Roundtable Review of Corporate Governance

Nightly Business Report
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SUSIE GHARIB: As we've just heard, the corporate board of directors is at the center of complaints about the system of corporate governance. Critics, such as Lucian Bebchuk of Harvard Law School, point to an alleged lack of concern that many boards have for stockholder interests. But others in the legal community take a different view, such as attorney William Savitt of the firm Wachtel Lipton. I spoke with both Bebchuk and Savitt and Savitt began the discussion by arguing that boards have to consider what's good for the company as a whole and not just shareholders.

WILLIAM SAVITT, PARTNER, WACHTELL, LIPTON, ROSEN AND KATZ: Stockholders are one of the many constituencies that form part of the corporate whole. Corporations ultimately aren't things that are owned; they are networks of people, groups, constituencies that are, when efficiently organized, strive together for the common corporate good. The role of the board of directors historically and today remains the appropriate coordination and mediation among the many corporate constituencies, including stockholders.

GHARIB: Professor Bebchuk, you have said that shareholders should be calling the shots, but you claim that isn't happening because they've been disenfranchised. Why do you say that?

LUCIAN BEBCHUK, DIR., CORP. GOV. PROGRAM, HARVARD LAW SCHOOL: Well, my research has documented that in the overwhelming majority of cases, incumbent directors run for reelection unopposed even when companies are significantly underperforming. Right now, the risk of replacement of the directors or even the risk of an electoral challenge is very low and this pattern is due to several factors. Outside shareholders are not permitted to place director candidates on the corporate ballot; only the incumbents can. Voting, you might be surprised to hear, is not confidential. In many companies, the shareholders cannot remove a majority of the directors in any annual meeting. And while the incumbent can charge all of their expenses to the company, all their company expenses, the challengers have to bear their own costs.

GHARIB: Well, let's get some reaction from Mr. Savitt. Do you think that corporate elections are tilted against shareholders?

SAVITT: I do not. Let me make two points in this connection. One is that much of the argument that Professor Bebchuk and others have sponsored I think is based on a very inapt analogy between corporate elections and elections in democracies. The difference is that in a democracy, the electoral process is a fundamental accountability check; it's a key incident of the democratic process. Where the analysis of Professor Bebchuck goes wrong I think is that the election in the corporate process is an entirely different animal; it is an accountability check of the last resort. It always has been infrequently resorted to and that's good for stockholders in the long run.

And that brings me to my second point, which is directors who are constantly operating in a fishbowl, they need to listen to stockholders and they do; they listen to the marketplace. They

exercise their best judgment in the context of those factors and many others. It's not so much a question of ignoring; it's a question of synthesizing. It's a job that requires directors to keep their eye on a much broader prospect, a much broader universe of constituencies. Stockholders are an important one, but they are not the only one.

GHARIB: A point that Mr. Savitt has made -- and I'm addressing this to you, Mr. Bebchuck -- is that, unlike shareholders, directors are liable for their actions and that makes them better able to determine the best interests of the company. How important is that?

BEBCHUK: Well, liability is again more of a theoretical rather than a practical aspect. Because empirical evidence indicates that putting aside the extremely unusual, exceptional cases of Enron and WorldCom, directors generally never have to pay out of pocket. So there isn't, practically speaking, director personal liability. That might be a good idea, but that makes it all the more necessary to have other mechanisms of accountability and giving shareholders the real power to replace directors is the answer.

GHARIB: Professor Bebchuck, given that this is the way the system currently works, what would you like to see happen? What changes would you like to see?

BEBCHUK: Bill agrees that we need to have some accountability mechanism and the problem is that right now it doesn't exist. The issue is not to have elections -- contested elections in most cases. The issue is for directors to face the possibility that there will be a contest if they under perform. So we need to make that easier and the way to do it would be, first of all, to give shareholders the ability to place candidates on the corporate ballot, not to reserve it only to the incumbents. We need to make voting by secret ballot, confidential. We need to give shareholders the power which often they will not use, but at least they should have the power to replace a majority of the board in any annual meeting. And we need, when challengers run a successful campaign, they should be reimbursed the way incumbents are.

GHARIB: Let's just to wrap up our conversation, let me ask each of you one question. Mr. Savitt, why do you think that it's important to have a system where directors and management manage a company instead of shareholders?

SAVITT: The social purpose of the corporation is not to empower stockholders. The purpose of the corporation, the reason that the legislatures of each of the states has provided for corporations is to provide an incubator for innovation, to provide an institution that can foster research and development and sustainable, long-term deployment of capital. The stockholder activist movement is a short-term movement. It is not concerned with the long-term perspective; it's only concerned with the short-term stock pot. And the only -- the only body within the corporate structure that has the long-term perspective, that facilitates the mediation of all of the corporate constituencies, is the board of directors. By turning authority over to the stockholder activists, one effectively shifts authority from the long-term perspective and the responsible perspective to the short-term perspective in a way that would be unhealthy for corporations and ultimately unhealthy for the country.

BEBCHUK: The issue, Susie, it's not about democracy; it's about accountability and efficiency. I agree with Bill that what we want is to have companies that produce long-term value. But in my view and in the view of most financial economists, to have people at the top that are unaccountable and don't have powerful incentives to focus on shareholder interests, that's not going to produce good results. So the only way to provide directors with incentives to focus on shareholder value is to make them accountable -- not necessarily all the time, but at least sometimes -- to shareholders. And the way to do it is to give shareholders the power to replace directors when directors under perform and to remove the defenses that have been erected from corporate takeovers.

GHARIB: I'm sure that this is a debate that is going to continue. We thank you very much for your time, Professor Bebchuck and Mr. Savitt.