Clipper Fund Board Rocks the Boat
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The **Clipper Fund** board is charting an independent course.

Contrary to predictions that it would stick with an affiliate of its current manager, the board announced in late November that it had chosen **Davis Advisors** as the fund's new advisor. The move to Davis will also bring a substantial advisory fee cut for the fund.

Morningstar hailed the board's decision as a "watershed event" for the fund industry.

The independent directors began a search for a new advisor when three current portfolio managers decided to jump ship, leaving the fund's advisor unable to run the $6.6 billion fund. The advisor announced that it would reorganize with an affiliated company, **Barrow, Hanley, Mewhinney & Strauss.**

The board subsequently stated that it was evaluating candidates to manage the fund; Barrow, Hanley was among them. The board's choice of Davis Advisors may be the "silver lining" of the improper trading scandal that shook the industry, says Christopher Traulsen, a senior fund analyst at Morningstar.

"I think they've been put on notice that the way things used to be isn't going to cut it anymore." He calls the Clipper board's decision "good news for shareholders."

In the past, a board in a similar situation would have been more likely to defer to the advisor. Two years ago, at the beginning of the improper trading scandal, New York attorney general Eliot Spitzer criticized boards for being "inert" and "passive." He called for them to become watchdogs rather than lapdogs. Some thought his criticism was misplaced, but many agree nonetheless that directors have become more proactive on shareholders' behalf since the scandal began.

While directors are unlikely to begin severing advisory contracts across the board, they are much more likely to take independent action when a disruptive event hits their funds, such as the departure of key portfolio managers, in Clipper's case. In the future, similar major changes — the merging of advisors or restructuring of funds — might also cause boards to reassess the funds' advisors.

"This situation most likely will be repeated in the future in the wake of the increased emphasis of the SEC on independent corporate governance, and the increased sensitivities that mutual fund directors have today," says Patrick Sweeney, partner at **Herrick & Feinstein**.

Sweeney also notes that in this case the affiliated advisor, Barrow, Hanley, was a legitimate candidate to run the fund. In fact, boards faced with such a situation in the future may ultimately decide that the funds' current advisor is the best candidate based on its past track record. But that's no longer a given.

"What this case points out is that it cannot be a foregone conclusion," Sweeney says.

It's not just the board's change of advisor that has scored points with Morningstar and other

industry observers, however. The board has also been praised for the process it undertook in searching for a new advisor.

Shortly after the portfolio managers announced they would no longer manage the fund, the board's independent directors disclosed that they had hired **Wilshire Associates**, a consulting firm, to assist in finding a replacement.

"We concentrated our efforts on firms that we believed would perpetuate the investment approach that Clipper Fund has maintained over the years," Norman Williamson, independent chairman of the board, said in a statement. After due diligence and consideration, the independent directors chose Davis Advisors, Williamson said.

For Niels Holch, founder of the Mutual Fund Investors Forum, the process the Clipper board undertook is more important than the result. "To me, it's not a matter of whether you change managers, it's whether you conduct an independent evaluation of who should be managing the fund," he says. "I think the process is as important as the result, if not more so."

With Davis Advisors, the board has selected a manager that is well-respected in the industry. And, as a further boon to shareholders, the fund's advisory fee will be cut. The new fee will be based on a sliding scale ranging from 0.65% of the first $500 million of assets under management to 0.48% of assets greater than $10 billion. For all of 2006, Davis will waive management fees in excess of 0.50%.

Davis proposed the fee reduction; the new fee is in line with the way Davis manages other funds, says a spokesperson for Davis Advisors.

While all of the candidates proposed advisory fee cuts, it was not the board's only basis for selecting a new advisor, says Michael Glazer, partner at **Paul Hastings** and independent counsel to the fund's independent directors. The main motive was the firm's investment management style, he says.

Clipper's investment style will not change significantly under Davis. It will continue to hold only 15 to 20 positions, according to a recent Morningstar article. The fund will probably not maintain such a large cash stake, which ranged from 20% to 40%. Instead it will likely drop that stake to around 10% or 15%, says Morningstar's Traulsen.

The advisor will invest $50 million in the Clipper Fund alongside its shareholders, Christopher Davis, the firm's CEO, said in a statement. "We are committed to holding the shares for as long as we are entrusted with the fund's management."

The Davis family, employees and directors have more than $2 billion invested in the funds the firm manages, according to the statement. Davis Advisors currently manages about $45 billion in mutual fund assets, including the Selected Funds. The Clipper board will remain separate from the board that oversees those funds.

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