

MEMORANDUM OF LAW

DATE: May 22, 1991

TO: Maryanne P. Dickson, Assistant Retirement Administrator, via
Lawrence B. Grissom, Retirement Administrator

FROM: City Attorney

SUBJECT: Proxy Voting

In a memorandum dated April 26, 1991, you indicated that the Proxy Committee for the City Employees' Retirement System (CERS) is developing voting guidelines. You stated that several issues have surfaced requiring further legal clarification. In this regard, you have posed several questions. Your questions and our answers follow:

1. With respect to proxy voting, are there certain state and/or federal laws that CERS, as a pension plan, is required to adhere to and vote in a specific manner? In particular, you make reference to a statement set forth in the guidelines from a pension plan in the State of California. That statement reads, "votes will be cast in favor of cumulative voting proposals as required for governmental pension funds under California law." Government Code section 6900.

Answer: Yes. Our memoranda to you dated December 29, 1987 and April 5, 1991 discuss the legal issues and law applicable to proxy voting. Copies of each are attached for your review. Briefly, Government Code sections 7450 and 7451 place the responsibility for voting proxies with the Retirement Board. Under Government Code section 7450, there does not appear to be any provision for delegation of this responsibility. It states in pertinent part:

Every local agency in this state owning common stock and whose stock is by contract managed by a fiduciary shall request such fiduciary to forward any proxies for shares owned by the agency which are to be voted in a corporate election to the governing body of such local agency.

For purposes of this section, "local agency" includes "every county, city, city and county, district, and authority, and each department, division, bureau, board commission, agency or instrumentality of any of the foregoing."

Interestingly, there is no parallel provision in the statutory scheme for state agencies such as Public Employees' Retirement System (PERS) or State Teachers Retirement System (STRS). Counsel for PERS has confirmed this. There is no similar restriction at the state level. As a matter

of practice and procedure, PERS has delegated, by contract, the responsibility of voting proxies with their small capital investment managers. They have also delegated proxy voting authority to investment managers handling foreign securities. Apparently, STRS also delegates proxy voting responsibilities in certain areas.

At present, we do not know why local agencies are prohibited from delegating the responsibility of voting proxies while state agencies are not. The available legislative history does not provide any insight. It merely recites the language of Government Code section 7450. There is, however, an agency entitled the Legislative Intent Service in Sacramento which will research the specific legislative history of a particular Code section. I have used this service on numerous occasions in the past. I have always been pleased with the quality of their service.

In light of the disparity of treatment on this issue at the state and local level, we recommend that additional legislative history be obtained. Review of that information may suggest a future course of action. Please let me know at your earliest convenience if CERS is interested in obtaining further legislative history in this area.

As to other legal issues, we note that Corporation Code section 711, effective January 1, 1990, imposes new reporting and recordkeeping requirements on employee benefit plans that invest in corporate stock. No exception is provided for public retirement systems such as CERS. Of special interest, section 711 gives California residents, who participate in employee benefit plans, the right to require the plans to disclose how their shares of corporate stock were voted. In addition, the voting record must be maintained for twelve (12) months. Please be advised, however, that the "public" nature of CERS requires a longer retention period for the proxy voting record. CERS, by definition, is a "local agency" subject to the California Public Records Act found in Government Code section 6250 et seq. Under the authority of Government Code section 34090, the public records must be retained for at least two (2) years. As such, CERS must maintain the proxy voting record for two (2) years.

Finally, letters recently issued by the U.S. Department of Labor, concerning proxy voting obligations under ERISA indicate that plan administrators must specify with clarity who has the power to vote. The plan administrator should also periodically review the voting record. In addition, in recognition that the voting of proxies is a fiduciary act, the vote must be done with prudence and for the exclusive benefit of plan participants and beneficiaries. Although CERS is not subject to ERISA, the same rules probably apply under California law to California public plans.

For your information, Government Code section 6900 referred to in your memorandum dated April 26, 1991 does impose one additional requirement. It states:

Whenever any governmental body is a shareholder of any corporation, and a resolution is before the

shareholders which will permit or authorize cumulative voting for directors, such governmental body shall vote its shares to permit or authorize cumulative voting.

As used in this section, the term "governmental body" means the state, and any office, department, division, bureau, board, commission or agency thereof, and all counties, cities, districts, public authorities, public agencies and other political subdivisions or public corporations in the state (emphasis added).

In light of the foregoing, CERS appears to be a "governmental body" for purposes of this section. As such, the proxy committee would be required to vote its shares to permit or authorize cumulative voting.

Please be advised, however, under Government Code section 7451 the Retirement Board is not prohibited from abstaining on a corporate or shareholder proposal if it provides written notification to the corporation of its desire to abstain on a corporate or shareholder proposal. Finally, as suggested in our memorandum dated December 29, 1987, the proxy committee, subject to direction from the Retirement Board, may avail itself of any source of advice, counsel or recommendation deemed appropriate for purposes of voting proxies.

2. How should CERS respond legally or by way of documentation with regard to proxies which have already been voted by one of the investment firms? In this regard, you have indicated that one investment firm has already received and voted several of CERS' proxies. You have also indicated that any proxies with a record date prior to April 24, 1991 will go to the investment management firm. Apparently, there is a forty-eight (48) hour grace period for changing record holder information, but after that, there is virtually nothing that can be done to alter the holder on file. You have indicated that CERS has instructed the investment firm to forward all proxies to CERS. You have also asked the investment management firm to supply you with a record of how the proxies were voted as soon as possible. Finally, you have indicated that the investment management firm involved handles small capital investments.

Answer: You have taken appropriate action under the circumstances. You have instructed the investment management firm at issue to forward all future proxies to CERS forthwith for voting. You have also requested a record of how the previous proxies were voted. The voting record should be reviewed by the proxy committee. After review, the proxy committee may wish to request verification nunc pro tunc by the Retirement Board. Pursuant to Government Code section 34090, the proxy voting record must be kept for at least two (2) years. The record should indicate which votes were handled by the investment management firm.

3. When proxies arrive too late (due to timing) for the proxy committee to vote what guidelines should be followed?

Answer: This is a policy question to be resolved accordingly. For your information, Government Code section 7450 discussed above merely

requires the Retirement Board to request their investment managers to forward any proxies for CERS shares for voting by the proxy committee. This section does not impose any liability for failure to request or failure to receive the proxies.

Obviously, the proxy committee can't vote proxies which are received too late. In addition, Government Code section 7451, also discussed above, only requires the Retirement Board to vote each proxy that is returned to the corporation, i.e., "when returning proxies to a corporation." Thus, the plain meaning of this section suggests that CERS would have had to have received the proxies in a timely fashion in order to be able to return them to the corporation. Again, nothing in this section suggests liability for violation of its terms. Importantly, Government Code section 7451 allows CERS to abstain on a corporate or shareholder proposal when CERS provides written notification of this desire. As such, you may wish to include written instructions to investment management counsel or the concerned corporations mandating abstention when proxies are not sent in a timely fashion.

Please contact me if you have any questions or need any further assistance.

JOHN W. WITT, City Attorney

By

Loraine L. Etherington

Deputy City Attorney

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Attachments

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