# BOOK REVIEWS

THE SILENT PARTNERS: INSTITUTIONAL INVESTORS AND CORPORATE CONTROL. By *Daniel J. Baum* and *Ned B. Stiles*. Syracuse: Syracuse University Press. Pp. xiv, 176. $5.95.

PROXY CONTESTS AND CORPORATE REFORM. By *Douglas V. Austin*. Ann Arbor: Bureau of Business Research, Graduate School of Business Administration, University of Michigan. Pp. vii, 93. $4.00.

THE ENSNARED SHAREHOLDER: DIRECTORS AND THE MODERN CORPORATION. By *Dr. Alexander Rubner*. New York: St. Martin's Press. Pp. xiv, 210. $7.50.

The annual meeting of shareholders has long ceased to be the routine cut and dry session it was in the early years of this century. This is as it should be because it is the one day in each year when employers meet their employees: management and the candidates for election.[1] As the annual proxy statement of the Southern Railways Company states so well: "The stockholders are invited to attend this annual meeting and to vote in person upon the questions there submitted. It is the forum provided by the by-laws for general discussion of the problems of the Company and the management not only desires, but believes itself entitled to the advice of every stockholder who is interested in the Company's welfare."

It is fitting that we are witnessing an expanding library of books in which the annual meeting receives its due. These books show that the general corporate counsel can play an important role in determining whether or not the meeting is going to be a successful one from the collective viewpoints of both management and shareholders. Like it or not, the corporation lawyer will take the blame or praise, as the case may be, after the session has ended. Whether there will be subsequent litigation or proxy contests may be determined in the conduct of the annual meeting. The trio of books being reviewed are important, not merely to the counsel for a corporation but for the young law student, for those who believe in the development of a people's capitalism and for those who wish to

[1] Fowler, *Meetings: A Change in Climate*, N.Y. Times, Feb. 27, 1966, § 3, p. 1, col. 1.

take an active part in shaping corporate policies by participating from the floor in an annual meeting.

Dr. Alexander Rubner, dealing with many aspects of this subject at American, British and German shareholder sessions in *The Ensnared Shareholder,* notes how a leading German banker used to be so contemptuous of differing expressions of opinion that he would demonstratively read a newspaper when an independent shareholder rose to speak. This was not only bad manners but a violation of the principles of *Roberts Rules of Order* which are a sine qua non for both management and shareholders if a meeting is to be orderly. If the chair does not set the example, is it any wonder the shareholders also grow disorderly? The banker in question, Dr. Rubner tells us, was not satisfied with this affront to the shareholders. He also declined to answer questions. The resulting litigation made German corporate history. The banker had thought himself immune because of the German deposit laws restricting derivative actions, but how badly he was fooled.[2] How new law was made is described with such gusto by the British author that it would be a shame to spoil it here, and this reviewer will merely suggest a reading of page 120 of the volume.

Now if reading newspapers and refusing to answer proper questions are bad manners, equally so is shareholder conduct described elsewhere in the Rubner book. The author describes a British meeting where a distraught shareholder hurled three eggs and one tomato at the board members! This obviously is the time when it is perfectly proper for the Pinkertons to be both seen and heard; not as in some meetings in the United States when differences over procedure or the right to ask questions pertaining to the notice of the meeting (or why it was not presented) have ended in ejections of the inquisitive shareholder, which tact and adherence to parliamentary law could easily have avoided.[3]

Commenting on such episodes at American meetings, Dr. Rubner notes, "I must confess that when I first heard Gilbert's repeated charges that some American companies deliberately provide no microphone for shareholders at their Annual General Meetings, or only one apparatus for an audience of thousands, in order to stifle opposition speeches, I was more than skeptical."[4] After noting a

[2] RUBNER, THE ENSNARED SHAREHOLDER 118-20 (1965).
[3] L. & J. Gilbert, 26TH ANN. REP. OF SHAREHOLDER ACTIVITIES 30-33 (1966).
[4] RUBNER, *op. cit. supra* note 2, at 122 n.1.

famous search of shareholders for portable bullhorn megaphones at one American meeting, he adds that this "and other independent evidence have persuaded me there indeed is no limit to the childish and stupid behavior of some directors."[5]

It is to the importance of shareholder questioning of management at the Annual Meeting that Daniel J. Baum and Ned B. Stiles devote much of their space in *The Silent Partners.* Mr. Baum, an associate professor of law at Indiana University School of Law, and Mr. Stiles, a member of a top-flight New York law firm and formerly a staff member of the Securities and Exchange Commission, are eminently qualified to discuss this topic. The importance of questioning has been the subject of much newspaper comment these days. "Stockholders have not only the rights but also the responsibilities of ownership . . . . Stockholders have an obligation to maintain a discipline over management without which self-serving autocracy can readily develop . . . Voting yes, i.e., goosestepping to every request by management regardless of intrinsic merit, is just not desirable. A stockholder should exercise his or her individual judgment. This is necessary to the maintenance of a viable business society."[6] Dudley Swim, author of the preceding quotation, is a director of some large nationally known corporations and is the chairman of one of them. Donald White, Financial Editor of the *San Francisco Examiner* puts it so well when he writes, "The question and answer period of the annual meeting is what shareholders really show up for."

If the small shareholders, not connected with management in any material way, have increasingly learned the importance of voting proxies intelligently and asking questions at their annual meetings, the same cannot be said of "the silent partners," to use the descriptive term of the second of the books being reviewed here. The authors indict the institutional investors for failing to be active participants in the companies in which they are holders.[7] Thoughtful people all over the nation should be asking themselves the same questions Baum and Stiles pose. The authors easily disprove the popular myth that stock ownership of public issue corporations by

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[5] *Ibid.*

[6] Swim, It's Up to You. Monterey, California, Peninsula Herald, Feb. 26, 1966.

[7] See also "A Study of Mutual Funds," prepared for the Securities & Exchange Commission by the Wharton School of Finance and Commerce. H.R. Rep. No. 2274, 87th Cong., 2d Sess. 417-25 (1962).

pension funds, college and state trusts is merely fragmental. True, as the authors say, individually no one fund or trust is able to hold more than five per cent of the shares of any company, but in the aggregate, these five per cents represent a stranglehold of voting power when proxies are voted blindly "en bloc" for a management proposal or against an independent one.

Relying solely on management's proxy statements dealing with the other than day-to-day matters and failing to attend annual meetings will only weaken the entire system of free enterprise. This behavior also leaves the floor open to unskilled questioners. The net result is to give us more "Atlantic Acceptance" situations. And nothing is more dangerous than asking questions of management merely in private. An executive can always say what he chooses and then if things do not work out well he simply says "You misunderstood that." When the questions are asked openly on the floor of the annual meeting, then the same answer has to be furnished all owners at the same time. This is another reason why independents and progressive managements alike are insisting, more and more, on rotation of the annual meeting to assure more active shareholder participation than would be likely in a Dover, Delaware or a Watertown, New York. No one has to agree with management's reply, but it has become a matter of record and should be in the post-meeting report, as is being done these days by such corporations as Continental Can, American Tobacco, P. Lorrilard, Xerox and Chesapeake and Ohio. It is difficult to comprehend how an institutional investor fund of the "silent partners" type can vote against such a post-meeting report. A fund is paid to and should try to make public the maximum amount of information, and it is absurd for them to vote against such proposals just because management may not want to send one out.

There are many instances of funds being rubber stamps for management proposals even though it may be in the funds' best interest to vote against management. These "silent partners" may, for example, vote against ending stagger systems used to counteract cumulative voting for directors but then switch their votes when management is persuaded by enough small shareholders that the ways of the past should be abandoned. This unquestioning loyalty to management by the funds makes a strong case for the secret ballot which has been demanded for so long by Wilma Soss, President of the Federation of Women Shareholders. The secret ballot would lessen the fears, rightly or wrongly, held by many funds that unless they vote with management on key issues, management may retaliate. With the growth of employee-shareholder interest, to say nothing of the customer or would-be supplier who may be a small shareholder in a company, we have yet another reason for use of the secret ballot. It is an unfair and undemocratic situation when a management can apply pressure on the corporation's shareholders.

The authors of the book also deservedly mock the "sell your stock" thinking of these institutions as being in reality something which may be quite costly in the long run to the institutional investor. To realize this we have but to recall the case of one of the most powerful closed-end trusts in the nation which was actually the second largest holder in Texas Gulf Sulphur as late as 1962. It sold its shares at a twenty-six per cent loss on its investment and everyone knows of the phenomenal rise in price since then.[8]

Paradoxically this "sell your share" theory actually promotes proxy contests which might otherwise have been avoided, since the shares sold in a company at low prices may bring into the company those who will be only too glad to engage in a contest or use the take-over bid variation. It is this which makes so timely the new book by Professor Douglas V. Austin, now the chief economist of the Cleveland Federal Reserve Bank, entitled *Proxy Contests and Corporate Reform,* in which he comments: "The owners, often taken for granted or ignored by management, suddenly take on new importance when they have the legal right to exercise control over their investment once again."[9] The need for the shareholders "to watch more carefully for dishonesty or fraud on the part of the top decision makers" is also not overlooked in Professor Austin's tome. He suggests: "One effective method of preventing the illegal use of company funds for personal gain is to increase the thoroughness and independence of exterual audits. Increased surveillance of company transactions has developed during the past decade, but the conclusions of this study imply that further improvement in this area is needed, especially with regard to transactions involving personal gains by management at the expense of the stockholders."[10] This is why the independent shareholder is so insistent that the

[8] L. & J. Gilbert, 25TH ANN. REP. OF SHAREHOLDER ACTIVITIES 195-96 (1965).
[9] AUSTIN, PROXY CONTESTS AND CORPORATE REFORM 79 (1965).
[10] *Id.* at 78.

auditors be present at the annual meeting to answer questions and further, that the choice of the auditors be ratified by the shareholders.[11] How can any "silent partner" vote against this when independents use a proxy statement to have this practice adopted? Or, how can they fail to join in the discussion when the auditors are placed in nomination? This is why independents persist in asking that items such as this be discussed when being voted upon and not lumped into any general discussion period at the end of the meeting. Questions pertaining to auditing, election of directors, and proposals are entitled to reasonable consideration at the time they are brought up, as distinct from the subsequent general question and answer period.[12]

Those corporate managements which adhere to reasonable equity and equality have far more friendly annual meetings than those adopting the restrictive alternatives which lead to newspaper headlines and shareholder irritation which are obviously not in the best interests of either counsel, management or shareholders in the opinion of this reviewer.

In airing these many points the distinguished authors have rendered a distinct service not only to corporate democracy and the making of better corporate citizens, but to all who follow the pattern of the annual meeting and its role in our free world economy.

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FOUNDATIONS AND GOVERNMENT: STATE AND FEDERAL LAW AND SUPERVISION. By *Marion R. Fremont-Smith*.† New York: Russell Sage Foundation. Pp. 564. $8.50.

> "Though I speak with the tongues of men and of angels, and have not charity, I am become as sounding brass or a tinkling cymbal . . . .
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> "Charity suffereth long, and is kind; charity envieth not; charity vaunteth not itself, is not puffed up, . . .
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> "Charity never faileth. . . ."[1]

[11] This is now done by a new high of 1,027 listed corporations. See SEC, 31ST ANN. REP. 56 (1965).

[12] See *How I'd Run an Annual Meeting, Interview with Lewis D. Gilbert.* Bus. Management, 1965.

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[1] 1 *Corinthians* 13:1-8.