

Corporate boards failing investors: as management scandals make it evident that directors provide little protection for shareholders, investors are turning to the Internet, courts and Congress for help - Nation: business leadership

Sheila R. Cherry

The relationship between a publicly held corporation and its stockholders is a lot like the relationship between a government and the taxpaying electorate. Critics charge that taking on entrenched corporate management is every bit as difficult as fighting city hall--especially when the corporation's board of directors is not sufficiently independent of management to exercise diligent oversight. That is, they note, until and unless fed-up stockholders organize to hold corporate executives strictly accountable for husbanding company resources.

In democratic countries, taxpayers tend to organize and vote the rascals out when they see their taxes wasted or their wishes ignored by the lawmakers mandated to represent them. True, stock ownership is more mobile than national residence, and when owners are disappointed by management a stock readily can be sold if stockholders know about trouble in time to act. Corporate leadership is meant to improve or maintain the interest of the corporation to serve the shareholders whose investments help fund its capital needs. When they don't, instead profiteering for themselves, they tend to act as secretly as possible, looting corporations before stockholders get wise.

So now the courts and the Internet increasingly are being used as vehicles by disgruntled shareholders intent on holding corporate officers and directors accountable when the company's interest is being subjugated by those of the chief executive officer or other officials. Of course, these matters can be as subjective as issues in an election for sheriff or dog catcher and tend to cross ideological lines.

One upstart online group of stock watchers at www.eRaider.com makes its capitalist agenda known with the message: "Welcome to the ruthless pursuit of profit." This Website declares its mission as targeting corporate managers "who have become sleepy, selfish or unfocused." Its goal, according to the site, is to improve corporate governance "by friendly persuasion if possible, by unfriendly action if necessary."

Deborah Pastor, eRaider vice president, is concerned that some corporate boards are hand-picked by company managers only to be depicted as "independent" in order to crowd out the voices and concerns of shareholders. And, unlike inside directors drawn from the ranks of management, the Website explains, independent directors are supposed to be free of conflicts that might prevent them from carrying out their duty to protect shareholder interests.

But, the group complains, board members who exercise genuine independence by asking too many questions that make management uneasy can get thrown off the board. "Except for an occasional proxy fight organized by a major investor, directors do not provide much protection for shareholders," the Website charges.

Shareholders organizing through eRaider are turning to technology to seek out like-minded investors. "The Internet has evolved a new way for people to make group decisions: the public message board," the Website explains. When anyone can post anything--even if edgier online posters veer into rudeness or misinformation--the strongest ideas ultimately will survive, according to eRaider.

The message-board experiment notwithstanding, traditional stockholder options remain, Pastor explains. The most effective way for shareholders to get an issue before the board and management, she indicates, still is the shareholder proposal. Lately, according to Pastor, corporate boards are starting to take shareholder proposals more seriously. They can be a powerful tool for reasonable ideas, she says, explaining that the proposals suggested by eRaider usually consist of a 500-word or less recommendation. The problem is that even when approved by the board the proposals only are guidelines and, therefore, only as effective as management is willing to make them.

But shareholders can effect change by gaining control of the board itself, Pastor explains, through the election or appointment process. However, there are significant obstacles that are not for the faint of wallet. For example, voting instructions are sent to

beneficial owners by the owners of record, which likely would be a stockholder's brokerage firm. Brokers who are the owners of record have the freedom to vote the shares of beneficial owners who do not send back their proxy statements and often vote with management, she says.

However, if despite the odds a challenger gets elected to the board, it is customary--but not mandatory--for the company then to reimburse their campaign expenses. "Right now it is very hard for any person who is not endorsed by management to run [for a corporate board]," according to Pastor, which inherently creates a conflict. "You [then] really owe your seat not to the shareholders but to the management," despite the board's role of overseeing management to protect shareholder rights.

A third option for getting management's attention, Pastor says, is to create a public discussion. Perhaps that is what was attempted at Hewlett-Packard Co. (HP) late last year. A board debate took a nasty turn when Hewlett heir and HP board member Walter Hewlett resisted the management decision to merge with the giant Compaq Computer Corp. A close associate of Hewlett tells INSIGHT that the heir now "just wants to move on" after the ordeal. "He took a big detour from his life to do this because he thought it was the right thing to do," but now Hewlett does not wish to further a controversy that might adversely affect the value of the company.

In any case, a proxy fight began after Hewlett raised questions about a Labor Day announcement of the merger proposal with Compaq and suggested a reconsideration of that proposal in a letter sent to the board in December 2001. "Not only did they ignore his letter, but then they came out firing," Hewlett's associate says. "Not long after that they sent out a letter to shareholders saying that, after all, he was just an `academic and a musician.'" The associate quips that the dig at Hewlett for his Stanford University affiliation ignores the fact that National Security Adviser Condoleezza Rice also was a Stanford academic and a musician.

The publicity-shy Hewlett and his siblings reportedly were united in their philosophical objection to HP moving out of its niche markets into the broader field of manufacturing and marketing personal computers. The Packard family foundation made a separate announcement opposing the merger as well.

But Walter Hewlett's message was focused on the economics of the deal, the associate insists. According to news reports and the Hewlett associate, Walter Hewlett, his siblings, his family's trust and foundation control almost 20 percent of HP stock. But that wasn't enough to prevent HP's management from deciding to go forward with the sale.

HP executives countercharged that they were exercising sound corporate governance and that the merger would benefit shareholder interests. "HP share owners deserve a carefully considered, comprehensive plan," charged a written statement from company management, "not last-minute propositions that change weekly."

After a Delaware judge dismissed his court challenge in May, Hewlett abandoned his efforts to overturn the merger. He had been an HP board member since 1987, but in April the board released a statement announcing its candidates for nomination. The announcement pointedly noted that the nominations "will not include Walter Hewlett."

Nonetheless, stock investors and pension-plan participants alike have become more wary of company accountability after the management scandals of the last year. And Congress has turned its attention to creating legislation aimed at strengthening investor and shareholder protections. In the House this session, for instance, representatives have been seeking to empower employees whose pension funds hold their company's stock. The Pension Security Act of 2002 (HR 3762) was introduced in the House Education and the Workforce Committee by Chairman John Boehner (R-Ohio).

According to committee spokesman Kevin Smith, the legislation, which had 33 cosponsors, passed the House in April with the support of 46 Democrats. But the bill, intended to provide additional protections to pension-plan participants from excessive investment in employer securities, has languished in the Democrat-controlled Senate ever since. The measure would allow workers to receive more-frequent information on the status of their company stock. Companies would be required to give quarterly earnings reports instead of annual reports. Boehner spokesman Steve Forde puts it plainly: "The more information that employees have about the financial security of their companies the better."

One avenue of the pending legislation would allow employers to contract with investment advisers to provide employees with independent advice about company stock holdings. Another, according to Smith, would allow workers to purchase investment advice on their own with pretax dollars, similar to medical savings accounts that employers offer workers. Still other changes would let

workers diversify their company stock after three years and allow pension-plan participants to sue the fiduciaries who administer the company pension plan to recover damages resulting from negligence or fraud.

"If the Senate does not pass the bill before adjournment then the issue dies for this Congress," Smith laments. "Then we will have to start all over again in the next Congress."

SHEILA R. CHERRY IS A WRITER FOR Insight.

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