

James J. Angel, Ph.D., CFA  
Georgetown University  
Associate Professor of Finance  
McDonough School of Business  
Room G4 Old North  
Washington DC 20057  
angelj@georgetown.edu  
1.202.687.3765

Ms. Nancy M. Morris, Secretary  
Securities and Exchange Commission  
100 F St. NW  
Washington, DC 20549-9303

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Dear Ms. Morris:

Here are my comments on the various proposals concerning shareholder proposals and director elections.

As a finance professor, I try to practice what I preach in terms of diversification. The massive reduction in transaction costs in recent years has made it cost effective for me to own small quantities of dozens of different stocks through services such as Foliofn. However, this also means that I get to vote in dozens of different corporate elections each year. As a shareholder, I don't want my time wasted on matters that have little likelihood of passing. Private companies are not required to spend precious management time debating initiatives unlikely to pass. Forcing public companies to do so is just one more additional burden raising the cost of remaining a public company.

**Contested elections impose costs on shareholders.**

Contested elections for directors and other shareholder proposals are quite costly to shareholders. Not only does the issuer incur direct costs which are passed on to the shareholders, but shareholders incur the direct cost of time spent analyzing the opposing views. As a large company may have millions of shareholders, a contested election imposes a substantial cost on a very large number of people. And this does not even count the costs of proxy solicitation and voting. As a shareholder, I only want to be bothered if there is a really good reason to vote on something. What are really good reasons?

In general, the interests of the board of directors and the shareholders are very well aligned. We both benefit from an increase in shareholder wealth. Furthermore, the directors usually have better information than the shareholders, so it is a waste of time to vote on day-to-day operating decisions.

For example, a shareholder may want to propose that a retailer carry more shoes in a specific size. However, the management and board of directors have every incentive to carry the profit maximizing inventory mix. Once the idea is presented to the firm, the management and the board of directors will presumably make the right business decision. After all, they should have more information than the shareholders. Thus, the shareholders rightly delegate such day-to-day operating decisions to the management of the company. If the directors are so incompetent that they are not making good business directions, then the shareholders should elect new directors, rather than debate what sizes of shoes to sell.

This discussion implies that there are basically three types of issues worth bringing to the shareholders to vote:

1. The election of directors.
2. Issues in which there is a potential misalignment of interests between the directors and the shareholders. This includes proposals that would alter the rights of shareholders, as well as compensation schemes for officers and directors.
3. Issues in which the shareholders may have better information than the directors.

### **More contested elections will make it harder to find good directors.**

At a first naïve glance, it may seem that having contested elections for directors is a good idea. After all, if contested elections are the hallmark of a healthy democracy, why not regularly have contested elections for directors? Why not give the owners a real choice? However, there is a very fundamental difference between elections for corporate directors and elections for political offices. The interests of all the shareholders and the directors (as well as the nominating committee for directors) are so much more aligned than the interests of the general population with our political leaders. Elections for public office are an important public choice process through which the people communicate their preferences for government policies in areas such as foreign affairs, taxation, privacy, education, health care, and other controversial issues.

There is much less need for policy communication from the shareholders to the company. It is clear what the shareholders want: they want the firm to engage in businesses that will maximize their shareholder wealth consistent with the laws and good ethical standards.

Corporations need good directors. And many of the most qualified candidates would not be willing to serve if they had to go through the politicking and mud slinging of political campaigns to get elected. Thus, contested elections do not make sense most of the time:

Only when there is good cause to believe that there are better candidates than the management-nominated ones should there be a contested election. This is not normally the case, as management has a strong incentive to nominate good directors.

**Areas with potential misalignment of interests are appropriate election topics.**

Misalignments can occur when consideration of the private benefits to the directors may influence their judgment. One example would be a competing takeover proposal in which one suitor is promising that certain directors will maintain their position following the takeover and the other is not.

Misalignments can occur when the overall interests of the shareholders differ from the narrow interests of the stock price of the corporation. For example, it may be good for the profits and share price of a tobacco company to get children addicted to smoking tobacco. However, the shareholders may be well diversified and also own shares in companies that bear the added health costs of tobacco smoking through medical insurance costs and taxes for public health programs. Furthermore, those shareholders may not want their own children to smoke. Thus, it may be in the interests of the shareholders as a whole to direct the firm to abstain from marketing tobacco products to children.

**Issues in which the shareholders may have better information are also appropriate election topics.**

Although management and the board of directors usually have better information than the shareholders, this is not necessarily always the case. In particular, CEOs and directors tend to come from a narrow professional class of society. They may have spent so much time in the rarefied air of the executive suite that they are out of touch with some major social trends that could impact the company. A management may feel that one aspect of the firm's operations in some controversial area meets all current legal requirements and thus is appropriate. However, management may be missing an important social trend that could later have a huge backlash harmful to the shareholders. As a shareholder, I would want management to be aware that the labor practices of a subcontractor may lead to a consumer backlash harmful to the firm. The company may think it is complying with today's laws on pollution only to discover that tomorrow the laws have changed. Thus, advisory social concerns can be extremely useful to corporations by giving them advance warning that the changing social acceptability of various practices. The size of the vote is an important signal to management about what the shareholders think about a particular issue.

**Shareholder proposals should be able to demonstrate substantial support before going on the ballot.**

However, this does not mean that every pet proposal of somebody with 100 shares belongs on the corporate ballot. There needs to be some reasonable mechanism for the vetting of proposals to separate the good ones from the not-so-good ones. The simplest approach is to require that the proponents of a proposal demonstrate enough support to make a shareholder vote worthwhile. In this way, the shareholders themselves can determine what is voted on and what is not. Their time and money will not be wasted voting on unimportant matters. Requiring a clear threshold of shareholder support in order to get access to the corporate ballot drastically simplifies the process of what should and should not be on the ballot. Five percent seems to be a reasonable threshold for putting advisory motions on the ballot. If a group of shareholders representing five percent of the shares feels that a proposal is worth voting on, then it is probably worth the time and effort to vote upon the proposal.

**A 5% threshold is way, way too small for director elections. 25% is better.**

It would be a big mistake to permit a raider who owns only 5% of a firm to launch a costly proposal or proxy contest at the expense of the other shareholders. The proposed rule would permit such a fiasco and make it too easy to have contested elections for directors. If such a raider wanted to do this at her or his own expense, that is up to them. But they should not be able to force other shareholders to pay for it through access to the proxy materials. A proxy contest with such a small foothold would result in much mudslinging with little chance of success. It would permit 5% holders to extort special concessions from the company by using the threat of a proxy battle, to the detriment of the remaining shareholders.

If the 5%-owning raider has a good business case for a proxy contest, it should be relatively easy for that raider to convince a few other large shareholders to join the cause. If the raider cannot get other shareholders to go along at the early stage, then the proxy contest has little chance of success and scarce shareholder resources should not be squandered on it. Such raiders have plenty of other public media at their disposal for making their case to management, to the public, and to other shareholders.

For this reason, a 5% threshold is way, way too small. As a shareholder, I would think that a group of shareholders with 25% of the votes should be able to put anyone they want on the ballot. I think it is extremely important that the threshold be large enough such that a single block holder acting alone is unlikely to meet the requirement. Making the required threshold larger than the typical poison-pill threshold does this. In this way, the block holder must reach out to other shareholders in order to shareholder nominees on the ballot.

**Using a threshold eliminates the need for no-action letters.**

The proposal notes that the SEC writes hundreds of no-action letters each year for firms that decide to exclude certain shareholder proposals from their ballots. This is a waste of taxpayer dollars that the SEC should be spending in more important areas, such as enforcement. A simple 5% threshold requirement for putting shareholder proposals on the ballot or 25% for shareholder nominees vastly simplifies the process of determining what goes on the ballot. This will allow the SEC staff to get out of the business of performing merit regulation on the details of shareholder proposals.

**The shares in favor of a putting a proposal or a shareholder nominee on the ballot must represent a legitimate economic interest in the firm.**

It is theoretically possible for someone to purchase shares and hold them in a cash account while shorting shares through a different account. This would permit someone to exercise voting rights without having a legitimate economic interest in the firm. Shareholders seeking to put a proposal or shareholder nominee on the ballot should be required to attest that they have not shorted or hedged the shares. Clarifying that the “holdings” reported on Form 13F include short positions would also help to alleviate concerns that “empty voting” may occur by bringing more transparency to short positions.

**It must be easy for shareholders to communicate with one another.**

However, in order for shareholders to put together the needed 5% in order to put a proposal on the ballot or 25% to place director nominees on the ballot, it has to be easy for shareholders to communicate with each other to plan and discuss proposals without running afoul of our securities laws. There should be broad safe harbors for shareholder discussions of proposed ballot items so that shareholders need not fear being prosecuted for making improper proxy solicitations.

The proposed electronic forums are a good idea, but communication among the owners of a firm should not be limited to such forums. Care needs to be taken in the construction of such forums such that risk averse compliance lawyers do not start advising shareholders that such forums are the only permissible means of communication with each other.

**Investors can also use other forums to achieve corporate change.**

Many investors with legitimate concerns about corporate activities may not be able to achieve the needed votes to get something on the corporate ballot in a particular year. With modern communication methods, there are numerous ways to communicate and debate these topics. Concerned parties can and do use the press, radio, television, and internet to broadcast their concerns. Within the corporate governance structure, concerned parties can and do wage “just vote no” campaigns for directors of certain companies. If the actions of the corporation are breaching existing laws, then the

corporation has a huge incentive to comply and no vote is necessary. If enforcement of existing laws is lacking, then it is appropriate to go to the correct enforcement agencies. If the laws are inadequate to deal with the social concerns, then the proponents should lobby the appropriate legislature to amend the laws in a consistent manner that applies to all entities, both public and private.

**The Commission should make it easy for retail investors to put voting on auto-pilot.**

While on the topic of corporate voting, I would also like to add a few words that would improve the quality of shareholder participation. I would like to see the Commission adopt policies that would make it easy for investors to permit others, such as their brokers or third party services to use judgment to vote the shares for them. I would very much like someone else, such as my broker or a proxy advisory firm, to take care of voting as long as I have the ability to override and vote myself when I want to.

This would be an improvement over the current process, in which brokers usually vote the unvoted shares for management on “routine” items. Making it easy for shareholders to delegate voting will increase the chances that the shares of retail investors are being voted intelligently and thus contribute to better corporate governance. It will also reduce cost to corporations of soliciting shareholders in order to achieve a quorum.

**The RFA analysis is inadequate.**

As usual, there is little mention of what other jurisdictions do in the proposing releases. In order to properly comply with the Regulatory Flexibility Act the SEC should explicitly consider potentially less costly approaches used in other jurisdictions. The SEC is not the only regulator on the planet that deals with these issues, and explicitly considering what other jurisdictions are doing should be a standard part of the SEC rulemaking process.

Respectfully submitted,

James J. Angel, Ph.D., CFA  
Georgetown University  
McDonough School of Business