NEW CONTRACTING PRACTICES BETWEEN INVESTORS AND CORPORATIONS

"WHO WILL MONITOR MANAGEMENTS ?"

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The notion of a special class of motivated, informed and involved shareholders as the "monitors" of corporate management has great appeal. The American experience suggests that "conflict of interest" cripples the most prominent shareholders - the institutional investors who, in the aggregate, hold half of all of the outstanding capital stock - from effective functioning.

Typically, public and private pension funds will own thirty percent of most companies. The trustees of the pension plans are appointed by the management of companies. Neither the trustees, nor their money managers nor the management who appointed them, are anxious to acquire a reputation for "activism". In extreme cases it would invite reprisal, in more moderate circumstances it would tend to make them "unclubable" in a world where lucrative management contracts are in the gift of management. Although the scope of pension fund trustee responsibility is created by federal law (the Employees' Income Retirement Security Act of 1974 - ERISA), neither regulators nor courts have been willing to enforce statutory provisions that require trustees to administer plans "for the exclusive benefit of plan participants". Thus, the strongest potential shareholder monitor has been permitted to do nothing. The same pattern exists with respect to mutual funds and bank trusts. Only the public pension funds are free of this conflict of commercial interest. They are not trying to sell anybody anything. That factor, rather than any particular competency in the commercial area or any real capacity for sustained involvement, is why funds such as the Public Employees' Retirement Security Fund of California (CalPERS) have been the most conspicuous of monitors. Public plans are free to raise important issues, but their salary limitations, limited business experience and exposure to ultimate political restraint place severe limitations on their suitability for monitoring.

There are many styles of capitalization which result in one class of equity holder having effective voting control of the enterprise while other class(es) may in fact represent a majority of the invested capital. Ultimately, the suitability of a voting class as "monitor" depends on whether it represents a sufficiently broad spectrum of ownership interest to give confidence that it can act as a reliable proxy for all of the ultimate owners. The American experience has usually been characterized by a "voting class" that functions as a device to ensure that specific individuals, and their heirs, retain control of the enterprise. For example, many publishing companies - NYTimes, Washington Post, Dow Jones, Los Angles Times - have traditionally been controlled by "founding families". This pattern is disingenuously justified as being in aid of a free press when it has more to do with the simple mechanics of perpetuating power in a special minority. Another example is the Readers' Digest, where the majority owner of voting shares is a charitable foundation. The question that needs be asked in all cases is - does the existence of a controlling class of equity stock enhance the position of all owners?

Finally, there is the Buffet phenomena. By negotiating the creation of a special class of security , not available to others, Warren Buffet has assured that the undoubted benefits of his involvement in companies will not entirely pass to others. Buffet's fame and skill make his involvement in a company value adding for all owners. The question is whether it is appropriate for Buffet and the management to negotiate the terms of his involvement without consultation or consent of the balance of the owners. If one considers the example of Champion Paper, for example, while it is clear that what is good for Buffet - a rising stock price - is good for all the shareholders, what is bad for all the shareholders is not so bad for Buffet who continues to collect a very expensive (from the company's perspective) preferred stock dividend in bad times as well as good. This

tends, of course, to depress the earnings and the value of the common stock. Even though Buffet sets his own price, there can be little doubt but that he has sufficient incentive to act as "monitor" for all owners. In a person, less scrupulous than Warren Buffet, such an arrangement could be abusive as the temptation for management to give a security with particularly attractive characteristics to a "White Squire" in exchange for the implicit undertaking by the Squire not to replace the management would be overwhelming.

Logically, we would prefer to have the opportunity for any large long term shareholder to be able to undertake the responsibility of monitoring without unacceptable expense and exposure. We proposed such a device for consideration at the 1992 Annual Meeting of Exxon -

April 3, 1992

Dear Exxon Shareholder:

You have by now received Exxon's proxy statement for the 1992 annual meeting. I wish to call to your attention a shareholder proposal I am making for the establishment of a committee of shareholder representatives. This is the sixth item of business at the meeting and appears at pgs. 16 - 17 of the proxy statement.

Let me explain what this proposal is all about. I believe a company does better for its shareholders if shareholders get actively involved in seeing that the company is managed well. Companies are managed by their boards of directors, so that positive shareholder involvement means intelligently evaluating what the directors do and interacting constructively with the board. This calls for an active, informed shareholder or shareholder representative.

In the case of large publicly held companies like Exxon, there usually is not a large shareholder who can fill this role. The largest shareholders of most large U.S. companies are institutional investors -- mutual funds, insurance companies, public or private employee benefit plans -- that hold significant equity stakes in many hundreds of companies. These institutions don't have the resources to play an active, informed shareholder role in their various portfolio companies.

My proposal would establish a three-person committee to take on the role of active, informed shareholder representatives. The three persons would be selected by shareholders, and the cost would be borne by the company -- hence proportionately by all shareholders.

How would this work? At each annual meeting shareholders would elect three persons to be members of the committee. Candidates would be nominated by shareholders. Large long-term shareholders, i.e., shareholders (or groups of shareholders) who beneficially own, and have owned continuously for three years, at least $10 million in market value of common stock, would have the right to have their nominees included in the company's proxy statement. (Other shareholders could nominate candidates, but I would expect those candidates that are included in the company's proxy statement would have the best chance of being elected.)

Committee members would be paid by the company in an amount equal to half the average amount a nonemployed Exxon director is paid* and would be entitled to a reimbursement of expenses and the same indemnification rights as an Exxon director. I believe this is necessary in order to attract capable and responsible individuals as committee members.

Sometimes the active, informed shareholder role requires expert assistance -- for example, investment banking advice on whether shareholder interests would be served by some type of recapitalization or reorganization. No one shareholder can be expected to spend its own money exploring such issues in depth. The committee would be authorized to engage such expert assistance at the company's expense. I would not expect such expenses normally to be significant in amount. In any event, such expenses in any year would be limited to 1 cent per share outstanding (approximately $12.4 million).

The committee's functions would be (1) to review the management of the business and affairs of the company by the board of directors, (2) to advise the board of its views and the views of shareholders which are expressed to the committee, and (3) to report to shareholders (in a report of not more than 2,500 words in the company's proxy statement) its evaluation of the management of the company by the directors and its recommendations on any matters proposed for action by shareholders. I would expect the committee to fulfill these functions by informing itself (hopefully, with the help of company management) on the fundamental strategic issues facing the company, obtaining independent expert assistance (if necessary) in evaluating these issues, and seeking and receiving input from shareholders on these matters.

I do not believe having such a committee need be "cumbersome and expensive." I do not believe such a committee "is likely to interfere with and reduce the efficiency" of the management of Exxon by its board of directors. Nor do I believe such a committee "would duplicate the shareholder communication efforts of the Investor Relations Department" of Exxon.

I fully understand why a board of directors would be reluctant to endorse a proposal to establish a committee to review and evaluate the board's performance. I believe, however, that shareholders, as owners, would be better off -- and shareholder values would be enhanced -- if they got actively involved in seeing that their company is managed well. This is a responsibility of share ownership. I believe my proposal to establish a shareholders' committee to take on the role of active, informed shareholder representatives is a positive first step in this process. I urge you to support it.

Sincerely,

Robert A.G. Monks

We have been very much involved over the last dozen years as an "activist investor" in many of the great companies of America - American Express, Westinghouse, Eastman Kodak, Sears & Roebuck, Stone & Webster, Tenneco, Corning and WMX among them. At first with the investment of our own money and latterly with over one hundred million dollars of clients' funds, we have - using the name LENS to connote our mode of focusing on underperforming companies - deliberately involved ourselves in situations where change appears necessary. LENS will complete next month its fifth year as a special purpose partnership dedicated to proving that a company having effectively informed and involved owners is worth more than one without (See McKinsey Quarterly 1996-4). Full details about LENS are available on the Web - http://www.lens-inc.com , so I will summarize here simply - activism adds value. There continues to be question as to whether the activist (lacking the charisma and the negotiating leverage of Buffet) can be adequately compensated because of the so-called "free rider" problem which allows unparticipating shareholders to enjoy the benefits of their expense.

It is clear that the single indispensable characteristic of a monitor satisfactory to protect the rights of all owners is the congruence of their interests - they must be exactly the same.