CRC
CAPITAL RESEARCH CENTER

Organization Trends

The Corporate Library: Servant of Special Interests

By John Berlau

***Summary**: Labor unions, left-leaning foundations and activists declare their support for "shareholder democracy" in calling for the adoption of shareholder resolutions at corporate annual meetings. But their efforts to gain shareholder proxies to endorse policy positions, restrict CEO pay, and replace company directors is really about shifting power from management to special interest groups. It's also about changing the mission of the corporation from maximizing profits for shareholders to serving their own social and political goals.*

Robert A.G. Monks, co-founder of the Corporate Library, distrusts corporations which he blames for "unemployment and impact on the environment."

* "The Corporate Library…came up with a list of five chief executives they're calling the 'Highest Paid Worst Performers' of 2008," blares the lead paragraph of a story on CNN.com.

* "It's only in the wacky world of CEOs where you get severance for failing," Corporate Library editor Nell Minow told the Associated Press in 2008.

* Business Week has dubbed Corporate Library's Minow "the queen of good corporate governance."

In news story after news story about CEO pay, one group is quoted as the objective expert and unbiased arbiter acting on behalf of shareholder interests. The group is called the Corporate Library, and its annual study on CEO pay and other studies on corporate governance are considered authoritative. Since it was founded in 1999—but especially since the financial crisis hit in 2008—the group has become one of the most widely quoted critics of executive compensation.

On its website, the Corporate Library describes itself as "an independent research firm focusing on corporate governance" and "the leading source for U.S. and Canadian corporate governance and executive & director compensation information and analysis." When it's not making public comments to the media, the Corporate Library publishes pricey publications such as the "Governance Information Screening Tool" and "Securities Litigation Risk Analyst."

It also issues governance reports on individual companies. The Corporate Library "universe currently encompasses over 3,200 U.S. and Canadian publicly-traded companies" that it ranks on measures of corporate governance. The for-profit firm notes that it sells its

February 2010

CONTENTS

products to interested parties such as "major insurance companies, institutional investors, law firms, investment banks, universities, public corporations, compensation consultants, and executive search firms."

The Corporate Library positions itself as an advocate for shareholders in public policy. It pushes for controls on CEO pay and urges the federal government to override state corporate law on director elections and shareholder resolutions. When the Corporate Library testifies before Congress or files comments with a regulatory agency, it identifies itself – as it did in an August letter to the Securities and Exchange Commission (SEC) – as "an independent corporate governance research firm" dedicated to "protect[ing] long-term shareholders' interests."

Working for Shareholders or Activists?

Yet the Corporate Library and similar corporate governance groups such as Institutional Shareholder Services are far from disinterested, and financial observers question whose interests they are really promoting. Clark S. Judge and Richard Torrenzano, experts on politically-motivated anti-corporate campaigns, argue that many shareholder activist groups have "hidden agendas."

Editor: Matthew Vadum

Publisher: Terrence Scanlon

Organization Trends
is published by Capital Research Center, a non-partisan education and research organization, classified by the IRS as a 501(c)(3) public charity.

Address:
1513 16th Street, N.W.
Washington, DC 20036-1480

Phone: (202) 483-6900
Long-Distance: (800) 459-3950

E-mail Address:
mvadum@capitalresearch.org

Web Site:
http://www.capitalresearch.org

Organization Trends welcomes letters to the editor.

Reprints are available for $2.50 prepaid to Capital Research Center.

The authors write in the Wall Street Journal: "One set of issues will be political and social. The other will be corporate governance concerns on executive pay, or the wisdom of a given product line or merger. These lines will blur. A campaign on, say, executive pay, may in fact be a stalking horse for promoting a director who stands for unionizing the work force, or embracing a 'green' initiative."

The Corporate Library frequently blurs the lines between promoting effective corporate governance and pursuing the liberal conception of "corporate social responsibility." The former holds CEOs accountable to produce a better return for shareholders, but the latter demands that CEOs bow to the agenda of labor unions, radical environmentalists, and other interest groups of the left.

Recently the Corporate Library and other interest groups have been pushing the SEC to issue new rules expanding use of shareholder proxies. They want to override state corporation law and place the name of board candidates nominated by a minority of shareholders directly on investors' proxy ballots. But as I noted in comments I prepared for the SEC about "proxy access": "There are two types of shareholder activism: one beneficial and one detrimental to the interests of the majority of investors and entrepreneurs."

Activism beneficial to all investors includes the proxy fight launched by hedge fund investors such as Carl Icahn and William Ackman. These often result in management instituting changes to business practices – from pursuing mergers to selling off divisions – that bring long-term improvement to a company's shareholder return. At the other side of the shareholder spectrum, however, are investors like People for the Ethical Treatment of Animals (PETA). These groups have no interest in improving corporate performance and often want to hinder a company's prospects in order to further a social agenda. PETA introduces resolutions addressing – in its own words – "the replacement, protection, and humane treatment of animals used in pharmaceutical testing, in the food industry, in pet-food testing, and in chemical testing, to name a few."

Although it claims improved shareholder performance as its main goal, the Corporate Library directly and indirectly lends its assistance to so-called "socially responsible" investors. In July 2009 it signed onto a letter to the SEC from the Social Investment Forum, which bills itself as "the U.S. membership association for socially and environmentally responsible investment professionals and institutions." The Forum's membership includes Greenpeace International, the AFL-CIO, the Service Employees International Union (SEIU), and the far-left Tides Foundation as well as several hundred politically correct mutual funds, money managers and financial planners.

The Forum's letter calls on the SEC to mandate that public companies report on "sustainability," the catch-all term environmental and labor groups use to define how "politically correct" a firm is on global warming, card check, and other liberal policy issues. Rejecting economist Milton Friedman's view that the purpose of the business firm is to maximize profits for its owners, the letter states, "Long term success in managing a business in today's complex economic, environmental and social landscape is increasingly dependent on factors not reflected in financial statements and in some instances thought to be outside the corporation's sphere of concern" such as "the environment" and "community relations."

Even when the Corporate Library does not directly support specific shareholder resolutions or board of director nominees, it does provide institutional support for "socially responsible" investor activists. It argues for what seem to be technical changes to rules governing the treatment of shareholders – adjustments that are incorporated in financial "reform" legislation Democrats push in Congress. Yet academic studies show that these proposals do not increase shareholder returns. Instead, they increase the power of unions and other liberal activists groups to pressure public companies. In a thorough study of corporate governance methodologies, scholars at Stanford's Rock Center for

Corporate Governance concluded, "Where the other ratings are the product of proprietary quantitative analysis, The Corporate Library ratings reflect subjective judgment and expertise."

Fearing adverse publicity, institutional investors often pay close attention to companies' governance ratings. And that gives groups like the Corporate Library a "significant ability to extract rents from the firms they rate," according to a new paper from Columbia University finance professor Charles Calomiris and National Bureau of Economic Research associate Joseph R. Mason, an associate professor of finance at Drexel University. Calomiris and Mason examine the activities of corporate governance activists and equate their actions to "holdup games against large companies…like ACORN's infamous actions to extract money from merging banks in exchange for agreeing not to oppose their mergers."

How "Corporate Governance" Abuses Shareholder Rights

To understand how the Corporate Library operates, it's necessary to review the history of the left's use of the shareholder proxy. In his 1971 book *Rules for Radicals*, a key text for generations of leftist "community organizers," Saul Alinsky devoted a chapter to describing a new method for bringing corporations to heel. He called it the "proxy tactic." Protests and demonstrations had their uses. But Alinsky urged leftist groups to understand that they could also gain control of the voting shares of companies, and that they could "use proxies for political and social purposes" and make "the so-called private sector live up to its public responsibilities."

What about firms' responsibilities to their shareholders, many of whom hold stock in their pensions for retirement or to fund their children's education? Alinsky admitted there was a conflict, but he brushed it off, rationalizing that "the stockholders will find such satisfaction and meaningfulness in their campaigns that these will be more important than a cut in dividends."

The Corporate Library, LLC

headquarters: Portland, Maine

Nell Minow, Editor and Co-Founder

Robert A.G. Monks, Co-Founder

Richard A. Bennett, CEO

website: www.thecorporatelibrary.com

Alinsky's answer, as satisfying as it may be to left-wing shareholder activists, does not satisfy the fiduciary duty of institutional investors. Mutual funds, for instance, are legally required to act in a shareholder's best interest. But Alinsky's "proxy tactic" promotes concepts that are harmful to shareholders: "shareholder democracy," in which shareholders claim a legal right to manage company operations, and "socially responsible investing" – a movement that dubiously claims that its social goals do not sacrifice investor return.

In the 1980s and 1990s the left began to focus its agenda on gaining entry into the corporate boardroom. With the loss of political power in the White House and Congress activists turned to so-called "corporate campaigns." They targeted companies, threatening them with bad publicity unless they changed their corporate policies. Activist groups also made use of the shareholder proxies of union pension funds, state government pension funds, and left-leaning foundations to force changes in corporate policy.

In an important book, *Biz-War And the Out of Power Elite* (2004), George Washington university professor Jarol Manheim chronicles how the left increasingly relied on corporate campaigns when Ronald Reagan and George W. Bush held the White House and when Newt Gingrich ran Congress: "The idea in each instance was that, if they lacked the resources to force government to change *public* policy directly, the advocates of the causes nevertheless could achieve their objectives by motivating private institutions to change their *private* policies and behaviors on such a large scale as to constitute a de facto change in public policy."

Corporate Library founders Robert A.G. Monks and Nell Minow took advantage of this development and have prospered. A liberal Republican (he was co-chairman of the Maine chapter of Republicans for Obama in 2008), Monks left the Reagan administration Labor Department in 1985, where he was administrator of the Office of Pension and Welfare Benefit Programs. He formed Institutional Shareholder Services (ISS), a proxy voting advisory firm that sells information on how companies should vote in proxy battles, both on shareholder resolutions and director candidates.

Why would an institutional investor buy this type of research? As Manheim puts it: "Institutions typically own shares in hundreds of different companies…When one adds in the increasing number of shareholder resolutions, being offered by parties other than management, which vary in number and content from one company to the next, the task takes on a high degree of complexity. To cast each vote in a manner defensible within the limits of fiduciary responsibility requires study and thought – of each ballot question, and in some cases, of each director. That creates a market niche…Enter ISS."

Unfortunately ISS has filled this "market niche" by advocating anti-market policies. Monks frequently complains that CEOs have too much power and he argues that institutional investors must become change agents. "Corporate power over the state tends to inhibit attention to non-profit-generating consideration," Monks said in a 1996 speech at Cambridge University. Arguing that corporations cause "externalities" such as "unemployment and impact on the environment," Monks concluded that "institutional shareholders possess the characteristics essential for an effective corporate monitor."

ISS has supported many dissident shareholder resolutions, including proposals concerning climate change and affirmative action, but union-related issues are especially prominent. Labor unions quickly became among the strongest of ISS allies, even after Monks left ISS in 1990. In 2004, for instance, ISS sided with unions in their effort to remove Safeway CEO and Chairman Steve Burd, who had clashed with them over employee benefits. Claiming that Burd was bad for shareholders, ISS urged institutional investors to vote to drop Burd from the company's board and worked openly with the unions, hosting the AFL-CIO at an ISS conference. As David Hirschmann, a senior vice president for the U.S. Chamber of Commerce, told the Associated Press, "This is a labor dispute disguised in corporate governance clothing."

Burd easily survived. Only 17% of the company's shareholders voted with ISS to oust him from the board. But ISS's influence keeps growing. Purchased in 2007 by RiskMetrics Group, itself a publicly traded company, it advises institutional investors and corporations around the world. For 2,750 institutional investors, the firm offers its proxy recommendations on some 35,000 securities ballot votes that must be decided each year.

Monks formed the Corporate Library after he left ISS. His partner was Nell Minow, who had been ISS general counsel. (Minow is the daughter of longtime Democratic activist Newton Minow, who as John F. Kennedy's Federal Communications Commission chairman became famous for calling television a "vast wasteland." He later would hire law student Barack Obama for a clerkship at the Chicago law firm Sidley Austin.) Nell Minow oversees Corporate Library publications and is the public face of the organization.

Besides rating the "corporate governance" of particular firms, the Corporate Library is perhaps best known for its annual study of CEO pay. This survey measures CEO compensation and then rates CEOs on whether they are being "paid for performance." But critics say the measures developed by the Corporate Library to judge whether a CEO's pay is merited are deeply flawed. Moreover, the Corporate Library applies its own ratings very selectively to CEOs and targets those that leftist activists believe guilty of "sins" against social justice.

The Truth About "Pay for Performance"

Minow has testified before Congress that for CEOs, "the pay-performance disparity is so outrageous, so atrocious that in my opinion it undermines the credibility of our system of capitalism." Trying to differentiate corporate CEOs from other well-paid persons whose unique skills are in high demand, Minow has argued: "It's a very small group in the stratosphere of pay: rock stars, movie stars, athletes, investment bankers, and CEOs. Of that group, the first four are in the ultimate pay-for-performance category…with deals that evaporate quickly if a movie, a CD, or a business deal tanks." For Minow, it seems that almost any base pay for a CEO is overcompensation.

In reality, neither CEOs, entertainers nor athletes are paid on pure performance. What they earn is a form of guaranteed payout based on their *past performance*. When the Los Angeles Galaxy signed British soccer superstar David Beckham, it *guaranteed* him a salary of $6.5 million a year for five years. Beckham has been paid this amount despite disappointing seasons in which he missed games due to injuries. His presence has failed to get his team into the playoffs. Similarly, movie star Angelina Jolie will likely keep a big chunk of her multi-million dollar contract for her next movie even if it bombs. Those who hire top athletes, entertainers and CEOs base their decision on past achievements. They know, in the words of investment jargon, that past results don't guarantee future performance. Guaranteed payment *and* performance-based bonuses are what virtually all highly skilled professionals demand when they select an employer that bids for their talents.

Despite the flawed logic that the Corporate Library uses to argue that executive compensation is excessive, labor unions and other shareholder activists have used "pay for nonperformance" assertions to devastating effect in their corporate campaigns against the CEOs of any publicly-traded company they choose to target.

It's not surprising that these campaigns against CEOs often coincide with other grievances that liberal activists have against companies. Take the campaign to oust Home Depot CEO Robert Nardelli. A top executive during Jack Welch's legendary tenure at General Electric, Nardelli "weighed many offers," according to USA Today, before taking the top spot at Home Depot in 2000. By many measures of his tenure at Home Depot, Nardelli performed well for his pay. As USA Today reports, "In six years, Nardelli made [the company] twice as big and into the 14th largest Fortune 500 company and second to Wal-Mart among retailers." Net income in October 2006, the paper noted, "was up 129% and revenue was up 100% from where they were in the same quarter of 2000, just before Nardelli joined. Net income and revenue of companies in the Standard & Poor's 500 were up about 65% during that time."

Yet the Corporate Library blasted Nardelli. "Performance has been poor and he has been hugely overpaid every step of the way," Minow exclaimed. She even demanded that the Home Depot board attempt to take back part of Nardelli's salary after he resigned in 2007. Why the indignation? Nardelli's critics claim that Home Depot's growth rate was slower than it was in the 1980s and 1990s, even though growth rates often slow down after a company expands rapidly. A more likely explanation is that the Corporate Library's liberal allies had demands that Nardelli wouldn't accommodate. Like Wal-Mart, Home Depot has a non-union workforce, and during Nardelli's tenure union organizing efforts at Home Depot stores in Michigan and Ohio were successfully rebuffed.

Nardelli's union critics worked hand-in-glove with the Corporate Library and couched their criticisms in corporate governance terms, while still airing union grievances. For instance, the AFL-CIO's "Executive PayWatch" bulletin used the Corporate Library's calculation of Nardelli's compensation and then contrasted its findings to the pay of a typical Home Depot worker. The bulletin noted that the stock purchase plan and 401(k) program available to employees "do not provide a guaranteed annual pension benefit" in contrast to Nardelli's retirement perks.

By contrast, the Corporate Library has little to say about the compensation of General Electric CEO Jeffrey Immelt. In 2000, Nardelli lost a contest with Immelt to become the next CEO of GE, which owns NBC and its cable affiliates. (GE has agreed to sell NBC to Comcast and the deal should go through in the third quarter of this year.)

Immelt's performance? "Under Immelt's eight years at the helm, General Electric has lost almost two-thirds of its value," writes Wall Street Journal business columnist Evan Newmark. "Earlier this year, GE was on the verge of a total meltdown."

But shareholder activists organized by corporate governance groups have issued few calls for Immelt's head. On the Corporate Library blog, senior research associate Paul Hodgson gives Immelt high praise for a West Point address in which the GE CEO condemned corporate greed and inequality. "A couple of Wall Street execs have said sorry, we should have done better, but no one's gone so far as Jeff Immelt," Hodgson wrote. The Wall Street Journal's Newmark had a markedly different view of Immelt's speech: "Was GE's "leadership" to blame? Apparently not. It's American capitalism that's at fault, Immelt implies…After I read his address, the only thing it renewed were my doubts over Immelt's past leadership and where he was taking the company."

Immelt is a CEO who knows how to play the political game. Journalist Timothy P. Carney calls GE under Immelt "the for-profit arm of the Obama administration." Carney's new book *Obamanomics* devotes an entire chapter to Immelt and GE, which enthusiastically backed cap-and-trade proposals such as the Waxman-Markey bill that last summer passed the U.S. House of Representatives. The legislation would ration energy to fight the unproven menace of catastrophic global warming. Carney shows how GE benefits from government favors such as subsidies and regulations that hurt its competitors. For these reasons and because many GE divisions are unionized, leftist groups treat the company with kid gloves.

Indeed only one shareholder advocacy group has tried to oust Immelt. This is the Free Enterprise Action Fund, a mutual fund founded by free-market advocates Tom Borelli and Steve Milloy. As owners of GE stock, the fund withheld its votes for Immelt as board director. "Under Immelt's leadership, GE's share price has dropped to 14-year lows and has underperformed in both bull and bear stock markets," Borelli said. The fund called on GE to stop backing causes such as cap-and-trade that harm the interests of GE shareholders and customers. While the Free Enterprise Action Fund ceased mutual fund operations in 2009, its shareholder activism continues as the Free Enterprise Project of the National Center for Public Policy Research. Borelli directs the Free Enterprise Project.

Conclusion

The movement to increase the power of shareholders has been politicized by liberal special interest groups and labor unions. Shareholders and policymakers need to do due diligence when they consider policies advocated for shareholders' benefit. Corporate Library-backed proposals such as "say on pay" – which would force companies to hold up-or-down shareholder advisory votes on executive compensation – and "proxy access" – which would force companies to put shareholder nominees for boards of directors in the companies' own proxy materials – may appear to give shareholders more power. But they are often harmful to shareholder returns because they are frequently proposed to serve special interests. As University of Illinois law professor Larry Ribstein, a longtime expert in securities law, puts it: "This isn't about 'shareholder democracy, but about shifting power from powerful managers to powerful shareholders (i.e. unions) who are even less likely to champion the interests of shareholders generally."

John Berlau is director of the Center for Investors and Entrepreneurs at the Competitive Enterprise Institute.

OT

BrieflyNoted

Apparently **Congressional Research Service** employees are as good at research as **ACORN** employees are at registering voters. The report commissioned by House Judiciary Committee chairman **John Conyers** (D-Mich.) and House Financial Services Committee chairman **Barney Frank** (D-Mass.) –both longtime ACORN allies– is a whitewash. CRS could find no examples of individuals registered to vote by ACORN who cast fraudulent ballots. In fact, at least two Ohio voters registered by ACORN, **Claudel Gilbert** of Reynoldsburg and **Darnell Nash** of Cleveland, Ohio, were convicted of vote fraud in 2007 and 2009 respectively. ACORN remains under investigation in Cleveland.

Separately, the **Government Accountability Office** (GAO), the investigative arm of Congress, has opened an investigation into ACORN. GAO said it decided to launch the probe at the request of Reps. **Darrell Issa** (R-Calif.), **Lamar Smith** (R-Texas), and other lawmakers.

California ACORN claims it is breaking away from the national group **ACORN** to become a new organization to be called **Alliance of Californians for Community Empowerment** (ACCE). The new group will keep the same mission and many of the same staffers which makes the purported separation from the ACORN network very difficult to believe.

Taxpayer-funded **National Public Radio** produced a left-wing video called “How to Speak Teabag,” that mocks members of the Tea Party movement who embrace low taxes and limited government, depicting them as simpletons. “You can be fluent in conversational Teabag in just a few short minutes,” the video begins.

George Soros’s well-funded smear factory **Media Matters for America** has 70 employees, according to a profile in the New York Observer. We had previously estimated the figure as between 60 and 100 professional character assassins.

Media Matters named radio and TV host **Glenn Beck** 2009 Misinformer of the Year. Last year Beck became a thorn in the side of the **Obama** administration and the American left’s Public Enemy Number One, surpassing fellow conservatives **Ann Coulter**, **Rush Limbaugh**, and **Bill O’Reilly** in terms of pure hateful bile generated.

Meanwhile, Soros, who has made it explicitly clear he wishes to destroy capitalism, wants the **International Monetary Fund** (IMF) to become a kind of globetrotting **Bernard Madoff**, offering low-interest loans to poor countries so they can invest in the global warming industry. According to Soros, the loans would allow developing countries to “jump-start forestry, land use, and agricultural projects – areas that offer the greatest scope for reducing or mitigating carbon emissions, and that could produce substantial returns from carbon markets.” Soros, who personally wants to invest $1 billion in “clean” technology, said he wants the IMF to help stimulate demand for the technology he plans to underwrite.

Radical anti-war group **Code Pink** is running ads on the official website of the Muslim Brotherhood, a terrorist sympathizing group. One of the ads is headed, “Arrest The War Criminals,” but it refers to former President **George W. Bush**.