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INSTITUTIONAL INVESTORS TAKE BACK THE STREET

"Shareholders own the company; it's as simple as that. If they are dissatisfied with their board representatives, they should be able to demonstrate that in a meaningful way."

SEC Commissioner Paul Atkins

By Benjamin Galdston

For one brief moment on March 3, 2004, Walt Disney shareholders brought months of simmering discontent with Disney management to a climax by registering a whopping 43% vote against re-electing CEO Michael Eisner as Chairman of the Board. Although the vote failed to oust Eisner, who is expected to remain Disney's chief executive through the duration of his contract, which expires in 2006, it marked a watershed in developing shareholder activism and sent a clear message across many boardrooms. Shareholders are no longer willing to sit by silently while directors fail to contend with perceptions of corporate mismanagement or outright fraud.

The California Public Employee Retirement System ("CalPERS"), which owns 9.9 million shares of Disney and is the nation's largest pension fund, rallied its fellow shareholders to action by showcasing its case against Eisner on its new corporate governance website. Originally, CalPERS hoped to garner support among at least 20% of Disney stockholders. But nobody could have predicted the overwhelming 43% of the shareholders who expressed their solidarity with CalPERS by withholding their proxy vote. What led up to this veritable "revolution" in corporate affairs and why have other institutional investors been content to sit back and let management unilaterally make important decisions for so long?

Background

Traditional notions of investors' role in corporate management are undergoing radical change. Institutional investors, such as large public pension funds, are largely responsible for the trend toward greater involvement in the management decisions that, in principle,

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SHINING LIGHT ON THE PRACTICES OF PENSION FUND CONSULTANTS: Who Are They Really Serving?

By Gerald H. Silk and Stephen W. Tountas

Pension fund consultants typically advise pension fund systems on critical financial and investment matters and, therefore, often occupy a position that is fiduciary in nature. As Justice Benjamin Cardozo noted, the standard of a fiduciary requires "something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior." Whether pension fund consultants are living up to this high moral standard is a question being raised as a

"Sunlight is said to be the best of disinfectants; electric light the most efficient policeman."

Justice Louis D. Brandeis

result of recent revelations of consultant transgressions and an ongoing U.S. Securities and Exchange Commission ("SEC") review of consultant activities in the pension fund arena.

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INSTITUTIONAL INVESTORS

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should lead companies to better profitability, shareholder return, and regulatory compliance. Having responded to Congress' 1995 mandate to represent injured shareholders in securities class actions and enforce the federal securities laws, many institutional investors now believe that being more active in the election of corporate directors can improve governance and perhaps avoid the need for litigation later.

How do shareholders participate in corporate management decisions? Shareholders have scant few mechanisms to make their views known: divest shares, submit proposals or exercise the proxy vote. But, none of these options is particularly effective when exercised by any individual shareholder. Moreover, investors selling their shares en masse really only severs the proverbial nose to spite the face because of the depressive market effect such an exodus has on the stock price.

Every spring, investors are allowed to vote on certain aspects of company affairs. In advance of shareholder meetings, information is distributed concerning proposed changes, including management's position either for or against any given proposal. These proposals may originate either internally, or from shareholders, or simply as a regular matter pursuant to the company's charter—such as the election of directors. In advance of the annual shareholder meeting, each stockholder receives a proxy card which provides two choices: either delegate the vote to management to vote as it sees fit, or withhold the vote in silent protest. Withholding a vote then is a symbolic gesture, as demonstrated by the landmark Disney vote, because the withheld votes are not tabulated as votes "against" the proposal or director candidate.

For the past ten years, shareholder proposals gained favor among large institutional investors because of the unique opportunity to broadcast information to fellow shareholders and make positions known to management. According to the Investment Responsibility Research Center, shareholders filed 1,111 proposals in 2003, up roughly 50 percent from the 737 submitted in 1998. For example, the Sheet Metal Workers National Pension Fund—a $2.6 billion pension fund with 72,000 members—has been very active in increasing the number of proposals it files. In 2003, it made only 23, but in only the first three months of 2004 the fund has already filed 42 proposals.

Current proxy rules do not permit shareholders to submit proposals that relate to fundamental management issues, consequently real change in corporate governance cannot be achieved through the proposal process alone. For that to happen, the proxy voting process must also change. Institutional investors want to reform the proxy process so that the vote can effectuate real change, both by putting fundamental management decisions to a majority vote and also allowing shareholders to nominate and elect directors. Recently proposed changes to the SEC regulations governing the proxy process may just tip the balance of power in favor of shareholders and provide investors with these rights.

Inside Look

This quarter, the *Advocate* touches upon two issues of vital importance to investors. In "Institutional Investors Take Back the Street," Ben Galdston discusses the unprecedented vote of Disney shareholders against re-electing Michael Eisner as Chairman of the Board. As Ben explains, although the Disney shareholders' vote failed to oust Eisner, it sent a clear message across many boardrooms that shareholders are no longer willing to sit by silently while directors fail to contend with perceptions of corporate mismanagement or fraud. The Disney shareholders' vote also renewed last year's controversy surrounding the SEC's proposed regulation, which would allow shareholders to place their director candidates on the company's proxy cards. As the SEC is seeking public comments on its proposed regulation, we are proud to bring you Ben's thoughts on this hotly contested issue.

In "Shining Light on the Practices of Pension Fund Consultants," Jerry Silk and Stephen Tountas focus on another controversial issue brought to light in the past quarter—the potential conflicts of interest of pension fund consultants. The SEC's recent inquiry into the practices of pension fund consultants called into question the consultants' independence in rendering advice to their pension fund clients and caused quite a stir in the pension fund community. Jerry and Stephen explain the basis for potential conflicts of interest, and explore ways in which pension funds can protect themselves from overreaching consultants.

We also draw your attention to our regular *Eye on the Issues* column. As has been the case for more than a year now, we could fill the entire *Advocate* with news reports affecting securities and corporate law. This quarter, Tim DeLange, our *Eye on the Issues* correspondent, has yet again insightfully compiled the most significant developments in the field for your easy reference.

We hope that you will find this issue of the *Advocate* informative, helpful and fun. As always, we endeavor to make it worth reading and we welcome your comments, questions and input.

Max W. Berger

Proposed SEC Rules

In early 2003, the American Federation of State, County and Municipal Employees Pension Plan ("AFSCME") asked the SEC to look into a dispute concerning a shareholder proposal that AFSCME had submitted to six companies in which it held significant shares. Each of the companies elected not to publicize the proposals to other shareholders and the Division of Corporation Finance issued "no-action" letters on the dispute, finding the companies acted within the securities laws because the proposals "relate[d] to an election for membership on the company's board of directors or analogous governing body"—fundamentally a management issue. On July 15, 2003, following a thorough review of the proxy rules, the SEC issued a formal report in which the Staff noted that "increased shareholder participation in the processes related to [director] elections has been a topic of interest and debate over the past 60 years." Because the "vast majority of commentators supported modifying the proxy rules and regulations," the report proposed several alternatives to increasing shareholder participation in the proxy process.

The SEC has since settled on Proposed Regulation 14a-11 (the "Proposed Regulation"), which creates a new shareholder proposal category — one that a company can not automatically disqualify — by allowing investors to place their director candidates directly on the company's proxy card. This regulation comes into effect upon the happening of a "triggering event," such as when one of the company's directors receives more than 35 percent "withhold" vote in an annual shareholder meeting, as happened with Disney's Eisner. In that case, shareholders would then have the right to place rival candidates on the next proxy card. Alternatively, a shareholder proposal requesting direct access to the nomination procedure that garners more than 50 percent of the vote would also trigger the right to place a candidate on the card.

Quarterly Quote

Warren Buffet, in his February 27, 2004 letter to Berkshire Hathaway shareholders discussing Berkshire's 2003 survey of the mutual fund management landscape:

"Despite the lapdog behavior of independent fund directors, we did not conclude that they are bad people. They're not. But sadly, 'boardroom atmosphere' almost invariably sedates their fiduciary genes."

"[W]hat are the directors of these looted funds doing? As I write this, I have seen none that have terminated the contract of the offending management company (though naturally that entity has often fired some of its employees). Can you imagine directors who had been personally defrauded taking such a boys-will-be-boys attitude?"

"On May 22, 2003, not long after Berkshire's report appeared, the Chairman of the Investment Company Institute addressed its membership about 'The State of our Industry.' Responding to those who have 'weighed in about our perceived failings,' he mused, 'It makes me wonder what life would be like if we'd actually done something wrong.'"

The Proposed Regulation has created quite a stir. Commentators criticize the rule for either going too far or not doing enough to empower shareholders. Some predict chaos, suggesting that fickle shareholders should not be permitted to undermine the methodical rationality required for a well-managed company. They also believe the Proposed Regulation might have the unintended consequence of making hostile takeovers more commonplace.

Others feel that the Proposed Regulation, while an excellent start, does not do enough to empower shareholders because its sets the bar for change too high. First, the "triggering events," required before shareholders can nominate their own candidate for the board, are unwieldy and unnecessarily prolong the process by requiring several successive votes. A more practical solution would allow shareholders to elect a proportion of the directors at every election, thereby eliminating the triggering requirement for a "no confidence" vote. The Proposed Regulation also contains a provision that might make it difficult for shareholders to find suitable candidates. According to the new rule, any candidate nominated by shareholders must be independent; that is, not linked in any way to the group or individuals recommending them.

The SEC is still considering public comment on the changes and will decide whether to adopt the Regulation later this year. But whatever the outcome, the Proposed Regulation is a testament to institutional investors' activism and their commitment to regulatory compliance, transparency and accountability in financial reporting, and preservation of the public trust in our capital markets.

Future Developments

What's next for the proactive institutional investor? SEC Commissioner Paul Atkins has said "[s]hareholders own the company; it's a simple as that. If they are dissatisfied with their board representatives,

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Eye On The Issues

LEGISLATIVE/REGULATORY UPDATES
AND RECENT DECISIONS OF INTEREST

By Timothy DeLange

MBNA Pressed to Revamp Its Board. TIAA-CREF, a financial services company that manages teachers' pension funds and owns 17.9 million shares of MBNA, is pushing to make MBNA's board more independent from management. TIAA-CREF is questioning the independence of Benjamin R. Civiletti, whose law firm does work for MBNA, and James H. Berick, a retired lawyer and longtime adviser to the family of Alfred Lerner, the company's former chairman and chief executive. Of particular concern, MBNA's proxy did not disclose that Mr. Berick is the godfather of Randolph Lerner, MBNA's current chairman. TIAA-CREF is urging other institutional investors to vote for its proposal at MBNA's annual meeting in May. The *New York Times, April 9, 2004.*

Tyco Trial Ends With Mistrial. The six-month trial of former Tyco International Ltd. chief executive L. Dennis Kozlowski and former chief financial officer Mark Swartz ended with a surprising mistrial. In declaring a mistrial, Justice Michael Obus cited the intense outside pressure on Juror No. 4 following the release of her identity by several media outlets after many in the courtroom perceived her flashing an OK gesture to the defendants. According to several former jurors, the mistrial came just hours before likely convictions on between six and nine felony counts. A retrial is expected. *The Wall Street Journal, April 5, 2004.*

Guilty! Martha Stewart, the homemaking diva, was convicted by an eight woman and four man jury of conspiring to obstruct an investigation of her sale of ImClone Systems Inc. stock. Stewart faces up to five years in prison on each charge after the jury concluded that Stewart deceived investigators about why she sold about 4,000 shares of ImClone on December 27, 2001, immediately before federal regulators rejected an application for a drug made by ImClone. Stewart also faces a civil suit by the SEC, which alleges that Stewart sold the ImClone stock based on an illegal tip from her broker that ImClone founder Sam Waksal was selling his company stock. *Bloomberg, March 5, 2004.*

Who Gets Paid From $155 Million Restitution Fund? In a settlement with the Securities Exchange Commission and the New York Stock Exchange, five of the NYSE's largest floor-trading firms, known as specialist firms, have agreed to pay a total of $240 million to settle charges they inappropriately traded for their firms' own accounts when investor orders should have been met. The question remains, how much will the aggrieved investors get, and when. Collectively, the five specialist firms will pay about $155 million to a restitution fund for the damaged investors and $85 million in fines. One of the greatest challenges, however, is figuring out precisely which investors lost money and what compensation they are entitled to. Although more than a billion shares are bought and sold daily in NYSE-listed stocks, only a tiny fraction of those trades are affected by the settlement. Therefore, tens of thousands of investors will have to be reimbursed, leaving each with only a fraction of the total fund. Historically, investors have not received the restitution money right away, leaving many dissatisfied. In addition, the high costs associated with the administration of these funds have diminished the eventual payout to investors. *The Wall Street Journal, February 19, 2004.*

Ebbers Charged With Directing WorldCom Fraud. Bernard Ebbers, the co-founder and former CEO of WorldCom Inc., was indicted and charged with directing one of the biggest frauds in U.S. history. Even worse news for Ebbers, Scott D. Sullivan, the former WorldCom CFO accused of implementing the fraud, agreed to a guilty plea and will likely cooperate with federal prosecutors in the ongoing investigation of Ebbers. In addition to Sullivan, the government has negotiated plea bargains with several former accounting officials who are cooperating with prosecutors. Ebbers' indictment is the culmination of a two-year investigation by the federal prosecutors. *Bloomberg, March 2, 2004.*

Pay Us Back. A growing number of corporate boards, regulators, creditors and investors are looking to the wallets of former chief executives for payback of their ill-gotten gains. These top executives, including those from Kmart, HealthSouth and Rite Aid, are fighting back, relying upon ironclad employment contracts. Recently, a federal regulatory agency filed administrative charges seeking to force Leland Brendsel, Freddie Mac's former CEO, to return about $34 million for his involvement in the accounting improprieties. Likewise, the New York Stock Exchange is attempting to recoup as much as $150 million paid to deposed chief Richard Grasso. In a letter to the interim chairman, Grasso said he would not return any money. Although efforts to recover portions of ex-CEO's pay rarely succeed, that may change because of certain provisions of the Sarbanes Oxley Act. Passed in 2002, Sarbanes-Oxley requires that CEOs and CFOs must forfeit certain bonuses and stock-sale gains in connection with an earnings restatement that results from misconduct. *The Wall Street Journal, January 7, 2004; Los Angeles Times, March 5, 2004.*

2003 Results In Three of the Largest Settlements of All Time. According to the latest research by NERA Economic Consulting, three of the largest shareholder class action settlements of all time occurred in 2003. The study, "Recent Trends in Securities Class Action Litigation: 2003 Early Update," reports that the $517 million paid by Lucent Technologies, Inc.

was the second-largest settlement of all time. In addition, both DaimlerChrysler AG and Oxford Health Plans paid some $300 million to class action plaintiffs in 2003, fifth and sixth respectively all time. *Business Wire, February 6, 2004.*

Criminal Charges Reach Mutual Fund Scandal. The U.S. Attorney's office in Manhattan charged three executives at Mutuals.com, a Dallas broker-dealer, with deceiving mutual fund companies by helping hedge funds and other large investors conceal market timing by setting up separate accounts to stay undetected. Two of the clients that Mutuals.com did market-timing for were Veras Investment Partners and Millennium Partners, two hedge funds at the center of the scandal. The charges are the first to allege that mutual fund market-timing can be a criminal act. *TheStreet.com, March 26, 2004.*

SEC Approves New Rule on Fund Fee Disclosure. The SEC initially approved a new rule ordering the $7.4 trillion mutual fund industry to disclose exactly how much shareholders pay toward each fund's expenses. The new rule, approved by unanimous vote, requires funds to disclose their holdings quarterly, instead of twice a year, and to inform investors of the typical costs associated with an investment of $1,000. For the first time, the SEC has asked aggrieved individual investors to comment on the proposed rule, soliciting comments from about 1,300 people whose names were gathered from a database that tracks investor complaints. The SEC is seeking comments on whether the language in the disclosure forms is clear and useful. *Los Angeles Times, February 12, 2004; Chicago Sun-Times, February 20, 2004.*

$675 Million More For Mutual Fund Settlements. Bank of America Corp and FleetBoston Financial Corp. agreed to pay $675 million to settle regulatory charges that they assisted favored clients in mutual fund trades at the expense of ordinary investors. Bank of America will pay $125 million in fines and $250 million in restitution and FleetBoston will pay $70 million in fines and $70 million in restitution. The settlements, which include a reduction in fund fees by $160 million over five years, are the largest to date in the mutual fund scandal. *Reuters, March 15, 2004.*

NYSE Trade Rule Comes Under Fire. The SEC recently voted to issue a proposal that would ease the hotly contested "trade-through" rule, which requires brokers and dealers to trade on the market or exchange that has the best price. Opponents of the trade-through rule, including the Nasdaq Stock Market, say speed is often an important factor in making trades and that the time it takes for an order to be handled can cost investors money, because that price can disappear. The SEC agreed to put forth a proposal for a rule to allow customers to decide for themselves if they want to trade through, ignoring a better price in exchange for speed of execution. Opting out would have to be done on an order-by-order basis. The NYSE and others have strongly defended the trade-through rule as an important, common-sense investor protection. John Thain, the new NYSE chief executive, has vowed to lobby against a proposed change to the trade-through rule. *Chicago Tribune, February 25, 2004.*

Study Shows Class Action System Working. A new study by two law school professors, which was not financed by corporations or by trial lawyers, concluded that both the average price of settling class-action lawsuits and the average fee paid to lawyers have held steady for a decade. Theodore Eisenberg, a law professor at Cornell and Geoffrey P. Miller, a New York University law professor, concluded that if the effects of inflation are taken into account, then from 1993 to 2002, "contrary to popular belief, we find no robust evidence that either recoveries for plaintiffs or fees for their attorneys as a percentage of the class recovery increased." The study covers the largest sampling to date of class-action litigation, ranging from civil rights violations to securities fraud. According to the study, the average settlement over the 10-year period, in inflation adjusted 2002 dollars, was $100 million. Those who advocate limiting class-action lawsuits are attempting to dismiss the study's results, arguing that the study focused too much on federal cases and ignored state court cases which may be a major source of oversized settlements. *The New York Times, January 14, 2004.*

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"It's an amazing coincidence, isn't it, that we all served on the same board of directors?"

PENSION FUND CONSULTANTS

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While most fund trustees have a reasonable basis to believe that the consultant to their fund is free from any conflicts of interest and is providing the fund with objective advice, this is not always the case. Recently, it has come to light that certain pension consultants may, in fact, suffer from certain latent conflicts of interest that could, at a minimum, create the appearance that they might be putting their own interests before their pension fund clients. More specifically, certain consultants derive significant revenues from the very money managers and broker-dealers whom they recommend to the pension fund. This situation would be akin to purchasing a new home based upon the advice of a real estate broker who tells you that the house is in perfect condition and is a must buy, but, at the same time, fails to inform you that he or she will receive double the ordinary commission if you purchase this particular home. Clearly, this is a fact that any reasonably prudent person would want to know prior to making such a purchase as it weighs directly on the objectivity of the broker's recommendation.

Ensuring that consultants are impartial is critical given that pension fund trustees rely on consultants for direction and advice in managing trillions of dollars of pension fund assets. Poor advice from a consultant can cost a pension fund millions of dollars. In order to ensure that consultants are acting in a responsible and conflict-free manner, the contractual parameters that govern the relationship between the consultant and the pension fund must be carefully reviewed and, if necessary, modified. At a bare minimum, pension fund trustees should require, as a condition of a consultant's contract, that, if the consultant is receiving compensation or gifts of any kind from the money managers that it recommends to the pension fund it advises, such compensation should be disclosed. The ultimate goal for the pension fund must be that it is receiving the fair and unbiased advice for which it contracted.

The Critical Role of Pension Fund Consultants

Pension fund consultants play a critical role in the pension fund community. Many pension fund trustees do not possess a consultant's technical expertise and, invariably, must rely upon consultants to provide them with critical investment advice. This is particularly true in selecting money managers, as trustees are unlikely to know the specific risks and benefits to each manager's investment style or how their portfolios should be allocated to minimize risk and maximize return.

In 2003, the Nelson Pension Fund Consultant Survey reported that consultants were retained by nearly 50 percent of the 4,966 plan sponsors with assets in excess of $100 million. Pension funds typically retain consultants to perform a variety of services, including the strategic planning of their investment policies, the evaluation of return and risk analyses, and, most importantly, guidance on selecting (or retaining) a money manager to handle their portfolios. Thus, a consultant's advice on a fund's selection of a money manager plays a vital role in determining how the fund's money will be invested and an effective consultant will act as a gatekeeper by providing advice based upon each pension fund's individual needs and objectives.

Surprisingly, pension consultants also offer a variety of services to money managers with whom their pension fund clients are advised to invest in. In particular, money managers often retain pension consultants for services such as strategic planning, marketing strategy development and client servicing development. Further, consultants regularly host investment conferences and seminars that are paid for or "sponsored" by the money managers with whom a consultant has business ties. During these conferences, money managers are provided with access to a consultant's "other clients"—the pension fund trustees who pay a nominal fee to attend such conferences. Some consulting firms even provide training for a fee on how a money manager can "answer the tough questions posed by consultants and plan sponsors" and best position itself in "retaining client loyalty during times of crisis, such as periods of poor performance."

By performing these services, pension consultants receive compensation from pension funds as well as money managers. However, the similarity stops there. Consultants are generally paid by pension funds in the form of a fixed annual retainer. In contrast, a consultant might charge a money manager a large fee just to attend a single conference or to provide marketing advice. According to some reports, a typical consultant could receive as much as hundreds of thousands of dollars a year in payments from a money manager billed under the pretense of "search" services. In addition, certain consultants that have broker-dealer affiliates derive additional revenues from their consulting agreements with funds. These consultants advise and encourage their pension fund clients (or the money manager they recommended to the pension fund) to trade through their broker-dealer affiliate and obtain substantial fees that are then shared with them by their broker-dealer affiliate.

The likelihood of a conflict of interest is only exacerbated when such fees or additional revenue streams remain entirely undisclosed to the pension fund. For instance, *The New York Times* reported on March 21, 2004 that a 2002 audit of Hawaii's pension fund revealed that its consultant recommended sixteen money managers over time and that fourteen of them were paying the consultant for so-called marketing advice and other services. Accordingly, the SEC has initiated an inquiry into the practices of pension consultants as a result of the often complicated and intertwined relationships that consultants enjoy with pension funds and the third-parties which seek to serve those funds, such as money managers and broker-dealers.

Pension Consultants Under Fire

The SEC's inquiry calls into question whether many of the largest pension fund consultants are truly offering independent advice to their clients. In mid-December 2003, the SEC issued a broad letter to a number of consulting firms, containing comprehensive questions and requesting information relating to their practices, compensation arrangements and disclosures. By gathering such information, the SEC seeks to determine whether pension consultants suffer from conflicts of interest as a result of their tangled relationship between the pension funds to whom they purport to provide independent advice and the money managers and broker-dealers whom they recommend to pension funds and from whom they earn substantial fees. According to Lori A. Richards, Director of the SEC's Office of Compliance, allegations of conflicts "are very serious and really triggered the [SEC's] interest."

While certain fund trustees have taken a pro-active role towards determining whether their consultants have received financial incentives from the money managers recommended by the consultants, many trustees are either unaware of this ongoing practice or are reluctant to take any action. On February 23, 2004, Bloomberg News reported that a former trustee of a $9.4 billion pension fund demanded that his fund's consultant disclose how much compensation, if any, the consultant had received from money managers. When the consultant refused to provide such information because it violated "client confidences," the trustee successfully made clear that his fund, not the money manager, was the consultant's actual client. Unfortunately, such pro-active measures have not always been successful, as some consultants have refused to comply with a trustee's request because of a supposed "duty of confidentiality" to the money managers. In addition, some fund trustees have simply made a conscious decision to ignore potential conflicts because they believe that their actions will be futile.

Protecting Your Fund's Assets from Potential Consultant Conflicts of Interest

Given that consultants occupy a position that is fiduciary in nature, there is little debate as to the obligations that they must abide by. It is beyond peradventure that fiduciaries have a strict obligation to act in the best interests of their clients — the pension funds that retain them. Under the law, a fiduciary must avoid acts that put his or her interests in conflict with the client he or she is serving. This standard requires that a consultant disclose to a pension fund client all potential conflicts of interest it could foreseeably have with the fund. In addition, as a fiduciary, a consultant is required to disclose all material information, such as other sources of income generated by the consultant which may bear on the consultant's objectivity to the pension fund that he or she serves. In short, a consultant who is a fiduciary must avoid acts that may put his interests in conflict with the beneficiary's.

The SEC has yet to provide a time frame on when, if at all, it will institute regulatory changes or seek legal action against the pension consulting industry. For the time being, pension fund trustees can take certain measures to prevent the occurrence of the above practices, including: (1) carefully reviewing current consulting agreements to determine if they have any provisions requiring disclosure of a consultant's receipt of fees from those who the consultant recommends as money managers to the fund; (2) re-negotiating retention agreements and demanding the inclusion of covenants regarding full disclosure of a consultant's compensation from money managers; (3) issuing a request for proposals to ensure that the fund is getting the best and most objective representation possible; (4) asking the right questions to determine the extent of a consultant's relationship with

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they should be able to demonstrate that in a meaningful way." Institutional investors, which are at the forefront of shareholder activism, responded swiftly to the recent spate of corporate scandal by taking the important lead in prosecuting securities class actions. These same institutional investors are now creating opportunities to intervene at the root of the problem, in the day-to-day corporate governance.

Most publicly-held companies convene regular investor conference calls to review their quarterly and annual financial results. Traditionally, these calls begin with a scripted description from management of the preceding quarter's highlights, followed by a restrained question and answer session with the professional stock analysts who report on the company. Management typically invites these analysts to participate and can also exclude them from the calls, but rank and file shareholders can only listen in or review transcripts after the fact.

Recently, institutional investors and financial reporting outlets have succeeded in opening the conference call forum by hosting more generalized discussions with management—if management is willing to participate. Ten days before the critical shareholder vote, Disney's CEO Michael Eisner agreed to participate in just such a call with investors, along with his chief financial officer and three fellow directors. They faced some tough questions from the institutions, including direct challenges to Eisner's compensation and the Board's decision to turn down a buyout offer from rival Comcast.

The call, which was only the fourth of its kind, marked a dramatic moment in the developing Disney drama by allowing institutional investors to air grievances while Eisner pleaded in defense of his management decisions. Who fared better? Although Disney's stock price climbed two percent during the call, perhaps because Eisner's responses were well-received by some in the audience, ultimately Eisner received a resounding "no confidence" vote at the annual shareholder meeting that soon followed.

Institutional investors are clearly taking a more active role in the management affairs of companies they own and making their opinions heard in a variety of ways. Recently, CalPERS even volunteered to assist in negotiations between grocery stores and striking grocery workers to resolve the strike that stymied Southern California commerce for six months. Following the Disney vote, CalPERS and five other public pension funds joined forces to demand an "immediate" meeting with Disney directors to discuss its performance and governance concerns. With this demand, the funds sent a message clear across American boardrooms: Institutional investors will not be satisfied by participating in the selection of directors alone.

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PENSION FUND CONSULTANTS

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various money managers and broker-dealers; and (5) if necessary, commencing litigation to recover potential losses.

Conclusion

While it appears that some pension fund consultants may have forgotten – or ignored – the basic precepts of honesty and fair dealing that should guide their relations with the pension fund community, there is no question that those who advise the investments of others must live up to their requirements of full and fair disclosure and, at the very least, provide their clients with the totality of information for the funds to make informed choices regarding their investments. We strongly encourage the pension fund community to keep a careful eye on the SEC's actions with regard to pension consultants. In the meantime, it is in each fund's best interest to protect their assets by taking the steps outlined above.

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