SEC Commissioner Warns Harvard of Vulnerability

Wall Street Journal
By Jean Eaglesham and Liz Hoffman
December 10, 2014

Gallagher Says Harvard's Shareholder Rights Project Could Spur Legal Action

A top official at the Securities and Exchange Commission has taken the unusual step of saying Harvard University could be vulnerable to legal action from the agency or investors over a corporate governance project.

In an academic paper, Daniel Gallagher, one of five SEC commissioners, criticized the Shareholder Rights Project at Harvard, which helps large investors like pension funds file shareholder ballot measures meant to help investors get more influence over corporate boards.

Mr. Gallagher and his co-author, Joseph Grundfest, say the project's work "exposes Harvard, as a university" to liability if it were targeted by the SEC or private shareholders. They argue the shareholder proposals backed by the project, pressing for annual elections of corporate directors, can be misleading because they don't reflect the full range of available research on the pros and cons of such a change.

Lucian Bebchuk, director of the Harvard project, rejected any suggestion the project's efforts violate securities laws, saying its work is "entirely consistent with SEC rules and not false or misleading in any way."

A spokesman for Harvard said the university doesn't comment on "hypothetical lawsuits."

The criticism from Mr. Gallagher comes amid a growing debate about how much influence shareholders, and in particular activist investors who buy stakes and press for corporate changes, should have on the direction of a company.

The Shareholder Rights Project in recent years has taken aim at a corporate structure, known as a staggered board, in which directors come up for election every few years. Supporters of the setup say it helps directors make decisions for the long term without fear of immediately being ousted. Critics, including Mr. Bebchuk, a Harvard Law School professor, argue that annual election of directors makes companies more accountable to shareholders.

The project, founded by Mr. Bebchuk as a clinical program for law students, has been a driving force behind the disappearance of staggered boards. Since 2012, it has floated nearly 200 proposals at some 130 companies on the issue.

The project works with a handful of pension funds, helping them craft language for shareholder proposals. The nonbinding measures the project has backed have received on average more than 80% of shareholder votes cast, according to the project's website.

Today, boards where only one-third of directors face re-election each year exist at 10% of companies in the S&P 500, compared with 60% in 2002, according to FactSet.

Harvard Law students have received academic credit for working at the Shareholder Rights Project, and Harvard Law School pays expenses for the project, according to Mr. Bebchuk.

Mr. Gallagher and Mr. Grundfest, a former SEC commissioner who is now a professor at Stanford Law School, say the project's proposals ignore five studies that don't support its conclusions on the benefits of annual elections.

The Harvard wording could "be viewed as materially false and misleading" because of this alleged bias, breaking SEC rules that require information to be accurate and fair, the academic paper said. If the agency agreed the proposal had a material omission, it could allow companies to refuse to put the proposal to a vote, the paper says.

If the SEC took the more draconian step of suing Harvard, the agency would be "in my opinion, very likely to prevail," Mr. Grundfest said in an interview.

Mr. Bebchuk defended the proposals' claims. He said the "paper itself makes false and misleading claims, and we will issue shortly a detailed refutation."

The paper will likely fuel a continuing debate over the role of activist investors. These funds now control more than $112 billion in assets, according to research firm HFR, and are increasingly winning the support of more traditional asset managers.

Yet some have raised concerns that the pendulum, once firmly in management's corner, has swung too far the other way.

In March, Laurence Fink, CEO of BlackRock Inc., the world's largest asset manager, warned CEOs that yielding to activist pressure for buybacks and dividends could hurt companies' long-term health.

Glenn Booraem, head of corporate governance at Vanguard Group, echoed those concerns in an interview. A short-term bump in a stock price does little to help Vanguard, a $3 trillion asset manager, if it comes at the expense of long-term growth, he said.

"We're going to be invested forever," he said. "If that benefit is temporary, we'll be there for the downside, too."