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December 12, 2007

Ms. Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F. Street, N.E.
Washington, DC 20549-1090

**RE: File Nos. S7-16-07 & S7-17-07
Shareholder Proposals & Director Elections
Request for Additional Comment**

I. Introduction

I am writing in response to the Securities and Exchange Commission's (the "Commission") Release Numbers 34-56160 and 34-56161. These amendments would grant shareholders qualified access to company proxy material. I would like to thank the Commission for its attention to this matter, as shareholders' rights are a relevant, timely and important issue of national and international concern. Moreover, I applaud the Commission's efforts to clarify and refine its regulations concerning shareholder proposals. As I will discuss, I believe that this is an important step in creating a balance between a corporation's need for efficiency and a shareholder's right to be heard on several aspects of corporate decision making.

Currently, I am a third-year law student at Villanova University School of Law. While at Villanova, I have focused my studies on corporate and commercial law, concentrating on corporate governance and corporate transactions. Prior to my legal studies, I attended Elizabethtown College where I studied politics and business administration. This background provides me with a firm foundation on which to discuss the theoretical and practical implications of the proposed rules. Importantly, my opinions, analysis and recommendations are my own, and do not necessarily reflect the views of Villanova Law School, Villanova University or Elizabethtown College.

The underlying theme in this Comment is that corporate governance has become an increasingly important aspect of American corporate law. A corporation's board of directors is an isolated group of individuals that wields great power. Although a corporation is owned by its shareholders, directors appoint executives and managers who run the company on a daily basis. This corporate system creates a separation between ownership and control. Control is vested in the corporate board of directors, whereas ownership is spread across the world among shareholders. This situation results in agency and monitoring costs, and I believe it is imperative that shareholders have a mechanism with which to "check" directors' personal and financial interests, to ensure that these interests do not stray from maximizing shareholder value. One source of

director accountability is the shareholder proposal, wherein a shareholder can add a proposal to the *corporation's* proxy material, as opposed to raising the capital and spending the time to create and distribute separate proxy materials. As the Commission well knows, shareholder proposals are only effective if the proposals manage to dodge numerous exceptions codified in Rule 14a-8. In an attempt to find a balance, the Commission proposed action that would have opened the corporate proxy to shareholders in 2003. Although this effort failed to generate the requisite support, I applaud the Commission for returning to the issue.

In the pages that follow, I propose a compromise that will allow shareholders greater access to a corporation's proxy materials in various situations. My plan envisions increased corporate transparency with increased shareholder access to the corporate ballot in situations where the governing board is unresponsive to the shareholders. In Part II of this Comment, I summarize the Second Circuit's decision in *American Foundation*, a decision that has prompted the Commission's action. The decision provided the impetus for the Commission's pending response. In that respect, the Second Circuit plays a large role in the current debate, and its reasoning must be discussed to foster a complete understanding of the relevant issues raised by the Commission's proposed rules. Part II also details the salient features of the proposed rules in an effort to illustrate how the proposed actions work in unison to block shareholder access to the corporate ballot in most circumstances. Part III of this Comment focuses on whether the Commission's proposed actions are necessary by examining the status quo. Specifically, Part III illustrates the means by which shareholders can currently effect a change in a corporation's governing body. Finally, Part IV discusses my recommendations and my balanced solution to the current debate.

II. Predicates to the Commission's Proposed Actions

A. A Moment of Reflection: Corporate Scandals Prompt Intense Debate

Broadly speaking, the current proposal was prompted by the corporate scandals that ripped through the American capital markets at the turn of the century. It is important to take a moment to reflect on these events. Just a few years ago, Charlie Prestwood retired after thirty-three years of service at an Enron power-plant.¹ Charlie lived in a small rural home just north of Houston, and looked forward to living on his life savings. In the blink of an eye, over 1.3 million dollars in savings, along with the idea of a peaceful retirement evaporated. Because of the fraud perpetrated by the executives at Enron, Bill now struggles to recoup his losses, admitting that he will not live long enough to recover that which was stolen from him. Likewise, Bill Peterson worked at Enron.² While still employed, Bill contracted cancer and was undergoing treatment, which was

¹ Gina Sunseri, *Enron Victims Look Forward to Justice at Trial*, TIME, Jan 30, 2006, <http://abcnews.go.com/Business/LegalCenter/Story?id=1556334&page=1>.

² Gina Sunseri, *Enron Victims Look Forward to Justice at Trial*, TIME, Jan 30, 2006, <http://abcnews.go.com/Business/LegalCenter/Story?id=1556334&page=3> (different webpage, same story).

covered by his company-provided health insurance. As a result of the Enron scandal, Bill lost his job and his health insurance. His family was forced to sell their home and car, while living without amenities that many Americans consider to be necessary. Charlie Prestwood and Bill Peterson are not alone in the struggle to recoup losses caused by the Enron scandal.

Meanwhile, WorldCom's Dennis Kozlowski's *stole* millions of dollars so that he could support his lavish lifestyle on the shareholders' dime.³ Enron, WorldCom, Tyco – I could continue, but I find it unnecessary. Corporate scandals brought director oversight to the forefront of American policy. Some pundits argue that this type of behavior is the exception, and that most executives run companies so that shareholders benefit.⁴ I disagree with this premise. The actions taken by the “players” in these corporate scandals can be boiled down to a basic human flaw: greed. This is not something that simply can be washed away with empty rhetoric. Rather, it is an innumerable affliction that must be accounted for, prevented and remedied in situations where it emerges. Again, I applaud the Commission for taking action to prevent human vices from affecting and injuring hard-working American shareholders.

B. The Second Circuit Rebukes the Commission's Interpretation of 14a-8(i)(8), Opting for a “Shareholder Friendly” Interpretation

As the Commission admits, its current actions were specifically prompted by the Second Circuit's opinion in *American Federation v. American International Group*.⁵ In *American Federation*, the Second Circuit interpreted the text of 14a-8(i)(8), holding that a board of directors could not exclude a proxy-access bylaw amendment proposal from the corporation's proxy materials. In doing so, the Second Circuit adopted a narrow view of the shareholder proposal exclusion. If the decision were to stand, it would allow shareholders to propose by-law amendments that, if adopted, would grant shareholder access to company proxy materials for the purpose of nominating directors in future elections.

American Federation involved AFSCME, a large public service employee union, and AFSCME's pension plan. The pension plan had a large investment in American International Group (“AIG”). AFSCME sent a shareholder proposal to AIG that would require AIG, in various instances, to “publish the names of the shareholder-nominated

³ Krysten Crawford, *Ex-Tyco CEO Kozlowski Found Guilty*, June 21, 2005, http://money.cnn.com/2005/06/17/news/newsmakers/tyco_trialoutcome/index.htm.

⁴ Rose A. Zukin, *We Talk, You Listen: Should Shareholders' Voices Be Heard or Stifled When Nominating Directors? How the Proposed Shareholder Director Nomination Rule Will Contribute to Restoring Proper Corporate Governance*, 33 PEPP. L. REV. 937, 982 (2006) (noting director fraud may be uncharacteristic).

⁵ 462 F.3d 121 (2d Cir 2006). Specifically, the Commission notes that “to eliminate any uncertainty and confusion arising from the Second Circuit's decision, we are issuing this release to confirm the Commission's position that shareholder proposals that could result in an election may be excluded under Rule 14a-8(i)(8).” *Shareholder Proposals Relating to the Election of Directors*, 72 Fed. Reg. 43488 (proposed August 3, 2007) (to be codified at 17 C.F.R. pt. 240).

candidates *together* with any candidates nominated by AIG’s board of directors.”⁶ Not surprisingly, AIG sought to exclude the proposal and the Commission issued a no-action letter in response to the issue.

The Second Circuit began its analysis by looking at the purpose of the exclusion. Under the current exclusion, shareholders meeting certain baseline qualifications⁷ can place shareholder proposals in the corporation’s proxy materials unless, *inter alia*, the proposal “relates to an election for membership on the company’s board of directors or analogous governing body.”⁸ Parties to the litigation presented two possible interpretations: (1) the exclusion only applies to an actual, pending and targeted election; and (2) the exclusion applies to elections in general, in the present or future. The first would not apply to a by-law amendment, whereas, the second interpretation (offered by AIG) would encompass by-law amendments that would “relate” to future election contests.

Although this Commission included an interpretation of the provision in a petition to the Second Circuit, the Court instead relied on a past interpretation offered by the Commission when the rule was promulgated. The Court reasoned:

A proxy solicitation nominating a candidate for a specific election would be made for the purpose of opposing the company’s proxy solicitation and would therefore clearly trigger Rule 14a-12. . . . By contrast, a proxy solicitation seeking to add a proxy amendment to the corporate bylaws does not involve opposing solicitations dealing with the election or removal of directors, and therefore Rule 14a-12, or, equivalently, the former Rule 14a-11, would not apply to a proposal seeking to accomplish the same.⁹

As a result, the Court held that AIG’s board could not exclude the shareholder proposal in question because the proposal related to a by-law amendment, and not to a particular election.

In reaching its conclusion, the Second Circuit claimed that it was not engaged in choosing sides in the ongoing battle between shareholders and corporate directors.¹⁰ Nonetheless, a boilerplate disclaimer cannot disguise the obvious impact that the holding

⁶ *American Foundation*, 462 F.3d at 124 (discussing facts).

⁷ See 17 C.F.R. § 240.14a-8(b)(1) (“In order to be eligible to submit a proposal, [a shareholder] must have continuously held at least \$2,000 in market value, or 1% of the company’s securities entitled to be voted on the proposal at the meeting for at least one year by the date [of the proposal’s submission].” (emphasis added)).

⁸ *American Foundation*, 462 F.3d at 125.

⁹ *Id.* at 127-28.

¹⁰ See *id.* at 130 (“In deeming proxy access bylaw proposals non-excludable under Rule 14a-8(i)(8), we take no side in the policy debate regarding shareholder access to the corporate ballot.”).

would have if widely adopted. Moreover, it cannot disguise the overall tone of the decision, one that is receptive to the plight of dissatisfied and alienated shareholders.

C. The Commission Responds to the Second Circuit

Release Number 34-56161 (the “*American Foundation Rule*”)¹¹ is the Commission’s direct response to the *American Foundation* decision. The proposed rule contains an interpretational release and a proposed textual amendment to Rule 14a-8(i)(8). The interpretation attempts to clarify the Commission’s stance on the scope of the election exclusion. It provides the following clarifications:

- Rule 14a-8 was not promulgated to help shareholders circumvent proxy disclosure; and
- Therefore, the Commission interprets the Rule to allow directors to exclude shareholder proposals that (1) would result in an immediate election, *or* (2) would create procedures for shareholders to contest future elections.

Not surprisingly, the Commission interprets the Rule to avoid future application of the Second Circuit’s holding. It is clear that the Commission intends the exclusion to include proposals that would impact a present or future election contest. Additionally, the Commission has proposed an amendment. The amendment would alter the language of the rule to avoid future confusion by making the following change:

- The text would be amended to read: “If the proposal relates to a nomination or an election for membership on the company’s board of directors or analogous governing body *or a procedure for such nomination or election*[.]”

Release Number 34-56160 (the “Shareholder Access Rule”)¹² provides an exception to the general bar on shareholder access to the corporate ballot that would be created if the *American Foundation* Rule is promulgated. Theoretically, the Shareholder Access Rule would allow a shareholder (or a group of shareholders) access to a corporation’s proxy materials if the shareholders meet a litany of threshold requirements. Importantly, to gain access to the company’s ballot, shareholders must be eligible to file a Schedule 13G. Schedule 13G requires:

- Shareholders own five percent of the company’s securities;
- Shareholders report ownership; and
- Shareholders own the shares passively, and not for the purpose of prompting a change in the corporate governance.

¹¹ Shareholder Proposals Relating to the Election of Directors, 72 Fed. Reg. 43488 (proposed August 3, 2007) (to be codified at 17 C.F.R. pt. 240).

¹² Shareholder Proposals, 72 Fed. Reg. 43466, (proposed August 3, 2007) (to be codified at 17 C.F.R. pt. 240).

Further, the proposed rule would require that shareholders own the five-percent block for more than one year. Although the proposed rule includes amendments to disclosure documents, this Comment focuses on the threshold requirements, leaving the issue of actual disclosure to the experienced discretion of the Commission.

III. Time for a Change

Whenever an agency proposes a rule, the agency should focus its initial inquiry on whether the action is necessary. To shift the focus immediately to the validity of the new rules overlooks an initial question, namely, whether the proposed rule will combat a problem that actually needs combating. Here, the question becomes whether the shareholder franchise is in such a position that it needs the Commission to enact what it calls a “protective rule.” It is my opinion that, in the current corporate context, the Commission does need to protect the shareholder franchise.

A. The “Shareholder Franchise”

Delaware corporate common law defines the shareholder franchise as “the ideological underpinning upon which legitimacy of directorial power rests.”¹³ Assuming shareholders have purchased voting class shares, shareholders have the ability to “check” the directors through the powers of corporate democracy. If a board of directors is not acting in a manner that maximizes shareholder value, shareholders are able to rectify the situation. This, in essence, is a form of self-help.

This theoretical concept exists, in part, to combat the agency costs associated with director power. It is not inconceivable (*see, e.g.*, Enron and WorldCom.) that a director’s interests can stray from those of the shareholder. Because of this potential, corporate law creates a system through which directors are accountable to shareholders. Shareholders ultimately possess the power to remove directors. Moreover, because directors are given *broad* discretion when making corporate decisions under the contemporary standards of the business judgment rule, the ability of shareholders to remove directors becomes, in theory, a shareholder’s most effective tool. It protects shareholders from the entrenchment of directors that make unwise, but legal business decisions.

B. Removing a Director Under the “Shareholder Franchise” Theory

When viewed in a vacuum, this practical solution to a shareholder’s dissatisfaction would appear to be sufficient. However, although not illusory, this power is fairly toothless in most circumstances. Shareholders are currently limited to three tactical options.

1. Shareholders can attend the corporation’s shareholder meeting and nominate directors (this option is subject to some threshold limitations);

¹³ See Lucian A. Bebchuk, William J. Friedman, and Alicia Townsend Friedman, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 676 (2007) (citing *Blasius Indust. v. Atlas Corp.*, 564 A.2d 651, 659 (Del. Chan. 1988)).

2. Shareholders can nominate/recommend directors to the corporation's nominating committee; and
3. Any shareholder, regardless of ownership percentage, can conduct a proxy battle.¹⁴

Each of these options has serious practical limitations; as such, I will address each individually. First, it is true that shareholders can attend a shareholder meeting. Shareholders, in reality, do not attend shareholder meetings in large numbers. Corporations have shareholders who are geographically spread throughout the country (or the world). It is wholly impractical to expect a large percentage of shareholders to attend shareholder meetings. Rather, shareholders vote through proxies prior to the shareholder meeting. Consequently, any shareholder nomination made at the meeting would be ineffective as non-attending shareholders would have already submitted proxies to the corporation. For this reason, the first option is not savory.¹⁵

Second, shareholders can submit nominees to the corporation's nominating committee. A glaring problem engulfs this option. The board of directors appoints senior executives, a group that likely includes those persons who would sit on the nominating committee. Accordingly, the interests of the committee likely diverge from the shareholders' interests. Further, as a practical matter, nominating committees do not recommend shareholder nominees to the board of directors.¹⁶ The reason for this is that the board of directors has ultimate control over which persons are members of the nominating committee. To stay in favor with the members of the board, the nominating committee has an incentive to include persons on the nomination list that will appease the board. Even if the nominating committee places non-directors on the list of potential nominees, the current board of directors can decide to exclude these persons from the corporation's proxy.

Finally, shareholders can conduct proxy contests. When pressed with the issue of shareholder access, this solution is commonly cited by corporations and large law firms as an adequate remedial measure for shareholders. Again, this "remedial measure" falls well short of practical utility. First, the costs alone deter many shareholders from engaging in a proxy contest.¹⁷ Although the Commission may have alleviated some costs by promulgating e-disclosure rules, these rules will not eliminate legal or opportunity costs. A recent proxy contest cost one shareholder group over \$850,000 in legal fees and

¹⁴ See Elizabeth Cosenza, *The Holy Grail of Corporate Governance Reform: Independence or Democracy?*, 2007 B.Y.U. L. REV. 1, 43-44 (2007).

¹⁵ See Bebchuk, *supra* note 13 at 676-690; Cosenza, *supra* note 14 at 43 ("[S]hareholders generally vote through the grant of proxy before the annual meeting, thereby making it difficult for a candidate nominated at the meeting to garner sufficient support for election to the board.").

¹⁶ See Cosenza, *supra* note 14 at 43-44 (discussing practical limitations of proposing shareholder-backed nominees to nominating committee, and reasoning that "the nominating committee, under the supervision of management, rarely nominates those candidates recommended by the shareholders").

¹⁷ See *id.* at 43 ("The prohibitive cost of conducting an election contest, however, deters shareholders from pursuing this option.").

printing costs alone.¹⁸ As the chart below illustrates, shareholder proxy battles are limited in number. The chart encompasses 1996-2005.¹⁹

Table 1.1 – Contested Proxy Solicitations Generally

Year	Contested Solicitations
2005	24
2004	27
2003	37
2002	38
2001	40
2000	30
1999	30
1998	20
1997	29
1996	28
TOTAL	303

It is important to note that this chart includes *all* challenged proxy solicitations. It is not limited to proxy contests involving the election of directors. The following table focuses on the number of proxy battles involving contested elections.²⁰

Table 1.2 – Contested Director Elections

Year	Contested Solicitations	Contested Elections	Percentage
2005	24	10	41.6
2004	27	15	55.5
2003	37	16	43.2
2002	38	14	36.8
2001	40	16	40
2000	30	7	23.3
1999	30	13	43.3
1998	20	13	65
1997	29	5	17.2
1996	28	9	32.1
TOTAL	303	118	38.9

¹⁸ See *id.* at 683. The statistics were compiled by Georgeson Shareholder, a “well known proxy solicitation firm.” *Id.*

¹⁹ See *id.* (noting that although directorial challenges increased after several corporate scandals, the average per year increased nominally, from twelve per year at the turn of century to fourteen per year after scandals).

²⁰ See *id.* at 686.

As the chart indicates, only thirty-eight percent of the shareholder-initiated proxy contests relate to the election of directors. More importantly, the market capitalization of the corporation appears to be an important factor in the number of contested elections. Not surprisingly, shareholders of smaller companies are able to wage proxy campaigns more frequently. This is likely the product of several factors, including a more limited number of shareholders to solicit, greater intrinsic connection to the corporation and easier access to a corporation's board.

Finally, it is important to view these numbers in the context of success. Accordingly, the final chart reflects the success that shareholders have experienced when waging proxy contests in corporate elections.²¹

Table 1.3 – Implications of Market Capitalization and Shareholder Success

Market Capitalization	Contested Elections	Percentage of Total	Success Rates Intra-Class
0-50M	61	52%	38%
50-100M	20	17%	40%
100-200M	13	11%	46%
200M+	24	20%	33%

As the charts reflect, shareholder proxy battles are few, and, for the money and time spent, are not overwhelmingly successful. Overall, a slate of replacement directors was successful thirty-eight percent of the time. Accordingly, the third option available to shareholders provides inadequate protection. Shareholders need practical means by which to reduce agency costs and to supervise competing financial and personal interests. The three options shareholders currently possess are inadequate.²²

It is important to note that I am not arguing that shareholder success rates alone are dispositive. I understand that shareholders are not always in the best position to judge corporate activity. Nor am I arguing that all shareholders should have unlimited access to the corporate proxy statement. Rather, I am arguing that the current options are inadequate, and the Commission is correct in attempting to remedy the inadequacy. My viewpoint does diverge, however, from the Commission's with regard to the remedy that the Commission has chosen in this situation.

IV. Critical Analysis

This section details the drawbacks of the Commission's proposed rules. First, I discuss the limitation in shareholder access that the proposed rules would create if finalized and promulgated as proposed. This section also analyzes the shortcomings of

²¹ *See id.*

²² Other impediments include costs, staggered board elections, and uncertainty concerning the abilities of the shareholder-backed slate of directors to effectively manage the company. *See* Bebchuk, *supra* note 13 at 688-94.

the Shareholder Access Rule. Although the Commission is facially granting shareholders access to a company's proxy statements, shareholders will unlikely take advantage of the exception that the proposed rule champions. Because the proposed action is predicated on Rule 13G, shareholder access would be sharply limited. I also propose four recommendations that would, if adopted, provide balance and completeness to the Commission's proposed action.

A. Evaluating the Proposed Action

The Commission's actions work together. First, the *American Foundation* Rule is a blanket exclusion of shareholder proposals that propose by-law amendments affecting future directorial elections. Second, the Shareholder access rule would create a narrow exception to the blanket exclusion. I agree with this idea in principle. This approach is vastly superior than relying on competing judicial interpretations of Rule 14a-8, assuming, of course, that other courts broaching the issue would adopt multifarious approaches.

The *American Foundation* Rule, standing alone, is a needed amendment. Under the Second Circuit's reasoning, any shareholder that meets the threshold requirements of the current 14a-8 regime would be able to include a shareholder proposal for a by-law amendment. This presents a real danger. The election exclusion is aimed at preventing shareholder candidates from appearing on the corporate ballot without making disclosures required of other, corporate-sponsored candidates.

If all shareholders were permitted to propose an amendment to the by-laws allowing for this, the Commission's detailed proxy rules would be reduced to mere surplusage. The care with which the Commission has crafted the disclosure rules would be circumvented, and candidates would appear on the corporate proxy material without disclosing fundamental pieces of information, a process that is vital to fostering an informed voting decision. Moreover, disclosure requirements favor shareholders by allowing for openness in the election procedure. Using a corporate proxy to wage an election would circumvent this important step, open the door to abuse, and jeopardize crucial disclosure requirements.²³

Still, the *American Foundation* Rule only works if a practical exception is present, as a blanket exclusion would remove valuable participation rights that shareholders possess. The exception, however, falls short of practicality. Because of this, I propose several alterations to the proposed rule that would retain the Commission's overall goal, but alter the means by which this goal is attained.

²³ It is true that this reasoning assumes that the shareholder proposal can garner the support necessary for its passage, while also assuming that in the years to come, shareholders will take advantage of the amended by-law. Nonetheless, the Commission is correct in taking into account this speculative situation.

B. Recommendations to the Commission

1. The Text of the *American Foundation* Rule Should Be Amended to Take into Consideration the Exception Created by the Shareholder Access Rule

My first, and most minor suggestion, relates to the language of the *American Foundation* Rule. As I mentioned in the foregoing, I agree with the Commission's decision to avoid confusion and adopt a clear stance on the issue of election exclusions. Still, because the Commission is also proposing an exception to the election exclusion in the Shareholder Access Rule, the Commission should include that exception in the text of the *American Foundation* Rule. I suggest that the Commission consider including language indicating that corollary rules provide for an exception to the *American Foundation* Rule. Such language would assist courts in construing the provisions together. This is not a material change to the rule, but it does promote completeness and consistency between the Commission's rules. If accepted, the Rule could read as follows (my additions are italicized):

Subject to competing procedures duly authorized by a company's by-laws, amended pursuant to and in compliance with [The Shareholder Access Rule], if a shareholder proposal relates to a nomination or an election for membership on the company's board of directors or analogous governing body or a procedure for such nomination or election, the company's board of directors or analogous governing body may exclude the shareholder proposal.

The above suggestion accomplishes three objectives. First, the language indicates that the exclusion applies to pending elections. This aspect of the election exclusion was unambiguous prior to the proposed amendment. Second, the language extends the exclusion to future elections. Adding this language codifies the Commission's position on the issue, and refutes the interpretation of the rule relied on by the Second Circuit. Finally, the provision would cite to and acknowledge the existence of an exception to the general election exclusion, thus providing a complete expression of the Commission's position.

2. Trouble Delineating Passive Investors from Corporate Raiders: The Commission Should Adopt a Presumption that Protects Shareholders Proposing a By-Law Amendment

The Shareholder Access Rule would require, via Schedule G, shareholders proposing by-law amendments be "passive," "beneficial" investors. My fear is that sitting directors will seek to exclude all by-law proposals relating to future elections on the ground that the proposing shareholder is not a passive investor. Corporations could foreseeably argue that proposing a by-law amendment that relates to future election procedures is itself, standing alone, an action that disqualifies the investor from obtaining Schedule G clearance. At the same time, creating a broad exception in favor of

shareholders and shareholder groups is not ideal. This point can be illustrated through a set of examples.

Case #1: Shareholder is an institutional investor that owns, beneficially, 5% of the corporation's outstanding stock. Upset with the current board's unwillingness to engage in constructive conversations with shareholders concerning various relevant aspects of the company's management, Shareholder wants to amend the by-laws so that in the future, shareholders would have a means to elect shareholder candidates that did not include an independent proxy contest. Shareholder is not subjectively interested in taking over or removing particular directors. During the next election season, Shareholder proposes the by-law amendment. The directors seek to exclude the by-law on the grounds that Shareholder is not a passive investor.

Case #2: Same situation as in case one, except that the shareholders are a group of dissatisfied individual shareholders that have pooled their respective interests to overcome the 5% threshold. Again, none of the shareholders are subjectively interested in taking over, but would prefer a means to possibly combat unresponsive directors in the future. The directors seek to exclude the proposal on the grounds that the shareholders have bonded together for the sole purpose of overthrowing the current board.

Case #3: Same situation as in case one, except that the shareholders or the shareholder group (whether or not the shareholders are institutional or individual investors) subjectively intend to overthrow the current board and impose their own directors. If the Commission were to allow for a broad exception to the "passive investor" requirement, the group could simply assert that its interests were benign, and regardless of the apparent pretext, the by-law amendments would be placed on the corporate ballot.

These hypothetical cases are situations that I envision courts confronting if the Commission does not. To cure this potential problem, I recommend that the Commission draft a provision that will *presume* passive investing activity of the shareholder. I am by no means advocating the adoption of a binding or conclusive presumption; the company will have the ability to rebut the presumption. Under the current 13G regime, the inquiry into whether a particular shareholder or shareholder group is passive is a fact specific, case-by-case analysis. Thus, creating the presumption simply alters the lens through which the courts or the Commission will view the case. Factors such as past ownership, shareholder admissions, recent stock accumulation, public statements, and the announcement of a tender offer could all serve as relevant evidence that a board of directors could proffer to overcome the presumption. The addition of this recommendation would still allow a board to prove that shareholder access is not passive. It would, however, foreclose directors from proving this fact solely by relying on the act of proposing itself.

3. The “Holding Percentage” Required by the Shareholder Access Rule Should Be Premised on Market Capitalization, and Should Be Adjusted Pursuant to the Occurrence and Success of a No-Vote Campaign

When proposing the 2003 proxy access rules, the Commission indicated that although eighty-four percent of companies listed on a national exchange had at least one shareholder owning at least one-percent of the company’s shares, only forty-two percent of these companies have a shareholder that would meet the five-percent threshold requirement.²⁴ I agree that some threshold requirements are needed, but I propose a two-part adjustment to the proposed threshold levels. First, the holding percentage should be adjusted based on the company’s market capitalization. Second, if a “no-vote” campaign is held and results in a thirty-five percent hold-out, the threshold/triggering percentage should be lowered for the next corporate election.

The first part of my proposal would reflect market capitalization. It is generally easier to garner five percent of the outstanding shares in a small-cap company than to accumulate the same percentage in a large-cap company. As the chart cited above indicates, proxy contests generally are more numerous and successful in small-cap companies. Because of the fluidity of shares in the current market, large-cap company shareholders are confronted with a challenging agency problem. As shares of a large-cap company are likely disbursed more widely than with a small-cap company, directors of the large-cap company are in a better position to entrench themselves. Moreover, if shareholders seek to join forces to meet the five percent threshold that the Commission has proposed, shareholders will run into a hurdle, having to prove that their interests are still “passive.” I do not suggest reducing the triggering percentage to a nominal amount, but some reduction is necessary to more accurately reflect economic reality.

Second, the holding percentage should be reduced on the occurrence of a successful “no-vote” campaign. As I am sure the Commission is aware, “no-vote” campaigns have become increasingly popular as the concepts of majority voting have become more widely accepted.²⁵ Nevertheless, many directors are still elected pursuant to a plurality system, wherein only the votes cast are relevant. Those shareholders choosing not to vote are not included. Under the majority voting system, shareholders that withhold votes are counted as voting in opposition of the board member that is up for election. Majority voting has gained popularity because it represents a cost-effective and practical means through which a shareholder can effect corporate change. Rather than engage in a separate proxy contest, a shareholder can simply withhold a vote (no need to get off of the couch).

The Commission’s proposed actions should reflect the increasing popularity of majority voting and the corresponding no-vote or withhold-the-vote campaigns. I propose that if a no-vote campaign is successful (e.g., a stipulated percentage of shareholders withhold votes), the holding percentage required to trigger the Shareholder

²⁴ See Zukin, *supra* note 4, at 975.

²⁵ See *id.* at 975-76 (discussing increased popularity and success of withhold-the-vote campaigns).

Access exception should be reduced in half for the next election. For the purposes of this Rule, the triggering percentage should be set at or around thirty-five percent.²⁶ This would allow shareholders qualified, but broadened access to the corporate ballot in certain situations. Moreover, it would assist in aligning the director's interests with the interests of the shareholders. Further, it would give the directors a wake-up call and allow the directors time to reassess the ways in which the directors respond to shareholder needs. If the directors become more responsive to the shareholders, shareholder proposals will not be necessary. Thus, even though the triggering percentage would be reduced, shareholders would not have an interest in utilizing the reduction.

There is a minor problem inherent in this recommendation. In line with the business judgment rule, corporate law should foster and encourage a businessperson to make risky, but economically sound business decisions. Corporate directors should not be held liable for bad business decisions provided the directors have implemented appropriate corporate procedure (e.g., directors are not interested, acting in bad faith, or acting without informed consent). Although I am reducing many important Delaware corporate law cases to one sentence, this is essentially the overarching theory to the resolution of several corporate governance issues. To include a "no-vote" clause to the Shareholder Access Rule could create an incentive for shareholders to withhold votes on the heels of a business decision gone wrong. A legitimate fear is that every loss of value would prompt a shareholder no-vote campaign. It is in the economic interests of shareholders for corporate executives to take risks. Causing an executive to fear losing a job over a business decision gone awry may result in executives steering clear of business opportunities that could greatly benefit the company and the shareholders.

To account for this fear, the threshold level would still exist, and directors would have the time between the successful no-vote campaign and the next election to restore favor with the shareholder population. Further, if a business decision does go wrong, the board of directors *should* be held accountable to some extent. Although directors should not be held civilly liable to the shareholders for a loss in company value, directors, like any other executive that engages in poor decision making, should bear the fair and reasonable consequences of the decision. If a football team in playoff contention lost the remaining six games of the year on the heels of poor coaching decisions, the coach would come under intense scrutiny. Likewise, corporate directors need to be held accountable for their actions. A no-vote campaign, coupled with a reduced threshold percentage can accomplish this goal while still giving the director time to restore credibility. To further my sports analogy, my proposal would give the director an off-season to make some personnel moves and improve the team.

²⁶ See *id.* (discussing triggering percentages in no-vote campaigns and noting that in 2004, among Russell 2000 companies, 137 directors received withhold the votes of 35% or more).

4. The Commission Should Not Require that Each Member of a Shareholder Group Own Shares for at Least One Year

Because it would defeat the purpose of the exception by creating too high a hurdle for shareholders to overcome, the Commission should not require that each member of a shareholder group own their respective shares for at least one year. Because the focus should be on future ownership and not on past ownership, I have formulated three solutions to this problem, each of which would be a fair resolution.

Solution #1	Solution #2	Solution #3
<ul style="list-style-type: none"> ▪ Require that 50% of the shareholders own their respective shares for at least one year ▪ The remaining 50% would have no holding time requirement 	<ul style="list-style-type: none"> ▪ Require that each of the shareholders own their respective shares for at least 6 months 	<ul style="list-style-type: none"> ▪ Require that 50% of the shareholders own their respective shares for at least one year ▪ Require that the remaining members of the shareholder group own their respective shares for at least 6 months

As is evident, each of the solutions focuses less on the length of ownership and more on the overall protection that the Commission is aimed at providing. The fear is that a raider will quickly acquire five percent of the outstanding shares and immediately propose an amendment that would enable the raider to elect board members at future elections. However, this fear is unfounded, as the “passive investor” requirement continues to provide sufficient protection. Therefore, the length of holding requirement is fairly unnecessary. Further, to the extent that past ownership is statistically indicative of future patterns of ownership, all of my solutions take this into account.

V. Conclusion

I would like to thank the Commission for tackling this difficult issue. As the variety of panelists at the Commission’s roundtables clearly displayed, several interests are at stake. While I do agree that the Commission’s action is necessary, my proposed compromise responds to my belief that the proposed rule, in its current state, cuts harshly against the interests of shareholders. The mechanisms that I propose will not open the “flood gates” for shareholder proposals; rather, the recommendations merely even the playing field to some extent. Moreover, the recommendations promote and create the correct incentive structure, hopefully resulting in more receptive and accountable directors.

I thank the Commission for considering my comments, and would be more than willing to discuss my proposal with the Commission if it desires.

Respectfully submitted,

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