

Ruling May Open Access to Proxies

Companies could be forced to allow more shareholder input in board elections.

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Publicly traded companies could be forced to give shareholders a greater say in their board elections under a ruling this week by a federal appeals court.

If the decision withstands appeal, corporate board elections could become highly politicized affairs — with union pension plans, hedge funds and other major shareholders running slates of dissident candidates against management's hand-picked nominees.

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"It's a significant case," said Keith Bishop, a securities lawyer with Buchalter, Nemer, Fields and Younger. "It would strengthen the influence of large pension funds and significant shareholders."

The appeals court said American International Group Inc., the nation's largest insurance company, improperly blocked a measure that would have given shareholders with at least 3% of its stock the ability to nominate board members and to have these nominees listed in the official proxy materials sent to shareholders.

The proposal was pushed by the American Federation of State, County and Municipal Employees' pension plan, which wanted it included in the proxy packets for the company's 2005 annual meeting.

AIG denied that request, contending that federal regulations allowed it to bar measures that would affect the upcoming board elections.

The pension fund sued, and AIG's position was upheld by a federal district judge. But on appeal, a three-judge panel of the U.S. 2nd Circuit Court of Appeals said Tuesday that federal regulations allow companies to deny shareholders access to their proxy only when they are seeking to affect the election of directors in the current year. The pension plan's proposal would have affected future elections, so it should have been allowed, the panel said.

Because the 2nd Circuit's jurisdiction includes New York, the nation's business capital, its rulings have a profound effect on corporate America.

"If this stands, it is the most significant change to shareholder rights in 30 years," said Richard Ferlauto, a spokesman for the American Federation of State, County and Municipal Employees pension plan. "This is the Holy Grail that we have always sought — to be able to easily and cost-effectively nominate a director who could stand on the proxy card, along with the company nominees."

AIG said it was reviewing the ruling. Its options include seeking a review by the full panel of 2nd Circuit judges, or appealing the decision to the Supreme Court.

The court also noted that the Securities and Exchange Commission had issued conflicting policy statements on the issue of proxy access that made it difficult for the court to discern the agency's intent.

In response to the court ruling, SEC Chairman Christopher Cox said the agency would review its rules for how shareholders could gain access to the ballots used to elect corporate directors at annual meetings.

Under the most recent SEC policy, any proposal that would lead to competitive director elections must go through a contested proxy election process, in which the shareholder submitting the proposal must pay the costs of printing and mailing the proposal separately — and absorb the cost of the legal challenges that the company may present.

That's a process that can take months and cost so many millions of dollars that even large shareholders are hesitant to do it, Ferlauto said.

"This can make a significant difference in the process of corporate elections, making them somewhat more real than they have been in the past," said Lucian Bebchuck, a Harvard professor who specializes in corporate governance issues. "It makes it possible to remove directors without expending huge costs."

Corporate governance advocates have made the ability to oust directors a favored cause in recent years, after the wave of corporate scandals that began with Enron Corp. in 2001. Shareholder activists contend that many board members fail to do their job of providing a check against excess by corporate managers.

The pension plan's proposal, for example, was submitted while AIG was under investigation by both the SEC and the U.S. attorney for alleged accounting and insurance fraud.

Although directors are legally shareholder representatives and are ostensibly elected by shareholders each year, many experts say that director elections are a sham.

The current rules make it too difficult and costly for dissident groups to run their own candidates, shareholder advocates say, and firms typically nominate just one person per seat. In addition, candidates usually don't need a majority vote to win — just more votes than anyone else. So if there aren't rival candidates, the election is almost always guaranteed.

Three years ago, SEC officials floated a proposal that would have made it easier for shareholders to put up rival candidates, but it died amid vehement business opposition.

Jennifer Handt, a spokeswoman for Business Roundtable, said the doomed SEC proposal would have made it too easy for special interests and short-term agendas to infiltrate boardrooms, to the detriment of shareholders overall.

Handt said the group had no immediate comment on the 2nd Circuit ruling.

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