

# Stock Activism's Latest Weapon

## Bylaw Changes Are a New Tactic In Fighting Corporate Policies; Targeting Poison-Pill Provisions

*The Wall Street Journal*

Mark Maremont & Erin White

April 4<sup>th</sup>, 2006

For years, shareholder activists have tried to change American corporations by proposing resolutions at annual meetings. Although many have passed, they typically have taken the form of nonbinding advisory resolutions, and directors often ignore them.

Now a few corporate-governance advocates are pushing a more radical approach: amending companies' bylaws, the rules governing a corporation's internal affairs.

To showcase the power of this rarely used weapon, Lucian Bebchuk, a Harvard law professor best known for opposing high executive pay, has targeted eight companies with bylaw amendments this year. Three companies—[American International Group Inc.](#), [Bristol-Myers Squibb Co.](#) and [Time Warner Inc.](#)—already have accepted his proposals or variants. Five others are opposing his proposals, so shareholders will vote on them this spring.



**Lucian Bebchuk**

California Public Employees' Retirement System, or Calpers, is proposing bylaw changes at three companies this year, after winning a shareholder vote on one last year. The American Federation of State, County and Municipal Employees, or AFSCME, pension fund has urged shareholders at four companies to prevent directors from being elected in uncontested balloting if a majority of shares are voted to withhold support. [United Technologies Corp.](#) accepted the amendment—aimed at preventing directors from being seated in such elections with only a minority of votes—without putting it to a shareholder poll.

The shift to bylaw-change efforts “is really the wave of the future for corporate-governance activists,” says Richard Ferlauto, AFSCME's director of pension and benefit policy. Governance advocates are tired of “Sisyphean” campaigns for resolutions that, after finally being passed, are ignored, he says. “Then you start the next year from the bottom again.”

The number of binding proposals is tiny: Eighteen of 1,056 shareholder proposals submitted last year were binding, according to Institutional Shareholder Services, which advises professional investors on how to vote their proxies. By the end of March, 10 of 890 submitted were binding.

The bylaw tactic could open a new front in the battle over corporate governance. Spurred by the spate of corporate scandals, activist shareholders in recent years have tried to gain

more say over how corporations are run. They have been stymied in efforts to get regulators to open up the process for nominating directors, which remains controlled by boards. Short of voting down a slate of directors—which is rare and difficult—advocates trying to sway a board generally have had few options beyond promoting annual advisory resolutions.

Bylaw-amendment proposals have limitations. One hurdle is state laws. States typically spell out some changes shareholders can make to corporate bylaws, particularly on procedural matters, but otherwise generally empower boards to run companies as they see fit.

“A lot of things shareholders might want to do are things that are really under the purview of the board” and can’t necessarily be dealt with via bylaw changes, says Patrick McGurn, an ISS executive vice president. Many governance issues fall into a gray area and haven’t been tested in court.

The effort also is impractical at companies that require overwhelming majorities to pass shareholder-initiated bylaw changes. At Wall Street firm [Morgan Stanley](#), 80% of the shares outstanding must be voted in favor of such resolutions for them to pass.

Another hurdle: Because bylaw changes are binding, the wording is “going to be picked apart by investors and groups like ours,” Mr. McGurn says. Even when investors agree with the gist of a proposal, they may worry that it is too sweeping or fails to anticipate complications or contains errors.

Last year, AFSCME proposed changing the bylaws of [Paychex](#) Inc., the payroll and human-resource services provider, to require a majority vote for electing directors. ISS recommended against the proposal, even though the organization generally supports majority voting. The reason: ISS was concerned the proposal didn’t address what should happen in contested elections, where ISS supports seating directors who garner the plurality of votes. The proposal was defeated.

On Friday, [General Dynamics](#) Corp. announced in a regulatory filing that it opposed Mr. Bebchuk’s proposed bylaw change on director elections, saying bylaw amendments should be advanced “only in cases of consistently poor performance or profound management misconduct.”

Perhaps the most unusual, and potentially far-reaching, of Mr. Bebchuk’s proposals would require companies to reimburse shareholders for expenses incurred in initiating and promoting successful resolutions and amendments, up to the amount the companies themselves spent to defeat them.

He argues shareholders have insufficient incentive to push proposals that benefit all stockholders. Limiting reimbursement to successful campaigns, he contends, would ensure that the arrangement wouldn’t encourage frivolous resolutions.

The board of AIG, the insurance company trying to recover from a scandal over past accounting and other problems, approved a variant of Mr. Bebchuk’s reimbursement amendment in March, eliminating the need for shareholders to vote on it. An AIG spokesman, Chris Winans, says the final wording was negotiated with Mr. Bebchuk, and calls the change “an example of AIG’s commitment to good corporate governance.”

The board of oil company [Chevron](#) Corp. recommended shareholders vote against the reimbursement resolution in its proxy statement, filed March 20. It called such spending an “imprudent use of stockholder funds” that could “provide an incentive to escalate the stockholder-proposal process into more of a vigorous campaign endeavor,” in part by funding “special-interest groups who were not representative of the stockholders at large.”

Mr. Bebchuk also is aiming to use bylaws to force change on the issue of takeover defenses, known as poison-pill bylaw provisions because they attempt to make hostile acquisition offers prohibitively expensive. He argues that such provisions can deny shareholders the ability to make their own decisions. Mr. Bebchuk is proposing a new bylaw requiring that poison-pill provisions be approved by a two-thirds majority of directors and expire within three years.

<b>Shareholders at the Gate</b>			
A look at some recent proposals by stockholder activists to amend companies’ bylaws:			
COMPANY	BYLAW AMENDMENT PROPOSAL	STATUS WITH BOARD	BOARD’S VIEW OF PROPOSAL
AIG	Reimburse shareholders for proposal campaign	Accepted	Good corporate governance
AT&T	Limit golden-parachute severance payments	Opposes*	Unnecessary; already moving to limit parachutes
Bristol-Myers Squibb	Make anti-takeover poison pills tougher to adopt	Accepted	Made sense
Chevron	Reimburse shareholders for proposal campaign	Opposes*	Imprudent use of funds
General Dynamics	Bar directors who don’t receive a majority of votes from running again	Opposes*	Current policy superior
Halliburton	Make anti-takeover poison pills tougher to adopt	Opposes*	Current policy sufficient; no poison pill now
Honeywell	Require majority votes for directors	Opposes*	Adopted different (and nonbinding) majority-vote policy
Wells Fargo	Require majority votes for directors	Opposes*	Current policy sufficient; proposal legally problematic

Source: the companies \*On proxy ballot