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GOVERNANCE QUARTERLY

PUTTING YOUR MOUTH WHERE YOUR MONEY IS:

Institutional Investor Activism and the Experiences of the New York State Common Retirement Fund

by H. Carl McCall

Responsible investors know that corporate governance is the key to long-term profitability. A company can get lucky and have a good year. In a bull market, a company can simply ride the waves and have a great year. But to sustain long-term growth and profitability, a company needs first-rate governance where both management and policies are committed to enhancing shareholder value. Without that, a company cannot sustain success, and it is destined to disappoint its shareholders.

As Comptroller of the State of New York, I serve as sole Trustee of the state's Common Retirement Fund (CRF), the pension fund for all New York state and local government employees. With assets in excess of \$120 billion and 880,000 active and retired members, the Fund is one of the largest pension funds in the world.

I take seriously my fiduciary responsibility to CRF members to protect and maximize the economic value of the Fund. To meet that responsibility, I make prudent, diversified investments. And I also establish corporate governance criteria to help ensure those investments are profitable.

There is no one right way to pursue good corporate governance. Each company is different, and different issues require different approaches. A review of CRF's recent activities illustrates the range of strategies available to investors.

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H. Carl McCall has been Comptroller of the State of New York since 1993 and, in that capacity, is responsible for governmental financial oversight and pension fund management for the State of New York, including serving as sole Trustee of the state's \$120 billion Common Retirement Fund. Mr. McCall has had a distinguished career in public service. Among many other positions, he has served as President of the New York City Board of Education, as a three term New York State Senator, as Ambassador to the United Nations and as a Commissioner of the New York State Division of Human Rights and the Port Authority of New York and New Jersey.

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Using the Proxy Process

The proxy process is critical to shareholders. In many instances, it is our only avenue for dialogue with a portfolio company. It is important for all shareholders to exercise their voting rights in a timely and thoughtful fashion.

■ **Each year, CRF votes proxies of 1,300 companies.** Our voting guidelines support resolutions that promote shareholder value and shareholder rights. While our staff considers every proxy on a case-by-case basis, CRF has voted against resolutions that create excessive executive compensation, dual class stock structures, stock option repricings, poison pills and golden parachutes.

■ **I also sponsor shareholder resolutions.** Some of these resolutions address issues of social concern, including tobacco sales to youth and fair employment practices in Northern Ireland. In all cases, I believe that social issues have a direct impact on a company's economic performance.

Dialogues with companies

CRF is a major investor in corporate America. When the Fund talks, companies listen. Knowing this, I try to use my influence to bring about reforms that will improve long-term performance. In letters, telephone calls and meetings, I regularly communicate with corporate management and other institutional shareholders to promote good corporate governance at portfolio companies. My goal is to develop a partnership with these companies, so that we might work together in pursuit of our mutual goal to achieve long-term, sustainable profits.

■ **CRF conducts a semi-annual performance review that identifies the poor performing companies in its portfolio.**

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Staff communicates directly with the companies to review their plans for turn-around and encourage changes in corporate governance that might improve performance. If a company fails to respond, CRF withholds support from the Board of Directors at the next annual meeting. CRF has withheld support from the boards of 30 companies in the past five years.

■ **I also communicate directly with corporate management when companies take actions that jeopardize shareholder value.** Recently, I contacted Michael Armstrong, Chairman of AT&T, to discuss his announced plan to split the company into four separate companies. AT&T's stock price has been depressed for a long time, and I was not convinced that Armstrong's plan was in the best interests of shareholders. Following my conversation with him, I arranged for a larger meeting between him and members of the Council of Institutional Investors. At that forum, institutional shareholders had an opportunity to ask questions and better understand the future of their investment.

■ **Earlier this year, I sent letters to the Chairmen of Mattel and Coca-Cola criticizing their decisions to award lucrative**

severance packages to ousted chief executive officers. I am greatly concerned about the effect that excessive executive compensation has on shareholder value. Such extraordinary recompense is particularly outrageous when executives have performed poorly, causing shareholders to suffer. Although my letters did not produce a change in the severance packages, the boards of both Mattel and Coca-Cola reacted to widespread public criticism by demonstrating a heightened commitment to searching for more appropriate executives and rewarding them on a more reasonable, performance-based formula.

■ **I am sharply critical of companies that have discriminatory policies or practices. Companies will thrive only when they promote a culture of equality, tolerance and fairness.** Anything less is not only unjust; it is unwise, as it poses a significant threat to a company's reputation and long-term value. Accordingly, when I learned that executives at Texaco had made racist comments and tampered with evidence in a racial discrimination lawsuit, I expressed my concern to the Chairman, Peter Bijur. Texaco's subsequent settlement of the lawsuit and its implementation of a comprehensive diversity plan strengthened the company and benefitted shareholders. Coca-Cola also faced a racial discrimination suit. I wrote to the Chairman and met with senior executives to discuss my concerns and urge them to settle. Earlier this year, they announced a legal settlement and a diversity plan. I have no doubt that Coca-Cola will be a better company because of these steps.

■ **I am also an active member of the Executive Monitoring Committee that addresses issues related to the restitution of assets lost by Holocaust victims**

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and survivors. Created in 1997 by New York City Comptroller Alan Hevesi, the Committee includes public pension fund trustees from all over the country. Our efforts have contributed to successful negotiations, including those with Swiss banks and the Austrian government. At times, we have leveraged our position as shareholders to encourage portfolio companies to participate in settlement talks. I believe this is an appropriate role to play. Companies that act responsibly and take steps to bring about some measure of justice will be better equipped to handle the economic and social challenges of the future.

Litigation

When all other efforts have failed, when shareholder resolutions have been ignored and communication has broken down, CRF considers litigation. To date, we have been Lead Plaintiff in four class action suits. In these suits, we seek recovery of financial assets and corporate governance changes that will enhance the company's long-term performance. Our greatest success was the \$3.2 billion settlement with Cendant Corporation and Ernst & Young, Cendant's former auditors. Not only was it the largest securities settlement in his-

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tory, it also incorporated important corporate governance provisions, including complete independent membership on the audit, nominating and compensation committees; a majority of independent members on the board; annual elections of all board members; and shareholder approval of stock option repricing. The financial settlement provides shareholders with some immediate compensation, and the corporate governance provisions help to ensure that shareholders will be rewarded going forward.

Responsible investors are active investors. We know that corporate governance is a fundamental component of corporate performance. It may not guarantee good performance, but bad corporate governance will certainly foretell bad performance. On behalf of all the members of CRF, I will continue to work with portfolio companies to protect and grow the assets of the Fund. I will be a partner with the corporate sector and will seek new ways to communicate and work together to benefit corporations, investors, and the retired employees of the State of New York.

Conclusion

I urge all institutional investors to be active investors. As demonstrated by the above examples, institutional investors — both large and small — can help to shape the conduct of corporate America. Whether by use of the proxy process, open communication with corporate executives or, when necessary, considering litigation, institutional investors can work to ensure that the companies in which they invest are managed properly and the interests of shareholders are adequately protected. Our fiduciary responsibility demands no less.



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