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Shareholder Proxy Access to the Ballot: What Will be the Implications of the SEC's Proposed Shareholder Access Rule if it is Adopted From Governance, Implementation and a Public Perspective?

Bryan J. Shea
Seton Hall University

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CONFIDENTIAL AND PRIVATE COMMUNICATIONS

SETON HALL UNIVERSITY

2004

Shareholder Proxy Access to the Ballot:

What will be the implications of the SEC's proposed Shareholder Access rule if it is adopted from governance, implementation and a public perspective?

by
Bryan J. Shea

MASTER OF ARTS

CORPORATE AND PUBLIC COMMUNICATIONS

SETON HALL UNIVERSITY

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Chapter 1

INTRODUCTION

The purpose of this paper is to examine the Securities and Exchange Commission's proposed landmark rule regarding director nominations by shareholders. Specifically, the paper will address the following issues: (1) What is Shareholder Proxy Access? (2) Corporate Governance and issues that are influencing this proposed rule (3) Proponents view of this proposal. (4) Adversaries of the proposal. (5) Survey of Institutional Investors (6) Interviews and Opinions. These topics and more will be examined and discussed at length throughout the paper and will help enhance the readers knowledge of what exactly is the importance of this proposed rule by the SEC. Shareholder Proxy Access is a proposed ruling by the Securities and Exchange Commission that at this point in time seems to be in a holding pattern. There are several issues to contend with in regards to the passing of this proposed ruling that has gone through heated debate among shareholder groups, institutional investors and a variety of special interest and business groups. This issue was also on the minds of the Presidential nominees during the recent Presidential election. George W. Bush has not at this point publicly weighed in on the shareholder access issue. John Kerry has and is on record as saying that he believes "that the SEC should allow long-term significant investors to have a voice in the selection of a portion of a company's board of directors." In a statement submitted to the AFL-CIO (American Federation of Labor-Congress of Industrial Unions) he said, "I believe that additional actions are necessary to ensure that corporate boards of directors are accountable to investors. For example, I strongly support the recent U.S. Securities and Exchange Commission (SEC) action to increase the shareholder voice in executive

compensation practices. I also believe that the SEC should allow long-term significant investors to have a voice in the selection of a portion of a company's board of directors.”

The SEC may decide to postpone any decision on the issue until after the November election period and possibly until the beginning of next year. In fact, William Donaldson, the current SEC Chairman, has been quoted as saying that there would be no final ruling until “meaningful consensus” was reached and that further action is very unlikely before Election Day. The basic goal of this proposed rule is to enhance corporate governance efforts in the aftermath of a barrage of corporate scandals that has shaken investor confidence and trust. “The issue has deeply divided the normally collegial five member commission” (TheHill.com, SEC Struggles with Shareholder Access, March 11, 2004).

During the turn of the last century good corporate governance issues were not exactly the first topic on both companies and shareholder’s minds as the stock market was breaking record highs. However, corporate scandals such as those at Enron and WorldCom sent the financial world spiraling out-of-control, both in the United States and abroad. In many instances these corporate scandals were linked to the excessiveness and hubris of company officers and directors who had one or both hands in the companies’ coffers. The balance of interest at this point in time was solely focused on management’s interest and as long as the shareholder was seeing multiple returns on their investments the focus was not centered on changing the corporate culture of a companies board. In the wake of these scandals is a changing environment that makes it acceptable for an independent

director to play a more verbose role in the company's growth. "Much of this attitude can be attributed to the Sarbanes-Oxley Act, the legislative overhaul of corporate governance standards passed by Congress in 2002, as well as tougher new listing requirements by the nation's stock exchanges". (The Detroit Business News, Pressure Increases on Independent Directors amid Corporate Governance Scrutiny, February 28, 2004).

The debate over shareholder access to management proxy cards and materials in order to nominate directors and other issues had been re-energized with a rulemaking petition submitted on August 1, 2003 to the Securities and Exchange Commission by the Committee of Concerned Shareholders and James McRitchie. The group wants the SEC to amend Rule 14a-8 of the Securities and Exchange Act of 1934, the rule governing shareholder resolutions, so that companies could no longer exclude proposals relating to the election of directors. The Committee of Concerned Shareholders, a group of individual shareholders who met on the internet and ran a grass roots proxy contest to replace director's at Luby's, Inc., and McRitchie, the editor of CorpGov.net, said "entrenched managers and directors will only improve corporate governance when they can be held personally accountable, e.g. voted out of office and replaced." Their petition, file #4-461 at the SEC, would enable any shareholder eligible to submit a resolution-those continuously owning at least \$2,000 worth of stock for at least one year-to nominate director candidates satisfying certain requirements. As proposed, shareholders would have to provide a letter of nomination containing a statement that the candidate would serve as director and include key information, including the candidate's name, age, business address, relationships with the company and work experience. The petition also

called on the SEC to prohibit broker votes (votes cast by brokers without the written consent of the beneficial owners) on the election of directors.

Also, eRaider, an internet confederation of investors, recently petitioned the SEC on the issue. The organization asked the SEC to mandate that public companies must place the names of all legitimate director candidates on ballots distributed to shareholders. The group had also urged the SEC to disallow broker votes for any candidate, to ban the use of corporate funds for campaigning for any candidate and to strike down unreasonable qualification tests for director candidates. Their petition did not set any requirements for director candidates, though it did state that it has no objection to some qualifications, such as age and stock ownership. In addition to eRaider, the Social Investment Forum, a trade association for financial practitioners promoting the growth, concept and practice of socially responsible investing, recently submitted a letter to the SEC asking it to consider requiring two candidates for each open board seat and to develop a way for companies to include shareholder nominations.

On October 15th, 2003 the Securities and Exchange Commission (SEC) published proposed rules allowing shareholders a new, but severely limited ability to propose nominees for corporate boards. Currently, investors have the ability and right to put forth a “short-slate“, or limited number of candidates for a board election, however, they must do so at their own expense. “Not having direct access to the corporate ballot means that investors have to spend huge sums to orchestrate a proxy contest, a step that’s ordinarily reserved for hostile takeover attempts“ (Investors Seek Proxy Election Reform, LA

Times, 2003, February 19). Damon Sivers, the associate general counsel at the AFL-CIO, stated, "I think that if we are trying to see to it that the corporate governance system works, then this is an inevitable reform." As a result, the election process to strengthen the independence and responsiveness of corporate boards disenchants many investors. The new SEC proposal has come under fire due to the fact that it requires certain "triggers" to take place in order for shareholders to earn the right to nominate a director to a board. The proposed rule places a stringent cap on how many candidates can be nominated, who can nominate, and under what conditions of corporate malfeasance investors can gain the right to propose a nominee.

The two triggering events that would have to occur in order for this rule to come into affect would be:

- Withhold votes for at least one director totaling more than 35 percent of the votes cast at an annual meeting after January 1 2004.
- A majority vote on a resolution to request shareholder access at an annual meeting after January 1, 2004. In order to be eligible to submit such a resolution, a shareholder or group of shareholders must own more than 1 percent of the company's stock for at least one year. The company would then be required to include in its proxy materials the nomination proposed by shareholders owning more than 5 percent of the company's stock continuously for two years.

The nominee must be independent of both the nominating group of shareholders and the company itself. According to the SEC, the nominating group must affirm in a notice to the company that the nominee is completely independent of the nominating group, in addition, meets the objective criteria for independence from the company as set forth in the listing standards of a national securities exchange or national securities association. An independent director is defined by the New York Stock Exchange as an individual whom the board of directors "affirmatively determines has no material relationship with a listed company." The NYSE also says that a former employee or a family member of a company executive, or someone with personal or family business connections to the company, would not be considered independent.

A board consisting of at least eight or fewer directors would be required to include only one nominee; a board with nine to 19 directors, no more than two nominees; a board with 20 directors or more, up to three nominees. If a company receives more nominees than required, the nominees from the largest shareholder group would take precedence over the others.

A shareholder or group of shareholders seeking control of the company would be ineligible to nominate a director. Furthermore, the rule would only apply where shareholders are permitted by state law to nominate a candidate for election to the board. According to an SEC official, the states where most public companies are incorporated, including Delaware, do give shareholders the right to nominate candidates to the board of directors.

An independent director is defined by the New York Stock Exchange as an individual whom the board of directors "affirmatively determines has no material relationship with a listed company." The NYSE also says that a former employee or a family member of a company executive, or someone with personal or family business connections to the

company, generally cannot be classified as independent, until three years after such a relationship has ceased. The NASDAQ Stock Market issues a similar rule designed to toughen the definition and power of independent board directors.

Research Question

What will be the implications of the SEC's proposed Shareholder Access rule if it is adopted from governance, implementation and a public perspective?

Definition of Terms

#1 – Proxy: A written authorization given by a shareholder for someone else, usually the company's management, to cast his/her vote at a shareholder meeting or at another time.

#2 – Shareholder: One who owns shares of stock in a corporation or mutual fund. For corporations, along with the ownership comes a right to declared dividends and the right to vote on certain company matters, including the board of directors.

#3 – Corporate Governance: A generic term, which describes the ways in which rights and responsibilities are shared between the various corporate participants, especially the management and the shareholders.

#4 - Sarbanes-Oxley Act: Legislation enacted in response to the high-profile Enron and WorldCom financial scandals to protect shareholders and the general public from accounting errors and fraudulent practices in the enterprise. The act is administered by

the Securities and Exchange Commission (SEC), which sets deadlines for compliance and publishes rules on requirements. Sarbanes-Oxley is not a set of business practices and does not specify how a business should store records; rather, it defines which records are to be stored and for how long. The legislation not only affects the financial side of corporations, but also affects the IT departments whose job it is to store a corporation's electronic records. The Sarbanes-Oxley Act states that all business records, including electronic records and electronic messages, must be saved for "not less than five years." The consequences for non-compliance are fines, imprisonment, or both. IT departments are increasingly faced with the challenge of creating and maintaining a corporate records archive in a cost-effective fashion that satisfies the requirements put forth by the legislation.

#5 - Brokers: Individual or firm, which acts as an intermediary between a buyer and seller, usually charging a commission. For securities and most other products, a license is required.

#6 - Beneficial Owner: The individual who enjoys the benefits of owning a security or property, regardless of whose name the title is in.

#7 - American Federation of Labor-Congress of Industrial Unions: The American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) is a voluntary federation of 60 national and international labor unions.

#8 - Independent Director: An individual whom the board of directors affirmatively determines has no material relationship with a listed company.

#9 - Annual Meeting: The company gathering, usually held at the end of each fiscal year, at which the previous year and the outlook for the future are discussed and directors are elected by common shareholders. Shortly before each annual meeting, the corporation sends out a document called a proxy statement to each shareholder. The proxy statement contains a list of the business concerns to be addressed at the meeting and a ballot for voting on company initiatives and electing the new Board. This proxy ballot authorizes someone else at the meeting (usually the management team) to vote on investors' behalf.

#10 - Shareholder Proxy Access: Currently, investors have the right to put forth a “short slate,” or limited number of candidates for a board election, but they must do so at their own expense, and with considerable difficulty under existing law. As a result, many investors feel disenfranchised by the elections process, and seek the right to propose board candidates to strengthen the independence and responsiveness of corporate boards. The new SEC proposal is controversial because it imposes additional barriers, or “triggers,” for shareholders to earn the right to nominate a director for the board. The proposed rule places a stringent cap on how many candidates can be nominated, who can nominate, and under what conditions of corporate malfeasance investors gain the right to propose a nominee.

#11 - Poison Pill: Any tactic by a company designed to avoid a hostile takeover. One example is the issuance of preferred stock that gives shareholders the right to redeem their shares at a premium after the takeover.

#12 - Enron: Energy trading company that was investigated for using off-the-book partnerships to conceal debt on balance sheets and to inflate profits. Company Chairman Kenneth Lay embezzled hundreds of millions of dollars in stock and other benefits before the company imploded.

#13 - WorldCom: With the financial world still reeling from the collapse of Enron, and the conviction of its former auditor Arthur Andersen for obstruction of justice, world financial markets were sent into further turmoil by allegations of massive fraud at global telecom WorldCom. Disgraced firm Arthur Andersen attacked former WorldCom chief financial officer Scott Sullivan for withholding vital information, as it faced accusations of an alleged \$4bn (£2.62bn) accounting fraud. The firm pointed the finger at the recently resigned CFO Sullivan, as telecom company WorldCom stated it would have to restate its financial results to account for billions of dollars in improper bookkeeping. The Securities and Exchange Commission charged the US telecommunications giant with fraud. Chief Executive Officer Bernard Ebbers faced Congressional Committee as the company improperly accounted for \$9 billion.

#14 - Securities and Exchange Act of 1934: With this Act, Congress created the Securities and Exchange Commission. The Act empowers the SEC with broad authority over all aspects of the securities industry. This includes the power to

register, regulate, and oversee brokerage firms, transfer agents, and clearing agencies as well as the nation's securities selfregulatory organizations (SROs).

The Act also identifies and prohibits certain types of conduct in the markets and provides the Commission with disciplinary powers over regulated entities and persons associated with them. The Act also empowers the SEC to require periodic reporting of information by companies with publicly traded securities.

Chapter 2

History of Shareholder Access

The SEC first addressed the issue of shareholder access to a company's proxy materials with the intent of nominating a director as early as 1942. The Securities and Exchange Commission solicited comments on staff proposals including a proposal to revise the proxy rules to provide that "...minority stockholders be given an opportunity to use the management's proxy material in support of their own nominees for directorship" (SEC Press release No. 34-3347 – 1942, December 18). According to testimony of Chairman Ganson Purcell before the House Committee on Interstate and Foreign Commerce, the staff had proposed that shareholders be permitted to use the management's proxy statement to canvass shareholders generally for the election of their own nominees for directorships, as well as for nominees of the management. Under the proposal, a company would not have been required to include more than twice as many candidates on the proxy as director positions to be filled. The Commission at this time did not adopt rules to provide such access.

Again in 1977, the SEC focused on shareholder access on top of a company's proxy materials regarding the nomination and election of directors during a broad review of shareholder communications, shareholder participation in the corporate electoral process, and corporate governance in general. In anticipation of public hearings held in September of 1977, the SEC, without formally proposing rule changes, requested comments on a number of issues, including whether shareholders should have access to management's proxy soliciting materials for the purpose of nominating persons of their choice to serve on the board of directors. In addition to this overarching question, many of the other issues raised in the press releases relating to the 1977 review still remain issues that the SEC will need to address if it attempts to provide shareholder access to company proxy materials.

After the 1977 hearings, the SEC proposed and adopted amendments to the proxy rules. These amendments did not, however, relate directly to shareholder access to companies proxy materials regarding the nomination and the election of directors. The SEC, however, did adopt a requirement that companies must state whether they have a nomination committee and, if so, whether the nominating committee will consider shareholder recommendations. Although the SEC stated its intent to address "some of the more complex questions which have been raised in this proceeding relating to corporate governance and the means by which corporations can best account to shareholders and the public" and determine "what further action, if any, is appropriate with respect to shareholder communications and shareholder participation in the corporate electoral process generally", the SEC did not take further action on shareholder

access to proxy materials. According to a 1980 staff report to the Senate, it was concluded that, due to the emerging concept of nominating committees, the SEC should not propose and adopt a shareholder access rule at that point in time. The staff recommended, however, that monitoring the development of nominating committees and their consideration of shareholder recommendations going forward. The staff report further cautioned that, if an insufficient number of companies adopted nominating committees or the efforts of these committees with regard to shareholder nominations proved insufficient, SEC action most likely would be necessary.

In the board proxy revisions adopted in 1992, the SEC briefly revisited the shareholder access issue in connection with amendments to the bona fide nominee rule set out in Exchange Act Rule 14a-4, which provides that no person shall be deemed a bona fide nominee “unless he has consented to being named in the proxy statement and to serve if elected.” In adopting the Exchange Act Rule 14a-4 amendments, the SEC stated that the difficulty experienced by shareholders in gaining a voice in determining the composition of the board of directors. The SEC also stated that proposals to require the company to include shareholder nominees in the company’s proxy statement would represent a substantial change in the SEC’s proxy rules. This would essentially mandate a universal ballot including both management nominees and independent candidates for board seats.

Rather than mandating a “universal ballot,” the SEC revised the bona fide nominee rule to allow shareholders seeking minority board representation to “fill out” a partial or “short slate” with management nominees, thus making it easier for shareholder wishes to

nominate only two candidates to a seven person board, Exchange Act Rule 14a-4 permits the shareholder to choose five of management's nominees to fill out his or her ballot, provided that the shareholder does not name those management nominees on his or her proxy card, but instead states only those management candidates that the shareholder is opposition to. Although the shareholder still must disseminate and file a separate proxy statement and proxy card, he or she can now, in essence, allow shareholders to vote for at least some of management's nominees on the shareholder's proxy card.

Currently, shareholders who wish to effect a change in the composition of a board of directors, may conduct an election contest, as noted briefly above, nominate a candidate at an annual meeting, or recommend candidates to a company's nominating committee or a group of directors fulfilling a similar role. Election contests can require substantial expenditure by the shareholder, who must prepare and disseminate proxy materials that comply with the SEC's proxy rules. Shareholders instead may nominate directors at the annual meeting, object to compliance with applicable state law requirements, as well as any requirements contained in the company's proxy material before the meeting has little chance of receiving sufficient support. Finally, although shareholders generally may recommend candidates to a company's nominating committee or group of directors fulfilling this role, shareholders have indicated that this is not effective, as companies rarely nominate candidates recommended by their shareholders.

In a press release issued on May 1st, 2003, the SEC solicited public views and feedback on the organization's review of the proxy rules and regulations relating to the nomination

and election of directors. The majority of commenters supported the SEC's decision to direct this review. Reflecting concern over the lack of accountability of corporate directors and the surplus of recent corporate scandals, the commenters generally urged the SEC to adopt rules that would grant shareholders greater access to the nomination process and greater ability to exercise their rights and responsibilities as owners of their respective companies. In addition, many commenters noted that current director nomination procedures afforded little to no meaningful oversight to shareholders.

The 690 commenters who responded to this solicitation were comprised of the following:

- 424 individuals;
- 165 unions, pension funds, institutional investors, and institutional investor associations;
- 24 social, environmental, and religious funds and their related service providers
- 18 law firms and attorneys;
- 16 associations;
- 10 corporations and corporate executives;
- 10 shareholder resource providers;
- 8 investment advisers and managers;
- 5 academics
- 5 other shareholder groups;
- 2 governmental representatives; and
- 3 miscellaneous commenters.

The vast majority of commenters supported the idea of modifying the proxy rules and regulations related to the nomination of the election of directors. Commenters who did not support such a modification included all of the corporations and corporate executives, most of the legal community, and the majority of associations (mostly business associations).

Very few commenters provided specific suggestions or alternatives about how the proxy rules should be reformed to allow shareholders to access proxy materials to nominate directors. Of those commenters who did submit detailed proposals, the level of specificity in those proposals ranged from merely suggesting minimum shareholder ownership thresholds for submitting director nominations to outlining extensive proposals for general proxy reform.

Most of the individual or “retail“ investors who commented indicated that they consider the current process for the nomination and election of directors to be an ineffective means of providing shareholders with the rights of company ownership, but very few offered detailed proposals or alternatives. In an interview with the CorporateCounsel.net on June 10, 2003 Jim McRitchie, Editor of CorpGov.net, addressed the reaction of retail investors to the proposed ruling. He stated, “the average shareholder contacting me has been outraged to learn that there is no democracy in corporate governance“. “They’re beginning to realize that all the regulations in the world and stiffer penalties will do no

good because there are too many avenues for greed and too few enforcers.”

Shareholder groups who supported some level of proxy reform stated that, aside from providing shareholders with access to the election process to nominate director candidates who would represent investors’ best interests, such reform also would have the effect of making all corporate directors more responsive to shareholder desires and concerns. An explicit or implicit reason behind the desire for reform in several comment letters was that reform was particularly necessary in those cases where the proxy process and shareholder communications were ineffective.

Commenters who opposed proxy reform to provide shareholders with access to company proxy materials to nominate directors advocated a cautious approach with regard to any changes to the nomination and election process. In this regard, the commenters cited that such access would be “terribly disruptive to the corporate governance process” and the SEC instead should give the Sarbanes-Oxley Act of 2002 as well as the proposed listing standard changes a chance to operate before making such a fundamental change to the director nomination process. In addition, some commenters also questioned the SEC’s authority to adopt shareholder access rules under Exchange Act Section 14(a).

A few of the commenters who opposed shareholder access to company proxy materials recommended that the SEC instead consider requiring enhanced disclosure about nominating committees or revising Exchange Act Section 14a-8(i)(8) to grant shareholder

proposals in order to establish a process for shareholder nominees on a company-by-company basis.

There have been several alternatives to increasing shareholder involvement in the nomination of election of directors, some of which could be employed in a combination with the other. The following are a few of the alternatives that have been suggested:

- requiring companies to include shareholder nominees in company proxy materials;
- requiring companies to deliver nominating shareholder proxy cards along with company proxy materials;
- requiring expanded disclosure regarding companies' nominating committees, the nominating process, and nominating committee consideration of shareholder recommendations, with possible requirements under applicable listing standards that nominating committees consider shareholder recommendations;
- requiring expanded disclosure regarding shareholder communications with board members with possible requirements under applicable listing standards that companies provide shareholders with increased access to, and direct communications with, board of directors; and
- revising Exchange Act Section 14a-8 to allow shareholder proposals relating to a company's nominating process.

Under the first alternative, a company would include on its proxy card the shareholder nominee or nominees and would include specific information, such as biographical information, about the shareholder nominee in the proxy statement. Arguments for and against each of the companies and the nominating candidates could be included either in a word-limited form in the proxy statement or wholly outside the proxy statement, for example, on one or more specified and designated websites. All proxy soliciting materials, including internet website postings, would be filed electronically with the SEC, as is currently the case for definitive additional proxy soliciting materials. In addition, all disclosure and communications would be subject to the prohibition against false and misleading statements.

Chapter 3

Opponents

As with any issue, this proposed rule has two very strong and heated opinions.

Opponents of the proposed rule express concern that if adopted shareholder access may result in cluttered ballots with too many investors suggesting alternate candidates and might be abused by dissidents to mount a no-premium corporate takeover disguised as a boardroom-coup. As the American Society of Corporate Secretaries noted in 1990 in response to an equal access rulemaking petition at the SEC, equal or shareholder access would result in a “costly, massive, unfocused, multiparty referendum that would jeopardize the integrity and functionality of the proxy process.” The Business Roundtable (BRT), an association of chief executive officers of leading U.S. corporations with a combined workforce of more than 10 million employees in the United States, feels as if the adoption of the proposed proxy access rules at this point in time would not be

appropriate. On the fourth of February 2004, the Business Roundtable provided an open letter to the SEC, which stated among other concerns that “Among other things, shareholder access to company proxy materials to nominate directors has the potential to alter dramatically corporate governance. It presents significant questions regarding the Commission’s authority, federalism, and the relative roles of the states and federal government in establishing shareholder rights and delineating the responsibilities of shareholders and boards of directors.” (Proposed Rules Regarding Security Holder Director Nominations, 68 Fed. Reg. 60,784 (Release No. 34-48626, 2002, October 23); (File No. S7-19-03). Another concern of the Business Roundtable was that the original press release by the SEC on October 23, 2003, left several questions unanswered and was asking for too many comments and public feedback. The Business Roundtable at this point in time requested that the commenting period be extended by 60 days in order for them to collect as much information on the topic as possible. They cited that “the Commission should extend the comment period for the proposed rules regarding security holder director nominations. The proposing release suggests that the Commission has been evaluating a proposal of this nature periodically for more than 60 years; there would be no harm, and would be great public benefit, in allowing the public an additional 60 days to respond.” (Proposed Rules Regarding Security Holder Director Nominations, 68 Fed. Reg. 60,784 (Release No. 34-48626, 2002, October 23); (File No. S7-19-03).

On March 10th, 2004 Franklin D. Raines, the Co-Chairman of the Business Roundtable who has recently stepped down as the Chairman and CEO of Fannie Mae amid a storm of scandals, followed up with another open letter to the SEC. The letter stated the

organizations support and efforts in corporate governance affairs but also stated “we cannot support the proposed rules for a number of reasons. First, the proposed rules would apply to all public companies, contrary to the Commission’s stated goal of targeting a limited number of unresponsive companies. Second, the rules would enable a small number of shareholders with narrow agendas to impose costs on all shareholders. Third, the election contests that would come about under the proposed rules would divert the time and energies of corporate management from the business of running the company. Fourth, the election of directors under the proposal would threaten the cohesion that is indispensable to an effective board of directors. Finally, the proposed rules exceed the Commission’s authority and improperly intrude on the role of the states in this area.” (“The Application of the Proposal to Companies and Investors“ Panel Roundtable Regarding Proposed Rules Relating to Security Holder Director Nominations File No. S7-19-03). After all, the main concern for those on the corporate side of the issue is that the proposed rule would give too much power to narrow interest groups and will leave shareholders open to the negative consequences of these narrow interest groups. Franklin D. Raines goes on to state in his letter to the SEC that “Notably, several groups already have acknowledged that they would use the proposed rules as leverage to advance special interests that are unrelated to the proxy process.” He also goes on to explain that “In addition to occurring far more frequently than the Commission has projected, election contests would impose greater costs than the Commission has recognized. A November 2003 survey conducted by the Business Roundtable suggests that each affected company would spend an average of \$700,000 per year under the

proposed rules. By contrast, the Commission has estimated the rules' total cost at a mere \$4,200 per company."

The Wall Street Journal had reported that a compromise to the proposal was in the works back in the spring of 2004. According to publication, "While details of the proposal are still being worked out, it would essentially allow shareholders to sit down with a company and agree on a person to replace a director who has been targeted by investors for removal. If an agreement couldn't be reached, shareholders would likely gain the right to nominate their own director the following year. The proposal may allow companies to bypass negotiating with investors if they agree to shareholder-backed nominees on the ballot the following year."

On August 12th, 2004 Stephen M. Bainbridge of the publication Tech Central Station offered his opinions on the proposed ruling and shed his views in a negative light. He asks several rhetorical questions to the proposed compromise. The first being: Which shareholders get to sit down with management? There are could be several million shareholders for some or any publicly traded company. If it is a select few, then how do we ensure that the interests of the few coincide with those of the many? He goes on to ask "How, for example, do we ensure that unions don't use the shareholder access rule for leverage in collective bargaining (as they often use the current shareholder proposal rule?) or that the social activists don't use it to promote a social agenda at odds with the profit-maximization interests of most shareholders"? (The SEC: From Bad to Worse, 2004, August 12).

Bainbridge also goes on to state, “if adopted, the proposal may deter qualified individuals from being willing to serve as a member of a board. There will be significant risk that activist investors will use the rule frequently and at numerous companies. Unlike the current system, under the rule, the activists will be targeting individual investors. Who would want to serve as a director if there is a significant risk one might be signaled out for a smear campaign by unhappy investors?” (The SEC: From Bad to Worse, 2004, August 12).

On December 22, 2003, C.R. Cloutier the Chairman of the Independent Community Bankers of America offered the organizations feelings on the topic of shareholder access in an open letter to the SEC. He stated, “ICBA opposes these proposed rules for a number of reasons. First, banks are still in the process of complying with all the SEC regulations issued under the Sarbanes-Oxley Act of 2002 and the new listing requirements recently issued by the stock exchanges. They are still drafting committee charters and reconfiguring their boards and committees to meet the independence requirements. These new additional proposed requirements will only add to the substantial regulatory burden that public companies are currently experiencing. The SEC should defer action on these proposals until companies have had a chance comply with the new listing standards and the rules under Sarbanes-Oxley.” He went on to comment that ‘we question whether it is good corporate governance to require companies to include shareholder nominees in their proxy materials. Directors have a fiduciary interest to serve the shareholders and therefore should have free access to the proxy statement to nominate persons that they believe will serve the best interests of all shareholders.’ The

organization believes that there are already procedures in place for shareholder groups to nominate directors and wage election contests. “Allowing shareholders access to the proxy statement only encourages contests between directors and shareholder groups and will result in boards that are not accountable to all shareholders.” Cloutier also notes that another reason they are against the proposed rule is that it is hard enough to attract qualified directors. “These proposed rules will make it even more difficult. Directors nominated by the company will become less interested in serving in that capacity if their boards become more adversarial and elections will become more contested.” Les Greenberg, the Chairman of the Committee of Concerned Shareholders, feels that “Determining who is and is not ‘qualified’ should be a decision for the shareholders, the corporate owners.” Greenberg also stated in an interview with CorpGov.net on June 6, 2003, that, “In my opinion, incumbent Directors and Management will always find a way to determine that an outsider candidate is not ‘qualified’.” Greenberg went on to comment that only verifiable criteria such as advanced degrees, etc. should be used to determine qualifications.

There are also political questions that will be evident if this ruling is approved. The election of a shareholder-approved director may cause friction and animosity with the existing board members, which would have a highly disruptive effect on the board’s decision-making processes. Granted, some companies may benefit from the presence of skeptical outsider viewpoints. It has been known that in some cases that management tends to hold back certain information to boards that have shareholder friendly or appointed members in fear that these members may use confidential information for

improper purposes. C.R. Cloutier the Chairman of the Independent Community Bankers of America has stated that “institutional shareholders most likely to use these new proposed election contest rules will be the labor unions and public pension funds that have interests and agendas that often are different from the company's. Directors who are nominated by these special interest groups will end up politicizing the board and impeding the board's proper function.” Stephen Bainbridge, a UCLA law professor, has stated “you cannot run a corporation by consensus“ and that “the new rules transfer internal decision-making to external decision-making“, potentially paralyzing directors forced to always look over their shoulders. With all of these following points being made one could argue that ineffective governance could a direct result of this ruling. This was expressed by the SEC republican commissioner Cynthia Glassman back in October of 2003 when she stated that “Even though our intentions are good,... the consequences of being wrong could be very serious“. Mr. Bainbridge has stated that if the SEC’s chairman William Donaldson’s two republican commissioner’s (Glassman and Atkins) “cannot kill the proposal, they should at the very least use it to emasculate the rule so that it does as little damage to corporate governance as possible“.

Steven Bainbridge also has stated that,“ a proponent of Rule 14a-11 likely would respond that the rule does not give shareholders the power to reverse board decisions, but only a power to replace one board member. Fair enough, but there are sound reasons to believe that Rule 14a-11 would lead to worse rather than better corporate governance. The problem is that introduction of a shareholder representative is likely to trigger a reduction in board effectiveness.“ Some opponents are saying that there is a risk that

companies will form "friendly" nominating groups to ensure that a candidate of the company's choice is nominated through any new shareholder access rule.

On October 3, 2003 a symposium on shareholder access to the ballot was held at Harvard Law School. This symposium brought together SEC officials, CEO's, directors, institutional investors, money managers, shareholder activists, lawyers, judges, academics, and others to discuss the subject of shareholder proxy access from a wide range of perspectives. The first part of this session focused in on the pros and cons of shareholder access. This symposium was moderated by Mark Rowe of Harvard Law School and contained the input of several leading authorities. One of the first commenters on the subject was Steven Rosenbaum who stated that the issue is not about "whether shareholders have the right to nominate, or put forward director nominations. They do in most every jurisdiction, and we obviously don't have any problem with that." He explained that the real issue is really about election contests. "The basic point is that people can run election contests now. They do run election contests now." There were about 40-election contest in 2003 and one of the main concerns is that this ruling may open the door for many more than this. Basically, the optimum number is about where it was in 2003 according to Rosenbaum. "Is it a good idea to have more election contests"?

Rosenbaum went on to expand his view of the proposed rule by saying "at least in the near-term, this will primarily be used by more political institutions: the public pension funds and unions, who really have other motives for using it. The institutions that really are focused on improving the economics of the corporation have better ways and better avenues to provide their input into the corporation than a public, adversarial proxy

contest. And they've been using those avenues." He went on to explain that, "the responsiveness of boards and managers to investor input has grown quite a bit, I think for the better. That should be allowed to continue without creating this politicized and adversarial process that will result from encouraging more election contests."

In addition to Steven Rosenbaum, Martin Lipton also had a negative opinion of shareholder access when discussed at the Harvard Law School symposium. He explained "I have a real issue here, and it is one of bending the will of management to that of the shareholders, and just how's that going to be accomplished." He went on to comment on how directors today are very concerned with the input of shareholders and of their reputations as a director. "Directors today are very concerned with the about the reaction of shareholders, and much more reluctant to accept advice of management, the advice of lawyers, even the advice of totally independent lawyers who have no connection with the corporation." He stated that one of the first question asked when something is awry is "Is this time to throw a whole new regime into the picture?" He said that this is not necessarily the way to go and stated that "I'm not sure at all that passing to a potpourri of shareholders the ability to have that much influence on the board of directors and management of the corporation is going to be good for the business of the corporation and, accordingly, good for the economy of the county." "The cost of mounting a proxy fight is impossible for the small investor", according to Robert Howell, a visiting professor of finance at Dartmouth and co-founder of the Center for Corporate Change in Denver. He has stated that the "the system is effectively broke". "The system is really not conducive to the democratic process."

On March 11 of 2004 the U.S. Chamber of Commerce announced that if the SEC adopts the pending shareholder access proposal, they would bring suit challenging the SEC's authority to do so. It has been challenged by many parties that the SEC has a very limited authority over corporate governance and corporate governance related matters.

Finally, it has been claimed by many that shareholders have a short-term outlook and that their nominees may not guard the long-term interests of companies. They may focus on a specific current matter and once that matter is taken care of their attention could sway and become disruptive to the rest of the board. Also expressing their opposition to the proposed rule are the Financial Services Roundtable, America's Community Bankers and the Employment Policy Foundation.

Chapter 4

Proponents

For all those who oppose shareholder access there are just as many or more who are proponents of the idea. According to Howard Dean, if we want more and better jobs, a fair trade policy, better behavior by corporate leaders, more pay equity between those who work and those who lead and better corporate morals, we need to make that happen by opening the election process for directors of publicly owned corporations so investors can easily nominate and elect outside directors. Public ownership of companies should mean public majorities on the boards - in other words more outside directors that are not hand picked by CEOs. Dean is not the only politician that is known to support the proposed rule, as John Kerry generally supports the idea of proxy access. The upcoming presidential election will play a major role in the shaping of this idea as the elected

president would be responsible for naming the replacement of the SEC's chairman William Donaldson who may retire after next year. Donaldson and both of his Democratic commissioners, Roel Campos and Harvey Goldschmid, support the idea wholeheartedly.

Shareholder access has been touted as a low-cost way for shareholders to run alternate candidates for board positions. Currently, the only way investors can run their own candidate is to lead an expensive proxy contest, which can cost at least \$250,000 on average. Some of the main reasons why shareholders and activists say the current system stacks the deck against the shareholders include the view that the director-nomination process is management dominated. Management says most of the time that it will entertain or consider candidates suggested by shareholders, however, the proxy card will be full of the companies nominees. Another concern is that management has full access to the companies' coffers to run its own candidates and oppose shareholder initiatives and candidates. The cost of running a proxy contest is considerable, especially when you consider the fact that management can increase the cost commencing expensive litigation, running expensive print ads and initiating multiple mailings. Shareholders also have to keep any resolution to a limit of 500 words even though management's opposing statements have no limit.

One of the main proponents of the proposed rule is the American Federation of State, County and Municipal Employees (AFSCME). Led by Rich Ferlauto, the Director of Pension and Benefit Policy at AFSCME, the organization has been calling for increased activism for over two years now. On November 26, 2002 in a statement marked for

immediate release, AFSCME called on all “public employee pension funds to increase their level of activism immediately in response to a scandal-filled year on Wall Street.” In a letter to 150 public employee pension funds, which collectively hold approximately \$1 trillion in assets, AFSCME President Gerald W. McEntree urged support initiatives that would give shareholders access to corporate proxy statements in order to enhance their power to nominate and elect directors of their own choosing. McEntree also stated that, “excessive executive compensation, manipulates earnings, numerous accounting irregularities and the other scandals that have surfaced in the past year are just symptoms of the larger problem: shareholders have no real voice in the make up of corporate boards. Our proposals aim to change that.”

The American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) has also expressed its desire to have “shareholder access” adopted by the SEC. In a letter addressed to the Securities and Exchange Commission on May 15, 2003, Richard L. Trumka, the Secretary-Treasurer of the organization, petitioned to have comprehensive new rules to permit shareholder-nominated director candidates to appear in the corporate proxy statement and proxy card. In the open letter, Trumka expressed the organization’s concern that “incumbent directors can freely spend the corporate treasury to get re-elected while shareholders are forced to mount costly proxy contests that are difficult for particular investors to justify absent a battle for corporate control.” The AFL-CIO is the federation of America’s labor unions, representing 65 national and international unions and their membership of more than 13 million working women and men. Union members participate in the capital markets as individual investors and through a variety of benefit

plans with over \$5 trillion in assets. Union-sponsored pension plans account for \$400 billion of that amount. Trumka also stated that they “believe this is essential to repair what is now a badly compromised corporate election process”. This letter also stated the organizations belief that any new rule adopted should be a practical tool to enhance the ability of long-term shareholders to nominate and elect directors to represent their interests. They stated that these new rules should not provide a tool that can be used to facilitate low-cost hostile takeovers by short-term investors. Like many their concern lies in the fact that the current incumbent-dominated director election process leaves little opportunity for shareholders to hold directors accountable for failing to meet certain fundamental standards.

Another proponent of the “shareholder access” rule is the Christian Brothers Investment Services, Inc., a registered investment adviser that manages approximately \$3 billion for Catholic organizations seeking to combine faith and finance through responsible stewardship of Catholic assets. In a letter addressed to the SEC on June 13, 2003, Francis G. Coleman, the Executive Vice President stated that CBIS ”believes that access to the proxy provides us with a critical way to communicate the views and opinions of the shareholders we represent on a very wide range of issues that affect the long-term interests of all corporate shareholders and corporate stakeholders.“ Their concerns stem from the fact that “the current process puts much of the responsibility on Board selection in the hands of management.” This leaves such organizations and shareholders dependent on management in the process of nominating and selecting Board committees.

In 2003, Lucian Arye Bebchuk, released a paper titled “Shareholder Access to the Ballot”. The argument made in this paper is that providing shareholders access to the corporate ballot, would improve corporate governance. Bebchuk analyzes each of the objections that have been raised against shareholder access and concludes that none of them provide a strong basis for they view of opposition. It is in the author’s belief that the case for shareholder access is strong. Bebchuk suggests that “shareholder power to replace directors is supposed to be an important element of our corporate governance system, it is largely a myth.” (Shareholder Access to the Ballot, Page 2) By and large, directors who are nominated by the company run unopposed the majority of the time and their election are all but guaranteed.

Bebchuk says that “By making it unnecessary for shareholder nominees to incur the expenses of sending materials to shareholders and obtaining proxies for them, this access to the ‘proxy machinery’ would make it easier for shareholders to elect candidates other than those proposed by incumbent directors.” The proposal is a moderate advancement in the direction of invigorating elections. Lucian Arye Bebchuk suggests that, “stronger measures would be worthwhile adopting.” One of the main aspects that the author focuses on in this paper is the topic of a “triggering event” which the SEC has clearly defined. Bebchuk states that “requiring a triggering event would further moderate the effects of a shareholder access rule by limiting shareholder nominations to instances in which there is already strong evidence of widespread shareholder dissatisfaction. It would also provide boards with ample time to address shareholder concerns before shareholder nomination is made. ”

Such a “triggering event” requirement may make an access rule too weak in some cases. “Suppose that, shortly after the annual election of a given company, substantial shareholder dissatisfaction arose due to certain board actions or disclosures. In such a case, if a triggering event in the form of prior shareholder vote were required, it would take two years until a shareholder nominee could be elected to the board.” (Shareholder Access to the Ballot, Bebchuk, Page 4) Such a delay could significantly reduce the rules effectiveness. Bebchuk suggests that if “a triggering event were to be established, it would be worthwhile to provide a safety valve - allowing shareholder nomination even in the absence of a triggering if support for the nomination exceeds an ownership threshold that is significantly higher than the threshold for nominations following the occurrence of a triggering event.”

While the proposed SEC ruling has its fair share of proponents it also has many still suggesting that more needs to be done. Rich Ferlauto, the director of pension and benefit policy for the American Federation of State, County and Municipal Employees has stated that, “We think the current proposed rule is a very modest step that is designed to only go after boards that have failed in the minds of a significant number of shareholders.” “It’s a misnomer to call that proposal shareholder democracy in any sense”.

According to Pat McGurn, special counsel to proxy adviser Institutional Shareholder Services, “companies have been much more likely to enact shareholder proposals in the past year than they have in previous years.” Lucent Technologies for instance,

eliminated its staggered board structure on shareholder proposals urging the annual election of directors received a majority vote for three straight years. Likewise, Merck agreed to declassification of shareholders passed a proposal urging it to do so for five years running. “The real impact of ballot access – we’re already seeing it this proxy season,” McGurn stated, “anticipation of punishment is almost worse than the punishment itself.” Institutional Shareholder Services has come out and stated that they do support the proposal. They feel that “reform is needed to right a steeply tilted playing field, in which management and board incumbents dominate the elections process. Moreover, shareholder access will build on the Sarbanes-Oxley Act and the new corporate governance listing standards. While those reforms enhance boardroom oversight of management, ballot access will enable shareholders to hold boards of directors more accountable.” ISS (Institutional Shareholder Services) does feel that there should be changes made to the proposal. They feel that in urgent cases, shareholders need to respond right away to redress egregious problems, without waiting for the two-step process (triggering event and then nomination) to play out over two years or more. Therefore, they believe that shareholder or groups of shareholders who have significant, long-term stakes in the company should have the unfettered right to propose candidates even in the absence of a triggering event. ISS believes that the bar for unfettered authority should be set high. If the SEC keeps the current thresholds, then eligibility for the unfettered right to nominate a director should be set at 10 percent. They also recommend that the SEC adjust its thresholds to require 1 percent ownership to file a resolution calling for shareholder nominations; 3 percent ownership for the right to make

nominations after a triggering event; and 6 percent ownership for the unfettered right to nominate director candidates.

Even without the right to proxy access, shareholders have other options. Those dissatisfied with management can simply sell their shares or mount a proxy contest, offering a competing line of directors against the incumbent board on a separate ballot. Both alternatives have their problems. Selling shares runs counter to the advice that financial planners preach. They urge investors to hold shares for the long term in order to deal with the markets ups-and-downs.

In an article penned in early 2003 by Delaware Chancery Court Chancellor William B. Chandler II and Vice Chancellor Leo E. Strine Jr., the pair described the election process as a “forgotten element to reform.” (The New Federalism of the American Corporate Governance System: Preliminary Reflections of Two Residents of One Small State, 2003, February 26). In pointed language, they called for the examination of the “management-biased corporate election system” and suggested that policymakers take up the issue of requiring equal access to “the proxy machinery between incumbents and insurgents with significant nominating support.” In 2003, Citigroup Inc. mounted a successful effort to block a binding shareholder proposal that, if implemented, would have permitted a shareholder or group of shareholders owning at least 3% of Citigroup’s shares to include a director nominee on the company’s proxy card. Citigroup’s winning argument to staff at the Securities and Exchange Commission was that proxy rules prohibit proposals that result in contested elections of directors. This proposal was one of a dozen binding and

non-binding proposals sent by the American Federation of State, County and Municipal Employees. All of the other companies had also asked the SEC to block the proposals.

Despite intense corporate lobbying, a Securities and Exchange Commission proposal to give shareholder director nominees a place on the corporate ballot is still alive. "I don't think it's dead," said Martin Dunn, deputy director of the SEC's division of corporation finance in an article written on July 8, 2004 (Dow Jones Newswire, Proxy-Access Proposal For Holder Nominees Is Still Alive). Dunn also stated "I think it's a work in progress" as he addressed the American Society of Corporate Secretaries' annual conference, in response to a question about the status of the proposed rule in light of speculation it was "dead" until after the presidential election - which would make it nearly impossible to get a rule in place for next year's annual-meeting proxy season. The corporate secretaries group, for its part, worries about unintended consequences, such as the possibility the relationship between investors and directors would become even more adversarial because the system would lead to a contested election.

Individual investors, otherwise known as retail investors are also, for the most part large proponents of the proposed shareholder access rule. Retail investors are concerned about who exactly is serving on the board of directors of the company that they have invested their money in. An example of this can be seen in a letter written by Deborah Yost, an individual investor from Lincoln, Nebraska to Jonathan G. Katz of the Securities and Exchange Commission on 09/17/03. Yost also went on to add that the proposed rule

should be reformatted to take the interests of the retail investor into account more. The letter reads as follows:

Dear Secretary Katz,

As an individual investor, I am submitting comments regarding the proposed rule on shareholder proxy access and the ability of investors to better nominate candidates for corporate boards. I urge the SEC to support greater democracy in the corporate elections process, and to vigorously support investors' rights to nominate legitimate candidates for company boards, and to do so through the company's proxy statement. For years, directors have failed to serve shareowners well in their role as investor representatives at public corporations, and it is time for this faulty governance system to be reformed. The three-year wave of corporate scandals and the continued excesses of executive pay only highlight the flaws in allowing incumbent boards to hand-pick director candidates.

I am concerned with what I've seen in the proposed rule. The rule should go much further in providing investors with strengthened rights regarding the nominations process. I oppose the "triggering events" described in the proposal. Put forward by opponents of shareholder access earlier this summer, triggers have no place in building more democratic board elections. The new rule must provide investors, large and small, with greater reins over the boards that represent them-if for nothing else but to pressure directors to clean up conflicts of interest.

The rule must provide fair and robust mechanisms for company owners to place highly qualified and truly independent people on the proxy ballot. Only then can shareholders effectively hold individual board members accountable for their actions. This proposal puts enough hurdles in front of shareholders that the new rule barely improves upon the current process-that of individual investors spending hundreds of thousands of dollars of their own money to run a single candidate for the board, which is then undermined by executives spending endlessly from the corporate treasury (investors' monies) to counter that candidate.

What we currently have in no way resembles an open, democratic election of directors. The triggers proposed in the rule make it even less so. Having direct access to the proxy without barriers or triggers seems a modest request, given that few investors would use their rights to nominate unless they felt a board and corporate executives were grossly mismanaging a corporation. There's also the burden of winning more support for an investor candidate than candidates proposed by management. It's just too much effort to find qualified candidates (under increasingly stringent rules of independence) and win majority support unless a company has failed its investors.

Until corporate governance is strengthened to make directors more accountable to shareholders, we'll continue having trouble regaining investors' confidence in markets and corporate management. Allowing the owners of companies to have a realistic say in the membership of the board is one of the best ways to curb the excesses and reduce the conflicts of interest that lead to corporate corruption. Thank you for this opportunity to offer my strong support for this historic proposal. I encourage the Commission to adopt final rules that are responsive to my concerns.

Sincerely,

Deborah Yost

770 N Cotner Blvd Suite 208

Lincoln, NE 68505

Although the shareholder access rules are not yet effective and are likely to change to some extent if and when it is finally implemented, companies need to consider the possible long-term implications of the proposed rule. According to experts, giving investors access to the proxy could drive up costs in several different ways. Tabulating votes for and against various directors, for example, could draw out and complicate annual meetings if this ruling is approved. Companies might need to hire more investor-relations staff, or need more legal advice on when to fight a proxy war. And there will be

additional printing, logistic and other costs simply to inform shareholders of the competing resolutions. In an article written by Matt Kelly for Compliance Week, an example of how expensive proxy fights can get was highlighted, “Roy Disney spent more than \$2 million in his battle to oust Eisner; Texas investor Sam Wyly reportedly spent more than \$10 million in his 2001 battle for control of Computer Associates Inc.—which he lost—only to see CA’s top executives resign this summer amid an SEC probe.” (Compliance Week, 2004, October 12).

Chapter 5

Impact on Financial Institutions

Another question is how financial institutions would react to proxy access. Activist institutions such as CalPERS, which heartily endorses proxy access, would certainly like to have such a powerful tool at their disposal; nine state treasurers sent a letter to the SEC in July of 2004 urging the agency not to weaken its proposal. Mutual funds, however, typically do much less jawboning with their portfolio companies, and simply sell their holdings if they disapprove of management. Elizabeth Saunders at Ashton Partners believes large players like Fidelity Investments or Janus Funds “won’t call a CFO and tell him to change his errant ways.” Instead, Saunders suspects, mutual funds will withhold support for management during a vote and then suddenly side with other shareholders who field their own proposals. And most observers expect institutions would tread carefully around proxy access. Should investors file a proposal and lose, management could potentially use the defeat as an affirmation of their own plans.

An important issue that needs to be evaluated is whether shareholders are permitted to nominate directors. The proposed rule for shareholder access would be available if passed unless state law permits companies incorporate in that state to prohibit nominations of directors by the shareholder community through provisions in the companies' charter or bylaws. Companies should review these documents and state law to determine whether the proposed rule would be applicable to them. Companies should also consider how provisions regarding director nominations, including advanced notice requirements and director qualifications, can be reconciled with the proposed SEC rules. Even if state law permits limitations on shareholder nominees for directors, companies need to be sensitive to the board's fiduciary duties and the traditional enhanced scrutiny by courts in matters affecting the shareholder base.

Institutional Shareholder Services believes that if the proposed rule is adopted it would improve corporate governance greatly. The rule promises to have a dramatic impact, focusing shareholder energy and producing positive outcomes. Triggers are supposed to transform vote-no campaigns at recalcitrant companies from the symbolic to the critical. Corporations will gain new incentives to remove dead wood from their boards, and they are likely to prove more responsive on non-binding proposals. By improving corporate governance, shareholder access will help restore investor confidence.

The proposed shareholder access rule will most likely put greater focus and scrutiny on the way companies handle the proxy process and communicate with shareholders.

Companies may want to take the time to review their practices against corporate governance rating systems that influence the way institutional shareholders use their

voting power, as well as their lines of communications with influential shareholders.

Companies may also want to review their “poison pill” rights plan, including the trigger thresholds and beneficial ownership language, to assess the implications of the shareholder access rule. Investors may eventually pressure companies to amend these provisions so that nominating shareholder groups do not trigger the pill. State anti-takeover law and charter provisions tied to beneficial ownership will also need to be analyzed.

The media continues to run articles containing rumors of where the SEC is headed with the proposed rule. On May 7, 2004, the New York Times ran a controversial column authored by Floyd Norris, which indicated, that the withhold vote trigger would be raised to 50% in exchange for not counting broker non-votes. Also, on May 10th, 2004 the Wall Street Journal ran an article, which stated that the SEC was going to drop its 1% opt-in trigger in exchange for speeding up the ability for investors to force a contested election. The article also noted that the SEC was considering the Business Roundtable’s suggestion to allow companies to implement a “cure” after a triggering event. Basically, the company would be able to remove one or more directors that received high, withheld votes. These articles come on the heels of the MBNA Corporation’s annual meeting at which a TIAA-CREF shareholder proposal received a majority vote regarding the appointment of additional directors without personal or financial ties to senior management. Two of the MBNA directors received more than 40% withheld vote due to their ties with management.

Chapter 6

Political Significance

In a paper published in October of 2004, the Public Citizen's Congress Watch, one of five divisions of the Public Citizen, examined what the role the Bush administration has played and will continue to play on the road to getting the shareholder access rule adopted. The Public Citizen's Congress Watch is a 160,000 member non-profit organization based in Washington, D.C. They represent consumer interests through lobbying, litigation, research and public education. The paper states that along with the Business Roundtable and the U.S. Chamber of Commerce, the Bush Administration has pressured the SEC to back down their stance on the shareholder access rule. The Business Roundtable also pressured the White House, Treasury Department, Commerce Department and Congress to stop forward movement of the shareholder access rule.

Federal lobbying disclosure forms show that the Business Roundtable spent more than \$12.8 million lobbying the federal government on the shareholder access rule and other issues in 2003 and the first half of 2004. "Five weeks after the shareholder access rule was proposed by the SEC, the Roundtable also tried to enlist the Office of Management and Budget in stopping the rule." (Public Citizen's Congress Watch, October 2004).

Multiple SEC officials have told four separate reporters that Treasury Secretary John Snow let it be known that the White House does not want the rule to proceed. One of the main reasons why the Bush Administration is opposed to the proxy access ruling is that some of the administration's largest financial backers are corporations that would be affected if it were passed. According to the Public Citizen, certain oppositional,

“companies and their employees contributed \$55.5 million to Bush’s campaigns, the Bush-Cheney Inaugural Committee and the Republican National Convention during the past 3 election cycles.”

“After vowing in May to pass the rule even if it meant splitting the commission, by June Donaldson gave the first indications that he was backing off” (Public Citizen’s Congress Watch, October 2004). An SEC official, speaking on the condition of anonymity, explained to a Wall Street Journal reporter that William Donaldson, “wants a compromise and he wants some access to be accomplished.” Donaldson has reportedly made one large concession to the Business Roundtable. According to the SEC, Donaldson has tentatively agreed to drop the “trigger” that would allow shareholders to grant themselves access to the proxy statement with a majority vote at a corporation’s annual meeting. There are also two other concessions that Donaldson could be possibly willing to abide by in regards to proxy access. The first one would increase the “threshold for triggering shareholder access by increasing the number of “no” votes needed against a board-nominated director from 35 percent to 50 percent” (Public Citizen’s Congress Watch, October 2004). The other concession would be to allow the board the chance at the circumvention of “no” votes. If a board-nominated director received more than the specified level of “no” votes, the board would be allowed to withdraw that nominee and put his replacement up for a vote the following year. Then, only if that nominee received the specified level of “no” votes, would shareholder access to the ballot be triggered. Shareholder access proponents say this alternative is not adequate because it would permit a three-year delay before investors could nominate their

candidate. "That won't provide a real improvement to shareholders," Rich Ferlauto, the Director of Pension and Benefit Policy at AFSCME said. Others, including Joseph Grundfest, a Stanford law professor and former SEC commissioner, have proposed another option: majority elections for directors. If directors are required to receive an affirmative majority vote from shareholders, companies will have a strong incentive to consult with investors on nominees, Grundfest has said. "Clearly, there will be some sort of compromise." What that compromise will be and what benefits it will offer remains to be seen.

The lack of movement and the delay in moving forward on the proposed rule has infuriated Democratic SEC Commissioner Harvey J. Goldschmid, who cited the lack of progress during a speech he gave to the Investor Responsibility Research Center on October 8, 2004. He stated that "the commission's inaction to this point has made it a safer world for a small minority of lazy, inefficient, grossly overpaid and wrongheaded CEO's" (Public Citizen's Congress Watch, October 2004). Goldschmid went on to comment, "So far, in my view, the worst instincts of the CEO community have triumphed" (Public Citizen's Congress Watch, October 2004). These comments came after months of negotiations with the SEC and its chair William Donaldson. Donaldson has recently commented on the further ruling delay by saying "On this issue the commission has done nothing for 40 years" (Public Citizen's Congress Watch, October 2004). With the shareholder access proposal basically stalled at this point, a coalition of CalPERS (California Public Employees Retirement System, New York State Common Retirement Fund, AFSCME and Illinois State Board of Investments have submitted

shareholder proposals to both Walt Disney and Halliburton to give shareholders the right to nominate up to two directors. Last year, the AFSCME submitted a similar proposal to Marsh & McLennan, but the proposal was withdrawn after the company appointed a former federal prosecutor to its board of directors.

Chapter 6

Conclusion

After the re-election of President George W. Bush in November of 2004 the issue of proxy access may be stalled. The Bush administration may now try and bury the proposed proxy access proposal. A Kerry administration might have named advocate, Harvey Goldschmid as SEC Chairman. However, Goldschmid might leave his SEC commissioner post by next August. Current SEC chair William Donaldson – once a proxy access proponent, today an agnostic – may also retire soon, giving the White House and the heavily weighted Republican Congress power to install a new leader committed to dumping the idea or exploring alternatives. Although the agency is officially independent, the SEC chair acknowledges that he does serve at the pleasure of the President. Donaldson, however, may seek to craft a weakened compromise in the period before the new Congress takes office in January of 2005. Further, expect the SEC staff to side more with executives trying to bat dissident shareholder proposals at companies.

With the current status of shareholder access being in a holding pattern there is every possibility that a decision will be postponed until late spring at the earliest. As each

interested party continues to mediate and lobby with their own specified versions, the conclusion to this much-debated proposal may end up in a totally different model than it is currently assembled. The debate will continue to focus on those in favor, who believe that greater access will result in a more structured system where accountability will be enhanced. The opposition will continue to express their belief that too much power in the shareholders hands may result in narrow interest groups gaining too much control resulting in negative consequences.

The results of personal interviews with individuals who each have their own perspectives on the issue and through a survey of financial institutions, show that some form of shareholder proxy access needs to be implemented and the majority of those spoken to would definitely support the proposed idea in one form or another. Of the 30 financial institutions that were surveyed the majority indicated that they would be in favor of some type of shareholder access rule but would need more time to study and learn about the issue. Of the 20 individuals contacted for personal interviews seven responded with succinct answers while the majority of those contacted were apprehensive in commenting at all or before learning more about the issue.

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Chapter 7

Personal Interviews

Law Professor from Widener College:

1. In your opinion should the Shareholder Access rule be approved by the SEC?

No.

2. How should the proposed rule work if adopted?

Not sure I understand this question. It may be responsive to observe, however, that if the rule is adopted it will be far more likely to be used as a negotiating chip than as a way to nominate actual director candidates.

3. How much at this point in time do feel Shareholder Access is on the minds of company executives?

At this point, not much.

4. Will this rule cause considerable costs in regards to implementation?

Yes. It would invest withhold campaigns with much greater significance, resulting in greater expense associated with otherwise ordinary annual meetings.

5. Do you feel that if adopted this rule could cause political strife on company boards?

“Could” cause strife, yes; likely to cause strife, no – because I doubt that the rule would result in very many actual competing nominations.

6. Will there be an effective way to limit the number of proposed nominees?

As a practical matter, I doubt that very many shareholders will actually take advantage of the rule.

7. What are the chances that this rule or a version of this rule will be adopted? Especially after the Presidential election?

I have no special or inside knowledge about this issue, but what I understand is that the rule is essentially dead in the water and unlikely to be propelled forward. The election results may have contributed to this situation, although it is unclear that a different election result would have had any different consequence as far as the rule is concerned.

Response from individual at the American Society of Corporate Secretaries:

1. In your opinion should the Shareholder Access rule be approved by the SEC?

I hate to answer your question with a question, but which form of the rule? The original version proposed access to the following year's proxy be granted to shareholders if the board's slate of nominees failed to garner 35% of the votes cast. Compromise versions have suggested that the threshold for access should be 50% (considered unreachable by many) and that there needs to be a self-curing provision. (Self-curing would allow a board to "fix" the situation and obviate the need for shareholder access – action such as splitting a Chair/CEO or de-classifying a board.)

Personally, I think a 35% threshold with a self-curing provision would be a good compromise.

2. How should the proposed rule work if adopted?

I'm not sure what formal processes should be adopted to ensure shareholder access. Since shareholder votes at annual meetings are a matter of public record, it's not as if these things can be hidden. Once the threshold was met, proxy access would have to be granted or a self-cure would have to have been made.

3. How much at this point in time do you feel Shareholder Access is on the minds of company executives?

At a company like Disney, probably a lot. At "quieter" companies, not much.

4. Will this rule cause considerable costs in regards to implementation?

It will cause some kind of implementation costs, and companies are sure to label whatever costs are incurred as "considerable."

5. Do you feel that if adopted this rule could cause political strife on company boards?

Maybe at first. But directors are sharp people — they wouldn't have gotten seats at the board table if they were dummies — they'll adjust. Within a few years of adoption, things will run smoothly. After all, most companies don't have the kind of strife among shareholders that is so prevalent at places like Disney. At a company with "happy" shareholders, the adoption of the rule would have minimal impact.

6. Will there be an effective way to limit the number of proposed nominees?

I have no idea. This is really a follow-up to your Question 2.

7. What are the chances that this rule or a version of this rule will be adopted? Especially since the Presidential election has been decided?

The Republican SEC commissioners are the ones who've opposed the rule as originally proposed — with President Bush having been re-elected they come from a position of strength in arguing for the compromises they want. The Democratic commissioners want to stick close to the original proposal,

and Chairman Donaldson seems unwilling to break the tie. I think it's highly likely that the 2005 Proxy Season (roughly February through April) will not see the rule adopted.

Response from individual at the State of Wisconsin Investment Board:

1. In your opinion should the Shareholder Access rule be approved by the SEC?

Yes. Shareholders should be able to communicate with the officers and directors at every public company. The directors need to be accountable to the shareholders, but in order to be responsible, they need to hear from the shareholders. Shareholders would also benefit in conversing with the directors and understanding the issues.

2. How should the proposed rule work if adopted?

Good question. Shareholders should be able to nominate candidates, but they also need to be cognizant of the individuals they request. We do not want to see the business "good old boys" changed into the institutions "good old boys." Currently the search firms look for specific criteria suggested by the companies. Perhaps the expansion of criteria would be beneficial ie. search firms look at CEO/CFO/CAO perhaps look at the qualifications more so than the title. As for the time limit, it seems that two years after the fact is far too long of a period to first be able to nominate a candidate for election. There needs to be something more direct and accessible.

3. How much at this point in time do feel Shareholder Access is on the minds of company executives?

Company executives are thinking about this issue. They do not want this issue to be approved by the SEC , thus are spending money and time to create ways to block the passage of access to the proxy.

4. Will this rule cause considerable costs in regards to implementation?

No.

5. Do you feel that if adopted this rule could cause political strife on company boards?

Political strife can be caused regardless of this particular rule. To some degree, there will always be the underlining "it's political" theme. However, if the process to address the issue is handled properly there should not be any additional mode of politics. Again, the search firms could increase their databases to include experiences as more important than titles (we all know that several people without the CEO CFO etc title are very capable of completing those duties).

6. Will there be an effective way to limit the number of proposed nominees?

I don't think there will be an over abundance of nominees. This is a process that is going to take a bit of time to build. The search firms will need to expand their databases, new director candidates may be hesitate to go to a board that is in turmoil, lots of factors play into the decision of whether or not to become a director. Additionally, while there are people out there whom are capable of the responsibilities, they may not be running to finish line to compete.

7. What are the chances that this rule or a version of this rule will be adopted? Especially since the Presidential election has been decided?

The push by large institutional investors to is adopt this rule. With the wherewithal of the public pension funds and the combined efforts of the funds, it seems as though it will pass. Another clue to passage would be the energy put forth by public corporations to block the passage. If the companies were not worried about this rule, they would not be taking the extra time and energy to fight it.

Response from individual at the National Association of Corporate Directors:

1. In your opinion should the Shareholder Access rule be approved by the SEC?

No. Before passing such a rule, the SEC should give the recent governance reforms (such as the relatively new SEC rule re nominating committees) a chance to operate.

2. How should the proposed rule work if adopted?

The rule contains a detailed description of how it would work.

3. How much at this point in time do feel Shareholder Access is on the minds of company executives?

It is not a management issue. However, it is very much on the minds of the members of board nominating committees.

4. Will this rule cause considerable costs in regards to implementation?

We have no comment on the cost issue.

5. Do you feel that if adopted this rule could cause political strife on company boards?

No, it would not cause political strife within the boardroom. However, in some circumstances, the rule could be a distraction to the work of nominating committees.

6. Will there be an effective way to limit the number of proposed nominees?

The rule contains provisions that if followed would curb the number of proposed nominees.

7. What are the chances that this rule or a version of this rule will be adopted? Especially since the Presidential election has been decided?

As we understand it, chances are 50 - 50, depending on how the chairman votes. We are currently looking into this matter. Please alert us if you hear anything.

Response from individual at Christian Brothers Investment Services:

1. In your opinion should the Shareholder Access rule be approved by the SEC?

We support the principle of shareholder nominees, though we have some differences with the proposal as written

2. How should the proposed rule work if adopted?

We believe that the proposal should offer ballot access to any shareholder that can gain the support of a majority of fellow shareholders, with reasonable safeguards to ensure that companies are not overwhelmed.

3. How much at this point in time do feel Shareholder Access is on the minds of company executives?

I don't know.

4. Will this rule cause considerable costs in regards to implementation?

It should not, since the barriers to actually getting a shareholder nominee on the ballot are high enough to ensure that few companies see one.

5. Do you feel that if adopted this rule could cause political strife on company boards?

Not sure what is meant by "political strife." If it results in boards debating issues and hearing more points of view than before, it would achieve an important goal.

6. Will there be an effective way to limit the number of proposed nominees?

Well governed and well run companies will likely not face shareholder nominees, so the best way to limit the number will be to avoid the issues that result in nominees from being offered.

7. What are the chances that this rule or a version of this rule will be adopted? Especially since the Presidential election has been decided?

In the current political climate, I presume that the chances are smaller. However, it is not yet clear that the direction of the SEC will change because of the election.

Response from individual at California Public Employees Retirement System:

1. In your opinion should the Shareholder Access rule be approved by the SEC?

Yes

2. How should the proposed rule work if adopted?

See attached website but the current position by the SEC has changed since our comment letter was submitted.

3. How much at this point in time do feel Shareholder Access is on the minds of company executives?

Fair amount

4. Will this rule cause considerable costs in regards to implementation?

No

5. Do you feel that if adopted this rule could cause political strife on company boards?

Not likely

6. Will there be an effective way to limit the number of proposed nominees?

See attached website as this will highlight our stance on this question.

7. What are the chances that this rule or a version of this rule will be adopted? Especially since the Presidential election has been decided?

Pretty good.

Response from individual at Glass-Lewis & Co. LLC:

1. In your opinion should the Shareholder Access rule be approved by the SEC?

The SEC should put forth the rule. Shareholders should have access especially when the history of the board is unreceptive.

2. How should the proposed rule work if adopted?

The rule if adopted should have specific thresholds where it can reasonable be reached by shareholders. Currently the proposed triggers are fairly substantial and hard to meet by investors.

3. How much at this point in time do feel Shareholder Access is on the minds of company executives?

Company Executives are paying attention even though the rule has not passed yet. They will continue to track the developments of the rule.

4. Will this rule cause considerable costs in regards to implementation?

Since this rule will probably rarely be used as is since the triggers are substantial probably not. If so then the shareholders are the ones that most likely will incur the cost.

5. Do you feel that if adopted this rule could cause political strife on company boards?

Political Strife? Most likely not since shareholders are capable of determining who should run and who should not. Board members do not have to be best friends as harmony does not have to be the key. No matter what the different agendas will be shareholder interest should be protected.

6. Will there be an effective way to limit the number of proposed nominees?

Since the rule does have proposed limits in regards to ownership thresholds depending on the size of the board I do not see this being a major problem.

7. What are the chances that this rule or a version of this rule will be adopted? Especially since the Presidential election has been decided?

Not in the format that it is in now. With William Donaldson most likely on the way out if it is going to be adopted it will have to change shape. Depends on who will be elected as the SEC Commissioner to take Donaldson's place. It is a hard concept to oppose but the thresholds are so hard to meet.

Chapter 8

Results of Survey Question

What is your view on the SEC's proposed "Shareholder Access" rule and how, if at all, will it affect your voting patterns if it is passed by the SEC?

The majority of the responses received from those responsible for proxy voting at financial institutions stated that they would be in favor of some variation of the proposed rule. Most of the respondents did state that they would back such an idea but that they would have to learn more about the parameters of the proposed rule and its effect in its final form. Surprisingly, a large number of those polled stated that they did not know enough about the issue currently and would only learn more when the issue was resolved by all parties involved. The names of the financial institutions below have been changed for the purpose of this paper. The following is a sample of the responses that were received in response to the survey question:

1. XYZ Investments:

Would most likely support it depending on the parameters of the rule. If for example there were 50 independents running for 5 spots on a board they would not look favorable upon it. They need to learn more about the subject before they could comment any further.

2. ABC Investments:

Proxy Contact at the institution was not aware of the proposed Shareholder Access rule. Needs to read up upon once it is decided on.

3. DEF Investments:

We are waiting for the ruling to come out in order to make a decision.

4. MNP Investments:

We are one of the leading proponents of the proposed "Shareholder Access" rule. Very much in favor of it.

5. LTC Investments:

We would be pro- "Shareholder Access" because they are shareholder friendly when making their decisions. We need to learn more on the topic but does not see it being a problem unless the cost to the company would impede them from running the company smoothly. What is the incremental cost to the company?

6. KJH Investments:

We are definitely supportive of the shareholder access rule. It's hard to say if it will affect our voting patterns because there is currently so much that is left to be decided about the rule.

7. LCX Investments:

If approved we would definitely support the ruling.

8. JYU Investments:

We would definitely be in favor of the proposed ruling but are waiting on its final form to comment further.

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