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## [A new look at proxies](#)

- Kathleen Pender

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The annual meeting season just getting under way will be anything but routine, thanks to a new rule that requires mutual funds to disclose how they voted in corporate elections, combined with escalating outrage over \$6, 000 shower curtains and other examples of executive avarice.

Starting this year, all mutual funds must disclose by Aug. 31 how they voted in corporate elections during the 12 months ending June 30.

In the past, many funds rubber-stamped their ballots, automatically voting for all incumbent directors and everything the directors wanted. Many funds don't even vote their own ballots; they outsource it to proxy-voting and advisory services like Institutional Shareholder Services.

The new disclosure rule is likely to result in more votes against incumbent directors and more votes in favor of shareholder proposals on issues such as expensing stock options and linking executive pay to performance (now there's a concept).

The new rule "is causing many, maybe most mutual funds to spend a lot more energy on proxy voting," says Greg Taxin, chief executive of Glass, Lewis, a proxy-advisory firm.

"It has become a potential marketing issue, a reputational issue. If you are the fund that voted in favor of all the Enron guys and your brethren didn't, that's not going to look so good."

Some funds are already becoming more cantankerous.

Vanguard voted for the full slate of directors in just 29 percent of the companies in which it owns stock last year, compared with 90 percent the previous year.

Companies whose fiscal year ends in December are just starting to send out their proxy statements for 2003.

These statements show how much directors and top executives were paid last year and provide information on shareholder proposals and other matters that will be voted upon at the annual meeting.

Corporate governance experts say the biggest hot-button issue this year will be executive compensation.

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The Investor Responsibility Research Center reports that "more than one- third of the more than 650 shareholder proposals submitted so far for proxy season 2004 address executive compensation issues."

Many companies are paying executives more even when their stock price and financial metrics are going down.

On top of their outsize pay packages (the median compensation for the chief executive of an S&P 500 company last year was \$7.06 million, according to Equilar), many executives are asking companies to pay for perks.

Martha Stewart tried (unsuccessfully) to get her company to pay for a lavish Mexican vacation and got the company to pay for her hair stylist and weekend driver.

Former Tyco chief Dennis Kozlowski got the company to pitch in half the cost of a \$2 million birthday bash for his wife in Sardinia. Tyco also paid for the infamous \$6,000 shower curtain and \$15,000 umbrella stand at Kozlowski's Manhattan apartment.

In the most egregious case of a greedy executive taking advantage of a compliant or somnolent board, former New York Stock Exchange chief Richard Grasso racked up \$188 million in current and deferred compensation before he was ousted last year. The NYSE is not a public company, but many of its directors were directors and CEOs of public companies.

"Our clients, large institutional investors, are more focused than ever on pay for performance, for two reasons," says Taxin.

"Pay going out the door has an economic impact to shareholders, and excessive pay to executives is often reflective of a board of directors that is not taking seriously their responsibilities to shareholders. It can be an important signpost of other governance problems."

Sean Harrigan, board president of the California Public Employees Retirement System, a large institutional shareholder, says executive compensation is "the primary issue that we're focused on right now."

Different approaches

Although investors agree that compensation needs reform, they can't agree on how to achieve it. Because there are so many different approaches, it's not clear which, if any, will succeed.

Glass Lewis is advising its clients to vote against directors who are members of a board's compensation committee if the company has overpaid its executives.

Last week, Glass Lewis recommended that shareholders withhold their votes (or essentially vote against) PeopleSoft's compensation committee members because PeopleSoft "paid (its executives) significantly more than its peers, but performed about the same as its peers on six financial metrics."

CalPERS, which is a Glass Lewis client, will not follow that advice on PeopleSoft (although it plans to withhold votes for certain directors for other reasons).

CalPERS had submitted a shareholder resolution at PeopleSoft calling for 75 percent of executive equity compensation plans to be performance-based. The proposal was withdrawn after PeopleSoft agreed to base 50 percent of executive pay on performance, says CalPERS spokesman Brad Pacheco.

"At this point, we have not been withholding for directors (on compensation issues) partly because we are launching a compensation model next month on our Web site that will compare executive pay to performance at all 1, 700 companies in our portfolio. The staff feel it's premature to focus on the directors until we have this up and running," he says.

Institutional Shareholder Services has advised clients to vote in favor of all directors at PeopleSoft's annual meeting this week.

So far, shareholders have submitted more than 200 resolutions involving executive compensation.

Most of them "call for a more 'commonsense approach' to awarding executive compensation or urge companies to utilize performance- and time- based restricted share programs in lieu of stock options when they are developing future equity compensation plans," the Investor Responsibility Research Center says.

"Numerous others call for companies to begin expensing their stock options or to begin requiring shareholder approval of certain golden parachutes for executives," the center says.

#### Mandatory expensing

Although the Financial Accounting Standards Board is expected to propose a rule this week calling for the mandatory expensing of options starting next year, "some investors want to be sure that FASB -- and the U.S. Congress -- get a clear message that they do not want option expensing derailed," the center says.

After compensation, shareholders appear most agitated over auditing issues this year.

More than 120 proposals ask companies either to require shareholder approval of a company's auditor or to limit the amount of consulting work an auditor can do for a client.

The Sarbanes-Oxley Act requires companies to stop hiring auditors for some services, but some shareholders want to see more non-audit services prohibited because they fear auditors may go easy on the books if they are getting big consulting fees.

There will also be more resolutions this year asking companies to have different people serving as chairman and chief executive.

So far, such proposals "haven't passed the 30 percent barrier. I think this year they will pass," says Pat McGurn, a director with ISS.

Some shareholders this year are trying to nominate representatives to the board. Generally,

the board nominates new members.

A group of investors including CalPERS had submitted a proposal seeking to nominate directors at Marsh & McLennan, the parent of Putnam Investments. (CalPERS recently fired Putnam as a money manager because of its role in the mutual fund trading scandal).

The investors dropped their proposal last week after Marsh agreed to nominate one director the investors had recommended.

The upper hand

Even with mutual funds becoming more active, incumbent directors will still have the upper hand on most issues.

That is because of a rule that lets brokers who hold stock for individual investors vote those shares if the rightful owners don't, but only on matters that have been deemed routine.

Routine items include the election of directors and the ratification of auditors.

Many individuals don't vote, and brokers vote overwhelmingly with management and the board.

"The vote is padded by a huge number of retail votes that aren't actively cast," says Taxin.

If more than 20 percent of the votes are withheld for a particular director, that would be considered a very large vote of no confidence.

If a matter is not routine, brokers may not vote shares held for investors. Shareholder proposals are not routine, and for the first time this year, neither are stock-option plans.

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