Panel remarks by Martin Lipton, Founding partner, Wachtell, Lipton, Rosen & Katz

Moderator: Roberta C. Ramo, Shareholder, Modrall, Sperling, Roehl, Harris & Sisk P.A., and First Vice President, The American Law Institute

Now we will have remarks from our panelists on these issues, and we’re going to begin with Martin Lipton, partner of a well-known firm with his own name and also, not listed, of course, one of the guiding and moving parties behind one of our nation’s great universities, NYU. Marty.

Martin Lipton: Bob gave you an excellent outline of the legal issues that exist today with respect to the voting system. In evaluating a voting system, I think you have to start with the question of what is the function of the board of directors. Why is this so important, what is the board doing, what do you want the board to do, and how do you want the shareholders to relate to what the board does?

It’s fairly straightforward that the board has three, four, five functions, not necessarily the statutory functions, but practical, everyday functions. One is to monitor performance of the company, and that really is basically to change the CEO when the company isn’t performing very well. Second, to monitor compliance with the law. That’s a requirement, and that’s been beefed up, both through litigation and some of the recent legislation and stock-exchange rules. Most important and traditional, to advise as to strategy – in effect be a coach to the management. Next, to deal with a crisis – when something goes wrong, you look to the board to take charge, whether it’s a product-liability issue, or whatever it is, the board has to jump in and deal with the crisis. And then finally, this issue as to whether the shareholders really should have a referendum right with respect to what the corporation does. In other words, should the shareholders have significant influence on the way in which the corporation is managed, and probably the most significant aspect of that and the one that the activist shareholders are most concerned with – should the shareholders vote on executive compensation?

There is a considerable movement, at the moment, to try and get such power and, in a large measure, the shareholder-access rule that the SEC proposed, that Bob described, was aimed at that. When the SEC decided that it would not go forward with the shareholder-access rule. The proponents of shareholder access immediately – even before the SEC decision, as the process at the SEC did not move forward – three years ago the proponents moved to propose precatory resolutions with respect to majority voting and, as Bob indicated, majority voting got resounding support from shareholders during the 2005 proxy season. There’s no question in my mind that majority voting is here in the U.S.; we will have majority voting, whether by statute or by companies wanting to avoid having to deal with resolutions seeking majority voting on a year-to-year basis adopting policies that provide for majority voting. Indeed, the action by Pfizer, the actions by Office Depot, Disney, Circuit City, and a number of others, all reflect that, in most boardrooms today, there’s a recognition that majority voting is here, and most companies aren’t going to wait for the ABA Committee to come up with statutory recommendations. They will move forward with corporate governance policies.

At the present time, the percentage of votes that will be received in major corporations on most issues is in large measure determined by the attitude that the ISS (Institutional Shareholder Services) takes. Right now, they are debating two things. One, whether to accept the Pfizer/Office Depot approach at all. In other words, to use corporate-governance guidelines that are voluntarily established by the company to deal with majority voting, which are, of course, subject to change by the board of directors at any point, or whether to insist that these changes be by charter amendment or bylaw amendment that cannot be changed by the board of directors without a shareholder vote. In other words, is this going to be something that’s flexible
and within the general discretion and judgment of the board of directors, or is it going to be a rigid requirement that directors be elected by a majority vote? The second, and I should say secondary, issue is whether it’s a majority of the votes cast, or a majority of the shares outstanding. Clearly, it is easier to get a majority of the votes cast withheld from a director than it is to get a withhold by the majority of the outstanding shares, and the shareholder activists are all pushing for a majority of the votes cast. It’s still an open question with ISS as to where to go.

A year ago, in February of 2004, the chairman of the board of the Disney Corporation, Michael Eisner, had 44 percent of the votes cast withheld against him. That night, he recognized what had happened and resigned as chairman of the board, and George Mitchell replaced him as chairman of the board. There was no corporate-governance guideline, there was no bylaw, there was no statute, there was no charter provision. The board and Mr. Eisner reacted to the fact that 44 percent of the shares were withheld.

A lot of us think that it isn’t really necessary to go through the kind of analysis and efforts that are being done right now with respect to what kind of statutory system there ought to be, if there’s going to be one – how the bylaws should read, how the charter should read, what the corporate-governance guidelines should say. There is in existence, right now, a very powerful influence on boards of directors, and that’s the withhold-the-vote campaign that’s been in use over the last half-dozen years. It goes back a while, but in large measure came about when companies ignored precatory proxy resolutions that received majority votes, in the key antitakeover area – staggered boards, poison pills – where the shareholders approved resolutions, asking companies to redeem poison pills or declassify a staggered board, and the company didn’t do it.

The following year, there was an effort to withhold votes against the directors who were in office at the time and that mushroomed over the last half-dozen years to the point where there’s almost a set pattern. If the precatory resolution was ignored, then a withhold-vote campaign was directed at those directors who were in office at the time. In some cases, directors – like in the Disney situation – were singled out for a withhold-vote campaign. That has had an enormous impact in boardrooms. And the reason why you see so many companies declassifying their staggered board or redeeming their poison pill, is because directors have said to the management, “We don’t want to be embarrassed by a withhold-the-vote campaign.” It is a major issue for many of the directors, particularly prominent people who are directors of large public companies, to have a lower total of votes in their favor, as other directors have had, or that someone can say, “The board of the XYZ corporation had 30 percent of the votes withheld at the 2005 annual meeting.” While it has no legal impact, it has an enormous psychological impact and indeed, some directors fear that it has a legal impact, that if a large percentage of the vote is withheld against the board and some action of the board then becomes an issue in a litigation, that a court is going to be less likely to think that it’s a board that was properly exercising business judgment. I don’t, in any way, personally credit that concern, but I hear it often.