NORTH DAKOTA’S PRO-SHAREHOLDER LAW: A MAJOR ADVANCEMENT

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The financial meltdown of the last two years, in my view, urgently calls for a fundamental restructuring of the relationship between the owners of companies—the shareholders—and their managements and boards of directors. Not since the Great Depression have so many trillions of dollars in shareholder wealth been obliterated as a direct result of the calamitous misdeeds of a small but potent group of traders and managers on Wall Street. Operating below most people’s radar screens, these executives built a house of cards that collapsed and dragged down the world economy, with help from indolent auditors, lax government regulators, self-serving rating agencies, and others.

There is much blame to go around in this unfortunate debacle. But one group of people was directly in a position to do something to prevent it: the boards of directors at these crippled titans. How could these boards have allowed managers at these financial institutions to leverage their assets by thirty times or more using risky derivatives that few likely understood? Where were the boards when managements were soaking up lavish salaries and bonuses when their companies teetered on the brink of collapse?

For me, this entirely preventable debacle is clear evidence that many non-executive boards are essentially impotent, rendering shareholders even less potent, even though technically shareholders elect board members to represent them. A decades-long power grab by management groups in the states’ legislatures and courts has given them far too much authority over shareholder assets. Now the pendulum must swing the other way.

The North Dakota Publicly Traded Corporations Act is a great stride in this direction. I applaud Governor John Hoeven and the North Dakota State Legislature for enacting this much-needed and important legislation in 2007. In time, it will be a cornerstone in the shareholder rights movement in this country. The Act enshrines the power at corporations where it should be—with the stockholders. It is now up to stockholders to exercise that power.

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Should a company choose to adopt its provisions, the new Act grants many rights and powers that shareholders rightfully always should have possessed. They include greatly improved shareholder power to propose resolutions and board candidates on a company’s proxy ballot, a split of the CEO and chairman role, advisory votes on executive compensation, shareholder reimbursement for successful proxy contests, restrictions on “poison pill” antitakeover provisions, and other important measures.

The Act does not guarantee that North Dakota-domiciled companies will operate better than those located elsewhere. But it does give shareholders the right to exercise greater influence, without having to spend millions of dollars in a proxy battle to elect a new board to properly represent them. Most importantly, the new law could finally get top managers to realize that they are accountable, not “imperial CEOs” that answer to no one.

But creating an environment for enhanced shareholder rights is only the first step in a larger movement. The next challenge is to get companies to reincorporate in North Dakota. Worried about a loss of their power, most boards and managements are unlikely to incorporate out of management-friendly states against their will.

Therefore, what is now urgently needed is federal legislation that allows shareholders to vote by simple majority to incorporate their companies in another state if they wish. Currently this power is vested solely with boards and managements. I have urged Congress to enact legislation to this effect and encourage others to advocate it. I am confident that we will achieve this aim, but it will not be easy. It is likely to face substantial opposition from powerful pro-management lobbies. In recent months, there have been a handful of proposed proxy resolutions that call on companies to reincorporate in North Dakota. And we have started to hear arguments from managements as to why they should not make such a move. They say it is too expensive to reincorporate, or that North Dakota’s body of jurisprudence is not as developed as other states, such as Delaware. Such arguments are weak and certainly do not outweigh the benefits of the new North Dakota law.

Reincorporating companies to other jurisdictions is not very expensive. The move could easily be financed by getting rid of a few corporate jets, or slashing managements’ lavish entertainment budgets and country club memberships!

Furthermore, state judges regularly draw on court decisions made in other states. It would not take long for North Dakota to have as robust a body of case law as Delaware or New York. I am sure the state would be happy to bolster its court budget to handle more cases.
But shareholder demands to relocate will have another beneficial effect on corporate governance. Heretofore, states have been in a competition in a “race to the bottom” in adopting provisions that cater simply to managements and crony-laden boards. I believe those days are over.

I am confident that the groundwork for a shareholder revolution is in place in this country. If there is any silver lining to this market meltdown, it is my hope that we emerge with a stronger body of shareholder rights in this great nation. It is long overdue.