

*Australian Institute of Superannuation Trustees
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Global Cooperation for Sustainability, Governance & Long term Returns

Session 1 – Investment Sustainability: Roles for Investors in Corporate Governance

OWNERSHIP BASED GLOBAL CAPITALISM

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1. Thanks to our hosts – Australian Institute of Superannuation Trustees
 - a. New globalism
 - b. Extraordinary originality and energy from Australia

2. If we are to achieve genuine sustainability in corporate functioning, it will be because of the informed involvement of ownership – the shareholders
 - a. Not directors, not management
 - b. Not government
 - c. We will need to harmonize the differing, often conflicting, characteristics of ownership securities on a global basis in order to be able realistic to rely on shareholders' as the ultimate assurance of responsible corporate conduct. Recent changes, which we will discuss later, have changed vastly the characteristic of ownership of global corporations
 - i. Sovereign wealth funds raise the prospect of political rather than economic interests in active ownership
 - ii. Hedge and Private Equity Funds represent a potent market force based on pure economics, necessitating a change in our traditional measurement systems.

3. The genius of the corporate form of organization is its unique capacity to create wealth
 - a. The challenge is to harmonize wealth creating energies with the interests of society in order to create sustainability
 - b. Symmetry / asymmetry
 - i. Nation state is not congruent with corporations
 - ii. Managers and directors have different time spans of interest
 - iii. Only long term owners are a proxy for the entire polity

4. Many countries have developed careful codes of performance to guide corporations – Australia
5. Canada
6. UK – and several prominent institutional investors, including the British telephone Pension System through its manager Hermes
7. Owners have very different rights in different countries – the underlying continuity is their entitlement to share the economic returns of successful risk taking with limited personal liability and the capacity to sell their shares
 - a. Countries restrict these rights to protect national interests – outside of the Anglophone world, the capacity of shareholders to transfer control over an enterprise is severely restricted
 - i. With through multi classes of stock
 - ii. Through government control
8. The United States is an anomaly – the appearance of ownership rights and a contradictory reality
 - a. Prevention of Dubai acquisition of ports vs. SWF investment in Wall Street
9. Shareholder rights in the United States is a misnomer
 - a. Virtually alone in the world, US shareholders do not have the unequivocal right to call a meeting at which directors may be removed by majority vote.
10. Largely because of the absence of ownership rights, American shareholders can have important impact through the litigation process.
 - a. The SEC during the last half dozen years has abandoned its mission as protector of shareholder rights
 - i. No access to ballot for nomination of directors
 - ii. No relief from “brokers’ votes”
 - iii.
 - b. Litigation settlement with Shell
 - c. Litigation settlement with BP
 - d. RAGM experience with ExxonMobil shareholder process
 - i. 40% of a precatory vote in a meaningless meeting
11. Under the circumstances prevailing in the US, shareholders have a better opportunity to protect their ownership rights through litigation than through the traditional governance processes – the Three legs
 - a. In answer to the needs for relief, an industry has developed in the US where under competitive firms are prepared to finance the costs of litigation entirely at their own expense
 - b. The plaintiff bears no risk of liability as a result of commencing the litigation
 - c. The law firm’s payment is entirely a function of a successful settlement, which increasingly is being used to achieve governance – and could be used for sustainability.
12. The owners of corporations are virtually half of the population of OECD countries

- a. These individuals, usually the beneficiaries of trusts, are proxies for the public good.
- 13. The institutions – trusts – who have voting power over a majority of the shares of virtually every publicly traded company have widely different characteristics and interests in corporate conduct
 - a. Owners selected by a mechanical process
 - b. Passive funds
 - c. Active funds
- 14. There are new entrants into the old Northern European + Colonies world
- 15. By 2012 – it is estimated that Petrodollars, Asian Central Banks, Hedge Funds and Private Equity will represent some \$21 trillion
- 16. Sovereign Wealth Funds represent an entirely new ownership phenomena
 - a. Active or passive
 - b. Political or economic
 - c. They will have to be dealt with if we are going to sustain a global pattern in which ownership of corporations has ultimate significance. Otherwise, we will need recognize the need for a new system
- 17. Hawley Smoot
 - a. Those who forget the past are doomed to repeat its mistakes
- 18. Hedge Funds – committed to economic objectives
- 19. Carl Icahn – the economists’ idol – struggle with Yahoo
 - a. Rockefeller family – sustainability at ExxonMobil – 2008 Annual Meeting
- 20. Goals – internalization of external costs to be required by a universal accounting practice
- 21. Goals – A single bottom Line – no matter how seemingly difficult, it is essential to reduce the criteria for management to a comprehensible uniform numeric.
- 22. Goals – empowered participants
 - a. Shareholders ratify management’s conduct, even if they know that it contributes to practices inimical to sustainability;
 - b. Customers rarify producers’ standards and so need the protection of an accounting system that include all true costs.
- 23. CERES has consolidated global efforts to focus on environmental consequences of corporate functioning.
- 24. Accounting purports to be an exact measurement of corporate functioning in a consistent manner over a period of time
- 25. Many efforts by well intentioned owners to require corporate sensibility to the impact on society of its operations are rejected by equally well intentioned managers who are hobbled by the current accounting system that requires as the ultimate arbiter – Cost Effectiveness

26. We may a leader – like most true leaders, they would disclaim any intention of leadership – but the Norwegin Pension system provides careful, open and detailed instructions for how responsible ownership could function.
27. The International Corporate Governance Network (ICGN) is a well established meeting forum for global investors which has produced position papers and dialogue on most important subjects
 - a. The ICGN is not itself an activist mechanism. It is a convener and a publisher.

28. The *ECONOMIST* 5 May 1990 raised the question as to whether shareholders in public companies should be viewed as Proprietors or Punters. With the passage of time and the emergence of many new elements of ownership around the world, we can be confident of the answer that we need a structure within which the needs and responsibilities of Proprietors as well as the economic interest of Punters can be accommodated.

- a. As we have noted, most of the institutional investors either cannot or chose not to involve themselves in the governance of the corporations in which they hold shares. There needs be an Ownership Class of stock which has all of the voting rights which would be held by institutions whose fiduciary conduct can be judicially enforced and by others who chose to commit themselves to function as owners.
 - b. Those in index funds and computer generated portfolios, as well as those choosing not to be involved in ownership responsibilities, should be able to hold and trade securities representing a pro rata ownership of corporations, although having no voting rights and no rights as plaintiffs.
 - c. The proprietors should be entitled to an economic return in exchange for their willingness to function as owners.
28. An illustration as to how this might work is the frequent experience of Warren Buffett taking an interest in a company through convertible preferred stock, not available to shareholders.
- a. He earns a superior return on \$ invested
 - b. The other shareholders have the assurance of his effective commitment to corporate functioning.