CORPORATE MANAGEMENT IN COMPANIES WITH STATE PARTICIPATION IN THE US ENERGY SECTOR

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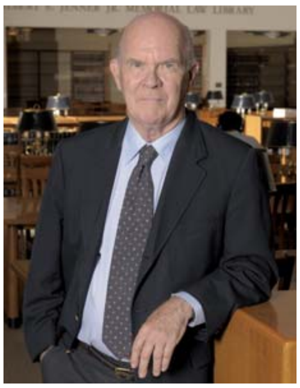

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Despite a high percentage of shares owned by government authorities in the United States, state stockholders hardly ever participate in business decision-making of private companies by voting. Generally, state authorities at any level (federal, state, local), except for pension funds, do not own corporate equities. When a share in a business somehow comes into direct state ownership, the government usually sells it, if possible. As of the third quarter of 2019, the Federal Thrift Savings Plan owned corporate equities totaling to USD 3.25 trillion. Like all other shareholders, state authorities managing retirement savings are entitled to influence corporate governance by voting at meetings of the shareholders and usually exercise this right.

Pension funds of states and cities also generally refrain from active voting with their shares. They tend to rely on recommendations of two dedicated agencies rendering consulting services for shareholders instead. Pension funds of towns generally allocate their funds in private open-ended funds. If this is the case, it is the fund managers rather than the town pension fund that determine the equity voting policy.

Keywords: *state-owned energy companies; corporate governance, pension funds.*

The number of state-owned shares in the energy sector can be easily calculated based on published statistics. Total capitalization of the US stock market amounts to 34 trillion dollars.[1] Total market capitalization of shares owned by state pension funds amounts to about 6 trillion dollars. Therefore, state pension funds owns 6/34 (=18%) of the total market capitalization. Market capitalization of the energy sector amounts to about 3 trillion dollars. [2] As state pension funds such as the Federal Thrift Savings Plan invests in market index funds, we can assume that the share of energy sector pension funds in the energy sector market capitalization will be approximately the same (18%) as the share of pension funds in the total market capitalization. Thus, state pension funds own 18% in the energy sector, i.e., USD 540 billion (18% x 3 trillion). However, this does not mean that pension funds will own 18% of each energy company's shares. Index funds strive to meet the market indices using complex algorithms allowing them to replicate market dynamics by buying shares only of a limited number of companies. This cuts administrative expenses, but inevitably results in small errors in market monitoring, [3] because the fate of a limited number of shares cannot precisely match overall market dynamics.

Even if the limitation of the number of companies the shares of which belong to an index fund results in rather large stakes in some companies, pension funds still vote with their shares on general corporate governance issues only, but not on business policy related issues. Therefore, despite a high percentage of shares owned by government authorities in the United States, state stockholders hardly ever participate in business decisions of private companies by voting.

Generally, state authorities at any level (federal, state, local), except for pension funds, do not own corporate equities. When a share in a business somehow comes into direct state ownership, the government usually sells it as soon as the opportunity arises. A notorious incident occurred in 1999, when the Internal Revenue Service levied execution on the Mustang Ranch, the largest licensed brothel in America, and obtained its assets. Media have jokingly wondered whether the government would pursue this profitable business for a long time. However, the federal authorities sold it.

Federal, state and municipal pension funds invest heavily in private companies, including energy ones. These funds actively exercise the right to vote granted by their shares. Several studies have shown that voting of such pension funds at meetings of shareholders has a measurable, although small, effect. Pension funds value diversification of investments, meaning that the share of any given pension fund in any company is almost always too small for the pension fund to be able to make decisions using its votes only at the meeting of shareholders. The share is usually too small for the pension fund to even appoint someone as a member of the board of directors.

Before elaborating on the role of pension funds, I would like to describe the pension system in the USA. The main source of retirement income for most Americans is the federal social security system funded by taxes paid by both employers and employees. There are individual federal retirement plans for state-paid employees funded from the federal budget. However, there is also an investment-based state retirement plan: the Federal Thrift Savings Plan [4] financed by the government and employees' contributions. State and local authorities also have retirement plans for their employees. Payments under such plans are generally made towards investment funds performance at state and local levels.

As of the third quarter of 2019, the Federal Thrift Savings Plan owned corporate equities totaling to USD 3.25 trillion. [5] As of the third quarter of 2019, state and municipal administration controlled pension funds owned corporate equities totaling to 2.75 trillion dollars. [6] Thus, the total volume of corporate controlling shares (voting shares) amounts to 6 trillion dollars or about 18% of the total US stock market capitalization.

Like all other shareholders, state authorities managing retirement savings are entitled to influence corporate governance by voting at meetings of the shareholders and usually exercise this right. Most state bodies implement a policy aimed exclusively at effective corporate governance. For instance, they sometimes vote against takeover defense measures (the so-called "poison pills"), because such measures help weak managers stay in control and adversely affect the stock value. The funds support increasing wages for good managers and oppose it for bad ones. They sometimes submit proposals for the agenda of the meeting of shareholders. Some state retirement organizations try to include such issues of social significance as environment and public health protection in the agenda of the meeting of shareholders, for the most part without success. Certain state-paid employees pushed for creation of a Social Responsibility Fund within the Thrift Savings Plan. [7] However, it would create major problems. [8] A study showed that, while proposals on corporate management improvement introduced by pension funds are sometimes adopted at shareholder meetings, those on social issues almost always fail. [9]

Since almost all pension funds diversify their investments extensively, they have to vote at numerous shareholder meetings. Therefore, most pension funds outsource these decisions. The fund managers simply do not possess sufficient information or expertise to make correct decisions on the issues put to vote. The largest fund, the Federal Retirement Savings Fund, delegates voting to a leading private investment company, Blackrock, by proxy. As a result, the voting policy is based on Blackrock's internal guidelines on proxy voting rather than government directives. Blackrock has two sets of rules, one for US securities, [10] one for European, Middle Eastern, and African securities. [11] These guidelines are based on standard views on protection of shareholders' interests generally recognized by economists globally.

Pension funds of states and cities also generally refrain from active voting with their shares. They tend to rely on recommendations of two dedicated agencies rendering consulting services for shareholders instead. Activities of these companies are not regulated by the government. They are criticized for conflicts of interest and being overactive. [12] Both reputable associations acting on behalf of large companies are currently lobbying for strict state regulation of activities of these two companies in an effort to reduce their influence. [13] Whatever the quality of the recommendations, it is obvious that their use rids the heads of state and municipal pension funds of political influence on the part of states and cities. Therefore, these funds, just like the Federal Thrift Savings Plan, are not proactively involved in exercising their shareholder rights.

Pension funds of towns generally allocate their funds in private open-ended funds. If this is the case, it is the fund managers rather than the town pension fund that determine the equity voting policy. Companies managing mutual funds often employ services of the same leading consulting agencies when making decisions and voting. ■

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