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August 7, 2009

Via Email
Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F St. N.E.
Washington D.C. 20549-1090

Re: Facilitating Shareholder Director Nominations (File No. S7-10-09)

Dear Ms. Murphy:

The American Federation of State, County and Municipal Employees ("AFSCME"), is the largest union in the AFL-CIO representing 1.6 million state and local government, health care and child care workers. AFSCME members participate in over 150 public pension systems whose assets total over $1 trillion. In addition, the AFSCME Employees Pension Plan (the "Plan") is a long-term shareholder that manages $850 million in assets for its participants, who are staff members of AFSCME and its affiliated subordinate bodies. The funds in which AFSCME members and retirees are participants and beneficiaries provide patient, long-term capital to support sustainable value creation at public companies. These funds are sufficiently diversified that they essentially "own the market"; as a result, AFSCME is keenly interested in corporate governance practices that promote accountability and enhance company performance.

We write in strong support of the Commission's proposed rule *Facilitating Shareholder Director Nominations* (the "Proposed Access Rule"), which promises to end management's monopoly on the company proxy statement. This historic reform has been considered for 70 years, since shortly after the Commission's birth. As discussed more fully below, the case for giving shareholders a meaningful way to exercise their right to nominate directors in a world where nearly all votes are cast by proxy is compelling. We support the choices the Commission has made in designing the Proposed Access Rule, though we note a few matters on which clarification would be useful. Finally, we support allowing shareholders to adopt a more expansive proxy access regime using the shareholder proposal rule; accordingly, we favor the amendments to Rule 14a-8 included in the Proposed Access Rule.

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Our Advocacy of Shareholder Access to the Proxy

For a number of years, AFSCME has been deeply involved in the debate over shareholder access to the company proxy statement. In 2002, the Plan became concerned about the adverse impact that poor board performance could have on certain of its holdings, spurred by board failures at Enron, Citigroup and elsewhere, and submitted shareholder proposals to selected corporations seeking implementation of a proxy access regime. After the Staff of the Division of Corporation Finance (the "Staff") allowed exclusion of the Plan's initial group of proposals on the ground that they violated Rule 14a-8(i)(8) (the "Election Exclusion"), the Commission began a process that led to its proposing, in late 2003, a proxy access rule that would have given significant long-term shareholders the right to nominate a certain number of candidates, provided certain triggering events had occurred.[1] We supported that proposed rule, though we believed that the triggering events made the rule overly complex and imposed unwarranted delay.

After it became clear that the Commission had abandoned the 2003 proposal, the Plan returned to its strategy of advocating for proxy access using the shareholder proposal process. The Staff continued to allow companies to exclude the Plan's proposals in reliance on the Election Exclusion, which we believed was inconsistent with the text and history of the shareholder proposal rule. Accordingly, the Plan challenged the Staff's interpretation, ultimately prevailing at the U.S. Court of Appeals for the Second Circuit in AFSCME v. American International Group, Inc.[2]

We opposed the Commission's proposal in 2007 to overturn the AFSCME v. AIG decision by amending the Election Exclusion to explicitly exclude proposals dealing with shareholder access to the proxy. In our comment, we urged that it made no sense to single out for exclusion proposals seeking to establish generic proxy access procedures when other similar proposals addressing election procedures were not excludable. Despite significant investor opposition, the Commission adopted the amendments.

Our various initiatives in support of shareholder access to the proxy reflect a view that the missing link in corporate governance reform is board accountability to long-term shareholders. We applaud the Commission for revisiting the proxy access issue and attempting to remove "impediments to the exercise of shareholders' rights to nominate and elect directors to company boards of directors."

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[1] See "Commission to Review Current Proxy Rules and Regulations to Improve Corporate Democracy," Press Release (Apr. 14, 2003) (available at http://www.sec.gov/news/press/2003-46.htm). The Staff subsequently issued a report analyzing the issues and discussing alternatives for reform. "Review of the Proxy Process Regarding the Nomination and Election of Directors," July 15, 2003 (available at http://www.sec.gov/news/studies/studiesarchive/2003archive.shtml).

[2] 462 F.3d 121 (2nd Cir. 2006).

Why Shareholders Should Have Access to the Company Proxy Statement

The Role of Director Elections in the Corporate Governance System

Shareholders in large public corporations depend on the board of directors to protect shareholders' interests by guiding the corporation's strategic direction and monitoring management's performance. This relationship between the board and shareholders is so important that Chancellor Allen, in an influential Delaware chancery court decision on shareholder voting, has stated:

> The shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests. Generally, shareholders have only two protections against perceived inadequate business performance. They may sell their stock (which, if done in sufficient numbers, may so affect security prices as to create an incentive for altered managerial performance), or they may vote to replace incumbent board members.[3]

Paired with the right to vote to elect directors is the ability to nominate candidates. Indeed, it has been widely recognized that the right to vote for the board lacks content in the absence of nomination rights. As Vice Chancellor Strine explained in a 2002 Delaware Chancery Court decision, "Because of the obvious importance of the nomination right in our system of corporate governance, Delaware courts have been reluctant to approve measures that impede the ability of stockholders to nominate candidates. Simply put, Delaware law recognizes that the 'right of shareholders to participate in the voting process includes the right to nominate an opposing slate.'"[4]

But where voting is carried out by proxy prior to the meeting of shareholders, nominating candidates is much more complex and difficult than simply showing up at the meeting and persuading other shareholders to vote for one's nominees. Instead, under the current system a shareholder must shoulder the costs of distributing a separate proxy statement and card to shareholders in advance of the meeting and tabulating the results, plus the expenses—printing, mailing, legal, advertising, public relations and solicitation—associated with conducting outreach to other shareholders voting by proxy.

Given this, it should not be surprising that director challenges that are not part of a contest for control or closed-end fund restructuring are extremely rare. A 2003 study by Lucian Bebchuk found that between 1996 and 2002, only 77 contests focused on who should serve on the board of a stand-alone firm were waged. Just 10 of the contests

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[3] Blasius Industries Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988).
[4] Harrah's Entertainment, Inc. v. JCC Holding Corp., 802 A.2d 294, 310 (Del. Ch. 2002).

occurred at firms with market capitalizations in excess of $200 million.[5] As two Delaware judges have noted, "The aberrational cases in which shareholder activists have actually mounted proxy contests tend to prove the incumbent bias of the system, rather than cast doubt on it."[6]

Thus, although in theory shareholders have the right to nominate director candidates, in practice they rarely do so. As a result, directors face no meaningful threat of replacement. In theory, such a threat keeps directors accountable to shareholders. The difficulty and expense of nominating dissident candidates have the impact of reducing board accountability to shareholders.

Enhancing Accountability and Restoring Confidence through the Proposed Access Rule

This lack of accountability imposes substantial costs on shareholders. In recent years, shareholders have seen tremendous destruction of value by companies whose boards of directors failed abjectly in their oversight responsibilities. Boards allowed companies to take on excessive leverage, approved overly risky business strategies, permitted off-balance-sheet accounting that misrepresented companies' financial conditions, signed off on obfuscatory disclosure and incentivized executives to focus too much on short-term performance, among other things.

The financial crisis that began last year has brought many of these shortcomings into sharp relief, though the current narrative echoes in many respects the criticism boards faced just a few years ago in the wake of the financial reporting, insider trading and self-dealing scandals at companies such as Enron, Qwest, WorldCom and Adelphia. Less spectacularly, shareholder value is squandered through excessive executive pay, ill-advised transactions and other decisions for which the board bears primary responsibility.

We believe that giving significant long-term shareholders access to the company proxy statement for the purpose of nominating director candidates would reinvigorate corporate elections and bring about greater board accountability to shareholders. Opponents of proxy access have argued that existing mechanisms—independent nominating committees in the Commission's 2003 rulemaking, majority voting in the current debate—are sufficient to address board accountability concerns. We disagree.

Although majority voting has strengthened shareholders' influence, it remains solely a means of registering negative sentiment regarding the incumbent board's

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[5] Lucian A. Bebchuk, "The Case for Shareholder Access to the Ballot," 59 Business Lawyer 43 (2003).

[6] William B. Chandler III & Leo E. Strine, Jr., "The New Federalism of the American Corporate Governance System: Preliminary Reflections of Two Residents of One Small State," at 66 (Feb. 26, 2002) (available on www.ssrn.com).

nominees. It has become the norm among large-cap companies, but is still a minority practice among mid-cap and small-cap firms.[7] And independence provides no guarantee that a director will be accountable to shareholders, given that CEOs continue to influence the director nomination process and some relationships that could compromise objectivity are not captured by the independence definition.

Moreover, the Proposed Access Rule would, if adopted, help restore investor confidence. A June 2009 investor survey by ShareOwners.org found that 57% of those surveyed agreed that "strong federal action to protect the rights of shareholders and other investors" would make them more confident about the fairness of the financial markets. Eighty-two percent of investors surveyed believed that "shareholders should have the ability to nominate and elect directors of their own choosing to the boards of the companies they own."[8]

Some commenters have urged that the Commission should abandon the notion of a market-wide proxy access right and instead allow access regimes to be adopted on a company-by-company basis.[9] While, of necessity, the Plan has pursued a company-specific approach in the past, we favor a uniform federal rule for several reasons.

First, from the perspective of a diversified shareholder, any flexibility benefits from a company-specific approach would be significantly outweighed by the complexity of having to navigate a different proxy access regime for each company. Many of the funds in which AFSCME's members are participants are heavily indexed, which translates into owning shares in hundreds or even thousands of U.S. companies. The variation touted by proponents of a more tailored approach—such as the ability to impose different ownership thresholds and holding periods, or the imposition of triggering requirements—would result in an unworkable administrative burden for broadly invested shareholders that need to track deadlines and requirements at many different companies.

Second, the very companies that would benefit most from a shareholder access regime are likely to put up the stiffest resistance to adopting access. In the Plan's

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7 Annalisa Barrett & Beth Young, "Majority Voting for Director Elections—it is Not Yet Standard Practice," Analyst Alert—The Corporate Library (Dec. 2008).

8 See "ShareOwners.org Survey: U.S. Investors Demanding Strong Financial Market Reforms, More than a Third Are 'Angry" Today," at http://www.shareowners.org/profiles/blogs/read-all-about-it (last visited August 2, 2009). Opinion Research Corporation conducted the survey of 1,256 U.S. investors. ShareOwners.org is a new nonprofit and nonpartisan organization founded to educate and organize U.S. investors.

9 See, e.g., Comment of the Delaware State Bar Association filed on July 24, 2009, at 2 (arguing that a federal rule would "unnecessarily deprive Delaware corporations of the flexibility state law confers to deal effectively with myriad different circumstances that legislators and rulemakers cannot anticipate . . . .").

experience attempting to engage the boards of Countrywide, Citigroup and Washington Mutual, the resistance of boards to fundamental change can lead to drastic results for shareowners. Some companies may have or adopt supermajority voting requirements to amend the bylaws or, in states that permit it, eliminate shareholders' right to amend the bylaws altogether. A 2002 review of corporate takeover defenses showed that nearly a quarter of companies limit shareowners right to amend bylaws and nearly a third have some form of supermajority voting requirements.[10]

Similarly, although Delaware has recently adopted changes to its corporation code designed to clarify the validity of proxy access bylaw proposals, other states have not done so. As a result, a company incorporated outside Delaware could stymie shareholder efforts to press for access by litigating the validity of a shareholder proposal, which would entail substantial expense and delay. Even Delaware-incorporated companies could mount challenges to the statute or particular drafting choices made by a proposal's sponsor, or their boards could repeal shareholder-adopted bylaws providing for access. (Unlike the Delaware statute on shareholder-adopted majority voting bylaws, the statute authorizing access and reimbursement bylaws does not state that such bylaws may not be repealed unilaterally by the board.)

The Commission has ample authority to adopt a uniform proxy access rule, contrary to the assertions of some commenters. Section 14(a) of the Securities Exchange Act empowers the Commission to issue rules regarding the solicitation of proxies "as necessary or appropriate in the public interest or for the protection of investors."[11] The Proposed Access Rule would not create a new substantive right for shareholders; indeed, it would operate only where state law gives shareholders the right to nominate directors. In this respect, it differs from the New York Stock Exchange listing standard struck down in the Business Roundtable v. SEC case, where the "one share/one vote" rule would have imposed new limitations on companies' freedom to structure corporate governance arrangements.[12]

Like Rule 14a-8, the Proposed Access Rule serves a disclosure function. It would address the inclusion of an item in the company's proxy statement used to inform shareholders of matters management knows will be brought to a vote at the upcoming meeting. The Proposed Access Rule's eligibility criteria and procedural requirements for using the proxy access process are similar to those found in Rule 14a-8 and reflect the Commission's judgment regarding which items merit company-financed proxy disclosure. Put another way, both the Proposed Access Rule and Rule 14a-8 allow

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[10] Bebchuk, Lucian A., Cohen, Alma and Ferrell, Allen, "What Matters in Corporate Governance?" at 49 (Sept. 1, 2004) (Available at SSRN: http://ssrn.com/abstract=593423).
[11] 15 U.S.C. 78n(a), http://trac.syr.edu/laws/15/15USC00078n.html.
[12] 905 F.2d 406 (D.C. Cir. 1990).

shareholders to exercise in a particular forum—the company proxy statement—a right they already have.

The Proposed Access Rule Strikes the Right Balance

We believe that the Proposed Access Rule strikes the right balance between facilitating shareholder nominations, on the one hand, and deterring frivolous nominations and avoiding excessive burdens on companies, on the other.

Application of the Proposed Access Rule

We agree that the Proposed Access Rule should apply to all public companies with registered equity securities, even smaller ones. We do not believe that the costs imposed by the Proposed Access Rule will be substantial because it will be used infrequently and only then at companies in the grip of real governance or other failure.[13] In our experience, smaller companies are at least as likely to have dysfunctional boards as their larger counterparts. Accordingly, there is no reason to exempt or delay implementation for smaller companies.

We also favor application of the Proposed Access Rule to investment companies. Governance at investment companies differs in some respects from governance at operating companies because state law generally does not require investment companies to hold annual shareholder meetings or allow shareholders to vote on directors each year. Interest in mutual fund governance has grown in recent years, however, as shown by the debate over mutual fund board chair independence, increasing scrutiny of mutual funds' proxy voting decisions and the mutual fund shareholder resolution campaign urging mutual funds to adopt investment policies dealing with genocide.[14] Moreover, state-law requirements could change, or investment companies could choose to hold annual meetings or give fund shareholders the opportunity to vote on directors. It thus makes little sense to exclude investment companies from the operation of the Proposed Access Rule.

No Triggering Events

The Commission's 2003 proposed access rule required that a "triggering event" occur before shareholders gained access to a company's proxy materials. Those triggering events involved the approval of a shareholder proposal granting access or the registering of a "withhold" vote of at least 35% against one or more directors. Proxy

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[13] See Comment of International Corporate Governance Network filed on July 15, 2009 (noting that it is rare for UK shareholders to use their rights to bring proposals and to call a special shareholders' meeting).

[14] See http://investorsagainstgenocide.net/shareholderresolutions.

access would then have been available at the annual meeting following the occurrence of the triggering event.

As we stated in 2003, the triggering event construction injected significant delay into the process, as it generally meant a year would elapse between the event and the election at which proxy access would be available. Such delay could cause additional loss of value at an already-troubled company.

In addition, interpreting and updating the trigger events would add significant complexity. For example, if a withhold vote trigger is used, how is it calculated? Should access be triggered if the director who received the high withhold vote subsequently resigns? What if she doesn't resign until after a candidate has been nominated using proxy access? How often should the triggering percentage be updated and what factors should be used to establish it? For those reasons, we favor a proxy access rule that operates without triggering events.

Availability Only for Short-Slate Contests

Like the 2003 proposal and the Plan's shareholder proposals, the Proposed Access Rule would not be available to facilitate contests for control of a company's board. In our view, this distinction is appropriate because the "free rider" problem—the fact that one shareholder's costly but value-enhancing initiative will benefit other shareholders—is not present in an acquisition context. There, an acquirer stands to capture all of the additional value flowing from a successful election contest and subsequent acquisition. As a result, would-be acquirers have sufficient incentives to engage in proxy contests even when they require the preparation and use of a separate proxy statement.

Moreover, in such cases the potential for conflicts of interest would militate in favor of the more expansive disclosure afforded by a separate proxy statement. Thus, we support the Commission's decision not to extend proxy access to control contests.

Design Considerations

The Proposed Access Rule uses a graduated ownership threshold in which a shareholder is entitled to proxy access at lower percentage ownership levels as company size increases. At companies that are non-accelerated filers, a shareholder (or group) must own 5% of outstanding shares, while at accelerated and large accelerated filers, the thresholds are 3% and 1%, respectively.

We continue to believe, as we have previously commented, that a 5% threshold would be challenging for long-term shareholders, like those in which our members participate, to satisfy. Applying a 5% threshold only to smaller companies, however, mitigates this concern because such companies tend to have more concentrated ownership and there may thus be an opportunity for pension funds to join with other shareholders in order to meet the threshold. In any event, it will be necessary to permit aggregation of holdings to prevent the Proposed Access Rule from being usable only by hedge funds.

At the other extreme, we do not concur with those who urge a minimal holding requirement like the one contained in Rule 14a-8. Mounting a short-slate contest is a serious effort and should be subsidized only for those shareholders with a significant stake in the outcome.

We view the one-year holding period as sufficient to deter use of the Proposed Access Rule by those with an interest only in a company's short-term performance. We would support an even longer holding period, such as the two-year period consistent with the Council of Institutional Investors' policy on proxy access, provided the Commission were to clarify the Proposed Access Rule to reflect the realities of share ownership by institutional investors in the following two ways.

First, the Commission should provide that the lowest number of shares held by a nominating shareholder or each member of the a shareholder group during the one-year period be used to calculate the percentage of securities owned and entitled to vote on the election of directors for purposes of the eligibility threshold. Such a baseline is easy to calculate and to maintain during the period leading up to the annual meeting. The shareholder or each member of the group would then be required to represent that it will hold no less than that amount through the date of the annual meeting.

Second, shareholders or each member of a group should be allowed to include shares that have been loaned to a third party, provided that the participant represents that it has the legal right to recall those shares for voting purposes, will vote the shares at the shareholder meeting, and will hold those shares through the date of the meeting. A shareholder may, consistent with its fiduciary obligations, lend shares to third parties, while retaining the right to recall and vote those shares. We believe that loaned shares should be counted as belonging to a nominating shareowner if the conditions outlined above are met.

The Proposed Access Rule would give a nominating shareholder or group the opportunity to promote the candidacies of its nominee(s) using a supporting statement of 500 words or less. We believe that this is insufficient. First, the Plan has substantial experience with the process of drafting proposals to be submitted pursuant to Rule 14a-8, which imposes a 500-word limit. That word limit makes it difficult to convey complex ideas in even a cursory fashion. We are particularly concerned about this limitation because the Commission has currently proposed "Proxy Disclosure and Solicitation Enhancements" rulemaking (File No. S7-13-09) to expand the disclosure requirements for directors and nominees. The goal of the new rulemaking is to provide investors with more information on the qualifications and background of each director nominee, whether incumbent, selected by the nominating committee, or put forward by other proponents. The potential incongruities of these two proposed rules should be considered in any word limits for the Proposed Access Rule. In our view, shareholders voting on directors should have the benefit of a more extensive supporting statement; we would favor a 750- or 1000-word limit.

Finally, the Proposed Access Rule would use a first-to-file approach to mediating between competing shareholders desiring access to the proxy at a particular company. We prefer the approach used by the Commission in its 2003 rulemaking, which gave preference to the shareholder or group with the largest holdings. In our view, subsidizing candidates nominated by the holder or group with the most at stake would best ensure that a proxy access regime is value-maximizing.

Amending the Shareholder Proposal Rule to Permit Proxy Access Proposals

The Proposed Access Rule would also restore shareholders' ability to submit proposals dealing with proxy access pursuant to Rule 14a-8 by amending the Election Exclusion. As we have discussed extensively elsewhere, we believe that permitting generic proposals that would establish a proxy access regime for future elections allows shareholders the fullest exercise of their state-law rights to bring proposals and amend corporate by-laws and is thus consistent with the Commission's own stated objective of fidelity to state-law governance rights. Such an approach would also be wise from a policy perspective; there is no constituency with a greater or more legitimate interest in the conduct of corporate elections than shareholders.

Assuming the Proposed Access Rule is adopted without major changes and a market-wide proxy access rule takes effect, it seems likely that shareholders will benefit from the revised 14a-8(i)(8) infrequently. We can imagine, however, circumstances in which shareholders will wish to impose a less stringent proxy access regime at a particular company. For example, at a non-accelerated filer with a more atomized shareholder base, the 5% threshold could be viewed as too onerous. If holders of a majority of shares concurred with this assessment, the ownership threshold could be lowered.

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We appreciate the opportunity to express our views on this matter.

Sincerely,

Gerald W McEntee

GERALD W. McENTEE
International President