December 12, 1991

To Our Clients

Corporate Governance Update

• Robert Monks is reported to be sponsoring a proxy resolution in the form of a bylaw amendment to establish a "Committee of Shareholder Representatives" at Exxon and perhaps also at Sears Roebuck. The "Committee" would have three members elected by the shareholders, have a budget of one cent per share, could hire outside experts, and would be allowed 2,500 words in the annual proxy statement. Since the proposal is in the form of a bylaw amendment it would be mandatory if approved by the shareholders. The proposal is subject to attack as not being in accordance with state corporation law and on other grounds. It has not yet been passed upon by the SEC or a court.

• Mr. Monks, together with the Batterymarch investment management firm, is also promoting the Lens Fund. The Lens Fund is seeking $1 billion from institutional investors. It proposes to make two $500 million investments in "undermanaged" companies, elect directors who will improve management performance or change the business strategy, and sell the investment when the market reflects the improvement.

• CalPERS has withdrawn from the proxy resolution business for 1992 and instead is writing to selected companies urging in some cases that they adopt the Avon-type shareholder advisory committee or in other cases the IT&T-type endorsement of the corporate governance principles espoused by the self-constituted "Working Group on Corporate Governance" that included the general counsel of CalPERS and the executive director of the Council of Institutional Directors.

• United Shareholders Association, the organization formed by Boone Pickens, has targeted 50 companies for 1992 corporate governance resolutions.

• Nell Minow, until recently the president of Institutional Shareholder Services and the co-author with Bob Monks of a book on corporate governance, is forming a firm to provide director candidates who are satisfactory to institutional investors.

• Michael Jacobs, a former Treasury Department official in charge of its corporate governance task force, has written a book critical of corporate management and performance and urging corporate governance changes.

• The NYSE has conducted a series of symposia on corporate governance and so too have dozens of other organizations.

• Graef Crystal has written a book claiming that corporate executives are excessively compensated and has become the media's favorite gadfly on this politically explosive issue. Congress has already reacted with the introduction of bills designed to limit executive compensation or facilitate shareholder resolutions aimed at that result. The SEC apparently will permit shareholder proxy statement resolutions that would enact bylaw amendments limiting executive compensation.

• The SEC proposals to change the proxy rules to facilitate shareholder proxy resolutions have been withdrawn. SEC staff members suggest that they will reappear in modified form in 1992.

It is clear that institutional shareholder activism is on the rise. The SEC has responded and Congress may respond. The average vote on shareholder proxy resolutions in 1992 may for the first time exceed 50%. This will have an impact in derivative litigation attacking compensation, failed business strategies and substandard management performance. We are in the initial stages of major changes that will rival the 1980s takeover frenzy in their impact on corporations. It is essential that corporations improve their relations with institutional shareholders and adopt policies and procedures that will protect management and the board of directors against liability through judicial erosion of the business judgment rule. Among the steps that should be taken are:

1. Direct contact by CEO with the larger institutional holders on a regular basis.

2. Direct contact by the board of directors with the larger institutional holders on a regular basis.

3. Prompt substantive response to institutional shareholder communications with respect to business strategy, executive compensation and any other matters of concern to the institutions.

4. More comprehensive presentations to boards with respect to business strategy.

5. Documented justification for retaining management when the corporation does not perform up to peer standards.

6. Compensation keyed to long-term performance and not significantly out of line with industry norms; compensation plans that provide big rewards to management despite declines in shareholder values will increasingly draw shareholder ire and derivative lawsuits.

7. Attitude of partnership, rather than confrontation, between the corporation and its institutional shareholders.

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