Who Owns Exxon? We Do.

Thanks to "pension-fund socialism," environmentalists may turn out to be the economic reformers of the 1990s. But who knows if they will succeed.

The most intriguing thing about the Valdez Principles — newly hatched guidelines for corporate environmental practice — is neither the companies that have signed up to endorse it, nor those that refused, nor the majority still mulling it over — nor even the engaging, clever activists who put the Principles together. The intriguing aspect is the investment climate which provoked those activists in the first place. It's as if, since 1974, the United States economy has been the victim of a giant-scale practical joke. And only now has anybody started to figure out the punch line.

If a nightclub comic were to tell the joke, he might start by asking a simple question. Who owns most mainstream companies? Robber barons, right? Fat cats. Investors with last names like Du Pont, Morgan, and Mellon — descendants of the industrial exploiters of the 19th century — plus a few modern-day barons like Trump, Milken, and Kravis. They all learned what Kurt Vonnegut Jr. described so evocatively in his 1965 novel *God Bless You Mr. Rosewater:* How to slurp from the "money river," the river of profits from investment, "the widest, deepest river of wealth ever known to man." If you befriended or scared the right people, said Vonnegut's lead character Eliot Rosewater (a disenchanted, middle-aged rich kid with a drinking problem), you would "be shown a place on the riverbank, and handed a bucket all your own. Slurp as much as you want, but try to keep the racket of your slurping down. A poor man might hear." (Incidentally, although *Rosewater* never achieved the popularity of *Slaughterhouse 5*, it is a cult favorite among disenchanted rich kids — with or without drinking problems.)

In the early 1970s, with almost no public notice (not even their own), the workers of America learned to slurp at the money river. One person who *did* notice was the eminent Austrian-born management/economics writer Peter Drucker. In his 1976 book *The Unseen Revolution,* he said the United States was becoming the world's first truly socialist country. American teachers, teamsters, corporate full-timers and city employees were, in aggregate, squirrelling away billions in more than 50,000 pension and retirement funds. The funds, in turn, invested that money in the stock market. By now, as Drucker pointed out in the *Harvard Business Review* this spring, pension funds have $2.5 trillion in assets, are enormous industrial lenders, and own 40 percent of American common stock — enough for a controlling interest in most companies. Who owns Exxon, GM, Du Pont and Citicorp? We do — at least those of us with pensions.

But the joke's on us. We might own America, but our influence falls within harshly narrow limits. The reasons go back to the 1940s, when then General Motors chairman Charles Wilson designed the first modern pension fund. He decreed that it should invest in all possible stocks, instead of just GM. That way, if GM's stock price suddenly collapsed, its pensioners (who vividly remembered the Great Depression) would be protected. Wilson was probably thinking of this pension fund when he said that what was good for GM was good for the country.

Wilson's design caught on among corporations, and Congress eventually wrote it into law, more or less, as the 1974 Employee's Retirement Security Act — colloquially known in investment circles as "ERISA" (pronounced to rhyme with "Melissa"). By the

BY ART KLEINER

1970s, pension-fund investments had become gigantic child-tyrants in the market, fussed over by independent stock analysts, whose only job (as "fiduciaries") was to get the best possible payback every day for their aging beneficiaries. Because of protective state laws, these fiduciaries could not take a personal interest in any company, or even bet a long shot; if they lost money for their pensioners, they could be liable for malpractice. This liability scared away banks, and suddenly small boutiques opened for managing pension funds, using computers to track stock performance on an almost moment-by-moment basis.

You may remember the "Greed is Good" speech in the movie *Wall Street*, where takeover pirate Gordon Gekko persuades stockholders that the management of their company is more corrupt than he is. In real life, his audience would have been pension-fund managers' representatives. Most of them would have felt honor-bound to go along with his offer of a higher stock price, no matter what they thought of his ethics. They would care as little for the company as a bookie might care for the health of Lucky Lady running in the 12th tomorrow at Aqueduct, and for the same reasons. Tomorrow, after all, would be another horse race — and they might not even own the company by then.

Thus, however well-intentioned its design, the pension-fund system has evolved into a monstrosity. It faces the same built-in dilemma as Social Security — funding an ever-growing proportion of senior citizens from an ever-shrinking work force. Another problem stems from the nature of trading: if *one* investor goes after quick gains, he or she will likely prosper. But if *all* major investors do the same, they will all lose. (Indeed, many pension funds, despite best efforts, have consistently undershot the stock market.) Meanwhile, the pension funds' need for quick profits, on top of debt from Gekko-like takeovers (which pension funds encourage) pressures managers to cut back new investments to the bone. That makes it hard for a healthy economy to thrive in the long run. It also undercuts environmental protection: Consider Pacific Lumber's desperate battles to cut down its old-growth redwoods in California, to satisfy its debt-laden new corporate parent, Maxxam. In the end, the system of pension-fund investment hurts the very future which pensions were designed to safeguard in the first place. End of joke. Drum roll.

Yet that punch line holds a hidden promise. Some sharp political veterans now have jobs managing pension funds: former New York City comptroller Harrison Goldin, current comptroller Elizabeth Holtzman, and Gray Davis, the chief of staff of former California Governor Jerry Brown. What if they — and the workers they represent — woke up to the fact that they own the corporations? What attitudes might emerge about growth, the legacy of the future, the way companies are managed? Eventually somebody had to pose the question. During the past year or so, that task fell — of all people — to a group of environmentalists.

"The conscience of a company has to rest somewhere. The managers feel it's the CEO, the CEO feels he's accountable to his Board, and the Board is trying to second-guess the shareholders. So let's give our voice about ... building a kind of world that the children of our participants will live in. The quality of that society will be the single most important factor in the quality of their retirement."

The speaker was Wayne Silby, a slim, dark-haired man in his early 40s; the audience was the Financial Executives Institute, composed of the most powerful corporate pension-fund administrators from Fortune 100 companies. Originally from Iowa,

ILLUSTRATIONS BY KEITH BENDIS

Faced with the Valdez Principles, companies are introducing their own codes of environmental ethics, or debating such codes at top levels.

Silby has a quick-witted, sardonic, and yet wholesome mien; he could have been a model for the running shoe entrepreneur played by Kevin Kline in *The Big Chill*. He had traveled through India, then (after law school) had co-founded the Calvert Investment Group, which dealt in "variable-rate securities" — refinancing government-insured loans. Calvert had endured its own Big Chill-like rite of passage. In the late 1970s, employees worked in blue jeans and bare feet; "customers would come in," Wayne would later reminisce, "and put their life savings down on a cardboard table." Then one of his staffers tried to steal $1.5 million. "I started wearing a tie the next day."

In 1982, Silby had set up a "social investment" fund within Calvert (which by then managed $1 billion overall). They screened out companies which dealt in tobacco or alcohol, polluted the air or water, built weapons systems, discriminated against women or minorities, produced nuclear power, or did business in South Africa. That list — taken verbatim from a *Washington Post* story — sounds simple, but the screening was not. Contrary to the expectations of some Calvert staffers, the fund took off. Silby discovered that a company with good "social" indicators *and* solid finances made for good investments in the long run. Environmentalism, after all, breeds efficiency; fair workplaces inspire enduring loyalty. And as the Japanese have demonstrated, efficiency and loyalty lead to stable profits.

Calvert did not dramatically outperform other money-market funds, but it remained above average throughout the 1980s and built a following. It also inspired a half-dozen similar funds (the Sept-Oct 1990 **GARBAGE** analyzed most of them). More importantly for this story, Silby found himself increasingly tapped to be an arbiter of corporate performance. When he questioned Arco's environmental-protection policies in Alaska, the oil company's chairman invited him to visit; he and his group tooled around Arco's drilling sites with the president of Alaska operations. And other leaders of social-investing funds were having similar experiences — most notably Joan Bavaria, the charismatic 45-year-old president of Franklin Research and Development, an independent Boston-based company which performed much of the research on which "social investing" companies based their decisions.

In 1989, Bavaria assembled CERES, the "Coalition for Environmentally Responsible Economies," whose 165 members were evenly divided between environmental groups, investment groups (like Wayne Silby's Calvert), and miscellaneous government agencies and economists. Significantly, the members included Elizabeth Holtzman and Gray Davis, representing two of the largest pension funds in the country: New York City and California employees. Another founding member, and co-chair along with Bavaria, was Denis Hayes, who is best known as the organizer of Earth Day in 1970 and 1990. But Hayes is also a lawyer, and during the mid-1980s he had begun investigating the potential poverty of the pension-fund system, thinking of writing a book about it. "Then I got lured," he said recently, "into doing some legal work against sleazebags who looted and pillaged savings & loans." CERES fit not just with Earth Day, but with his other current project too — the still-under-development Green Seal rating system for products.

Bavaria had the idea that brought CERES together: creating a list of potential rules for environmentalist companies, along the lines of the Sullivan Principles for corporate investment in South Africa. Of all the people who had tried to reform institutional investing (including Peter Drucker), only the Sullivan Principles had ever seemed to have much influence on pension-plan managers. Here again, General Motors figured prominently: a black minister from Philadelphia, Leon Sullivan, had been added to the GM board after a proxy battle over

minority representation in the early 1970s. Sullivan developed his principles as a guide to fair treatment of blacks within businesses that operated in South Africa. But he later changed his mind, denounced his own principles as lacking teeth, and (working with a coalition of church investment groups) pressured many companies, including GM, to divest from South Africa entirely.

Sullivan's enlistment of large-scale investors provided an example for CERES; the Valdez oil spill provided a name. There were ten Valdez Principles in all, drafted with agreement among the CERES members (listening to Bavaria talk, I got an impression of endless telephone debates over minor wording changes). The first six principles are such standard tenets of corporate environmentalism as sustainable use of natural resources, waste reduction, "wise use" of energy, and the marketing of safe products.

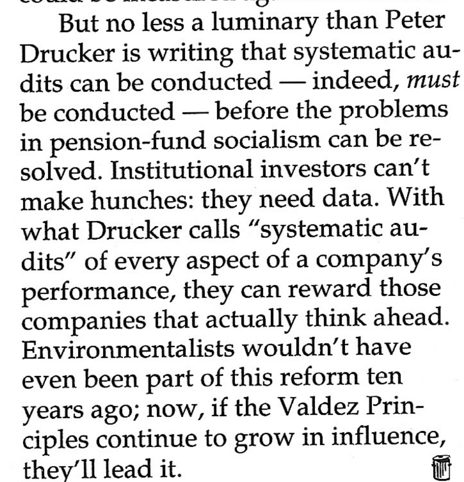
But the last four principles had more — well, more teeth. Number seven suggested that after causing any ecological damage, companies would "make every effort to fully restore the environment and to compensate those persons who are adversely affected." Number eight promised to disclose any potential environmental, health, or safety hazards. Number nine promised to appoint someone representing environmental interests onto the board of directors of the company. And number ten promised an annual public audit of a company's progress.

How successful have the Valdez Principles been? Depends on how you define success. The 21 companies that have signed so far include some iconic standard-bearers of Good Business Practice: Smith and Hawken Tools, Stonyfield Yogurt, and the Aveda cosmetics company. (Ben & Jerry's ice cream company is reportedly considering signing.) Some giant companies, including such prominent large "environmentalist" firms as Du Pont, McDonald's, and General Electric, were targeted by CERES members (notably by church groups, who by now are old hands at stock proxy battles). These companies are ruminating over the Principles. Signing would mean tremendous public-relations value (CERES encourages companies to announce that they have signed them); but corporate lawyers have worried that the Valdez compensation and disclosure clauses might give potential litigators more grounds for a lawsuit.

More significant still is the effect which the Principles might have on institutional investors. The pension-fund managers whom Wayne Silby spoke to, a year and a half ago, sat stonily through his talk. They asked if he wanted them to invest in charity projects, like subsidized housing for the homeless, and sacrifice their return on investment. But this October, the Association for Basic Management Research — a group of pension-fund analysts — held their own conference on socially conscious investing. Meanwhile, investors' resolutions at 40-odd companies will be voted on this spring, sponsored by CERES members, suggesting that GE, Du Pont, Chrysler, GTE, and others sign the Principles. Most of the proxy battles will involve institutional investors — who flexed their muscles a little bit in 1989 by forcing Exxon to add an environmentalist to their board of directors. (The funds suggested Robert Redford, Gary Hart, or Gaylord Nelson, the senator who had first suggested Earth Day. Instead, Exxon chose Dr. John H. Steele, the president and senior scientist of the Woods Hole Oceanographic Institution.)

Most of these proxy battles will probably fail; last year's Valdez Principles resolutions scored around five percent of the vote each. But Silby, Bavaria, and Hayes, each in their own way, insisted that wasn't the point. Five percent is considered a fair showing for a first-year proposal. Also, faced with the Valdez Principles, companies and industries are introducing their own codes of environmental ethics, or debating such codes at top corporate levels. Some of these ethics include agreements (by Kodak, Ford, GM, Corning, American Express, Gannett) to answer CERES' intensive questionnaire. Sometimes, this represents the first time a CEO has considered his company's pollution or energy practices.

Like many of the corporate reform efforts of the past few years, the Valdez Principles will require an immense amount of data-gathering about companies. Indeed, CERES' people (while they've released their first questionnaire for corporations, in a booklet resembling an SAT exam) are still deciding what sorts of disclosure they should require from companies. Should they seek pollution-measuring numbers? Or (asks Bavaria) will numbers turn out to be as potentially misleading as budget projections have been in the financial world? (That's the unknown scandal of the "bottom line": all too often, it doesn't measure anything.) If CERES describes a company's record in words, how can they ensure that the words are fair? They'd have to standardize such evanescent forms of data before one company's good works could be measured against another's.



But no less a luminary than Peter Drucker is writing that systematic audits can be conducted — indeed, *must* be conducted — before the problems in pension-fund socialism can be resolved. Institutional investors can't make hunches: they need data. With what Drucker calls "systematic audits" of every aspect of a company's performance, they can reward those companies that actually think ahead. Environmentalists wouldn't have even been part of this reform ten years ago; now, if the Valdez Principles continue to grow in influence, they'll lead it.

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