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October 2, 2007

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

Re: Proposed Rules Relating to Shareholder Access
(File No. S7-16-07 and S7-17-07)

Dear Ms. Morris:

The U.S. Chamber of Commerce is the world's largest business federation, representing more than three million businesses and organizations of every size, sector, and region. The Chamber is pleased comment on Release No. 34-56161, IC-27914, entitled "Shareholder Proposals Relating to the Election of Directors" (the "*Short Release*"), and Release No. 34-56160, IC-27913, entitled "Shareholder Proposals" (the "*Long Release*"), each dated July 27, 2007. Each of these releases attempts to resolve, in a different and mutually exclusive way, the previous uncertainty regarding whether reporting companies can exclude shareholder proposals relating to director election procedures from their proxy. The Short Release affirms the Commission's long held view that companies may exclude these types of shareholder proposals, and as a supplemental matter proposes wording changes in the rules that would make this more clear. The Long Release, if adopted, would overturn the existing interpretation and require the inclusion of these types of shareholder proposals if specified criteria are met.

We acknowledge and strongly support the interpretive guidance set out in the Short Release. This guidance reaffirms a long-standing interpretation of the Commission staff (the "*Staff*") that has proven to be a workable and beneficial one. In light of recent statements by the Staff and others, we suggest that, to avoid any further confusion, the Commission should reiterate and take steps to ensure that this guidance is immediately effective. We agree that the wording changes proposed in the

Short Release would make the Rule clearer on its face, and are advisable to avoid any confusion in the future.

Conversely, we strongly oppose the proposal in the Long Release as unnecessary, overreaching and potentially disruptive and harmful to companies and shareholders, as discussed further in Section II below. Beyond these fundamental issues, we believe that specific aspects of the Long Release would lead to undesirable and unanticipated consequences for companies and shareholders, some of which we detail below in Section III.

I. Comments on the Short Release

1. *The Commission should take action to clarify that the guidance in the Short Release has immediate effect.*

The Short Release expressly has two purposes: first, to provide immediately effective interpretive guidance as to the scope of Rule 14a-8(i)(8); and, second, to propose revisions to that Rule so that the Rule's wording expresses its scope more clearly. For at least 17 years the Staff has interpreted Rule 14a-8(i)(8) to permit companies to exclude shareholder proposals relating to director election procedures. This interpretation was a practical and deliberate one, rooted in and informed by the Commission's statements upon adopting the Rule and the Staff's view of the Rule's place in the framework of the proxy rules. The interpretation was consistently reaffirmed and applied by the Staff and survived numerous proposed and adopted changes to the proxy rules. The interpretation was and is an integral, accepted and well-understood component of the proxy rules that the Commission has previously affirmed. As described further below in Section II.4, this interpretation has not prevented shareholders from exerting significant influence on the corporate governance of reporting companies, but has appropriately prevented the company's proxy from being the battleground for the agendas of activist shareholders.

Commission guidance on this question became necessary purely due to an *extrinsic* development – the decision of the Second Circuit that, as a procedural matter, the development of the current Commission and Staff interpretation of the Rule was

not accompanied by a sufficient reasoned analysis.[1] There has been no change in the factual backdrop, the nature of the securities markets or the underlying purpose of the Rule that would warrant a change in the current interpretation. The Second Circuit invited the Commission to confirm the interpretation and we agree with the Commission's determination to do so. Even though any ambiguity in the Rule's wording may not have been clearly resolved by the Commission or the Staff for a significant period of time following adoption of the Rule in 1976, we believe that the discussion in the Short Release, together with numerous other statements made by the Commission over time, constitutes a substantive and compelling reasoned analysis for the current interpretation.

We also note in this regard that this interpretation is just one of many relating to Rule 14a-8 that have developed over the years in the written statements of the Commission and the Staff, and in the actions of the Staff in administering the operation of the Rule. These positions are well understood by the corporate governance community and the bar, and they operate in an integrated fashion; we believe it would be inappropriate public policy to radically revise this one position in isolation from the others, on account of the unintended and unknown consequences that could follow. We suggest that the Commission eschew single, arbitrary revisions to this integrated system.

The Short Release clearly and expressly contains guidance that is intended to take effect immediately. The Commission, in the Short Release, states: "[T]o 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 contest may be excluded under Rule 14a-8(i)(8). We *also* are soliciting comment as to whether we should adopt proposed changes to Rule 14a-8(i)(8) to *further* clarify the rule's application" (emphasis added).

The immediate effectiveness of the guidance in the Short Release is supported by statements made in the open meeting adopting the Short Release. Commissioner Atkins specifically noted in the open meeting that the Commission, in issuing the Short Release, was providing current interpretive guidance as well as proposing

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[1] *American Federation of State, County & Municipal Employees, Employees Pension Plan v. American International Group, Inc.*, 462 F.3d 121 (2d Cir. 2006).

changes to the rule wording, and asked the Staff "in view of the action that we are . . . going to take today, would you follow Commission interpretations in administering our rules?" In response, John White, the Director of the Division of Corporation Finance, responded that the Staff would follow Commission interpretations.[2]

Subsequent statements by Commissioner Atkins are in accord. In a speech before the Federal Reserve Bank of Chicago, Commissioner Atkins noted that the Second Circuit invited the Commission to confirm its interpretation, and he stated that, through the approval of the Short Release:

> "The SEC did just that . . . . We specifically adopted a current interpretation of the director election exclusion that is consistent with the SEC's long-standing interpretation and the interpretation that we put forward to the Second Circuit. As directed by the court, we have provided a thorough explanation for that position. This interpretation, *which now governs our administration of that provision*, will provide the necessary clarity and uniformity for both investors and companies alike until an amendment is adopted in the future."[3]

Despite the clear language of the Short Release and the confirmatory statements made at and subsequent to the open meeting, we believe that there may be some confusion as to the immediate effect of this guidance. For example, press reports and public statements made regarding the Commission's actions often indicate, and may perpetuate, some uncertainty on this point. We believe that, regardless of whether the proposed clarifying changes to the wording of the Rule are ultimately adopted, the Commission should clarify, for the avoidance of doubt, that its interpretative guidance had immediate effect. A reaffirmation of the Commission's interpretation would also be advisable to ensure compliance with the notice and

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[2] *See* SEC Open Meetings Webcast, July 25, 2007,at 4:34, *available at* www.connectlive.com/events/secopenmeetings/.

[3] *Speech by SEC Commissioner: Remarks Before the Federal Reserve Bank of Chicago Seventh Annual Private Equity Conference by Commissioner Paul S. Atkins* (Aug. 2, 2007), *available at* http://www.sec.gov/news/speech/2007/spch080207psa.htm (emphasis added). Despite the clarity of these statements, we believe additional clarification from the Commission is necessary, since the views expressed in the speech are conveyed as those of Commissioner Atkins and not necessarily of the Commission.

public comment requirements of the Administrative Procedures Act, to the extent they are applicable.[4]

2. *The Commission should adopt the wording changes proposed by the Short Release.*

The Short Release would codify the long-standing position of the Commission and the Staff that Rule 14a-8(i)(8) permits the exclusion of proposals to modify a company's election procedures, and not just proposals relating to a specific election. The Commission has reaffirmed this interpretation, and to avoid any future confusion by courts, shareholders, companies or otherwise, we believe that the Rule should be revised as proposed.

II. Reasons That We Strongly Oppose Adoption of the Long Release

1. *The proposed rules exceed the Commission's authority under Section 14 of the Securities Exchange Act of 1934.*

The Long Release would directly regulate the balance of power between corporations and their shareholders, and between large shareholders and other shareholders, in a manner that exceeds the Commission's authority under Section 14 of the Securities Exchange Act of 1934. Under the guise of disclosure and facilitation of existing state rights, the Commission would be effectively adopting federal corporate governance standards that would provide certain large shareholders with a new federal substantive right of proxy access that does not generally exist under state law.

The limits of the Commission's authority under Section 14 were the subject of a 1990 opinion of the Court of Appeals for the District of Columbia, in *Business Roundtable v. SEC*, 905 F.2d 406 (D.C. Cir. 1990). In that case, which related to the Commission's "one-share, one-vote" rule, the court stated that the Commission's authority to regulate proxy disclosure does not permit it to regulate "the distribution of powers among the various players in the process of corporate governance" or to

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[4] While the Commission's view as expressed in the Short Release is that this is not a new interpretation but rather a reaffirmation of a long-standing interpretation, the status of the interpretation under the Second Circuit decision is sufficiently unclear that we believe a reaffirmation of the interpretation at the end of the public comment period is advisable, if only for the avoidance of doubt.

regulate issues that are "part of corporate governance traditionally left to the states." In this regard, the court noted that when enacting the Exchange Act in 1934, Congress expressly disavowed any intent to regulate or interfere in the internal affairs and management of corporations. The court stated that:

> Congress acted on the premise that shareholder voting could work, so long as investors secured enough information and, perhaps, the benefit of other procedural protections. ***It did not seek to regulate the stockholders' choices.*** If the Commission believes that premise misguided, it must turn to Congress. (emphasis added)

The Long Release, citing discussions at the Commission's roundtables on federalism and the question of authority, frame the proposals as merely "facilitating the exercise of shareholders' rights under state law." We believe that one must look beyond the form of the proposed rules to recognize that the practical effect of the rules would fundamentally and substantively change the relationship between corporations and their shareholders with regard to director elections, a matter which lies at the core of corporate governance.

The Long Release states that "[t]he amendments we propose today are designed to provide shareholders with additional disclosure to allow for better-informed voting decisions." However, permitting shareholder access proposals in the company proxy would fundamentally change the nature of the proposals that end up coming to a shareholder vote. The Commission would indeed be seeking to "regulate the stockholders' choices." Mandating shareholder access to proxy statements for the purpose of advancing a shareholder access proposal would create a substantive federal requirement under which a company, in effect, must solicit proxies for the establishment of director election procedures that it does not support, and that will lead to future proxy contests in opposition to the company's own candidates. Such substantive regulation is clearly inconsistent with Congressional intent, as it goes far beyond the central and process-based purpose of the proxy rules; namely to ensure a fully informed and orderly vote on matters coming before the shareholders.[5]

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[5] *See Business Roundtable*, 905 F.2d at 410 ("The goal of federal proxy regulation was to improve [the] communications [with potential absentee voters] and thereby enable proxy voters to control the corporation as effectively as they might have by attending a shareholder meeting.")

As the Supreme Court stated in *Sante Fe Industries v. Green*, "corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law *expressly* requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporations." 430 U.S. 462 (1977) (emphasis in original, quoting *Cort v. Ash*, 422 U.S. 66 (1975)). Clearly, the internal affairs of a corporation include the "relations between management and stockholders." *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541 (1949). The proposals in the Long Release would substantively alter existing state systems of corporate governance, and work fundamental and substantive effect on the state-determined allocation of governance power among shareholders and directors. States that want to permit shareholder access to proxy statements can do so, and in fact have done so. The Commission's role is not to override these state-level determinations.

The limitation of the proposed rules to those by-law proposals that are permissible under state law does not affect this conclusion. Even if a state permits shareholders to amend the by-laws, the proposed rules would expand these rights and, in fact, create a new right – the right to require the company to include the by-law proposal in the company's proxy statement at company's expense. Thus, in the states where the rules would apply (*i.e.*, the vast majority of states), the rules would substantially modify shareholders' rights.[6] If the Commission were merely facilitating existing state rights, then it would make no sense to create a distinction between 5% shareholders and other shareholders, since no such distinction exists at the state level. Why would the Commission facilitate the rights of large shareholders, who are in the best position to advance their own rights, and not those of smaller shareholders?

We note that Congress, in enacting the Sarbanes-Oxley Act of 2002, made significant and sweeping changes relating to corporate governance, financial reporting and related matters, and would have had ample opportunity to expand the Commission's authority in the area of director elections. We believe the lack of Congressional action should lead the Commission to act cautiously in interpreting its authority under Section 14 to relate to matters of corporate governance.

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[6] In addition, as discussed further below in Section II.6, this would result in extremely disparate treatment of shareholders under the federal proxy rules, depending on the state of incorporation.

2. *Adopting the Long Release would be costly and disruptive to companies.*

The potential negative effects of the proposed rule changes on the corporate election process and functioning of boards of directors need to be carefully considered. If the Long Release is adopted, it is likely that proxy contests (in which the company is required to solicit proxies on behalf of shareholders) will ensue and may become customary. These proxy contests would be at two levels – first, an initial proxy contest over a shareholder proposal to permit shareholder access to the proxy and, second, upon the approval of any such proposal, perennial proxy contests over particular shareholder nominees. Such contests are inevitably an extremely disruptive event for a company that will divert vast amounts of time, energy, and funds away from the company's operations and towards defending the company.

The Long Release addresses these increased costs in only an indirect way, stating that "we estimate that the annual additional burden to companies of preparing the required proxy disclosure would be approximately 270 hours of company personnel time and a cost of approximately $36,000 for the services of outside professionals. . . . In addition, the company could incur increased costs relating to the solicitation of proxies in support of the board's candidates and against the shareholder nominees." The Long Release does not estimate what the increased solicitation costs may be. We believe that these solicitation costs are likely to dwarf the cost and time estimates that are given in the Long Release, and that it is essential for the Commission to factor the costs of proxy battles into its cost-benefit analysis.

We believe that the adoption of the Long Release would lead to an increase in full-scale proxy contests that will cause companies to expend significant resources to oppose by-law amendments or to defend their slate of board members against competing slates offered by a large shareholder. Such proxy contests are currently relatively rare, but the proposals in the Long Release would make shareholders much more willing to advance a slate of nominees – once a shareholder access by-law is passed, a qualifying shareholder would be able to include its nominees in the company proxy at the company's expense, and therefore the shareholder would suffer very little downside financial risk in initiating a proxy contest.

The intensity with which companies will campaign against the election of shareholder nominees depends on the particular circumstances, but given the

centrality of directors to a company's business, it is highly likely that a company would take extraordinary efforts to oppose a slate of shareholder nominees that it does not consider qualified or appropriate for the company. This would involve significant media and public relations efforts, advertising in a number of forums, mass mailings and other communication efforts, as well as the hiring of outside consultants and advisors and the expenditure of significant time and effort of the company's employees.

A sense of the potential costs associated with such intense campaigns may best be gained from looking at the estimated costs of some recent major proxy contests. Among the most prominent and strenuous proxy contests relating to director elections during 2007 were those of Motorola, Inc., H.J. Heinz Company and H&R Block Inc. In their respective 2007 proxy statements, these companies estimated the total costs of proxy solicitations in connection with the contests to be $14 million, $7 million and $4 million, respectively. The costs for proxy contests at smaller companies or for less serious challenges are, of course, smaller than these, but often represent equally great burdens proportionately on the income or assets of these companies. The availability to companies of the Commission's e-proxy rules (which are discussed further in Section II.4 below) would not necessarily reduce the costs of printing and mailing proxy materials, because a company in a serious proxy contest may well determine that a mailing of physical materials is a more effective method of conveying its views, and in any event will likely incur significant additional expenses beyond mailing costs.

We believe that adoption of the Long Release would rearrange the incentives such that these sorts of full-scale proxy contests (whether they relate to shareholder nominees or to a shareholder access by-law amendment) would become much more common and perhaps even a perennial feature of director elections. The company's resources would be expended to the detriment of shareholders generally, but for the benefit of the large, but still minority, shareholders whose proxy solicitation would be funded by the company. The fact that the company (in effect, the shareholders) will be forced to fund the proxy solicitations of certain shareholders is particularly worrisome because of the likelihood that some large shareholders will abuse a system that does not force them to internalize the costs of their behavior. Under the current system, any shareholder, large or small, is free, within the confines of applicable state law, to wage a proxy contest against a company's current director election procedures

or current slate of directors. But in doing so, the contesting shareholder must consider whether the associated costs are an efficient use of its resources. If large shareholders are able to use the company's assets to fund a proxy contest relating to director elections, they will have no incentive to avoid wasteful activities or proposals designed merely to garner publicity or gain leverage against management to advance a narrow agenda, as discussed in the next section below.

3. *Adopting the Long Release will impair the functioning of boards to the detriment of all shareholders.*

It is likely that most proposals to permit shareholder access and to advance shareholder nominees will be advanced by the types of activist shareholders that traditionally have used the shareholder proposal mechanism for the promotion of parochial interests or political or social issues having little to do with the company's business. To the extent that such shareholders are actually successful in instituting shareholder access and ultimately electing special interest or "protest" directors, the effect may be to create divided boards of directors with a diminished capacity to function effectively. If management or directors feel that certain other directors are working with an agenda other than the best interests of the company, this could actually cause management to limit discussion with the board, or could cause the board to create working committees that exclude the special interest directors.

More generally, creating an environment where election contests are a constant threat will turn the company-shareholder relationship into an essentially adversarial relationship, instead of one where the parties' interests are aligned and the parties are working toward a common purpose. We also believe that the threat of acrimonious, contested elections and the resulting uncertainty may dissuade many qualified directors from board service. In recent years, stock exchange independence and other corporate governance requirements, the Commission's rule-making under the Sarbanes-Oxley audit committee requirements and the expansion of director compensation and related-party transaction disclosure have already made it much more difficult for companies to find qualified independent directors who have the time, ability and inclination to serve, and the proposed rules would aggravate this situation.

4. *There has been no compelling, objective showing of need for the new rules.*

We do not believe that there is a demonstrable need for the adoption of the Long Release. The Long Release does not advance any objective basis for believing that shareholder access to company proxy statements would be a benefit to shareholders or an improvement to the director election process. The Long Release indicates that an intent of the proposal is "vindicating shareholders' state law rights to nominate directors" but does not indicate what the proposal would vindicate these rights *against*. The extent to which, and the manner in which, shareholders may nominate directors or amend the by-laws to permit shareholder nominations are established and delineated by state law, and these rights are in no way under attack or in need of federal vindication.

We believe that corporate governance developments and advances in recent years on a number of fronts have indicated that there is no need for the new rules. We note, in particular, the following.

Changes in state law. As discussed further in Section II.1 above, state law defines the rights of shareholders, including the extent to which shareholders can propose by-law amendments and nominate directors, and the extent to which they have access to the company's proxy to do so. States can and do modify their laws to adjust the balance of power between companies and shareholders as they see fit, and to give more or less discretion to companies as to the rights that shareholders have. For example, North Dakota has recently modified its corporate law to permit corporations to offer a suite of enhanced rights to shareholders, including proxy access for 5% shareholders, majority voting for directors, advisory shareholder votes on compensation reports, reimbursements of costs for successful proxy contests and separation of the role of CEO and chairman.[7]

In 2006, Delaware modified its corporation law to better accommodate majority voting standards (as opposed to plurality voting standards) for director elections. In particular, the Delaware law amendments permit irrevocable agreements by directors that they will resign if they do not receive a specified vote for reelection and provide that a corporation's board of directors cannot unilaterally amend or

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7 *See* N.D. Cent. Code § 10-35 (2007), *available at* http://www.legis.nd.gov/cencode/t10c35.pdf.

repeal a stockholder-approved by-law amendment which specifies the vote that is necessary for the election of directors. In July 2007, Ohio passed a similar law making it possible for corporations to adopt majority voting standards.

State law is the traditional and appropriate forum for defining the rights of shareholders with regard to director elections, by-law amendments and other fundamental corporate matters. The recent revisions in state law in these areas illustrate that states are appropriately responsive to shareholder concerns and able to balance the competing interests. The laws of the various states provide flexible environments in which new corporate governance ideas can be tested, refined and applied. There is no reason for the Commission to override state decision-making in this area and impose a one-size-fits-all federal solution.

Corporate responsiveness to shareholder concerns. In recent years, a growing number of corporations have revised their corporate governance practices in significant ways in response to shareholder concerns, including with regard to director elections. Surveys indicate that nearly two-thirds of companies in the S&P 500 index have adopted board election reforms in recent years, in some cases affirmatively requiring election of directors by majority vote (as opposed to a mere plurality) and in other cases imposing a requirement that directors who do not receive a majority vote will, as a matter of policy, offer to resign. In 2007 alone, 140 companies received shareholder proposals relating to majority voting, most of which were withdrawn after the companies decided to voluntarily adopt director election reforms. Of those that were opposed by management and submitted to a vote, the average level of support received, according to Institutional Shareholder Services, was approximately 50%.[8]

In addition, over the past few years a large number of companies have determined to destagger their classified boards and to subject their directors to annual elections. Currently, a majority of the companies in the S&P 500 index do not have classified boards. According to an ISS study, the percentage of S&P 500 companies with classified boards has been steadily declining, from 61% in 2004 to 45% in 2006.

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[8] It is interesting to note that, in comparison, only *two* proposals relating to proxy access went to a vote, despite the fact that, due to the Second Circuit decision, this was the first year that such proposals were required to be included. Neither proposal won a majority of the votes. This response seems to suggest that proxy access is not generally seen by shareholders as a particularly desirable right.

We believe that these recent developments have shown that large shareholders and shareholder interest groups are increasingly capable of influencing corporate action, and that corporations are increasingly responsive to investor concerns. There is a significant likelihood that this trend would be reversed if the Long Release is adopted. For example, if companies are subject to a greater risk of costly proxy contests at each director election, they have an incentive to return to having staggered boards to reduce the number of elections.

SEC and stock exchange rule-making. In recent years, the New York Stock Exchange, the Nasdaq Stock Market and other major stock exchanges, acting in response to a Commission request, each adopted significant changes to their corporate governance listing standards. Under these standards, the independent directors, generally in the form of an independent nominating committee, have greater involvement in the director nomination process. In addition, these standards heightened the requirements for determining whether a director is "independent" of management and the company. Numerous additional corporate governance changes have been imposed by the stock exchanges, as well as by the Commission under the Sarbanes-Oxley Act of 2002 and in its executive compensation rule changes in 2006. The 2006 rule changes require increased proxy disclosure relating to director compensation, transactions between the directors and the company and director independence determinations.

The Commission's 2006 rule changes incorporate and supplement earlier rule changes, adopted in November 2003, requiring disclosure in company proxy statements as to the nominating committee process and actions, as well as communication between shareholders and board members. These disclosure requirements, which are currently set out in Item 407(c)(2) of Regulation S-K, require the company to provide detailed information on the practices and policies of its nominating committee. In particular, any U.S. reporting company is required to disclose the following:

- If the nominating committee has a policy with regard to the consideration of director candidates recommended by shareholders, a description of the material elements of the policy (including, but not necessarily limited to, a statement as to whether the committee will consider director candidates recommended by shareholders). If the

committee does not have such a policy, the company must include a statement of that fact and the basis for the view of the board of directors that it is appropriate for the company not to have such a policy.

- A description of the procedures to be followed by shareholders in submitting recommendations for director candidates, if the nominating committee will consider them.

- A description of any specific, minimum qualifications that the nominating committee believes must be met by nominating committee-recommended board nominees and any specific qualities or skills that the nominating committee believes are necessary for one or more of the company's directors to possess.

- A description of the nominating committee's process for identifying and evaluating nominees for director, including nominees recommended by security holders, and any differences in the manner in which the nominating committee evaluates nominees for director based on whether or not the nominee is recommended by a security holder.

- With regard to each nominee approved by the nominating committee for inclusion on the company's proxy card (other than nominees who are executive officers or directors standing for re-election), the company must disclose which one or more of the following categories of persons or entities recommended the nominee: shareholder, non-management director, chief executive officer, other executive officer, third-party search firm, or other specified source.

- If the nominating committee receives a recommended nominee from a shareholder or shareholder group who, either individually or in the aggregate, beneficially owned more than 5% of the company's voting common stock for at least one year as of the date of the recommendation was made, identification of the candidate and the shareholder or shareholder group who recommended the candidate, and

disclosure of whether the nominating committee chose to nominate the candidate.

These disclosure requirements, together with the other corporate governance enhancements arising from stock exchange and Commission rules in recent years, seem to represent a significant departure from the prior disclosure philosophy – rather than relying on the company's judgment and the fiduciary obligations of the board of directors to evaluate suggested nominees, the process has been largely laid bare for investors and the general public to evaluate. Regardless of the wisdom of this approach, it can be said that, unlike the Long Release, Rule 407(c) has the benefit of primarily being about disclosure, without seeking to directly regulate the choices that shareholders have.

The effect of the SEC's existing disclosure rules is to provide investors with a great deal of information on a company's director nomination process, thus enabling them to participate fully in this process to the extent permitted by state law and the company's policies, and to enable comparisons of the processes of different companies in the interest of developing best practices.

We believe that these stock exchange rules and Commission rules obviate any need for greater shareholder access to the issuer proxy statement. As the Commission has previously recognized, use of independent nominating committees addresses the same concerns that underlie the shareholder access proposals.[9] The stock exchange and Commission rules have had a significant impact on the director nomination process and have expanded the information available to shareholders in making director election decisions.

We believe, in fact, that the enhancements established by the stock exchange and Commission disclosure rules, which emphasize the involvement of independent directors and the transparency of the nominating process, constitute a superior system for protecting the interests of all shareholders as compared to the shareholder access

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[9] *See SEC Staff Report on Corporate Accountability Printed for the Use of the Senate Comm. On Banking, Housing and Urban Affairs*, 96th Cong, 2d Sess. A61-62 (Sept. 4, 1980). The Staff supported the use of nominating committees as an alternative to shareholder access rules and recommended postponing the introduction of shareholder access requirements until it was determined whether the use and accessibility of nominating committees was expanding.

requirements. The company's directors have a fiduciary duty to *all* shareholders, and the heightened independence standards ensure that the independent directors can truly act in a manner independent of management. These independent directors are in the best position to weigh all recommendations – from management, shareholders or other sources – and make recommendations to the full board as to the nominees for inclusion in the issuer proxy.

The proposed shareholder access rules would give certain large shareholders the ability to force the company to expend funds to modify the director election process or to advance the nomination of the shareholders' nominees. These shareholders do not owe a fiduciary duty to the corporation or to other shareholders, and there is no reason to think that they will strive to act in the best interests of the other shareholders or of the corporation. The interests of all shareholders are best served by having the independent directors, and not large shareholders, serve as the primary filter for director nominees, or at least by permitting companies to make that determination.

E-proxy rules. In December 2006, the Commission adopted rules permitting issuers and other soliciting persons to furnish proxy materials to shareholders through a "notice and access" model using the internet. While we have concerns regarding the effect of the e-proxy rules on issuers and individual shareholders, we believe that this method of distributing proxy materials is likely to permit large stockholders to wage effective proxy contests at a lower cost. The Long Release includes as one of the purported benefits of the proposal that a "bylaw amendment that allowed shareholder nominees to be included in the company's proxy materials would reduce the cost for a shareholder to nominate candidates for election on the board since the nominating shareholder would not need to incur the cost of preparing separate proxy materials and mailing those materials to other shareholders." The e-proxy rules are, to some extent, separately aimed at achieving a similar cost reduction for soliciting shareholders. The effective date of the e-proxy rules was July 1, 2007, so the 2008 proxy season will be the first season for which they are effective. We believe that the Commission should, at a minimum, observe the functioning of these rules during the next proxy season before making significant additional changes to the proxy access rules.

5. *Adoption of the Long Release would increase the burden on the Staff.*

Rule 14a-8 currently places a significant burden on the Staff. The Staff is currently in the position of evaluating, on a case-by-case basis, hundreds of requests by companies for no-action letters permitting exclusion of shareholder proposals under Rule 14a-8, many of which involve considerable factual and legal analysis and extended communications with shareholder proponents and companies. As the Long Release indicates, "Rule 14a-8 thus places the Commission's staff at the center of frequent disputes over whether a proposal must be included in the company's proxy materials."

The Long Release would modify Rule 14a-8(i)(8) so as to make it by far the most complex basis for exclusion. An assessment by the Staff as to whether a proposal may be excluded under proposed Rule 14a-8(i)(8) would require the Staff to resolve numerous factual and legal questions. It is likely that a company seeking to exclude a shareholder proposal will question the satisfaction of the criteria of Rule 14a-8(i)(8), including the nature of the proposing shareholder's holdings, the "group" status of multiple shareholders, the shareholder's Schedule 13G eligibility and whether the shareholder's Schedule 13G contains "all required information." These questions will be intensely fact-specific and in many situations will require a much more extensive discussion and in-depth analysis than the Staff customarily is required to undertake. This process will entail the expenditure of significant time and resources by the Staff, the company and the proposing shareholder.

6. *The Long Release would create a two-tier system at the federal level depending on whether shareholders have a state law right to amend by-laws.*

Most states require that shareholders have the power to amend a corporation's by-laws, even if they share this power with the board of directors. In other states, corporations are permitted to vest the power to amend by-laws exclusively in the board of directors. The states in the latter category include Maryland and Nevada, each of which is the state of incorporation for a large number of reporting companies. In 2006, over 200 Forms 10-K were filed by companies incorporated in Maryland and over 700 Forms 10-K were filed by companies incorporated in Nevada. In addition,

Maryland is a common incorporation location for investment companies, with over 700 Forms N-CSR filed for Maryland investment funds in 2006.[10]

Adoption of the Long Release would have no effect on companies whose shareholders do not have the right to amend the company's by-laws, and (as discussed above) would have an extraordinary impact on companies whose shareholders do have such a right. The Long Release justifies this difference by stating that the proposal is merely "vindicating" existing state rights. However, we believe that the proposed revisions in the Long Release would have such a far-reaching impact on shareholder rights that their application to some shareholders and not others creates a two-tier application of the proxy rules at the federal level. The proposals would magnify a state law distinction and raise it to the federal level, thereby treating shareholders in a disproportionately disparate manner. The Commission should not adopt rules at the federal level that treat shareholders so differently based on the company's state of incorporation. There is no reason to think that state legislatures, in crafting the balance of power between shareholders and companies, would expect that federal rules would attach such expansive ramifications to these state law distinctions.

III. Specific Problems with the Application of the Long Release

The proposals in the Long Release, if adopted, would extend further into areas traditionally left to the states than the Commission has previously ventured. For this reason, we believe the Commission should proceed cautiously and ensure that no rule adopted in this area extends farther than is strictly necessary to implement the Commission's goals. The effects of any rule changes in this area are difficult to predict, and therefore it is best for changes to be made incrementally. We believe that, in addition to raising the more fundamental issues discussed above, adoption of the Long Release would have a number of unanticipated and undesirable effects and would seriously damage the director election process and the rights and interests of all shareholders. Any rule adopted in this area would, we believe, need to address these problems.

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[10] Of course, many Maryland and Nevada companies do, as a matter of corporate governance, grant shareholders the right to amend their by-laws. We believe that if the Long Release is approved many of these companies will strip shareholders of these rights in order to avoid being subject to shareholder access proposals.

1. *Companies and their shareholders should be able to opt out of the proposed access regime by voting to approve an alternative system.*

Some companies may determine that the costs of permitting shareholder access proposals or shareholder nominees to be included in the company's proxy statement (*e.g.*, the time and attention of management and the board and the funds of the company being spent on proxy contests as opposed to on business matters) outweigh the benefits. In such cases, companies should be allowed to opt out of the application of proposed Rule 14a-8(i)(8) by adopting charter or by-law provisions that prohibit by-law amendments permitting shareholder access.[11] These revisions would be subject to shareholder approval to the extent required by state law or the company's organizational documents. The Long Release seems to recognize the desirability of an "opt out" right, when it provides that a "substantive limitation" on such by-law amendments would be that "imposed by . . . the company's charter or by-laws."

This concept, however, is not clearly provided in the proposed rules themselves. The Long Release seems to contemplate that Rule 14a-8(i)(1) may be utilized as an "opt out" mechanism, stating that "most state corporation laws provide that a corporation's charter or bylaws can specify the types of binding or non-binding proposals that are permitted to be brought before the shareholders for a vote at an annual or special meeting. Rule 14a-8(i)(1) supports these determinations by providing that a proposal that is violative of the corporation's governing documents may be excluded from the corporation's proxy materials."

Absent specific authority in the rule itself, however, it is questionable whether a corporation could use Rule 14a-8(i)(1) to opt out of the proposed system. Under federal case law, a corporate by-law (and presumably a charter amendment) cannot act "as a block or strainer to prevent" shareholder proposals from inclusion in a company's proxy materials.[12] Any rule adopted in this area should specifically permit

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11 Of course, shareholder approval would only be required if the charter or by-law provision is made as an amendment to existing documents. A newly formed company that undertakes an initial public offering would be able to have such a provision in its organizational documents at the outset.

12 *SEC v. Transamerica Corp.*, 163 F.2d 511, 516 (3rd Cir. 1947) ("The power conferred upon the Commission by Congress cannot be frustrated by a corporate by-law"). *See also* Louis Loss & Joel Seligman, *Securities Regulation* 1997 (3rd ed. 1999) ("It is probable . . . given existing case law, that the courts would not permit a certificate of incorporation provision or bylaw to act 'as a block or strainer' augmenting the requirements of Rule 14a-8").

exclusion of shareholder access proposals that are prohibited by the company's charter or by-laws.

2. *Shareholders who successfully advance a by-law amendment should not be able to propose nominees under that by-law provision.*

One concern under the proposed rules is that a shareholder may advance a shareholder access by-law amendment as part of a multistage attempt to gain access to the company's proxy for its own director nominees. The Long Release seems to acknowledge this concern by requiring that any proponent of a by-law amendment under Rule 14a-8(i)(8) must be eligible to file Schedule 13G, and therefore must not have acquired or continue to hold the securities with a purpose or effect of changing or influencing the control of the issuer.

Nothing in the rule as proposed, however, would prevent a Schedule 13G filer that successfully advances a by-law amendment permitting shareholder access from later utilizing that by-law provision to propose directors. Although such a maneuver would suggest that the two steps were part of a plan to influence the control of the company, it would be difficult to prove that this was the proponent's initial intent. In order to ensure that a proponent of a by-law amendment under proposed Rule 14a-8(i)(8) is motivated by a genuine desire to enhance the company's director election process and not merely to advance its own candidates, any rule adopted in this area should expressly prohibit the proponent of a shareholder access by-law amendment from later proposing nominees under that by-law provision. At a minimum, the proposing shareholder should be prohibited from proposing nominees for a significant period of time – we would recommend a five-year prohibition period, which would be consistent with the time period used for assessing resubmissions under Rule 14a-8(i)(12).

3. *The Schedule 13G eligibility requirements should expressly reference intent to access the company's proxy.*

We believe that if the Long Release were to be adopted, there would be a significant risk of shareholders misusing Schedule 13G and proposed Rule 14a-8(i)(8) to attempt to gain influence over the company. Shareholders who want to be able to include nominees in the company's proxy will have an incentive to claim "passive investor" status in order to propose a by-law amendment permitting shareholder

access. In addition to the concern raised in the preceding section, we believe that if Schedule 13G filers are permitted any degree of enhanced proxy access for director elections, then the qualification provisions of Schedule 13G should be revised to specify that acquiring or holding securities with the intent to subsequently access the company's proxy to nominate director candidates will be deemed to be acting with the purpose and intent of changing or influencing control of the issuer.

4. *Rule 14a-8(i)(8) should include limitations on the substance of the proposed by-law amendment.*

The proposed amendments would permit an eligible shareholder to include in the company's proxy *any* proposed by-law amendment that establishes a procedure for shareholders to include director nominees in the company's proxy. The rule would not impose any substantive requirements on the by-law amendment and would not provide companies any way to exclude or otherwise deal with proposals that are extreme or unworkable. There is little reason to believe that shareholders who are advancing by-law amendments will have the expertise or inclination to ensure that the proposed amendment functions consistently with the existing organizational documents (which are generally fairly intricate and interconnected), or with the legal and regulatory environment in which the company functions. In particular, we believe that any rule adopted in this area should in no event require companies to include by-law amendments unless the amendments impose the following requirements on nominating shareholders and on shareholder nominees:

- Nominees must be independent of the company under applicable director independence standards. Since the independence determination will, in most cases, involve a subjective determination by the board of directors, the amendment would have to provide that no director could be nominated who has or has had any relationship with the company whatsoever, other than those relationships that are expressly determined to be immaterial under the company's then-existing guidelines for director independence, if any.

- Nominees need not be included in the company's proxy if their election in lieu of any of the directors on the company's slate would decrease the number of directors who are "outside directors" under Section 162(m)

of the Internal Revenue Code, "non-employee directors" under Rule 16b-3 under the Securities Exchange Act of 1934, "audit committee financial experts" under the Commission's rules, or eligible audit committee members under stock exchange standards and Rule 10A-3 under the Exchange Act.

- Nominees must meet the company's internal director qualification standards, if any. The company should not be required to lower its standards to accommodate a shareholder nominee.

- Nominating shareholders must have held at least 5% of the company's voting equity securities for at least one year prior to the nomination, and must express the intent to hold that level of securities for the duration of the nominee's term. The eligibility standard for including a nominee in the company's proxy should be no lower than the eligibility standard for proposing the by-law amendment. Otherwise a 5% stockholder could propose an extreme by-law amendment that would permit shareholders with insignificant holdings to include nominees in the company's proxy, which would be detrimental to stockholders generally.

- Nominating shareholders must not have submitted a director nominee (whether or not elected) within the preceding three years. A single shareholder or group of shareholders should not be able to monopolize the nomination process year after year. This time period would be consistent with the three-year period in Rule 14a-8(i)(12), and would also permit ongoing renominations in the case of a company with a typical three-class staggered board.

5. *The eligibility requirements for proposing shareholders should be increased.*

To the extent that large shareholders are given access to the company's proxy statement for election-related matters, we recommend increasing the requisite ownership percentage from 5% to 10%, at a minimum. Shareholder access to proxy statements for director elections, to the extent it is permitted at all, is only appropriate in cases where there is widespread shareholder dissatisfaction with the company's management. In the case of such widespread dissatisfaction, shareholders will be able

to coordinate efforts and create a 10% shareholder group. Establishing a 5% threshold would make it too easy for a handful of dissident shareholders to work together to put forth a by-law amendment that is not in the best interest of all shareholders.

We further believe that any shareholder access rule that permits a group of shareholders to collectively satisfy the ownership threshold should require the group to have been filing as a group on Schedule 13G for one year prior to seeking access to the company's proxy materials. This one-year period is consistent with the general one-year holding period under the proposed rules, and serves a similar function. It ensures that the shareholders are not opportunistically coming together and filing as a group solely for the purposes of meeting the threshold, after which they could just disband. This is particularly important if the threshold is not increased from 5%.

6. *The resubmission thresholds should be increased, both in general and specifically for by-law amendments relating to shareholder access.*

Rule 14a-8(i)(12) provides a range of time periods during which shareholder proposals may not be resubmitted, depending on the level of support that earlier similar proposals had received. As discussed further in Section II.1 above, we believe that a by-law amendment permitting shareholder access would have a significant impact on a company, and a proxy contest relating to such an amendment could impose significant costs on the company. For this reason, we believe that, in the event such proposals are permitted, resubmissions should be prohibited for a period of five years – the maximum time period referenced under Rule 14a-8(i)(12) – regardless of the level of support that the proposal received. If shareholders vote down a shareholder access proposal, then the company (and, indirectly, the shareholders) should not be required to bear the costs of another proxy contest on the same subject for a substantial period of time.

More generally, we believe that the thresholds in Rule 14a-8(i)(12) no longer provide companies and shareholders with meaningful protection against the repeated submission of proposals that have been soundly defeated in recent years. The Rule permits a company to exclude a proposal if substantially similar proposals received: (i) less than 3% of the vote if proposed once in the preceding 5 years; (ii) less than 6% of the vote on its last submission if proposed twice in the preceding 5 years; and (iii) less

than 10% of the vote on its last submission if proposed three times or more in the preceding 5 years. These levels have not been changed for over 50 years.

We believe that, due to increased shareholder activism, greater institutional investment and a sharpened focus on corporate governance, it is common for proposals that lack broad investor support to nevertheless obtain a "protest" vote of significantly over 10%. In such cases, even though the vast majority of shareholders opposed the proposal, the proxy rules do not provide the company or the majority of shareholders with any protection against repeated submissions. This has led to many companies being forced to include nearly identical proposals in their proxies year after year, imposing a needless cost on the company and, ultimately, on the shareholders who continue to vote down the proposal.

We recommend that the Commission increase the Rule 14a-8(i)(12) submission percentages significantly. Based on our experience with the votes commonly obtained by resubmitted proposals, we recommend that the percentages of 3%, 6% and 10% be changed to 10%, 25% and 40%, respectively. We believe these percentages would appropriately balance the right of particular shareholders to submit proposals against the right of shareholders generally to meaningfully vote down proposals that they oppose.

7. *Proposed Item 24 of Schedule 14A should not apply if the company is opposing the shareholder's proposal.*

Proposed Item 24 of Schedule 14A would require company disclosure of information regarding its relationship with a shareholder proponent of a by-law amendment. We believe that this type of disclosure requirement should only apply if the company is supporting the shareholder's proposal. This disclosure is properly the responsibility of the shareholder and the Item 24 disclosure would be duplicative of much of the disclosure in the shareholder's Schedule 13G. Any material relationships between the company and a 5% shareholder are already required to be disclosed under Item 404 of Regulation S-K.

8. *Companies should not be required to include multiple shareholder access proposals in a single year.*

To avoid confusion and duplication, companies should in no event be required to include in a single proxy statement more than one proposed by-law amendment that qualifies for inclusion under Rule 14a-8(i)(8). This can be accomplished by specifying that all such by-law amendments shall be deemed to be substantially duplicative for purposes of Rule 14a-8(i)(11). In addition, Rule 14a-8(i)(11) should be modified so that the company need not include the first such proposal that it receives. A shareholder access proposal can have such significant implications for a company that the rules should not give qualifying shareholders an incentive to rush their proposals. If a company has received multiple qualifying proposals, the company's nominating committee should be permitted to determine which one to include.

9. *As a general matter, the minimum dollar threshold for submission of proposals should be increased from $2,000 to $10,000.*

The minimum dollar requirement for submission of shareholder proposals was initially set at $1,000 in 1983 and was adjusted to $2,000 in 1997 to account for inflation. We believe that the Commission should take the opportunity to increase this threshold to $10,000. In our experience, a significant number of proposing shareholders hold a number of shares only slightly above the threshold, often at a large number of companies. Shareholder proposals have an impact on all shareholders, both in the company's expenditures to address them and in their potential impact upon adoption. The minimum threshold should be set at a level to give greater assurance that proposing shareholders are motivated by a desire to protect their investment rather than to merely advance an agenda. Any amount below $10,000 raises the concern that the shareholder has acquired a *de minimis* amount merely to become eligible to make the proposal.

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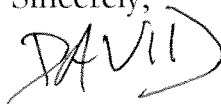
We appreciate the opportunity to comment to the Commission on the releases, and would be pleased to discuss any questions the Commission may have with respect to this letter. Any questions about this letter may be directed to David Hirschmann, Senior Vice President, at (202) 463-5609.

Sincerely,



David T. Hirschmann