Institutional Investors See Light at End of Downturn Tunnel

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By Frank Reynolds
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For the institutional investment fund managers and advisers attending the annual Global Shareholder Activism Conference in New York Dec. 3, it is both the best of times and the worst of times, a panel of corporate and business law experts agreed.

The faculty of jurists, attorneys, academics and financial professionals said that on one hand, Congress is poised to vote on a slate of corporate law reforms that will give shareholders greater access to the boardroom and more say about their CEOs' pay.

On the other hand, the panelists said, the pension funds the attendees manage and advise have been devastated and their contributors reduced by mass layoffs caused by the 2008 economic implosion.

The Institutional Investor Educational Foundation and prominent shareholder plaintiff firm Grant & Eisenhofer sponsor the yearly conference to update institutional investors on how to get their concerns heard in Washington and on Wall Street. This year the shortened conference was webcast for the many members coping with tightened budgets and schedules.

The promised new shareholder power could not come soon enough for most of the investor advocates, who blamed out-of-control executives for betting their companies on risky investments in search of short-term profits.

However, Vice Chancellor Leo Strine of Delaware's prestigious business court said "if you want to play the demonizing game," some of the blame has to go to investors in hedge funds and mutual funds who pushed corporate officers to quickly increase profits any way they could.

"Management didn't get much input from the long-term investors," Strine said, "and with the (officers') stock options (based on the company's stock price) as a big part of their compensation, CEOs had a perverse incentive to think short-term profit," which often hurt the firms' long-term fiscal future.

Prominent Harvard Law School professor Lucian Bebchuk added that investors suffer far more than corporate officers when stock prices go on a short-term profit roller-coaster ride.

"While everyone loses when the stock price drops, the executives get to keep the bonuses they got for inflating the stock with temporary profits," he noted.

Bebchuk said that if executives had to wait five years to cash in their stock options, they would be less likely to be swayed by short-term investors.

Several of the corporate reforms that institutional investors have long sought may soon be passed by Congress and signed by President Obama, the panelists predicted.

The most controversial of those measures are:

- "Say on pay," which lets shareholders vote on whether their executives' compensation is excessive;
- Proxy access, which allows investors to run their own candidates for director using company proxy materials rather than their own funds; and
- Majority voting, which would enable shareholders to unseat individual directors by a simple majority of the votes cast rather than the total number of shares.

Vice Chancellor Strine said the federal laws that would enable those reforms, while well intentioned, are a one-size-fits-all answer that may not fit many companies very well.

He said Delaware, where most of the nation's largest companies are incorporated, already allows shareholders to decide how the company charter should govern executive compensation.

However, "you have to start with the right defaults," professor Bebchuck cautioned.

"Shareholders should not have to fight to change the status quo to get the benefit of any those reforms," he said.

David Katz, a partner of the law firm Wachtell, Lipton, Rosen & Katz, which often defends corporate management in shareholder disputes, said it appeared that investors pushing for greater profits had helped to fuel the disastrous binge of risky investments that triggered the Wall Street meltdown and the current recession.

In addition, short-term investors bullied boards into returning inordinately large amounts of corporate cash to shareholders, leaving companies strapped for growth capital.

"I think the reforms will ultimately increase the pressure for short-term investments," Katz said.

Katz's comments stirred a flurry of indignant replies.

Richard Fermata, a representative of labor union AFSCME said: "It's hard to conceive of being responsible for that when ... (shareholders) had little or no information or power. We had no clue that companies like AIG or Wachovia were risky investments."

Attorney Jay Eisenhofer, a name partner of Grant & Eisenhofer, responded, "Do you think anyone believes that shareholders are to blame for the hollowing out of U.S. industry, the increasing dependence on the paper profits of the financial industry and the greatest over-inflation of assets in U.S. history?"

In summarizing the investors' position, Charles Elson, a law professor at the University of Delaware, said blaming shareholders was like being charged with assault and battery because "your face punched someone's fist."