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November 27, 2006

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

Re: Shareholder Access to Corporate Proxy Materials

Ladies and Gentlemen:

This letter is submitted on behalf of the Committee on Federal Regulation of Securities of the Section of Business Law of the American Bar Association (the "Committee"). We are writing to express our views concerning shareholder access to corporate proxy materials in connection with the Commission's consideration of this matter as a result of the decision of the U.S. Court of Appeals for the Second Circuit in *AFSCME Pension Plan v. American International Group, Inc.*[1] This letter was drafted by members of the Task Force on Shareholder Proposals of the Committee (the "Task Force").

The comments expressed in this letter represent the views of the Committee only. They have not been approved by the American Bar Association's House of Delegates or Board of Governors and therefore do not represent the official position of the American Bar Association (the "ABA"). In addition, this letter does not represent the official position of the ABA Section of Business Law nor does it necessarily reflect the views of all members of the Committee or the Task Force.

The *AFSCME* decision raises, at a key time, an important issue about the administration of Rule 14a-8 under the Securities Exchange Act of 1934, as amended (the "Act"). Many companies have already begun preparing for their 2007 annual meetings of shareholders and for many of them the deadline under Rule 14a-8 for submission of shareholders proposals will pass within the next few weeks. The Commission has announced that it intends to consider the

consequences of the *AFSCME* decision at its open meeting on December 13, at which it will also consider other significant matters, including its proposed rule amendments relating to use of the Internet in proxy solicitations. The purpose of this letter is to make certain observations about the shareholder proposal process generally under Rule 14a-8, the director election exclusion addressed in the *AFSCME* decision and practical measures for dealing with these matters for the 2007 proxy season.

Discussion

At the outset, it is important to consider the scope of the issue before the court and the holding in the *AFSCME* case. The court had before it a shareholder proposal that sought to amend a corporation's by-laws to require, in certain circumstances, that certain information about a shareholder nominee be included in the board of directors' proxy statement and that provision for voting in favor of such nominee be included in the proxy card distributed to all shareholders on behalf of the board. The recipient corporation did not include the proposal in its proxy materials based on Rule 14a-8(i)(8)'s exclusion of proposals that "relate to an election for membership on the company's board of directors…," having received a no-action letter from the Commission accepting its omission of the proposal. The AFSCME Pension Plan challenged the omission, arguing that the director election exclusion did not permit the omission.[2]

The court first found that the exclusion under Rule 14a-8(i)(8) was ambiguous with respect to AFSCME's shareholder proposal and therefore required interpretation by the Commission.[3] In considering how the Commission had interpreted Rule 14a-8(i)(8), the court first noted an interpretation of the exclusion the Commission made in its 1976 release proposing amendments to the rule, which indicated that the exception applied to campaigns for board positions.[4] The court then referred to subsequent applications of the exclusion by the Commission staff, which starting in 1990 applied the exclusion to proposals that the staff concluded might result in contested elections if adopted, even though procedural in nature.[5] The court's ultimate finding was that because the Commission had not explained its reasons for changing its interpretation starting in 1990, the Commission's 1976 interpretation should govern. Based on, and deferring to, its reading of the Commission's 1976 interpretation, the court concluded that the AFSCME proposal should not have been excluded. Thus, the court's holding dealt only with the process by which the Commission interpreted and applied the exclusion. The court acknowledged its willingness to "afford the Commission considerable latitude in explaining departures from prior interpretations" and the opinion strongly suggests that it would have accepted the Commission's interpretative position if the record had reflected an explanation of the reasons for that position.

Some commentators and shareholder groups have characterized the *AFSCME* decision as opening the door for the Commission to adopt a rule mandating shareholder access, suggesting that the decision impacts the policy and legal considerations that would be involved in establishing a right of access.[6] However, it is clear to us that the court took no position on whether access should be provided under the Act. Indeed, we note that the court

specifically maintained its neutrality on whether proposals seeking access to corporate proxy materials for shareholder nominees should be excluded under Rule 14a-8, stating as follows:

> "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. There might be perfectly good reasons for permitting companies to exclude proposals like AFSCME's, just as there may well be valid policy reasons for rendering them non-excludable. However, Congress has determined that such issues are appropriately the province of the SEC, not the judiciary."[7]

Moreover, the court did not in any way address the desirability of mandating access to corporate proxy materials for shareholder nominees or the Commission's authority to do so. Therefore the decision essentially means, at least in the Second Circuit, that the Commission must provide sufficient reasons for a material change in its interpretation of Rule 14a-8, particularly with respect to the scope of the director election exclusion.

We suggest that the Commission can readily comply with the *AFSCME* decision without a change in the interpretative position on the director election exclusion of Rule 14a-8(i)(8) that it has applied since 1990. If the Commission wishes to address the policy and legal issues relating to access, it should do so apart from its interpretation of the exclusion. The reasons for the current interpretative position are compelling. In 1976, the principal means for shareholders to exert influence over companies through the exercise of their voting rights was a proxy contest for control between a rival slate of nominees and the slate nominated by the board. We doubt anyone at the time even considered the possibility of shareholders using Rule 14a-8 to establish access requirements for the election of directors. Things have changed dramatically in the last 30 years. Currently, there are many other ways in which shareholders can exercise influence over the selection of directors. Since 1976, changes in the director selection process include the following: independent nominating committees have come to control the selection of the board of directors' nominees at listed corporations; the Commission has significantly expanded the disclosures required about the nomination process, creating greater transparency; the limited exception from the disclosure provisions of the proxy rules provided by Rule 14a-2(b)(2) was adopted in 1992, significantly easing the requirements for engaging in proxy solicitations by those who do not seek proxy authority; the role and influence of proxy voting advisers has increased; majority vote standards for the election of directors have begun to become prevalent, along with director resignation policies in respect of "holdover directors;" "short slate" and "withhold vote" campaigns have become prominent ways of contesting the election of board nominees; the elimination of broker voting in non-contested elections is likely to become effective in 2008; and "vote buying" has become a significant factor in contested solicitations.[8]

As a consequence of these and other developments which have converged in recent years, shareholders have gained considerably more influence in the director selection

process than was imagined, let alone existed, 30 years ago. Shareholder solicitations and proxy contests are becoming easier and this increased shareholder power is being exercised by a broader range of parties, including institutional investors, hedge funds and activist groups some of whom have goals that differ from those of shareholders generally. The Commission's pending proposal to facilitate use of the Internet to ease the process and reduce the costs of soliciting proxies will further change the process by which directors are selected, enhancing the ability of shareholders to exercise influence over corporations. The many developments that have occurred in the proxy solicitation process in general and in the director selection process in particular should be considered in determining the scope of Rule 14a-8, particularly the director election exclusion, which has been a fixture of the rule virtually since its inception. Given these changes in the director election process, we strongly support the well-founded interpretation of the director election exclusion that the Commission has now applied for more than a decade.

It is also important to note that in 1990 the decision of the Court of Appeals for the District of Columbia Circuit in *The Business Roundtable v. Securities and Exchange Commission* established that the SEC did not have authority to mandate listing standards regulating how voting rights are to be allocated among stockholders since the allocation of voting power involved a fundamental area of state corporate law that Congress had not preempted.[9] The court found that the SEC did not derive authority to regulate such a fundamental aspect of corporate governance by implication from its authority to regulate proxies under Section 14 of the Act or from its authority under the Act over listing standards.[10] Thus, a question exists whether mandating under Rule 14a-8 inclusion in corporate proxy materials of an access proposal is within the Commission's authority. The manner in which directors are elected and the control by the board of directors, as a fiduciary for all shareholders, over corporate resources, including the board of directors' proxy statement and proxy card, are fundamental matters of corporate governance. Access by shareholders to corporate proxy materials is unknown under state corporation law. The current interpretative position of the Commission regarding access proposals not only reflects the developments in the director selection process discussed above but also avoids issues about the scope of the Commission's authority to regulate corporate governance by means of Rule 14a-8. There is nothing in the *AFSCME* decision that alters the significance of *The Business Roundtable* decision or that limits or prohibits the continuation by the Commission of its current interpretative view regarding the director election exclusion of Rule 14a-8.

The broader policy issues concerning shareholder access to corporate proxy materials for shareholder nominees should not be addressed by a reinterpretation of the director election exclusion on the eve of a new proxy season. Most calendar year companies will receive shareholder proposals for the current proxy season no later than the end of December, which will require a response within a few weeks.[11] This timing creates a good deal of uncertainty for proponents and corporations alike with regard to access proposals. The establishment of a right of shareholder access to corporate proxy materials for shareholder nominees, whether as a result of a shareholder proposal under Rule 14a-8 (as involved in

AFSCME) or in a rulemaking or legislative context, raises many complex regulatory and corporate governance policy and legal issues.

We therefore urge the Commission to take an interpretative position on Rule 14a-8(i)(8) currently that can be readily applied by corporations and shareholder proponents for the 2007 proxy season, and to support that position with a clear statement of its reasons. This should satisfy the holding of the Second Circuit in the *AFSCME* decision and establish a nationwide rule for dealing with access proposals under Rule 14a-8. Should the Commission also desire to change the language of the rule to codify or modify its current interpretation, this could be done on a longer term basis by publishing a rule proposal for comment. We believe it might be useful to alter the language of the exclusion to make it clear that it relates to any proposal that would change the director election system so that it may result in a contested election of directors. For these purposes, a contested election of directors should be defined as an election where there are more nominees than positions to be filled at the election. This would be consistent with the longstanding practice of regulating director election contests under the other provisions of the proxy rules, applying the Rule 14a-8 shareholder proposal process to other matters. Shareholders interested in pursuing access arrangements at particular companies would continue to have the ability to do so, apart from Rule 14a-8, by making and soliciting shareholder support for proposals on the subject in accordance with the proxy rules, including, if the Commission adopts changes to its proxy rules along the lines it has proposed, in a more streamlined manner through Internet proxy solicitations.

We recognize that in addressing the *AFSCME* decision the Commission may also wish to consider its no-action process under sections (g), (j), (k) and (m) of the rule in regard to situations where a material change in the Commission's interpretation of the rule is involved. The Rule 14a-8 no-action letter process is unique and efficient and serves a vital purpose, in large part because it adapts the application of the rule to changes in market practices, technology and the issues and circumstances that generate shareholder proposals. We believe that the Commission over the years has been reasonable and flexible in its interpretation of and in taking no-action positions under the rule, providing sufficient guidance to corporations and shareholders, and therefore has served the shareholder and corporate communities and the capital markets well in its administration of the rule. As the Commission has long noted, a no-action letter issued under Rule 14a-8's procedures does not itself involve a formal interpretation of the rule.[12] Recognizing the evolving nature of the issues that arise in the administration of Rule 14a-8 and the hundreds of no-action positions the staff may take under the rule in a year, it may be difficult in any general, proscriptive way to identify those applications of the rule through the no-action letter process that involve material interpretative changes. However, it may be feasible to address situations that involve a material interpretative change through a procedural mechanism whereby the parties-in-interest to a shareholder proposal could be obliged to define for the Commission the circumstances that they believe involve a material change in interpretative position.[13]

We also recognize that there are a number of alternatives that the Commission could consider, including revising and reproposing Rule 14a-11, declining to issue no-action letters with respect to access proposals pending further consideration of this matter or making some distinction in applying the director election exclusion between precatory and binding access proposals. It is our view that these are not desirable alternatives. We believe that the Commission can address the limited scope of the *AFSCME* decision and avoid continuing uncertainty about the status of access proposals under Rule 14a-8, including the Commission's authority, without reopening the many issues related to access in doing so.

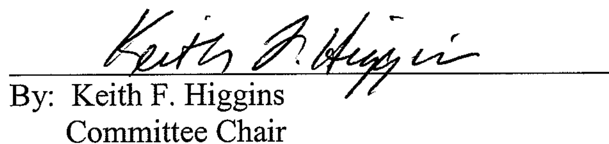
Conclusion

We recommend that compliance with the *AFSCME* decision be achieved by a current interpretation by the Commission of the director election exclusion of Rule 14a-8 consistent with the no-action positions taken by the staff in recent years, accompanied by an explanation of the reasons why that interpretation is appropriate at this time in view of circumstances that have emerged since the 1976 Commission interpretation of the exclusion applied in the *AFSCME* decision. It is important that a clear interpretation of the director election exclusion for the current proxy season be announced and implemented as soon as practicable.

We hope that these comments will be helpful to the Commission and its staff. We would be pleased to discuss with the Commission and its staff any aspect of this letter. Questions may be directed to the undersigned (617-951-7386), Robert Todd Lang (212-310-8200) or Charles Nathan (212-906-1730).

Respectfully submitted,

Committee on Federal Regulation of Securities



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John W. White, Director, Division of Corporation Finance
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[1] *AFSCME Pension Plan vs. American International Group, Inc.*, 462 F.3d 121 (2d Cir. 2006).

[2] The case was appealed to the Second Circuit following the district court's denial of AFSCME's motion for a preliminary injunction to compel AIG to include the proposal in its proxy statement. *See AFSCME Pension Plan vs. American International Group, Inc.*, 361 F. Supp. 2d 344 (S.D.N.Y. 2005). The district court, after reviewing the SEC's 1976 release and subsequent no-action letters, found that AFSCME's proposal both related to an election and was likely to cause an election contest.

[3] *AFSCME*, 462 F.3d at 125-126. The no-action letter issued by the SEC staff to AIG did not provide any reason's for the staff's conclusion that Rule 14a-8(i)(8) was applicable to the proposal. *See* American International Group, Inc., SEC No-Action Letter, 2005 SEC No-Act. LEXIS 235 (February 14, 2005).

[4] *AFSCME*, 462 F.3d at 125-126. *See* Proposed Amendments to Rule 14a-8 Under the Securities Exchange Act of 1934 Relating to Proposals by Security Holders, Exchange Act Release No. 34-12598 (July 7, 1976). The proposed amendments included the relocation of the director election exclusion so as to include it among the substantive exclusion provisions of the rule and to provide additional wording to refer to other elections as well as director elections. The Commission's specific comment on the exclusion addressed both election contests and the election process: "Notwithstanding its applicability to any election to office, the principal purpose of the provision is to make clear, with respect to corporate elections, that Rule 14a-8 is not the proper means for conducting campaigns *or effecting reforms in elections of that nature*, since other proxy rules, including Rule 14a-11, are applicable thereto *[emphasis added]*." Rule 14a-11 was subsequently repealed in favor of regulation of election contests under the other provisions of the proxy rules (other than Rule 14a-8). Regulation of Takeovers and Security Holder Communications, Exchange Act Release No. 42055 (October 22, 1999). The proposed addition to the wording of the exclusion was not adopted, leaving the text of the exclusion substantively unchanged. In commenting in its adopting release on its decision not to adopt the additional wording, the Commission stated, "the inclusion of those words in the proposed version led many commentators to the erroneous belief that the Commission intended to expand the scope of the existing exclusion to cover proposals dealing with matters previously held not excludable by the Commission, such as cumulative voting rights, general qualifications for directors, and political contributions by the issuer." Adoption of Amendments Relating to Proposals by Security Holders, Exchange Act Release No. 12999 (November 22, 1976).

[5] *See AFSCME*, 462 F.3d at 128, *citing* Thermo Electron, SEC No-Action Letter, 1990 SEC No-Act. LEXIS 549 (March 22, 1990), Unocal Corp., SEC No-Action Letter, 1990 SEC No-Act. LEXIS 183 (February 6, 1990), Bank of Boston, SEC No-Action Letter, 1990 SEC No-Act. LEXIS 206 (January 26, 1990).

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[6] *See, e.g.*, Letter from James P. Hoffa, General President, International Brotherhood of Teamsters to Christopher Cox, Chairman, Securities and Exchange Commission (September 27, 2006) (*available at* <http://www.teamster.org/resources/luleaders/corpgovernance/hoffaletterssecrule14a8(i)(8).htm>); Letter from Rob Feckner, President, CalPERS Board of Administration to Christopher Cox, Chairman, Securities and Exchange Commission (September 13, 2006) (*available at* http://www.calpers.ca.gov/eip-docs/about/press/news/invest-corp/sec-proxy-access-letter.pdf>). *But see* Letter from Steve Odland, Chairman, Corporate Governance Task Force, Business Roundtable to Christopher Cox, Chairman, Securities and Exchange Commission (September 29, 2006) (*available at* http://www.businessroundtable.org/pdf/20061010002BRAFSCME_AIGDecision_Response92906.pdf>.)

[7] *See AFSCME*, 462 F.3d at 131.

[8] Moreover, although the staff had not given a reason for its interpretation of the director election exclusion in its no-action response to the objection to the proposal in *AFSCME*, the application of the director election exclusion to that proposal seemingly involved only a nuance in the application of the 1976 interpretive comment, which specifically referred to "effecting reforms in elections" as well as "conducting campaigns." The line of interpretation of the director election exclusion applied by the staff starting in 1990 primarily involved proposals to change the election process in ways that may result in election contests. The full Commission recognized this in early 2003 in determining not to review, and let stand, the staff's application of the director election exclusion to access proposals in a series of no-action letters. *See, e.g.*, Citigroup, Inc., SEC No-Action Letter, 2003 SEC No-Act. LEXIS 160 (January 31, 2003); SEC Press Release 2003-46 (April 14, 2003). In the Citigroup no-action letter, the staff stated as a basis for exclusion that "the proposal, rather than establishing procedures for nomination or qualification generally, would establish a procedure that may result in contested elections of directors." In its 2003 press release, the Commission announced that it had directed the staff to conduct a study of the proxy rules, a study which later that year led to the Commission's proposed rule on shareholder access. That rule proposal, in turn, included a modification of Rule 14a-8 to create an exception from the director election exclusion for proposals to "opt-in" to the specified access system the proposed rule contemplated, a modification considered necessary because the exclusion had been repeatedly applied by the staff as applicable to access proposals. *See* Proposed Rule: Security Holder Director Nominations, Exchange Act Release No. 34-48626 (October 14, 2003); *see also* Amendments to Beneficial Ownership Reporting Requirements, Exchange Act Release No. 34-39538 (January 12, 1998) (discussing the potential for shareholder proposals to represent an effort to influence control over a company, including by engaging in a contested solicitation).

[9] *The Business Roundtable v. Securities and Exchange Commission*, 905 F.2d 406 (D.C. 1990).

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[10] *Id.*, at 411.

[11] Rule 14a-8(e) and (j).

[12] *See* Statement of Informal Procedures for the Rendering of Staff Advice with Respect to Shareholder Proposals, Exchange Act Release No. 34-12599 (July 7, 1976) (explaining no-action procedures with respect to shareholder proposals, characterizing the staff's advice as "informal" and "not binding" and stating "Because the staff's advice on contested proposals is informal and nonjudicial in nature, it does not have precedential value with respect to identical or similar proposals submitted to other issuers in the future.").

[13] One possibility is to require that a corporation in objecting to a proposal indicate whether it believes that the proposal raises a point that involves an issue not previously addressed by, or that warrants a material change in, the Commission's interpretation of the rule. The shareholder proponent similarly should be required to address whether an objection does so, by either accepting or rejecting explicitly the corporation's view of the basis for an objection or, if the proponent decides not to comment on the objection, be deemed to have accepted such view. Under section (k) of the rule, proponents already have the opportunity to comment on a corporation's objection to a proposal, so this requirement would merely provide guidance on the logical consequence of a proponent using or foregoing its right to comment. The Commission, consistent with its longstanding role in the shareholder proposal process, would be the decisionmaker as to what constitutes a material change in its interpretive positions for purposes of determining compliance with the rule's procedural requirements. Both proponents and corporations would continue to have the same ability as they currently have to seek judicial review of an exclusion decision, while the context for such review would be enriched by this additional process.