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SEC plan may alter board elections

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By Len Boselovic, Pittsburgh Post-Gazette

A proposal approved this month by a divided Securities and Exchange Commission is shaping up as a showdown between those who want to give investors more say in electing corporate boards and those who fear the democratic initiative would hamstring Corporate America with a one-size-fits-all approach.

On May 20, the SEC approved, 3-2, a proposal that would give shareholders who meet stock ownership thresholds the power to nominate a limited number of directors in corporate board elections. Their nominees would be included in the proxy statements companies mail to shareholders in advance of the annual meeting, where directors are elected. Being included in the company materials would allow shareholders to forgo the considerable expense of waging a proxy contest on their own.

Those expenses are one reason why incumbent directors almost always decide who will be nominated and why their hand-picked choices are rarely voted down. Many say the problems with that system are evident in the failure of boards to prevent the excesses that have eroded confidence in Corporate America.

"There will probably be a lot more willingness to accept something like this," said Gary Miller, an attorney who specializes in corporate and securities law with Eckert Seamans Cherin & Mellott.

Under the SEC proposal, shareholders would be permitted to nominate up to 25 percent of a company's board -- or one nominee in the case of a three-person board. To make the nomination, a shareholder or group of shareholders would have to own at least 1 percent of a company's stock if the company had a market capitalization (the number of shares outstanding multiplied by the share price) of $700 million or more. The ownership threshold would increase to 3 percent at companies with market caps from $75 million to under $700 million and 5 percent for companies with a market value of less than $75 million.

Additionally, shareholders would have to own the shares for at least a year, sign a pledge to hold their shares through the annual meeting, and certify that they weren't seeking to gain control of the company.

"This proposal represents nearly seven years of debate about whether the federal proxy rules should support -- or stand in the way of -- shareholders exercising their fundamental right to nominate directors," SEC Chairman Mary Schapiro said.

The Business Roundtable, which warned that previous attempts to grant shareholders greater say raised the spectre of "special interest groups hijacking the director election process," has a slightly different perspective.

"This is an unprecedented pre-emption of state corporate law -- the bedrock of corporate governance -- that will turn the boards of more than 15,000 publicly traded companies into political bodies and threaten their ability to function," warns John J. Castellani, president of the business interest group.

At the other end of the spectrum is Les Greenberg of the Committee of Concerned Shareholders. The grass-roots group was spawned in 2000 by Luby's shareholders who launched a proxy fight against the cafeteria operator after organizing on a Yahoo message board. The group spent less than $15,000 to nominate directors who received 24 percent of the vote, while Luby's spent $250,000 of shareholder money to oppose their effort, Mr. Greenberg says. He has been lobbying for shareholder rights ever since.

Mr. Greenberg called the SEC proposal "a sham upon the investing public," saying it grants equal access "only for a small number of wealthy shareholders." Mr. Greenberg says pension funds haven't used their considerable power to influence director elections under the current rules and are unlikely to do so under the proposal. If they were to, they would have to form coalitions to nominate directors, and maintaining those alliances is difficult, he says.

A study released last week by Proxy Governance and the Investor Responsibility Research Center reveals that insurgent shareholders are having increasing success in getting a handful of directors put on boards and that the results have been positive for shareholders. They looked at 120 "hybrid" boards composed of company-selected directors and a handful of directors put forward by hedge funds and other activist investors. On average, shareholder value increased 19 percent a year after a blended board was installed, significantly above the average of that company's peers, the study found.

Scott A. Fenn, senior managing director of Proxy Governance, expects the SEC proposal will be a hot political issue. Advocates will say it is a step toward better corporate governance while opponents will warn of "barbarians at the gate," he said.

The issue of whether federal law should supersede state law on the issue could lead to a court challenge, according to Mr. Fenn and others who have examined the issue. That roadblock notwithstanding, the SEC is putting its proposal into writing so that it can be published in the Federal Register. The public will have 60 days to comment before the SEC takes final action.

The agency hopes to have the new regulations in place in time for next spring's annual shareholder meeting season.

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