

The Debate on Shareholder Access to the Ballot, Part I

(Lucian Bebchuk, ed.)

Abstract

This paper contains the proceedings of the first part of a symposium on shareholder access to the ballot held at Harvard Law School in October 2003. The symposium brought together SEC officials, CEOs, directors, institutional investors, money managers, shareholder activists, lawyers, judges, academics, and others to discuss the subject from a wide range of perspectives.

The first part of the symposium included three sessions. The first session focused on the basic pros and cons of shareholder access. It featured a presentation and discussion of two papers: "Election Contests in the Company's Proxy: An Idea whose Time has not Come" by Martin Lipton and Steven Rosenblum, Wachtell, Lipton, Rosen & Katz; and "Shareholder Access to the Ballot" by Lucian Bebchuk, Harvard Law School.

The second session focused on the perspective of boards and management. The session's panel speakers were: Richard Breeden (Chairman, Richard C. Breeden & Co.), John Castellani (President, The Business Roundtable), James Rogers (Chairman of the Board and Chief Executive Officer, Cinergy Corp.), and Ralph Whitworth (Chairman of the Board, Apria Healthcare Group, Inc.).

The third session focused on the perspective of institutional investors. The session's panel speakers were: Orin Kramer (Partner, Kramer Spellman, L.P.A), Robert Pozen (Visiting Professor of Law from Practice, Harvard Law School and formerly Vice-Chair, Fidelity Investments), Michael Price (Managing Partner, MFP Investments) and Sarah Teslik (Executive Director, Council for Institutional Investors).

Each session started with opening presentations by the panelists, followed by a discussion among the panelists and between the panelists and other participants in the symposium.

Key words: corporate governance, directors, shareholders, shareholder voting, corporate elections, proxy fights, proxy contests, proxy rules, corporate elections, SEC.

JEL classification: D70, G30, G32, G34, G38, K22.

Editor's Note:

This edited transcript seeks to make publicly available the proceedings of the Symposium on Shareholder Access to the Ballot that was held at Harvard Law School on October 3, 2003. Editing was done by the speakers and the editor, with the aim of retaining the spirit of the symposium while ensuring that the speaker's message is clearly and accurately conveyed to readers.

The conference was the first event of the recently established Harvard Law School Program on Corporate Governance. It was sponsored by the Program and by the Harvard Law School John M. Olin Center for Law, Economics, and Business. I wish to thank Professor Steve Shavell, the director of the Olin Center, and Dean Elena Kagan for their support.

I am also grateful to various colleagues for their help in organizing the symposium and moderating its sessions, including John Coates, Brian Hall, Howell Jackson, Reinier Kraakman, Jay Lorsch, and Guhan Subramanian; special thanks go to Mark Roe for his advice and encouragement throughout. Finally, for their help in administering the symposium as well as in preparing its proceedings, I am grateful to Erica George, Julie Johnson, Kiwi Kamara, and Rob Maynes.

The Debate on Shareholder Access to the Ballot, Part I

Session 1: The Basic Pros and Cons of Shareholder Access: pp. 1-29

Panelists:

Martin Lipton and Steven Rosenblum, Wachtell, Lipton
Lucian Bebchuk, Harvard Law School

Moderator:

Mark Roe, Harvard Law School

Participants in the Discussion:

Robert Monks, Lens Governance Advisors
Brian Hall, Harvard Business School
Jay Lorsch, Harvard Business School
Charles Nathan, Latham & Watkins LLP
Joseph Grundfest, Stanford Law School
Matthew Bishop, The Economist
Allen Beller, U. S. Securities and Exchange Commission
Michael Price, MFP Investors
Leo Strine, Delaware Court of Chancery

Session 2: The Board/Management Perspective: pp. 30-52

Panelists:

Richard Breeden, Richard C. Breeden & Co.
John Castellani, The Business Roundtable
James Rogers, Cinergy Inc.
Ralph Whitworth, Apria Healthcare Group

Moderator:

Jay Lorsch, Harvard Law School

Participants in the Discussion:

John Wilcox, Georgeson Shareholder
Robert Pozen, Harvard Law School
Damon Silvers, AFL-CIO
Robert Todd Lang, Weil, Gotshal & Manges

Session 3: The Perspective of Institutional Investors

pp. 53-73

Panelists:

Orin Kramer , Kramer Spellman
Robert Pozen, Harvard Law School
Michael Price, MFP Investors
Sarah Teslik, Council for Institutional Investors

Moderator:

Reinier Kraakman, Harvard Law School

Participants in the Discussion:

Robert Clark, Harvard Law School
Joseph Grundfest, Stanford Law School
Brian Hall, Harvard Business School
Damon Silvers, AFL-CIO
Leo Strine , Delaware Court of Chancery

Session 1: The Basic Pros and Cons of Shareholder Access to the Ballot

Panelists: Martin Lipton and Steven Rosenblum, Wachtell, Lipton,
Rosen & Katz
Lucian Bebchuk, Harvard Law School

Moderator: Mark Roe, Harvard Law School

Mark Roe: I'm Mark Roe; I'm going to moderate our first panel. Just a few introductory comments; the people on the panel don't need any introduction. The mechanics: Marty and Steve will talk for about twenty minutes on their topics. Lucian will talk for about twenty minutes on his topic. There've been heavy negotiations on the moderator's authority, and I have much more authority than is typical. I have this bell to keep people quiet after twenty minutes, or if the questions go on too long. After twenty minutes, a few minutes of response on either side, and then questions to the people presenting the papers.

I think it's fair to say that Marty Lipton's been, of the last 25-35 years, the most articulate, thoughtful spokesman for the view of maintaining managerial autonomy in large firms, and Lucian has provided several of the deepest analyses of why firms would be better-run with more authority moved to shareholders' hands. There's a surreal quality about addressing these issues today, in that we know the SEC is going to propose a rule that we're going to be talking about today, but we don't know the details of the rule, so we can't focus on details. We can only focus on the big picture. And the surreal quality, I think, corresponds to the panel this morning.

In some ways, the big picture is clear. We kind of know what Marty has got to say, and we kind of know what Lucian is going to say, although the details may differ, and the analyses may get to a deeper level. So I've actually suggested this morning that we approach this in a different way, consistent with this being a law school education. Marty, I suggested, should take the position that managerial autonomy has gone much too far, and I suggested to

Lucian that he take the perspective, and defend the perspective, that managers really need to be left alone so that they could run their companies and these kind of things are just distractions that don't do anybody any good. So we'll see if they take this up! Marty? Steve?

Steven Rosenblum: Okay, I'm going to start and then turn it over to Marty. I wanted to say thank you to Lucian for inviting us and letting us put some of our ideas down on paper and present them here. We've obviously made a number of arguments in our paper, and we don't have time to touch on all them. I just wanted to make a couple of points, and then Marty has a few more.

First, we take issue with the title of this morning's session: "The Basic Pros and Cons of Shareholder Nomination of Directors." This isn't about whether shareholders have the right to nominate, or put forward director nominations. They do, in most every jurisdiction, and we obviously don't have any problem with that. The real title ought to be "The Basic Pros and Cons of Encouraging More Election Contests," because that's really what this proposal is about. Alan Beller referred to this yesterday as "an incremental proposal," and it *is* incremental. How big the increment is, is open to debate. The basic point is that people can run election contests now. They do run election contests now. There were about forty of them last year. And really, the question is, "Do we want more of them, and if we want more of them, how many more of them do we want?" I was heartened to hear Allen say that we don't want fifteen thousand. I think Marty's and my view is that the optimum number is about where it is today, and really the debate is: is it a good idea to have more election contests?

I also wanted to try to explain a little bit as to why we devoted so much of our article to the academic model of shareholder as principal or owner and managers as agents. It's really a model that I think dominates the academic literature, and it's one that I know I've been contesting, not just going back to Marty's and my quinquennial article, but all the way back to law school, when I had this young Turk law professor straight out of law school named Reinier Kraakman, who had these new notions. He threw away the textbook and gave us a bunch of Xeroxed handouts from Berle & Means and Jensen & Meckling, and told us that the central issue of the modern corporation was the separation of ownership and management, giving rise to the agency

problem, and how to get managers to conform to the wishes of the owners and put aside their self-interest. That model really does dominate the academic literature and, I think, also finds its way into the rhetoric of the debate of this issue, as well as a number of other issues.

If you accept the notion that the shareholder is the owner of the corporation in the same way that I own a car or a building, then the answer is pretty easy: the shareholder is the owner, so more shareholder voice is better, more shareholder control is better. The question answers itself. Which is why we felt the need to talk a little bit about how it's more complex than just to say that the shareholder is the owner. Obviously, shareholders provide a very important input into the corporation in terms of risk-taking capital, but there are all kinds of other constituencies that also provide significant inputs into the corporation, and all those need to be balanced. I think the question, and the debate in the context of this proposal is, "Where is the right balance? Is the right balance to put more control into the hands of shareholders, or is the right balance to come up with other mechanisms for constraining and motivating. One of the problems I think we have with the notion of "the shareholder is owner, and therefore should control the corporation," is that it leads pretty quickly to what we've dubbed "the managerial discipline model." This model says that the main goal of corporate governance is to discipline managers so that they don't go astray, which, again, is a great oversimplification.

What you want is to find a way not just to discipline managers, but to motivate managers, to have them run the corporation more successfully and better, to the benefit of shareholders and all the other corporate constituencies. The trend in the current corporate governance environment, not just with this proposal, but with some of the other proposals, seems to be to focus on the constraints as opposed to the incentives and the motivations. We think this is to the detriment of the operation of the corporation in terms of excessive risk aversion, in terms of people being afraid to do things that they really should be doing in terms of running the company.

The one other point that I wanted to talk about is what is the likely impact of the proposal. We're in a bit of a vacuum in terms of not knowing exactly what the proposal is, but one has to believe that the likely impact is that, at a minimum, there will be more election contests. Because if there

aren't going to be more election contests out of this proposal, what's the point? And probably, given more election contests, there will be more successful elections of dissident directors. What we tried to do in the paper is to focus on, "Is it a good thing? Is it a good thing to have more election contests? Is it a good thing to have more dissident directors in boardrooms?" We obviously think there are significant costs to both of those, and Marty is going to talk a little bit about that. And we have yet to see a compelling argument for, "What is the benefit in terms of the operation of the corporation."

The public debate seems to focus on "shareholders are owners, more shareholder voice is better, therefore this is good." But if you're able to get past the model of shareholder-as-owner and say, "Well, that's a useful analytical tool for some purposes, but it really doesn't drive you to the end conclusion," then really the question is, "What is going to make the corporation run better and operate better and be more successful." And you have to ask, "What benefit are you getting out of (1) more election contests, and (2) more dissident directors?" I think there is debate among at least some of the institutional investors as to whether they really want this - the institutional investors who are really purely economically motivated.

My view is that, at least in the near-term, this will primarily be used by the more political institutions: the public pension funds and the unions, who really have other motives for using it. The institutions that really are focused on improving the economics of the corporation have better ways and better avenues to provide their input into the corporation than a public, adversarial proxy contest. And they've been using those avenues. I think there's no question that, over the last two decades that I've been in law practice, and a couple more decades that Marty has, the responsiveness of boards and managers to investor input has grown quite a bit, I think for the better. That should be allowed to continue without creating this politicized and adversarial process that will result from encouraging more election contests.

Another, I think unintended, impact that comes out of one aspect of the SEC proposal - namely, the trigger mechanism - is that if that's adopted, it will give much greater leverage to 14a-8 proposals. We're already seeing this concern among our clients. The notion of saying "If we pass this precatory resolution and you don't adopt it, then we're going to impose this access

regime,” is like putting a gun to the head of the board and saying, “If you don’t do what we tell you to do in this precatory resolution, then you’re going to have to face this consequence that you probably don’t want to face.” My view of it is that if you’re going to pull the trigger, just pull the trigger and get it over with. Don’t have the constant threat of the gun to the head, with a mechanism that says “If you don’t do what I want, I’m going to shoot you.” Anyway, with that, I’ll turn it over to Marty.

Martin Lipton: As Mark said, all the arguments back and forth are well-known. This red folder contains a full compendium of the philosophical and the pragmatic arguments, including a very innovative variation on the theme that Joe Grundfest will talk about this afternoon. I’d like to pick up on the last point that Steve mentioned as to what are we really getting at here, and share some practical experience over the past three or four years with the interplay between 14a-8 resolutions relating to redeeming the poison pill, un-staggering the board, and similar types of what I’ll call “corporate governance proposals.” I have a real issue here, and it is one of bending the will of management to that of the shareholders, and just how that’s going to be accomplished. As Steve said, no one disputes that the shareholders have the right to nominate directors and, ultimately, to control the makeup of the board of directors. Clearly, the shareholders can conduct a proxy fight to replace the board of directors – it’s settled law every place. Indeed, in Delaware, much of the learning is that you can’t unduly interfere with the shareholders’ franchise; that the great no-no, insofar as taking action with respect to shareholder control, “Don’t mess with the ability to vote.”

The growth in Rule 14a-8 precatory resolutions on governance subjects started, more or less, in 1986, ’87, when TIAA-CREF first proposed precatory resolutions with respect to the poison pill. It’s built over the period since then. Each year there are several hundred resolutions. They grow each year – I guess they’re up to nine hundred currently. There have been on average in recent years about 50-60 poison pill resolutions, and almost all of them now gain a majority vote. Indeed, in many cases, a substantial majority vote. The same seems to be true of the un-staggering-the-board proposals and some of these others. The reaction to these precatory resolutions, frequently based on advice that we and other lawyers would give the company, was that these issues are basically business judgment issues for the board of directors, that the board was not bound to accept the advice of the shareholders expressed in

the precatory resolution, and the board could exercise its business judgment as to whether it was going to redeem the poison pill or not redeem the poison pill.

As we come closer to today, particularly after the Enron/WorldCom scandals, the New York Stock Exchange corporate governance proposals, Sarbanes-Oxley, SEC regulations, and so on, there's a much different attitude in the boardroom. Directors today are very concerned about the reaction of shareholders, and much more reluctant to accept the advice of management, the advice of lawyers, even the advice of totally independent lawyers who have no connection with the corporation. Basically, they are saying, "Well, this is what the shareholders are saying, and I don't want to face a withhold-the-vote campaign." Directors today are very, very concerned about the impact on their reputations if one is singled out as the culprit on one of these precatory resolutions, or two or three are singled out, and there's a withhold-the-vote campaign and they get a significantly lower vote than the other directors.

The institutions obviously have become aware of this. Within the past two weeks, CalPERS announced that it was going to withhold the vote for audit committee members of corporations that continued to allow their auditors to give tax advice - not preparation of the tax return, but tax *advice*. This was an issue that the SEC considered under Sarbanes-Oxley, and in the rule adopted by the SEC, auditors are not barred from giving tax advice. But as far as CalPERS is concerned, the SEC didn't go far enough. Therefore, CalPERS is taking an independent position with respect to auditors providing tax advice to the company that they audit, and they're trying to force their opinion through withhold-the-vote campaigns.

I think these are quite significant developments. Today there is a much greater response to the desires of shareholders. When you consider that along with the new corporate governance regimes, the first question I have is, "Is this the time to throw a whole new regime into the picture?" In other words, is this the time to say, "The ability to propose Section 14a-8 resolutions, the ability to conduct withhold-the-vote campaigns and so on, is not enough. Something more is needed. And now we have to run a direct election contest, where shareholders will propose one, two, three directors to run in opposition to the incumbent slate of directors."

Think about that for a moment, and consider the board of a typical large public company – it has 11-12 directors, more than half of them are CEOs of other large public companies – when the company has been faced with a precatory resolution. Or not even a resolution – consider a company that has received a letter from shareholders, or an institution, or an advisory organization to shareholders, asking for something to be done or not to be done. And consider if the company does not do what has been requested, and the shareholders commence a withhold-the-vote campaign or, if the failure to do what has been requested is sufficient to trigger this access proposal, and two or three nominees are then placed in opposition to the incumbent directors. There are very, very few directors who are CEOs of major companies who want to run the risk of the embarrassment of losing one of these election campaigns, and the natural reaction is to turn to management, and try to get management to go along with whatever the request may be. In large measure, there's an enormous shift in influence, from the board of directors and the management considering collegially what is the appropriate strategy or action for the corporation, to this pressure on directors to go along with what shareholders want.

Joe Grundfest, in a little exchange he and I have had recently with respect to our respective proposals, stated it best. He said, "Well, to sum up your position, Marty, what you really object to is a proxy fight on the cheap." And I think that does sum up my position. I object to a proxy fight on the cheap. If shareholders feel strongly enough about either a governance position or a corporate strategy, whatever it may be, I think the appropriate thing is for them to conduct a real proxy fight, not a proxy fight on the cheap. And not try to combine the various 14a-8, withhold-the-vote, and now access provisions to, in effect, dominate the board of directors with respect to their particular issue, and force their view in opposition to the view of management and the board of directors. I think it's a significant problem. It's going to have a major impact on management's attitude toward certain kinds of risky ventures, transactions, and so on. There is a real concern that management will not engage with the board of directors, for fear that the strategy that's adopted will not be acceptable to investors and, therefore, result in a real difference of view between management and the board of directors.

I'll close by commending to you two articles in *Fortune* magazine within the last year. The first was an interview by the reporter with Daniel Vasella, who is the chairman of the board of Novartis, a major Swiss pharmaceutical company, and the other is an article by Bill George, the recently-retired CEO of Medtronic Corporation. Both are quite well known here at the Harvard Business School. Both have been participants in Jay Lorsch's symposium on corporate governance issues, and each of them discusses the tremendous pressure that they felt as CEOs to meet quarterly earnings goals, the pressure that they got from analysts, portfolio managers and so on, and how difficult it is for a CEO to resist those pressures. They discuss how many CEOs succumb to those pressures to create reserves or, in one way or another, to fiddle with the books, cook the books, some of them crossing the line in the scandalous situations, actually committing fraudulent acts. I'm not at all sure that passing to a potpourri of shareholders the ability to have that much influence on the board of directors and management of the corporation is going to be good for the business of the corporation and, accordingly, good for the economy of the country. On that note, I'll end.

Mark Roe: Thank you, Marty.

Lucian Bebchuk: What I do in my paper for the Business Lawyer symposium, and what I'll try to do here, is to give an overview of the case for shareholder access to the ballot. The starting point is – and it's worth reminding us of this starting point -- that elections do play a critical role in the accepted theory of the corporation.

Chancellor Allen, in his well known *Blasius* opinion, reminds us that “the shareholder franchise is the ideological underpinning upon which the legitimacy of the directorial power rests.” In *Unocal*, the Delaware Supreme Court stresses that “if the shareholders are displeased with the action of their elected representatives, the powers of corporate democracy are at their disposal to turn the board out.” Marty Lipton and Paul Roe, in an article published last year in support of takeover defensive tactics, stress that, whereas shareholders should not have a choice with respect to takeovers, shareholder choice has a place elsewhere. They say: “There is one critical place in the statutory scheme for ‘shareholder choice,’ ... ‘shareholder choice’ is excised in elections for corporate directors.”

Shareholder power to replace the board is supposed to serve as a safety valve, improving both the selection and the incentives of directors. But this safety valve is actually missing; it's largely a myth. Marty and Steve said earlier this morning that shareholders have the right to nominate directors. But this right is very theoretical. To see that this is the case, let's take a look at the data.

In the last several weeks - with the help of some students, especially Fred Pollock and Rob Maynes who are here in the audience - I looked at the incidence of challenges to the board of directors. There were 200 cases of contested solicitations in the seven-year period from '96 to 2002 - that's roughly 30 a year. And as Marty and Steve mentioned this morning, there were about 40 such cases last year. But only a minority of these cases were of the type to which the above quotes refer.

The contests about which the Delaware Supreme Court talks in Unocal are ones in which a rival team proposes to run the firm as an independent entity in a way that would serve shareholders better. Of the 200 cases of contested solicitations, some are not about directors, many are in connection with an attempt to acquire or sell the company, and some concern attempts to open-end or restructure a closed-end fund. We were able to find less than 80 cases during the seven-year period 1996-2002 in which a contest was fought over who will run the firm as a stand-alone entity. This is about 10 per year.

Moreover, among the companies that were the subject of such attempts, most were very small companies. In terms of market capitalization, about 25% percent were below \$30 million, 50% below \$37 million, and 80% below 200 million. So we were able to find only 11 such contests - it's less than two a year - for companies with a market cap above \$200 million.

Steve Rosneblum suggested earlier that our session should be titled "Should we have more elections?" I am happy to have this characterization of our subject. Given the above data, our question is whether we should have more elections than the negligible number we currently have. To concretize the likelihood of an electoral challenge that directors are currently facing - the likelihood of their confronting such a challenge in any given year is roughly similar to the likelihood of their being killed in a traffic accident in that year.

Also in terms of empirical evidence, a substantial body of empirical evidence produced by various researchers now indicates that insulation of boards from takeover threats hurts shareholders. Researchers have found that such insulation reduces firm value. It leads to worse performance along several dimensions, and it makes executive compensation less sensitive to performance.

Marty Lipton talked earlier this morning about the pressure from investors to de-stagger boards. It is worth mentioning in this connection an empirical project about staggered boards that Alma Cohen and I have recently completed. We find that charter-based staggered boards are associated with a reduced market value. The reduction in market value associated with such staggered boards is economically significant, with a median of about of about 6%. These findings, of course, raise questions of causation that we are exploring in our study. But the only point I wish to make here is that the shareholders pushing for de-staggering boards might not be completely wrong.

Now, I agree with Steve Rosenblum that the question of “What’s the optimal incidence of electoral challenges?” is a difficult one. It’s certainly less than 15,000 a year – it’s much less. But I think it’s highly likely that the optimal incidence is higher than the negligible one we have at present. If so, it would be desirable to move the incidence up. Furthermore, we must keep in mind that the current proposal is a very mild, moderate step, unlikely to produce overshooting.

The proposal currently under consideration is moderate in several ways. It’s only about short slates. Furthermore, there is not going to be any reimbursement of campaign costs (which is desirable for reasons I discuss in my paper). Without any reimbursement of outsiders’ campaign costs, it’s not going to be the “proxy contest on the cheap” that worries Marty. It’s going to be a bit cheaper, but it’s not going to be all that cheap. In addition, we’re going to have ownership and holding requirements, and the SEC is now talking about adding triggering events; such triggers would make the arrangement too mild in my view, though still a step in the right direction.

In my paper, I tried to go over all the objections that appear in the letter comments to the SEC and to explain why none of them provides a good basis

for opposing the proposal. With the paper providing a comprehensive response to the full range of objections raised, I'll just note here the weaknesses in some of the main objections.

One main objection is that shareholder access would produce a lot of disruption and waste. However, given that there will be costs and threshold requirements, we are probably going to have only a limited number of contests. More than a couple a year for over 200 million dollar companies, I hope, but not a very large number. In any event, since the SEC can adjust the threshold requirements as experience accumulates, it can ensure that the incidence of contested elections will not grow too much.

A second objection that opponents make is related to what Steve Rosenblum said earlier. He wondered: if the reform gets you to 30 or 40 electoral challenges a year, is this such a big deal? Well, if it's not a big deal, why are Marty and Steve and other supporters of board control so concerned about the change? The reason is, I think, that 30 or 40 electoral challenges a year can have a system-wide consequence. Thus, actual costs will be incurred only, say, in 30 or 40 cases, these contests are going to have an impact on accountability across the board.

A different set of objections accepts that shareholder access could have a significant impact, but argues that their impact on the composition of boards would be a negative one. One concern that is raised is that we'll have special interest directors. But the shareholder access proposal does not really open the door to special interest directors. This could happen if we had cumulative voting, so that 10% of the shareholders could get a person on the board. But with the majority of the shareholders necessary to elect a shareholder-nominated candidate, special interest directors would not be elected. Indeed, when you look at the patterns of voting on precatory resolutions, you find that proposals catering to special interests do not come even close to passing. The only proposals that ever get sufficient support from institutional investors to get a majority are those that institutions conclude, whether correctly or incorrectly, would increase shareholder value.

Opponents of shareholder access also worry that the election of shareholder-nominated directors creates a risk that the board would be Balkanized and become dysfunctional. But this risk is one that voting

shareholders would recognize and could take into account. They would presumably vote for someone only on those rare occasions in which they conclude that, given directors' dismal performance or their corporate governance failures, the risk of Balkanization is worth bearing. Note also that the number of cases in which shareholder-nominated candidates would be actually elected would not be large, whereas the benefits would result in companies across the board.

It is worth noting that, in their well-known article from ten years ago Marty Lipton and Steve Rosenblum found a shareholder access regime acceptable. To be sure, they proposed to have shareholder access in the context of a proposal to prohibit hostile takeovers, which the law has since largely done, and they proposed to have elections with shareholder access only once every five years. But the mechanism that they propose, and that they thought would work well, is similar to the one that we are discussing here. Under their proposal, shareholders with over 5% would be able to put someone on the ballot. Indeed, Marty and Steve were willing to provide challengers with a reimbursement of costs. They also dismissed the concern that we would have a wholesale replacement of directors on grounds that the main effect of such reform would be indirect: the very credibility of an electoral challenge would lead directors and managers to behave differently.

Marty Lipton talked earlier about the concern that, if we make directors more accountable to shareholders, this will subject management to incentives and pressures to act in a myopic, short-termist way. The claim that shareholder influence will lead to corporate myopia is one that has been often invoked by supporters of insulating management from takeovers. But there is no empirical evidence that this kind of effect is of significant magnitude. To the contrary, the empirical evidence indicates that insulation from takeover pressures is correlated with lower firm value and worse performance.

In any event, even if one is concerned about management's not being able to pursue a long-term strategy, one should at most oppose having real, serious elections each year. Holding this view might lead someone to seek measures that facilitate an electoral challenge only every two or three years. But such measures are necessary at some point. The answer to when a serious electoral challenge could be mounted should not be "never."

Opponents of shareholder access also raise the issue of other constituencies, the stakeholders. The claim is that we shouldn't increase accountability to shareholders, because that might come at the expense of stakeholders. It's good to insulate management, so the argument goes, in order to enable it to protect stakeholders. But we must keep in mind that directors' interests are hardly aligned with those of stakeholders. Thus, by providing broad insulation, we are reducing accountability to shareholders, but we are not creating accountability to stakeholders. Insulation simply creates accountability to no one. It protects and facilitates occasional poor performance that can hurt not only shareholders but likely also stakeholders.

I also would like to say a few words about the objection that "maybe it's a good idea, but now is not the time." Now is not the time, it is argued, because we already have some recent and pending reforms, which would increase the dominance of independent directors on boards in general and on nominating committees in particular. But director independence, by itself, is not a magic cure-all.

For each company, there are millions of people who would qualify as independent director. In the face of such a vast pool of independent candidates, the question is: "How do we ensure an optimal selection of those people and to provide those selected with the right incentives?" For these purposes, we need not only independence from insiders -- but also some dependence on shareholders. Even if we expect the nominating committees to do a pretty good job most of the time, it would be beneficial to have at least a limited safety valve. Indeed, having the safety valve would make it more likely that nominating committees would work well to begin with.

Let me conclude by answering Steve's question. Do we want to encourage more contests than the practically zero contests we now have for public companies of any significant size? The answer to this question should be "yes." The case for moving the incidence of electoral challenges up is very strong. How far up might be a question, but not one that we need to bother us when examining the moderate step that the SEC is now considering. Indeed, for reasons that I discuss in my paper, it would be desirable to adopt some additional measures for further invigorating the corporate elections process.

Mark Roe: Marty? Steve?

Martin Lipton: Ah, yes, we have comments, I'm sure.

The statistics that Lucian uses are essentially irrelevant to the debate. It isn't a question of how many election contests there are, whether companies that have staggered boards do, in fact, have a lower market value than those without. For every one of the statistical studies one can find a counter statistical study. The real issue here is: will this have a beneficial impact on the way companies operate? Because what we're really concerned about is: what is the overall impact on a society that, basically, is a corporate economy society?

Today it has become extremely difficult for companies to recruit new directors. I think that this proposal will exacerbate that problem. The combination of the reforms, together with the litigation and reputation exposure, has done two things. One, most major companies are now limiting the number of boards their CEO can serve on. Many, many companies today say to their CEO, "You can only serve on one outside board" for a combination of reasons, but the principal one is that the job of a director today takes so much time that an active CEO really doesn't have the time to serve on three, four or five boards. At best, that's something that a retired CEO can do.

Anything we do at this time that is a deterrent to companies being able to create boards that can be helpful with respect to the strategy and the business of the company is a mistake. I think that most boards - the overwhelming majority of boards of the major companies today - are acutely aware of the governance issues, and so on, and we don't need a further safety valve. The safety valve is having a board that has a majority of independent directors, and appropriate procedures so those directors focus on the issues that they should focus on. The history of the past 10 years, starting with General Motors, is that boards of major companies will take action to change management when it's clear that management should be changed.

Mark Roe: Lucian? Couple of minutes?

Lucian Bebchuk: A quick reaction to Marty Lipton’s point that “the statistics are irrelevant.” The question of “What way would it be better to run the economy?” cannot be resolved fully except with hard empirical evidence. There are policy arguments on both sides and empirical evidence is needed to shed light on the significance and magnitude of potential effects. Marty said that for each study, there is a study that goes the other way. But I don’t know of any study that shows that board insulation in general, and staggered boards in particular, improve value. And if Marty can find or produce such a study, I promise to write a strong letter to the SEC objecting to the shareholder access proposal.

One point that Marty made—and this is a point that probably rings strongest of all the objections filed with the SEC—was that the considered reform could deter good directors from serving, so it could make matters worse rather than better. We should keep in mind that, in the business world, individuals holding various business positions may generally be replaced to provide a safety valve for selection and to provide incentive. And this makes me wonder: is there no way to run our corporate system without ensuring that the people at the very top face no risk whatsoever – even not a risk of 3% a year – of an electoral challenge.

Note also that, if the proposed measure is adopted, directors asked to serve on a board will not have to expect that they will necessarily and immediately have to participate in a contest. They would just face some likelihood that, down the road, if the company doesn’t perform well, a short slate might be run against them. This sort of small risk is something that we could compensate people for. The value of improved accountability and incentives in our large publicly traded companies is sufficiently significant that we should not be deterred easily by having to increase compensation to directors.

Martin Lipton: I don’t see anything in this proposal about it being triggered by the company not running well, Lucian. And as you well know, what’s going to trigger this is not the way the company runs, but whether some gadfly’s favorite corporate governance point has been acceded to by the Board of Directors, and whether enough pension funds and union funds will be frightened enough by ERISA or something else into supporting the position that the gadfly is urging. So if this was, in fact, an election based on

whether the company was doing well or not, you'd have a valid point. Absent that, I think that you're accomplishing nothing favorable. Insofar as comparing companies, unless you're comparing peer companies with respect to things like staggered boards or poison pills or something else, your statistics are totally invalid.

Lucian Bebchuk: Actually, we *are* controlling for all the relevant company characteristics. We will send you the paper and we look forward to comments. As far as we can tell, we have controlled for all the relevant –

Martin Lipton: All of your studies, Lucian, your control points and mine are totally different. Staggered boards, poison pills, and so on...

Lucian Bebchuk: Okay, but –

Mark Roe: In lieu of reading the papers right now, why don't we... Lucian has a quote. And then after the quote, questions and comments from the rest of the group.

Lucian Bebchuk: Marty was asking me, "Why would it happen mainly with poorly-performing companies?" Well, if we look at the current proxy contests, most of them are for companies whose performance is worse than the industry. We can expect that shareholders will have a meaningful chance of electing a dissident short slate, and thus will bother to nominate one, primarily when performance is rather poor.

In their article on their quinquennial proposal, Marty and Steve explained why they thought that a five percent threshold will get it right as follows: quinquennial proposal "These thresholds are high enough to exclude 'gadfly' stockholders, but low enough not to impede the serious, substantial stockholder who wishes to propose nominees ... in an election contest...". I also believe that a threshold ownership requirement of this sort can serve as a good screening device. The screening mechanism that was good for Lipton and Rosenblum in their youth should be for good enough for us and for the SEC today.

Martin Lipton: It's my very old age; it was Steve's youth. But again, you're taking it totally out of context. It was in the context that the election would be

based on the company's performance, with performance statistics. It had nothing to do with thresholds or anything else other than that was the starting point. The whole purpose of the proposal was to have a focus on the company performance in relationship to the performance of peer companies. So, again, you're taking it out of context to make your point. That's not what we were proposing. We were not proposing, willy-nilly, that at some threshold, institutions should be permitted to run an election contest at the cost of the company.

Mark Roe: Questions? Comments? Mechanics – say your name, if you like, a short biography after your name and a tape, then, will be transcribed.

Robert Monks: I'm Bob Monks, and I'm never sure what a gadfly is. The people I refer to as gadflies, I don't like, but I've been referred to as a gadfly very often by a lot of people, and, as I hear the discussion, I really want to put it in some kind of context, and the context is: do we presently have a problem? And to my way of thinking, going back to 1992, Congress indicated, as a matter of public policy, they wanted to discourage increased pay for CEOs, and they wanted to put a \$1 million cap on deductibility.

According to Pearl Meyer, the compensation consultant in New York, the principal managers of American companies own, or had options on, 2% of the total of public company stock in 1992. In the year 2000, according to Pearl Meyer, they have 13%, so during the 90's, 11% of the total capital of publicly-traded companies moved, in effect, from shareholders to managers. A certain amount of this, deservedly, is called "stealth" compensation, because people really did not understand the implication of options. I submit that this is the classic case of the definition of a problem. It's, in effect, a 10% tax on shareholders in a year. How many more 10% decades can shareholders stand? How soon are we going to destroy a common stock as being something that intelligent people buy as a repository for their wealth?

We already see, increasingly, people going into private equity. Why do they go into private equity? Well, if you get 10% taken off every ten years of the value of your holding, it's not going to be very valuable, so I think there's a kind of crisis. So, as I listened to the discussion – which is a very informed and learned discussion, for which I am grateful – I'm a little confused, because to my way of thinking, we have to do something. The situation is not

tolerable, the present level of CEO pay is not tolerable, and the only question is *what*?

Now, having been involved in the effort to effect change in a number of these things for many years, I am drawn back to the fact that the really legitimate place for shareholder focus is on the board of directors. I mean, shareholders really have no business trying to manage companies – they’re not paid to do it, they’re not qualified to do it – but one place where ownership expresses itself is through the composition of the board. As a practical matter, the board is – it’s not a secret – a self-perpetuating institution. So long as it is a self-perpetuating institution, there really is no meaningful way for shareholders to be involved in the process. So the question, to me, is *how* they should be involved.

Now, anytime anybody stands up and makes a proposal for how they should be involved, they will be wrong, because they will make a mistake. That should not bother anybody. What is really important here is that the proposition of the entitlement and the propriety – indeed, the necessity – of shareholder involvement in the selection of directors be affirmed.

Mark Roe: I’ll interpret that as a question to Marty.

Martin Lipton: I thought it was an affirmation for Lucian.

Mark Roe: There were other hands. Brian? Brian Hall?

Brian Hall: Yeah, I do have a question for Marty. Brian Hall, professor at the Harvard Business School. I don’t understand your comment about the independence of directors, because one of the things that seems pretty clear is that even if we passed rules that ensure independence, that there’s really no effective way, when the CEO is the Chairman of the Board in a self-perpetuating situation, that that influence isn’t going to be very strong. I mean, that is the fundamental problem – is that the board is not independent, and I just don’t see how we could have any comfort, given our current situation, that that won’t continue. There’s just really nothing that can penetrate that board, if the CEO is exercising an influence. The screening is going to happen no matter what we do, and I don’t understand what counter-proposal we have to solve that.

Martin Lipton: I'm going to refer your question to your colleague, Professor Lorsch, who's sitting there in front of you, who is much better at responding to it than I am.

Jay Lorsch: Brian, I just really don't agree with you that it's impossible for boards to be independent. We've made a lot of progress in that direction. There's no question in my mind that independence is not only a legal concept, but a psychological concept, and that directors always have the problem, the longer they've been on the board, of maintaining their independence from the management and the CEO, particularly if the company is doing well, but I think, you know, unless we're going to scrap the whole idea of boards of directors as we know them in America, we've got to stay with this idea of independence and believe we can make it work.

Brian Hall: So, Jay, you wrote a terrific book about 12 years ago, and the basic point – really a great one – was just that boards often look like pawns. Read the WorldCom report today, if that looks like a pawn board. I agree that things have gotten better, but it sure looks like there's a lot of pawn behavior going on out there; I'm not sure what it is that we have that's going to stop that.

Jay Lorsch: Well, you and I need to go across the river and have this debate.

Mark Roe: After that, Chuck Nathan.

Charles Nathan: It's Chuck Nathan, and the issue I'd like to raise for both Marty and Lucian is along the following lines: Marty, in the beginning of his remarks, gave what I believed to be a very fair characterization of the true dynamic of today's board in the face of precatory proposals, at least in the area of governance, and perhaps farther than the area of governance; that, very often, they lead to a negotiation with the proponent of the precatory in an effort to get the precatory proposal withdrawn and find an accommodation that is deemed suitable by the proponent, very often a large public pension fund or union pension fund, and I think Lucian skirted around the same issue.

The question I have is: are we really talking today about 15 or 20 or 30 of what Alan Beller calls “small-‘c’ contests” for directors – you know, for shareholders to place directors on board. Are we talking about a fundamental shift in the power relationship between the large public pension funds and union funds and boards of directors that will be exercised and take place behind the scenes in negotiations not only about who is on the board, but about all other sorts of corporate behavior. I mean, isn’t that the real issue that we’re addressing today, although we’re not characterizing it that way?

Martin Lipton: Yes.

Lucian Bebchuk: No, but...

I wish to comment on the precatory resolutions and the “pressure behind the scenes” that Marty and Chuck talked about. There are about 200 resolutions for dismantling or de-staggering boards a year, and most of them receive majority support. It’s still very common for the board, whatever happens behind the scenes, to ignore a precatory resolution in favor of de-staggering the board. Boards do so even though the staggered boards are often ones that were installed back in the 80’s or even earlier, when their current anti-takeover significance was not fully anticipated.

I also wish to react to what Chuck said about unions and pension funds. The concern is that their influence might be dangerous because they have an agenda that does not fully overlap with increasing shareholder wealth. But the unions and the pension funds generally do not even come close to having a majority of the votes. Thus, the issues that can lead to a majority vote against management are only those that have substantial and broad support from institutional investors that focus on shareholder wealth.

Mark Roe: Joe, you were going to say?

Joseph Grundfest: Yeah. Joe Grundfest, Stanford Law School. Two observations and a question for Marty and a question for Lucian to keep it fair. First off, I think it’s clear that if you like, or if you’re entertained by the California gubernatorial campaign, you will love the commission’s proposal. There are fundamental similarities there, and one should expect similar experiences.

Second, Marty made an observation that I think is accurate with regard to an authority that shareholders already have – and Bob and Sarah, they know about this authority – is to withhold authority for the re-election of a director. It's my impression that a large percentage of directors have fairly thin skins on these issues, are susceptible to a great deal of pressure and to moral persuasion and the like, and perhaps shareholders haven't been using authority that they have had for a very long period of time most effectively to try to get to many of the changes that many of the shareholders want to have. So if we see a bit of a governance crisis, is it possible that part – I'm not suggesting all – that part of the responsibility comes from the fact that the shareholder community itself hasn't been as effective as it could have been in joining issue with corporate boards?

The question I'd put to Lucian first is, that I agree with your reading of the data with regard to shareholder value – that the evidence is that if you insulate corporations from takeovers, that's very bad for shareholder value – but many of these proposals we're talking about have nothing to do with anything that's ever been demonstrated to enhance shareholder value, and they are susceptible to being vehicles for special interest agendas, and as Marty, I think correctly, points out, there's no reason to expect that the commission is going to link that way.

And the question that I'd put to Marty is – and here I'm quoting you, you just said that “If this is an election on whether a company is doing well, you would have a valid point” – but that's what I thought a takeover was about, and much of the agenda that you've been advocating over the years, Marty, raises the cost of an election about whether a company is doing well, and, from my perspective, I'd be willing to grant tenure to boards of directors, make them academic-type positions, make them monarchical, if you had an easier market for takeovers. If somebody said, “Look, this is not a proxy on the cheap; this is a proxy on the expensive. Here's ten billion dollars; here's an X percent premium over what the company is trading at today. That's as expensive as a proposal gets. Let's put it up for a vote – take it or leave it.”

Mark Roe: So, Marty? Tenure? Takeovers?

You could just say “yes” again.

Martin Lipton: I guess I could say yes. I think it's the whole point of the quinquennial proposal – a referendum on whether the company was doing well, rather than a different way of getting at a change of control for companies that aren't doing well. I think that shareholders *should* change the management of companies that aren't doing well. I think that there's virtually no permanent takeover defense today, Joe. It is extremely rare that a company remains independent in the face of a takeover bid today, or very, very rare that a board stands in the face of a cash bid at a significant premium for 100% of the shares of the company. In most cases, the effort is to use the takeover defense to try and obtain a better deal for the shareholders. So I don't really see any need for this kind of proposal to deal with the takeover issues.

You and I have always disagreed with respect to takeover defenses; we're not going to agree today or in the foreseeable future. I don't see any real utility to unlimited hostile takeovers, and I don't think the results on a zero-sum basis have been favorable for the shareholders of companies at all. You need to take into account the shareholders of the acquiring company and balance that against the obvious profit or benefit that the shareholders of the target company get and, therefore, it's not beneficial for the economy as a whole. But I'm afraid that's a debate that's taking us off the main point of this.

As I said to you, I think your idea with respect to withholding the votes is an interesting idea. I don't think you'd need to go as far as you've gone with it in terms of handicapping the director who's had votes withheld. Just the withholding of the vote is a very potent weapon, and before the SEC takes this step, we ought to have a bit more experience with that. I think the CalPERS position with respect to the audit committee members is an interesting experiment, and we should see how that goes.

Mark Roe: Lucian?

Lucian Bebchuk: Joe Grundfest views pressure from shareholders to dismantle the takeover defense as good. But then has asked "What about all those other proposals out there?" Well, the evidence on precatory resolutions, which the Georgeson shareholder website provides, indicates that the only

proposals that pass are those about de-staggering the board and dismantling poison pills. Proposals that are of a special interest or social activism nature regularly fail to pass. Mutual funds and money managers, whose support is necessary to getting a majority, do not vote for such proposals. The evidence suggests that institutional investors are somewhat deferential to management, and that they will support proposals opposed by management only on issues such as takeover defenses where they feel that management's position is clearly not serving shareholder wealth.

As to Marty's point that, in the end, takeover defenses do not really prevent takeover targets from being acquired: John Coates, Guhan Subramanian and I provide evidence on this issue in an article published last year. We find that a majority of the companies with an effective staggered board that receive a hostile takeover remain independent -- both in the short run and in the long run, defined as two and a half years down the road. Furthermore, remaining independent reduces significantly, both in the short run and in the long run, the returns to target shareholders. The evidence on this topic, at least, is clear: takeover defenses do work, and they do so to the detriment of the shareholders of targets that have them.

Mark Roe: I've seen several hands pop up in the last few minutes, and we now have about a few minutes to do it, so why don't we work on short, pointed questions and short answers. Matthew Bishop?

Matthew Bishop: Yes, I was rather shocked by Marty's denunciation of the quality of people on corporate boards and in shareholder institutions; they seem to be these figures that will roll over at the first criticism by a shareholder to a corporate board member, and you won't be willing to go to a board if you're going to be criticized and in some bruising election. Likewise, institutional shareholders, you seem to feel, are such weak people that a trade union could put a proposal on a proxy and they'll just roll over and vote for it for fear of being embarrassed.

I must say, my experience of dealing with people both in shareholding institutions and on company boards, as a journalist, is that they aren't these figures, but I'm willing to go with this that they're all terribly weak and feeble individuals, and I was wondering what Marty feels we can do, actually, to

raise the quality of people on boards and journalists on boards might be the answer.

Martin Lipton: What we have to do is put journalists in both positions, as portfolio managers and as corporate directors.

Matthew Bishop: Strange that we've never been asked. I'm willing to sell out, though.

Martin Lipton: How noble!

Alan Beller: This has been extremely interesting and helpful to me. I think there is a sea of windmills in the middle of this table, and I think that this conversation and, I think, the subsequent ones might be more interesting if we got some of them out of the way. I might be able to help since I suppose I know more about what we are contemplating than others. First, to Joe's comment - I'm sure the average intelligence has gone down at 4 55th Street since you left the building, but I *promise* you we are smart enough to avoid the California election whatever it is.

Secondly - and more seriously - a lot of the discussion has focused on the inter-relationship of what the SEC might be thinking about and the current issues with respect to precatory shareholder proposals. It is true that the Division's report talks about adopted, unimplemented precatory proposals as a possible triggering event. For those of you who weren't at dinner last night, I did spend a little time talking about why that prong suffers from some issues of indirection and the like. I don't think the discussion today should be anywhere near dominated by that particular issue. I think there are more important ones out there to talk about.

And I suppose the last thought I would share with you is I don't quite understand the on-the-cheap point, and I don't quite understand the at-the-company's-expense point, with respect to this kind of a short-slate proposal. At least, I don't necessarily understand it, and it seems to me a more profitable dialogue around those points would be, "What should companies be required to do if you have such a proposal?" Don't assume it looks like 14(a)(8); don't assume anything.

And secondly, I think— I don't understand how one can expect the majority vote without some activity by the proponents, and I don't think that's "on the cheap." Any proposal of the sort talked about in the report would not require the proposing shareholders to make that very expensive initial mailing to all the shareholders. That, I would ask you to discuss as the principal economic difference between what might result if the commission were to move forward, and the case today, and I guess I don't understand why taking a million dollars of the shareholders' money and throwing it in the wastebasket is either an expense to the corporation or causes the election to be "on the cheap."

Now, to my question, because I wouldn't have raised my hand without one. Marty, would you be interested if we had a triggering event? We've talked about it in the report as a possibility. Suppose we had a triggering event that *was* tied to corporate performance: Less than X percent earnings or EPS increase over the last three years; less than Y percent return on assets. Would it be appropriate to open the kind of proxy process we are talking about to be used at companies where these kinds of performance targets aren't satisfied?

Martin Lipton: Not on the basis of your proposal right now. There are things like the quinquennial proposal, where I think that is an appropriate approach. But I think this approach, the approach that, in effect, is opening every company to a proxy contest with respect to some members of the board of directors, is a mistake.

Alan Beller: Every company that doesn't perform.

Martin Lipton: Every company; every company, whether it performs or not. I think there are means for dealing with under-performing companies or companies that are not performing, but I don't think this is the way to accomplish it.

Mark Roe: Okay, a couple more questions, and then maybe a minute or two...? I see Michael Price right now, and Leo Strine.

Michael Price: I'm Michael Price. I used to run a mutual fund, now I'm an individual investor. A few comments on what I've heard, and then one big

point that I think everyone is ignoring. The comments are first to Bob Monks, on the idea of “We’re giving 10% of our equity away, and that’s why so much money is flowing to private equity,” makes no sense if you look at what private equity managers get paid.

Robert Monks: I know what they get paid.

Michael Price: It doesn’t go anywhere. I think there’s also a kind of blending of shark-repellant arguments with this corporate governance issue. To me, a staggered board is solely shark repellent. I don’t like ‘em. But it has nothing to do with outsiders proposing directors.

And the last point – and then my big point – is there seems to be a grab of power from Delaware, mostly, and other states, to Washington, in this effort, and, basically, since ‘92, and even back into ‘80, we had pretty good success with forcing change. I think that boards today are not circling the wagons the way they did in the 80’s. I think boards and managers, CEOs – and their lawyers, because, you know, often, they’ll sit in on meetings if we call someone to task – will really push hard. They have a whole different mentality, and this is not the time to introduce this kind of grab by Washington from Delaware.

But there is one big problem I have, and we all have, and that is you can’t find good directors. Okay? If there are 10,000 more-or-less decent-sized companies in this country, so that means there are, call it 60,000 outside non-management directors? Maybe 500 or 5,000 are good. Maybe. And, out of those 10,000 boards, I’ll bet you half of them are looking to add at least one, and 10 or 20% are looking to add two or three directors today. They’re all doing searches. There’s no way to find anywhere near that number of directors who will take phone calls on a Saturday morning when they have a golf game, right? Who have a net worth, because they’re 60 years old and they have some net worth, that are going to subject themselves to, you know, lawsuits by shareholders, SEC actions, shareholder criticism, *The Wall Street Journal*, *The Economist*, whoever want to write about them, okay? They’re not there today!

So here you’re all arguing about, “Oh, let’s put guys up or not.” There aren’t good people to put up. That’s our big problem. Finding directors (a)

who have credentials is number one, and (b) who have backbones. You might have credentials but you don't have a backbone. And the third is they have to be paid a lot more than they've been paid, so we're ignoring the fact that they're not there to put on boards.

Mark Roe: Leo? So you scared away all the good directors?

Leo Strine: Leo Strine from the Delaware Court of Chancery. I was struck by how much this current discussion really, as Mike said, this is really a sort of sideshow to the real discussion, in that what we're doing is trivial things, so that the SEC doesn't have any real Congressional mandate to do any of this, and the stockholder advocates are frustrated about staggered boards... Why not just go to Delaware, ask us to get rid of staggered boards in exchange for management not having to deal with silly precatory proposals, and then we'll see how that works for a couple of years with Sarbanes-Oxley.

Now, that might be a mature discussion about costs and benefits, but this seems to be about people not wanting to put up long slates, they want to put up short slates, and they want to do it every year in a few situations, management doesn't like that— I mean, it doesn't really sound like a real debate about institutional change in any sophisticated way that takes into account, "Where are you going to get these people? Who's going to fill out these slates?" And if you only want to put up short slates because you can't put up a long slate, maybe you're not really a responsible entity to be determining the future of a public company.

Martin Lipton: I'd back that deal right now.

Mark Roe: People will have more chances at the microphone later in the day. Why don't Lucian and then Marty or Steve take a minute to sum up, or get one point that you've got to get out before we take a coffee break?

Lucian Bebchuk: Just a quick reaction to the discussion of antitakeover arrangements. Antitakeover arrangements and the absence of shareholder access to the ballot are quite connected. Michael Price views them as very different things, but they are connected in that both are part of what defines how insulated the board is from shareholders. And, as Joe Grundfest said

before, strong insulation from takeovers that now exists makes the voting mechanism all the more important.

Also, Michael said that having shareholder access will require paying directors much more. But improving the incentives and selection of directors even a bit would be valuable to have – given that publicly traded companies have a value in the order of \$10 trillion – even if this required paying people somewhat more, or even significantly more.

Mark Roe: Marty? Steve?

Steven Rosenblum: Just a couple of points. One is about statistics – and I generally agree with Marty that they are largely irrelevant – but I was interested that Lucian’s statistics went from 200 election contests in seven years, to two a year, to one a year, to practically zero, and to being similar to the risk of dying in a traffic accident. The fact of the matter is that the incidence of election contests today does drive and affect director and management behavior. Just as the fact that not many people die in traffic accidents doesn’t stop people from wearing seatbelts and worrying about car safety. And there are many other avenues already that are putting pressure on directors, and pressure on management, to be responsive.

I think that Michael is actually right in that there’s been a huge transformation over the last fifteen years. There’s been a whole panoply of new governance proposals that will have impacts – exactly what they are is too early to tell – but to be throwing this on top of all those is a mistake.

And your point that the SEC can gain experience and then modulate the threshold to create the optimal incidence of contested elections, I think, is just wrong. Once the threshold is set, you’re never going to raise the threshold, at least in the near term politically. In the governance environment we have today, it’s just not doable. So you’re taking a shot in the dark that we think is going to have an adverse impact, if any impact. And I’d also agree with Michael and Leo that it’s really missing the point, which is finding good managers and good directors to perform better. This proposal will not help that; it can only hurt.

Mark Roe: Well, thank you. This is a good discussion. We've got a whole day ahead of us, and I can see that minds are being changed and people are giving up opinions that they had when they came in the room! Coffee break, and then we reconvene in about fifteen minutes.

Session 2: The Board/Management Perspective

Panelists: Richard Breeden, Richard C. Breeden & Co.
John Castellani, The Business Roundtable
James Rogers, Cinergy Inc.
Ralph Whitworth, Apria Healthcare Group and Relational Investors

Moderator: Jay Lorsch, Harvard Law School

Jay Lorsch: Okay, good morning. Good morning again. We'd like to get started. I thought Mark did such a good job of being a moderator that I was going to follow his example, so say very little, and ring the bell when necessary. We have four distinguished gentlemen who are going to give us their views about this proposal, and although he's objected, we had a little discussion here and decided we'd go in alphabetical order. So we'll first hear from Dick Breeden, and then go alphabetically from there. We'll try to take about five minutes each, so we'll have some time for questions and answers and discussion afterward. Dick?

Richard Breeden: Thanks, Jay.

Jay Lorsch: You're not going to read that whole report, are you?

Richard Breeden: I'm not going to. I was just going to say I hope you all work hard on getting the balance right of accountability and responsiveness versus concerns of orderliness and tidiness that we've been debating this morning, because if you don't, then you may wake up someday, and find you have a corporate monitor, and you'll get a whole bunch of recommendations. You won't have just one recommendation to deal with, you'll have about seventy-five.

While I'm on that subject, because it has been a question of some debate out there as to whether restoring trust represents a set of recommendations that every company in America ought to adopt, and I just wanted to indicate that WorldCom - and I don't delve into its sordid past and

history – but it was about as bad a set of facts of corporate governance as could occur, and so I think not surprisingly, the clean-up there involves everything up to, and including, the kitchen sink. And I think all the recommendations we put forward, we thought are a good idea for WorldCom, and would work at other companies.

That doesn't mean that every company ought to adopt all of them. We do think it's a menu of items that a particular company in a particular set of circumstances can look at the different suggestions that we've made and, some of them may make sense in a particular company, none of them may make sense in a particular company, or all of them might make sense, but governance is not a one-size-fits-all, and we weren't trying to write a piece of legislation, and we didn't have the challenge that Harvey and Allen have of working on regulations that would apply to all of corporate America. It was a tailored solution to try to clean up one very big, very sick company, and to really fix the problems of that company.

Apropos of this issue about the regulations, obviously the point in our report that bears most directly on it is a requirement that the company, commencing in 2005, have at least one new director every year, and it must utilize a process under which the nominating committee, upon developing a list of nominees, could be in an ad hoc group of shareholders representing at least 15% of the shareholdings of the company. Hopefully, they could agree on candidates that the company was considering would be proposed. If they're acceptable, fine. If the shareholders object, they would have a discussion. If they couldn't agree on a mutually acceptable candidate for that vacancy, then the shareholders group would have the right to put an alternative candidate on management's proxy.

In our system, there is no requirement of triggering events. The triggering event was the destruction of \$200 billion in shareholder value. We think that's enough to trigger a bit of intervention, and so that's the system that will be in effect if there are any vacancies in 2004. You'll see it work in 2004. If not, you'll see it working in 2005.

Just to mention briefly a couple of other issues that are touched and some related points: I was struck a little bit by the discussion of whether or not you can find directors. Maybe going on the board of MCI is the most

attractive offer that anybody could get these days, but I've been actively involved in the search process of looking for new directors, and I can tell you that we had more than three times as many candidates – *good* candidates, I mean very solid candidates, every one of whom met standards of excellence – for every seat on the board.

A number of those people – Eric Holder, one example, former judge, both state judge and federal judge, and former deputy attorney general of the United States, had never served on a public board. I think there are lots and lots of people in this country who are highly capable board candidates, including, I suppose, journalists. We certainly didn't find any difficulty, though we did go a bit outside the normal pond to fish in, looking for our candidates, but we certainly had no trouble finding them.

We also believe pretty solidly on the question of whether you should pay directors more. So many companies in the U.S. say they can't find any directors, but they do expect their directors to put their entire personal net worth at risk for a relatively tiny board fee: \$30 thousand, \$40 thousand, \$10 thousand to sit on an audit committee is not uncommon in the U.S. At WorldCom, the annual board retainer was \$35 thousand a year. The board met four times. The compensation committee met seventeen times a year, reflecting both their per-meeting fees and their priorities. We increased the board retainer substantially.

A lot of people don't want to do that because, I guess, there's a notion that if we paid directors more, heaven forbid they might think they're supposed to *do* something, and we actually do expect our directors in the future to attend quite a few meetings of both the Board itself and committees to be actively involved with the Company in assessing and evaluating its risks and working with management, and we think that's a very big job, a time-consuming job, and one that should merit reasonable compensation. So our proposal was with committee fees, all of our directors will be getting between \$175 thousand to \$225 thousand a year, and then 25% of that they would be required to re-invest in company stock, and in an attempt to actually align shareholder interests with those of managers and directors, we're actually going to make them pay for the stock instead of giving it to them. So we're paying a cash retainer, letting people pay their taxes on that, and then from that, reinvest in stock in the company.

My time is up, and I'll stop there. Thanks very much!

Jay Lorsch: You're a marvelous panelist, Dick. Thank you. Thanks to Floyd's newspaper this morning, I noticed that there are sort of two sides to this debate. If you saw the Times' business section, you'll notice that Sarah Teslik and her colleagues had a meeting, I guess yesterday somewhere. You weren't there, were you? I think you were reported as having been there. In any event, the point of view of those institutional investors represented there was that this proposal is not enough. And I think we're maybe going to hear now from John Castellani. I'm assuming that the Business Roundtable will offer the other point-of-view, which is that this proposal is too much. So, John?

John Castellani: Thanks, Jay. I feel, even though this is the second panel, a little bit like the person Shaw introduced one time during his illustrious life, with the introduction saying, "Everything that has been said about the topic has been said, but not unfortunately, not everybody has had a chance to say it."

So I'd like to take my brief time here to make several points, and first, let me say that nobody planned this. It has come about as a result of some unfortunate circumstances, but it is one of those teachable moments for reminding us about what the roles of shareholders and directors are in a corporation.

Secondly, to no surprise, as Jay said, we feel that there are a number of technical and legal problems with the SEC proposal, or at least what we think the SEC proposal will be.

Third, we think that the unintended consequences could be very serious.

And fourth, and perhaps the best thing that we feel we should do, is to step back and absorb the reforms that we've implemented over the last eighteen months, and understand the results of what we have done, because we have done so much.

Let me begin with the first point, the useful debate. It has been useful in challenging the public impression that corporations operate like a New England town meeting. I think we all know that that's not what corporations and shareholders are about, but I'm not sure that everybody who is involved in this process does understand that. We know that these are teams for stakeholders that range from our managers to our employees to our customers to our communities, and, yes, the most important, our shareholders. And on this team, calling the plays are the management and directors, holding these positions because of proven competence, experience and commitment. And there are a series of checks and balances in place, especially with Sarbanes-Oxley, the proposed listing standards, and some of the principles that our companies have adopted, and they will provide new and important accountability.

And further, a point I'd like to make is that, despite the popular impression to the contrary, there has been a tremendous turnover in both chief executive officers, and a decline in holding periods of stock of institutional investors, which demonstrate that the premise that managers and directors are permanently entrenched is not correct. Just to point out: when you come to our meetings, the average time in a job of a chief executive officer of the Business Roundtable in 1985 was eight-and-a-half years. It is currently four-and-a-half years, and 30% of our members have held their jobs for less than two years. So running a corporation like a New England town meeting, while it sounds great in the abstract, the reality is - and it should be - that it should be a team approach, and it should be a team that is always the best, and turns out to be the best.

The second point I'd like to make is that there are a number of technical problems with the SEC proposals. These are important problems, and we're not just nitpicking. For example, currently, all director nominees have to go through a very rigorous vetting process conducted by nominating committees composed solely of independent directors. And when we survey our members, we now have in excess of 80% of our members with two-thirds of them holding independent directors, and most are moving to having a completely independent nominating committee, well ahead of the requirements of the listing standards. Boards won't have the opportunity to do this same kind of due diligence on shareholder nominees that are inserted into a company proxy statement under a shareholder access rule.

And secondly, direct shareholder access may be inconsistent with state corporation laws. Third, under the proposal, proxy battles could proliferate, resulting in constant disruption of corporate operations, and that's certainly something we need to be concerned about. Candidates put up by special interests for directors could have financial ties to competitors, or otherwise not be independent, and that could violate other regulations. And last, the so-called "trigger events" that we've seen so far have been so broad that they could drag many well-managed companies into damaging proxy battles.

My third point of unintended consequences is also something about which we need to be very cautious. The famous sociologist Robert Merton wrote in the 1930's about the five sources of what he terms "unanticipated consequences." The first two are "ignorance" and "error," which certainly don't apply in this room or anywhere else. But the third was "the imperious immediacy of interest," and that happens, he wrote, when people want a result so badly that they choose to ignore any evidence of unintended consequences, and that's what we want to avoid; that we strive so hard to rid ourselves of rogue corporations and officers that we ignore the very real possibility of collateral damage to our corporations, and to those corporations' economic prospects.

One of the possibilities of a more direct control by shareholders could be the replacement of experienced, involved directors committed to the long-term success of the corporation by nominees put up by special interest blocks of shareholders, directors with axes to grind, or outside agendas. Second, as I mentioned, frequent proxy campaigns and excessive director turnover. Third, disrupted meetings and other director deliberations that consume the attention of the CEOs and the senior management who should be running the corporation and not be preoccupied by Board politics. And most importantly, while we've talked about, and Richard just talked about, the availability of well-qualified candidates, there is a difference between finding well-qualified candidates for boards of directors - and there are many out there - and well-qualified candidates who are willing to run in a contested election. And what we're talking about is, potentially, contested elections.

Everybody's talking about the California recall campaign, and I think it is relevant. But it goes beyond just California for a lesson, and that is in state

after state, we've seen where voter referenda are straight-jacketing legislators and governors on issues ranging from property tax limits to protecting sows from inhuman confinement during their pregnancy. We should all learn lessons from state governments. Yesterday, as Damon knows, when I was testifying in front of the Senate Banking Committee on Sarbanes-Oxley a year later, senator Sarbanes said, "Well, we're a democratic process. We work very well." The concept of the Senate Banking Committee managing a large corporation was something that, thankfully, I didn't respond to immediately.

I think we do have to be concerned, because we are concerned, because we are talking about economic enterprises, and right now, that economy is suffering an overhang after the terrorist attacks and the ongoing war on terror, the bursting of the 1990's technology bubble, and the unfortunate loss of investor confidence due to the corporate scandals. We have to be careful in moving forward so that we don't create a fourth overhang, and that is a risk-adverse environment for companies and their management.

My fourth and last point, that slowing down and taking stock may be best, requires some explanation. Remember, we've not yet fully understood the full impact of all of the Sarbanes-Oxley and the listing standard reforms that have been put in place just a year ago. We do know that corporate America has taken the reforms seriously, even though all of them are not legally required at this point, and in the survey that I referenced, let me just reiterate a couple of the high points: Eight of ten Business Roundtable members have boards that are at least three-quarters independent now. Virtually all of them have a closed meeting of independent directors without a CEO present. In fact, more than half of them expect to have at least five of those meetings per year in this year. Most all of our members have appointed an independent lead director or presiding outside director, or a chairman who is not a CEO.

And so the independence, and the independence that is so important to these reforms, is certainly taking on and taking hold. Some of the things we do know are these things are working. Some of the things we don't know yet are the long-term impacts of the reforms. And this'll take time, meaning we should all take a deep breath, watch this new era of corporate governance take shape, and learn from the need for further reforms, rather than jump into further reforms now.

Now, while much work remains, let's appreciate the new way corporations are being governed today. There is a great commitment, and an even greater and growing commitment, to independent directors and accountability of senior management. It is our desire to catch the misdeeds of rogue corporate officers and directors. They have hurt all of corporate America, and they have hurt both the value and the reputation of companies that had no reason to be affected because they were run well and governed well.

But let's not rush headlong into a new regulatory adventure that we don't know how it'll work, just because it seems like another good reform. Let's also appreciate how strongly our private sector is reformed in great part because of the confidence and dedication to serving all of the stakeholders. By and large, our directors have intimate, specific and deep knowledge of their companies, and their companies' entire commercial mission: its products, its capabilities, its competitive environment, its regulatory boundaries and its problems. And that's something that's worth protecting, and it's my hope that we do just that.

Wrapping up, we believe we need to digest the important reforms of the last eighteen months before we embark on a whole new set of reforms that could potentially jeopardize what we're trying to accomplish. Thanks.

Jay Lorsch: John, thank you very much. When Lucian asked me to help put together this panel, I figured we needed a real CEO, so we got Jim Rogers to come, and we're delighted you're here. People like Jim, as has already been attested to, are very, very busy, so I appreciate your time.

James Rogers: Jay, thank you very much. I'm delighted to be here. I was somewhat nervous, but as a CEO of an energy company, I've become increasingly comfortable with being in a room with many lawyers. I think that's a good thing. And even though we're headquartered in Cincinnati, I want the record to reflect that we had nothing to do with the August 14th blackout. So let me start.

Let me, if I may, frame my comments around three points, or three questions. One question is: will this proposal - and we're not entirely clear

what the proposal is at this time – will this proposal actually encourage shareholder activism, and is there a need for that? Is that good public policy? And as I think about that, I would really direct you to consider I.S.S.’s numbers for last year for the proxy season. It was our first 1K proxy season, where we had over a thousand shareholder proposals, more than 800 governance resolutions, 152 majority votes – which is greater than ever, with the highest prior year at 106. So to put this in some context, I don’t believe this is an aberration. This is a trend. And it’s not clear that more proposals are needed to have greater shareholder activism when you see the level of activism we had last year. So, again, that would be the first consideration.

The second approach would be, in a broader context, from a public policy perspective: do we need this proposal to rebuild confidence in, and improve the credibility of, corporate America? Do we need it to restore the integrity of capital markets? Now, a bull market would really restore the integrity very well. Just kidding. Indeed, we need to rebuild confidence in corporate America, and maybe this idea (Proxy Access) is a good idea. Sarbanes-Oxley has already taken steps in that direction. We’ve yet to see the results completely of the enactment of that legislation.

And my third area is whether this proposal (and, by the way, this isn’t a new proposal; in the late 40’s, the early 70’s and again in the early 90’s, similar proposals were considered by the SEC)... will alter the behavior of members of boards and CEOs? And, frankly, I think you need to look at what the actual motivation is behind a shareholder proposal. If the motivation is simply poor performance, I believe that most boards in this country – and I serve on two other boards – are highly motivated to deliver.

We feel the scrutiny more now than ever. So if it’s about poor performance, I don’t believe this proposal will actually change those behaviors. It might accelerate the reaction to the poor performance, but I think it’s an open question as to whether it really changes the focus that currently exists on performance. Now, if the motivation behind the proposal is special interest – it raises a different set of questions. Our company has received a number of shareholder proposals.

For example, as an energy company, we burn 30 million tons of coal per year. We have significant emissions from our plants of SO₂, NO_x,

mercury and CO₂, and we've had a number of shareholder proposals from environmental groups. Also we have received proposals from unions who want us to use union contractors rather than non-union contractors. In summary there are many specific interests that are pursued through shareholder proposals. The fact of the matter is I've sat down with these groups and have reached mutually agreeable outcomes without our shareholders feeling the need to submit a proposal for a vote of shareholders. But I think that you have to look at the motivation behind the shareholder proposal, and, again, it really gets to the specific issues that are being driven. And so I believe that boards will respond - and our board has responded - when specific interest groups came forward with proposals. I don't think it will change the behavior of boards with respect to that, because I think we're already paying attention.

If you look at the SEC proposal and it's not clear... My dad was a lawyer and he always said the devil was in the details; my mom always said God was in the details. And I heard a lot of religion here in the earlier panel with respect to this issue. I happen to be in the God's in the detail camp. But here are the facts: if the proposal is as the SEC, I believe, has suggested, it's a two-step process. And if you think institutional investors are going to hang around when the primary driver of the proposal is poor performance, they won't be there. They'll be out of there. There'll be a new set of shareholders there at the time. So, from an institutional shareholder's perspective, it will not make much of a difference.

The second point I'd make is that, again, it gets back to the motivation behind the proposal. I believe, at the end of the day, most managements and boards will negotiate outcomes with these special interest groups. I would conclude by saying that the best defense for proposals motivated by poor performance is a great shareholder price and strong performance in the market, and the best defense to special interest is really good governance practices that are centered on a stakeholder philosophy, and that's certainly been our philosophy. Thank you.

Jay Lorsch: Thank you, Jim. Okay, now, finally, we're going to hear from Ralph Whitworth, who has been involved with a company which, I understand, Ralph, has a little bit of this proposal already in place and in action.

Ralph Whitworth: Yes. Okay, it's an interesting position for me to be sitting on a panel discussing the board and management perspective. I have served on a number of public company boards, and chaired a couple of them. I continue to chair the board of Apria Healthcare, which is the largest home healthcare company in the world. I've thought a lot about this issue going way back into the 1980's.

Back then, I wrote a petition for rulemaking to the SEC, and one of our panelists, Richard Breeden, was the commission's Chairman then. We had lots of discussions. We asked for basically three things: better compensation disclosure, a change in the "bona-fide nominee rule," because prior to that time if you wanted to run for a board you had to run a whole slate or no slate and you couldn't run a so-called "short slate," which we can now, and third, it asked for shareholder access to the proxy.

Well, the SEC, as we all know, did the good work on compensation disclosure, and they changed the bona-fide nominee rule. They didn't change proxy access. That issue has now resurfaced. Back then, we heard the same horror stories about the short slate process that we are now hearing about proxy access. Well, since then, the short slate rule has only been used about thirty times. I've used it about six or seven of those, and it's been very effective. It hasn't been disruptive.

None of all of the terrible things that were predicted have arisen from that, and I would argue that it's been extremely positive because it gives investors a process other than watching a company go bankrupt, making a tender offer, or seeking control of the entire board to effect change and spur optimal performance. So this isn't - I mean, we've heard a lot this morning - this isn't about just waiting until a company is so crippled or has such problems like WorldCom, where you get a monitor, or where you're bankrupt, or where your price has sunk so low that someone can buy you out. This is really about spurring optimal performance.

If you think about our elections system in corporate America, we have the incumbents, they pick a slate, they make out a ballot, they send it out to the investors, the investors vote, they sign their name and send it back to the incumbent, the incumbent counts it and they tell you how it turned out. But

whether you vote for, against, or not at all, you get the same slate. No matter how many votes are withheld, that's the slate you get. So proxy access is about changing that. Why do we need that change, and why did we make that change at Apria?

Let's look at all of the corporate scandals that we've experienced. And by the way, we talk about how we don't want to disrupt these well-run companies and vaunted companies, well, these companies that suffered these scandals were *the* most vaunted, venerated companies in our country. This was WorldCom. This was Enron. It was on the cover of all the business magazines. This was Tyco, which was the "new model for the conglomerate." So these were not "rogue companies," these were not "rogue directors," these weren't "rogue managements."

And when you look at the boards of these companies, and you look at the people, you would say, my goodness, these were - maybe not to-the-person - but there were many very good people on those boards. It causes you to wonder: why is it that no one blew the whistle when Enron's management went to its board and said, "We've got a great idea, but there's a little difference here from some of our previous ones, we have to waive our ethics policy."

And they talked for three minutes about it. Why didn't someone blow the whistle? Well, my thesis for that is that you dance with who brought you. I don't say that cynically. I say that because we, as human beings, tend to defer to those people that have shown confidence in us, and people that we feel collegial with, and we want to be liked, by and large, and we want to be considered to be thoughtful and collegial. That is the prevailing environment on corporate boards. It really is. I mean, that's been all of my experience.

So is there anything we can do about that? Well, maybe not, but does that mean we shouldn't try? So here's what we did at Apria. I woke up one morning and said, "Gee, I've been an advocate of this proxy access concept, and here's a company of which I'm Chairman. I at least have the obligation to propose this to my board and get them to debate it." And so I did; I proposed a straight-access process without the triggering mechanisms.

The triggering mechanisms -- we can get into those, but essentially, what they're doing-- the premise of those is that this isn't a good idea, and so let's make it so that it would be very rare that it would ever be used. I mean, if the SEC is going to do it, then they just go ahead and do it. If they're not, then let's forget about it. There is already a process for us to nominate and try to elect short slates, and it's been used effectively in a number of cases.

So at Apria we said, "Okay, let's have an access process." It was debated; we have a former member of the SEC on our board, you know, some very thoughtful people. We talked a lot about it, and we concluded, after also consulting our lawyers, of course, that the best approach was a straight access policy that says that if a shareholder or a group of shareholders has 5% of the stock, if they want to nominate a director, they can nominate a director, and we'll put him on the proxy and give him the same dignity as all the other directors. We don't consider it a "proxy battle" if someone says, "Gee, you know, instead of Ralph, how about Joe?" and their credentials are there, the shareholders can have a look at it.

A lot of these arguments, if you think through them, they're basically saying, "Well, we need to be careful because shareholders are stupid. They're going to put these special interests on the board; they're going to disrupt things, or they're going to put an environmentalist or maybe a women's rights activist or a union activist on the board." But they're not going to do that if they think that that's going to impair the value of their investment. And remember, they're going to have to get a majority of the vote to place one of these people. And people said, "Well, don't you fear that?" And we said, "No, we think our investors are smart." This is going to spur us to look at our board every year and try to make sure that we don't have that vulnerability. So we won't have people who have conflicts, who don't own stock, who have too close connections to other members of the board.

There's obviously a lot more to be said and already has been said, as John said, about this, but that's a summary of my views on it after having thought a lot about this over a number of years.

Jay Lorsch: Thank you, Ralph. I was debating whether we should open it up for questions or whether the panelists wanted to say something about what they heard from each other, so I'm going to compromise and say whoever

raises their hand, whether they're on the panel or out there, I will recognize, and we'll get a discussion started, I hope. So let me just see - is there anything anybody on the panel has to say about what they've heard from each other first?

Richard Breeden: I think there's an element of truth in both sides of the arguments here. I do tend to agree with Ralph on the triggering events. If this is something that it's worth doing, it's worth doing without making it a two- or three-year process before it takes effect. That's why we avoided any triggering event in our system for MCI. But I think there's truth on both sides.

Management has a legitimate interest in wanting to have a strong role in running a company, and if they do a bad job, ultimately, they should be replaced. The ultimate mechanism is for a board to replace management that isn't performing, either through board action or through a changing control transaction. And in the meantime, they need an awful lot of discretion and authority to run the business of the company, and I think anybody that's been involved in -- you only have to spend a couple of days running a \$24 billion/year revenue company with 55,000 employees and you become very sensitive very quickly to how many decisions have to be made, and you can't always go get shareholder views or get board views. So there's a good deal of truth in the Roundtable position and talking about the importance of protecting management's responsibilities.

On the other hand, I just don't think you can sit here at this time in our country's history, having watched the string of these enormous companies where tens of billions of dollars of shareholder investments were blown away through rampant wrongdoing on the part of senior managers with boards that were sound asleep, and say there isn't a problem. There clearly *is* a problem.

The problem isn't that there's rampant fraud in American companies. I don't believe that to be true. I think that we have a very good record in the business community of most companies being well-run by honest people. But, clearly, we do have a problem, a problem in executive compensation. It is out of control. And there hasn't been enough of a private sector response to find a workable mechanism to try to control excessive behavior. And I think,

rather than debating this – are the proposals of any kind going to unleash complete chaos in corporate America? – that the best thing and most healthy thing we can be doing would be for each company to be assessing how it can go beyond the minimum standards and create an excellence in their own internal governance practices, and find means that will work in that company of controlling excessive behavior. It’s a risk we all face.

Jay Lorsch: Thank you, Dick. Are there other comments or questions? Yes – could you just state your name, please?

John Wilcox: Yes, John Wilcox. I’d like to ask Ralph a question. You made mention of the changes in the 1992 proxy rules that opened things up and made short slates possible, and, as we’ve discussed, shareholders also have the right to present nominees to the nominating committee. Why haven’t these been used more by shareholders other than you and maybe Mike Price, who has also been very aggressive?

It seems to me that it can be argued that there are lots of avenues that large shareholders particularly could use to influence board behavior, and what the large shareholders have done is complain and whine about the failure of companies to do what shareholders want without really making an effort to use the tools available to them. So we are now considering some more tools, which some people have argued probably won’t be used very much anyway. Where does this cycle end, and why are shareholders not using the techniques that are available to them?

Ralph Whitworth: Well, I think you’re absolutely right. I think they won’t be used that much, and so it’s not that we don’t have to worry about the harm from them. We won’t achieve a lot of the good that could come from it. And that is quite an enigma to me. I gave a talk way back in 1993, and said that one of the things that we should fear from the short slate rule was that it may potentially be used by special interests, sort of a harassment technique and so on. That’s a fear, and that’s a legitimate concern today as we talk about this access issue, but that really hasn’t happened.

And investors, I don’t think, have been very responsible at all. I’ve talked to groups. I’ve talked to Sarah’s group and others. I’ve said if we really want to look at who’s to blame for what’s happened in corporate

America, we really have to look to the owners because they do have the tools, they have the tools already in place, without changing the rules any further, to have a very powerful effect on the composition of boards. And they're not used very often. It is expensive. There's a lot of legal hurdles; this access rule would make it bit cheaper, would streamline the process.

But it's a very good question, and it's probably worth a whole other panel, but I think if anything, it goes to sort of the incentives and the structure, governance-wise, of how most of this money is held. I mean, if you look at these institutions that hold the money and what their incentives are, their own processes, it doesn't pay them to get that involved. It's much easier for them to just sell their shares and move on.

Jay Lorsch: I was just, as you were talking, thinking about Pozen over there, who wrote an article in the Harvard Business Review. I can't remember when it was, Bob, but you made the basic point that shareholders are more likely to sell, particularly people who have the capability to make buy-and-sell choices. I don't know if you want to comment on that or not, but...

Robert Pozen: I think the question of why institutional shareholders haven't used this nominating process more really goes back to the basic cost-benefit analysis that most institutional shareholders utilize. Some of the costs are out-of-pocket costs, but the more serious costs are management-time costs, because any time Fidelity was involved, I had to get involved, and there was also serious time cost for the portfolio managers. And then you have legal risks - though the SEC, in some of its proposals, has talked about legal safe harbors, which would be helpful.

On the benefits side, even if you own two or three percent of the stock you have a huge free-rider problem. Basically, you're competing against a lot of other institutions. Now, actually, Michael Price ran a different sort of fund where he had a few very large positions, and probably had a different philosophy. But if you were running the sort of money that we were, which was \$800 or \$900 billion, you're going to have these big positions, but you're not really interested in engaging in costly tactics that are going to make all your competitors get better returns. And you have no way to actually recoup any of the benefit that's generated for other interests. People have to deal

with these questions like whether or not there could be some sharing arrangement on costs in order to encourage institutional activism.

On rare occasions, Fidelity would put up names to nominating committees, and sometimes they would be considered, and sometimes they would be elected, and sometimes they wouldn't, but it usually was only when we thought performance was really bad at the company. I think that the second point – and I think somebody else made this point – is that the time frame here is very important. So one of the things that bothers me the most about the SEC's triggering events, is that it looks like a two-year process, and two years is an eternity in this game. If you have to have a set of problems, and then you have to go through a procedure, and then you have to go through another procedure, that's just not a viable approach.

People like to think of institutional investors as the great hope of corporate governance, but until we come to grips with the fundamental cost-benefit analysis that institutional investors employ (and their timeframes) they will be disappointed. And that's why I was interested to hear Marty's comment to trade off precatory resolutions for staggered boards. If the board is really doing a bad job and the company is really in trouble, you want to do something now. Even if the staggered board makes it more difficult to do, I suggested cumulative voting as a way for one shareholder to make a quick impact by electing a director.

Jay Lorsch: Damon?

Damon Silvers: I'm Damon Silvers, I'm with the AFL-CIO. We in the labor movement, and our pension funds, in thinking about this issue, thought a lot about the special interest question that has been raised a whole bunch of times by this panel and the other panel. And after a fair amount of debate, we concluded that the threat that the mutual funds might extort benefits from the companies in terms of 401(k) management was a risk we were willing to take.

The point I'm trying to make here – a little bit at Bob's expense – is, although I agree, actually, with everything that Bob just said – it is the point that, in fact, when you look at participants in the corporate governance arena, almost everyone has multiple interests in the companies. Management does, as a recipient of salaries and other benefits. Obviously, to the extent that

pension funds are vehicles for employees, those employees have other interests. Service providers have other interests. There are very few other people who truly don't represent some interest other than that of the company as a whole.

So I just had to say that first, but I have a question: I'm very interested in the panel's response to Dick Breeden's point that there needs to be a way of dealing with misconduct. Misconduct, not only that which rises to the level of flagrant illegality, but a range of other matters, and particularly a response to the idea that, with all the objections that have been aired today to the proposal for proxy access, the fundamental question of "What do you do if not this?", in light of what Bob just said about the costs of other kinds of action. There was some burden, I believe, on those who think that we should, first of all, do nothing, to suggest how it is that a responsible long-term investor would act in the current environment, in light of the corporate law regime that John Castellani referred to, in which, in fact, ultimate remedies, with real muscle behind them legally, are not available to shareholders.

Jay Lorsch: Does anybody want to respond to that question?

James Rogers: I'll start out by making the observation that if it's misconduct or if it's fraud, that's unacceptable. I think most companies have an ethic that anything that's unlawful or fraudulent is just totally unacceptable.

But the point I would make is that a lot of people are tending - and the media does a wonderful job of implying this and actually making the point - that somehow, if we have incredibly independent directors, whatever *that* means, and somehow, if we have world-class corporate governance, that all investors, forever, will be insulated from cycles in the market; from business risks; from just bad business decisions. I hear it here, a little bit, in the comments, like somehow, if we just get this mechanism or we just get this governance, somehow, it'll always be 10%-15% returns forever, and life will be good. I just don't think that's the way capital markets operate, and we will breed even more cynicism if we leave people with the impression that somehow, with this mechanism coupled with good governance, that the investor is insulated from market risk.

Jay Lorsch: Todd?

Robert Todd Lang: Could I sort of answer that question? That's not what I was going to ask.

Jay Lorsch: You can ask that question and then answer a question.

Robert Todd Lang: Okay. Look, I think there's already a place to go. You've got a governance listing standard that, presumably, will be adopted at some point, which requires an independent nominating committee except with respect to controlled companies. I think it's a powerful thing, not just another paper-over what you've been doing before. It doesn't apply so far to unlisted companies, which was going to be my question. So it seems to me that that's coupled with an SEC requirement that the nominating committee issue a report to be included in this proxy statement - we have one for the compensation committee and we have one for the audit committee - and talk about the process that they follow, not individualizing any person because you don't want to affect their reputation, but the fact of the matter is that there's going to be a spotlight on what they do.

It's up to the private sector, then, to take this mechanism and use it effectively. If it doesn't, then there's going to be something else coming up. But I think that's available, and that should be allowed to work before you go into access, because every form of access that's being discussed has got some warts on it. Nobody likes it entirely; you're looking for methods of sustaining it; what are good triggering events?; are these real?; does one size fit all?; and all that sort of thing.

The other thing I was going to say, and my question to the panel was: the underlying premise of all this discussion so far is that we're dealing with larger companies. That there's fifteen or so thousand public companies in the United States, but maybe four or five thousand are listed - I don't have the exact number - and the rest of them are not. And I'm just wondering if you can use the same mechanism for those thousands of public companies with their thousands and thousands of shareholders as you will for IBM and General Motors and Intel and so forth. I wish somebody up there would talk on that. It's something I've discussed a lot with Alan Beller and others have, as to whether the SEC should have a rule on this subject that says, "One size fits all".

I think that we should design a system for the size of the company and take into account other specific company conditions applicable to all these smaller companies. You've got somewhat the same problems with Sarbanes-Oxley. You know, the costs for smaller companies dealing with all that looks onerous to some people. So I think somehow, the more we can adjust these rules and regulations for company size as well as, perhaps, some other things, the better off we're going to be in making this system work. And Dick wanted to comment on something else.

Richard Breeden: I would agree with that, except I'd put a little gloss on it, on that point. I think there are common principles that every company should have to deal with: conflicts; independence; qualifications. But small companies have to deal with things in a different way than huge companies, so you can't have one-size-fits-all, that you try to use the exact same techniques to try to accomplish goals like preventing fraud or inaccurate financial reporting. You have to be willing to use different techniques in different-size companies.

On the question of some of the responses, how we deal with some of these problems... There is this mentality that the Stock Exchange listing standards have solved all the problems and, if anything, it is manifestly unclear by recent shenanigans at the New York Stock Exchange and the behavior of its own board should be - and, certainly, we have found it be the case in WorldCom - that those standards are by no means perfect as this point, and they need a little retooling. WorldCom, for example, had 80% of the board that officially met New York Stock Exchange independence standards, but we had 1.2 directors who were actually independent. Maybe one and a half.

And we had people who officially met the standards of independence who were people who, for the last 20 years, had done nothing in their lives but work for Bernie Ebbers in one form or another, and yet they satisfied the standards of independence. So I think we have to look at some of those practical issues of conflict, because it's conflicts and lack of independence that, more than any other thing, will create problems. And they create problems not just for shareholders - they create problems for good managers, too! And so when you have problems of conflicts on the board, that can lead

to a lot of subtle problems down the road, so I think if there were one area that would be a nice starting point - and I agree that the access issue is important - but independence and conflicts or something that we need to spend attention on. Not just that we have an official standard, but having a standard that works.

Ralph Whitworth: The problem with the independence that Bob brought up - that let's let this independence rule work - is that we define director independence by whether they work at the company or not, or whether they have a financial conflict with the company or not, and that doesn't nearly go deep enough, as Richard just was alluding to, instead of, "How did you get your job?" And that conflict, in any of the systems that have been proposed, has really not been dealt with. And as far as, just quickly, to your question: We have Sarbanes-Oxley, we have 10(b)(5), we have lots of rules for fraud and abuse, and plenty of laws for that, and I don't think that's really what this is about--it's how do we deal with bad actors? Because we're going to have them, as Jim said. We're not going to have a perfect world. We're going to take risks, and some are going to work and some are not.

For me, here's what this is about-- Sarbanes-Oxley set some minimum standards, but it did nothing, nothing to spur optimal performance. That cannot be done by government, that can only by the owners, by the investors, and yes, if you want to give them some more tools, fine, I've been a proponent of that. But even if we don't do that, the investors still have to step up here and become much more engaged in these companies. I know there's a lot of impediments, as Bob talked about, but if that doesn't happen in this country, it's going to be very hard for government to cause it to happen.

We're going to continue to have very similar things happen over time. And we shouldn't kid ourselves, or let the public think that, well, we've fixed all of this because we passed Sarbanes-Oxley. Because all it hits are symptoms. Like, when I used to cut the tops off dandelions and my mom would say, "No, no, you've got to dig down and get the root out." Well, that's what Sarbanes-Oxley did - it just cut some tops off some dandelions. It did nothing to really get into the root of the real problem here.

John Castellani: I want to get to the same point and address that same point, and the point that Richard raised. And that is we can all agree on one thing:

the best corporate governance comes from qualified, active, involved and independent directors dominating the process, and that independence is not the just in independence that's defined in the proposed listing standards, Richard. Our principles say it's independence both in fact and in appearance, and it has to be a much tougher standard that goes to the kind of things that Ralph talked about and Richard talked about, about where did you get your job? Where do you play golf? How long have you known each other?

But the key I think that we can all agree on with the combination of the listing standards and Sarbanes-Oxley – and the work that's being done in corporate America over the last twelve months, which has been a tremendous period of a lot of blocking and tackling. I don't know why I'm on sports metaphors, especially now Boston is 0 and 2, so I'll stop sports metaphors. But there's been a lot of very good work, but the best of the work is when you have truly independent directors who are capable and bring a broad diversity of capability, who are not only on the nominating committee (exclusively independent), on the audit committee (which we all agree on exclusively independent), but also, to get to Bob Monks' point earlier, on the compensation committee, that are truly independent and capable. And those are the things that we support. Those are the things that are taking place and, we believe, now need to take place more often, and more deeply.

Jay Lorsch: I have a note that we need to end, but since I'm the chairman, I get to say the last word, right? I wanted to come back to the dandelion analogy, which I had not heard before, because I think it's important in this discussion to remind all of us that we're focused on this particular proposal, and therefore on boards and the relationships between boards and shareholders, whether they're the owners or not – that's a debate we haven't had yet, perhaps, fully.

But I think the other thing I'd like to remind all of us of is we're talking about a complex system of corporate governance which involves – and it's not just the SEC and shareholders and boards, but also auditors, investment bankers, analysts... a whole range of people and institutions engaged. And I think our view in the workshops we've been running over the last year, as our Dean says: "It's not just a few rotten apples; it's a problem with the barrel." There are a lot of problems with the barrel.

And the problems with the barrel exist in a lot of institutions, which has led us to the position we find ourselves in, where there's so much emphasis on short-term results and we have all these accounting tricks that have been going on, some legal, some just questionable, and we also have this excess compensation which has been referred-to several times. All that, I think, is the product of the system. So while I think we may be focusing on an important issue here, it's only one of many, many issues that I think we need to address.

And on that note, I'll stop. Thank you!

Session 3: The Perspective of Institutional Investors

Panelists: Orin Kramer , Kramer Spellman
Robert Pozen, Harvard Law School
Michael Price, MFP Investors
Sarah Teslik, Council for Institutional Investors

Moderator: Reinier Kraakman, Harvard Law School

Reinier Kraakman: Why don't we start? I'm Reinier Kraakman and I'm delighted to be the moderator of this panel because, as Steve Rosenblum mentioned earlier today, I've always been on the side of principals in the principal-agent conflicts, and here we have the panel of principals, the owners, the shareholders or at least their agents, I guess.

So I want to start by posing a general question to my panel, which they are free to ignore, and that is the theme that's been running through the entire conference thus far: Why don't the principals, i.e., the owners, do more? Why don't they engage more?

More particularly, if the point (that Michael Price made earlier on, and I guess that Leo Strine made earlier on) is that there are not enough good directors out there, then maybe access to the corporate proxy just isn't enough. Maybe the most important self-help measure that the principals, the owners, would take, is to grow their own (collectively, not individually), fine folks out there with the incentives and the independence, or, should I say, *dependence* on shareholders, that make for a good corporate director. Now, Bob Pozen has mentioned the collective action problems associated with that, or with any kind of institutional action, but why not think about having to surmount those problems?

Now, I'll just throw that out there, and now I'll let the panelists proceed unimpeded, beginning with Orin Kramer.

Orin Kramer: I think that was an introduction that could go on for an hour, but in any event. I think I'm here wearing two hats. I run a private

investment pool; I have for a number of years, and we've been, from time to time, an activist shareholder, including, actually, in situations Mike probably doesn't know about, but with his whole firm. And in addition, I am the Chair of the Security Investment Counsel that oversees the state pension fund system. With the caveat that I am speaking for myself and not other Council members, I'd make several points.

Number one, corporate law in this area rests on a set of theoretical constructs: that the directors act as our agents, us being the owners of the company; that the directors actually oversee management; that they engage in arm's-length agreements with management on compensation; that the directors, independently of management, nominate people who will serve our interests; and that, at the end of the day, these are real elections which act as a check to assure that our interests are genuinely being served. Without debating the prevalence of the problem, there are clearly many instances where there is a disconnect between those theoretical constructs and what is happening, and that's what I think we're trying to address.

My view is that if there are a significant number of shareholders, not two labor unions, not two politicians, but if there is a significant body of shareholders who believe that this disconnect exists and that their interests are not being represented by the people who are their putative agents, that there ought to be a window for their acting, and that is totally independent of the legitimate point Mike Price made earlier, which is that there is a paucity of qualified directors, and we don't pay them enough. That's a separate issue from whether we ought to have legal recourse when they're not acting in our interest.

Secondly, on the SEC proposal, my view is that there ought to be certain inalienable rights for owners. Those rights should not devolve into some kind of two-year effort. Bob Pozen raises the fair point that for many shareholders who think of themselves as renters, a two-year program just won't work. As the SEC proposal has been described to me, it creates serious problems in terms of actually having some meaningful corrective power.

Third, there has been a lot of concern here expressed today about moving too fast. Part of the argument for not doing anything in this area is that we've already implemented significant reforms, and we should let things

gestate for a while. I share the concern that we are moving too much toward a set of highly-regimented rules-based prescriptive remedies, that we've got this new Roberts' Rules of corporate governance. That is a problem, but that is distinct from the issue of whether we want to be able to throw people out if they're not representing our interests. In general, I would give boards more operational flexibility, but also give shareholders the ability to act when management is not acting in our interest.

The argument has been raised that if you open the door in this area, you're going to empower splinter groups carrying their social agendas. The concern is that there are a limited number of socially, politically motivated funds in the country, that they will be carrying the ball on their own issues, and we're going to be in this constant political campaign for corporate America, and that's obviously not productive for the economy. What strikes me when I hear that concern is that it reflects an inordinately critical view of corporate management and capitalism.

I don't believe that corporate management is so poorly-perceived that you would have a widespread problem with large numbers of companies facing a credible threat that the majority of the stockholders will want to overthrow management. And, too much credit is being given to the social conscience of institutional investors. I live in that world. While we often make mistakes, and we often lose money, I am not aware of any instance where any institutional manager I know ever acted for reasons other than risk-aversion and greed.

The real problem is not that institutional investors en masse will support some social agenda, which is not going to happen, but that it is difficult to induce most institutional shareholders to act against management even when the purely economic incentives are clear. There's a reason the sleeping giant is sleeping - because the sleep makes the conflicts disappear. That's a serious problem, so it's going to be hard enough to motivate institutional activism under any set of circumstances, but at least we need a regime that removes the friction cost when some institutions are actually willing to do the work.

Reinier Kraakman: Thank you. Bob Pozen?

Robert Pozen: Thank you. I've already given my usual spiel on cost/benefit analysis, as elaborated in my paper, but let me try to make three specific points. First, if we look at the cost/benefit analysis, I think one really good thing about what the SEC has been talking about in the staff report is the use of the Internet for proxy solicitations. This is a big step forward. Obviously, there are lots of other proxy costs – John Wilcox would tell us all these – but it's a good start to really try to get that cost down to a reasonable level.

I think the benefit side is much more difficult, and one I think people ought to look at by analogy -- when we allow institutional investors to be the lead plaintiffs in class actions – and try to learn from that experience about how few private managers ever want to do that because it involves a huge cost. The first time a group I know served as a lead plaintiff, they were deposed by a plaintiff's law firm about whether they were really a representative group so the question is, "What's the benefit?"

And there, in that context, I would think that we ought to at least try to come to grips with whether there should be a premium for institutional investors who play such a role. We have to figure out a way to reward these institutions who are really sticking their necks out, taking a huge amount of management time, et cetera. If we can't figure out how to give the lead plaintiff some sort of premium in a class action recovery, the chances of figuring out how to give a premium to an institutional investor who took the lead on director nominations are probably much less.

The second thing, which I think was alluded to by James Rogers when he was here, is the question of what type of benefit we're really looking for. There is a fundamental divide, which has been papered-over somewhat in the institutional community. On the one side are people like Orin, who focused on either greed or avoidance of risk—the critical question is, "Is the share price going to go up?" That's the issue. And for most institutional investors, it's really not a question of good corporate governance or bad corporate governance – they want to know, is this company going to have a better financial return over the medium term, meaning two or three or four years. On the other hand, when we see who are the activists among a subset of the institutions, there are a lot of people who seem to have more of an interest in corporate governance as a process, than getting financial returns for their shareholders.

You can argue that better process in the long term will lead to better financial returns for your shareholders, but I think all of us who have seen the studies know that they are not that closely allied. That has two implications. One is that for some institutional investors – and I think this is what’s being said, perhaps by Marty and other people – their benefit includes a political benefit. Roberta Romano has argued this point, in contrast to financial returns, so I think that you see a real split here.

The second implication is that, for people who are really interested in financial return, time is of the essence. This is where we get back to the issue that waiting for these two-year and three-year scenarios to be completed is just much too long. But I think we ought to recognize that there’s a big difference between people who want corporate governance to improve and have some sort of faith that corporate governance over the long-term produces better financial returns, versus those people who are looking mainly at the financial returns and what they’re interested in, in the specific case, is how to get that better financial return.

My third point, which is related, is: We’ve heard a lot about “triggering events” and “precatory resolutions” but one thing people haven’t made clear enough yet is how to implement this new director election process? According to the staff report, what you’re going to have is a triggering event leading to a precatory shareholder proposal for a new director election process. Ironically, one triggering event is a shareholder vote on a precatory proposal which management ignored, and so you solve that problem by having another proposal to change the director nomination process, which is precatory in itself. This is because the SEC doesn’t seem to have the authority to require a mandatory proposal for a new election process. Will management, which has already shown itself to be not particularly responsive to a precatory shareholder vote in the first instance, become very responsive in the second instance to a precatory shareholder vote?

This just points up that the whole problem for the SEC is a matter of authority – and I’m sure the legal mavens will tell us more after lunch. Similarly, the SEC has little authority to de-stagger the boards or to require cumulative voting... These are much more direct ways to change the election process than this notion of a two-step precatory proposal. The problem is, as

we all know, those measures have to be initiated by the board under corporate law. So the SEC is constructing this not-too-effective proposal because it has limited authority to approach the election process directly. I'll stop there. Thanks.

Reinier Kraakman: Wonderful. Thanks, Bob. Michael Price?

Michael Price: Thanks. I thought when the last panel left off, Jay Lorsch had a very good point, which is there are so many balls up in the air now – new laws and new pressures and press and cleaning up some huge spills of the late 90's – that it makes sense to me to see where a lot of things work out. Boards are getting better all the time. I still think that it's very easy to find directors for MCI coming out of bankruptcy; when the balance sheet's clean, when it's a high-profile, big New York Stock Exchange company. It's tougher, when you get down to the next couple of hundred companies, to find really qualified directors.

But I want to spend two minutes going back through a little history of our money management business from when I started, which was in the '73, '74, '75 period, when nobody in America wanted to own common stocks. And I remember my partner/mentor Max Heine said, when I showed him a very cheap stock – but it was an A and a B, the A voted and the B didn't – he said, "Oh, we can't buy that because you don't get the vote." So I learned very early on that when I buy a share of stock, I get two things: I get ownership and I get the right to vote.

Well, what happened in America was back, you know, from the mid-70's, when the ownership of common stocks was unpopular, to the mid-80's when it became very popular, and it became very popular, and the flows into Fidelity and other mutual fund groups were so huge, those portfolio managers said, "I've got to put this money to work. I'll buy Coors non-voting Class B stock or Comcast, which happens to be well-run, non-voting – where, you know, the family has 5% of the economic interest but 95% of the vote – or Sumner Redstone or Rupert Murdoch or any of the successful managers, but they entrench themselves and protect themselves with the A/B structure.

So we had the pressure of this huge amount of money to invest, and we started to go away from our principles, which, when stocks were cheap, we

didn't have that much money to invest, we could *find* things to do with the money. Then stocks got more expensive and we have to look in other places, and we have to take fewer protections. Just like in the bond market before Milken invented junk bonds, you know, you would buy first-mortgage railroad bonds backed by railroad cars, real estate, warehouses, double-track, all this stuff. Then they invented junk bonds because companies needed to raise money, and you gave up those indenture provisions, and so many of the bonds that were issued that created all these losses in the WorldComs and the Enrons of the world had no provisions for the bondholders. Why? The investors - our own group - we were at fault in buying securities that didn't protect us. Okay?

But I'll tell you - frankly, from when I started in the business, I didn't want to give up my vote. In the 80's, I felt I had it all along. I remember Marty Lipton, calling me from the floor of a stage in the Irving Trust/Bank of New York merger, asking for my vote. We had 440,000 shares and decided to vote for it, but, to make a long story short, I mean, we always had the right to vote, and we exercised it, and waiting until the last minute to exercise it, and that's the right thing to do. We have it. We have it today, we go to Delaware, we protect it, so I don't think anything needs to be done. I think you watch and you pay attention, and investors have lots of rights.

Now, that leads me to my colleague here. Some very large investors with all sorts of votes - powerful blocs of stock - don't use them enough, and I really don't understand why. I think the basic idea that, well, maybe they'll lose a corporate client. Yeah, that's part of it, but I think it's, you know, giving up part of your job. You're not doing part of your job if you don't take management and directors to task. You're in, you're out. Harvard - Harvard has, you know, Harvard management here... They've run proxy fights. Harvard funded a firm in Boston called Highfields. They run proxy fights. All that's been terrific. I mean, Highfields has forced *Reader's Digest* to do things - They eliminated the A & B shares. The management was so poor at *Reader's Digest* that they're losing money anyway.

So just because you use your rights doesn't mean you can't lose money, right? If you pay too much for the stock. But that's really good to see, and I'm pretty surprised that after we had some success that led to good performance and growth in assets because of the press we got in running

corporate fights, that more people aren't more active. There are a few, but there aren't that many. So I think there's enough mechanism there today.

Reinier Kraakman: Sarah Teslik?

Sarah Teslik: Thank you. I always get nervous when a meeting starts with someone telling us to pay no attention to the data, as we heard at the beginning, when Lucian Bebchuk was offering data and Marty Lipton said, "Well, actually all the data are conflicting, and you just ignore the data." It's like, "Ignore the man behind the curtain." I think that, in fact, probably everyone in the room, whether or not we admit it, has some sense of what the data are - and it goes a lot farther back than Lucian's data - and has some sense of what the data tell us.

I recall, about 20 years ago, reading a book that looked at the early civilizations of China, India, other Eastern civilizations - and the question the book asked was, "Given that Eastern civilizations started much earlier than ours, and were much more sophisticated than Western civilizations in the Dark Ages, why did Western civilizations eventually triumph?" And the answer was - and it was backed up with really a phenomenal amount of data - that Western civilizations put fewer barriers between owners and property, and that by far, the best wealth-generating mechanism we know is to turn people's self-interest, which will motivate most of us most of the time, most fiercely, and channel it in such a way that creates wealth. And what we're talking about here today is whether or not we should increase or decrease exactly that barrier.

Whether or not you're familiar with these particular data comparing civilizations, most people in the room probably have a knee-jerk reaction - a gut view - that that is the case; that when owners tend to their property, they will do a better job than managers, on average, over time, not because they're any smarter, but because the motivations will, in general, make them learn what they need to learn. I call a lot of the people who will oppose access to the proxy, or other mechanisms that allow owners of companies to act like owners, "NIMBY capitalists," "not-in-my-back-yard capitalists," because they do believe in capitalism everywhere else in the economy, except at their own companies.

People who are opposing shareholder access, if they were a big owner in a venture capital company, would expect to put people on the boards; if they owned a restaurant and the cook didn't cook, they would expect to fire the cook rather than the cook telling them to sell, or telling them that they didn't know enough to know what was good cooking, and that, in fact, it is a principle that most of us, whenever we had our first economics classes, believed, and that although it *sounds* better to look at Soviet collective planning, where the people in central casting know best what we all need, that, in fact, that doesn't work as well, hasn't worked as well, and through the history of time, hasn't worked as well.

I agree with Orin Kramer that a lot of the governance provisions that we currently have in statutes, in regulations, in policies, and in governance plans for boards, could be ditched if we could merely increase the effectiveness of shareholders selecting directors, because, although it is the case that shareholders do have a vote, and many of them, like Michael Price mentioned, are voting, there aren't as many important things to vote on as there should be, because the number one thing to vote on is "Who represents you?" And I don't particularly care about the quality of directors as much as I care about who picks them. I don't know how to define a great American or an archangel, and I don't particularly want to try.

It's not so much that directors should be independent from management as they should be accountable to shareholders, and I think that is, actually, the foundation-stone of our entire private sector, and if we don't agree on that - but I suspect we do - and we have professional and other needs not to agree - we are really very far apart, indeed.

I know it's lunchtime. I looked at the agenda, and I knew you would need two minutes out of me max, and so I'll answer, in closing, the question that was asked to open this panel, and that is essentially, "Why aren't institutional investors more active given the current rules that we have?"

Two reasons: one is that the current restrictions on shareholder actions are much more substantial than most people understand, and although a Michael Price might be willing to undertake both the costs and the reputational risks of being sued by submitting a slate of directors, if you are a public pension plan, and you file a slate of directors and you are sued - and

it's technically a suit for securities fraud - and the paper runs the headline, "Iowa State Pension Fund Sued for Securities Fraud," you don't keep your job. And you can't plan a year in advance when you budget, because institutional investors are not individuals, and they can't just say, "What the heck, let's spend \$20 million." They have to budget. You can't budget for a proxy fight, because you cannot predict, with any kind of ballpark figure, what it will cost. The costs are huge. As I said at the beginning, what we've learned from history is that the more you reduce those costs, the better off we are.

But there is also an aspect of habit here, and of law. Since this is the Law School, we might as well end before lunch on a legal point, and that is: Trust law which governs pension funds and some other institutional investors derives from English common law of trusts, when trusts were developed where one person took care of one other person's assets for a short period of time. Like you managed your great aunt's money until she died. And, therefore, what trust law recommended was that you diversify all over the place, and in a truly conservative way, and be prudent in an inactive, terribly diversified way. That's the only legal precedent there is for trust law, and, therefore, the lawyers applying trust law to pension funds take that law and apply it. And, essentially, one of the four principles of ERISA is "diversify," which most pension funds therefore interpret to mean, "Buy tiny stakes of 1,300 companies." There is no reason under trust law or ERISA to buy tiny stakes in 1,300 companies.

The securities law is not to buy 5% - and that's a crime, because it seems to me that, really, the reason behind §13(d) is to say no shareholder can own enough to be a real owner - but the fact is, you could be fully diversified and own a hundred companies, 4.9% of them, and then these questions would become a lot easier. But there's a legal overhang here that makes that difficult, as well as an avoid-the-headlines phenomenon that, indeed, a number of pension funds after this era of frauds *further* diversified from 1,300 companies so that no matter what company tanked, when the reporters called and said, "How much did you own?" the answer was, "Almost nothing."

Reinier Kraakman: Thank you, Sarah. Let me give you each a chance to respond to anything said by anyone else on the panel before turning it over to questions.

Michael Price: Proxy fights today don't cost \$20 million to run. You know how a proxy fight runs? You hit the holdings screen on your Bloomberg, you see who else owns the stock, and you call. And then if you've sensed that there's 5, 10, 20% of the stock that agrees with your point-of-view about the management, the board, the acquisition they are making (just like we've seen with Hewlett-Packard/Compaq in the last year), today – I mean, right away, you know if you've got 20 or 30% of the vote, then you guys go call the CEO and say, "Hey, we'd like to come and see you." That's today's version of the proxy fight. It's very effective, you don't spend any money, period. So there is not the barrier that you claim there is.

Sarah Teslik: Well, actually there is. If you're an institutional investor, it's not quite that simple.

First of all, the decision-making process cannot happen with your reading the paper and deciding to make the phone call. And if you have to put it on a board agenda – and there's really no other way if you are a public entity – you can't make that call that quickly. In addition, to form a group, the filings that you have to make require a budgetary allocation, and §13(d) filings are expensive to make. And you will get sued, which is a major problem if you are taken seriously. And a number of our members have been advised, that, since, of course, most of them externally manage, that all of their money managers who have any amount of stock in the company you're interested in will also have to file §13(d)'s.

So it's really a much more complicated proposition, and one that can't be done as quickly, and can't be budgeted for, and even if it's millions – which, actually, it still is, given the lawsuits and given the deposing of all the board members, which, when Lone Star Steakhouse had a dissident running for the board, the company called us, they called the major pension funds that were members and said, basically, "If you make even a noise suggesting that you like this, we will depose all of you," and you can't responsibly run a pension fund without preparing your board members. It's a substantial undertaking.

Reinier Kraakman: Anyone else of the panel? Bob?

Robert Pozen: I think what we see here is that like most categories, institutional investors have a lot of different flavors. I mean, Michael Price represents a type of fund that takes highly-concentrated positions and is very adept and very experienced at really putting a lot of pressure on management and gets returns that have a significant impact on the performance of his funds in those relatively few positions. And his investors are all prepared to take the heat in terms of this sort of thing happening because that's why they come to Michael Price. That's his rep, and he's very good at it.

But I think that isn't the same position for a lot of institutional investors, and I think, in fairness to Sarah, what you're hearing is people who have run very large pools of money (meaning several hundred billion) and have a very strong diversification requirement wind up with relatively small positions with companies - 1% or 2% at most - so they have a very different viewpoint. And, to the extent that they have to explain to a board of trustees, many of whom may not be investment experts, as to why, exactly, they are in these types of fights and what they're getting out of them, it's a much more difficult situation.

So I think there is not a real conflict, we just have two very different groups that are both called "institutional investors". What we have is very different groups that are responding to the realities of their situation, and I think it's really not fair to say that the big pension funds and mutual funds don't exercise their vote - they do! They diligently vote their proxies. They diligently vote on every shareholder proposal. Most of them have guidelines that say that they will vote for the repeal of poison pills, they will vote against most anti-takeover amendments and various other things. But we ought not to confuse voting with a form of activism that involves putting pressure on management to change its strategy. That's a very different thing, and for most very large institutional investors with diversified portfolios, and with boards who have a very different view than your board and your management team... That's a much more complicated challenge.

Reinier Kraakman: Orin?

Orin Kramer: The only thing I would say is, in general, it's hard to find these situations where (a) there's a problem with the company, (b) there's a fairly easy-to-understand answer about what ought to be done about the problem,

but then (c) that I've got 20-plus percent of the shareholders, who are, in effect, willing to have their name used when I go and talk to the CEO, and (d) in situations where there has been the 20 or 30 percent it's certainly been my experience, and the experience of others from time to time, that a CEO understands that, ultimately, you don't have the leverage to force them to do anything, and they can make whatever arguments they want, but the discussion basically just dies.

There are a significant number of shareholders who will say, "I cannot be perceived as being active in some manner. Having said that, if there is something actually on the ballot, then I will be able to vote in my economic self-interest, but I can't speak outside the ballot, in my economic self-interest." That may be indefensible, but there's a lot of that that goes on.

Reinier Kraakman: I'm going to open up the questions now. Brian, I saw your hand up first.

Brian Hall: I have a question for Michael Price. So let's bring some data into the analysis. What - because, in a sense, what you're arguing, that maybe the Fidelities and other groups of the world aren't taking advantage of a situation that they could take advantage of - and so what I'm wondering is, just empirically, what percentage of the companies could you realistically go in and - say you decided that you wanted to do something - not of the companies that you're investing in, but if you look at the 8,000 publicly-traded companies, you look at the list, and you'd actually know who to call -

Michael Price: Mid-cap and smaller, assuming they are value kind of stocks. Stocks that trade at discounts from their asset values, where the management's making a big mistake.

If you're in the growth stock area, which we're not - You know, you're going to have a whole different set of owners that don't think the way we think, and, you know, they're betting on that management big-time, and they're subject to a lot more risk. And if you think back to the Enron and WorldCom situations, they were totally loved by Wall Street.

Brian Hall: So would you agree, though, then, that we had this serious problem with all of those other companies?

Robert Pozen: I think he's really saying that there's actually a fairly small group of companies we're talking about. He's probably trying to identify ten companies in a year out of all those small- and mid-cap stock. Sarah would probably say that most institutional investors invested in those companies, especially large pension funds, can't be having a 15% position like a hedge fund.

Orin Kramer: In terms of most people's economic interests - because I traffic in that same world - but in terms of, "Where do people have the money in life," 85% of the money is in the companies which are outside the world of activism opportunities.

Michael Price: Take General Electric. General Electric basically went from the absolute darling three years ago, right before Jack Welch left- and \$65 a share - to \$20 a share after Jack left. They have a great new CEO, they probably have the best corporate governance, but look how they were criticized. And nobody could influence them with votes, really. It's too big.

Reinier Kraakman: Bob?

Robert Clark: I'm Bob Clark, a professor here and former Dean. A question for Bob Pozen: several times this morning, you've mentioned the problem with the triggering event - the two-year - which Fidelity-type institutional investor is ever going to do anything with that kind of time frame? So let me get specific. Suppose something like the SEC proposal suggested by the staff was adopted without the triggering aspect, but with just a threshold. Would we see any change in behavior of the large mutual fund complexes, and the implication of the shareholder access rule?

Robert Pozen: At Fidelity, when I was there, we would get involved, as Michael would say, informally put pressure on management in at most 10 cases a year. And in those cases, we would be disposed to actually put pressure on management pretty quickly -

Orin Kramer: And it would go up to 20 a year.

Robert Pozen: Maybe. Maybe that level or lower. But the fact is that anything that involves waiting two years is just not attractive. If the stock is undervalued now, if you have a big position, you've got to decide if you are going to sell the stock or is there enough potential here, in a relatively modest amount of time (meaning nine months or twelve months), to get a better return. And, in many situations, the election of a new director may or may not be helpful in solving the company's problems.

Now, if you had a situation where you had somebody who was getting affiliated contracts, where you really felt the company was being exploited, then putting somebody on the board might make a difference, because somebody might stand up and say, "Look, you've got to re-price these contracts." So then you'd want to get that person on the board right away. But, how many situations are there in that category?

Leo Strine: I had a question for you all about, what is this system. I mean, if you analogize this to a system of accountability in the political process, what is the system you all want? Is it a representative democracy? Is it a popular democracy? I mean, I've heard a lot of misuse of terms, I've heard "New England town meetings" used to describe a move toward representational democracy, but what we have is a really mixed system, because remember, stockholders also have significant voting rights that involve, for example, approval of major transactions like mergers, sale of substantially all of the assets. There are actually some increased voting rights now about certain compensation types of things under the law, plus you have the ability to elect directors.

And I wonder whether there's a difference between the Bob Pozens and the Mike Prices of the world about what they want, which seems to be the ability to weigh in when, really, control of the board and company policy is really critical to maintaining value. I mean, Bob has said he's a renter; I mean, he wants to kick the vote right away. He wants to kick the bastards out or he wants to sell, which sounds like we're back to the takeover debate, whereas I may be hearing something about pension — And I just wonder, what is the thing you want? Do you want this mix of popular democracy and representative democracy? Do you want representative democracy? What would you ideally have?

Reinier Kraakman: Michael, can you start with that?

Michael Price: I think that, when we look at something... We study the board before we buy the stock, and we have an impression of whether the guy who's running it, the CEO, who's a director, is good or not. Sometimes, there's more value when they're not and you try and do something about it, but I think what we're really talking about is where you made the mistake of becoming an owner, and he wasn't as good as you thought, and you need to do something about it, because you just don't want to sell so cheaply, okay? Then you need a process.

And what I've said all day is I think the process is in place. I think that the '92 changes helped a lot, I think the frequency of management's threatening shareholder litigation is gone, and the very easy way to deal with that is call Floyd Norris at *The Wall Street Journal*, or *The New York Times*, and say, "Hey, I just got a phone call threatening me!" They love those stories.

Robert Pozen: I don't think I disagree much with Mike Price. I think basically, you try not to buy into those companies in the first place. But what you're really talking about is where you've bought into a company, and you have a pretty big position, then you feel like with some change in management or policies, you can realize a lot more value.

So I think when you say, "What is it that institutional investors want?" in those situations - which are a limited number of situations - you want to be able to press the safety valve fairly cheaply and fairly effectively. And what that means, in many cases, may just be having more certainty on the §13(d) rules, so you can put informal pressure on the management. I guess *occasionally* that could mean electing a director: for example, in the exceptional situation where you really want someone on the board who'll say no, you can't do this affiliated transaction. The most important thing is to figure out a way to keep the cost low and get some sort of return on the activism. So I get back to this question - Why would anybody be a lead plaintiff in a shareholder class action unless you, as an investor, can get some sort of premium for playing that role? Michael is often in a situation where his fund owns 15% of a stock and so it can have a huge impact on the return of his fund. That's not true of most large pension funds and mutual funds.

They won't have that big a position, and even if they did, the dollar value of impact on their total returns is pretty low.

Leo Strine: Well, I mean, what we've seen is either over-weighted people who take big positions, or certain public pension funds.

Orin Kramer: I don't believe under any set of circumstances, you would have a lot of contested elections. A contested election is a failure to achieve what any activist shareholder tries to achieve, which is a negotiated outcome. If you say, "What is it that you want?" What you want is to have a legal framework which conditions those negotiations, which recalibrates the balance of power between the owners of the company and the people who are supposed to be their agents.

Joseph Grundfest: I think Orin's point is apropos. A question I'd like to ask to anybody on the panel who wants to answer it. We're talking very much in the abstract about the idea of shareholder access. Can we make the conversation more concrete in the following sense? Let's assume some version of the Commission's rules are adopted and enacted. Which boards would institutions actually target? I'd like to hear some names. Which directors would they want off? All right? I'd like to hear some names. Which directors would actually be proposed to replace those directors? I'd like to hear some names. And why? What would the rationale be for picking those companies, targeting those directors, and suggesting those replacements? Because, to me, it's really remarkable that we've spent all this time talking about these things in the abstract, and I know I would be illuminated if I could understand, well, all right, what do you want to do? Anybody?

Damon Silvers: I think that's a very good question. I'm willing to answer it, at least in part. And the reason I had my hand up is probably in relation to this. I'm here in part, at least, on behalf of funds that share Michael Price's willingness to mix it up with folks.

To a certain extent, unions and union pension funds are prepared to fight. However, we're very aware that there's a range of preparedness, and a lot of funds that invest our members' retirement money don't have that kind of ability for the very reasons that Sarah outlined. But nonetheless, the bulk

of our money, as Orin Kramer said, is in large-cap stocks, where there isn't anybody with the willingness to fight and the concentration of ownership to take it on.

If this were to pass, which would solve that problem; if the Commission votes and we get something real, then those are the type of companies that our funds are going to be interested in trying to organize a candidate. Large-cap companies where our money is. And I'll name one, because I know of one company that we would be prepared to run a candidate tomorrow. Unfortunately, I can tell you who it is we want to take out; but I haven't figured out who we would want to put in, but I can describe the kind of person we would want to put in.

A company we'd be prepared to run a candidate on tomorrow is Lockheed Martin, and the reason is because Lockheed Martin continues to have a former Enron director, Frank Savage, who cannot explain what he did to help prevent or cure what happened at Enron. He's been there for two years. We've had withhold campaigns at that company that have gotten the highest level of withhold votes at any large-cap company in the history of the world, and he still sits there, and they keep re-nominating him. And we want someone else! Now who's the someone else? Well, we haven't come up with an individual - and if we had, I wouldn't want to out them here without asking them - but I can tell you the kind of person we're looking for, and I'll tell you it's not -

Robert Pozen: Can I press you on this? Because this is a good illustration, as I happen to know Frank, I happen to think he's a reasonable guy. I think he became a director in Enron very late, though he may not have been diligent enough about the complex transactions in Enron. But what makes you think that taking Frank Savage off the board - and let's assume not replacing him with anybody - is going to make any difference to Lockheed Martin's financial returns?

I can assure you, that's not what Michael's looking for. He would pick a company that's a significant value company that's under-performing, where he thinks that getting new blood on the board is going to really result in a new policy. Or the other example that I've tried to give, where there really is a conflict with affiliated transactions, where you really wanted somebody to

stand up and say, “Hey, no. This isn’t any good.” But you get Frank Savage off the board, it would probably have little impact on the stock price.

Joseph Grundfest: Any new examples or are we doing all this rule-making to get rid of Frank Savage?

Damon Silvers: I mean, this is why Fidelity, I believe, declined to withhold, is this particular argument. And, frankly, that’s why we didn’t get a majority – because a couple of mutual funds think that that’s the kind of guy that ought to be protecting our money. We disagree.

In terms of the outcome, though, think about what our funds—what we do. Our members’ money is invested, indexed across the whole world of companies. We don’t want people with that kind of record protecting our money. And we believe that holding them accountable to their records protects our investment and adds to value across the board. Feel free to disagree. I don’t think very many people you took this argument to out there in the larger world, the people whose money it actually is, I don’t think that there’d be very many investors who’d be very interested in the idea of continuing to protect such people.

And, frankly, with 30% of the company’s stockholders at Lockheed Martin withholding, there’s a pretty powerful argument there that they don’t agree, either. Now, can I tell you exactly what event will happen at Lockheed Martin as a result of removing Frank Savage? I don’t know, but I’m pretty certain that I would sleep better at night as a steward of other people’s money invested in that company if I knew that he wasn’t on that board and somebody with a demonstrated record of protecting people’s money was. And that’s the kind of person we would be looking for. The kind of person we would be looking for to replace Savage would be an experienced, savvy businessperson, not a labor movement person, not a social activist, but an experienced, savvy businessperson with a history of independent thinking and hard questioning. That’s what we’re about.

Michael Price: It’s interesting that you pick Lockheed Martin, because Lockheed Martin, I think in the late 80’s, fought off Harold Simmons and gave a board seat or two to Lanny Martin and Harold Simmons. They pushed him hard. We were involved with that – we owned 5% of it then.

The company outperformed, I believe, through the 90's, and then we got to the war phase of the whole defense deal and they've done okay. The stocks are too high now, but what I think you need to do is focus on, "Why do you index?"

Damon Silvers: We index because indexing is cheaper and more effective in the long run than wasting money on active managers as a group, frankly.

There's a stack of books and data, which some people are contemptuous of here, over at the Harvard Business School, that proves that, to the satisfaction of anybody who doesn't have a financial interest in the opposite proposition.

Joseph Grundfest: I'm sympathetic on many levels, but what kind of expense should be incurred in order to induce fundamental change at the corporate level, and, from an economic perspective, what the agency would be doing would be lowering the barrier to entry in order to make a fundamental change in the structure of the corporation's board. Now, whether, in this context, outside of a takeover area, whether that's going to be a good idea or a bad idea is an interesting question. We know we don't have data that have already run that experiment. Why? Because we've never had that regime. Therefore, we can't do that event analysis. So that's real easy to resolve. But what we *can* do is we can ask the players - we have many of the key players in the room - if you had the authority that the agency is thinking about giving you, how would you use it?

Lucian Bebchuk: I would like to respond to Joe Grundfest's challenge. He was asking which companies would be targeted. In addition to Lockheed that Damon is going to target, I expect that the set of companies that will be targeted will include two types of companies: first, companies that have been chronic underperformers for a long period of time; second, companies that seem to have severe corporate governance problems -- a record of serious self-dealing, abuse of executive compensation, and so forth.

Joe's second question was: "Who in the world will be the directors we choose?" Just sitting here and looking around the room, and without asking those people to say "yes" or "no," I notice Bob Pozen, Bob Clark, Brian Hall, Joe Grundfest, Jack Coffee, and Richard Breeden. So here are six people -

and, you know, the table here is not all that large – who conceivably could be candidates.

Finally, to Joe's third question: "What would they do when they get in there?" The main point to emphasize is that, when they get in there, because the shareholders nominated them, their loyalty will be to the shareholders. It has already been mentioned today a source of potential problems with current independent directors has to do with how they got in there. We're all socialized so that when we are invited by somebody, then, at least on the margin, this is going to influence how to deal with things. So, Joe, if you were invited to serve on the board, and you were asked to do so by institutional fund managers rather than incumbent directors, then I expect that you'd be more attentive to shareholder interests than the average director getting in there as a result of nomination by incumbents.

Reinier Kraakman: I've got time for one last question, very short. Brian?

Brian Hall: Yeah, I was just going to say, you know, getting back to your earlier point, Joe, it would be, I think, the main group that would be targeted would be the same groups that would be targeted in takeovers, but Delaware has made it sufficiently difficult to do that, that we are going to this, we're having this conference because we're looking for a second-best solution, which has a lot less teeth, but given that difficulty, I think it's something to seriously consider.

Reinier Kraakman: Okay, let's break for lunch. I'm sure more names will be named afterward.