Roundtable Discussion Summary
Corporate Governance 2011—Where we’ve been and where we’re going

Hosted by:
Institutional Investor Educational Foundation (IIEF)
John L. Weinberg Center for Corporate Governance at the University of Delaware

Moderator:
Charles Elson, Director of the John L. Weinberg Center for Corporate Governance at the University of Delaware and a nationally known corporate governance expert

Executive Summary

(Read the Full Discussion Summary on Page 3)

The December 9th Roundtable was attended by three dozen people selected for their diversity of perspectives and direct involvement in shareholder governance issues: corporate attorneys, shareholder attorneys, private and public pension fund managers, law professors, pension consultants, governance experts and a proxy advisor. Several members of the financial media attended but did not participate in the discussion.

After short opening remarks by Bill DiBlasio, Public Advocate for New York City, Charles Elson moderated a two-hour roundtable discussion of five corporate governance topics:

- Proxy Access - What Happens Now?
- SEC Whistleblower Rule - Will It Gut Compliance?
- Has The News Corp Debacle Proven That It’s Time To Do Away With Dual Class Stock?
- Say-on-Pay – Effective Reform or Boondoggle for Consultants?
- Proxy Advisors – Too Much Power?

Several participants felt that the proxy access rule called for in Dodd-Frank has been disappointing and deeply polarizing, while others believe that it still has some value as a shareholder engagement tool. The recent D.C. Circuit Court decision has weakened it and ownership threshold requirements pose a significant barrier to proxy access for most investors.

Moderator Elson’s arguments in favor of proxy reimbursement were countered by the argument that the out-of-pocket costs of proxy access actually represent a trivial barrier to shareholder engagement.

(Continued)
The morning’s most lively discussion focused on the issue of **dual class stock**. While Moderator Elson argued vehemently for doing away with dual class stock, others did not believe that the often-cited “bad apples,” including News Corp, Massey Coal and Hollinger, are proof that the entire system of dual class stock is wrong. Most of the participants did not want to see such a restriction in the capital markets, despite the challenges of oversight and enforcement in a controlled company.

The discussion of the **SEC’s Whistleblower Rule** was less heated. It has not resulted in a flood of new cases, and those that have been brought to the SEC have been well documented. A few participants would like the rule to require initial reporting of securities fraud to be handled internally. Others believe that it is not realistic to expect most whistleblowers to risk their careers by going to their internal compliance department before going to the SEC, because securities fraud by definition involves top management.

Although **Say-on-Pay** has not been a magic bullet, several participants expressed that it has been valuable in promoting shareholder dialogue with corporate boards and management. Public shaming through a “no” vote has encouraged boards to be more responsive and to look more closely at compensation incentives. Several pointed out that the rising income gap has become a major societal issue, especially with regard to those in the top 0.1%. Everyone agreed that executive compensation should be looked at in a nuanced way – considering the mix of pay and incentives as well as the absolute dollar amount. A key question remains to be answered: How does “excessive” pay affect the company’s performance?

Most participants agreed that the **proxy advisory firms** have had a big impact on shareholder voting – affecting an estimated 20% of all proxy votes. A corporate governance director for a major pension fund, as well as a proxy advisor, argued that it’s still the responsibility of fund managers to establish their own voting policies and do their own due diligence. Proxy advisory firms’ recommendations should be used as just one source of information and advice, and institutional investors in turn should share their own research and perspectives with the proxy advisors. The issue of conflicts of interest related to some proxy firms’ consulting activities was touched upon briefly, but not pursued because of time constraints.

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*We encourage you to read the full, detailed summary of this substantive roundtable discussion—beginning on Page 3.*
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Introductory Address: Bill Di Blasio

The session began with opening remarks by Bill Di Blasio, New York City’s Public Advocate. He discussed the impact of Citizens United and stressed the importance of shareholder engagement. The following are a few highlights from his address:

Since Citizens United, there has been a lack of debate about the ramifications of that ruling – and issues such as Say-on-Pay and Proxy Access – that define the pivot point where government and corporations come together. Like many, I underestimated the overall impact of the Citizens United decision, and how few avenues it would leave for moderation. The lack of any subsequent federal moderation makes it clear to me that the discussion needs to move to the state and local level – and to shareholders and leaders of corporations.

When you add to Citizens United other recent Supreme Court Decisions, it’s clear to me that the Supreme Court will consistently side against greater transparency and checks and balances in corporate America. As we see in companies like News Corp, Massey Coal and Google, there has been a pattern of laxness in corporate behavior that is only encouraged by the Supreme Court’s decisions.

I believe the tools to respond to it are much greater, more numerous and more powerful than the current debate gives credit for. We have tried to use our role as pension investors to encourage corporations to think again about participating in elections and choose a path of greater restraint – and to provide disclosure if they do spend on elections.

We’ve gotten a mixed response: positive responses from some of the big financial firms like Goldman Sachs, and a very negative response from Google, which prides itself on talking about the new world of information and transparency. When we asked Google to be transparent about their political spending, they said they needed to keep their options open because they have so many enemies. They didn’t want to unilaterally disarm and give away the right afforded them under Citizens United to spend in any way. Clearly, some corporations understand that it’s better for their bottom line and reputation to offer full disclosure, while others are circling the wagons and ignoring the public desire for transparency.

With News Corp, where you’d think shareholder reach would be limited, we can see that shareholders did make a difference in the decisions the company had to make. At Massey Coal, shareholders made a difference in the response the company made and is partly why it ended up in other hands.
“The polling data shows that 80% of the public opposes the Supreme Court’s Citizens United decision – and that opposition is bi-partisan. How we respond will be definitional.” - Bill DiBlasio, NYC Public Advocate

**Bill DiBlasio Opening Remarks—Continued**

Every time there’s an effort to put the genie back in the bottle and repress shareholders, they break through on a number of levels. That’s why I remain fundamentally optimistic as long as we keep using whatever tools we have.

I recommend reading three studies – from the IMF, Harvard Law School and University of Minnesota – that look at the impact of lobbying and political spending on company behavior. The studies show that companies that are heavy on lobbying and political spending lean consistently away from their core mission. We can’t ignore that while believing that we’re providing true oversight.

I’ve been involved in creating a national Coalition for Accountability in Political Spending, made up of pension and government officials around the country who have something to do with procurement or regulation. We came up with a “Holiday Shopping Guide” - available at [www.politicalspending.org](http://www.politicalspending.org) - to show consumers which companies were doing a good job with disclosure and self-restraint and which were not. I remain optimistic because the public cares deeply about these issues. The polling data shows that 80% of the public opposes this Supreme Court decision – and that opposition is bi-partisan. How we respond will be definitional.

**Roundtable Discussion**

**Moderator Elson** explained that Chatham House Rules would be followed for the roundtable discussion. Therefore, only the moderator is identified by name in the following summary.

**Moderator Elson:** One size doesn’t fit all and proxy access misses the main issue, which is the cost of access. Proxy access covers the cost of printing and mailing, but the cost of a campaign goes way beyond that. I think the more appropriate approach is proxy reimbursement, which is a state-initiated, shareholder-initiated system. The idea is that if you mount a campaign and win, you get your expenses covered. If you lose by a little bit, you get some reimbursement. If you lose by a lot, you get nothing. The idea is to let the shareholders determine the worthiness of the campaign.

**Activist Union Investor:** We can’t go back and restart this. We have to pursue the right that was laid out in Dodd-Frank. Where we’ve had the most success is coalescing around companies like News Corp, Massey and Bank of America – forcing reform on a company level. While the U.S. Chamber of Commerce and other forces are working forcefully against this on a systemic level, let’s pick one or two companies where we can build shareholder majorities and go at ‘em.

“**Our funds have long promoted universal access to the proxy.”**

**Taft-Hartley Investor:** However, given the DC Court’s ruling, we don’t expect universal access any time soon. Our funds have sponsored one proxy access proposal for this year: Hewlett Packard, where there have been numerous issues and a lot of frustrations for investors. Prior to waiting for the SEC or a more market-wide standard, there will be case by case deliberation by investors and boards about how to propose alternatives to the board. The downside of going company by company is that, in some companies, there is significant insider control that will affect debate.

**Moderator Elson:** Can you do that with a dual class company?

**Taft-Hartley Investor:** It would be a significant challenge. A market-wide standard would allow investors a more meaningful prospect of proposing an alternative mechanism without the opposition of insider control.
"I don’t understand why anybody thinks proxy access will help shareholders meaningfully. Why not spend the energy negotiating around some new directors?" - Activist Fund Manager

"I don’t think the SEC has the legal authority to proscribe proxy access."

Shareholder Activist: I don’t think the SEC should have gotten involved with this. I think the folks in this room who want proxy access would be better off spending their time bringing a Breach of Fiduciary Duty action when the board refuses to include all legitimate nominees in the proxy.

Moderator Elson: Who here thinks proxy access and proxy reimbursement are bad ideas?

Corporate Litigator: You have to be more specific about what proxy access you’re talking about. There are a number of proxy access resolutions that have been proposed this year, but it’s not clear what form they’re taking.

Taft-Hartley Investor: The form of our HP proxy access proposal follows the SEC and closely follows the Council on Institutional Investors’ 3 & 3 model: 3% ownership for 3 years. Our proposal is advisory only, in part because the 500 word limit will make it difficult to make it a binding one.

We’ve taken a high road approach and are open to discussion. We want the board to take responsibility if there’s significant investor support, to mold the wording that’s appropriate for them. The 3% ownership threshold is definitely a significant challenge.

Issuers Counsel: Do you think if someone proposes a candidate, and that candidate gets elected, that they should be required to continue ownership?

"We think that certain restrictions within proxy access would be sensible."

Taft-Hartley Investor: As pension fund investors, we’ve always taken a long term view. We think that certain restrictions within proxy access would be sensible; having a long term position in the company could be part of that.

Activist Fund Manager: I don’t understand why anybody thinks proxy access will help shareholders meaningfully. Regarding HP, they have had a series of board problems and maybe there needs to be new directors there. But your proposal will require a precatory proposal this year that may or may not get enough support. If it does, and the board decides to adopt a binding bylaw, that won’t be in place for a year and half from now. Then, if you own 3% of the stock—which is a $1.5 billion in the case of HP—you’ll have the chance to save the cost of stamps and ink. If you own $1.5 billion of HP stocks, and you care about HP’s problems, saving the cost of stamps and ink shouldn’t be reason enough to wait a year and half to get new blood on the HP Board. Why not spend the energy negotiating with HP around some new directors?

Moderator Elson: Access to reimbursement makes the threat of a fight more credible, which means you settle.

"The number one thing boards look to is whether or not the activist feels strongly enough to go on the road and talk to other investors."

Activist Fund Manager: As an activist who does this every day, the number one thing boards look to is whether or not the activist is willing to go the distance and feels strongly enough to go on the road and talk to other investors. When you say, "I’m not even willing to spend money on stamps and ink," I think you actually lose credibility with boards. Also, as we recruit directors to serve on proxies as dissident directors, which we do every day, the nominees ask, "Are you going to advocate for me? Will you defend my reputation? What if the company says something negative about me?" If a nominee gets the message that you don’t have the money to defend him, you’ll lose.

Corporate Governance Expert: I was profoundly disheartened by the Supreme Court decision. I think the U.S. Chamber has overhyped the dangers of access, and I suspect others have exaggerated the effect that access will have.
"I think the market has shown that people would rather have dual class companies public than private. As long as people think it's good to have them public, it's a mistake to legislate them away." - Corporate Attorney

Corporate Governance Expert: The discussion of access has been so polarizing that it has taken up all the oxygen from other things. There are other extremely important developments that we should be spending more time on, the 3D project for example that CalSTERS has put forth. I also think there's a second order implication to the SEC's failure to respond to the Supreme Court's decision. Despite the Dodd-Frank provision that there be an investor advisory committee and an investor advocate, the SEC has failed to act on either of those so far, and it's been too long.

Has the News Corp Debacle Proven that it’s Time to Do Away with Dual Class Stock?

Moderator Elson: Let's move on to what I think is the biggest governance story of the year - News Corp. Does it signify that it's now time to do away with dual class stock?

Public Pension Fund Corporate Governance Director: Is it just dual class stock itself or unequal voting rights for the classes?

Moderator Elson: Unequal voting rights; voting rights out of proportion to economic interest. Is it time to say, as a public policy, that this type of capital formation shouldn't exist?

Issuers Counsel: I think the market has shown that people would rather have these companies public than private. As long as people think it's important to have dual class companies public, it's a mistake to legislate them away.

Corporate Attorney: I read in the newspapers that you can now buy stock in the Green Bay Packers. You get no voting rights, you get nothing. At the end of the day, it's a financing technique. You as an investor may or may not benefit – but that's your choice.

Charitable Institutional Investor: The problem is that you pick up non-voting News Corps stock in the indexes. I think there should be rules excluding them. Also, the markets should be determining whether these stocks should be listed on the exchanges.

Corporate Governance Expert: We had a huge public debate in the ‘80s about whether these shares should be listed.

Moderator Elson: In the ‘80s, we did in the end allow it. The fear was that if you allow a dual class structure, it removes accountability and potentially bad things could happen. The two cases we’ve seen have been fascinating. With Hollinger, it was proven that there was malfeasance; with Murdock, the argument is that there was negligence in the oversight of the operation. We didn’t see these accountability issues in the ‘80s.

Law Professor: Two examples don’t prove anything. There are lots of firms where dual class ownership has worked well: The New York Times, The Wall Street Journal in the days before News Corp ownership, Ford, Comcast. Should ownership diversity be flattened out? In the ‘80s, there were huge mid-stream changes. Shareholders of single class firms suddenly became owners in dual class firms - with dramatic changes in their governance rights. That’s not the case in a firm that has an initial dual class public offering. The idea that we know what is the right ownership and governance form for all companies is a statement we should think twice about. There are many things that are governance experiments and we shouldn’t lock them out.

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Moderator Elson: The argument for dual class stock is that it centralizes control in one person. In the case of a media company, it protects editorial integrity. The flip side is that there is no accountability. The malignant side of centralized control is that it also means they can do bad things with the assets.

"Why not focus on the board here? News Corp’s directors were the ones that failed."

Law Professor: The role of a director in a dual class company is to be willing to throw their body in front of the train. Before we decide to abandon an ownership form that has served some use, the role of directors should be looked at in a closer way. I've heard little discussion of the role of the directors in the News Corp case.
“There’s evidence that dual-class companies underperform in the short run but may outperform in the long-term, because they don’t crash and burn as often.”

- Governance Consultant

Corporate Counsel: I agree that you can’t draw any conclusion from two dual class companies that have had problems. By that rationale, we should ban all stock because there have been far more frauds involving single class stock companies. You also can’t say there is no accountability; it just changes the accountability. We need an investment structure that promotes longer term horizons for investing capital, not shorter term horizons. Dual class structure does that. Comcast and Google are splendid examples of how this structure works in promoting long term shareholder value by not having the managers of the business subject to yearly turnover and yearly pressures for short term performance.

Public Pension Fund Corporate Governance Director: Our discussions with News Corp have focused on the Board. That’s really our issue with News Corp – especially the independent directors. I depend on them more because of the dual class stock system. We have no choice about investing in them when they’re in the indexes, which a fund our size is. Do you go after the indexes? That’s another whole issue.

Moderator Elson: Can you be an effective director in a company where you can be replaced by the person you’re supposed to oversee?

“I think you need voting rights because litigation can be unwieldy.”

Labor Investment Fund Executive: We are plaintiffs in a derivative suit against News Corp and are focusing on the directors. When you have conduct like this, I think you need voting rights because litigation can be unwieldy.

Shareholder Activist: What does the dual-class structure of the stock do to its value? Does it undervalue it or raise it because it increases long-term value? If it lowers it, why would the company issue it in the first place? Why wouldn’t they issue stock that gets the most value?

Moderator Elson: The idea is that the control outweighs the value.

Shareholder Activist: So as an investor you get a better deal and should have no complaints.

Governance Consultant: Our institute just agreed to do a study of controlled corporations, which seem to be proliferating, not just in the media but also in Silicon Valley. There’s evidence that they underperform in the short run but may outperform in the long-term. On an aggregate basis, they underperform.

“We have an increasing number of controlled corporations in the U.S.”

I don’t think anyone in this room could answer what percentage of market capitalization is represented by controlled companies. That’s a more interesting question from a capital markets point of view than the important but carefully delineated question of the directors’ responsibilities in dual class companies. If we’re undergoing a major capital market shift, that raises a bunch of questions.

Moderator Elson: The argument about dual class stock has always been that it only harms those that invest in it. There’s a counter argument that there is a cost to the public, because in a dual class company you reduce the monitoring role of the board. The monitoring function is exported from an internal mechanism to a public mechanism such as the Department of Justice. Because there is a public cost, there should be a public reason for limiting the use of dual class stock.

Governance Consultant: That argument would suggest that half the stock markets in the world don’t work, because most have controlled corporations. Clearly the idea of the legal responsibility of independent directors is that they’re supposed to represent all shareholders. Even in dual class stock companies, there are nomination rights for classes, even those with minority voting rights.
“The SEC rules provide some incentive for whistleblowers to bring their concerns to internal compliance first, but I would like to have seen even more incentive for doing so.” - Labor Investment Fund Executive

Attorney: It’s interesting to look at Hollinger. It was the independent directors who put an end to their bad behavior. When push came to shove, they acted in the interests of all shareholders.

Charles Elson: One could also say that with an independent board, he wouldn’t have acted the way he did.

Attorney: The majority of the board members were independents.

Prominent Shareholder Attorney: I’m all in favor of dual class stock because they provide us with some of our very best cases. (laughter) If we’re going to have dual class stock companies, are there changes that need to be made in the legal regime to deal with the problems those companies present? There is a concern that we don’t want to limit people’s ability to invest in companies, or limit companies’ access to capital markets. But it doesn’t necessarily follow that the same rules should apply to both dual class and single class ownership companies. The Conrad Black example is a good one, because it took an absolute crisis, and that crisis becoming public, before the independent directors took action. The guy had been extracting improper payments from the company for years. Was that challengeable under our existing system? I think it probably was and it wasn’t a failure of the legal rules.

Corporate Law Professor: With controlled companies, the devil is in the details, and we depend on vigorous legal enforcement. People within in the system are clearly conflicted about the degree of intervention we want from the courts and the degree of scrutiny we want over independent directors. Investors are counting on the legal system to protect them, but the system is struggling with the complexity of ways that controlling shareholders can siphon off value.

Moderator Elson: I still believe the negatives far outweigh the positives of dual class stock. I believe it more often than not leads to malfeasance, misfeasance or just plain lousy management.

The SEC Whistleblower Rule: Will it Gut Compliance?

Moderator Elson: The Whistleblower Rule, part of Dodd-Frank, allows a litigant or advocate to share in some of the penalties extracted for a restatement or nefarious activity. Will paying bounties to whistleblowers enhance compliance or gut the compliance structures we have in place? The National Association of Corporate Directors has argued that it will kill compliance, while the National Whistleblowers Foundation believes that paying whistleblowers will enhance compliance.

Labor Investment Fund Executive: I offer the perspective of an in-house counsel, and sometimes plaintiff in lawsuits. The rules provide some incentive for whistleblowers to bring their concerns to compliance first, before going outside, but I would like to have seen even more incentive for doing so.

Shareholder Engagement Consultant: Has there always been some financial incentive for whistleblowers to come forward?

Moderator Elson: No. It was included in Dodd-Frank, I think through the efforts of the Whistleblower Foundation. Unfortunately, the way the SEC has drawn up the rule, you don’t have to go in-house first; you go right to the SEC. Corporate folks question what the point is of having compliance. What if your lawyer finds something and decides it’s better to be paid by the transaction than by the hour?

“Recent news reports have indicated that the level of internal fraud reporting has gone up rather than down.”

Public Advocate: Recent news reports have indicated that 1) the SEC is not being swamped with tips and 2) the level of internal reporting – and internal fraud reporting - has gone up rather than down. The tips the SEC is getting are coming with much more detailed information.
“Whistleblower actions have been permissible on behalf of state and federal governments for 150 years under the Qui Tam laws. This new law is an expansion of those principles to actions brought by the SEC.” - Shareholder Attorney

Prominent Shareholder Attorney: The question of whether a securities fraud should be reported internally before going to the SEC is really a practical one. Securities fraud, almost by definition, requires the participation of the most senior people in the company before it can be reported as a violation. If you require internal reporting first, you’re asking the whistleblower to report that possibly the CEO, CFO or a board member is responsible for committing fraudulent acts. It’s not realistic to expect widespread reporting if you have a requirement like that.

Whistleblower actions have been permissible on behalf of state and federal governments for 150 years under the Qui Tam laws. This new law is an expansion of those principles to actions brought by the SEC. The difference is that if the government declines intervention in a Qui Tam suit, the whistleblower can choose to pursue the case anyway. Under the new law, if the SEC declines intervention, the whistleblower cannot pursue the case. The SEC ruling is final.

Corporate Law Professor: There are so many contingencies built into recovery under this system that it hardly creates robust competition to become whistleblowers. And there’s much evidence that it’s often destructive, if not fatal, to people’s careers. I don’t see it conflicting with internal compliance programs or creating a stampede toward whistle blowing. I see the law principally as more validation of the general importance of reporting fraud and the importance of whistle blowing in extreme cases.

“The ultimate goal of whistleblower provisions is to increase legal compliance by the company.”

Law Professor: If senior management thinks a fraudulent scheme could be exposed by an employee going to the SEC, that may well increase compliance on its own. The goal is not to have lawsuits, but to find a mechanism by which management does the right thing. It’s important to not look at these rules as embedded in stone. The dialogue will be better if people look at the positives and negatives of the rules, and engage with the SEC to revise them.

Moderator Elson: The lack of heated discussion about this here may indicate that the Whistleblower law was not so far off. When it first came out, there was a lot of controversy.

Say-on-Pay – Effective Reform or Boondoggle for Consultants?

Moderator Elson: Say-on-Pay is now a requirement for everyone under Dodd-Frank. I was very negative about it initially. Injecting shareholders in the process, in my view, dilutes the authority of the board, which ultimately results in worse compensation.

“Carl Icahn, ‘friend of the working man and investor,’ uses the analogy that CEOs and the hand-picked boards around them are like his fraternity supper club.”

Union Pension Fund Director: Apparently, Icahn was the guy in his fraternity who glad-handed everyone, rose to the top, wanted to be liked by everyone and was always worried about the guy behind him. Pay studies now show that not only is the pay at the top out of line, but it’s also out of line as compared to the pay of his/her next in command. That’s a topic for another time: incentivizing your successor.

If you buy Icahn’s analogy that the CEO is like the fraternity or sorority president, whether a Say-on-Pay vote passes is the wrong question. If we investors want boards to change practices, not only with regard to levels of pay but also incentives and board accountability, it’s important to know that the CEO is worried about getting a “C” or “D” - getting shamed in their annual shareholder meeting.

We’ve had two years of Say-on-Pay, the jury’s still out, and we’ve seen some interesting results in places like Goldman Sachs. I’m sure Lord Blankfein was not happy with the 30% disapproval rating at his annual shareholder meeting. That was a “C-” for him.
“When 20% or 30% of the Say-on-Pay vote is negative, that sends a message to the board that something’s wrong. Say-on-Pay is not a magic bullet, but it is a communication device.” - Union Governance Analyst

Moderator Elson: The idea of shaming someone assumes that they’re capable of shame.

Union Pension Fund Director: These people are terrified about how they appear in the press and in front of their country club peers. If they get a 30% disapproval and their peer gets a 15% disapproval rating, that bothers them.

Moderator Elson: Enough to take a pay cut?

Union Pension Fund Director: It’s not a silver bullet. It’s another tool to improve board accountability and oversight over compensation consultants, incentives and contracts.

Corporate Governance Expert: It’s too early for hard data, but anecdotally company boards are, in fact, very unhappy about the prospect of a negative vote against management on this issue. The point of Say-on-Pay was to prompt a dialogue between boards and the investing community. It remains to be seen how investors will cope with this vast new right.

It’s unlikely that most investors will be able to do deep dive analyses on all of their holdings, which means they’ll be relying on intermediary resources like Glass Lewis and ISS. The Council of Institutional Investors will also be stepping up to provide more information on pay for investors.

“For a quick look at the future, we can look at the UK, which has had Say-On-Pay since 2005.”

It hasn’t done the trick of reducing excessive compensation as much as people wanted, and very recently the Institute of Directors (the equivalent of the National Association of Corporate Directors here) argued for binding Say-On-Pay. A government commission in the UK just came out with the recommendation that compensation committees consult with employees or include them on the committee. These are directions few would have predicted.

“There is more complexity and nuance than the media is portraying.”

Union Governance Analyst: The media narrative has focused on just the relatively small number of negative votes, concluding that everyone’s happy with pay. 42 negative votes is more than the UK has had – ever– and I think a lot of people are missing the big picture. When 20% or 30% of the vote is negative, that sends a message to the board that something’s wrong. Say-on-Pay is not a magic bullet, but it is a communication device.

In several cases this past season, when a proxy advisory service said it was going to advise a negative vote because something wasn’t explained well, the companies went back, fixed some things and did a better job explaining how the compensation was tied to performance. Improving communication is a good thing. Will it stop excessive pay? Probably not, but it will create more of a barometer for boards to look at. Another point to look at is the whole yellow card/red card system. Instead of immediately voting against the compensation committee, shareholders can give a warning card.

“I think it’s been successful in focusing boards’ attention on some of the concerns shareholders have about pay - not just the level but the mix of pay.”

Public Pension Fund Corporate Governance Director: We are a “no” voter, and still operate under the red card. The jury is still out about how successful it’s been. In terms of the work involved, we have 7,000 companies in our portfolio and have sent 125 letters to the ones we think have the most problems. It takes a lot of time and attention to explain our concerns. I think it’s been successful in focusing boards’ attention on some of the concerns shareholders have about pay - not just the level but the mix of pay.

Say-on-Pay has prompted that discussion better than anything else has.
“In this populist ‘Occupy Wall Street’ world, we’re allowing people to vote on executive compensation, and in most companies it’s being approved by Politburo type votes.” - Corporate Attorney

“We can’t ignore the social aspects of this issue.”

Charitable Institutional Investor: I think 40 is a big number for the first year. People immediately went after the low-hanging fruit. Some of those cases were pretty shocking. We can’t ignore the social aspects of this issue. Executive compensation in this country is way out of bounds when compared with Europe, Japan or Asia - and certainly way out of bounds when you look at the ratios to what the average worker makes. To a large extent, compensation is socially determined, and we currently have a mutually back-scratching elite that’s in the driver’s seat. Lucien Bebchuck’s book, Pay Without Performance, asserted that the issue is not that pay is correlated positively or negatively to performance; it’s often not correlated at all. All the studies of wealth distribution in the U.S. show that it’s not been a redistribution of wealth to the top 1%; it’s redistribution to the top one tenth of 1%. Top executives account for 60% of that 0.1% and their lawyers and real estate people account for another 15-20% of that 0.1%. Say-on-Pay is an important first step in looking at this - but only a first step.

Corporate Attorney: I’m sensitive to what’s been said but I look at the numbers a bit differently. In this populist “Occupy Wall Street” world, we’re allowing people to vote on executive compensation, and in most companies it’s being approved by Politburo type votes. My second comment comes from the perspective of having sat in a lot of board rooms and on compensation committees.

“Directors don’t want bad publicity. There’s a sense of, ‘What can we get away with?’”

The point about the shame factor is right, but not all the way. It’s not the CEOs but the outside directors who are really worried about embarrassment; they’re scared. I’m troubled by how often the board discussion is focused, not on what’s best for the corporation, but on how we can avoid a fight with the institutional shareholders with whom we don’t necessarily agree. They don’t want bad publicity and there’s almost a sense of, “What can we get away with?”

Law Professor: I’ve written a couple of pieces on Say-on-Pay, including one that suggests an opt-in rule rather than a universal rule on the grounds that we can end up with too limited a menu of choices. The irony is that we now have more pay for performance now than we ever had, and that’s created some of the issues we have with high levels of pay. In the wake of the financial crisis, people are reconsidering pay levels in absolute terms. It’s not only about pay for performance (in fact US companies are doing very well in general), but it’s a socio-political moment when the right level of pay is being reassessed.

Pay is not set in a spot market. It’s not like oil or copper. Pay is set out of a very different type of market in which people’s sense of entitlement and what peers are getting are factors in determining the pay package. Say-on-Pay can provide an occasion for a public discussion about what the absolute levels of pay ought to be, and what the right balance is. Similarly, the High Pay Commission in the UK is looking at compensation as a way to address what kind of society they want to have. Say-on-Pay will be very important going forward, but perhaps not for the traditional governance reasons its early proponents envisioned.

“Clients who have not historically had robust engagement programs are now developing them.”

Proxy Advisor: We provide proxy voting services to about 900 institutions around the world. A lot of the people I see at these conferences are the same group of terrific people – people who take governance seriously and have been engaging with companies long before Say-on-Pay. I see anecdotal evidence that a lot of other clients who have not historically had robust engagement programs are now developing them. This is year one for them, and it’s encouraging to see a dedication of resources to engagement.

Activist Fund Manager: I think Say-on-Pay was one of the worst reforms for the capital markets that we’ve had in a long time.
“What we’ve now created is a race among compensation committees to figure out what technique the proxy advisors and engaged investors are using to determine proper pay packages.” - Activist Fund Manager

**Activist Fund Manager:** I’m a member of the school of corporate governance that says we should have experienced, objective, independent directors who are engaged, work hard, attend 75% of the meetings—and appreciate the subtleties and strategic challenges in that business. I think the key role of the corporate governance world and shareholders is to make sure you have a board that looks like that. There is no way that an institutional investor with 7,000 companies in their portfolio can deeply understand all those companies in the middle of proxy season. You are going to make mistakes, no matter how big your staff is.

What we’ve now created is a race among compensation committees to figure out what technique the proxy advisors and engaged investors are using to determine proper pay packages. I’ve seen compensation committees, who have worked hard on the right compensation package, ask “What will ISS think? What do we need to change to fit in their rubric?” I think that’s horrible—the opposite of what we want that board to do. We’ve encouraged them to just adopt a generic approach to pay.

I think we’ll see companies regress to the mean in approach and absolute pay levels, targets and descriptions. And we’ll lose the great expertise of the independent directors that we’ve been fighting so hard to get onto independent compensation committees. If this job were as simple as putting someone in front of a computer to crank out some numbers, we didn’t need to have independent compensation committees, we didn’t need that reform in Sarbanes-Oxley, and we didn’t need to be fighting all these years for voting rights for independent directors.

**Shareholder Activist:** This is a principal/agent problem. If you’re really gung ho on Say-on-Pay, how many people in this room would like their compensation to be voted on by the people who ultimately pay them?

**Pension Consultant:** Shaming is not such a bad thing. I agree that people on compensation committees are nervous. I want them to be nervous, and I want them to explain themselves. And if this process forces them to explain themselves, then it’s done a load of good. The notion of shaming some people and exposing a sore in our society is a damn good thing in my opinion.

“Shame is a great tool, but you want to be sure you’re shaming the right people.”

**Activist Fund Manager:** It’s hard for shareholders, on the basis of a 30-40 page proxy disclosure that 90% of investors don’t read, to figure out who’s worthy of shame and who isn’t. If you really understood all the subtleties, you might well conclude that the board made good, rational decisions about pay.

**Proxy Advisor:** Isn’t it the company’s responsibility to tell the story? You’re saying investors are not equipped to understand the story, and I disagree.

**Shareholder Activist:** I think a lot of the story can’t be told, i.e. the need to incentivize a team leading a division that’s about to be sold, or the need to retain a particular executive. These aren’t things you can put in a proxy disclosure.

**Moderator Elson:** The key is how comfortable you are with your agents. It’s why you have a board. Is the board incentivized correctly, and does the board have the proper tools? For example, we feel that the widespread use of peer grouping in compensation has been a big problem. Even with Say-on-Pay, and even with better boards, unless the tools are appropriate you won’t have a package that reflects real performance rendered.
“It’s amazing that we’ve been stewing on compensation for 20 years and we haven’t made much progress. Pay continues to escalate 15-20% each year and nothing we’ve done has had much impact on that.” - Moderator Elson

Prominent Shareholder Attorney: I’ve heard some talk today about compensation levels being a societal problem, but we haven’t talked about whether they’re a problem in terms of corporate performance. Are they interfering with the shareholder returns? Should excessive compensation be redistributed in the form of profits? Should it go to other workers, and would those workers then be more productive? Are we talking about a problem of corporate performance or about a societal problem?

“I thought Say-on-Pay was silly when it came out, but I believe the conversation and attention has been salutary.”

Governance Consultant: We tend to talk about large cap companies. I’ve just done consults with some $3 billion cap companies, and those boards had no idea that they had a problem. I saw stuff we wouldn’t expect to see anymore - structural issues as well as performance disconnects – and they’ve subsequently changed their packages. It’s valuable to have a metric to force a boardroom discussion, and I think Say-on-Pay has some value that way.

I would love for the compensation analysis disclosure to read: “Our compensation committee is composed of experienced corporate executives who have hired and fired people for years. We have decided to compensate our named executive officers the following amount for the following reasons. If you like this, please vote for us; if not, vote against us.”

The problem with that is that it would require a real accountability regime. You need real majority voting; you need a way that shareholders actually pay attention. So what we have now is governance by proxy of governance, where Say-on-Pay is useful to focus around an issue. I do think it wakes people up, encourages discussion and provides some accountability metric. I thought Say-on-Pay was silly when it came out, but I believe the conversation and attention has been salutary.

“What Dodd-Frank actually says is that companies should explain, not that they should adhere to any particular form of pay.”

Corporate Governance Expert: What Dodd-Frank actually says is that companies should explain, not that they should adhere to any particular form of pay. It says that whatever decisions you make, you need to persuade your investors that those are right for the company. Most boards haven’t had to persuade anybody except themselves.

Say-on-Pay opens up conversation with themselves and their advisors about what’s right for the company. That’s what the law says, but I think you’re more on target when you say companies think they need to game the system and need to satisfy the proxy advisors. Are investors actually applying their own judgment? I think there’s good reason to suggest that investors are not going in lock step with the advisors.

Moderator Elson: It’s amazing that we’ve been stewing on compensation for 20 years and we haven’t made much progress. Pay continues to escalate 15-20% each year and nothing we’ve done has had much impact on that.

Shareholder Activist: Here’s an example of why Say-on-Pay is a symptom not the problem. I got a call from a guy who’s a shareholder in a closely held company. The company was doing poorly, the CEO was making $300K a year, so they fired him. When they looked at his severance package, he was required to be paid 20x his annual salary. There was probably nothing they could do.

Moderator Elson: Can a court effectively ever make a good judgment on pay and be a substitute for the board? That’s why we put so much weight legally on shareholder powers. If you don’t like what the agent has done, get a new agent. Replace the board.
“For argument’s sake, let’s say that everyone is voting with the proxy advisor. It’s not an issue with the proxy advisor; it’s a suggestion that the institutional investor is shirking its fiduciary responsibility.” - Proxy Advisor

Proxy Advisors: Too Much Power?

Proxy Advisor: The right way to start this conversation is to begin with a discussion of how investors manage their engagement programs and how they use proxy advisors.

Public Pension Fund, Corporate Governance Director: We subscribe to all the advisory services. Proxy advisory services are one piece of data and advice we use, but our board adopts what our voting policy is. We vote a lot of “withholds” on directors, because they are who we hold accountable. Some say that proxy advisors sway 20% of the vote, and that investors vote blindly with what they say. I’m sure there are small funds that don’t have the bandwidth to do their own research and need to outsource that role. But you need to look at how the proxy advisors work and provide input into that process.

Proxy Advisor: From our perspective, a proxy advisor has a responsibility to provide accurate, objective research and tools to investors. Our firm was founded to fill the need for custom policy implementation. The vast majority of our clients are implementing a custom policy or using ours in a hybrid way with a lot of controls to ensure oversight. Are we too influential? For argument’s sake let’s say that everyone is voting with the proxy advisor. It’s not an issue with the proxy advisor; it’s a suggestion that the institutional investor is shirking its fiduciary responsibility. I’m sure there are institutions with limited resources that are using their tools effectively to apply their own policies and look at key votes.

“**In our experience, accountability has been fought every step of the way by corporate management.**”

Charitable Institutional Investor: I agree that the major issue is accountability, and sometimes dealing with symptoms is the only path we have. In our experience, accountability has been fought every step of the way by corporate management. They do that by raising the threshold of cost.

“When we first brought resolutions on some of the topics we’ve been discussing, the first thing management did was bring in their attorneys to knock us off. Now that’s changed.”

Charitable Institutional Investor: The first step in our engagement process is almost always an invitation to a discussion – not a threat. Almost always, management takes a default position instead of dealing with the real issue. When we first brought resolutions on some of the topics we’ve been discussing, the first thing management did was bring in their attorneys to knock us off; there was no discussion. Now that’s changed. The important thing is that you should not have to spend a certain amount of money to have credibility. When we reach a point where credibility depends on the amount of money you spend, then we’re in a plutocratic world that all of us should question. Proxy services help lower transaction costs in a responsible way.

Moderator Elson: I say, “Don’t shoot the messenger.”

Corporate Law Professor: I’d like to hear about cross-selling and conflict of interest issues with advisory firms. A lot of us don’t want to see hard regulation of consulting firms, but that’s the Achilles heel that needs to be addressed.

Proxy Advisor: We don’t provide consulting services to the companies we write on. We’re owned by a large investor, so there are obvious conflict issues there, but we strive to have a business model where the conflicts are not inherent. Although the SEC has considered prohibiting proxy advisors from having consulting business, I expect instead that there will be rules requiring a lot more disclosure. The Department of Labor is revisiting the definition of a fiduciary. However, I don’t think having proxy advisors defined as fiduciaries is a good thing for investors because it will mean a lot of costs that have to be passed on to our clients.

Although the participants had a lot more to say on each topic, the Roundtable was adjourned on schedule at 10:30 AM.