The Advocate
FOR INSTITUTIONAL INVESTORS

Standing Together

A Conversation with Professor David Webber

"Labor's Capital" at Work: How Pension Funds are the Last Line of Defense Against Fraud

By Julia Tebor and Kate Aufses

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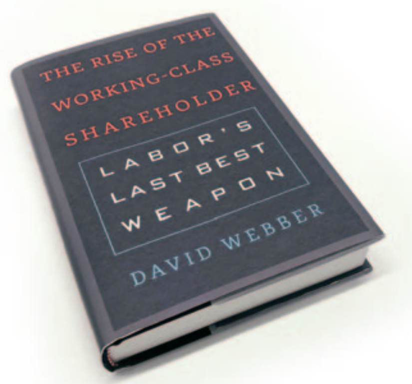


David H. Webber is a Professor of Law and the Associate Dean for Intellectual Life at Boston University School of Law. The winner of Boston University School of Law's 2017 Michael Melton Award for Teaching Excellence, Professor Webber also co-teaches the Pensions and Capital Stewardship course for the Harvard Trade Union program at Harvard Law School. He is a graduate of Columbia University and NYU Law School.

A singular voice for the critical role that pension funds have played as stewards of the financial markets over the last two decades, Professor Webber has published op-eds in several major news sources, including The New York Times, the Washington Post, the Chicago Tribune, and The Los Angeles Times on the topic of shareholder activism and litigation. He also co-edited the "Research Handbook on Representative Shareholder Litigation" (Elgar), and has published scholarly articles, including "The Use and Abuse of Labor's Capital" in the New York University Law Review and "The Plight of the Individual Investor in Securities Class Actions" in the Northwestern University Law Review.

Professor Webber's most recent book, "The Rise of the Working-Class Shareholder: Labor's Last Best Weapon," was published in 2018 by Harvard University Press and has been reviewed or otherwise covered in The New York Review of Books, the Financial Times, Publisher's Weekly, Bloomberg Radio, CSPAN's BookTV, Forbes, the Harvard Law School Forum on Corporate Governance and Financial Regulation, and numerous other outlets.

Professor Webber sat down with our editors, Julia Tebor and Kate Aufses, to discuss institutional investors' impact on shareholder activism.

The main thing I worry about is "pension reform." There is a concerted, nationwide, extremely well-funded effort to take big public pension plans, which is where most of the assets are, and "smash and scatter" them into millions of individually managed 401(k)s which then get farmed out to the usual mutual funds. If that happens, I think a lot of the activism goes away and that void will not be filled by the mutual funds.

JT Welcome Professor, we are very excited to have this discussion — thank you so much for making the time to join us. You have written extensively about the value of shareholder activism and, in particular, how public pension funds can use the Delaware corporate law and the federal securities laws to push back against abuses by corporate managers and insiders. Your book argues that these institutional shareholders are now effectively the last free market answer to combating corporate fraud. Can you explain for our readers some of the key themes in your writing?

DW I'd be happy to. These ideas first started crystallizing for me when I was in private practice and I saw how public pension funds and labor union funds were playing this key role in shareholder litigation. They were taking lead plaintiff positions in securities fraud class actions and M&A class actions, and these actions were becoming more effective, and having positive impacts on the marketplace. Subsequently, in my academic career, I started to attend meetings of pension trustees and learning about all the other forms of shareholder activism that they were engaged in, including shareholder voting and proposal initiatives, and directly lobbying on significant issues in Washington. I saw that these pension funds were doing a terrific job as market monitors — that they were active stewards of the assets that they had under management. For example, when you look at the remarkable transformation in shareholder voting that has occurred in the last 7-8 years, the lobbying that's gone on in Washington to get favorable outcomes for investors, much of it has been due to this institutional shareholder activism. Dodd-Frank getting private equity funds to register for the first time, shedding light on the CEO-to-worker pay ratio, pushing back on excessive CEO pay and executive compensation — so much of what has occurred in the corporate governance movement — this push for more accountability comes from these same pension funds, from public pension funds and from labor union funds. I really was just so interested in the role that these entities were playing — in this kind of fascinating idea of "labor's capital." Labor's capital behaves like ordinary capital generally, but it's actually looking out for the interests of workers in a way that much of the rest of financial markets or corporations are not. And furthermore, I've become thoroughly convinced that this activism by public pension funds and labor funds is not just good for the participants and beneficiaries in these plans, it's actually good for the rest of us.

KA You have written about the backlash against pension funds. Could you talk about what that backlash has been and what you propose as a response?

DW Well, there are various forms of a backlash. Some of it is just an attack on investor rights such as mandatory arbitration provisions potentially being approved by the SEC, and other efforts, which to date have been unsuccessful, making it harder to file shareholder proposals. There is some more conservative shareholder activism that is being designed to thwart this type of activism, but the main thing that I am really worried about most is "pension reform." Pension reform is not something that ordinarily gets thought of in this sort of "corporate investor rights" space, but those of us who focus in this space need to pay very close attention to what is going on with this seemingly unrelated but, in fact, quite closely related issue. As I document at length in my book "The Rise of the Working-Class Shareholder," there is a concerted, nationwide, extremely well-funded effort to take these big public pension plans — which is where most of the assets are — and convert them from collective traditional defined benefit pension plans into individually managed 401(k)s. And if that happens, I fear that much of the activism, the capacity for activism that I describe in the book, will simply go away. The necessary pre-condition for this activism — the proxy access fight or to push for majority voting or to push for de-staggering of corporate boards or even to bring, in some senses, credible shareholder litigation — is to have large pools of separately managed capital. For example, you have New York City Pension Funds, California Public Employees Retirement System, or the California State Teachers' Retirement System or even smaller pension funds. They need not be quite as big as those, but the key is they are sizable separately managed pools of capital. And so they can bring shareholder proposals and they can exercise some real muscle — they can truly provide some shareholder voice. The problem with these pension reform proposals is that they aim to take these pensions and "smash and scatter" them into millions of individually managed 401(k)s which then get farmed out to the usual mutual funds. If that happens, I think a lot of the activism goes away and that void will not be filled by the mutual funds.

Professor David Webber

JT Is it fair to say that pension fund activism has encouraged or influenced other types of funds into demonstrating some more pro-investor behavior?

DW I think so. One of the big developments of the last couple of years is that two years ago Vanguard and BlackRock actually voted in favor of environmental shareholder proposals that were put out by New York City and others, at some of the energy companies. So that's a nice position for BlackRock to

I've become thoroughly convinced that activism by public pension funds and labor funds, is not just good for the participants and beneficiaries in these plans, it's actually good for the rest of us.

When I think of key achievements, I would start with shareholder voting, which has been almost entirely transformed by these pension funds. The three key aspects that have seen great change fostered by the efforts of these activist funds are proxy access, majority voting, and de-staggering of corporate boards.

be in — they don't file the shareholder proposal itself, but they can change the outcome by voting for it, given how big they are, so that, in a way they themselves have some benefit from somebody else being the heavy, not to mention, by the way, that they can still collect their pro rata share of settlements in cases that are brought by pension funds.

KA Could you talk about some of the signature activist achievements of public pension funds and other institutions? What do you see as the biggest achievements and why do some want this activism to go away?

DW When I think of key achievements, I would start with the transformation in shareholder voting in the last three years, and the ongoing presence of meaningful shareholder litigation results. As you know, public funds have been behind a huge number of the largest shareholder litigation recoveries in history. They pay, in percentage terms, lower attorney fees and get higher recoveries in deal litigation and in 10b(5) securities fraud class actions — that has been illustrated in a couple of studies.

Shareholder voting has been almost entirely transformed by these pension funds. The three key aspects of shareholder voting that have seen great change fostered by the efforts of these activist funds are: proxy access, majority voting, and de-staggering of corporate boards. Shareholders have been fighting for proxy access since the 1940s at least. Basically, you are allowed to nominate candidates to run for the board. But the problem historically has been that while you can nominate the candidates, you can't get the companies to list those candidates on the proxy. You have to circulate your own proxy and your own proxy cards and send those out to investors with the names of your nominees. This is enormously expensive and time consuming to do. And that is why historically the only people that ever did that were hedge funds. Hedge funds would run a proxy fight and spend millions of dollars to put up their own proxies and circulate them to investors to challenge a corporate board. But for all the big diversified investors, such as a big public pension fund, historically it made no sense to do that because as a diversified investor, you own a small percentage of a broad range of different companies. For you to spend millions of dollars to have a proxy fight with one company is economically irrational. As a fiduciary, it makes no sense to spend millions of dollars to do something like that. So the bottom line is, because there was no proxy access, nobody would exercise those rights — which is exactly how corporate management has always liked it. And so, in the Dodd-Frank Act, the Council of Institutional Investors and other entities that serve as lobbying arms for public pensions and labor funds pushed and got proxy access into Dodd-Frank. To make a very long story short, proxy access found its way in to Dodd-Frank through the efforts of activist institutions, the SEC made the rule, and the rule was struck down by the D.C. Circuit Court of Appeals. I tell that whole story in the book, too, for readers who might be interested. The bottom line is that it looked like proxy access was dead. But the story doesn't end there. What followed is New York City, under the leadership of Scott Stringer, the

New York City Comptroller, picked up the baton and filed shareholder proposals with 75 companies just in the first year to get them to adopt proxy access which basically would say, if you own 3 percent of the company for three years, your nominee gets listed on the company's proxy. It saves millions of dollars because the companies have to circulate those proxies anyway. And so, the bottom line is, in the first year only approximately five of the S&P 500 companies had proxy access, but because New York City and a couple of the pensions pushed for it, now hundreds of the S&P 500 companies have it. That transformation never would have happened without public pension funds picking up and running with proxy access.

Same thing with majority voting. It used to be just plurality voting. Apple famously had a policy that said that if an incumbent director or a board nominee got one share voted in his or her favor, he or she would be seated at the board. And you could vote for yourself. That's not real action; that's a joke. The United Brotherhood of Carpenters Union filed 700 plus shareholder proposals with different companies to get them to adopt a majority voting rule, and those companies have, and now it's spread like wildfire. So that empowers shareholders to run a withhold vote campaign, even when there is a competing candidate. If you can stop a director you don't like from hitting the 50 percent threshold, you can unseat them.

The third prong here is the de-staggering of corporate boards which was pushed by a bunch of public pension funds through the shareholder rights project. So now instead of one-third of the board being up every election cycle, the whole board is up every election cycle at many of these companies. The point is that you add these reforms together — proxy access, majority voting and de-staggering of corporate boards — and what you have are boards that are now much less insulated from, and much more accountable to, shareholders. That never would have happened without these pension funds.

The last thing is just the lobbying piece — getting "say on pay" in Dodd-Frank, getting the SEC to issue the CEO-worker pay ratio guidance, which finally happened last year. Those are some additional achievements by these funds.

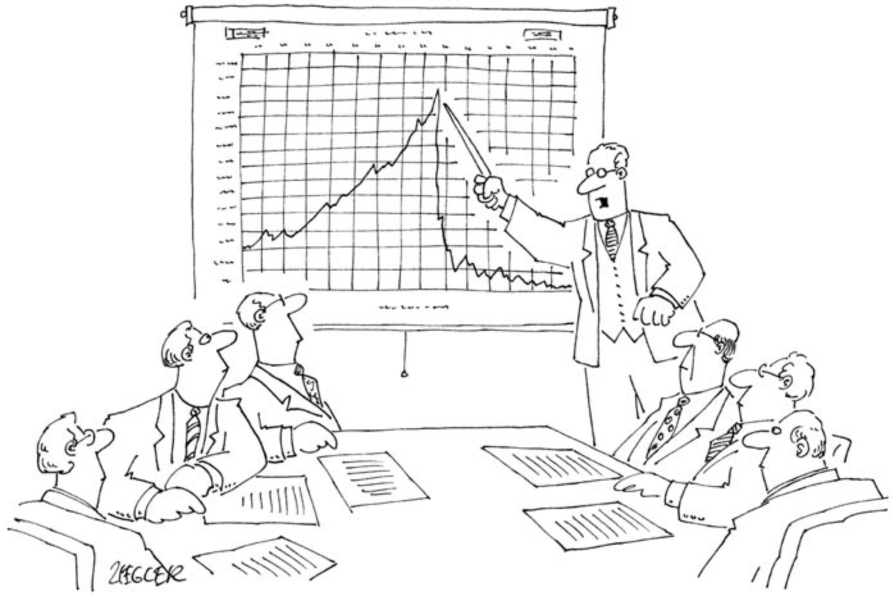
JT What are your concerns about the state of the federal securities laws and the trends you are seeing specifically under the Trump administration? What setbacks are you seeing and what are your hopes in terms of coming back from those setbacks? What key issues should the institutional investor community be focused on?

DW Before the Democrats took the House, there was some very dangerous legislation afoot in the form of the Financial Choice Act, which would have raised the shareholder proposal threshold to 1 percent. Today, in order to make a shareholder proposal at a public company, you have to own $2,000 in stock. If they had raised the threshold to 1 percent, then for Amazon, a trillion-dollar company, you'd have to have a $10 billion investment in the company to make a shareholder proposal. This would have killed off as a practical matter a lot of shareholder proposals. Fortunately, that did not get adopted. The SEC is looking at some potential changes in the share-

Another achievement is the ongoing presence of meaningful shareholder litigation results. Public funds have been behind a huge number of the largest shareholder litigation recoveries in history.

holder proposals that have to do with refiling thresholds and things like that. But, the worst was avoided there, I think. I think there is definitely still concern about mandatory arbitration provisions and some signaling from the SEC that they might be open to letting companies put that in corporate charters and such.

On another front, it is also not something we think about too much in the corporate space, but there are some things going on at the Department of Labor that merit mention. The Department of Labor oversees pension plans including union pension plans, and they offer interpretive bulletins of the fiduciary duties of the pension trustees. Are they just supposed to maximize returns? Can they take other things into account like the environmental/social/governance factors? Things like that. A few months ago, the White House issued an executive order to the Department of Labor, basically asking them to revisit the question of fiduciary duty of pension funds that are filing shareholder proposals on the environment. Frankly, it appears that a bunch of oil companies went to the Trump administration and said they are getting these shareholder proposals from pension funds that ask us to do X, Y, and Z about global warming and they want that shut down. The Trump administration sent a shot across the bow asking the Department of Labor to revisit the question. I don't think it is going to go anywhere, but it shows a measure of hostility to shareholders rights in yet another context. Those are some of the main, most relevant, developments in the regulatory front.



"It was at this point, gentlemen, that reality intruded."

KA And given those developments, is there anything right now that institutional shareholders should be doing or should be focusing on?

DW I would say continue to fight against arbitration provisions and lobby the SEC not to go in that direction. Arguing that this is not a shareholder friendly move that would be welcome. Being very careful to protect shareholders' proposal rights and argue on their behalf. Some tweaking around the margins of some of the rules wouldn't be the end of the world. But shareholder proposals are a key element of the shareholder voice and they should be preserved. ■

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I see hostility to shareholder rights in multiple contexts. It's important to continue the fight against shareholder-unfriendly moves.

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