
RESEARCH NOTE

January 2010

Authors:
Kenneth L. Altman
James F. Burke

Review of Letters Submitted to the SEC on “Proxy Access” (Dec. 19-Jan. 19 Comment Period)

INTRODUCTION

The Securities and Exchange Commission (SEC) proposed changes to proxy rules in a release dated June 10, 2009, and titled “Facilitating Shareholder Director Nominations.”¹ On December 14, 2009, the Commission moved to reopen the comment period on the proposed rules for the express purpose of seeking comments “on additional data and related analyses that have been included in the public comment file.”² The Commission was seeking comments related to issues examined in the following studies already in the comment file (File Number S7-10-09):

- Report on Effects of Proposed SEC Rule 14a-11 on the Efficiency, Competitiveness and Capital Formation, in Support of Comments by Business Roundtable, NERA Economic Consulting (submitted on August 17, 2009 by the Business Roundtable);³
- “Why Did Some Banks Perform Better During the Credit Crisis? A Cross-Country Study of the Impact of Governance and Regulation,” by Andrea Beltratti and Rene M. Stulz (submitted on September 11, 2009 by the Business Roundtable);⁴
- “The Limits of Private Ordering: Restrictions on Shareholders’ Ability to Initiate Governance Change and Distortions of the Shareholder Voting Process,” The Corporate Library (submitted on November 18, 2009 by the Shareowner Education Network and the Council of Institutional Investors);⁵ and
- A supplemental analysis of share ownership and holding period patterns from Form 13F data by the Commission’s Division of Risk, Strategy, and Financial Innovation, dated November 24, 2009.⁶

The primary topics covered in those reports included: the potentially detrimental effects of the proposed rule on U.S. equity market competitiveness; stock price performance for companies with dissident directors; a finding by Andrea Beltratti and René M. Stulz that “banks with more pro-

¹ “Facilitating Shareholder Director Nominations,” Release Nos. 33-9046; 34-60089; IC-28765; File No. S7-10-09 (June 10, 2009), 74 FR 29024 (June 18, 2009).

² <http://www.sec.gov/rules/proposed/2009/33-9086.pdf>

³ <http://www.sec.gov/comments/s7-10-09/s71009-267.pdf>

⁴ <http://www.sec.gov/comments/s7-10-09/s71009-528.pdf>

⁵ <http://www.sec.gov/comments/s7-10-09/s71009-568.pdf>

⁶ <http://www.sec.gov/comments/s7-10-09/s71009-576.pdf>

DISCLAIMER: This report is for educational purposes. Information contained in this report was obtained from letters sent to the SEC, and posted in the public domain on the SEC’s web site. No representations or warranties are made as to the accuracy of the information and claims contained in, or derived from, those third party letters. No responsibility or liability, including for consequential or incidental damages, can be accepted for any errors, omissions or inaccuracies in this report. Nothing in this report should be deemed a recommendation or offer to purchase or sell any security. Nothing in this report should be considered or used as legal advice. All trademarks, copyrights, and comments are owned by their respective authors.

shareholder boards performed worse during the crisis”;⁷ views on “private ordering” and “opt-outs”; and estimates of the number of companies that could be affected by the proposed rule, including the impact of various ownership thresholds on the number of investors likely to be eligible to nominate directors under PR14a-11.⁸ The NERA Economic Consulting study also cited statistics to support an argument that goes largely without contention - the marketplace already presents numerous mechanisms to hold management and boards “accountable.” In addition, the authors of that study, Dr. Elaine Buckberg and Prof. Jonathan Macey (Yale Law School), included data to advance the following contentions: “The low frequency of proxy contests and activist campaigns, along with the frequent success of company/board slates against dissidents, suggest that shareholder dissatisfaction with outside directors is rare and that finding superior substitutes for incumbents is more difficult than generally is assumed.”

REVIEW OF LETTERS SUBMITTED

The comment period on the proposed rule was reopened for 30 days (through January 19, 2010), during which the Commission received some 46 letters (as posted on the SEC’s web site).⁹ The largest number of letters came from pension funds (10 in all, from CalPERS to OPERS), professional associations, academics (from Harvard’s Lucian Bebchuk to Stanford’s Joseph A. Grundfest), and various other proxy and corporate governance experts. A large minority of the comments that were submitted focused on a broader range of issues than the specific topics raised by the four studies cited in the SEC’s release. Notably, the Independent Directors Council (IDC) submitted a letter urging the “Commission to exclude investment companies from the current proposal...the proposal does not account for the fundamental differences in governance models between public operating companies and investment companies.”¹⁰ Among the responses that did address specific topics mentioned in the four reports, more comments were received on the subject of “private ordering” than on any other topic.

Among the new comment letters were two from listed companies that had not previously submitted letters on the proposing release – Assurant (AIZ)¹¹ and TriQuint Semiconductor (TQNT).¹² The responses from AIZ and TQNT brought the total number of public companies submitting letters on the proposed rule up to 114. In addition, more than two dozen additional listed companies, which did not submit letters to the SEC on the proposed rule, were among participants in a survey on proxy access issues conducted by The Altman Group -- the results of which were included as an attachment to a

⁷ <http://www.sec.gov/comments/s7-10-09/s71009-528.pdf>

⁸ The NERA Economic Consulting study also cited statistics related to the high costs for companies to vet outside director candidates and the marginal savings to shareholders nominating directors resulting from having companies include PR14a-11 candidates in company proxy materials. However, none of the letters submitted to the SEC during the reopened comment period offered any new substantive data or arguments on these particular issues.

⁹ <http://www.sec.gov/comments/s7-10-09/s71009.shtml#33-9086>

¹⁰ <http://www.sec.gov/comments/s7-10-09/s71009-591.pdf>

¹¹ <http://www.sec.gov/comments/s7-10-09/s71009-620.pdf>. Assurant’s Chief Legal Officer, Bart Schwartz, wrote that if the Commission “were to adopt some version of the proposed new Rule 14a-1,” then it should also “allow shareholders, by majority vote, to adopt conditions or procedural protections”; “allow the Board’s independent nominating and corporate governance committee (or, in the case of NASDAQ-listed companies with no such committees, the Board’s independent directors) to interview and comment on (but not to veto) any shareholder nominees”; “increase the ownership threshold for large accelerated filers...to five percent”; “restore the independence requirement from the 2003 proposal, and require nominees to meet all of the company’s independence standards (not just the NYSE objective standards) and to make other independence disclosures”; “replace the proposed first-in-time regime with one that gives nominating priority to larger shareholders”; and “clarify that the SEC will enforce the ‘substantially implemented’ exception to Rule 14a-8 to deter sequential filing of shareholder-access proposals.”

¹² <http://www.sec.gov/comments/s7-10-09/s71009-582.htm>. TriQuint Semiconductor’s CFO Steve Buhaly wrote a short note urging that “enhanced proxy access be granted only to investors who have held at least a 5% ownership position for a minimum of two years.”

comment letter submitted to the SEC during the reopened comment period.¹³ We will not repeat all of that survey’s results herein, and urge readers to read the summary report, which is available on The Altman Group’s website.¹⁴ Readers will also want to reference our special report on letters submitted to the SEC during the first comment period on the proposed rule. That report is available for downloading from our website, and is titled *Proxy Access: A Study of 500+ Letters Submitted to the SEC on “Facilitating Shareholder Director Nominations”* (The Altman Group, Special Report, published November 30, 2009).¹⁵

The following is a review of letters submitted to the SEC during the most recent comment period on “Facilitating Shareholder Director Nominations.” In the sections below we identify and summarize new data and arguments submitted to the SEC on the main topics raised by the four reports cited by the SEC in its release of Dec. 14, 2009.

Issue: Competitiveness of U.S. Equity Markets

While more than a few prominent supporters of Proposed Rule 14a-11 (hereafter “PR14a-11”) have been noticeably shy when it comes to addressing the issue of risk that the proposed rule may deter some U.S. and foreign companies from accessing U.S. equity markets, more than a few directors and executives of companies expect a direct proxy access rule to negatively impact the competitiveness of U.S. capital markets. The Altman Group’s survey on proxy access issues drew responses from directors and executives of 36 public companies, 80.85% of which agreed that the proposed direct proxy access rule “will deter some U.S. private companies from going public and some foreign companies from listing on U.S. exchanges.”

Corporate directors and executives are not the only ones expecting the rule to drive companies away from U.S. equity markets. For example, Richard Tullo submitted a letter offering perspectives from “an investment analyst for an activist hedge fund” who has “participated in roughly 23 shareholder actions and proxy contests.” He questioned just how effective the proposed rule will be: “I want shareholder access to proxies but the current rule does nothing to thwart the corporate counter measures that are adopted by boards to subvert shareholders...this plan will encourage boards to lower Shareholder Rights or Poison Pill thresholds to 1% and I predict even companies with top tier corporate governance will adopt classified boards to subvert the shareholder vote entirely. Moreover, in today’s global markets, I think many companies will relocate to foreign countries and list their securities on the exchanges with more forgiving corporate governance.”¹⁶

Issue: Potential Impact on Stock Price Performance of PR14a-11 Directors

The Commission’s release solicited comments on two studies that presented and cited statistics showing that “banks with more pro-shareholder boards performed worse during the crisis”¹⁷ (paper by Andrea Beltratti and Rene M. Stulz) and “when dissident directors win board seats, those firms underperform peers by 19 to 40% over the two years following the proxy contest” (NERA Economic Consulting study by Dr. Elaine Buckberg and Prof. Jonathan Macey).¹⁸ Buckberg and Macey also cited

¹³ <http://www.sec.gov/comments/s7-10-09/s71009-605.pdf>

¹⁴ <http://www.altmangroup.com/pdf/AltmanGroupSurveyProxyAccessJan19.pdf>

¹⁵ <http://www.altmangroup.com/pdf/ProxyAccessAltmanGroupRpt.pdf>

¹⁶ <http://www.sec.gov/comments/s7-10-09/s71009-588.htm>

¹⁷ <http://www.sec.gov/comments/s7-10-09/s71009-528.pdf>. The main argument of Andrea Beltratti and Rene M. Stulz was that “banks that were pushed by their boards to maximize shareholder wealth before the crisis took risks that were understood to create shareholder wealth, but were costly ex post because of outcomes that were not expected when the risks were taken.”

¹⁸ Studies cited in that report are a 1993 study by David Ikenberry and Josef Lakonishok, which looked at stock price performance over extended periods following proxy contests in cases drawn from the years 1968 to 1987, and a 1992 study by Lisa Borstadt and Thomas Zwirlein. See David Ikenberry and Josef Lakonishok, “Corporate

data indicating significant underperformance for companies over 12-and 36-month periods when at least one dissident joins the board (citing Ikenberry and Lakonishok [1993]).¹⁹

The most significant response to the SEC’s request came in the form of a new study from Prof. David F. Larcker (Stanford University, Rock Center on Corporate Governance), who submitted the results of an analysis examining general stock market reactions to “proxy access events” triggered by headlines regarding regulatory and legislative developments.²⁰ What Larcker and his co-authors found was that “the evidence suggests shareholders react negatively to regulation of proxy access...the market perceives that shareholders of firms with many large blockholders are harmed by proxy access and is consistent with critics’ claims that large blockholders will use the privileges afforded them by proxy access regulation to manipulate the governance process to make themselves better off at the expense of other shareholders. Interestingly, the results also suggest that shareholders of firms with many small institutional investors are harmed less, either because the market perceives proxy access as less likely to occur at such firms, or because smaller institutional investors are perceived as less likely to promote agendas that are deleterious to value.”²¹ Prof. Joseph A. Grundfest also brought to the attention of the Commission a second new study documenting negative reactions to the prospect of proxy access regulation: Ali C. Akyol, Wei Fen Lim and Patrick Verwijmeren, “Shareholders in the Boardroom: Wealth Effects of the SEC’s Rule to Facilitate Director Nominations,” Department of Finance, University of Melbourne, Dec. 14, 2009.²²

CalPERS cited the widely consulted IRRC Institute study titled “The Effectiveness of Hybrid Boards,” which was based on a study of 120 US companies from 2005-2008 where, according to CalPERS, “shareowners had successfully nominated candidates to sit alongside management nominated board members, much as would be the effect of the proposed SEC rules on proxy access.”²³ However, the report’s limitations, including a sample base from only 2005-2008 – including case studies at the frothy top of a bull market, render the results as interesting, but with limited policy relevance. The report’s most interesting finding was of “a sizeable contest effect increase in share prices,” in particular during a three-month period leading up to the formation of the hybrid board. However, the report offered this caveat: “*the contest effect...was clearly related to a specific activist initiative – the proxy contest – rather than a general expectation of productive activism*” (italics added). From the IRRC report (with data “from 2005 through 2008”): “On average...total shareholder returns at ongoing companies with hybrid boards were 19.1% – 16.6 percentage points better than peers – from the beginning of the contest period through the hybrid board’s one year anniversary...Among the 15 ongoing businesses in the sample for which three years of performance data was available following the creation of a hybrid board, total

Governance through the Proxy Contest. Evidence and Implications,” *Journal of Business*, Vol. 66, No. 3 (1993). Lisa Borstadt and Thomas Zwirlein, “The Efficient Monitoring Role of Proxy Contests: An Empirical Analysis of Post-Contest Control Changes and Firm Performance,” *Financial Management* (Autumn 1992).

¹⁹ Ibid.

²⁰ David F. Larcker, Gaizka Ormazabal & Daniel J. Taylor, “The Regulation of Corporate Governance,” Rock Center for Corporate Governance and Graduate School of Business, Stanford University, Jan. 16, 2010. <http://www.sec.gov/comments/s7-10-09/s71009-598.pdf>

²¹ <http://www.sec.gov/comments/s7-10-09/s71009-598.pdf>

²² Ali C. Akyol, Wei Fen Lim and Patrick Verwijmeren, “Shareholders in the Boardroom: Wealth Effects of the SEC’s Rule to Facilitate Director Nominations,” Department of Finance, University of Melbourne, Dec. 14, 2009. See http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1526081. Quoting from the abstract: “We find that the proposed rule is perceived as costly by shareholders. The cumulative average abnormal return is -2.26% around the first announcement of the proposed changes in May 2009...The most negative effect of the proposed rule is observed in financial firms with entrenched management. The cumulative average abnormal return around the event dates for those firms is -5.79%. These results imply that shareholders of financial firms expect the strongest implications of the new rules on director nominations...Overall, our results suggest that empowering shareholders is not necessarily perceived as a good thing by most shareholders.” Both this study and Larcker, Ormazabal, and Taylor, “The Regulation of Corporate Governance” were cited by Prof. Joseph A. Grundfest in his most recent comment letter to the Commission at <http://www.sec.gov/comments/s7-10-09/s71009-599.pdf>.

²³ <http://www.sec.gov/comments/s7-10-09/s71009-622.pdf>

shareholder returns averaged only 0.7% over the three-year period – 6.6 percentage points worse than peers.”²⁴ Thus, over a 3-year period following the creation of a hybrid board the results showed companies underperforming – a finding more consistent with studies cited in the NERA Economic Consulting study.

David Hirschmann, President and CEO of the U.S. Chamber of Commerce, attached to his submission a copy of a recent study by Prof. Brian R. Cheffins of the University of Cambridge titled “Did Corporate Governance ‘Fail’ During the 2008 Stock Market Meltdown? The Case of the S&P500.”²⁵ Cheffins’ conclusion was “generally ‘no,’ based on a study of a sample of companies at ‘ground zero’ of the stock market meltdown, namely the thirty-seven firms removed from the iconic S&P500 index during 2008.”²⁶ Hirschmann argued that the Cheffins report indicates that: “the corporate governance systems of those companies that were most impacted by the crisis generally worked...these companies were impacted by a financial crisis rather than a corporate governance crisis, and the case for dramatic governance reform has not been made.”

Issue: “Private Ordering” and “Opt-Outs”

The comment period saw more than two dozen letters submitted addressing “private ordering” alternatives, including “opt-out” provisions if PR14a-11 is adopted. Survey data submitted to the SEC documented the breadth of support for some kind of private ordering alternative, including potential opt-outs if PR 14a-11 is adopted. A key advocate of including an opt-out provision, The Society for Corporate Secretaries & Governance Professionals, weighed in with a letter informing the Commission that “a survey conducted by the Society of its member companies shows that, if available, a large majority--approximately two-thirds—would seek to implement an opt-out from the proposed rule.”²⁷ The Altman Group’s letter to the Commission included the results of a survey involving 36 directors and executives from public companies, which found that 86.11% of them favored exempting from PR14a-11 companies that have a “bylaw governing direct proxy access.”

Among listed companies, only AT&T submitted a letter responding directly to the SEC’s requests, including comments with regard to The Corporate Library’s arguments against an “opt-out” provision. AT&T’s Wayne Watts (Sr. Exec. VP) wrote that: “the number of companies with bans on bylaw amendment...is exceptionally small, and cannot provide a basis for a sweeping proxy access rule...non-binding shareholder proposals give shareholders the ability to influence corporate governance even at companies where shareholders cannot amend bylaws.... The real focus of the Corporate Library Paper...is supermajority voting requirements...such requirements do not foreclose shareholders from amending bylaws, and, in fact, they can serve legitimate ends -such as contributing to stability and predictability by ensuring that a bare majority cannot effect structural changes to a corporation's foundational documents.... Furthermore, shareholders may avoid bans on bylaw amendments and supermajority voting requirements by going directly to a board of directors and requesting that the board implement a bylaw change on its own. Indeed, AT&T’s own experiences demonstrate the influence shareholders wield over corporate governance.”²⁸

Jeffrey W. Rubin, Chair of the Committee on Federal Regulation of Securities for the American Bar Association was also critical of The Corporate Library report in his letter to the Commission: “First, that some 35-40% of companies included in three major stock indices have supermajority voting requirements

²⁴ Chris Cernich, Scott Fenn, Michael Anderson and Shirley Westcott, “Effective of Hybrid Boards,” May 2009 (ProxyGovernance Inc. for the IRRC Institute for Corporate Responsibility).

http://www.irrcinstitute.org/pdf/IRRC_05_09_EffectiveHybridBoards.pdf

²⁵ The study first appeared in *The Business Lawyer*, Vol.65 (November2009).

²⁶ BrianR.Cheffins, “Did Corporate Governance ‘Fail’ During the 2008 Stock Market Meltdown? The Case of the S&P500,” *The Business Lawyer*, Vol.65 (November2009).

²⁷ Letter from The Society of Corporate Secretaries & Governance Professionals (submitted by Darla C. Stuckey). <http://www.sec.gov/comments/s7-10-09/s71009-610.pdf>

²⁸ <http://www.sec.gov/comments/s7-10-09/s71009-629.pdf>

for bylaw amendments has no logical connection to the merits of shareholder choice. It is analogous to saying that we should not have Presidential elections because the Electoral College may not mirror the popular vote or that we should not elect legislators because some legislative districts are gerrymandered.... Moreover, supermajority voting requirements reflect a governance regime approved or accepted by shareholders of companies with those regimes. While it may not be consistent with what some consider to be the best governance regime, it is the regime that investors accepted when they acquired shares of companies with supermajority voting requirements. Converting the theoretical objections by some corporate governance activists to supermajority voting requirements for bylaw amendments into a principal reason to bar the operation of shareholder democracy in shaping proxy access for all public companies would constitute a classic example of a tyranny of the minority.”²⁹

Also stepping up to expand upon their arguments for opt-outs was the “Group of Seven Law Firms,” which submitted another joint letter to the Commission.³⁰ The Group of 7 Law Firms advocates what it calls a “two-way” opt out for PR14a-11, whereby “the proposed SEC rule” only permits shareholders “to adopt less restrictive provisions to facilitate proxy access (a ‘one-way’ opt-out).” Shareholders, they argue, should “be permitted to adopt either more or less restrictive provisions (a “two-way” opt-out), including an alternative regime or a complete exemption. Two-way opt-out could be implemented by shareholders directly adopting a by-law amendment, approving a by-law amendment submitted by the board or ratifying a board adopted by-law amendment.” The Group of 7 Law Firms asserted that “a two-way opt-out is widely endorsed by the SEC’s constituencies, with only narrow opposition.” The group also advanced an argument to extend implementation of the proposed rule out to the 2012 proxy season, because companies and shareholders will need the 2011 annual meeting to: “tailor proxy access to their company’s individual circumstances. Otherwise, companies could be subject to a type of ping pong effect of being subject to the status quo in 2010, to the default proxy access rule in 2011 and to a privately ordered modified (or eliminated) proxy access rule in 2012. In addition, the transition year would allow each company and its shareholders to assess any workability issues and determine how to address them using an opt-out. As an alternative means to minimize confusion and address workability, Rule 14a-11 could include a board-approved opt-out (without a requirement for shareholder approval) solely for the transition year of 2011.”

The opposition to a “private ordering” alternative and “opt-outs” was led by a group of public pension fund managers and the Council of Institutional Investors (CII). Among the public pension funds and state investment authorities submitting letters supporting the adoption of PR14a-11 without a “private ordering” provision were the: Washington State Investment Board (“We would further oppose any provision for a private ordering solution”),³¹ State of Wisconsin Investment Board (“SWIB opposes a private ordering solution”),³² AFSCME (“under a private ordering regime boards may, to the extent permissible under state law and their governing documents, further restrict shareholders’ power to amend the bylaws and take other similar measures to limit shareholder choice”),³³ CalSTRS (“private ordering would delay much needed changes to these board rooms by requiring shareholders to first place a bylaw amendment on the ballot and wait until the following year to propose board candidates”),³⁴ CalPERS (“any form of opt out from federal securities legislation is to be avoided at all costs”),³⁵ SURS of Illinois (“a uniform, federal proxy access rule is essential”),³⁶ Colorado PERA (“COPERA finds the private

²⁹ <http://www.sec.gov/comments/s7-10-09/s71009-624.pdf>

³⁰ Cravath, Swaine & Moore LLP, Davis Polk & Wardwell LLP, Latham & Watkins, LLP, Simpson Thacher & Bartlett LLP, Skadden, Arps, Slate, Meagher & Flom LLP, Sullivan & Cromwell LLP, and Wachtell, Lipton, Rosen & Katz. <http://www.sec.gov/comments/s7-10-09/s71009-619.pdf>. The original letter from this group of law firms can be found at: <http://www.sec.gov/comments/s7-10-09/s71009-212.pdf>.

³¹ <http://www.sec.gov/comments/s7-10-09/s71009-594.pdf>

³² <http://www.sec.gov/comments/s7-10-09/s71009-593.pdf>

³³ <http://www.sec.gov/comments/s7-10-09/s71009-613.pdf>

³⁴ <http://www.sec.gov/comments/s7-10-09/s71009-623.pdf>

³⁵ <http://www.sec.gov/comments/s7-10-09/s71009-622.pdf>

³⁶ <http://www.sec.gov/comments/s7-10-09/s71009-603.pdf>

ordering methods troubling...companies that adopt a proxy access bylaw may circumvent the effectiveness of the bylaw by setting ownership thresholds so high proxy access could rarely - if ever - be exercised by long-term institutional investors. Any rule that would allow for an opt-in or opt-out proxy access method cannot be defined as an ‘investor choice’ model”);³⁷ Florida State Board of Administration (“We do not support an opt-in system due to the extremely high costs of private ordering among investors and the high likelihood that companies in greatest need may not see adoption of any standards”);³⁸ OPERS (“OPERS does not support any type of ‘private ordering’ or ‘opt-out provisions.’ Only state laws or company bylaws that provide greater shareowner proxy access rights should over-ride the SEC’s rule”);³⁹ and Connecticut State Treasurer Denise L. Nappier, who oversees the Connecticut Retirement Plans and Trust Funds (“I strongly oppose this approach - private ordering - since I believe it would undermine both the intent and the implementation of the proxy access process....”).⁴⁰

The Council of Institutional Investors submitted a letter arguing against “private ordering” and “opt-outs,” while asserting that “only a uniform, federal proxy access rule can truly remedy the deeply flawed director election process and empower investors to hold boards accountable.”⁴¹ CII argued that: “leaving proxy access to Delaware and other states could result in a hodge-podge of standards that would differ from company to company and from state to state. This would be burdensome, costly and unnecessarily complex for investors, particularly those like Council members with diversified portfolios of thousands of companies incorporated in multiple states. Further, the 500-word limit for shareowner proposals severely constrains an investors’ ability to draft and discuss a proxy access bylaw. Finally, as a November 2009 white paper commissioned by the Council and ShareOwners.org describes, many companies have supermajority voting requirements to amend the bylaws making shareowner-proposed proxy access bylaw amendments nearly impossible to implement.”⁴² The latter is the specific study cited by the SEC in its release extending the comment period, in which The Corporate Library found that: “Approximately 4% of companies in the Russell 3000 and Russell 1000 indices do not allow shareholders to amend the bylaws. Among S&P 500 companies, about 3% prohibit shareholder bylaw amendments altogether.... Larger proportions of companies have supermajority voting requirements.... Between outright prohibition and supermajority voting requirements, shareholders at approximately 40% of companies in the three indices face meaningful barriers to adopting a bylaw amendment opting into or out of a proxy access regime.”

Harvard Law School Prof. Lucian A. Bebchuk and Scott Hirst (Co-Executive Director of the Program on Corporate Governance, Harvard Law School) submitted to the Commission a copy of their new paper titled “Private Ordering and the Proxy Access Debate,” which is expected to be published in *The Business Lawyer* (February 2010).⁴³ In that paper, Bebchuk and Hirst argued their case for the “default” regime to be direct proxy access under PR14a-11 rather than the current no-access default: “In particular, assuming that shareholders will be allowed to opt out of the chosen default, we discuss two clear reasons why a no-access default is inferior to, and dominated by, an access default...we support SEC consideration of allowing opting out to no-access, provided that the opting-out process contains adequate safeguards to ensure that proxy access is denied only in those cases where shareholders are and remain in favor of opting out. In particular, any opting out of the SEC’s access regime should require shareholder majority approval in a vote in which the benefits to shareholders of an access regime are adequately disclosed, and shareholders should be able to reverse past opt-out decisions by a majority vote at any time.”

³⁷ <http://www.sec.gov/comments/s7-10-09/s71009-612.pdf>

³⁸ <http://www.sec.gov/comments/s7-10-09/s71009-627.pdf>

³⁹ <http://www.sec.gov/comments/s7-10-09/s71009-601.pdf>

⁴⁰ <http://www.sec.gov/comments/s7-10-09/s71009-607.pdf>

⁴¹ <http://www.sec.gov/comments/s7-10-09/s71009-592.pdf>

⁴² The Corporate Library, “The Limits of Private Ordering: Restrictions on Shareholders’ Ability to Initiate Governance Change and Distortions of the Shareholder Voting Process” (November 2009). Available at <http://www.cii.org/UserFiles/file/The%20Limits%20of%20Private%20Ordering%20UPDATED%2011-1709.pdf>.

⁴³ <http://www.sec.gov/comments/s7-10-09/s71009-604.pdf>

Issue: Number of Companies Likely to Be Affected By the Proposed Rule

Several letters to the Commission specifically addressed the issue of how many companies are likely to be impacted by PR14a-11, and in particular through nominations advanced by activist hedge funds. First, The Altman Group submitted data from its survey on proxy access issues, including responses to a question asking participants what “% of all companies listed on U.S. exchanges” do they expect to face “a shareholder director nomination under PR 14a-11 in 2011” if the proposed rule is adopted in time for next year’s proxy season. The average forecast from a survey base comprised of directors and executives of public companies and other proxy and corporate governance experts was 15.02% (median forecast = 10.00%) of all companies listed on U.S. exchanges.

The Business Roundtable (BR) submitted a letter commenting on the 13F analysis conducted by the Commission’s new Division of Risk, Strategy, and Financial Innovation.⁴⁴ BR zeroed in on the most serious weakness of that report: “the Form 13F data do not reflect the most likely scenario, the potential formation of investor groups aggregating share ownership to qualify for proxy access.” Nevertheless, the Commission’s 13F study had two important “takeaways” for us: the large number of companies that would be exposed to a potentially “routine” use of PR14a-11 by a single large institution, and the sharp drop in the number of companies that would be exposed to such conduct if the Commission raises the ownership threshold above 3% of shares outstanding (and for each 1% increase thereafter).

Tina Yang (Villanova University) wrote to inform the Commission that a recent study co-authored by her found that (based upon a review of shareholder proposals from 2000-2006): the “average institutional investors who submit shareholder proposals in the US own more than 1% of the target firm. Average investors who solicit contested proxies own nearly 10% of the target firm. Thus, the current proposed ownership requirements should not pose as a constraint on shareholders to become eligible for the proxy access process, especially if shareholders can form groups to nominate directors.”⁴⁵

Darla Stuckey from The Society of Corporate Secretaries & Governance Professionals also noted in a letter to the Commission that data from Bloomberg showing 273 companies in the S&P500 having hedge fund ownership at or above 5% of shares outstanding indicates: “that even at ownership thresholds of 5%, a substantial percentage of large cap companies could be subject to more frequent contested elections at a significantly lower cost. Moreover, given their relatively smaller capitalization, small and mid-cap companies would be particularly vulnerable to an activist hedge fund with a narrow agenda.”⁴⁶

Other Comments

Among the letters that did not deal directly with the main topics described above, the most interesting belonged to Carl T. Hagberg (Carl T. Hagberg and Associates), who wrote to the Commission to offer his perspectives as “someone who has served as the Inspector of Election at well over 400 annual and special shareholder meetings, and at well over 50 shareholder meetings where non-management shareholders had nominated director candidates of their own.”⁴⁷ Hagberg observed that: “most truly serious nominators of director candidates will surely produce their own proxy materials, and take control of their own ‘electioneering’ with materials and proxy cards of their own, if they want to stand a reasonable chance to win.”

Hagberg’s comments highlight a serious flaw in the thinking of some advocates of PR14a-11, in particular as it relates to estimated costs/savings for shareholders nominating directors. Simply getting

⁴⁴ <http://www.sec.gov/comments/s7-10-09/s71009-626.pdf>

⁴⁵ <http://www.sec.gov/comments/s7-10-09/s71009-608.htm>. The published study is Buchanan, Bonnie, Netter, Jeffrey M. and Yang, Tina, “Proxy Rules and Proxy Practices: An Empirical Study of US and UK Shareholder Proposals” (September 15, 2009). Available at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1474062

⁴⁶ Letter from The Society of Corporate Secretaries & Governance Professionals (submitted by Darla C. Stuckey). <http://www.sec.gov/comments/s7-10-09/s71009-610.pdf>

⁴⁷ <http://www.sec.gov/comments/s7-10-09/s71009-597.pdf>

dissident candidates into corporate proxy materials, with only very limited space to “make their case,” will often not be enough to ensure successful contests. Many shareholders nominating directors under PR14a-11 may still have to undertake their own limited mailings and targeted solicitation campaigns in order to have a reasonable chance of winning.

CONCLUSION

In our view, this latest group of letters to the SEC has, on balance, strengthened the case for a “private ordering” regime for proxy access. The Commission has been informed of new studies documenting negative reactions in equity markets to headlines signaling increased risk of regulation of proxy access. In addition, the only thing that has been conclusively demonstrated through all of the performance statistics submitted is a short-run “contest effect” driving up stock prices in the months preceding a vote that results in the creation of a hybrid board (IRRC/“The Effectiveness of Hybrid Boards”). That same IRRC study found companies underperforming over a 3-year period following the creation of a hybrid board – a result that is consistent with earlier comparable studies cited by opponents of the proposed rule. All told, it is still not clear why shareholder dissatisfaction with corporate directors, which is, as described by Dr. Elaine Buckberg and Prof. Jonathan Macey, an issue that is “rare” among thousands of public companies, requires such a sweeping, and problematic, “solution.” It will be up to the Commission to decide if the gains from a direct proxy access rule will outweigh all of the costs, including (among many) the burden the rule will create for hundreds of companies each year and the rule’s impact on the competitiveness of U.S. equity markets.

After reviewing all of the arguments made by advocates of PR14a-11, it is also apparent that some of their conclusions are based on flawed assumptions -- the most significant of which is that once the rules of the game are changed companies will keep playing by the old rules instead of adapting. If PR14a-11 is adopted, companies will, in our opinion, be more likely to adjust poison pill provisions, move to other jurisdictions, and pursue other options to marginalize the impact of PR14a-11.

Moreover, if PR14a-11 is adopted, the rule might ultimately prove to be a “high-water mark” for shareholder activism. Some of the most significant gains by activists over recent years, most notably the widespread adoption of a majority vote standard, have come as a result of cooperation and accommodation by corporate boards. The proposed rule will drive both companies and supporters of activist agendas into more confrontational postures, and marginalize opportunities for cooperation and consensus. In other words, the total “influence” of shareholders on boards may actually be reduced as a result of the sharp escalation in the number of confrontations that PR14a-11 will unleash.

Over recent years, the pendulum has certainly swung sharply in favor of shareholder activists and proxy advisory firms, but we wonder if the SEC’s rule-making with regard to proxy access might actually trigger a reversal of that trend. Many companies are already facing serious challenges in director elections this year as a result of Amended NYSE Rule 452, which will sharply reduce total votes in such elections by eliminating uninstructed voting by brokers of shares held in Street name. Now, if PR14a-11 is adopted without a “private ordering” provision, companies facing potential PR14a-11 contests will be literally driven into taking decisive counter-measures.

In the final analysis, one can’t help but get the sense that 2-3 years after a rule on direct proxy access is adopted the Commission could end up being compelled to revise the rule as a result of unintended and unexpected consequences.

--END--