.⁶² It has not gone much further than that. But in concept, half of the advisory board is composed of representatives of personnel and unions, acknowledging that employees are stakeholders and thus must be part of the decision makers. The other half consists of persons elected by the shareholders.⁶³ This first-tier board appoints the second-tier management board, which is composed of inside directors and/or executives of the company.⁶⁴ I think the relationship between the two boards is by definition amiable because one appoints the other.

Now is that totally independent? No. Dick [Schlefer] asked the question earlier. We ask the same question in Europe. Who appoints the supervisory board? They are elected by the employees. Thus, they represent different classes of employees: blue collar, white collar, senior executives, and the unions. On the other hand, they are also simultaneously representing shareholders, in theory.⁶⁵

How can it affect a United States corporation? I do not know. Actually, United States corporations

⁶¹ Patrick Speeckaert is the Managing Director of the International Division of Morrow & Company, Inc. His responsibilities include shareholder identification, proxy solicitation and corporate governance consulting in Europe and the Far East.

⁶² Benjamin T. Lo, *Improving Corporate Governance: Lessons From the European Community*, 1 IND. J. GLOBAL LEGAL STUD. 219, 239-44 (1993) (reviewing the two-tier board model and advocating its adoption in the United States); *Jardine Fleming Group Reorganizes Officials, Creates 2 Tier Board*, WALL ST. J., Sept. 27, 1996 (noting Jardine Fleming Group Ltd. adopted a two-tier board in order to "reassure clients" after an investigation discovered regulatory violations in the company's big-fund management division); *contra* Audrey Choi, Maureen Koine and Peter Truell, *West European Managers Lose Footing*, WALL ST. J., Aug. 29, 1994, at A7 (critical of European corporate governance and noting that many continental European countries are considering changes in corporate governance structures and may be moving toward the Anglo-American model).

⁶³ Lo, *supra* note 62, at 239-40 (providing a general explanation of the two-tier board system).

⁶⁴ *Id.* (explaining the role of the first-tier board).

⁶⁵ *Id.* (discussing how the two-tiered board model, in theory, provides representation for various parties interested in the corporation).

have inside directors less and less; more and more they have outside directors. This more or less represents the part of the shareholder-elected supervisory board members which is from other industries.⁶⁶

It is interesting to note who sits on the board of a German company? You have the banks, because the banks are large shareholders, and thus they are on most every board existing of large listed companies.⁶⁷ They are also stakeholders because they are simultaneous owners and creditors. The lender relationship is different, it is a relationship that is not just a shareholder but it is also a lending situation. Their interests as creditors may be different from their interests as shareholders unless they extend long lines of credit.

Bank borrowing, especially in Europe, has been a way of providing capital to companies instead of going to the stock market all of the time. The European stock markets often do not have the liquidity of the American capital markets. Investors are more fixed income-oriented. It is true for Spain and it is true for Germany. The recent privatization of Deutsche Telekom, AG showed that European investors were hesitant. While it was a success, it was something quite new in Germany. The general investing public stepped in and bought equities in large quantities. Historically, holding companies, banks, and insurance companies were the only participants in the equities market.

So the concept of stakeholder is really the idea that works in two-tier boards. But what does it change? A company still has to be competitive, it has to make money, and needs to grow. I do not think we can see a tremendous differences between a competitive German company and an equally competitive company in the United States. But there are differences.

European corporations have many more social obligations. That is because most of Europe has a socialistic concept of providing enormous benefits to employees, as seen in their generous pensions and

⁶⁶ *Id.* at 239-40 (discussing the structure of a two-tiered board).

⁶⁷ Joel Chernoff, *Europeans Creeping Ahead*, PENSIONS & INVESTMENTS, Oct. 28, 1996, at 20 (noting that German banks play a "major role in supervisory boards" and taking a somewhat critical view of the European corporate governance system); see also Nicholas Bratt, *The Cultural Aspect of International Investing: Dealing with Foreign Corporations*, VITAL SPEECHES, Mar. 1, 1996 (discussion of the governance of corporations around the world, including consideration of the role of banks); Freidheim, *supra* note 51, at 6 (review of the changes in corporate boardrooms around the world); William Hall, *New Board at Ciba Specialty*, FIN. TIMES, Feb. 6, 1997, at 22 (reporting that the Swiss company Ciba Specialty Chemicals has appointed representatives of Switzerland's three biggest banks to its board); Stephen M. Davis, *In Search of the Global Board*, CORP. BOARD, Jan. 11, 1997, at 7 (discussing the composition of corporate boards around the world).

medical care programs, which have been mandated by the bylaws. These programs are not based on corporate decisions, *per se*, but rather, it is the socialistic government imposing them.⁶⁸

That is why most of the other investors used the "Wall Street rule," because they do not have influence.⁶⁹ If, for instance, a board voted to downsize 100,000 to 120,000 positions in a European company, there would be revolution. The government would inevitably step in and pass legislation prohibiting such a reorganization. It is very difficult. Companies in such nations can only gradually accomplish such changes.

So the importance of the stakeholder is there. It is the law. It is there because that is the way business is done in those locales, and boards cannot change that next week. They must provide for their various stakeholders; for example, when companies lay off people, the government absorbs most of the costs of early retirement, not corporations.⁷⁰ Consequently, the government steps in and order the corporation: "you are not allowed to do that" or "you have to find a different way."

I do not see that European corporations can switch to the United States model, and I do not predict that the European model will be widely applied in the United States any time soon. There is a huge liability in the social responsibility of maybe not the shareholders, but of the corporations in most European countries.

PROF. FISCH: I would now like the members of our audience to have an opportunity to ask questions of the panel.

QUESTION: I would just like to ask Richard [Schlefer]. I know TIAA-CREF has been a supporter of board diversity as a form of good corporate governance, and I wonder if he would talk a little bit about the

⁶⁸ Kamm, *supra* note 31 (discussion of the fear of many European workers that the adoption of a single European currency may lead to the reduction of their generous social benefits system); Warner, *et al.*, *supra* note 31, at 62 (discussion of the "much wider social safety net" that is found in European and Japanese corporations); Benjamin, *supra* note 31, at A1 (noting the German cut back on worker benefits as a result of economic recession in that country).

⁶⁹ Minow, *supra* note 33, at 227 (discussing the options stockholders have when they disagree with a corporation's policies).

⁷⁰ See Peter F. Boone and Frans A.J. van de Bosch, *Discerning a Key Characteristic of a European Style of Management: Managing the Tension Between Integration Opportunities and the Constraining Diversity in Europe (European Management?)*, INT'L STUD. MGMT. & ORG., Sept. 1, 1996, at 109 (discussing the role that European governments play regarding corporate policies and employment).

rationale for that and what TIAA-CREF has done in encouraging the board to be diverse.

MR. SCHLEFER: Well, our board is extremely diverse.⁷¹ To start with, we have many women and members of minorities. That has been true for many years.⁷² We represent a very diverse community, the academic community, and we have always believed that it is appropriate to have the many voices of that community represented on our board.

Several years ago, we filed some shareholder resolutions asking companies to seek ways to increase the diversity of their boards.⁷³ Most companies, once they received our resolution, sat down with us and agreed that it was a good idea.⁷⁴

Often, there are practical problems that companies point out. For example, some told us that they had tried to recruit particular people but that the people that they wanted on their boards were so much in demand that it was impossible to get them. We were convinced, in most cases, that the companies we spoke to were making good-faith efforts and thus, were we were able to withdraw our resolutions.

QUESTION: Do you see it as good corporate governance as well as being socially responsible?

MR. SCHLEFER: We would not file a shareholder resolution if our trustees did not believe that it was in the long-term economic interest of the company to consider the resolution.

PROF. FISCH: Other questions?

QUESTION: I have a question I would like to address to Mr. Lukomnik. There appears to be some evidence that the most activist investors are the state and municipal pensions funds, and these tend to be investors who have probably the least control in terms of their oversight. For example, who monitors California Public Employee's Retirement System ("CalPERS")? Who is the board that oversees the investment strategy of the people who run the CalPERS pension fund? Could you just speak to that issue a little bit, about who is watching the people who are watching you?

⁷¹ See John A. Byre, *Putting Your Mouth Where Your Money Is*, BUS. WK., Nov. 25, 1996, at 106 (acknowledging TIAA-CREF's diversity and its policies to advocate independence and diversity in other corporations); Leslie Scism, *Teachers' Pension Plan to Give Tough Exams*, WALL ST. J., Oct. 6, 1993, at C1 (announcing TIAA-CREF's new corporate governance policies, which include a push for more diverse and independent boards).

⁷² *Id.*

⁷³ Leon E. Wynter, *Business & Race*, WALL ST. J., Nov. 8, 1995, at B1 (discussing TIAA-CREF's proposal to 15 companies, in 2 years, to increase the diversity of their boards).

⁷⁴ *Id.*

MR. LUKOMNIK: First off, just to correct an erroneous impression, I think that it is true that historically we were the most activist. If you want to know the reasons for it, part of it stems from the idea of being very comfortable with making a public argument. But I do not think it is true anymore. As Marty [Lipton] and I said, Michael Price,⁷⁵ or Al Kingsley,⁷⁶ or Guy Wyser-Pratte⁷⁷ are more, and I think, the corporate management would view them as a very different type and much more active than we are.

So far as your governance question, I flatly reject the statement that public funds have the least oversight. I think we have the most oversight. Number one, the Taft-Hartley plans, which are the union funds, are covered by Employment Retirement Income Security Act of 1974 ("ERISA").⁷⁸ Number two, for instance, CalPERS has an elected board of directors that the members have to elect.⁷⁹

In New York City, there is a bizarre statutory scheme.⁸⁰ First off, there is not one New York City plan, there are five; and if you count all the subsidiary plans and life insurance companies, there are actually twenty-three. But each one of those has a board of trustees. The board of trustees is roughly, it varies by fund, equal status between labor and management, so it is a split labor and management board.

⁷⁵ Jeahnee Kim, *The Legends' Pick; The Favorite Stocks of Five Famous Investors*, MONEY, Sept. 1997, at 70 (noting that when 200 investment professionals were asked which money managers they most admire, Michael Price, the 46 year old chief executive officer of Franklin Mutual Advisers, was among the top five named); Daniel Kadlec, *Going to Bat Against IIT; Two Heavy Hitters Play Hardball. Is This Fair?*, TIME, Aug. 25, 1997, at 59 (discussing Michael Price, who controls \$26 billion at Franklin Mutual Advisers).

⁷⁶ Dan Dorfman, *Tisch Sees Beauty in Ugly Bethlehem Steel*, FIN. WORLD, Feb. 18, 1997, at 14 (calling Al Kingsley of Greenway Partners an "activist money manager"); Judy Temes, *CEO's Time Runs Low to Restore Woolworth; Crumbling Business, Spin-Off Push May Foil Farah's Three-Year Plan*, CRAIN'S N.Y. BUS., Feb. 12, 1996, at 3 (noting that Al Kingsley is the senior managing director of Greenway Partners L.P., a Manhattan-based firm that is Woolworth's single largest shareholder); see also *Proxy Season Reveals Trend Toward Spinoff Proposals*, CORP. FINANCING WEEK, July 8, 1996, at 4 (noting Kingsley of Greenway participation in a proxy to Unisys to change the company's structure and his belief that "corporate management rarely warms to shareholder suggestions on strategy").

⁷⁷ Jill Dutt, *Arbitrageurs Who Didn't Bail Out Winning the Office 'Poker Game'*, WASH. POST, Mar. 13, 1997 (citing Guy Wyser-Pratt, President of Wyser-Pratte & Co. Inc., as one of Wall Street's "best-known arbitrageurs"); see also Linda Kay Sakelar, *Investors Launch Proxy Fight Against Bethesda Satellite Co.*, RADIO COMM. REP., Apr. 14, 1997, at 27 (discussing Guy Wyser-Pratte and his company, noting their ownership of 2.56 percent of Comsat).

⁷⁸ 29 U.S.C. §§ 1001 *et seq.* (providing that the federal act supersedes many state laws for private pensions).

⁷⁹ Jennifer H. Van Heeckeren, *Manager's Journal Why Investors Push for Strong Corporate Boards*, WALL ST. J., June 30, 1997 (discussing the influence of CalPERS and how its \$80 billion portfolio of securities make it and its corporate governance guidelines impossible to ignore); Matthew Greco, *CalPERS Plan Corporate Governance Strategy for 1997*, INVESTOR REL. BUS., Sept. 30, 1996 (considering CalPERS proposed 1997 corporate governance program which includes taking a closer look at corporate boards and compensation).

⁸⁰ Statutes governing public pensions are in a constant state of flux. There are a number of different retirement systems and pension funds maintained by New York City; they are governed by the N.Y.C. Administrative Code.

The way the people get to be on the board again varies by fund. Some are by direct election by members, some are by indirect election, in other words, if you are the president of the Fire Fighters, by virtue of being the president of the Fire Fighters, you sit on the Fire Fighters Board, but again the members do elect in that sense.

Finally, there is some statutory oversight. We are governed by the State Insurance Commission. And perhaps the biggest oversight is because they are public plans, they are subject to more intense scrutiny than anyplace else. It is all subject to the Freedom of Information Act. New York City and California have an incredibly aggressive press. Justice Brandeis's old dictate that "sunshine is said to be the best disinfectant"⁸¹ certainly comes into play.

But the answer, I think, is that there are more levels of control. There are boards which have fiduciary obligations elected, appointed, or *ex officio*; there is government oversight, either ERISA or, in our case, the State Insurance Commission; and then there is simply public scrutiny.

QUESTION: This phrase that keeps getting buzzed around, the original buzzword all evening, is shareholder value. I have heard it in about six different shades of meaning here tonight. I was wondering if any of you would care to essay a succinct definition of shareholder value that would cover all of the contingencies that you have talking about?

MR. GALLAGHER: I do not think there is a succinct definition. It is something we all struggle with. Certainly there is the shareholder value concept which views the role of the company as maximizing profits for shareholders.⁸²

QUESTION: Over what time frame?

MR. GALLAGHER: Either over a quarter or a longer time frame. That is another nuance of shareholder value. Beyond that, you have the stakeholder concept of shareholder value, which includes being responsive to the community and the environment. There is also another gloss in the kind of nonfinancial measures of performance that some would say increase shareholder value in a much different sense from the return of the quarterly or annual bottom line.

⁸¹ L. BRANDEIS, *OTHER PEOPLE'S MONEY* 92 (1932).

⁸² Friedman, *supra* note 13, at 125 (stating position that a corporation's duty is to maximize profits).

So there is not any real agreement. That is one of the many open questions in corporate governance. In fact, as some of the speakers said earlier, there are many different definitions of corporate governance and people view it very differently. So we are in very much of an open phase where we are all trying to struggle and come to some consensus.

That was part of our company's decision to support academic studies in the area of corporate governance,⁸³ to attempt to coalesce some of these ideas and try to come to some understanding. We recognized, as we got into it and tried to approach it in a responsible way, that there is not much agreement as to the definitions of important terms in corporate governance.

MR. SCHLEFER: I do not know if I should bring up finance theory to a law school audience, particularly after nine in the evening, but I think many people would argue that, believe it or not, the price of the stock really does represent the long-term value of a company to the shareholders.⁸⁴

People often say that institutional shareholders are short-term oriented and that all they are interested in is the price of the stock today. But if that were true, biotech, stocks, for example, would be given away because many of those companies do not earn a penny. What shareholders are really looking at is their expectations of the long-term growth potential of the company, what kind of products do they have in the pipeline that could be highly profitable in the future.

If a stock is properly priced by the market, that price really should reflect the company's environmental posture and its potential environmental liabilities, its labor relations and potential work stoppages, products that it is developing, all kinds of things.⁸⁵ So I vote for the stock price as the best proxy for shareholder value.

MR. LUKOMNIK: To throw out one other definitional problem to everyone here, you have all heard the phrase "institutional investors" a great deal tonight. That is not a monolithic group. Public Pension Funds, as someone mentioned, have been traditional activists. We have had a discussion about the Michael

⁸³ Pfizer has supported the work of Margaret Blair of the Brookings Institute. In addition, Pfizer supported three lectures at the American Enterprise Institute and published by the AEI Press. Among these lectures was Michael Novak, *On Corporate Governance: The Corporation As It Ought to Be*, THE AEI PRESS (1997).

⁸⁴ Alfred Rappaport, *Manager's Journal: Taking Stock of Your Company's Real Worth*, WALL ST. J., Mar. 2, 1987 (discussing the importance and significance of a company's stock price).

⁸⁵ Van Heeckeren, *supra* note 79 (noting that CalPERS is looking for long-term returns and are considering management and many other factors to determine which companies will be able to offer such gains).

Prices of the world. There are mutual funds who look at next quarter's performance very differently than we who have pension liabilities. Guy Wyser-Pratt is an arbitrageur, endowments are different, religious investors are different, and so nothing about this is very monolithic.

One should just be aware that what is happening out there in fact is a marketplace of ideas, a competing marketplace of buyers and sellers, but also competing ideas about corporate governance. I go back to something several people said, and I think Joe [Geoghan] said it best, that is this has been a constructive tension. I think that if we iron it out so that everyone agrees perfectly, that probably is not the best solution because we will have gotten it wrong.

PROF. FISCH: I think we have time for one more question.

QUESTION: The question was for the institutional side. I was wondering, with the relaxed proxy rule, how much communicating are you doing with your fellow shareholders? Dick [Schlefer], you have 4,000 issues that you follow, Jon [Lukomnik] 2,200. Can you quantify how much communication you do?

MR. SCHLEFER: Well, how about a concrete example. Marty Lipton mentioned the W.R. Grace situation,⁸⁶ where one day in the CREF conference room over forty percent of the company's shares were represented. The purpose of that meeting was not for institutional shareholders to form a group to try to gain control of the Company. The purpose was for us to listen to the interim Chairman of the Board talk about some of the problems the Company was facing and for him to hear our views as to the things the Company had to do, and really had to do quickly. So that is an example of very effective communication.

We certainly have the ability to solicit support for proxy resolutions we file. But the climate has changed over the past ten years to such an extent that although this season we have filed fourteen shareholder resolutions on two subjects, only one resolution will probably come to a vote. All the others have been withdrawn, or will be withdrawn, based on successful private negotiations between us and the companies.

So the answer is that there is a lot of communication going on, not only among shareholders but between shareholders and corporations, and you do not read in the papers about ninety percent of what goes on behind closed doors.

⁸⁶ Lipton, *supra* note 5.

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MR. LUKOMNIK: I would echo that; and add a point. We do this because we believe in the capital market. We believe in the United States corporate management, by and large. This is not an antagonistic view.

Terence [Gallagher] mentioned the poison pill. He was nice enough not to say that I was one of the people he came in to see and say, "What do you think?" We do not always agree, but it is usually a very cooperative endeavor.

Corporate governance is about five percent of my job. I have a staff that does it, but it is five percent of my job. I have no desire to meet with 2,200 United States companies each year. Like most people, we go through a winnowing process. We probably pay really close attention in a good year to twelve situations, in a bad year to twenty. In those situations probably five to six each year become what might be considered the "corporate governance poster child of the moment," the Archer Daniels Midlands, the W.R. Grace & Company, a few years ago, Sears, Roebuck and Company. There are really very few. Then people call us, Disney being most recent, and there are communications.

But it is really the vast minority of cases, and people should not leave here thinking that there is this vast pool of antagonism. It is a minority of cases. Even as Dick [Schlefer] said, most of those cases get amicably settled with the companies. In five to six cases over the course of a year, we might really take advantage of the proxy rules and do something like a voting announcement, or a call around, or that sort of solution.

REV. SMITH: I think there is a lot of cooperation, and has been, among the religious investors, but what we are finding is there is much more cooperation now with a wider range of investors. For the last eight years we have been cooperating very closely with New York City around the Coalition for Environmental Responsible Economies ("CERES")⁸⁷ and their principles for environmental responsibility. We worked previously with TIAA-CREF on South Africa and with New York City. I think what we are

⁸⁷ David J. Freeman, *ISO 14000 Standards Make Official Debut: May Be A Watershed In Environmental Regulation*, N.Y.L.J., Oct. 15, 1996, at S3 (includes review of CERES Principles); see also *Principled Way to Solve Complex Road Problem*, TIMES OF LONDON, May 26, 1997, at 42 (recommendation for further provisions for companies to adopt in order to prevent environmental damage, and discussing how the CERES principles have been used in the United Kingdom).

finding today is that a number of other groups are coming in. Social investment firms, for example, are beginning to sponsor resolutions and coming in, and we are working very closely with them.⁸⁸

There is a kind of a community, not only of the social activists, but also corporate governance, and it flows back and forth. Different groups have different priorities, but we all tend to be in touch. I think, there is a larger sense of community and communication in terms of the kinds of issues that are raised, how they are raised, and every the particular tactics that are employed. Whether we will go after one company and put on a hard press and leave all the resolutions in, or whether we will really attempt to work out a solution. We within the ICCR certainly do much more now in terms of having real dialogue, substantial dialogue.

I think CERES again is a very good example of that kind of cooperation, not only between the investors, but with the companies. We are increasingly seeing CERES as a cooperative effort, a partnership, to work with all parties participating and seek the best solution for all who are involved.⁸⁹

PROF. FISCH: I think my responsibility at this point is to turn the microphone back over to Kim [Morrow] for closing remarks.

Before I do that, I would like to take the opportunity to thank the panelists. I think it has been a very interesting discussion, and I really appreciate being a part of it.

⁸⁸ Nicole Gaouette, *Do-Good Investing Grabs Market Share in U.S.*, CHRISTIAN SCI. MONITOR, June 5, 1996, at 8 (consideration of the trend toward socially responsible investing and noting that 10 percent of American investment is based on ethical, as well as, financial considerations).

⁸⁹ Freeman, *supra* note 87, at S3 (discussing CERES principles); *see also Principled way*, *supra* note 87, at 42 (considering how CERES principles are used in Great Britain).

