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Shareholders Will Pick Up the Bill This Time, Too

By GRETCHEN MORGENSON

SHAREHOLDERS who had been both bloodied and bowed by revelations of improper accounting at [Xerox](#) during the late 1990's took another hit on Thursday. That's when the company said its shareholders would pay most of the \$22 million in penalties levied by the Securities and Exchange Commission against six former executives in settling the case.

Only \$3 million of the penalties, classified by regulators as a fine, would be paid by the executives named in the case. Xerox also disclosed that its long-suffering shareholders would pay the legal fees of the individuals who had settled the case without admitting or denying guilt.

The \$19 million and undisclosed legal fees may be chump change compared with the billions in losses that Xerox shareholders have incurred since reports appeared of accounting irregularities at the company. But requiring shareholders to pay regulators' penalties certainly adds insult to injury. It illuminates yet another failing in corporate governance, one that shareholders must pick up their pitchforks to correct.

Unfortunately, Xerox shareholders are not alone in being required to pay such a bill. Because of so-called indemnification provisions in most companies' bylaws, shareholders almost always end up paying the penalties to which company officials agree when they settle with regulators. But the provisions can also mean that shareholders cover these costs when companies choose to litigate such cases rather than settle without admitting or denying guilt.

S.E.C. rules say the existence of such provisions must be disclosed annually by companies. In a speech on Thursday, William H. Donaldson, the chairman of the commission, said he was no fan of state laws that allow shareholders to pay penalties ordered in legal cases involving corporate officers and directors. But it is unlikely that the S.E.C. would move to force companies to eliminate the policies; that would be outside its normal purview.

A state legislature could ban indemnity provisions for all companies that choose to be domiciled within its boundaries. Delaware is officially home to most American corporations, but New York, where Xerox is incorporated, and California also have their share. Alas, quick action on this matter by the states is unlikely as well.

Of course, companies that care about shareholders could change their bylaws to make their officials culpable in such cases. Then again, hell might freeze over first.

A possible force for change could come from the stock exchanges, in a new listing standard. Memo to Richard A. Grasso at the New York Stock Exchange and Robert Greifeld at the Nasdaq market: if you want to appear to be on public shareholders' side, institute a new standard barring the companies whose shares you list from indemnifying their officials.

But considering how futile it has been for investors to let others fight their battles against me-first managers, investors should take the matter into their own hands. Put it to a vote of shareholders at companies' annual meetings.

Although indemnification of corporate officials is distressingly common, it is hard to recall even one occasion when a shareholder proposal aimed at eliminating the policy made its way into proxy materials. Given Mr. Donaldson's views, it might not be too optimistic to think that the S.E.C. would allow such proposals to appear on proxy ballots. Shareholders can only hope that thousands of such proposals bloom next year and that they can vote to rid themselves of this nonsensical practice.

A Xerox spokeswoman did not return a call for comment on Friday. But on Thursday, she said that because those individuals in the S.E.C. case were not found guilty of wrongdoing, the company's bylaws required it to pay most of the penalties. True enough. But ridiculous. And ripe for change.