Fund Management: Global Eye

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With the year skidding to a close, the US Securities and Exchange Commission (SEC) appears no closer to finalising its proposal to give shareholders rights to nominate dissident directors.

But investors may now have discovered a way around tangled regulations. In 2005, the sleeper dissident resolution on corporate ballots could turn out to be one that makes the revolutionary call for directors to be elected by a majority vote.

Majority vote is the commonplace method of electing boards everywhere in the world. But not in the US and Canada. There, shareholders can only vote "yes" or withhold their votes. "No" is not an option in director elections. Ludicrously, a solitary share voting "yes" can prevail even if every single other share is "withheld". No wonder that two of the highest judges in Delaware, a haven for most US corporations, last year branded board ballots "an irrelevancy".

The result is that boards are only barely accountable to their owners, leaving few hurdles before those CEOs that are bent on squandering shareowner value through, for instance, pay untethered to performance.

The SEC framed its "proxy access" proposal as a solution, even if a stupendously complex one. If investors cannot play a meaningful role in electing a board, chairman William Donaldson's logic went, then they should at least be given powers - albeit tightly constrained - to nominate candidates to run against approved slates. The SEC never seems to have considered engineering simple "no" votes.

The agency acted in this respect like the famously loopy "wise men of Chelm" in the Isaac Bashevis Singer stories. When informed that a cavernous pothole was causing injuries to travellers on the only road to town, the worthies chose not to fill the hole, but to build a hospital next to it.

Actually, the SEC made the Chelmites look judicious. Regulators were only planning half a hospital. Over time, the commission hammered back its bold, original vision so as to accommodate business opposition, despite more than 12,000 letters in support of access.

Even the new proposal was not enough to mollify opponents. The sorry version last seen by the public was brought to a halt by politics in the run up to the presidential election.

Now a second, re-energized Bush administration will doubtless be even more opposed to meaningful access, while the strongest internal advocate of reform - commissioner Harvey Goldschmid - announced last month that he is leaving the SEC next year.

For months, meanwhile, US investors acted as if they were afflicted with the Stockholm Syndrome. Used to subjugation, they hailed even the small kindness of Mr Donaldson's access proposal as the breakthrough of a generation.

The truth is gloomier. Access, carbuncled with triggers and timeframes, would now produce only marginal benefits for investors. But something else might work: dissident resolutions calling for director election by majority vote.

The idea is not wholly new. The Carpenters' union pension fund petitioned for the first such proposals at 14 US companies earlier this year. No one took much notice. But they drew from 7 to 18 per cent support - hefty figures for a newborn campaign.

For 2005, three union funds have filed the same type of resolutions at 12 US blue chips, including Citicorp, MBNA, US Bancorp, and Merrill Lynch, according to the Investor Responsibility Research Center.

More are due. The issue may well emerge as one of the highest profile corporate governance priorities for institutional investors in the United States.

Why? For one, activist funds are desperate to find a policy lifeboat if and when access sinks. Majority vote election resolutions are clear-cut, grounded in US values, and hard for companies to argue against. More important, majority vote rules would suddenly transform US board elections into a meaningful exercise of accountability.

Directors could finally be not merely independent of management, but "dependent on shareholders", as advocated by Harvard Law's Lucian Bebchuk and University of California-Berkeley's Jesse Fried in their new book Pay Without Performance.

Second, Stephen Lamb, Delaware vice-chancellor, speaking at a recent International Corporate Governance Network conference, confirmed that bylaws requiring majority vote would be legal under state statutes. Listeners took the comment as a virtual invitation to investors to file resolutions pressing such bylaws. A buzz is now flitting through the fund community as pension plans mull a drive to make majority vote elections routine in the US.

Third, the three proxy advisory firms that make influential recommendations on voting are likely to re-think their baffling, but unanimous, opposition to majority rule.

Finally, funds can mount majority vote resolutions on their own, without waiting for regulators to act.

If the SEC does eventually scrap its access proposal, though, it might be able to take the edge off the inevitable investor backlash by embracing a proposal crafted by Joseph Grundfest, a Stanford Law professor.

Under this, any director failing to win a majority could still be elected - but the individual or company would then face federal or stock exchange sanctions. Most minority vote directors, Grundfest guesses, would withdraw from service. Call the idea "majority rule lite".

Either way, 2005 promises the beginning of the end of rubber-stamped US boards.