CATERPILLAR

August 17, 2009

**VIA E-MAIL**

U.S. Securities and Exchange Commission
100 F. Street, N.E.
Washington, D.C. 20549
Attn: Elizabeth M. Murphy, Secretary

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

Landies and Gentlemen:

I am writing on behalf of Caterpillar Inc. ("Caterpillar") in response to the Securities and Exchange Commission's (the "Commission") request for comments to the proposed rules regarding shareholder director nominations (the "Proposed Rules") described in Release Nos. 33-9046; 34-60089 and IC-28765 (the "Release").

For more than 80 years, Caterpillar has been building the world's infrastructure and, in partnership with approximately 180 Caterpillar dealers across the globe, is driving positive and sustainable change on every continent. With 2008 sales and revenues of $51.324 billion, Caterpillar is the world's leading manufacturer of construction and mining equipment and diesel and natural gas engines and industrial gas turbines. Caterpillar is also a technology leader in transportation, mining, forestry, energy, logistics, remanufacturing, financing, electronics and electric power generation.

Over the years Caterpillar has built a solid reputation as a highly ethical company, and we recognize and take seriously our responsibility in fostering sound corporate governance. Consistent with this commitment, we have spent a significant amount of time and effort analyzing and reflecting on the Release, the Proposed Rules and the comments and suggestions presented herein.

For the reasons presented below, we strongly oppose the adoption of proposed Rule 14a-11. However, if the Commission decides to pursue regulations to allow proxy access, the adoption of Rule 14a-8(i)(8), with modifications, is a better approach. Nevertheless, if the Commission determines to proceed with Rule 14a-11, it should be modified so that it is workable without undue burden to companies.

## I. A Federally Mandated "One Size Fits All" Proxy Access Process Is Unnecessary.

Recent significant advances in the corporate governance arena coupled with recent developments in state corporate law make the adoption of a federally mandated "one size fits all" proxy access system unnecessary.

### *(A) Corporate Governance Developments*

It is unquestioned that the corporate governance landscape has experienced significant and widespread change over the past decade. As an example, since the Commission's 2003 proposal on proxy access (the "2003 Proposal"), there has been a significant move by large companies to adopt a majority-voting standard, or a similar standard such as a director resignation policy, in uncontested elections of directors.

These recent changes in corporate governance have significantly improved director accountability, which is highlighted in the in the Release as being a contributing factor in the Commission introducing the Proposed Rules.[1] And, with the Commission's approval of revised New York Stock Exchange ("NYSE") Rule 452 - which precludes brokers from voting uninstructed shares in uncontested director elections - director accountability will only be enhanced. The inability of brokers to vote uninstructed shares makes it highly likely that fewer shareholder votes will be cast in an uncontested director election. As a result, it will be more difficult for a director up for election at a company with a majority vote standard to be elected or re-elected, especially if a proxy advisory firm recommends a "withhold" vote for a particular director. Similarly, revised NYSE Rule 452 will also increase the impact of "vote no" campaigns because there will likely be fewer "for" votes to setoff the "no" votes generated by such a campaign.

It is also important to note that the bulk of recent corporate governance changes were accomplished via "private ordering" and shareholder communication and not a result of federally mandated rules or regulations. This validates that corporate governance initiatives can be accomplished with existing shareholder tools and without federally mandated, "one size fits all" proxy access rules.

### *(B) State Law Developments*

As a number of other comment letters have pointed out, corporate governance has traditionally been left to the states to form and manage. Consistent with this approach, states have recently taken the necessary steps to allow proxy access. For example, for corporations incorporated in North Dakota, proxy access is allowed for a shareholder

[1] "Second, the possibility of shareholder nominated candidates being submitted for inclusion in a company's proxy materials, as well as the possibility of the shareholder nominee's election, may lead to enhanced board performance. If the proposed rules are adopted, the responsiveness of boards may increase in an effort to alleviate concerns expressed by shareholders on certain matters and thereby avoid shareholders submitting nominees pursuant to the new rules. The board may feel a need to be more attentive to the company's operations as a result of *this enhanced accountability* to shareholders." 74 Fed. Reg. pg. 29026 (emphasis added).

owning 5% or more of voting stock for a period of two or more years.[2] In addition, recent amendments to the Delaware General Corporation Law allow companies and shareholders to adopt their own specific proxy access procedures.[3] As proxy access gains more momentum or attention, we anticipate that many states will follow Delaware's and North Dakota's lead and amend their statutes to allow for proxy access in some form.

Clearly, some states have started to address proxy access, and if provided sufficient time, additional states will follow their lead. Delaware's proxy access legislation is particularly noteworthy as it allows shareholders of each company to determine the appropriate standards for governing a proxy access system. Accordingly, it is unnecessary for the Commission to impose a federal "one size fits all" proxy access system.

## II. Unintended Consequences.

The adoption of the Proposed Rules will likely introduce significant and unintended consequences. Among other things, the Proposed Rules will likely (i) cause boards to focus on short-term goals and objectives at the expense of creating long-term shareholder value (i.e. short-termism) and (ii) encourage the election of special interest directors.

### *(A) Short-Term Focus*

Various commentators have suggested and opined that the 2008 financial crisis was caused, in large part, by boards focusing on short-term goals or gains, rather than creating long-term value for shareholders. This sentiment has been adopted by federal and state legislatures as they have commented on and introduced legislation to combat such "short-termism," especially in the context of executive compensation. For example, in a statement by Treasury Secretary Timothy Geithner on executive compensation, he repeatedly expressed how compensation should be based on long-term value, as opposed to short-term performance: "[c]ompanies should seek to pay top executives in ways that are tightly aligned with the long-term value and soundness of the firm . . . compensation should be tied to performance in order to link the incentives of executives and other employees with long-term value creation."[4]

Yet, the Proposed Rules will only encourage boards to focus on short-term goals and objectives. The annual threat of director election contests that comes with proxy access will encourage boards to focus on short-term gains and goals to appease those shareholders, such as hedge funds, focused on short-term results and to gain support for its own slate of directors. In other words, the adoption of the Proposed Rules will force boards to focus "year-to-year" in order to survive "year to year," as opposed to addressing and tackling long-term goals or objectives, such as capital expenditures or

[2] N.D. CENT. CODE § 10-35-01 *et seq.* (2009).
[3] 8 DEL. CODE ANN. § 112 (2009).
[4] From Statement of Treasury Secretary Timothy Geithner on Compensation, June 10, 2009.

research and development, that may not generate as much revenue or profits in the short-term but will serve as the foundation of generating long-term shareholder value.

*(B) Special Interest Directors*

The Proposed Rules will also likely lead to the election of "special interest" directors who will promote and protect the interests of his or her sponsor shareholder to the detriment of all other shareholders. It is well established that directors and officers have fiduciary duties to their company's shareholders – namely a duty of care and loyalty. Consequently, directors are obligated to act in the best interest of not only the company, but also its shareholders. Dissimilar to directors, shareholders do not have a fiduciary duty to act in the best interest of the company or its shareholders – in fact they are expected to be self-interested. As such, shareholders who pursue proxy access will likely nominate individuals who have that shareholder's best interest in mind to the exclusion of all other shareholders. Moreover, if a special interest director is elected, the board will likely be less efficient because it will be required to address the "special interests" of such director.

Exacerbating the prospect of a "special interest" director is the Commission's failure to require shareholder nominees to be "independent" from the shareholder (see discussion below). We believe the Commission has drastically underestimated the extent to which shareholders will influence the director nominee and the difficulty a shareholder nominee will have separating himself or herself from the shareholder or group of shareholders who put him or her in the director position.

## III. Proposed Rule 14a-8(i)(8).

For the reasons presented above, we do not support proxy access in any form. However, if the Commission is determined to advance proxy access, the adoption of proposed Rule 14a-8(i)(8), with modifications, is our preferred approach. This approach will allow shareholders and companies to develop a proxy access structure that best fits the needs and concerns of the company and all of its shareholders – rather than a "one size fits all" federally mandated proxy access system.

The eligibility requirements under proposed Rule 14a-8(i)(8) should be adjusted to reflect the significant impact proxy access will have on a company. The current "at least $2,000 or 1% of the company's securites" standard falls well below this level and should be adjusted upwards. Consistent with other comment letters, we support an ownership eligibility threshold of at least 1% of the company's outstanding shares before a shareholder would be eligible to submit a proxy access shareholder proposal. We acknowledge that this eligibility requirement is higher than needed for other shareholder proposals. However, we believe (i) the eligibility requirement for all shareholder proposals should be adjusted upwards to allow only shareholders with a significant financial interest in the company to present shareholder proposals, and (ii) a proposal proposing proxy access procedures will have a greater impact on a company and require significantly more time and resources to address than the majority of other shareholder proposals.

Further, eligibility should be restricted by allowing companies to disqualify proponents that have submitted a proxy access proposal at any of the previous three annual meetings where such proposal failed to receive at least 25% of the votes at the annual meeting. We believe that companies should not have to include proxy access proposals from shareholders that in the past have shown an inability to muster significant shareholder support. This approach is consistent with the Commission's approach to shareholder proposals, albeit the "resubmission levels" are much higher.[5]

## IV. If the Commission Adopts Proposed Rule 14a-11 the Following Revisions are Necessary.

If the Commission adopts some form of Rule 14a-11, we request that it consider making the following modifications:

### *(A) Eligibility Requirements*

#### *(i) Higher Ownership Requirement*

The proposed shareholder ownership eligibility requirement under the Proposed Rules is much too low. The Release provides, among other things, that "long-term shareholders with significant holdings" will have the ability to have their nominees included in company proxy materials. However, the proposed ownership requirement does not amount to "significant holdings."

A better approach would be to set the ownership eligibility requirement at a level that requires multiple shareholders to combine or group their holdings in order to nominate a director. This ownership level would ensure that shareholders have the support of other shareholders before initiating a proxy contest and consuming significant company resources. Accordingly, we support an ownership eligibility requirement of at least 10% of a company's outstanding shares.

#### *(ii) Term of Ownership*

Consistent with the Commission's intent to allow only "long-term shareholders" to utilize proxy access, we believe a holding period longer than a one year period found in the in the Proposed Rules is necessary. We believe that a holding period of two years or more is a suitable time period to signify long-term investment intent.

Further, if a shareholder nominee is elected, we believe that the "sponsoring" shareholder should be required to maintain its holdings through the term of service for its sponsored director, subject to any fiduciary duties that would mandate otherwise. Allowing a shareholder to "dump" its holdings after its director is elected would be

[5] *See,* Rule 14a-8(i)(12).

contrary to the Commission's intent to allow "long-term shareholders" to participate in the proxy access system.

### *(B) Resubmission Threshold*

Consistent with the Commission's resubmission thresholds regarding shareholder proposals under Rule 14a-8(i)(13), shareholders and shareholder nominees should be subject to thresholds to prevent resubmission if their proposal does not receive a certain percentage of votes. We believe that where a shareholder's nominee fails to receive between 25% of the vote at a meeting, the shareholder should be prohibited from submitting another nominee for a period of two years. Likewise, if a nominee fails to receive sufficient support (25% of the vote), the nominee should not be eligible for nomination by any shareholder for the same two-year period. A resubmission threshold will incentivize shareholders and shareholder groups to present quality nominees and prevent company resources from being wasted on shareholders, shareholder groups or nominees that have not received significant support from all shareholders.

### *(C) Allowing Shareholders to Nominate up to 25% of the Board is Too High of a Percentage*

The Proposed Rules would allow shareholders to nominate director candidates for up to 25% of a company's board at any single shareholder meeting. We believe that this percentage is much too high. The Commission should consider the significant influence and impact 25% of a board could have on the entire board - especially if the 25% is consistently adversarial with the remaining members of the board. For example, 25% of Caterpillar's board is 3 board members.[6] From our experience, if three board members do not share a similar philosophy or fail to work as a team with the remaining board members, the board will be less efficient and will likely fail to adequately manage and address the long-term goals of the company - results that do not benefit all shareholders.

Moreover, a 25% turnover of board members at one time will significantly disrupt board and management operations. Instead of focusing and working on goals and initiatives of the company that drive long-term shareholder value, the board and management will be required to address matters such as new director orientation, training and education and familiarizing new directors on the company and how and where it operates.

### *(D) "First In Time" Rule is not Workable*

The Proposed Rules would give priority to nominating shareholders based on the order in which companies received the nominations. This priority system will result in companies receiving a number of nominations on the first day nominations can be submitted. However, it will be impossible for companies to accurately determine which shareholder submitted its nomination first. We prefer the approach under the 2003

[6] Technically, 25% of 15 is 3.75, however, pursuant to the Proposed Rules we rounded down. *See,* 74 Fed. Reg. pg. 29084, Instruction 1 to paragraph (d).

Release where the largest shareholder nominees would have priority in the event of any "conflict."

### *(E) Shareholder Nominee Independence*

#### *(i) Must Be Independent of the Nominating Shareholder*

As noted previously, a shareholder nominee that is not independent of the shareholder will encourage the introduction of "special interest" directors. Accordingly, we believe a shareholder nominee must be independent of the nominating shareholder, meaning that the nominee should not be (i) the nominating shareholder, (ii) an immediate family member of any nominating shareholder or (iii) a partner, officer, director or employee of a nominating shareholder or any of its affiliates. These qualifications will ensure that shareholder nominees are better positioned to independently and effectively fulfill his or her fiduciary duties to <u>all shareholders</u>.

#### *(ii) Must Meet Objective and Subjective Independence Standards*

While we agree with the Commission that shareholder nominees should meet the objective independence standards of the national securities exchange on which a company's securities are listed, we disagree that such nominees should not be required to meet the subjective independence standards of such exchange. The Commission has previously stated "that requiring boards to make an affirmative determination of independence, and to disclose these determinations, will increase the accountability of boards to shareholders and give shareholders the ability to evaluate the quality of board's independence and its independence determinations."[7] In addition, shareholder activists and the Commission alike have placed a premium on the independence of board members.[8] Failure to require shareholder nominees to adhere to the subjective independence standards effectively undermines the importance the Commission, national securities exchanges and shareholders have placed on director independence. Accordingly, the same independence standards applicable to board nominees should be applicable to shareholder nominees.

At the very least, shareholder nominees should be required to complete and submit to a company a director questionnaire. It is imperative that companies receive the information recovered under these questionnaires so that it can comply with applicable laws and regulations. For example, in the event the questionnaire uncovers that the shareholder nominee is not independent, this fact is likely material and a company would be required, under applicable law, to disclose it in the company's proxy statement.[9] Additionally, under NYSE regulations, a company is required to, within thirty days of its annual shareholder meeting, certify and provide, among other things, the independence of the board (i.e. which directors are independent) and a brief biography for each director, including, share ownership and any material relationships the director has with the

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[7] Commission Release No. 34-48745.

[8] With respect to the Commission, *see Item 407, Reg. S-K.*

[9] *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

company.[10] Without the information recovered under a standard director questionnaire, it will be extremely difficult, if not impossible, for a company to comply with this NYSE regulation.

### *(F) Shareholder Nominee Must Meet Board Eligibility Criteria and Director Guidelines*

One of the primary responsibilities of a nominating committee is to select and recommend candidates for directors. As part of this role, nominating committees carefully craft director eligibility criteria to ensure the board is pursuing and retaining candidates that will benefit the company and its shareholders. The board criteria also, in part, ensures that any potential candidates will assimilate with the board, both in terms of expertise and personality. Moreover, the nominating committee establishes director guidelines, such as mandatory retirement age, "overboarding" restrictions and share ownership requirements, to support corporate governance.

Allowing shareholders and shareholder nominees to disregard board eligibility criteria effectively negates the work and importance of the nominating committee. In addition, allowing shareholder nominees to disregard board criteria will also significantly disrupt board operations. For example, if a shareholder nominee supplants a member of the board that has experience and expertise in operating a company in developing countries that no other board member has, the board (and company) would lose a valuable asset that would likely not be replaced by the shareholder nominee.

Shareholder nominees, if elected, should also be required to follow a company's director guidelines. We believe that once a shareholder nominee is elected, there is no reason why the shareholder nominee should not have to follow these guidelines. Moreover, these type of guidelines have been adopted, in large part, to support the company's corporate governance initiatives. For example, if a director is "overboarded" this may impact the company's corporate governance score issued by proxy advisory firms or other institutions and, possibly, cause the entire nominating committee, at the next annual meeting, to receive a "withhold" vote recommendation from proxy advisory firms.

### *(G) Timing Issues need to be Addressed in Connection with Challenges to Shareholder Nominees*

The Proposed Rules do not provide adequate time for companies with standard advance notice bylaw provisions to challenge the inclusion of a shareholder nominee. Under the Proposed Rules, a shareholder would be required to provide notice (on Form 14N) of its intent to nominate a director to the company by the date specified by the company's advance notice provision in its bylaws <u>or,</u> where no such provision is in place, no later than 120 calendar days before the date that <u>*the company mailed its proxy materials for the prior year's annual meeting*</u>. If a company desires to exclude a nominee, the company must provide notice of its intent to exclude the nominee and the basis for its

[10] Section 303A.12, NYSE Listed Company Manual.

determination to the SEC no later than *80 calendar days before the company files its proxy statement*. While this "no action letter" process may work under the Commission's proposed 120 calendar days standard, companies with standard advance notice bylaws that permit shareholders to submit their nominees for directors as late as *90, 60 or 30 calendar days prior to the shareholder's meeting* will be effectively precluded from challenging a shareholder nominee.

For example, assume Company XYZ's advance notice provision in its bylaws establishes that it must receive notice of a matter to be heard at its annual meeting no less than *90 days prior to the annual meeting* and Company XYZ's proxy statement is mailed out 45 days prior to the annual meeting. If a shareholder of Company XYZ provides notice of its shareholder nominee pursuant to the advance notice provision (90 days before the annual meeting - or 45 days before the company's proxy materials are mailed), Company XYZ will be shut out of the "no action letter" process because it would be impossible for it to submit a no action letter to the Commission "no later than 80 calendar days before the company files its proxy statement."

One solution is for a company to amend its bylaws to be consistent with the Proposed Rules. However, such a solution is not as practical as it may appear. It is not uncommon for a company's bylaws to require shareholder approval before they can be amended, which is unlikely to happen prior to 2010. Also, it is inequitable for the Commission to impose on companies the expense and time to amend its bylaws to conform to technical timing issue when the Commission was aware of the issue prior to the enactment of the Proposed Rules. Rather, the Commission should simply adopt the same timeline, 120 calendar days before the company mails its proxy materials, for all companies.

*(H) Liability of the Company*

We do not agree with the liability standard proposed in Rule 14a-11(e) and in the note to Rule 14a-19, which would make a company liable for statements of shareholders or shareholder nominees included in a company's proxy materials if the company "knows or has reason to know that the information is false or misleading." Given the time constraints for reviewing and addressing shareholder and shareholder nominee statements under proposed Rule 14a-11, it is highly unlikely that a nominating committee will have the necessary time and resources to determine whether such shareholder statements are false or misleading. Moreover, even if a company believes a shareholder statement contains false or misleading information, such information can only be excluded if the Commission agrees (see discussion on challenge process above) with the company. If the Commission does not agree, the company, under the Proposed Rules, will be required to include shareholder statements in its proxy, even if the Company "has reason to know" such information is false or misleading.

Instead, similar to the shareholder proposal process, we believe that a company should not be responsible for the statements submitted by shareholders or shareholder nominees. Rule 14a-8 provides that companies must include shareholder proposals in their proxy materials in certain circumstances. However, Rule 14a-8(l)(2) provides that a company is not responsible for the contents of a shareholder proposal or supporting statements. Seeing as statements provided by shareholders in support of shareholder proposals is analogous to the current issue, the Commission should not hold companies responsible for the statements of shareholders or shareholder nominees under proxy access.

## V. Conclusion.

In summary, we are opposed to proxy access, especially in the case of a federally mandated "one size fits all" proxy access system. If the Commission is unwavering in implementing proxy access for the 2010 proxy season, our preferred approach is the adoption of a modified Rule 14a-8(i)(8). Likewise, if the Commission decides to implement a proxy access system using proposed Rule 14a-11, significant modifications as outlined herein are necessary to make it workable.

Thank you for the opportunity to comment on the Proposed Rules and the Release. We would be happy to discuss our comments further at your convenience. If you have any questions regarding this letter, please do not hesitate to contact me, Christopher C. Spears, Associate General Counsel at 309-675-1094 or Joseph H. Currin, Corporate Counsel at 309-266-3825.

Very truly yours,

James B. Buda

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