FIRESIDE CHAT: SHAREHOLDER RIGHTS
TUESDAY FEBRUARY 15, 2005

THERESA GABALDON: Good afternoon. I'm Theresa Gabaldon, Professor of Law and Carville Dickinson Benson Research Professor of Law, at The George Washington University Law School, as well as this year's host of the Fireside Chats of the Securities and Exchange Commission Historical Society. The Securities and Exchange Commission Historical Society is a non-profit organization, separate from and independent of the SEC. The Society preserves and shares the history and historic records of the SEC and of the securities industry through its virtual museum and archive at www.sechistorical.org. Today's chat will be preserved in the museum so you can listen to the discussion or read the transcript later.

Today's Fireside Chat looks at Shareholder Rights. Our panelist today is Nell Minow, editor of TheCorporateLibrary.com. TheCorporateLibrary.com compiles research, study and critical thinking about the nature of the modern global corporation with a special emphasis on boards of directors and executive compensation.

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As we begin, I'd like to thank our museum visitors, some of whom have sent in questions which I'll include in this chat. Starting with our first question: Nell, in your view, who is the modern shareholder of the publicly-held corporation?

NELL MINOW: Well, that's kind of like saying who is the human being on the face of planet Earth, and that's really the strength and the beauty of the capitalist system is that the shareholder could be a large institution or it could be a retiree who is living on the dividends. It could be a young person making his first investment as a speculation. It could be somebody who intends to hold it for a very short time, someone who intends to hold it for a long time. Individuals may be smart or stupid, but groups are smart, and the idea of the shareholder is that there are so many of them with so many different interests that the sort of the diagram of all their interests together is probably the smart thing to do for the long term, and so while individual shareholders may differ, the shareholder as a whole is somebody who is looking for present value and long-term shareholder value and I think that's very consistent with good public policy.

THERESA GABALDON: Do you think that the demographic of the shareholder has changed much in the last 20, 30 years?

NELL MINOW: Yes, it has changed. It's not that long ago that the majority of stock was held by individuals who were buying on their own behalf and were stock-picking. They would say this company is a good bet. This company is a bad bet. But the rise of pension funds and mutual funds has meant that the majority of stock now is held by intermediaries on behalf of those shareholders, and again, I think that that's a very good thing. I think the reason that that occurred is because we recognize that there is such a thing as expertise, and if I'm going to play basketball against Michael Jordan, I probably shouldn't do it for money. So if I'm only going to be able to spend about an hour a week deciding what my investments should be, maybe I should spend that hour picking a mutual fund manager and letting Michael Jordan work for me, instead of betting against him.

THERESA GABALDON: Museum visitor Larry Mitchell sent in a somewhat related question, and I quote: "Nell, you're one of the leading shareholder advocates in the nation. Although we know that institutions often have significant stakes in given corporations, aren't most shareholders nothing more than market-driven animals? If that's not right, what is? And why should a distant, apathetic investor with an average time horizon of a few months matter to anybody? How does privileging such a person affect long-term corporate value and behavior?"

NELL MINOW: Well, thank you very much, Larry, for the compliment and for the typically hard-hitting question that followed, which I'm going to have to unpack a little bit because there's a lot going on in that question. The answer is really very similar to what I said before which is that all shareholders together are going to provide the right result, just as all voters together are going to provide the right result, maybe not every time in every election, but over the long term, that's the way to go. And so, yes, you're going to have some apathetic, short-term shareholders, but unless they can persuade everyone else to go along with them, then I don't think we're going to have a problem. It's a good thing that the majority of stock now is held by institutional investors, somebody like the California Public Employees Retirement System, the largest investor in America, is essentially going to hold 1% of every company in America forever. Those are permanent investors. They provide a very stable infrastructure and they're investing on behalf of people who've got an average of 30 years from the day a dollar goes in until the day they take it out for their retirement. And so they, by definition, they're interested in the long-term. It's also important to remember that shareholders are not corporate managers. They have a very important, but a very, very limited role in determining the direction of the corporation. They don't decide whether the General Motors cars are painted red or blue, or how much to charge for them, or whether they should start a new model. What they do decide is this the right Board of Directors, is this the right executive group, are we paying them in a way that creates the right incentives? Are the financial reports something that we can feel confident about, and is this the right overall strategy? So for those very limited, broad, long-term questions, I think that the shareholder community is in the right position to be able to come up with the right answer.

THERESA GABALDON: You mentioned, of course, the relationship of investors and management. I'd appreciate it if you could go into a little more detail on that. How would you characterize the modern relationship of investors and management?

NELL MINOW: I tend to think of it as being very much like the checks and balances that are the basis for our political system because it was really set up for the same purpose. Just as our political system was set up to provide accountability in government, the capitalist system was set up with checks and balances to provide accountability for money. Now I myself have my own business. If I decide to take some time off, no one loses any money but my partners, and if they think I'm taking too much time off, they can tell me, but that's because it's our money and we all know each other, and all of our shareholders are on the Board. So we don't have a lot of what are called agency costs. We don't have a lot of what lawyers call conflicts of interest. We're all right there in the same room together. But if I'm going to give my money to a company where I'm not in the room, where I don't know what's going on, I need to have some reason to believe that I can trust these people, that they're not going to take my money and buy a yacht with it, they're going to take my money and invest it in a way that's going to bring returns to me in the long run.

We do have a lot of checks and balances. That's pretty much what our securities laws are all about is a way of making up for the fact that I can't be in the room, making up for the fact that there are inherent agency costs in any kind of a system where one person is providing the capital, another person is providing the judgment. And so that's the difficult balance between shareholders and management. Management is there to make the day-to-day decisions with shareholder money, and shareholders just want to have protections in place to make sure that those decisions are to benefit them and not to benefit management.

THERESA GABALDON: That more or less presupposes that sometimes the shareholders aren't entirely satisfied with the protections that are in place and I'd be very interested at this point in hearing a little bit about shareholders activism, how it's evolved since its early days, things along that line.

NELL MINOW: Well, that's one of my favorite subjects because what I just explained to you was the theory and not the practice. The theory was that there would be these checks and balances, but they've been pretty much circumvented. One of my favorite examples of that was when we were involved in fighting with a pretty well known company, Sears, and at that time, the same man held several different jobs. He was the CEO, and he was the Chairman of the Board. He was the CEO of the company's largest and worst-performing division, which meant that his performance evaluation probably went pretty quickly. He was also the head of the Nominating Committee, so he was picking all of his own Directors, several of whom actually worked for him. And, this was my favorite; he was Trustee of 22% of the stock that was invested on behalf of his own employees. So that would really be like going back to my checks and balances in the political arena example, that would pretty much be like taking George Bush and making Chief Justice of the Supreme Court, Speaker of the House, Senate Majority Leader, Head of the Joint Chiefs of Staff and Doorkeeper at the Senate. Basically, you circumvented all of those checks and balances by putting the same guy in all of those jobs. Various other developments also occurred that made it much, much more difficult for shareholders to exercise oversight, so it's been a long time that since shareholders began to try to develop these rights and it's been quite an uphill struggle. The first real effort to develop any rights for shareholders was the work of two brothers – John and Lewis Gilbert, who I was very privileged to meet. They were great heroes of mine. Back in the 1920's, when they were very young men, they started trying to go to annual shareholder meetings, which are supposed to be open to the public. And very often, they were not allowed in or they were not allowed to ask questions. After the stock market crash in 1933 and 1934 when the SEC was just getting started, their experience was very much in the mind of the early Commissioners as they started to write the rules that would govern shareholder responsibilities and rights, and it was really because of the Gilberts that shareholders have the right today to submit a shareholder proposal that must be circulated with the company's proposals on the company's proxy, saving the shareholder postage money, and also be allowed to speak at meetings to ask questions, to get those questions answered on the record, and all that. So the Gilberts would really pretty much have the whole world to themselves then for the next few decades. There was a woman named Wilma Soss who worked with them and who was the inspiration for one of my favorite plays and movies, <u>The Solid Gold Cadillac</u> which I strongly recommend to anyone interested in movies or corporate governance.

And that was pretty much it until the 1960's, and then a young lawyer named Ralph Nader came up with an unusual idea. He was trying to demonstrate that companies like General Motors were not necessarily acting in the best interests of the consumers and the employees, and he said, well here's this structure here that allows for shareholder proposals. It's never really been used by anybody other than the Gilberts. The Gilberts were using it for things that are extremely prescient by today's standards; they were laughed at back then, but they were filing resolutions about CEO pay and Boards of Directors, things that we think are very important now. He said, I bet I could use that same mechanism for some of my issues, and he started a thing called "Campaign GM" and he had a shareholder proposal that was pretty much in favor of motherhood and apple pie, you know. It was be good to the employees, be good to the environment, be good for safety, everything like that. It was a bit of a mish mosh, but okay, fine. That led to some shareholder proposals in the area that we would call social policy or political activism. During the Viet Nam era, there were some shareholder proposals about companies that made napalm, for example, and again that was pretty much it until the rise of the institutional investor. In the late 1980's, that's when we saw really the birth of modern corporate governance activism. That was, I would say, the Boston Tea Party of shareholder activism was when Texaco, in an anti-takeover attempt, paid off the Bass brothers, paid them green mail and that infuriated the shareholders, one of whom was a very outspoken politician in California named Jesse Unruh, big daddy Jess Unruh. He was at that time the State Treasurer which ran fiduciary for the California State Pension Fund, and he called down, do we own any stock in Texaco? And they said, yes, we're the largest single shareholder in Texaco. And he said, well, I don't like what they're doing. What are we going to do about that? And that was when he got together with other institutional investors and they began to complain about anti-takeover devices which entrenched management, or takeover abuses which stole money from shareholders. Either way, shareholders were getting taken and they needed to fight back about it a little bit. So to quote another movie network, I'm mad as hell and I'm not going to take it anymore. So that led to a focus on CEO pay in the early '90's as kind of the symptom of bad corporate governance and ultimately where it is now on Boards of Directors. Of course the scandals of 2002 and 2003 led to even more of a focus on corporate governance and now shareholder activism is considered to be an investment opportunity as well as a social policy opportunity.

THERESA GABALDON: Now you've mentioned federal law and we'll be coming back to that in a few minutes. Before we do that though, I'm curious to hear what you think about the rights of shareholders as a matter of state law. Are there any significant protections there?

NELL MINOW: There are not enough protections there. It was the former Chairman of the SEC, William Cary, who spoke about what he called the race to the bottom. The idea was that really from the very first moments of this country's lawmaking, corporate governance was left to the states, and in my opinion, that was a mistake, but we seem to be stuck with it. And the reason it was a mistake is that instead of the states competing against each other to see who could have the most appealing corporate governance situation, the most appealing laws for shareholders, they, of course, competed to see who would have the most appealing laws for corporate managers, since corporate managers get to pick the state of incorporation. Now if shareholders got to pick the state of incorporation, then I would stand up and say hooray. Let the states compete and we'll make it into a cost of capital issue. That would be wonderful. But since managers get to pick the state of incorporation, they tend to pick Delaware, which is the second smallest state and has quite a nice source of income in pandering to corporate managers and directors, and I always the official motto of the state of Delaware is the customer is always right, and the customer, of course, is corporate management. So, for that reason, a law like Sarbanes-Oxley, which I know we'll be talking about later on, a federal law can do very little to address the rights and responsibilities of shareholders. All of that is really left to the states, and a lot of what the SEC does to try to help shareholders kind of nibbles around the edges instead of going straight through because of this odd federalism situation, something that our friends and colleagues that we work with abroad have a hard time understanding.

So under state law, there are very important rights and I'll tell you my favorite one because no one ever uses it, but I used it with a great deal of pleasure several times when I was investing in underperforming companies. And that is the right to books and records. You do have the right to inspect the company's books and records if you're a shareholder, and companies tend to forget that. And so we would file these requests in Delaware courts and generally, to use a technical term, it would really flip them out, and so they would come back to us and negotiate and say we don't really want to open up everything to you. Is there something specific you're interested in? And that was a very, very good way to get their attention, so I think that's my favorite right under state law.

THERESA GABALDON: Do you think that there's anything significant that shareholders might do now about lobbying for changes to state law that would be beneficial to them?

NELL MINOW: I think it's unlikely. It's interesting that there was a moment there in the early rulings on the Ovitz case, which I will talk about in a minute, where shareholders thought that perhaps Delaware was going to step up to the plate and for the first time since the famous Transunion case, perhaps issue a ruling that would hold directors responsible for very bad decisions. And the preliminary ruling in the Ovitz case, which had to do with the Disney company's decision to hire and then fire a man named Michael Ovitz and to pay him $140 million for just about a year that he worked there. The question is did the Board do something so bad, was their judgment so poor in that case that they violated the rights of shareholders? And a preliminary ruling in that case led many observers, including me, to believe that Delaware courts were looking for a fact situation where after over 25 years they could once again say, yes, the directors have gone too far. However, the way that case has come and people will be listening to this in the future after the case has been decided, so forgive me if I'm wrong, but the way the evidence has come down, I think it's unlikely that the Delaware court will find the Disney Board of Directors responsible. They may say, well, they made some bad decisions, but we don't substitute our judgment for bad decisions. We wait and see if they have actually violated the duties of loyalty and care, and they have not done that in this case. I think that's probably what's going to happen, in part because of the recent settlements finding directors personally liable at WorldCom and Enron. I think that Delaware may feel that rather than being out front, they need to be a little bit more of a balance wheel. So, yes, sure there are a lot of things I would like to see done to improve state law, but based on my two bad experiences of trying to get laws that are more beneficial to shareholders in Delaware, I think it's highly unlikely.

THERESA GABALDON: It sounds then as though you think that concentrating on federal rights might be a superior strategy for shareholders in this day and age. Is that correct?

NELL MINOW: Yes, I do. It's always easier to have one target than fifty, and so I think that there's a lot to be done there, but to be honest with you, I think that we will look back on this era and find that all of the many sweeping legislative and regulatory changes, Sarbanes-Oxley, the creation of the Public Company Accounting Oversight Board, the changes in the listing standards at the NYSE and the NASDAQ, the regulatory changes, that all of them are dwarfed by the changes that have appropriately properly come about through market forces, which I think is a much, much better way to address these issues. So for example, just about this time last year, Moody's downgraded a company's debt purely on corporate governance grounds. They said the corporate governance of the company was so bad they simply didn't believe in management anymore, and that's not something they did because a regulator told them to do it or because somebody didn't check off the checklist that they were supposed to check off, that was the kind of judgment call that they made purely on the basis of economic. I think that that's a very good sign. It shows that Wall Street is incorporating corporate governance as a risk factor, which is exactly the way they should see it. Every analyst report coming out of Wall Street now reflects this kind of thing. Also, last year at this time, AFSCME, the Federal and County pension system, negotiated to put a director on the Board of Marsh & McLellan, and so with or without the proxy access rule that I know we'll be talking about later on, these steps are being taken. Three companies have already agreed to adopt proxy access voluntarily, or somewhat voluntarily in connection with settlement of litigation, so I think there's a lot that can be done just on the market side without worrying about whether we need more regulation or legislation.

THERESA GABALDON: Nonetheless, regulators keep on regulating, and you mentioned proxy access and proxy access proposal, and I guess that does bring us back to federal rights. It sounds as though you would characterize the most significant shareholder rights as in terms of access to management's proxy. Is that correct, or are there other things that we're leaving out here?

NELL MINOW: You're absolutely right. The difference between doing a proxy contest where you have to locate all of the other shareholders and put stamps on envelopes and mail to them versus one where that's all done for you is the difference between not being able to do it or being able to do it. I really believe that there are limits to structural solutions, and of course regulations and legislation are always about structural solutions. And I always say that in the first year of law school they teach you all the structures, and in the second two years they teach you how to subvert them. I have no faith whatsoever in any indicia of what people may call independence in terms of deciding who's on the board of directors or who's on what committees or who hires what counsel, I have no faith in that whatsoever. There is not one of those reforms that can't be completely undermined, and splitting the chairman and CEO, all of those structural reforms I think are trivial, ultimately. Therefore, the only reform that matters is who decides who's on the board. That's my definition of an independent director is one not picked by the CEO, and my other definition of an independent director is one who insists on a legitimate pay plan that ties pay to performance. That's the definition of an independent director. If you do that, I don't care if you're the CEO's brother, you're independent of mind and spirit, and you've got a spine, and you can stay on the board as far as I'm concerned. So I think that yes, proxy access is the key issue because proxy access will make it possible for certain shareholders in very, very limited circumstances to nominate their own directors on the company's proxy and if corporations and their boards don't want to be subjected to a market test, maybe they should get out of the capitalism business.

THERESA GABALDON: What's the current status of the proxy access rules?

NELL MINOW: Permanently stalled, I believe. That means that it could be unstalled at some point, but it doesn't look too likely. That's why I'm really focused right now on self-help and I'm bringing about proxy access company by company.

THERESA GABALDON: Perhaps we should back up just a step there and talk in a little more detail about exactly what proxy access means.

NELL MINOW: Proxy access means that if the shareholders are unhappy with a company that under certain limited circumstances they will be able to nominate their own candidates who will appear on the company's proxy the way that you might go into a voting booth and you might see Kerry running against Bush. Those limited circumstances could include a company's failure to adopt a shareholder proposal that got a majority vote, as often happens, or there might be certain performance standards that a company would be failing performance for a couple of years, but it would normally be a two-step process to give the company a chance to clean up its act before their directors were subjected to a real election. You know, we call it an election now. We "elect" these directors, but as Edward J. Epstein said, it's more like North Korea than it is like anything resembling a real democracy. Management nominates the candidates, no one runs against them, and management counts the votes, so how real is that?

THERESA GABALDON: What kinds of things can shareholders presently get on to the proxy?

NELL MINOW: They can have non-binding shareholder proposals. Now non-binding means the company does not have to do them even if you get 100% of the vote. I got a call from one director who was complaining because my company rates boards of directors and we gave his board a D, in fact I think they got an F after that, but at this time they were simply a D. And he asked me why and I gave him various reasons, but one of the reasons I gave him was that his company had had three shareholder proposals that had over 60% of the vote and the company had adopted none of them, which they're not legally obligated to do. And he said well, no, the corporate secretary said that the people who supported those resolutions, I hope that you're listening Larry Mitchell, were fringe shareholders. And I said, you know what, if they've got 60% of the stock, you're the fringe. I'm not saying you absolutely have to do everything that they say, but you've got to give them a better answer than we don't think so. Now shareholder proposals not only are non-binding, not only are advisory only, but they're limited to certain specific topics, which is right. You should not be able to file a shareholder proposal because you got fired or because of something the company has no authority over, but on certain limited topics, shareholders can submit proposals which go to all the other shareholders for a vote and we hope that if the vote is a majority that management will take it seriously.

THERESA GABALDON: But they can't at this time submit the name of particular directors that they'd like to have considered?

NELL MINOW: That is true. They can't. And they should be able to do that. Now I have done that informally. I sat down with the head of a nominating committee, and he said to me, you know, it's great that you've got some names for me, but all three of these directors want to stay on. And I said, okay, now's a good time for me to explain what the nominating committee does. It's really not up to them. It's up to you, and I'm going to tell you why all three of those guys have to go. One of them is the former CEO. One of them is the lawyer of the former CEO. He's got to go too. And I said, the third guy, you know and I know he's an alcoholic. You either send him to the Betty Ford Center, or you replace him, but he cannot continue to serve on the board. Well, interestingly enough, all three of them left.

THERESA GABALDON: You mentioned earlier, Sarbanes-Oxley and indicated your willingness to return to the subject. Obviously in these post-Enron days and post-Sarbanes-Oxley days, people are very much more concerned about corporate governance then they were for decades before that. How did Sarbanes-Oxley really affect shareholders and shareholder rights?

NELL MINOW: As I said before, because of the fact that corporate governance is left to the states, Sarbanes-Oxley, perhaps the greatest incursion in to states' rights we've ever had in this area still does just nibble around the edges. There's very little that it does. The SEC is primarily a disclosure agency. They can't really make companies do anything, but they can make them disclose what they do, and so Sarbanes-Oxley added to that. One particular provision that is getting a lot of attention right now is Section 404 and I have to say a little mischievously amused by the brouhaha over Section 404 because companies have been required to have internal controls for quite a long time, more than 20 years. And Section 404 for the first time makes the companies tell us how effective those internal controls are. Now you would think that that would not be a big deal. They were already supposed to have them. One would hope that they were checking them out once in a while to make sure that they worked because they wanted to know whether they worked or not, but apparently not, because all I'm hearing these days is how many millions of dollars everybody is spending to try to figure out if their internal controls work. And my response to that is, education is expensive unless you consider the cost of ignorance. Do you really not want to know if your internal controls work? If they do work, wouldn't you be happy to have the market know that they do work, or that they don't work and you're working on making them work? And yet people are really flipped out over the issue of the 404 disclosure.

I think another part of Sarbanes-Oxley that I like very much is the creation of the Public Company Accounting Oversight Board and I think under Bill McDonough they've done a superb job. I think they've just been great. Rather than having the industry regulate itself, it's great to have an independent entity and I'm very happy with them. I'm also happy about some of the initial penalties and streamlining that the law has made available to the SEC, in particular, the SEC now has the right to prevent people who are bad directors from serving on other boards. And while they have not used yet, they have used the right to negotiate that with certain directors, and I think that's been just terrific.

THERESA GABALDON: You mentioned the Moody's downgrade before. Do you think that the regulatory changes have set the stage for Moody to pay attention to that kind of thing, or is it something that market forces would have naturally brought about?

NELL MINOW: Both. Certainly the increased sensitivity on corporate governance indicators I think is the basis for the decision last year. However, additional disclosures like the 404 disclosures will certainly provide the kind of data that people like Moody's love to look at.

THERESA GABALDON: As you indicated, the federal securities scheme is disclosure-based, and Sarbanes-Oxley basically has to do with tuning up the disclosure system. Nonetheless, I think that in many people's minds the conversation drifts sort of naturally from whatever happened to Enron to the subject of corporate ethics in general. What do you think we're really talking about here? Is there such a thing as an ethical corporation?

NELL MINOW: It's not an oxymoron. I know people often think that, but it isn't. Certainly there is such a thing as an ethical corporation, but it is always a work in progress and you know, like democracy, the price is eternal vigilance. I think my biggest problem with the way most people talk about ethics in the corporate context is that they think of it as something that is an additional item to be checked off. They don't realize how integral it is to everything that goes on within the corporation and they compartmentalize with the obvious out-of-control example being Enron, where not only did the board waive the company's conflict of interest and ethics policy three different times, it's like waiving the laws of gravity, or it should be. They conducted Wall Street analysts on a tour of the facility that included a fake trading floor. They had employees at dead terminals pretending to make trades so they could persuade the analysts on Wall Street that they had this flourishing division that never existed. Think about how many people had to lie in order for that to happen. That's not an ethical corporation. That's not a corporation that teaches its people that ethics are important. I think the problem is that when you talk about ethics, when you use the word ethics, people are always afraid that you're going to start singing hymns at them, and it really isn't about that at all. It really is a systems issue. It's an operational issue. It's an execution issue. All those wonderful words that management MBA students like to use really are very profoundly affected by ethical concerns. I think you'd have to look at ethics the same way you look at corporate governance as a risk issue. And if you do that then people will realize that whether you're taking pens home from the office or waiving the conflict of interest rules, it's all part of the same thing and that having a wonderful ethics policy is not the same thing as following a wonderful ethics policy. One of my all-time favorite corporate governance documents is a fabulous speech from a CEO circa 1999 about the importance of having complete integrity on your board of directors, and that speech was given by Ken Lay in an ethics conference at the University of Houston, and so I keep that very much in mind to restore my sense of humility and to remind myself and others that there's a big difference between talking the talk and walking the walk.

THERESA GABALDON: Certainly a very large part of corporate ethics in my mind has to do with: a) not stealing, and b) not covering it up once you've stolen, and generally making sure that shareholders aren't lied to. Is there any other component in terms of human treatment of workers, eliminating animal testing and things like that? Are those things that shareholders should care about?

NELL MINOW: Well, shareholders certainly care about executive pay. I don't think there's a better indicator of the health of an organization then executive pay. In fact, I think that if a corporation is a person, then executive pay is the temperature, and you take that temperature first and if they've got a fever then you know you've got a problem. So, that is an ethical issue, but it's also the best possible indicator of how the company is handling agency costs and how they are communicating, how effectively they are communicating what there priorities are, and if the CEO candidate you're interested in comes to you and says I'd like to take the job, but I just won't even walk in the door unless I get a $50 million cash signing bonus. That's pretty much when you look for the button on your desk marked eject that opens up the trap door under his chair because he's telling you he's the wrong guy for the job. Now that was Gary Wendt at Conseco who not only turned down a very, very fair offer for the company to take that $50 million signing bonus, but then drove the company into bankruptcy. So, I think that executive pay is an ethical issue and it's also a primary indicator of whether you've got a fundamental problem at the top in terms of communicating.

You've got Carly Fiorina who was fired this week and is leaving with a $20 million pay package. Now what does that say to the CEO community about what is fair for them to expect if they come into a situation like that? If I were on a board of directors, I would not accept a candidate who insisted on that kind of downside protection because if they're not willing to bet on themselves, I shouldn't be willing to bet on them either. In fact, probably the most well-known accomplishment that I have in the field of corporate governance is that in January of 2000 I published a report saying that there was one company that had the worst pay package in America, which included a $10 million signing bonus and 2 million options at $10 a share below market. So the fact that the make and model of Mercedes was also in the contract, and free rights to use the corporate aircraft and that the CEO's mother was going to be flown out to visit him once a month on the company dime first class, those were indicators too, but for me, the primary one was the below market options because I said to myself, here is a CEO who thinks the stock is going to decline in value. That's a bad sign, and here's a board who doesn't seem to care about that. That's a bad sign, too. So I issued a report saying he had the worst pay package in America. I got to go on Dan Rather. I got hate mail from people who said this is the fastest growing stock in the history of the New York Stock Exchange, and if his mother being out there visiting him makes him do a better job, I'm happy to pay a quarter of a cent per share to fly her out, but that was Global Crossing. And I think that it is fair to say that those are indicators of problems.

Certainly I'm also very interested in what we call non-traditional financial reporting, particularly the global reporting initiative, which I think has been very, very worthwhile. I'm always interested in companies that are willing to do that kind of disclosure on other kinds of issues like their environmental impact and their human rights concerns, and I do believe that is a cost of capital issue, that the better disclosure we get from companies, the more they will reduce their cost of capital, which is as it should be.

THERESA GABALDON: What specifically would you call on other shareholders to do in the area of executive compensation? What can an average shareholder do about it?

NELL MINOW: Well, average shareholders normally invest through intermediaries as I said, and I think I would start there. After 14 years of arguing with the SEC, a subject perhaps for another one of these oral histories, we finally got the SEC to adopt a rule requiring money managers and mutual funds to disclose how they vote their proxies. So the first thing that I would tell an individual investor is to look and see who's managing your money, who's managing your pension fund, your 401(k) and look on their web site and see whether they're voting in favor of these pay packages because there really aren't that many ways to differentiate money managers. They all charge about the same, and one value fund is pretty much the same as another value fund, one index fund is pretty much the same as another index fund, but there is still a lot of difference in the way that they handle their shareholder rights, and if your money is being managed by somebody who's voting in favor of these Mike Ovitz-type pay packages and these Gary Wendt-type pay packages, then maybe you should move your money someplace else.

THERESA GABALDON: Vote with your feet.

NELL MINOW: That's right.

THERESA GABALDON: What other really large issues do you think are facing shareholders today?

NELL MINOW: The most important ones have to do with changes in technology. Really, all of 20th century corporate governance was balanced on one simple fact point, and that was the inability of shareholders to find each other and communicate with each other, and that's why it was possible for us to have theoretical rights that were impossible to exercise. So in theory, shareholders could nominate their own directors. In theory, shareholders could throw out the board of directors. In reality, that was not true. How could that happen if you cannot even find and communicate with the other shareholders? But all of that changed very dramatically with the differences in technology, and one good example was that there was a company that was doing very, very badly and a professor at Northwestern bought the stock at a dollar per share, thinking it couldn't get any worse, and you know what happened. It got a lot worse. It went down to 10 cents a share, so he was pretty unhappy about that, and he felt that misery loved company. He went on the Yahoo! message board. Yahoo! of course and Motley Fool have set up message boards to talk about every publicly traded company for shareholders to come and chat. So he went to the Yahoo! message board, and there were a lot of unhappy people there – employees and other shareholders – and he asked them, he said well, we're all complaining here about what a bad CEO this is and what a terrible company this is, could I just ask, how much stock do you all have? And it turned out that 40% of the stock was on the Yahoo! message board. So he called me and he said, you don't know me, but I'm a professor at Northwestern and I've got 40% of the stock behind me in a company that we don't like and what should we do about. And I said okay, hang up the phone and call a lawyer and have him explain to you what a 13(d) filing is right now because you're not allowed to have these conversations with the other shareholders without making this filing, but once you've done that, call me back and then we will discuss it further. At that point, the company went into bankruptcy and here's the shocking part. The Yahoo! message board became the equity committee in the bankruptcy. Nothing like that has ever really happened before and in fact, about a year later, the Yahoo! message board threw the CEO out of a small, publicly traded company called Lonestar. So I think that's the most important thing for individual shareholders to be aware of, that there are these opportunities to provide some checks and balances that were not available before, that don't come from regulatory changes, they come from technological changes. So, if you are invested in a company, in a specific company instead of just in a mutual fund, by all means, go and see what people are saying about it on Yahoo! or the Motley Fool and join in the discussion.

THERESA GABALDON: Speaking of joining in the discussion, I do have a couple of additional questions here from museum visitors. First of all, this one is from James Allen. Is anyone doing any empirical research on trends in shareholder participation in corporate governance? For example, is anyone generally tracking shareholder satisfaction with corporate management?

NELL MINOW: I think the best way to track shareholder satisfaction with corporate management is to look at the stock price and the results of the proxy votes. I don't think you need to poll them. I think that you get a much better sense by the way they show their commitment to the company, so certainly those things are tracked very, very carefully and the rise in level of support for shareholder votes has truly been shocking. I mentioned earlier that the big turning point was when institutional investors started filing shareholder proposals dealing with corporate governance back in 1987, and when we got 21, 22, 23, 24% of the vote, we really thought we had just died and gone to heaven. We could not imagine that there would be anything more wonderful than that, and now shareholder proposals routinely get 40, 50, 60, even 70% of the vote and I think that's a very powerful signal of the way the shareholders feel about the company. Last year at Disney, Michael Eisner, the chairman and CEO received only 43% of the vote from shareholders, a very powerful vote of no confidence, and certainly a factor in the very dramatic changes that company has made since. They deserve my most improved player award very much as a result of that wake up call that they got last year.

THERESA GABALDON: Another question from James Allen. In the US, is there much direct interaction between corporate ethics officers and shareholders, or do the ethics officers deal directly with corporate management?

NELL MINOW: The ethics officers tend to deal directly with corporate management. Their role is changing very dramatically as a result of both cultural and legal changes following Enron, Global Crossing, Adelphia, etc. So I think that may change over time, but right now they are considered to be very internal and that is an essential part of their job.

THERESA GABALDON: And finally, another interesting question from James Allen. What are other countries, especially those in the EU, doing about increasing shareholder rights? Can you give us a comparative overview?

NELL MINOW: I certainly can, and we have extensive information on that in my book, the latest edition of my MBA textbook, memorably enough called *Corporate Governance*, has a significant amount of information about a wide variety of countries and also on our web site, The Corporate Library, we have corporate governance information about just about every developed country in the world. There's a lot that's going on. Kenya has a great corporate governance code, for example. The World Bank has done thrilling work in developing countries on corporate governance. In fact, it's so good that I've asked to get the US classified as a developing country so that we can get on their list. So far, they won't go for it yet, but they have fabulous training materials for regulators and directors on how to do their job. I've been visited by delegations from China, so a lot of work is being done in the developing world. With regard to the established economies, I think my favorite is probably the UK. I dream of having the kind of rights that shareholders have in the UK. Now having said that, in part there are cultural and legal underpinnings that make those rights possible, and I'm never in favor of just trying to transplant any one right or any one law from one country to another. However, I do think that it's wonderful that in the UK, 10% of the shareholders can call a special meeting and anything over 50% of the shareholders can throw the board out without running a separate slate. I think that's very, very important. I'd also like to mention in the UK that as recently as 20 years ago, most board members in the UK were insiders, and the institutional investors really decided to do something about that. They were not happy about that. They wanted more independent oversight of the corporations. It's a smaller community, in every sense of the word. There are fewer publicly traded corporations. Everybody sort of knows everybody else. It's not that big a country, and so you saw these same people over and over again, and what could the institutional investors do to try to make boards more independent. Well, they all got together and they started a search firm that was called PRO:NED, that stood for the promotion of NED, non-executive directors. That's what they call outside directors, or independent directors in the UK, and through the efforts of PRO:NED and the cultural consciousness raising that came about as a result, there was a huge transformation on the board of directors on British companies, and now almost all of them have separated the chairman and CEO, and almost all of them have independent majorities, and again, that was simply brought about through market forces.

THERESA GABALDON: You mentioned separation of the CEO and the chair a couple of times now, and I'm interested in inquiring into that a bit further. What's your impression now on the frequency in which a single person occupies both positions in American corporations?

NELL MINOW: It's almost universal that the same person occupies both positions and we have a spread sheet on our web site that people can download that shows of the top 2000 companies which account for more than 85% percent of the market cap in the US, which companies do split the two jobs and significantly we also say in the spreadsheet at which it means something and which it does not because it's very easy to make that one of the structural solutions that gets subverted. You can split the CEO and chairman jobs. Let's talk about one of my favorite companies because I'm a very enthusiastic consumer: Dell Computer. The CEO of Dell Computer, Michael Dell, also the founder of the company, announced last year that he was resigning as CEO and he was staying on as chairman. I can't really classify that as a split CEO/Chairman situation because I think that's as we used to say in law school a distinction without a difference. I think that's moving nameplates around. If you want to have a genuinely independent chairman, you need a genuinely outside person, not somebody who used to be the CEO yesterday, and is still in the same office and is still coming to work every day. So there are a lot of split Chairman/CEO situations like that one that are really not very meaningful in the US, then there are some that have been thrust upon the company as at Disney where Michael Eisner did relinquish the chairman job and George Mitchell is now the non-executive chairman. But I think everyone at Disney assumes that that's a temporary situation. They are doing a search for Michael Eisner's replacement. I would guess that he would come on as both CEO and chairman. That's very much a part of the American culture. I really like the conference board's approach to this issue. They came out with a report just over a year ago which said here's the problem. You don't want the CEO controlling the agenda and the access to information of the board. You can address that a number of ways. You can split the chairman and CEO position in a meaningful way, not in a purely nominative way, or you can create either a lead director or a presiding director or you can call him, you know, whatever you want, but you just have to have a person who makes sure that the agenda and the information are independently verified and not under the control of the CEO because if the CEO controls the agenda then the really important issues never come up.

THERESA GABALDON: Do you think that splitting the CEO and chair positions correlates with improved shareholder value as a theoretical matter, or is it something that you have actually documented as well?

NELL MINOW: As I said, the key is whether it is meaningful or not, and so it's kind of a self-answering question. This is a good moment for me to talk a little about what we do at The Corporate Library because we rate boards of directors, and unlike some people who are in the business of rating boards of directors, we don't rate them on structural indicators, on who's independent, who's on what committee and who went to summer camp together. We rate them on the decisions they make. I think that's the only way that you can make them. So if you make the right decisions on areas like CEO pay, financial reporting, overall strategy, then it's a good board. If they don't, it's a bad board, no matter how they look on paper.

THERESA GABALDON: We were speaking earlier about a comparison of the way we do it in America and the way they do it, say, in Europe, and in the corporate community, quite often when one is talking about how they do it in Europe, the subject of worker empowerment comes up. How do you think worker interests and shareholder interests can and should be balanced?

NELL MINOW: I think they should be the same thing. There's no reason on Earth that the workers shouldn't be the largest shareholders, and the real tragedy is that in the cases where that does occur as in Sears, where 22% of the stock was held on behalf of the employees, it was being voted by management. It wasn't being voted or managed on behalf of the employees, and a really tragic case that I was involved with had to do with a company called Stone and Webster, where 37% of the stock was held in an employee benefit plan and we went to that employee benefit plan fiduciary and we said, hey, the value of the stock has decreased by about 80%. At what point are you obligated as a fiduciary to try to do a proxy contest or try to throw out this bozo management or do something to prevent this company from going bankrupt? And basically their answer was: huh? So, I think that it would be great to see workers participate as shareholders and in the cases of the union pension funds, I think there have been tremendously constructive involvement there.

THERESA GABALDON: How would you feel about a proposal to the effect that management should owe a duty, not just to the shareholders, but also to the employees and to other corporate constituents?

NELL MINOW: I think that those laws that have been adopted in about 22 states are entirely to the benefit of entrenched management. I think that if you're accountable to everyone, you're accountable to no one, and their completely meaningless to the extent they have any meaning. They work to the benefit of the wrong people. Of course management owes a duty to the employees, and the best way to make sure they live up to that obligation is to address the interests of long-term shareholders because, believe me, long-term shareholders want the employees to be well taken care of. They're not going to be happy unless the employees are happy. In our book, we have a very revolutionary proposal. We say that after a certain number of years, after a certain amount of return to the outside shareholders, companies should begin to be bought out by their employees who have the long-term interests of the company in mind better than anyone else. I would love to see a system where that happens, and we talk a little bit about the Mondragon model in Spain and how effective that has been, but the overall point is of course management has a duty to its employees. What's the best way to enforce that duty? It's shareholder primacy. I really believe that.

THERESA GABALDON: Do you see anything else looming on the horizon as a coming issue? You've identified, for instance executive compensation as something that we all know is a problem now. What's next?

NELL MINOW: I think there will continue to be much more focus on the boards of directors and I have always said we pay them too much for what they do and too little for what we want them to do, so I think they will play a more important role. It's important to make clear, however, that they will always be the forest people, not the trees people. There was a case some years ago where a publicly-held restaurant got into such a terrible mess that its board of directors was screaming at each other in the boardroom about the flavor of pudding that they were serving, and obviously that is the last thing that we want them to do, but what we don't want them to do is to be rubber stamps anymore. And I want to mention in particular Tyco. The CEO of Tyco, who was generally considered to be the strongest CEO imaginable, Dennis Kozlowski, worked for four years without a CEO employment contract. And then he came to his board, now I would like to have a contract and nobody said why. Nobody said, what has changed. Everybody said sure, anything you want. And he gave them a contract which they signed which said that conviction of a felony was not grounds for termination unless it was directly and materially relevant to the company itself. So, no director said, I'm sorry, Dennis, were you planning to knock over a bank or have you killed somebody? What's the deal, here? And they all signed it, they all signed it. And that seems to me should have been a red flag, so I think you're going to see a lot more focus on directors. As I said, we rate boards of directors A through F. We're working towards a system where we will be rating individual directors A through F. Right now we just flag the problem directors, the people who take bad governance or bad outcomes from one company to another, and although we designed our system for investors, I was surprised, but also gratified that our primary customers have not been investors. They've been D&O liability insurers, again a very powerful market response to this issue. So it wasn't that long ago that O.J. Simpson was on an audit committee and he got D&O insurance. I don't think that that will happen again. So I think you're going to see more emphasis both from what I call the demand side, the shareholder community and also from the market side, the D&O, director and officer liability insurance.

THERESA GABALDON: O.J. Simpson gives me the perfect entrée for a question I was dying to ask you. It has to do with what kinds of disclosure do you think should be made with respect with what we might think of personal morality issues?

NELL MINOW: I would love it if you're asking me what my dream is. I would love it if director candidates had to respond to a list of questions. Since they do run unopposed, I would love to hear them respond to questions like what do you think are the most important principles with regard to CEO pay? What is your opinion about what is the best way to disclose the following kinds of financial operations? Under what circumstances would you be willing to approve a strategic acquisition? I would love to see them comment on those issues. That's the kind of disclosure that I think is much more meaningful than the fact that they're on the Ford Foundation. We do have on our web site, you have to pay to get to this, but we do have the kind of Kevin Bacon game of directors. Ninety thousand directors in our database and all their first, second and third-degree connections, including their for-profit, non-profit, trade association, Augusta Golf Club, alumni association, and other connections to each other. I think those kinds of disclosures are lots of fun, but I'd like to have more meaningful disclosures about director capabilities and priorities.

THERESA GABALDON: Do you think that those director interlinks are good things or bad things?

NELL MINOW: We run data on it all the time, and basically what we've found too much is a bad thing, too little is a bad thing. So the people who are over-connected don't seem to do very well. The people who are under-connected seem to do equally poorly. So if you're picking people off the street, apparently that's not a good thing. You want to have people who do have some relationships to the corporate community.

THERESA GABALDON: I think we have time for probably just one more question.

NELL MINOW: Okay.

THERESA GABALDON: And that would be what other indicators would you really be looking for in designing your perfect candidate given the information that you've got now?

NELL MINOW: Oh, that's a great question and with director stock ownership the one corporate governance element that does strongly correlate to increased performance, decreased risk is director stock ownership, so you want directors who care as much about the company as you do. We have a wonderful quote in our book from a guy who said that every director of a particular company had more than a million dollars in stock. You never saw the pocket calculators come out some fast. That's the kind of energy and attention that you really want to make sure that your capital is being well cared for.

THERESA GABALDON: That makes a lot of sense. And it looks as though our time is just about up. I'd like to thank you for a very informative discussion of shareholder rights. Just a reminder: today's chat is now archived in the Society's virtual museum and archive, so you can listen again to the discussion or read the transcript later on. Our next Fireside Chat will look more at Executive Compensation. Our panelist then will be professor Lawrence Mitchell of the George Washington University Law School and Kerry D. Moynihan, managing partner of executive search firm Christian and Timbers. Please join us on Tuesday April 19th at 3PM Eastern Daylight Time. Thank you all for joining us today and a very big thank you again to you, Nell.

NELL MINOW: Thank you. I enjoyed it very much.