THE INSTITUTIONAL INVESTOR'S GOALS
FOR CORPORATE LAW IN THE TWENTY-FIRST CENTURY

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PROFESSOR HAMERMESH: Welcome back.

Let me introduce our panelists, but do that after a few opening words about the subject of our presentation. Vice-Chancellor Jacobs' story about the predictions of the dominance of Rule 10(b)(5) in corporate governance, in corporate law generally, prompts me to make the following observation. The content of this panel will include forward-looking information. There can be no assurance that the actual outcome of future events will correspond to what is suggested here. Such outcomes will depend upon many factors, including business results, marketing changes, etcetera, etcetera. And having discharged my duty under the Private Securities Litigation Reform Act of 1995, we can now proceed with the substance.

It was a very happy accident that occurred to me one day a little over a year ago that the hundredth anniversary of the enactment of the original Delaware General Corporation Law coincided, pretty closely anyhow, with the millennium. And with the deluge of millennial thinking, it prompted me to wonder whether or not it might be an opportune time for us to gather to think about major changes forthcoming in corporate law over the next hundred years.
The occasion was not purely the product of a chronological accident. The speakers in our previous panel have already pointed out major seismic changes in the world in technological progress, globalization, all interrelated, all of which will have an enormous effect on the way we do business as lawyers and as business people in the coming years.

Picking up on Dick Agnich's suggestion, I start out this panel with one blindingly obvious observation: a revolution has occurred in corporate law through the advent of the institutional investor. The term "institutional investor" is one that perhaps twenty years ago didn't roll off the tongue as commonly as it does today, but it does roll off the tongue all the time today for very good reason. As Dr. Carolyn Brancato will explain in specific numerical graphic detail, the institutional investor has arrived as a major economic force and, therefore, a major force in corporate governance and the structure of corporate law generally.

Our job in light of this sea change seismic development with the advent of the institutional investor is to consider what its likely impact is going to be on corporate law and Delaware general corporate law in particular in the coming years. I have the pleasure to have here with us today some of the very top people who are in a position to analyze that question and tackle that job.

Dr. Carolyn K. Brancato is the director of the Global Corporate Governance Research Center of the Conference Board, the author of two major books on corporate governance, Institutional Investors in Corporate Governance, Best Practices for Creating Corporate Value,\(^1\) and Getting Listed on Wall Street.\(^2\)

Dr. Brancato has twenty-five years of experience in this field and I think judging by her curricular performance and what materials she's churned out, I think it's fair to characterize her as one of the deans, one of the top analysts of institutional investor behavior. So it's definitely a pleasure to have you with us this morning.

I will say for the benefit of those who would prefer to be out sailing on a nice day like today that Dr. Brancato has given up that opportunity, has abandoned her vessel moored usually in Annapolis and is with us today instead.

Let me next introduce Michael Price. Mr. Price is also someone one would fairly characterize as a dean of institutional investors. The difference is that, I think Dr. Brancato would concede this, he is an active practitioner.

of the art as opposed to an accomplished analyst of it. Mr. Price is distinguished, in part, by having received a Doctor of Humane Letters from the University of Oklahoma from which he graduated, but I think among the minds of most of us he's most distinguished by his long and distinguished career as an institutional investor and a leader in what might be described broadly as the corporate governance movement.

He's the Chairman of the Board of Franklin Mutual Advisers and Franklin Mutual Series Fund, formerly chairman of Mutual Shares Fund. And we're also very pleased to have his insights with us today.

As commentators, aside from myself, I want to introduce two very distinguished people. First of all, let me introduce Joseph Rosenthal of the Wilmington firm of Rosenthal, Monhait, Gross & Goddess. I would characterize Joe as being someone who has used his long years in the Bar to stride the colossus of the plaintiff's bar and corporate class action litigation with a deep devotion to shareholder rights and a commanding knowledge of shareholder litigation. And I'm most interested in having his observations about how his field dovetails with the institutional investor phenomenon we'll be looking at here today.

Last and certainly not least, Chancellor William B. Chandler, III, Chancellor of the Delaware Court of Chancery. Chancellor Chandler has made it, as many of you are well aware, a practice of commenting publicly on corporate law developments, and he and the other members of his Court and the Delaware Supreme Court to my mind are to be complimented for their extracurricular devotion to the subject that brings us here today, corporate law and corporate governance.

And without further ado, I will turn the matter over initially to Dr. Carolyn Brancato and proceed from there.

DR. BRANCATO: Thank you very much. Today, I hope to give you some perspective on what shareholder issues have been of concern to institutional investors in the past and what issues they are likely to pursue in the future. I will also discuss how the courts of Delaware will continue to shape the corporate governance debate as they serve as arbitrator between corporations and their institutional investors. Indeed, the interplay between legislative and judicial decision in Delaware profoundly affects the contours not only of U.S. corporate governance but, in the absence of a transnational body to arbitrate between boards and shareholders, Delaware will have

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3See Hon. E. Norman Veasey, History and Recent Developments Implicating the Interaction Between the Delaware Court of Chancery and the Supreme Court, 7 METROPOLITAN CORP. COUNS., May 1999, available in WESTLAW, The Metropolitan Corporate Counsel, METCC ("Over half the Fortune 500 and over half the New York Stock Exchange companies are Delaware corporations.").
continued and increasing influence in establishing global "best practices" in corporate governance.

**Trends in U.S. Corporate Governance**

U.S. institutional investors,\(^4\) despite great variations in investment outlook and behavior\(^5\) will continue to press for greater say over corporate decisions directly affecting shareholder returns, such as changes in corporate control (e.g., rejection of Delayed Redemption Provisions and other forms of Poison Pills as in *Quickturn*\(^6\)).

U.S. institutions topped $15.4 trillion in total assets in 1998, up from $14 trillion at the end of 1997 and $6.3 trillion in 1990. U.S. institutions continue to control nearly half of the U.S. equity market, although this amount has leveled off in recent years with increased individual investing. Pension funds still control the largest block of U.S. institutional assets, although their share of total assets has been giving way to open-end mutual funds. In 1998, pension funds held forty-eight percent of all assets. Among the various types of pension funds, private trusted funds are those held by publicly traded U.S. corporations. These funds accumulated an increasing share of institutional assets during the 1970s, reaching 26.7% in 1980. In 1990, they began a slow descent from holding 26.4% to 25.4% ($3.6 trillion) of total institutional assets at the end of 1997. But in 1998, this figure jumped to 28.8%, as private trusted pension fund assets grew faster than all other categories. Public funds continue to increase their share of total institutional investor assets. At the end of 1998, they held $2.3 trillion or 16.6% of total assets, up from only $196.6 billion or 10.4% in 1980.

The fact that public pension funds continue to devote an increasing amount of their assets to equities has significant corporate governance implications. These public pension funds are the most "activist" on corporate governance matters, and as they increase their presence in equity

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\(^5\)See Carolyn Kay Brancato, *Institutional Investment Report: Turnover, Investment Strategies, and Ownership Patterns*, 2 CONF. BD. No. 2, Aug. 1998, at 11-13. Turnover and trading varies by type of investor and by segment of the portfolio. For example, at the end of 1997, the average turnover for all institutional investors, weighted by portfolio value, was 42.5%. Public pension funds continue to have the lowest average portfolio turnover at 19.3% and money managers, as would be expected, have the highest average turnover at 53.0%. *Id.* at 11. However, turnover varies by type of investment within the portfolio so that, for example, money managers pursuing an "aggressive growth" investment strategy have 95.1% turnover for that segment of their portfolio. Public and corporate pension funds do not generally pursue this type of aggressive growth investment strategy and, with a higher percent of indexed funds, generally have lower turnover. *Id.*

\(^6\)Quickturn Design Sys., Inc. v. Shapiro, 721 A.2d 1281 (Del. 1998).
markets they increase their clout. In 1988, these public pension funds accounted for only 7.1% of the total equity market, but, by the end of 1998, they accounted for 10.3% of total equities. By comparison, corporate pension funds actually lost ground as a percentage of total equity ownership: in 1988 they held 15.5% of total equities, which had declined to 13.3% by 1998.

In addition to changes in corporate control, which have been the most direct catalyst for activism, an increasing number of investors press for improved corporate governance. They see governance as a means to improve the general quality of their investments, and provide assurances and reduce risk of negative returns in the event of market downturn.

Thus, they will continue to press for stronger levers of power over election of directors, higher standards for directors to adhere to in exercise of their fiduciary duty, and more stringent fiduciary requirements for directors even to monitor corporate compliance (e.g., Caremark).3

Corporate governance in the U.S. developed through various stages. In the early 1980s, public pension funds lead the corporate governance movement. They opposed what they perceived to be abuses by management at such companies as Walt Disney that avoided a takeover by paying "greenmail" to a "raider." Later in the 1980s, public pension funds began to press for more independent directors on the theory that director independence would ensure appropriate monitoring of corporate performance.

Early in the 1990s, public pension funds began to directly monitor performance, through various profitability screens, evaluating measures such as excess stock price returns, returns on stockholders' equity and, most recently, through analyzing EVA which refers to economic value added or the amount earned on the embedded cost of capital. Most recently, certain large institutional investors in the United States have begun to press for higher level one-on-one meetings, not only with management but also with outside board members. These meetings are structured to discuss the company's strategy and its processes for achieving its strategic goals. Strategic performance measures which go beyond the next quarter's bottom line are increasingly of interest in this dialogue.9

Certain activist investors have traditionally been more

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3While the "activist" public pension funds account for less than 15% of total institutional investment assets, in recent years, they have been joined by certain mutual funds, and even some corporate pension funds, in pressing corporations for greater shareholder accountability.


"interventionist" than the large public funds, e.g., LENS and mutual funds run by Michael Price seek more direct influence over companies through: (1) intensive discussions regarding director nominees, and (2) discussions regarding specific courses of corporate action such as restructurings and spin-offs. Even some of the major funds, however, have lately stepped up their pressure: (1) TIAA-CREF in an unusual move ran its own slate of directors for a company and won, and (2) CalPERS has begun to file shareholder derivative suits.

The development of corporate governance as we know it today in the United States took nearly fifteen years and was filled with great acrimony. Yet, many major U.S. corporations and institutional investors have come to agree on certain fundamental corporate governance values. Guidelines promulgated by General Motors, the Business Roundtable, TIAA-CREF, and CalPERS reveal remarkable similarities in such areas as the long-term mission of the board of directors, the need for independent non-executive directors, and the need to establish board processes to evaluate the board's performance and determine CEO succession.

A. Global Developments in Corporate Governance

For Delaware, governance trends in the U.S. provide continuation of the historic. There are, however, new and far more global trends for the twenty-first century that result from the changing landscape in global equity markets. These trends will put greater demands on courts like Delaware to shape corporate governance not just on a national but on an international scale.

The United States must certainly be regarded as the crucible for global shareholder activism and U.S. investors will continue to be influential in global markets for two important reasons:

(1) U.S. Institutions Control Largest Proportion of Global Investment

Financial assets of institutional investors in France, Germany, the United Kingdom, the United States, and Japan were worth $21.6 trillion at the end of 1996. U.S. institutions accounted for 61.9% of the five-country total. The financial assets of U.S. institutions were approximately six times those in the United Kingdom, ten times those in France and Germany and nearly four times those in Japan.10

Global Corporations Are Increasingly Dependent on Equity

Corporations throughout the world will rely increasingly on global equity financing for future expansion; as a result, they will come face to face with dominant and demanding U.S. investors. Investing in the future will be more dependent on global equity markets. This will shift economic clout to investors with equity stakes, especially those willing to become activists. At the turn of the century, the U.S. economic model resembled current models in Germany, France, and Japan. Capital expansion was accomplished with internal corporate retained earnings, bank loans from a closely-knit banking community, and/or substantial long-term equity raised through extensive and virtually permanent corporate cross-shareholdings. Gradually, the U.S. developed a broad and deeply liquid equity market with dispersed ownership. This model is now being emulated around the world, as countries rely more on equity market expansion in place of traditional ownership patterns of highly concentrated ownership among founders, families, or small numbers of dominant institutional or corporate shareholders.

Conference Board data show just how much of the current corporate equity of the largest twenty-five corporations (measured by capitalization) in countries such as Germany and Japan is closely held. Blocks of stock held by non-financial institutions, such as banks and other corporations, amount to as much as 33.5% of the equity of the top twenty-five companies in France, and 24.2% of top twenty-five company equity in Germany. Available data for Japan indicate this percentage to be 21.2%, although limited availability of data for Japan means that the actual proportion is considerably higher. These ownership amounts will be "unwound" in the next few years, as companies enter global equity markets and deal with global shareholders who want them to achieve competitive returns on equity and comparable dividend payout.

Additional Conference Board data support the possibility of a potential explosion in global equity markets by showing how much room there is for investors in France, Germany, and Japan to provide equity for corporate expansion. The largest allocation to equities — 67.2% of assets — was made by UK institutional investors, followed by U.S. institutions at 40.3%, French institutions at 25.8%, Japanese institutions at 20.6%, and German institutions at only 14%.

The weighted average of equity allocation across the five countries is 37.5%. In 1996 bonds dominated the investment portfolios of French institutional investors, accounting for two-thirds (63.1%) of financial assets. By contrast, UK institutions allocated only 15.7% of their total assets to bonds. German institutions were heavy investors in loans (38.2%) of
financial assets) and bonds (42.9%), and had the lowest proportion of their financial assets invested in equities (14%).

Finally, globalizing equity markets and dispersing ownership is further reinforced by massive world-wide privatization programs. Ironically, this dispersion can actually increase the influence of shareholder activists; as certain more passive global investors (banks and corporate pension funds) decline involvement in shareholder activism, assertive U.S.-style shareholders gain a larger than proportionate share of governance clout.

Companies participating in global equity markets of the future will encounter a myriad of transnational investors who will increasingly evaluate them according to a loosely evolving set of global governance standards. While governance laws and regulations are rapidly changing in such countries as Germany, France and even Japan, transnational investors often want higher standards than home country law requires. Moreover, some corporations outside the U.S. routinely provide investors with higher levels of disclosure, quarterly instead of semi-annual reporting, reconciliation to U.S. GAAP on a quarterly basis, and other governance practices not mandated by their home country law.

Some investors, such as the California Public Employee’s Retirement System (CalPERS), recognize local governance practice in their governance guidelines. Certain minimum standards, however, have emerged from the U.S. corporate governance experience that clearly influence transnational investor expectations around the world. These expectations may be summarized as follows:

(a) Assurances of Accountability to Investors

Investors want companies to establish adequate auditing systems, including external and independent review of these systems. Under most systems of corporate law around the world, investors empower boards of directors to oversee and monitor the operations of the company. Boards must therefore establish procedures to ensure the reliability and independence of the auditing process and to quickly come to terms with and correct any failures.

There is also a growing concern that investors should not be disenfranchised from decisions affecting their investment that boards and management might make unilaterally. As major blocks of shares are unwound in favor of broader equity participation, minority shareholders insist their position must be improved with regard to fairness of voting rights, access to the proxy, and ability to provide appropriate input to management.
(b) Running Corporations Professionally

Investors want assurances that companies are professionally run and have relied on the concept of "independence" for boards of directors to provide this assurance. This means attracting more non-executive directors with broader perspectives, which requires companies to rethink the structure and size of their company boards.

Adding global board members either to the full board or on an advisory board may provide useful input. Reducing the number and increasing the intensity of board meetings may overcome some of the logistical problems associated with globally professionalizing corporate boards. Companies in other cultures frequently utilize executive board members in more managerial capacities and leave the top layer of non-executive directors to function more as a supervisory board. It is desirable to have a general consensus approach to board operations, evaluations and top executive succession and to communicate these approaches to investors seeking assurances that power is not lodged within one person who may be unresponsive to changing economic conditions. Boards should develop processes for evaluating the strategic direction of the company as well as how performance measures up to achieving strategic goals and they should communicate these processes to investors.

(c) Providing Transparency to a Broad-Based Capital Market

Investors want the opportunity to earn rates of return commensurate with risk in a fair market environment where material information is available on a timely basis to the entire market. Outside the U.S., higher concentrations of ownership among smaller numbers of investors traditionally fostered closer relationships between companies and a core group of investors. Now, the issue is how to broaden this disclosure to the market as a whole.

If carefully structured, discussions of strategy can be conducted between interested "investor-shareholders" and managements and boards of directors for the mutual long-term benefit of both parties. However, certain caveats apply. First, care must be taken not to trigger illegal trading based on selective disclosure. Second, companies must continue to balance the benefits of disclosing information useful for the "market" to evaluate it with the costs of divulging information which either prompts lawsuits or is useful to competitors.

Outside the United States, there is significant pressure to bring disclosure of information to the investing public up to those standards applied within the United States. First, regulators or stock exchanges are pushing companies to increase disclosure and transparency. Second, market
forces are compelling many companies in Europe and elsewhere to seek capital from global equity markets. This is opening up the traditionally close relationships between companies and institutional investors, especially banks, in countries such as the United Kingdom and Germany.

These close relationships, which are more traditional outside the United States, and have tended to include exchange of considerable amounts of strategic performance information, may be somewhat modified or even curtailed as a result of new disclosure laws in various countries. At the same time, more in-depth communications are being encouraged in the United States, as a result of pressures from institutional activists or through initiatives such as the safe harbor legislation.

The ultimate result of these divergent trends will probably be a move towards the middle, with U.S. companies more involved in strategic discussions with their major investors and non-U.S. companies more transparent about their discussions with their major investors.

I note five major trends which will affect the institutional investors, corporations and the Delaware court for the future.

(1) Large investors outside the U.S. have begun to adopt some of the early U.S. style pension fund confrontational tactics. However, many large investors in the U.S. now acknowledge that there is much to learn from the governance systems in other countries like Germany, France, and Japan.

In the U.S., the widely dispersed stockholder ownership base has generally not permitted some of the desirable close "relational investing" aspects of these other systems, whereby large investors regularly meet with management to discuss corporate strategy. We may therefore see a convergence of styles of activism, as companies outside the U.S. become more open in their response to shareholder concerns and investors in the U.S. develop more "relational investing" styles of communication.

(2) Concerns about global volatility and the flight of capital may actually bring long-term investors and their companies closer together.

No issue continues to polarize corporations and institutional investors more than "short-termism" — the notion that institutional investors are only speculators or traders and will immediately sell company management out during trading swings or for a raider's premium. Corporate governance guidelines of major U.S. institutional investors, however, reveal a surprisingly consistent recognition that investments should be undertaken for long-term return, not for short-term trading gain.

TIAA-CREF is the largest retirement system in the world with nearly $250 billion under management. Its approach is consistent with that taken by many large institutional investors. As far back as the early 1970s, the fund rejected the so-called Wall Street Walk to sell stock when unhappy
with management. TIAA-CREF believes that the most responsible, and in the long run the most successful, investment approach is to present shareholder concerns directly to management to encourage management to make needed changes. Moreover, the fund's Policy Statement says: "[T]he primary responsibility of the board of directors is to foster the long-term success of the corporation consistent with its fiduciary responsibility to the shareholders."\(^{11}\)

While many U.S. investors did tender their stock to raiders during the 1980's takeover wars, things have changed in recent years. Investors have voted for limited versions of poison pills to enable a company to fend off a raider. They have also supported management by refusing a takeover premium if management presents a better alternative strategic plan.

The Conference Board has done considerable work to determine that institutions have widely different trading and investment patterns. Turnover characteristics vary not only by type of institution, but by segment of the portfolio. While a large number of "momentum" traders operate in U.S. securities markets, most of the major public pension funds which are the most activist in the corporate governance arena actually trade the least. They don't just sell if they don't like a company's immediate short-term outlook. The average turnover ranges from a low of 16% for the indexed portion of the average public pension fund portfolio to a high of more than 95% for the aggressive growth portion of the average money manager portfolio.

Corporations can seek out long-term oriented "investors" as opposed to "traders." Moreover, many of these large investors are looking more in-depth into companies in their portfolios that show up on their governance screens. When they intervene on governance issues, they often want to discuss the strategic direction of the company and how it intends to achieve its goals.

This is a bit like the "relational investing" style of communications between companies and a small group of banks and other investors so common in other cultures such as Germany and Japan. Thus, although the U.S. has clearly carved a path for investor intervention, the future of shareholder activism may be shaped by a blending of — hopefully — the best of the current U.S. and non-U.S. governance practices.

(3) Mega cross-border mergers are spreading the influence of U.S. corporations and U.S. shareholders throughout the world in unprecedented ways.

Just as the Standard Oils of the turn of the twentieth century had widespread economic influence, the cross-border mergers of today are generating new sets of global corporate influence as well as international shareholder expectations. Since companies still must reside in some home country jurisdiction, and since Delaware is still a favored incorporation locale, things are not so very different, except for the scope of potential influence Delaware will continue to enjoy. Now, instead of just responding to demands from U.S. shareholders, British, Swedish, and South African shareholders of a cross-border merged company will join their U.S. counterparts to press courts such as Delaware for greater corporate fiduciary responsibility and shareholder accountability.

(4) With the breakdown in trade barriers, evidenced by trends such as the Euro, global shareholders are evaluating companies in a freer climate of comparability.

International investors are no longer looking at German auto companies, they are looking at European auto companies. As the world economy continues to globalize, international institutional investors will be reducing their regional sector allocations and moving towards worldwide comparisons of companies. This gives these investors greater incentive to adhere to a loosely set of evolving global corporate governance standards (as described above). And, in the absence of some transnational body, courts such as Delaware, with a history of important precedent relating to shaping fiduciary responsibilities of boards and shareholder rights, will be increasingly looked to as a "model" for governance standard setting around the world.

(5) The role of Delaware as a global model, is reinforced by recent global financial crises.

These crises have demonstrated that weak corporate governance can undermine investor confidence in entire markets as well as in individual corporations, possibly intensifying high stock market volatility, capital flight and the disruption of international capital flows.

Intergovernmental organizations, specifically the OECD, the World Bank, and the IMF, are responding with efforts to define worldwide corporate governance principles, and to help improve market regulations and controls. Individual companies, within this rapidly changing regulatory and legal framework, have the opportunity to take proactive steps to strengthen their competitive position in the global capital markets. An important way to accomplish this is to improve corporate governance practices to meet rising shareholder expectations and to attract stable and committed international investors.
With Delaware as a preeminent model, case law arising from shareholder and corporate debate here can not help but shape international corporate governance. In the twenty-first century, Delaware will clearly play a role in governance expectations to minimize the risk of future financial crises — not just for U.S. companies and shareholders but for global companies and their increasingly transnational shareholders as well.

So the question is what will be the impact of the adjudication process that has evolved here in Delaware between shareholders and boards? As was discussed earlier today, there will be a great deal of private ordering between investors and companies. These private ordering arrangements will be based on certain precedent-setting cases which determine the corporate governance nuts and bolts, e.g., what happens when directors do this and shareholders do that. In the absence of any other transnational body, Delaware will continue to be preeminent not only on the domestic scene but increasingly on the international scene as corporations and investors look for wise precedent.

I would like to close by emphasizing a couple of points. The investor movement is not monolithic. There are many different types of investors including pension funds and mutual funds. Data that we have developed at The Conference Board articulate not only the differences in the amount of money they control, but their different investment objectives and turnover and trading patterns. CalPERS, for example, is a highly indexed and a very long-term investor with extremely low turnover. Another type of investor, e.g., a money manager, will have a much more aggressive growth portfolio combination, and they will have a much higher turnover and more active trading pattern.

So, the answer to the question raised in the prior session as to whether these investors are short-term or long-term: the answer is that they're both. Their investment horizon depends on their investment objectives. It depends on their range of risk. It depends on who they are and how they value their companies. Many corporations believe that some of the investors are extremely short-term, but other investors have been having more one-on-one dialogue, more in-depth communications with corporations on strategic issues.

Even some of the large pension funds have charters that contain the goal of having long-term investment. Given these variations, corporations can begin to sort through the universe of institutional investors to find allies in some of the long-term large funds. These funds are more likely to hold them for the long-term. They are also increasingly likely to recognize this benefit of corporations' tracking their success by using strategic performance measures, like measures to reflect the value of intellectual capital, R&D —
things that don't translate to this quarter's bottom line but are value generating for the corporation over a long-term.

The Conference Board is engaged in extensive research on this topic. There is a tremendous movement going on in terms of dialogue between the investors and the corporations. And I think it is one of those unifying forces that can move the corporations and the investors forward together.

Finally, turning to the international side of the equation, it's clear that the global equity markets are very rapidly becoming highly liquid and well advanced. At the turn of the century in this country, we actually relied a great deal on large family-owned businesses financed by internal capital and bank loans. Over a period of sixty to seventy years, we developed a highly liquid dispersed ownership market. A similar trend is happening in Europe now and throughout the world, as companies are moving from family-owned businesses and closely held business structured and financed by local capital or internal retained earnings to the global marketplace. And when they come to the global marketplace, they have to come up against the U.S. investors because of their dominance in terms of their size, number, and the magnitude of their assets.

These U.S. investors are imposing a loosely evolving set of requirements and expectations on non-U.S. companies. These relate to basic assurances of shareholder democracy, access to information, ability to vote, fair treatment for all shareholders, including minority shareholders, especially when the government is involved. The recent Eramet case in France where TIAA-CREF took a very active position when the government attempted to restructure the minority shareholder position sent ripples through European boardrooms.

Some of the U.S. investors have moderated their early approach to activism in Europe. Originally CalPERS came into Europe with a style which was very active and aggressive, alienating some major European companies. I think you'll begin to see a convergence of the U.S. and European styles of communication. U.S. investors are beginning to engage in higher levels, strategic discussions which have generally been much more common in Europe where there is a much more concentrated ownership base, with fewer institutions owning much higher stakes in corporations. In Europe, there is a tradition of having very intense and in-depth conversations between investors and corporations. U.S. investors are beginning to emulate some of that style of deep conversations.

By the same token, the Europeans are dealing with new laws requiring transparency and disclosure to a broad market. Corporate executives are realizing that they have to communicate to their general shareholding public even as they talk to their three major shareholders. I think there's going to be some resolution of these two historically different styles of
communication as we move to more global standards of transparency that prohibit selective disclosure.

Finally, one of the major areas that we are extremely concerned about is global volatility. We have undertaken a major project at The Conference Board to look at how the direct investment of corporations is now being affected much more rapidly and profoundly by volatility in portfolio investment. For example, years ago major corporations would place a direct investment in Brazil. The value of this direct investment was not affected by the volatility in the general stock market. But now, as a result of the Asian flu, because of the very rapid migration of capital, not only is portfolio investment becoming more highly volatile, but direct foreign investment is becoming much more subject to volatility and rapid movements in capital outside the country. The Tequilla effect was one of the first manifestations of this phenomenon.

At The Conference Board, we are undertaking a project to work with corporations in developing markets like Brazil, Chile, India, and South Korea. We will develop a type of corporate governance ISO 9000 to develop indicators of confidence that the corporations themselves can evolve. These ISO indicators will help companies develop a process to achieve a high level of governance standards and to differentiate themselves from other corporations in the region. This will, hopefully, inspire the confidence of the investors.

We are going to be working not only with corporations both in the developed and the developing world, but also with investors such as TIAA-CREF and CalPERS to see if we can evolve a set of clearer understood goals that corporations themselves can achieve. For example, many corporations in the U.K., don't have to report earnings except on a semi-annual basis, but many report on a quarterly basis because they believe the investing public wants that information. They also reconcile to U.S. GAAP on a quarterly basis to meet investor expectations. While there are companies located in countries that are in flux and have considerable deficit in their governmental regulatory oversight systems, there are things that companies can do right now to give themselves a competitive edge in the governance field. These will make them worthy of consideration in this highly competitive international capital pool.

By giving all the participants a sense of limits between shareholder demands and director fiduciary responsibility, the courts in Delaware will continue to provide case study precedent to elevate the corporate governance debate throughout the world.

MR. HAMERMESH: Dr. Brancato, let me ask you one follow-up question. To the extent you predict that Delaware will serve as a model of baseline corporate governance minimum standards globally, to what extent
will that translate into actual use of the legal structure offered in Delaware as opposed to mimicking through alternative forms of regulatory structure?

DR. BRANCATO: That's going to be very interesting because obviously a lot of different cultures have begun to adopt laws which are somewhat patterned after the U.S. legal system. For example, Germany recently enacted a transparency law that is much more like what we have at the federal level here. On the other hand, in places like India, they already have some major elements of UK law there. A major factor in corporate governance is the ownership patterns and structures that are somewhat different, especially in some of the developing countries.

It may be that we're going to look for certain surrogate governance measures of, for example, director independence. If you have a closely held family business in Brazil and you want to achieve director independence and external shareholder accountability, instead of saying you need five new directors outside the family, you may try to put in a check-and-balance system. This system would pertain to transactions over a certain size and would require an extra layer of approvals from other non-executive directors. These governance guidelines are going to have to be adapted to the cultural environment and the ownership structure of companies throughout the world. I think the principles that you are setting here in Delaware are key for how companies and investors should behave.

MR. ROSENTHAL: How do institutional investors react to the new entity forms that minimize or even eliminate fiduciary standards or haven't they reacted yet? I mean, you heard the previous panel. This is the new generation of entity forms and it's going to have perhaps a profound effect on the relationship between shareholder expectation or investor expectation and management performance.

DR. BRANCATO: As was mentioned earlier, there are a lot of joint ventures and corporate transactions that occur outside a registered stock exchange and across transnational boundaries. They're contract-based rather than based on the laws of a supraregulatory agency. Investors and companies have been making these transactions for quite some time in the private markets and in the joint venture arena.

I might ask Michael Price how he views this. The level of requirement is very high when you have these contract-based transactions, especially on the debt side. If you're talking about releveraging or working out a debt transaction, you want a certain level of accountability, even if you may not articulate the same governance standards that are most generally in vogue. But, as a debt holder or a joint venture partner, you certainly want accountability in terms of audit statements and reconciliation to US GAAP.

I recently talked to a privately held Indian company. They do a lot of joint ventures with U.S. companies and they've adopted GAAP because their U.S. partners in the joint venture require it. These private ordering
transactions will push companies towards higher governance standards which both investors and, in this case, corporations will demand.

MR. ROSENTHAL: Well, there are now public entities in various entity forms which essentially will by their internal documents eliminate or diminish fiduciary standards as we know it. So I'm not talking about private ordering necessarily in terms of investor entity, but I'm talking about the public capital markets, now the public capital markets are going to relate to the entities that Mike Goldman, for example, sees as the wave of the future.

MR. PRICE: Right. But I think that corporate governance provisions in these new entities directly affect the value of them. Absolutely from day one. If they do well going forward, that effect or discount gets narrowed. If Goldman Sachs profits do well going forward, no one's going to care and that discount will go to zero. They're going to stumble at some point in the future. The discount starts to widen. If there's ever a problem, the liquidity of the stock or the entity will be affected and the value is going to be affected.

So, I think all these things affect liquidity and market value. It goes right to it. I'll pay less for a Class B non-voting shares than for the voting Class A, assuming they're both as liquid. It's just a rule.

DR. BRANCATO: Some of these actions go forward because people buy a stock like Berkshire Hathaway.

MR. PRICE: It's not your typical example.

DR. BRANCATO: Right. Because it's performed so swell. But the governance structure of Berkshire Hathaway is not ideal.

MR. PRICE: How many CEOs own fifty-one percent, or whatever, of the common? Or used to, anyway.

You want me to start?

PROFESSOR HAMERMESH: Please.

MR. PRICE: Actually, I've been feeling pretty good lately. You know, the market's making new highs, 10,000, 11,000 on the Dow. I think it has to do something with not just how well companies are doing and the economy's doing. I think it has to do also with how well companies are working for their shareholders or reacting to bids or voting in independent directors, how well companies are auditing their books and how independent the independent directors and independent auditors are. I think it all tends to raise our confidence in our markets, in our corporate leadership, in our judicial leadership.

Nowhere more than this state are guidelines pushed out. I mean, I don't know, three or four thousand major U.S. corporations have domiciles here. This is the place that sets the stage. And I hope, if there's a reporter or two here today, that some of the recommendations don't die this afternoon or tomorrow afternoon when this conference ends.
I think that every court pays attention and looks back to Delaware. Some state statutes, I'm not a lawyer, but I believe some state statutes actually point to Delaware in cases.

So anyway, other than Connecticut and Pennslyvania who have the silly dead hand provisions, I think that things have moved, generally speaking, pretty well.

I started my career investing back in the '73, '74, '75 period, and I started moaning when a little bra and girdle manufacturer called Splentex tried to go private at six bucks a share and I thought it was worth eight. And we threatened to sue and probably against Joe or somebody down here, and we probably never got to court. I remember going to a conference room and arguing over a buck or two with the guy and I was long 60,000 shares of stock. So I was fighting for $60,000 but I thought it was right. Never got to court.

On and on into the later '70s, early '80s, I remember when Carl Lindner and American Financial tried to go private and they were offering something like 29 or 30 bucks a share. And I had an analyst working for me then and we thought it was worth maybe $34-$35 a share. So I said to my junior analyst, well, you talk to the Wall Street Journal reporter on the phone and tell him why the price is unfair. So the next morning I woke up and I read the front page of the Wall Street Journal, and my junior analyst had used the wrong number of shares outstanding. So he came up with something like $60 a share instead of 34-35. It was kind of embarrassing. But we learn as we go along and Carl Lindner eventually took American Financial private at a higher price probably blessed by the Court here at some point. Maybe he paid thirty cents to settle and more to the lawyers to agree to the settlement.

But anyway, things have evolved and I feel the trend is good and I feel that laws and lawmakers tend to, way in the back recesses of their mind, know that there's a pendulum swinging and maybe it swung kind of too well too far this way because Mike Price is happy this morning and maybe we'll let it swing back a little bit. I don't want it to swing back and I'm not that happy.

There's a great irony today in what happened this morning. I bet none of you, because you've been here, know that Pennzoil agreed to be taken over today for two-and-a-half billion dollars less than Union Pacific wanted to pay for it a couple of years ago. A company called Devon Energy agreed with Jim Pate, chairman of Pennzoil, to take over Pennzoil today. And the irony's incredible.

Just to remind you, back in about '97, I think, Pennzoil stock was trading at fifty. A Delaware corporation, that's why I'm bringing it up. Pennzoil stock had been around fifty from 1993 through 1997. Pennzoil was rewarded $3 billion in a settlement when they fought over Getty with
Texaco. All right? They didn't do much with the $3 billion. They fettered it away. And out of the clear blue, Union Pacific bids 84 bucks a share. They had some talks but Union Pacific out of the clear blue offers 84 bucks a share. Please say yes. I happened to pull the file this morning and here's just say yes, a message to Jim Pate Pennzoil CEO. Please take our money. Even though it was a ridiculously high price at the time, Union Pacific had to do something.

Well, what happened? And why did it happen? And does what happened back then and what happened this morning have to be a lesson or should it be a marker or should it lead to some action in this state going forward? I think it should.

Pennzoil stock had been a tremendous underperformer for the five years leading up to the bid. The S&P 500 had gone up 108% for the five years. Pennzoil stock was down thirteen percent. Keeping in mind at the beginning of the five-year period, they got a windfall $3 billion settlement from Texaco. So the guys had all the money in the world to go drill whatever they wanted to around the world and couldn't find a barrel of oil.

The guys from Union Pacific come in and what happens? Well, Pennzoil had a staggered board. They had a poison pill. The shareholders couldn't take any action by written consent. It wasn't just the pill. It wasn't just the staggered board. It wasn't the lack of written consent process. It was the combination of all of these things coupled with the fact that this was a poorly performing American corporation holding strategic reserves, oil reserves which our government views as pretty strategic. Today their oil's 15-16 bucks a barrel. But at some point in time it's going to be important to this country that its oil companies produce good returns and build reserves and not be dependent on foreigners.

So basically what happens, as many of you will remember, is that Pennzoil was able to hide and just say no with all of their takeover defenses and avoid being taken over.

There was a solution. Oh, Union Pacific could run a proxy fight. They did. They got the vote. It didn't matter. Angry shareholders could come in and get seats on the board. Well, guess what? One of them did. Guy Wyser-Pratte went to the next year's annual meeting said I'd like to run. And guess what? His intentions were good but he settled. He settled for some expenses plus they hired Korn Ferry to go find some independent director to join the board and what happened? Pennzoil stock, it just languished at fifty. No one could take the $84 a share, today agreed to sell out for a half a share of Devon Energy which is about 14 bucks a share. Now, they had spun out Quaker State worth 16. So the combined value is thirty instead of $84, which Union Pacific was offering.

Well, there were 47 million shares outstanding. Well, that's two-and-a-half billion dollars that the Delaware structure cost the Pennzoil
shareholders. Two-and-a-half billion dollars of lost money two-and-a-half years ago. Well, if you had put that money in the S&P 500 Index, it would be four or five billion today. Don't forget the fact that the opportunity missed from a couple of years ago needs to be invested to get to what the cost was today. Okay?

So how do you weigh that? Is that significant for all of you? Is that significant that boards are so separated from the shareholders in whether or not to take bids or a chairman and president can mess with the corporate process to avoid a proxy fight? In fact, in the 1998 annual meeting of Pennzoil, still a Delaware corporation, they hadn't moved yet, the president actually stepped off the board to create a vacancy, to create a lower number of directors, thus making the vote required to get control of the board thirty-three percent instead of twenty-five percent. And then after the annual meeting, and they settled with Guy Wyser-Pratte, he got back on the board.

I mean, my point is this: Whether it's board machinations, legal advice, investment banker fairness opinions, or corporations writing checks, CEOs can get people to say whatever those corporations want them to say. Okay? In cases where corporations have underperformed like Pennzoil, which is a great example, I think, it doesn't work right.

Now, sure, we've had Sears do the right thing, GM, Eastman Kodak. General Motors has been doing all the right things for the last few years, basically. J.C. Penney agreed last week under some soft pressure to separate their drug store business from the main corporation through a tracking stock which is less than perfect but it's a start. But what we need to do is keep the Pennzoils from extending their underperforming lives.

And ironically not only is today the date that they agreed to be taken over, but it's also the date when Jim Pate somehow will be the new chairman of the merged company. I hope that the Devon management, a couple of guys named Nichols who I actually know from Oklahoma, will be the CEO and president. I'm going to call them this afternoon and say, please, don't let Jim Pate have anything to do with running the company, number one.

Number two, it's also so ironic that the same people who opined for Pennzoil back in 1996 and '97, Lehman Brothers, J.P. Morgan and Baker & Botts represented them. J.P. Morgan also gave the fairness opinion at today's $14 deal when they opined that 84 wasn't fair in 1997. And they're also represented by Morgan Stanley, Dean Witter for both Devon and Pennzoil.

Another example of the fact that you can get bankers to say whatever you want. And all of you know that.

So you have to take it beyond the fraudulent fairness opinion. Right? We have to go to what the bylaws of corporations should allow. For instance, I don't think that management directors should be allowed to vote on whether a board adopts a poison pill. Why should they? The
independent directors should vote on the adoption of poison pills, for starters.

I got on the board — we were involved in the Canary Wharf bankruptcy in 1995. And we wound up with a quarter of it. We brought it public a few months ago and Reichmann wanted me to go on the board for a little while which I agreed to do. I'm not on any other boards. And I got a book from the, I think it was from the London Stock Exchange, and it must have been this thick. Duties and obligations of a director of a U.K. company. And it's either from the stock exchange or one of the entities over there. And it was very, very serious. The forms I had to fill out before going on the board were very lengthy, asking about affiliations, past bankruptcies, not a problem for me, other than being on the board of Macy's which was a problem. Asked me about conflicts of interest, business I did with companies. So much more extensive than U.S. proxy disclosure rules. I was very surprised that the U.K. took the proxy/director process so seriously. And I think that that would be a good guideline for a state or a state as important as Delaware to the corporate process to look into. Delaware should adopt Public Company Director Laws.

I also think that at some point either driven by Delaware or the SEC, I don't know who should do it, the role of boards with the selection of audit committees and auditors need to be addressed after Sunbeam and Cendant.

And, going back to my opening, I talked about confidence in the markets. If we don't trust the figures and if there are conflicts with audit firms and if, for instance, the auditor or lawyers are on the board — I've got a big problem with that. And as you know, corporations want to increase their profits and mutual funds and corporations look hard at the audit fees.

I kind of think, and I drive — I mean, we have Ernst & Young and every year we're trying to get that bill under a quarter of a million. Can't you do more work better for less money? Well, we're kidding ourselves. We should be saying do better work, we'll pay you a little more. It'll save us down the road.

So I'm kind of leaning in favor of increasing audit fees, pulling from the management's right the nomination of independent auditors, giving it to an independent audit committee made up only of independent directors, truly independent, and so we'll pay a little more in audit fees. It's a rounding error. And we'll avoid some of the Sunbeams and Cendants in the future. Because all of these auditors were hand-picked. Same thing with the investment bankers giving fairness opinions. Why could Jim Pate have picked Morgan Stanley or J.P. Morgan? It's not right. The cost of the share was two-and-a-half billion dollars.

Options repricing. Compensation plans follow. I think some of that has to be left to the good directors. And there's so many examples of terrific directors taking the process in some cases away from the management. But
when the combination of the staggered board and the bylaws work together to protect the management who has underperformed and disenfranchised the shareholders, it's not a happy ending in a lot of cases.

We've got to close the gap, starting with Delaware, because it comes from Delaware and goes out to the other states who have some corporate citizens. We've got to close this gap between that isolated board and the shareholders' needs. So, I hope looking into the future -- and I don't want to look too far, I don't think you can look too far — I hope that rulings and decisions and appeals go along the lines of keeping, the shareholders in mind, not just incumbent management. And they have in some cases, but keep *Pennzoil* in mind. Keep the two-and-a-half billion in mind.

I would love to see, I don't know if we're going to have this, one of those — Times Square atomic clocks showing the population of the world or the time in those big letters? If you're walking up the steps to the courthouse, here in Wilmington, what if we had the two-and-a-half billion dollars accruing at eight percent a year in big numerals, for all to see?

Thank you very much.

CHANCELLOR CHANDLER: Michael and Carolyn both have raised a couple of issues that I think I'd like to follow up on.

The *Pennzoil* case was pending before me in the Court of Chancery, and I know several attorneys here today were involved in that litigation. There were no institutional investors that stepped forward that I can recall or that tried to intervene or take a position in the case. Where were the institutional investors in that case.

MR. PRICE: We voted, I think, sixty percent of the shares voted to open up a bidding process, but we were absolutely stopped dead in our tracks. I don't think filing *amicus* briefs over time has really worked. It's not what we're all about. Right? Our only choice, the shareholders' only choice, 47 million shares could only sell to lower bids in the market if they wanted out because of the pill, the staggered board and the lack of a consent process.

I think if you said from the stand, hey, let's reconvene next Tuesday, I'd like to see ten *amicus* briefs, you'd have them.

CHANCELLOR CHANDLER: You mentioned the Lindner/ American Financial going-private transaction — the fact that you thought the offer was too low and that it was eventually settled in court, with both a settlement fee and significant attorneys' fees.

In Delaware, at least, institutional investors almost never appear in the settlement hearing process. So the Court is presented with a situation where the defendant company is willing to settle and the plaintiff who filed the

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action is willing to settle for the class, but there is no other independent voice present and willing to express an alternative point of view. Why don't institutional investors do that?

MR. PRICE: Well, today I was focusing on more the bylaws, the directors, process, the pill. I'd love to reconvene later and talk about the strikesuit to lawyers, class actions, pilgrims and things like that. You know, we've acted in some of those.

I think what happens in the real world is that once you get more than a reasonable amount of money under management, 500 million, a billion, five billion, you just kind of grow beyond doing that. You're going to negotiate eye-to-eye across the table rather than file suit. I mean, if you look at the average number of shares held by your plaintiffs in strikesuit cases, there are a hundred shares or 500 shares or in some cases five or ten shares and, there was a firm out of Philly who I think got really severely reprimanded by filing frivolous suits just to get settlements. So that whole process is, I think, really kind of been hurt over the years. And that's evolved into these days when companies have the earnings, everybody sues. And it's just -- it's a watered down process.

Once, for an institutional investor, the dollars are so large you step away from that and you look at the larger issues. And I think that that's what's happened. But I think there's -- there is a venue to take your grievances. I don't disagree with that.

PROFESSOR HAMERMESH: Michael, let me jump in and throw another challenge down to you.

You probably never thought you'd come to Delaware and be asked why institutional investors aren't doing more, being more active. But I've got a similar question for you. And it's on the turf that you identified: the bylaws, the governance rules and so forth and that would include the directors. The *Pennzoil* case you talk about turned very significantly on the fact that there was a staggered board and everybody knows that that has a very important effect on the dynamics of the process. But those provisions don't come from nowhere. Sometimes the stockholders themselves approve staggered board charter provisions. I don't know if that was the case in *Pennzoil* or not. I doubt too many stockholder bodies are likely to do that today. Alternatively, of course, companies go public with that kind of provision in their charters. And the question I put to you is: What's going to happen, not that you can speak for everybody, but what's going to happen when governance terms like staggered board provision come out in IPOs and there's some question about their likely effect?

MR. PRICE: Listen, an IPO, the guy can write his own ticket. He's bringing his company public, he can say I will bring non-voting stock public. So you buy it or you don't buy it. I think the focus for Delaware isn't how he brings his corporation public. The focus should be do we have laws that not
by themselves, Section 203, but grouped together, allowing corporations to manipulate the process to the point where the underperforming management is so protected that it hurts the country, the company and the shareholders. That's the point.

PROFESSOR HAMERMESH: And I don't take anything away from the point you're making. There's a converse question, and you're right. Delaware perhaps should have nothing to do with how institutional investors price IPOs or issue IPOs. But indirectly, is there anything that you expect that will be done to punish IPO issuers with a discount if they include defensive charter provisions?

MR. PRICE: No. In this market, they could do anything they want and get away with it. It relates to a bull market versus a bear market. If you're into a sloppy kind of bear stock market, IPOs dry up or the prices that they come public at will be a lot less. And then at some point the sellers won't come public.

IPO shouldn't be the focus in the Delaware system. It should be the established mature corporations that have substantial assets and employees and shareholders and net worth or market value that should be the focus.

DR. BRANCATO: Prior to the Asian flu-related flight of capital, neither companies nor investors were that careful about corporate governance. For a while, they have increased their concern over governance. Companies now realize that they have to put more on the table in order to attract the investors. Michael's point, on an international level, is that governance depends entirely on the dynamics of the market, who's got the money, who needs the money, and how badly people who need the money want the money.

MR. PRICE: Just so you know, one of my partners is Mark Mobius of Templeton who runs a lot of funds in the developing countries. And he actually, on the corporate governance issues where he's gotten totally raked over the coals, totally disenfranchised, he has gone to the process of the IMF and where they're lending money and said to the IMF look, we're a big American investor, why are you guys advancing funds in a country that disenfranchises shareholders when something important is going to happen?

So, there's a process out there. Templeton is one of the largest international investors and they're working very hard to protect their shareholders. We do some of that but we only do it in western Europe. And as you said, they're adopting U.S. GAAP in a lot of cases and in some cases Euro accounting is even more conservative than U.S. accounting.

And there's been a big move in the last few years in Europe to improve how they treat shareholders, to eliminate preferential voting and to unlock some of the kind of holding company structures. So, that's allowed more U.S. dollars to flow over there and find more opportunities and we feel better about it.
DR. BRANCATO: We're doing a program in Singapore next week at which Mark Mobius will be speaking. The Conference Board was asked to put together this program by Temesak, which is the Singapore holding company for about 800 corporations in which the government of Singapore has some ownership and at least a minority stake.

Temesak is keenly aware of the need to reform governance to enable the companies in Singapore and elsewhere to attract global capital. So we are extremely encouraged that they asked us to do this program, and we will be doing similar projects in places like Beijing and India.

MR. PRICE: Another example of how people look to the U.S. and Delaware in particular.

DR. BRANCATO: Exactly. Delaware is seen as a real trendsetter. But there is another factor which is changing the corporate governance equation. Not only are the U.S. investors putting pressure on companies in places like Singapore, but pressure is also coming from the network of U.S. companies that would like to international business conducted on a level playing field. These companies are subject to laws such as the Foreign Corrupt Practices Act. They are playing by many of these governance rules and they resent other corporations who refuse to play by the same rules.

We are seeing the development of a loose confederation of some of the more thoughtful and longer-term investors and corporations who are interested in long-term sustainable development. They see raising the bar of international corporate governance standards as an important part of this equation.

PROFESSOR HAMERMESH: Let me take the occasion just to say a couple words and then turn the matter over to the other commentators up here.

I think the critical question for Delaware corporate law over the next twenty years, maybe even longer, is defining how to capture this trend of institutional investor involvement in the law, or to capture it at all. And, of course, one of the big topical debates these days is the role of stockholders in direct democracy and adopting bylaws that govern matters, such as the directors' ability to maintain the poison pill in place.

I believe, and, of course, history could prove me wrong, it probably will, but I believe that the mandate, the model that Delaware has developed over the last hundred years of management by directors is not likely to disappear. We're not likely to see institutional investor governance enshrined directly in terms of direct management by institutional investors, direct roles in governance operations. I think, therefore, that this phenomenon that we're witnessing about institutional investor involvement is likely to express itself informally, not ineffectively, but informally.

And I say that for a couple of reasons. One of Dr. Brancato's opening points was that the institutional investors are not monolithic. I don't think
you can overstate the importance of that observation. When we see that the most active institutional investors represent fifteen percent of total institutional investment holdings, we've got to recognize that not all institutional investors are the same. Not all institutional investors have the same time horizons, same investment goals, same orientation. And we ought to find some way in our legal structure to encourage those institutional investors who have the orientation we want, that we think is socially desirable, to express themselves and not to empower automatically those whose orientation maybe is not going to be the most helpful in the long-run. At least I think that ought to be the goal of Delaware law.

There have been a number of factors in the last five to ten years that have made institutional investor power much more obvious and effective. The relaxation of SEC proxy rules permitting inter-investor communication has at least had one obvious effect in creating a whole lot of websites that reflect institutional investor positions and facilitating inter-investor communications about initiatives, by-law initiatives, shareholder proposal initiatives and the like.

The other thing that's happened, of course, is not only the proxy rules; the technological means to facilitate that kind of communication have just exploded in the last decade.

But with all that explosion, with all that change, legal and technological, I think there's still one ultimate barrier to institutional investor involvement that nothing has ever been able to surmount, and that's the problem of human capital. Institutional investors are ultimately people. Not all of them are Michael Price. Not all of them are as sophisticated. Not all of them have the same time, energy and talent to devote to monitoring issuers in which they have investment holdings. And in light of that, we have to, I think, make a very cautious step, take clear and cautious steps toward empowering institutional investors directly.

I think I'm most comfortable with the approach that seems to be the one that Dr. Brancato identified; namely, that institutional investors are becoming active through informal channels. Recognizing always that their ultimate club is throwing the bums out — that is, electing a new board of directors, taking steps short of that direct threat, to move management along in directions that the stockholders think are desirable, seems the most likely and practicable direction for institutional investor activism.

That doesn't always work. I'm sure in Pennzoil, Michael Price feels it failed miserably. But, in a lot of cases we're seeing positive communication between institutional investors and managers to the point that maybe the roles of the two, while not merging in a formal legal way, are starting to come together. And we're seeing what Dr. Brancato quite correctly describes in her materials as the development of relational investing
much along the European and Japanese models starting to become more prevalent here.

I would hope that would continue. I think it's useful. But I also don't think that it's something that Delaware law is likely to raise in any kind of formal way. I think we're still going to have, for many more years than we've had now, the formal model of management by and under the supervision of the board of directors.

Joe, do you want to go next?

MR. ROSENTHAL: All right. I'll be happy to. You know, I was going to put this at the end of my remarks but I'll sort of put it at the beginning. If I were an institutional investor, one of my goals looking into the twenty-first century would be to clone Michael Price. I think the institutional investors are going to need to be active and have activists like Mike Price who will lead the charge. I agree with Larry Hamermesh, that the progress is going to be made through the informal processes, communications between shareholders who have clout, who have leverage such as the institutional investors and the managements.

By the way, those of you who may have missed a word that Mike used, pilgrim. That means early settler. Perhaps I think he used it --

MR. PRICE: That's exactly how I used it, right.

MR. ROSENTHAL: And then in response to a question by Chancellor Chandler, I first met Mike back in, what, Mutual Shares versus, what was it, Continental Air?

MR. PRICE: It could very well be.

MR. ROSENTHAL: Yes.

MR. PRICE: Lorenzo.

MR. ROSENTHAL: Right. And so Mike himself has been -- when he talks about litigation, he knows what he's talking about, at least in that one experience. I hope it was a good experience, but I think basically he reflects the views of the institutional investors going into the twenty-first century. They have a certain degree of cynicism about the utility of litigation as an instrumentality for moving things forward.

And let me then go to something that I wanted to say. I don't want to talk about mergers and acquisitions and takeovers. Those are exciting phenomena in the corporate world, but I think much more rudimentary and basic is the question how are the managers managing? And I think that is the area where the institutional investor will play a larger and larger role as we go forward into the twenty-first century.

Until the 1980s, the judiciary, particularly the state courts, Delaware was the leader, exercised a considerable amount of oversight and what surprised a lot of us today, if we look back to those years, to see just how much oversight the courts exercised in corporate governance issues. And
they did that largely through the derivative lawsuit, which as we all know is an action brought by a shareholder for the benefit of the corporation.

Just by way of example, judicial decisions, particularly in Delaware, the Court of Chancery and our Supreme Court, shaped the legal contours of investment compensation programs from stock options, stock rights, executive bonuses to profit-sharing plans. I think to many of us that would probably be unheard of today.

In the mutual fund industry, as another example, derivative litigation played a large role in setting the parameters of the fees that investment advisory firms charged to the mutual funds themselves.

Now, for a variety of reasons, which I will not go into today because it would take a week, the derivative action as an effective instrument of corporate governance, lost vitality in the 1980s. And it's not recovered and I fear it's not going to recover. The landmark decisions that law students still study today would likely never have gotten off the ground in the current legal environment. Whether that's good or bad may be debatable. But it is a fact and I believe, as I said before, it's irreversible. Now I don't mean to suggest that the courts in Delaware or anywhere else are less devoted today to the principles which were enunciated in the landmark cases that we all know, such as *Guth v. Loft*. If anything, our judges are even more committed to those principles than ever.

But the courts no longer get into the nuts and bolts, the nitty-gritty issues dealing with the manager's relationship with the entities they serve and their performance except on rather rare occasions. And as I said, while takeover battles are exciting phenomena and they've attracted a lot of judicial and legislative attention, we must not lose sight that what corporations and other entities which aggregate capital are all about is making money. And making money is what managers are supposed to do and that, I think, is where the institutional investor largely focuses its attention.

Unfortunately, or fortunately, depending upon your point of view, I think the institutional investors must rely on their individual and collective resources going forward. The courts are infrequent visitors in the arena of managerial oversight. They don't tell managers what auditors to hire or not hire. They don't second-guess directors in dealing out bonuses, stock options and so on. Our courts leave the day-to-day management of corporations to the managers.

The SEC is largely concerned with disclosure. It's gone into some of these issues to a certain extent. Auditing, for example. But the SEC is basically understaffed and, again, it's not going to tell the managers how to manage except in very isolated areas.

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13 A.2d 503 (Del. 1939).
And the state legislatures, and Delaware is no exception, seem to want to give management as free a hand as possible. And I think that's going to continue into the next century, particularly with these alternative entities where fiduciary standards essentially may well be written off the books. And, again, whether that's good or bad is debatable, but it is a fact. So unless there's a sea change in judicial and legislative attitudes toward the question how the managers are managing, institutional investors will be left largely on their own to challenge, if anyone will, management performance outside the context of the takeover arena. And if I were to predict, I would say that in the next twenty years or so, the mergers and acquisitions phenomenon, the takeover battles may well be looked at as an interesting feature of history. But going forward, we're still all going to be interested in whether the entities are making money and we're going to put that on the top of the scale.

On the other hand, if the institutional investors are left to their own devices, they bring a lot of leverage to the challenge, to management's performance in ways that are unavailable to anyone else. And I don't mean just through the ballot box and proxy contest, but also, as Dr. Brancato said, among other things, through access to the capital markets, they can influence that access enormously, and that gives them a lot of clout.

And even giving notoriety to poor-performing managers: there was a study done for the Council of Institutional Investors which identified poor performers during the period 1991 through 1993. As soon as the names of these poor performers hit the list, they started out-performing the S&P 500 and I think they did it on average by about eight percent. So just publicizing, as CalPERS does, who is doing well, who is doing badly is something that the institutional investors can contribute to improvement in how entities, I don't like to leave it just to corporations, entities will perform in the twenty-first century.

The decline of derivative litigation as an effective tool for corporate governance has been accompanied by legislative initiatives such as the so-called raincoat statutes which permit corporations to exculpate directors from liability for monetary damages for breach of fiduciary duties. I think to lay people that may seem like a sort of bizarre circumstance, but that is what has happened and I think it has generally been applauded throughout corporate America. I don't know whether or not other countries permit that. And I am curious how the institutional investors react to these raincoat provisions which are now commonplace among the large American corporations.

These legislative initiatives have contributed to the erosion of the once esteemed derivative action. Indeed, generally that's a defense that's thrown up almost at the beginning of every derivative action these days. And in the takeover arena, states, like Pennsylvania, have enacted antitakeover statutes
which give management almost unlimited power to disregard shareholder wishes.

Now, these legislative initiatives have come to the fore contemporaneously with the emergence of the institutional investor as a force to be reckoned with in corporate America. What that says to me as an outside observer is that activism in the board room and executive committee levels is not enough.

I think in the twenty-first century, the institutional investors must be adept in the political arena as well. I expect that will be particularly true abroad where politics and business are intertwined in ways that would be unimaginable in the United States. And Mike alluded to what I expected were rather informal methods of trying to bridge or breach that impediment to good managerial performance in foreign countries.

So it just seems to me if we did have more Mike Prices, I think we could all be perhaps more sanguine about what is going to happen in the twenty-first century. Those are going to be challenging years. I don't think litigation is going to contribute much to it. To answer Larry's question, where will the plaintiffs' bar be, because I'm supposed to be a representative of the plaintiffs' bar. I think we'll play a very, very small role, we may already, in these developments. The world is getting too complex. The aggregation of capital is just gigantic and I think litigation is not just an appropriate tool to harness all the forces that will be necessary to move the capital markets and business in the twenty-first century.

And I'm very grateful to the institutional investors for being there on the scene, being willing to take up the cudgels on behalf of all the rest of us who are just mere individual investors.

PROFESSOR HAMERMESH: Joe, we have a whole panel tomorrow morning addressing the question of the likely role of corporate litigation as a factor in affecting corporate governance and corporate performance. But I hope people will keep your remarks in mind and respond to them tomorrow.

Chancellor, do you want to add any thoughts here?

CHANCELLOR CHANDLER: Thank you, Larry. In the few minutes that we have left, let me add one or two observations. Let me preface those, however, by identifying a sub-text or theme that has been through not only this panel but the earlier panel — namely, the internationalization, so to speak, of corporate law and, in particular, Delaware's corporate law.

As I am sure most of those in attendance here today would, I would be glad to see greater visibility for Delaware corporate law principles. I think that is a desirable end. And I, therefore, look to the day when duty calls the Chancellor to far away places, such as Bora Bora, Trinidad, Brussels, to speak at corporate law CLE seminars. But in the meantime, let
me turn to a few issues that Carolyn Brancato and Michael Price have described that we should think about.

I am hesitant at a conference like this to opine about the future of corporate law because, I think, it is difficult in this area to look much beyond tomorrow, let alone ten, twenty, or fifty years from now. And I am reminded of the old saying that "those who live by the crystal ball must learn to eat cracked glass."

Now, with that caveat, it seems to me that the description we have heard this morning about cross-border investments by public investors has created a true sea change in our economy and in the world's economy. Not only are corporations going multinational, but investors are as well.

Access to internet trading will only expand the number of international investors. That trend will support the harmonization, if not the Americanization, of the laws governing securities and corporate governance. As cross-border investment by public investors grows, citizens of one country will find themselves holding investments governed by perhaps very different laws of another country. And to reduce risk and uncertainty, many believe that international investors will demand harmonization.

Now, because America has the world's most active securities markets and a long history of successful equity market operations, it is natural, or we think it is natural, to assume that America's system of corporate governance and securities regulation will serve as a role model for the rest of the world. I do not dispute the effectiveness of that system and I certainly agree that there are many successful features to it — and perhaps they deserve to be copied or limited. But at the same time we must consider the fact that the American legal system may not be as exportable as we might assume. Consider the following aspects of our legal system.

First, as others have described, the United States has a common law system that develops legal principles in an evolutionary way — interstitially, slowly, gradually, leaving great areas of uncertainty, unpredictability. We have a split between state corporation law and federal securities laws. We have a proliferation of lawyers who provide specialized litigation services for profit. We rely on private enforcement largely by plaintiff shareholders who pursue derivative and class actions. And then we have the existence of a powerful regulatory agency, such as the Securities and Exchange Commission that oversees significant aspects of the corporation's periodic disclosures, M&A activities, and policing activities, such as insider trading.

It is safe to say, in my opinion, that the federal/state split is a historical accident, not a logical or a purposeful development in securities regulation. But there is very little reason to think that other countries might want to mimic this aspect of our system. And many foreign businessmen, I understand, are dismayed by the influence and power of attorneys in the American economy and would be loathe to introduce such a system in their
native country. Governmental officials just as often view the power of U.S. attorneys as a threat to their own turf and would be reluctant to license the great number of attorneys necessary to maintain a corporate litigation regime. For similar reasons, many business and government leaders would eschew reliance on plaintiff shareholders to solve corporate governance problems through litigation.

Finally, I would note that the bureaucratic fiat of the Securities and Exchange Commission is probably more palatable for government officials in places like Tokyo and Brussels than other aspects of our corporate governance regime.

So to bring out the crystal ball, I do not know that we can predict very much about what the global corporate governance regime will include in the future or what it will look like. Perhaps it will include national regulatory agency with jurisdiction over corporate securities law. Along the lines mentioned of Vice-Chancellor Jacobs and others this morning, we may find administrative law judges or arbitrators will adjudicate the very types of disputes that now come before the Delaware Court of Chancery. That form of dispute resolution could take place under the supervision of a national or international agency, perhaps even without the use of licensed attorneys.

Now, one other factor is pushing the world toward a more harmonized international corporate governance regime and that factor is the gradual realization in Asia and Europe that our system, costly as it may be in some sense, does a reasonably good job of structuring M&A activity. It used to be that in many places of the world, from Berlin to Tokyo, the words "hostile acquisition" described an all-American activity that carried highly negative connotations. But Japan's nine years of recession, the meltdown experienced in the economies — possibly with the exception of Taiwan — as well as moderate stagnation in Germany and other parts of Europe, have led foreign policymakers to reconsider the value of merger and acquisition activity.

Why? Simply because in times of economic stagnation, a need exists to transfer assets being used inefficiently to new, more productive uses. Corporate mergers and acquisitions, with changes in management and the employee downsizing to go with it, are an excellent way of moving assets and revitalizing an economy. For example, Japan, faced with almost a decade of economic problems, has opened up its economy to foreign M&A activity, including a foreign stake in Mazda, and Peugeot's bailout of an ailing Nissan.

These foreign acquisitions have taken place as Japan's government strips away regulations that have served to protect its corporations from the very kinds of economic pressure that United States companies — facing public shareholders, institutional investors, and potential hostile acquiror — have taken for granted. Governments in Bangkok, Seoul, and Eastern Europe have committed themselves to building American-style equity
markets. But it remains to be seen what sort of regulatory regimes would ultimately emerge.

The Asian meltdown, which some have blamed in part on the pullout by arbitragers and easily spooked short-term investors, is seen by some as a weakness of a global economic system incorporating U.S.-style equity markets. The Asian crisis points out that international finance contains elements not present in domestic finances, exchange rate volatility being one example, and demonstrates the need to come to an international consensus on what are the desirable features of international finance systems.

In the meantime, I do think that if Delaware seeks to maintain its competitive edge in the corporate law area, we need to keep our eye not only on developments in Nevada, but on places like Hong Kong and London as well. And as Dr. Brancato and Mr. Price and Steve Goldstone have mentioned, we may need to focus internally on certain areas of Delaware corporate law, examining their applications domestically as well.

As the globalization of the financial markets accelerates, however, it is easy to conclude that we all will benefit from the insightful comments and writings of Carolyn Brancato and Michael Price. It gives me comfort to know that people with such skill and expertise are self-consciously studying, and thinking about, these issues.

On behalf of the Court of Chancery, I also want to thank all of those in attendance for taking the time to be with us during this conference.

PROFESSOR HAMERMESH: Thank you, Chancellor.

Let me take a couple of minutes, if necessary, to give our panelists here a chance to respond. Anybody want to weigh in with any last-minute comments?

MR. PRICE: Yes. The one thing we kind of missed was that back in '92, the SEC allowed or changed the proxy rules to some extent. Prior to '92, we'd have to, if we wanted to talk to more than nine shareholders of a company, file proxy forms and be delayed and run up an expense, so we could never do that.

After '92, basically we were allowed to talk to anybody we wanted as long as we weren't soliciting their vote on a specific item. And that kind of led us to some deals that worked out okay. And that, coming from the SEC in Washington, coupled with some of the terrific decisions here, has helped a lot in kind of making me feel better.

But as I said before it's a balancing act. You know, decisions kind of go both ways. And there's been a big improvement, though, in the last ten years in our ability to influence events and some of it came from that, from the proxy rule changes as well.

PROFESSOR HAMERMESH: I suggest a lot of it may come from sheer growth in the importance of power of the institutional investors of holdings.
MR. PRICE: Yes.

DR. BRANCATO: This issue of harmonization reinforces what Michael Price just said. Investors are increasing the depth with which they are willing to engage in conversations with management. Ten years ago, an investor such as Mark Mobius might not have come to a conference on how to improve corporate governance in Asia, but now he does.

There is now much more willingness on the part of both the corporate and the investor communities to take the time to engage in dialogue with meaningful follow-up — in short to have the positions known and articulated. Where there is no universal standard of law and regulation in the global economy, it's even more important to have these positions out in the open.

Lacking international rules to ground our international corporate governance, requires all the parties to be even more articulate about expectations in this global economy so we can harmonize some of these relationships between the companies and the investors.

CHANCELLOR CHANDLER: I did have one question for Dr. Brancato. Concerning the techniques that institutional investors use domestically to encourage management to keep in mind the shareholders' interests — weapons such as litigation, the vote, the right to sell your shares — will those techniques or "weapons" be transportable to and as easy to use in Japan or Germany as they are in the United States?

DR. BRANCATO: Some of them will and some of them won't. Just a few years ago Japan instituted a law that enabled shareholder derivative suits. I believe a number of other countries have allowed derivative suits. In addition, in a number of these other countries, substantial shareholders that sit on boards. In Brazil, for example, by law the pension fund representative shareholder sits on the board. A number of these Brazilian pension funds have come to the states twice now to talk about what they should do as members of the board of directors. In Germany, of course, you have a co-determination system where labor representatives sit on the supervisory board. Communications with these types of investors or labor representatives may be more in-depth than what has been the usual level for U.S. pension fund investors. They are learning new methods of communications from these longer term relational investors. At the same time these relational investors, especially in places like Europe, are adopting a more aggressive demands for dividend payout, management action to increase shareholder value, including spinning off divisions and so on. There appears to be a trading off of both styles of communication and institutional investor demands.

This was reinforced in 1992, with the removal of barriers to communicate among U.S. investors. And there really are no such barriers in the global equity markets. These global institutions have created the
International Global Corporate Governance Network (ICGN) which has been meeting annually for three or four years. The next meeting is in July in Frankfurt. The ICGN includes all the major pension funds from around the world, including not just those from the U.S., but also from the UK, Australia, Continental Europe, and Japan. They are getting together as a supracouncil of institutional investors to devise global governance guidelines and articulate those governance strategies that are of greatest concern to them.

This kind of institutional investor activity that is evolving in this global market is, in a very real sense, leap-frogging over local governance standards and laws. These investors are shaping global governance principles and they are transferring them very rapidly throughout the world.

PROFESSOR HAMERMESH: We are starting to intrude on the lunch hour, but let me take just a minute to see if anyone has any questions they want to pose to the panel, questions from the audience.

Seeing no hands, let me thank my co-panelists very much. I appreciate you coming here.