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August 17, 2009

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: Comments on Release No. 33-9046; 34-60089; IC-28765; File No. S-7-10-09

Dear Ms. Murphy:

We are pleased to submit the following comments with respect to the proposals of the Securities and Exchange Commission (the "Commission") to amend the federal proxy rules published in the Commission's Release Nos. 33-9046; 34-60089; IC-28765 (the "Release"). Our Firm has a long-time interest in corporate governance matters and has previously commented with respect to the Commission's proposals on proxy access in 2003 and 2007.

Because of the scope of the proposals in the Release, the complexity of the many detailed issues raised and their far-reaching implications, we joined together with a number of other law firms to present a comprehensive response to the Release that addresses many of the specific questions raised.[1] In this letter, we limit our comments to a select number of fundamental questions posed in the Release:

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[1] *See* Letter of 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, dated August 17, 2009. We also concur with the comments submitted by Joseph A. Grundfest. *See* Letter from Joseph A. Grundfest, The William A. Franke Professor of Law and Business, and Co-Director, Rock Center on Corporate Governance, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission (July 24, 2009) (available at http://www.sec.gov/comments/s7-10-09/s71009-64.pdf).

- In Part I, we examine the rationale for this far-reaching change. We respectfully disagree with the Commission's assumption that the recent financial crisis was caused by insensitivity of boards to shareholder concerns. While the causes of the crisis are undoubtedly complex, there can be no dispute that major contributing factors were excessive risk-taking and leverage, and an undue emphasis on short-term results—ills that would be exacerbated by changes that give activist shareholders even more power to direct corporate behavior.

- In Part II, we explain why shareholder access, if it is to be pursued, is best accomplished through private ordering by companies under enabling state law. If the Commission decides to pursue shareholder access, it should adopt the proposed amendments to Rule 14a-8 to facilitate private ordering, but not adopt Rule 14a-11, which would preempt private ordering.[2] Moreover, even if the Commission considers it appropriate to continue exploring the merits of a federal mandate of the type set forth in proposed Rule 14a-11, we do not believe it would be reasonable to attempt to rush such a fundamental rulemaking to have it apply for the 2010 proxy season, given the scope and complexity of the issues raised and the dramatic impact this will have on our public corporations and national economy.

- In Part III, we address one of the Commission's most important questions regarding proposed Rule 14a-11: whether shareholders should be permitted to opt out of the rule or make changes that would narrow the access right. If the Commission chooses to adopt Rule 14a-11, it is vital that it be a default standard that each company may tailor or opt-out from based on its unique circumstances. It would be an ironic policy error for the Commission to adopt a shareholder access mandate that negates shareholder choice.

- In Part IV, we address a select number of the Commission's questions regarding the design of proposed Rule 14a-11. We submit that the proposed ownership eligibility criteria are too low, that a "largest shareholder" rather than "first-in" prioritization method should be used and that protections against abuse of the regime for takeovers should be enhanced.

In its Release, the Commission observed that shareholder access to the proxy is a "significant change," and that it is therefore "appropriate to take an incremental approach as a first step." We also note the Commission's emphasis in the Release on "removing impediments" and "unnecessary obstacles" to the ability of shareholders to exercise their rights under state law. We urge the Commission to bear in mind the wisdom of incrementalism and the value of private ordering under state law as it considers how best to advance its stated objectives.

[2] We strongly echo the views of Commissioner Paredes. *See* Troy A. Paredes, SEC Comm'r, Remarks at Conference on Shareholder Rights, the 2009 Proxy Season, and the Impact of Shareholder Activism (June 23, 2009) (hereinafter "Paredes").

I. Does the Commission need to facilitate shareholder director nominations or remove impediments to help make the proxy process better reflect the rights a shareholder would have at a shareholder meeting (A.1.)?

No. The Release argues that proxy access is needed because directors of American companies are insufficiently accountable to shareholders—citing the financial crisis as evidence and noting the differences between American corporate governance rules and their foreign counterparts. The Release does not, however, offer any support for the purported link between the financial crisis, or any other malady affecting the economy or corporate performance, and shareholder access to company proxy statements. The evidence supports the opposite conclusion: shareholder power has grown substantially in recent years and has more often been applied to increase, rather than decrease, systemic risk.

A. Shareholder Power Is Already Highly Concentrated and Activism Widespread

The recent financial crisis is not a valid basis for the Commission's proposed changes. If anything, this crisis suggests a need to moderate shareholder pressure on corporate decision-making. The Release states that "the proxy process has become the primary way for shareholders to learn about the matters to be decided by the shareholders and to make their views known to company management,"[3] that each other method of influencing corporate action "has drawbacks that limit its effectiveness,"[4] and that the "chief complaint from shareholders about the existing options is the high cost involved in mounting a proxy contest."[5] The impression is one of diffuse shareholders rendered impotent by the federal proxy apparatus, bereft of a meaningful voice in corporate affairs. The reality is quite different.

Institutions hold over 75% of America's largest companies.[6] These institutions have access to senior corporate executives. They can also easily coordinate their activities, diminishing collective action concerns. In particular, indirect coordination through proxy advisory firms has become prevalent, with many large shareholding institutions actually or effectively outsourcing their voting decisions to unregulated proxy advisory firms, creating large blocks of votes. The cost of mounting a proxy contest is well within reach for these shareholders; indeed, such contests have recently been waged at an increasing rate.[7] Costs have also become less of a hurdle given the SEC's e-proxy rules and recent state legislation authorizing adoption of corporate bylaws to require the reimbursement of shareholder expenses incurred in election campaigns.[8]

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[3] Facilitating Shareholder Director Nominations, 74 Fed. Reg. 29,024, 29,025 (proposed June 10, 2009) (to be codified at 17 C.F.R.).
[4] *Id*. at 29,028.
[5] *Id*.
[6] CAROLYN KAY BRANCATO & STEPHAN RABIMOV, THE 2008 INSTITUTIONAL INVESTMENT REPORT: TRENDS IN INSTITUTIONAL INVESTOR ASSETS AND EQUITY OWNERSHIP OF U.S. CORPORATIONS (Sept. 2008) (showing institutional investor ownership in the largest 1,000 U.S. corporations has risen to "an unprecedented 76.4 percent of corporations by year-end 2007").
[7] *Proxy Fight Trend Analysis, 2001-Present*, www.SharkRepellent.net, *data retrieved* June 29, 2009; *see also* John Laide & Jim Mallea, *2008 Year End Review: New Highs Set for Unsolicited M&A and Proxy Fights* (Jan. 23, 2009), https://www.sharkrepellent.net/pub/rs_20090122.html.
[8] *See, e.g.*, DEL. CODE ANN. tit. 8, § 113 (2009).

Heightened shareholder power is not merely hypothetical. In the post-Sarbanes-Oxley world, shareholders have become extremely effective agents for corporate change. The percentage of S&P 500 companies with classified boards declined from over 60% in 2002 to 34% in 2008, the percentage with rights plans declined from 60% to 22% in the same period, the percentage providing shareholders with the right to call special meetings rose from 41% in 2002 to 46% in 2009, and the percentage with majority voting in place rose from virtually zero several years ago to over half today.[9] Changes such as the elimination of discretionary voting for directors by brokers of uninstructed shares at the NYSE,[10] and the SEC's recent decision to allow insurgents to list each other's short-slate candidates on their proxy cards,[11] will increase shareholder power further. Moreover, a recent study reported that "it is no longer unusual for determined shareholder activists to obtain representation on the boards of targeted companies. In fact, during the four-year period covered by the study, dissidents were able to gain representation at approximately 75% of the companies targeted."[12] Strikingly, the study found that, when dissidents won a board seat, they generally did so through negotiating with the board rather than by winning an election contest.[13] Shareholders have reshaped the governance landscape in the past decade and possess effective avenues to secure board representation when desired.

It is clear that shareholders have exercised substantial influence in recent years; but it is far less clear whether that influence has been beneficial for the companies in question or the economy as a whole. A major contributor to the severity of the financial crisis was excessive risk-taking and widespread over-leverage.[14] Because leverage increases both potential equity

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[9] *Takeover Defense Trend Analysis, 2001-Present*, www.SharkRepellent.net, *data retrieved* July 26, 2009.
[10] *See* NYSE, Inc., Proposed Rule Change to Amend NYSE Rule 452 to Eliminate Broker Discretionary Voting (Feb. 26, 2009), *available at* http://www.sec.gov/rules/sro/nyse/2009/34-59464.pdf.
[11] *See* San Antonio Fire & Police Pension Fund v. Amylin Pharm., No. 4446-VCL, 2009 WL 1337150 (Del. Ch. May 12, 2009); Icahn Assocs. Corp., SEC No-Action Letter, 2009 WL 861554 (Mar. 30, 2009); Eastbourne Capital, L.L.C., SEC No-Action Letter, 2009 WL 1143160 (Mar. 30, 2009).
[12] PROXY GOVERNANCE INC., EFFECTIVENESS OF HYBRID BOARDS 4 (2009), *available at* http://www.irrcinstitute.org/pdf/IRRC_05_09_EffectiveHybridBoards.pdf.
[13] *Id*. at 13 ("More than three times as many contests which produced hybrid boards were resolved via settlements (76%) as were resolved via shareholder votes (24%).")
[14] *See, e.g.*, Richard A. Posner, A FAILURE OF CAPITALISM 322 ("[N]o single bank, in the highly competitive financial-intermediation industry, could justify to its shareholders reducing its risk-taking (for example by reducing its leverage), and therefore its return on equity . . . "). *See also The Administration's Proposal to Modernize the Financial Regulatory System: Hearing on the Oversight of TARP Before the S. Comm. on Banking, Housing, and Urban Affairs*, 111th Cong. 2 (2009) (statement of Timothy Geithner, Sec'y, U.S. Dep't of the Treasury) (discussing the contribution of the lack of "adequate constraints on leverage" to the financial crisis); H. OF COMMONS TREASURY COMM., BANKING CRISIS: DEALING WITH THE FAILURE OF THE U.K. BANKS, 2008-9, H.C. 416, at 38 (stating that in the U.K., "the financial sector has significantly increased its leverage over the last two decades, and those firms that showed the greatest appetite for rapid growth, particularly in the last five years, through leverage are amongst the heaviest casualties. Increased debt simply led to increased risk."); Adrian Cho, *Leverage: The Root of All Financial Turmoil*, 324 SCI. 452-53 (while "it may seem obvious that massive leverage leads to trouble," leverage is in fact the essential cause of the recent economic meltdown); Scott Patterson, *What's Really Needed: Leverage Scorecard*, WALL ST. J., June 19, 2009, at M1 (describing leverage as a cause of "the recent turmoil"); Alan S. Blinder, *Six Errors on the Path to the Financial Crisis*, N.Y. TIMES, Jan. 25, 2009, at BU7 (discussing "sky-high leverage" as one of six basic causes of the financial crisis); Eric Wasserstrom, *On the Financial Crisis: It's Not Just Weak Oversight*, N.Y. TIMES, Sept. 17, 2008 (discussing leverage as one of the three critical issues facing regulators in the wake of the crisis); John Geanakoplos, *Solving the Present Crisis and Managing the Leverage Cycle* (describing the financial crisis as "the acute crisis stage of a leverage cycle"), http://cowles.econ.yale.edu/~gean/crisis/solving-present-crisis.pdf.

returns and bankruptcy risk, shareholders (who can easily and inexpensively diversify their investment across many companies) tend to prefer that companies incur more leverage than do directors or managers (whose position and reputation are closely linked to the success or failure of a particular company). Contrary to the thrust of the Release, if this crisis should teach us anything about the relationship between boards of directors and shareholders, it is that shareholders already exert too much pressure on board decisions.

The activist agenda is often narrow, e.g., consisting of demands that a company buy back shares, declare extraordinary dividends, or initiate a sale process.[15] Boards under activist pressure may become unduly focused on such matters, sometimes to the detriment of traditional board considerations such as long-term strategy, investment and corporate health. In many cases, activist shareholders use their power to press a generic financial agenda while disregarding the effect on other corporate constituents and failing adequately to consider (or in some cases to understand) company-specific issues and challenges.[16] Indeed, a recent study has found that so-called "hybrid boards," which are formed when activist shareholders place directors on a board, perform no better than boards without such dissident directors.[17]

It is also noteworthy that foreign countries that have a shareholder access regime did not avoid the financial crisis. Consider the United Kingdom and Japan, each of which allow investors access to company proxy statements to nominate board candidates.[18] In 2008, while the United States stock market lost 33.8% of its value,[19] the Japanese market declined by 42%[20] and the British market declined by 31%.[21] According to a report by the United Kingdom House of Commons Treasury Committee (the "Committee"), one of the principal causes of the financial crisis in the U.K. was excessive risk taking and leverage—behaviors that were often encouraged, not restrained, by shareholders.[22] Royal Bank of Scotland, whose former chief executive reportedly pursued "the sort of highly leveraged banking that shareholders, institutional

[15] An analysis based on S&P data concluded that companies in the S&P 500 incurred $1.78 trillion in indebtedness for the purpose of repurchasing shares between 2004 and 2008—an amount that is greater than the total recognized losses of the global banking crisis. ROBERT W. THOMPSON, SHARE REPURCHASES: MAKING CORPORATE AMERICA SUBPRIME 3 (May 2009), http://www.advantuscapital.com/adv/pdf/ShareRepurchase.pdf.

[16] A study by Standard & Poor's showed that only one in four companies that repurchased shares over an 18-month period outperformed the index during that time. STANDARD & POOR'S, HOW REWARDING IS CORPORATE SHARE REPURCHASE ACTIVITY? 3 (Oct. 2007).

[17] *See* PROXY GOVERNANCE INC., *supra* note 12, at 38-39.

[18] Under the U.K. Companies Act, investors can nominate candidates at an annual meeting if they collectively own at least five percent of a company's share capital or are part of a group of at least 100 shareholders who each hold stakes worth 100 pounds ($146) or more. In Japan, shareholders who own at least one percent of a company's capital or 300 share units for six months may propose business for a corporate agenda, including nominating board candidates or seeking the removal of directors. Broc Romanek & Dave Lynn, *SEC Proposes Shareholder Access Again: Third Time's a Charm*?, May 21, 2009, http://www.thecorporatecounsel.net/blog/archive/002090.html.

[19] *Year-End Timeline – 4th Quarter*, WALL ST. J., Jan. 2, 2009, at R12.

[20] *For Global Stocks, It's Too Little, Too Late*, WALL ST. J., Dec. 31, 2008, at C3.

[21] Nikhil Kumar, *FTSE 100 Tumbles 31% in Worst Year on Record*, INDEP., Jan. 1, 2009, at 38.

[22] *See, e.g.*, H. OF COMMONS TREASURY COMM., BANKING CRISIS: DEALING WITH THE FAILURE OF THE U.K. BANKS, 2008-9, H.C. 416, at 3 ("The culture within parts of British banking has increasingly been one of risk taking leading to the meltdown that we have witnessed. Bankers have made an astonishing mess of the financial system."). In a separate report, the House of Commons Treasury Committee stated that it "found that some shareholder engagement had encouraged increased leverage and the pursuit of more rapid growth." H. OF COMMONS TREASURY COMM., BANKING CRISIS: REFORMING CORPORATE GOVERNANCE AND PAY IN THE CITY," 2008-9, H.C. 519, at 61.

investors, and regulators all cheered on,"[23] nearly collapsed and is now owned by the U.K. government. Northern Rock, which the Committee found to have pursued a "high-risk, reckless business strategy [with a] reliance on short- and medium- term financing,"[24] has also been nationalized after near collapse. Despite having a board of directors comprised primarily of representatives of its controlling shareholders, KBC Bank of Belgium has received over $40 billion from the Belgian government to recover from "disastrous mortgage bets that its financial engineers and traders made when times were good."[25] These examples demonstrate that a shareholder right to nominate directors does not prevent and may sometimes encourage the behavior that led to the financial crisis.

Moreover, proxy access is only one of many dimensions along which corporate governance systems differ. The Commission should not casually seek to adopt one particular overseas governance standard, such as proxy access, without taking into account other aspects of corporate governance, such as the fact that U.S. directors on average face shareholders for reelection more frequently that many of their overseas counterparts. Experts have noted that "U.S. corporations fall at the short end of th[e] spectrum" of length of a director's term of office, as compared to companies based in other countries.[26] While directors of American companies are usually elected for one-year terms (or, in the case of staggered boards, up to three-year terms, in general), the directors of German and French companies, for example, may be elected for terms of up to five or six years respectively.[27] In comparing the accountability of U.S. boards to that of their foreign counterparts, one must consider the totality of the legal and institutional structure—and on this basis, U.S. shareholders have ample power as compared to their foreign counterparts.

B. <u>Proxy Access Has the Potential to Cause Real Harm</u>

As we have noted in past comment letters,[28] proxy access poses serious risks to the smooth functioning of companies, including:

- <u>Significant Distraction</u>. The increased number of election contests would distract management and impose a significant cost on companies and the economy. An election contest is a tremendously disruptive event, consuming management attention and corporate resources. Consider that in 2008,

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[23] Peter Gumbel, *Saving Britain's Broken Bank*, 159 FORTUNE 10 (May 11, 2009).
[24] H. OF COMMONS TREASURY COMM., THE RUN ON THE ROCK, 2007-8, H.C. 56-I, at 19.
[25] Landon Thomas Jr., *Bank Woes Deepening in Europe*, N.Y. TIMES, July 1, 2009, at B1.
[26] THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 37 (Renier R. Kraakman et al. eds., Oxford Univ. Press, 2004).
[27] *See, e.g.*, France Telecom, Report of Foreign Private Issuer (Form 6-K), at 200 (Apr. 14, 2009) (thirteen of fifteen current board members serving five-year terms on board of French corporation); Dassault Systemes, Registration of Securities of Foreign Private Issuers (Form 20-F), at 52 (May 29, 2007) (members serve six-year terms on board of French corporation); EDAP TMS, Registration of Securities of Foreign Private Issuers (Form 20-F), at 52 (Mar. 31, 2009) (members serve six-year terms on board of French corporation); Deutsche Bank Aktiengesellschaft, Registration of Securities of Foreign Private Issuers (Form 20-F), at 109 (Mar. 24, 2009) (members serve five-year terms on board of German corporation); *see also* De Beers, Governance, http://www.debeersgroup.com/en/Inside-De-Beers/Governance (last visited July 22, 2009) (Luxembourg corporation with six-year term).
[28] Please refer to our comment letters of June 11, 2003, November 14, 2003 and September 19, 2007.

shareholders presented 1,141 proposals to companies at annual meetings.[29] If shareholders were permitted to run election contests with the same ease, the cumulative disruption and diversion would be significant and harmful.

- Board Balkanization. Shareholder access to the corporate proxy would facilitate the election of special interest directors.[30] Electing directors who view themselves as representing shareholder activists, unions, social activists or some other subset of the shareholder population would balkanize boards. A board works best when it works as a unified whole, without camps or factions and without internal divisions.

- Discouraging Board Service by Good Directors. It will become more difficult to recruit qualified directors to serve. The cumulative impact of corporate governance reforms and increased fear of liability is already making it harder to recruit top directors. Increasing the number of election contests will only exacerbate this problem.

More generally, shareholder access to the company's proxy materials conflicts with the board-centric approach to governance that has been the engine of economic growth and job creation in the United States for generations. A centralized decision-making body is important for efficient, nimble, well-informed corporate governance. Governance by shareholders—who have varied interests, an absence of fiduciary duties and less company-specific or insider knowledge—would be comparatively ineffective.[31] Directors mediate the diverse and potentially self-serving interests of shareholders,[32] and also use their business judgment to consider the interests of other important corporate constituencies, and it is important that boards be sufficiently autonomous from the short-term pressures of any one constituency in order to fulfill this role.

II. Would adoption of only the proposed amendment to Rule 14a-8(i)(8) and the related disclosure requirements meet the Commission's stated objectives (A.10)?

Yes. Assuming the Commission intends to act, it should simply facilitate private ordering and avoid preemptive mandates.

For over a century, states have been responsible for the development of laws relating to the internal affairs of business enterprises. This structure has allowed for comparison across jurisdictions, experimentation, and gradual evolution of business law in state legislatures and courts, some of which have developed substantial expertise with respect to specialized

[29] RiskMetrics, *data retrieved* July 27, 2009.
[30] *See* Paredes, *supra* note 2 ("[S]pecial interest directors may have goals that compete with maximizing firm value, putting such directors at odds with the best interests of shareholders.").
[31] *See* KENNETH J. ARROW, THE LIMITS OF ORGANIZATION 68-69 (1974) ("Under conditions of widely dispersed information and the need for speed in decisions, authoritative control at the tactical level is essential for success."); Paredes, *supra* note 2 ("As a practical matter, public company shareholders are not well-positioned to run the enterprises in which they invest.").
[32] *See generally* Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 564 (2006) (discussing the importance of vesting primary control in directors to respond to "the need for mediating the various and often conflicting interests of shareholders themselves").

governance and business issues. The process by which directors are nominated and elected lies squarely within the states' purview, and the proposed rule change would mark an abrupt and fundamental departure from the deep-rooted system of corporate lawmaking in America. Such a departure might be warranted if there were evidence of passivity at the state level or a demonstrable need for a uniform federal standard. But neither is the case. There has been a great deal of state legislative and other regulatory reform related to corporate elections in recent years, and, as we noted above, the corporate governance practices of companies are changing very rapidly.

The case of majority voting is an instructive example. Only a few years ago, majority voting was in place at few if any companies and was not contemplated under any state corporate law. On August 1, 2006, amendments to the Delaware General Corporation Law (the "DGCL") to facilitate majority voting became effective.[33] Other states followed shortly thereafter, including California, Washington, Virginia, New York and others.[34] These laws provided companies with the flexibility to design majority voting processes that met their unique circumstances, and many companies did so. Today, 90%[35] of companies included in the Dow Jones Industrial Average, over 50%[36] of S&P 500 companies and nearly 50%[37] of Russell 3000 companies have implemented a majority voting standard. Not every company has adopted majority voting, and it may not be appropriate for every company to do so. But the development is continuing to unfold, and the lesson is clear: a fundamental change to board elections has occurred at hundreds of companies large and small in a short period of time, and has been implemented in an effective and tailored manner through the interplay of state enabling statutes and thoughtful corporate action.

This same process has now begun with respect to shareholder access to the corporate proxy. The North Dakota legislature passed the North Dakota Publicly Traded Corporations Act in 2007, which permits companies to provide a right of proxy access to shareholders who have owned more than 5% of its voting securities for a period of two years, and requires reimbursement of proxy solicitation expenses incurred by any nominating shareholder in proportion to the number of nominees successfully elected.[38] Delaware recently added two new sections to its corporate law, which became effective on August 1, 2009, permitting the adoption of bylaws by companies or shareholders that would require a corporation to include shareholder nominees in its proxy material and/or to reimburse shareholders for expenses in soliciting proxies for the election of directors.[39] The committee responsible for drafting revisions to the Model Business Corporation Act (the "MBCA"), which has been adopted in whole or in part in over 30 states, has approved proposed amendments to the MBCA consistent with the new provisions of the DGCL.[40] As with majority voting, the new Delaware

[33] DEL. CODE ANN. tit. 8, §§ 141(b), 216 (2009).
[34] *See, e.g.*, CAL. CORP. CODE § 708.5 (Deering 2009); WASH. REV. CODE ANN. § 23B.08.070 (West 2009); VA. CODE. ANN. §§ 13.1-669, 13.1-679 (West 2008); N.Y. BUS. CORP. LAW § 614 (McKinney 2008).
[35] Sharkrepellent, *data retrieved* July 27, 2009.
[36] FactSet Sharkrepellent, *data retrieved* June 26, 2006.
[37] The Corporate Library, Analyst Alert (Dec. 2008).
[38] North Dakota Publicly Traded Corporations Act, N.D. CENT CODE § 10-35 (2007).
[39] DEL. CODE ANN. tit. 8, §§ 112, 113 (2009).
[40] *See* Press Release, Am. Bar Ass'n, Corporate Laws Committee Takes Steps To Provide for Shareholder Access to the Nomination Process (June 29, 2009), *available at* http://www.abanet.org/abanet/media/release/news_release.cfm?releaseid=688.

and proposed MBCA amendments do not impose a mandatory framework upon companies, but rather permit each company to develop a tailored approach suitable to its unique circumstances. There can be no doubt that many companies will be considering such bylaws. Indeed, our Firm has proposed a model Delaware bylaw that provides eligible shareholders with a right to nominate directors in the Company's proxy statement.[41] We believe that the process of private ordering in this area would already be underway were it not for the Commission's proposal to adopt preemptive regulations, which has led most companies to adopt a "wait and see" approach.

This process of state law development and company experimentation would be preempted by the proposed mandatory federal regime, which would render state enabling statutes largely superfluous. The potential impact of such a federal rule was well illustrated by Commissioner Paredes,[42] when he raised the hypothetical example of shareholders of a Delaware company approving a bylaw to allow access to the company's proxy for board nominations from shareholders that have owned over 3% of the company's shares for two years. The shareholders may have concluded that these eligibility criteria appropriately balance the desire to allow shareholder nominations with countervailing considerations such as board stability and cost. The bylaw in this example would have the considered support of the company's shareholders and would be expressly authorized by state law. That the shareholders' wishes and the legislature's intent would be thwarted by federal law—a law expressly "intended to remove impediments so shareholders may more effectively exercise their rights under state law"[43] —demonstrates a deep-seated problem with the proposed rule.

Preemption of state laws may be appropriate where uniformity is critical to the effectiveness of a regulatory regime, as may often be the case in the Commission's traditional regulatory domain of disclosure. But uniformity would do serious harm in the area of shareholder access to the proxy, which raises countless issues and implementation design challenges that simply cannot be addressed by a single mandatory scheme. The Release, and the hundreds of questions it contains, is the best evidence of the complexity raised by shareholder access. While some of those questions may have a single best answer (which answer is much more likely to be found through company experimentation under state enabling statutes than "one shot" federal regulation), the answer to many others will depend on the company in question. For example, the ownership and holding period thresholds that are appropriate for a company may depend not only on the company's size, but also on the composition of its shareholder base and other factors. A fully articulated bylaw that addresses the complexities of derivative ownership, group formation, prevention of "Trojan Horse" proxy access corporate takeovers and other matters may be appropriate for a large corporation, but may at the same time be needlessly complex and unwieldy for a small company or for a public company with a majority stockholder. This is simply not an area where "one size fits all"—and any attempt to fashion a single size for all will impose inappropriate mandates on some companies while retarding or eliminating the identification of best practices.

[41] *See* Wachtell, Lipton, Rosen & Katz, Strategies for the New Reality of Shareholder Access (May 7, 2009), *available at* http://blogs.law.harvard.edu/corpgov/files/2009/05/wlrk-model-proxy-access-board-resolution-and-bylaw-05-09.pdf.
[42] *See* Paredes, *supra* note 2.
[43] Facilitating Shareholder Director Nominations, 74 Fed. Reg. at 29,026.

Federalism aside, corporate governance involves a complicated and delicate balance of powers and responsibilities. The wisdom of focusing on any single aspect of the corporate governance regime—here, shareholder nominations of directors—and issuing a one-size-fits-all rule is questionable. There is no evidence that states and companies are unable to address this issue in a timely and appropriate manner or that national uniformity is desirable in this domain. There is no justification for short-circuiting the private ordering process that is underway, and no cost to taking an incremental approach by waiting to monitor that process while it unfolds. For these reasons, we believe that, if the Commission decides to take action with respect to proxy access, then the Commission should adopt Rule 14a-8 amendments to facilitate private ordering while continuing to study the merits and demerits of broader changes.

III. Should Rule 14a-11 be inapplicable if such shareholder-approved provisions are more restrictive than Rule 14a-11? Should Rule 14a-11 be inapplicable if such shareholder-approved provisions are less restrictive than Rule 14a-11? Or both? (B.7)

Both. If the SEC enacts a federal shareholder access rule, we urge that it adopt a default rule that each company may supplement, replace or repeal as befits its individual circumstances. While any default rule would likely suffer from the many policy concerns we have expressed, as well as significant implementation issues, a shareholder opt-out approach would still enable the kind of state- and company-level tailoring that would be critical to the sound implementation of such a far-reaching change.

It is important for a company to be able to customize the shareholder access rule not only so that it can fashion its broad contours—such as eligibility criteria, shareholder prioritization and nomination limits—in a manner that reflects the company's unique circumstances, but also so that it may fine-tune the details to ensure that the access regime actually works in practice. The proposed federal rule raises a host of workability and implementation issues, and the effectiveness of the rule could be significantly compromised if companies are not permitted to address these issues in an individualized manner. Consider the following illustrative list:

- How to handle multiple classes of stock
- How to treat directors nominated by significant shareholders
- How to handle cumulative voting
- How to ensure that the access regime works with the company's particular advance notice bylaws
- How to ensure that the access regime works with the company's particular majority voting policies
- How to ensure that independence and other director qualifications are applied
- How to treat derivative and other synthetic ownership
- How to ensure adequate protection against "Trojan Horse" takeover activity
- How to adjust procedures in the event of a concurrent takeover contest
- How to treat shareholder-sponsored directors re-nominated by the board
- How to treat nominating shareholders that violate their representations
- How to treat shareholders that have made unsuccessful past nominations

A default rule that can be varied or eliminated by shareholders would at the very least represent an acknowledgment that there is no single "correct" answer to each of these and a host of other questions.

Although, as proposed, Rule 14a-11 and the change to Rule 14a-8 would allow shareholders to modify the federal right of access to the corporate proxy, shareholders would only be permitted to increase the access right, not restrict it in any manner. This assumes that there is no valid justification—for any company in any circumstance—for narrowing shareholder access, even if the shareholders of a particular company believe that such a justification exists. If shareholder democracy is truly at the heart of the Commission's proposed action, no access rule it adopts should prevent shareholders and the companies in which they have invested from opting out of, or otherwise modifying, one or more aspects of that rule.

IV. Suggestions regarding the design of proposed Rule 14a-11

In addition to this comment letter, we have submitted a comment letter along with six leading corporate law firms – Cravath, Swaine & Moore LLP, Davis Polk & Wardwell LLP, Latham & Watkins, LLP, Simpson Thacher & Bartlett LLP, Skadden, Arps, Slate, Meagher & Flom LLP and Sullivan & Cromwell LLP. In that letter, we and our colleagues offer many specific suggestions regarding the operation of the proposed rule. We endorse the suggestions made in that letter, and comment here only briefly on several aspects of the proposed rule that we believe should be changed:

- Ownership Thresholds: The proposed 1% ownership level for companies with a market capitalization greater than $700 million is too low. Lowering the bar to 1% gives activist and special interest holders an extremely low-cost avenue to disrupt board composition and corporate strategy. We propose a 5% threshold (with a higher threshold for groups, as described below).

- Prioritization Scheme: The proposed "first-in" prioritization scheme is a mistake. A "first-in" rule creates incentives for routine election contests, as shareholders race to make access nominations in order to gain control over the process. We believe nominations should be prioritized on the basis of the size of the principal nominating shareholder's share ownership.

- Treatment of Groups: The proposed rule is too permissive with respect to group formation. The rule would allow an unlimited number of shareholders to aggregate their ownership, substantially reducing the efficacy of the thresholds and creating the potential for significant disruption and waste. We suggest implementing a higher ownership threshold for groups (i.e., 10% for large companies).

- Takeover Protection: The proposed rule would require a nominator to certify that it does not have a current intent to take control of the company, but nothing prevents the nominator from changing its intent once its candidates are on the board. In order to prevent the proxy access regime from being abused to support takeover bids, nominators should be required to agree that they will not take any steps towards a takeover for one year following the election, and the nominated director should be required to resign if any such steps are taken. For the same reason, as provided in our model bylaw, we believe that shareholders should be limited to one nominee per election and that a nominator should be forbidden from running a proxy contest related to the same election in which it has nominated a candidate using the company's proxy materials.

V. Conclusion

We believe that enacting a rule along the lines outlined in the Release will have negative consequences for U.S. corporations and our nation's competitiveness. The proposed rule fails to address the issues that have been proffered in motivating it, such as the financial crisis. Moreover, the proposed rule is counterproductive in that it would give rise to a corporate governance regime that is ultimately unfavorable to companies' financial health. The Release fails to take into account the many other recent and proposed grants of shareholder voting rights, and ignores the deeply unique needs of individual companies.

If the SEC is determined to advance shareholder proxy access notwithstanding the concerns we have raised in this letter, we believe that the negative consequences we have outlined would be mitigated by a more measured and judicious final rule. We recommend that any final rule regarding shareholder access be limited to an amendment of Rule 14a-8 that would facilitate private ordering. If the SEC insists upon enacting an affirmative federal access rule, we urge that shareholders be permitted to opt out of such a rule or modify it without restriction to suit a company's unique circumstances.

Wachtell, Lipton, Rosen & Katz