PERSHING SQUARE CAPITAL MANAGEMENT, L.P.
888 SEVENTH AVENUE, 42ND FLOOR
NEW YORK, NY 10019
P: 212-813-3700 F: 212-286-1133

August 17, 2009

**Via Email: rule-comments@sec.gov**

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

**Re: *Shareholder Proxy Access*; File No. S7-10-09;**
**Release No. 33-0146; 34-60089**

Dear Ms. Murphy

Enclosed please find an article submitted as a comment in response to the Commission's proposal to facilitate shareholder director nominations.

PERSHING SQUARE CAPITAL MANAGEMENT, L.P.
Sincerely,

/s/ Roy J. Katzovicz
Chief Legal Officer

# Shareholder Proxy Access and the Balance of Power in Corporate Governance

Pershing Square Capital Management, L.P.
August 17, 2009

## Shareholder Proxy Access and the Balance of Power in Corporate Governance

Our experience with concentrated, long-term investments in large, public companies has taught us that the overwhelming majority of corporate directors are smart, diligent, and capable business people trying the best they can to faithfully discharge their fiduciary duties. They do not, however, always get it right.

Something is broken in corporate America. Particularly over the last decade, prudent risk management took a back seat to the quest for short term profits. Now we are all suffering the consequences. There is, however, reason for optimism. A number of tectonic trends in corporate governance appear to be converging, and a subtle rebalancing of power between management, their boards of directors and shareholders appears likely. We think that is a good thing.

Engaged shareholders with meaningful stakes in the companies in which they invest have the potential to regulate corporate conduct through private and market behavior. The existing tools of shareholder engagement, however, have not proven to be sufficient or optimally suited for that task. We believe that the SEC's proposal to require public companies to include shareholder nominees in corporate proxy materials goes a long way toward better equipping shareholders to be more effective monitors of corporate behavior and, as a result, another force for good corporate governance.

We applaud this initiative and view it as a market-based solution in that the government is now trying to empower market actors to manage risk rather than trying to achieve the same goal through direct government intervention into the day-to-day affairs of corporations.

## Corporate Governance Failures and the Government's Response

In the wake of unprecedented economic turbulence, the government at various levels has undertaken an examination of our existing regulatory and corporate governance regimes. Stated more simply (if not less charitably) some are out to find one or more protagonists on whom to lay blame. Corporate boards of directors are receiving their fair share.

With the publication of recent shareholder proxy access proposals, our lawmakers and regulators are betting that stronger shareholder voices in the governance of U.S. businesses will reduce risk in our system, limit future wealth destruction, and trigger competition for the best candidates to rise to the role of director and help govern our businesses. Even if the absence of shareholder access to corporate proxy statements was not the primary cause of the recent economic crisis, the hope is that it may play a large role in the solution.

Some critics have faulted the SEC's approach as the federal government's intrusion on traditional state regulation of corporate governance. State-level advocates have voiced a preference for a more incremental approach that would allow incumbent managers, boards and shareholders of individual companies to decide whether shareholder proxy access is desirable and, if so, the details of any conditions that should be included in the company's bylaws.

Generally, we believe that the shareholder franchise mechanics for U.S. corporations practically impede shareholders' ability to nominate and elect directors of their choosing. If the solution is left to a company-by-company approach, it is likely to suffer from the same inertia that has frustrated direct shareholder representation in the past. While some may fault the SEC's proposal as too blunt of a tool because it applies to all corporations, we have no such objection. The fundamental policy aim of the proposal is to facilitate greater participation in corporate governance by shareholder representatives system-wide. It is a systemic solution for a systemic problem and is, therefore, appropriately broad in scope.

Furthermore, the federal government's proposed policy change should not be viewed as rash or punitive. Instead, it should be viewed as a forward-looking attempt to fashion appropriate incentives for those people who are in the best position to avoid the repetition of past mistakes and maximize future value of U.S. corporations taken as a whole. It should be judged on its ability to achieve this goal and as part of the larger mix of regulatory reforms.

## Why It Might Work

Shareholders are the participants in corporate America who only get what is left over after customers are served, employees, lenders, vendors, and taxes are paid. Accordingly, shareholders are the corporate constituency that is among the most sensitive to risky and bad business decisions by managers and boards. As a class, shareholders have unique economic incentives to monitor the activities of the firms in which they invest to ensure the success of those firms' businesses over the long run. In its current state, however, corporate democracy is democratic in name only. Shareholder expression through nominating and voting for directors has failed to live up to its potential as a positive feedback mechanism.

If shareholders had a more meaningful opportunity to elect directors of their own choosing, it would be easier for them to hold individual incumbent directors accountable. This in turn would give incumbent directors even greater incentive to more actively engage management teams and avoid mistakes in the future. As self-interested participants who would just as soon not waste time and money unnecessarily meddling in the affairs of firms, we believe that shareholders will generally only exercise their newfound powers at moments where intervention is likely to create or protect more shareholder value.

In any event, by injecting a greater element of competition at the board of directors-level, the mere possibility of the exercise of this power by shareholders should cause directors to be more effective in their roles in hopes of maintaining their positions.

The SEC's proposal would (1) lower the direct costs of nominating and campaigning in favor of alternative director candidates, (2) reduce the procedural complexities of nominating those candidates, (3) minimize the uncertain and often large litigation costs incurred in the context of contested elections by fostering an administrative dispute resolution process, and (4) as a consequence of the previous three elements, give shareholders a stronger hand in direct negotiations with managers and boards of companies who would just as soon avoid potentially embarrassing or disruptive campaigns.

For those who view active monitoring and engagement by shareholders as an effective tool in building long-term value, these are meaningful and helpful changes.

## Why It Won't Go Wrong

Critics of shareholder proxy access proposals question whether shareholders can be trusted to faithfully fulfill the hoped-for aims of the proposed policy change. These critics are wary of relying on the alignment of each shareholder's economic incentives with the long-term success of a corporate enterprise. Unsurprisingly, critics target two types of shareholder groups that are already active in the arena of corporate governance: (1) activist hedge funds and (2) governance-focused pension funds.

## Activist Hedge Funds

Hedge funds are typically painted with a broad brush and are generally criticized for having short-term trading strategies that, while economically rational from the hedge funds' perspectives, may not serve to build the long-term value of corporate enterprises in every situation. We do not dispute that this criticism may have merit for some subset of funds, but to say that it applies to all or even most funds without regard to their diverse strategies and areas of specialization goes too far. By branding all funds as "short-termists", critics have blamed these private investment pools for the prevailing myopic focus of U.S. public companies on near-term stock performance at the expense of the long-term health of corporate enterprises.

These criticisms of hedge funds are dubious. Activist hedge funds seeking short-term performance in the form of leveraged recapitalizations, corporate self-tenders or forced sales of companies were not the cause or even a major contributing factor of the financial crisis. Any such suggestion is as suspect as blaming short sellers for the demise of the shadow banking system.

The short-term focus on stock price of many public company managers and boards long pre-dates the recent growth of hedge funds in public markets. Indeed we see great danger in misattributing this problem to shareholders rather than the managers and boards with responsibility for directing the day-to-day affairs of their firms. This argument deflects scrutiny of the disturbing and perverse incentives inherent in certain executive compensation programs that pay out short-term bonuses for short-term performance. And, we are alarmed by the lack of introspection on this point by outside professional advisors who enable such behavior (many of whom now object to the SEC's shareholder proxy access proposal).

Almost by definition, hedge funds that seek and achieve direct representation on the boards of their portfolio companies cannot be short-term traders. The SEC proposal includes a one year holding period for any shareholder who desires proxy access for its nominee. Moreover, the time and commitment it takes to wage a proxy contest is substantial. And, if a hedge fund gains a seat for one of its executives or affiliates, they and it will be subject to (1) the public company's internal policies that limit trading by directors and their affiliates to certain open window periods, (2) the transparency imposed by prompt disclosure rules when directors or their affiliates sell shares, and (3) the short-swing profit disgorgement requirements imposed by our securities laws on insiders such as directors. Collectively, those requirements provide effective impediments to short-term trading. It is, therefore, counterintuitive to attack an entire class of market participants as short-termists when their participation on boards of directors yields the opposite result.

Moreover, across the U.S. our state fiduciary laws protect minority shareholders from self-dealing or disloyalty on the part of corporate directors no matter who their sponsors are. The long history of private enforcement in this area alone should protect against the outside risk that hedge fund-nominated directors would act to the detriment of shareholders taken as a whole in order to confer some private benefit on those who nominated them to their posts.

## Pension Funds

Governance-focused public and union pension funds are often criticized by opponents to shareholder proxy access as political animals focused on aggrandizing the politicians at their helms or – worse – as shills for the labor movement in search of leverage to extend the benefits of union members at the expense of the shareholders the purport to represent.

More than any other actors, over the past decade pension funds have led the fight for better corporate governance practices.

While there are pension funds that openly view their efforts as part of a broader strategy that takes on issues beyond shareholder value, they tend to be the exception rather than the rule. In our experience, the larger, returns-focused institutions have successfully led campaigns for governance improvements. Often indexed in their holdings, these fund managers view broad-based incremental improvement to governance as long-term value enhancing across all equities. Critics would generally be hard pressed to find fault in the agendas and intentions of these funds as they are very much driven by shareholder value considerations.

To those who have voiced particular skepticism regarding the role of union pension funds as governance advocates, we would point out that unions have long been in the business of providing benefits to constituents beyond their membership. Over time, for example, the mere threat of unionization has likely resulted in higher wages and better terms and conditions of employment for non-unionized workers. Notwithstanding the motivations of active public and union pension funds, all shareholders have benefited from many corporate governance reforms pressed by these advocates.

Whether in the area of majority voting for directors, increasing transparency of executive pay, limiting the use of poison pills, eliminating discretionary broker non-votes, increasing the independence of key board committees or battling against staggered boards, pension funds' corporate governance efforts have largely been pro-shareholder and positive for the system.

For so long as these governance-focused pension funds continue to concentrate on those areas that increase shareholder value, they will continue to receive support from a substantial portion of the shareholder community.

**Ultimate Protection: The Shareholder Franchise**

Even if the critics are right about some of their concerns, fear and rejection of shareholder proxy access would be an overreaction. The proposal simply lowers costs for shareholders to engage in already permissive behavior. Can it really be that an incremental reduction in proxy campaign costs will usher in the collapse of U.S. corporations? That seems implausible.

In America, our business leaders have rarely shied away from competition – where we find it we tend to take comfort that we've achieved the most reliable results. In our own experience, we have found eager participants in industry leading executives who are typically (though not always) unaffiliated with our investment funds but yet willing and eager to serve on alternative slates. If the fear is that, as a class, American business people who are focused on building long-term value will no longer be eager to serve as directors of public companies because of this modest increase in competition, our experience suggest that this outcome is unlikely.

Moreover, there is at least one major attribute to current shareholder proxy access proposals that should provide significant and sufficient protection against the hijacking of corporate boards by special interest groups. Current proposals only give sponsors the ability to put alternative director nominees on a ballot. They do not assure the alternative candidates' election. Proponents of shareholder nominees have to convince other shareholders to support them. We can assure you from personal experience that this is no easy feat.

The mechanisms of the shareholder franchise are sufficiently daunting that the introduction of shareholder proxy access on its own is unlikely to herald a revolution in shareholder representation on boards.

Many common protections of political democracy are absent from corporate democracy. These include two or more candidates for every open seat, secret and universal ballots that allow shareholders to vote from among all available candidates, the absence of record dates for eligible voters and campaign spending limits. In particular, the absence of universal ballots, on which shareholders can vote from among all nominees regardless of who proposed them, is glaring and clearly anti-choice. There is no positive case for effectively requiring shareholders to vote for slates rather than being able to choose from among the best individuals nominated from all parties.

Beyond the absence of these protections in the corporate context, in our own experience we have found that institutional investors who value their access to management often fear that access will dry up if they support dissidents. They are, therefore, unlikely to support even a minority of alternative independent directors.

One of the greatest threats to the efficacy of shareholder proxy access is the absence of institutional shareholder voting policies or procedures to address minority, non-control proxy contests where independent alternative candidates are nominated. In addition, we are aware of institutional shareholders whose pro-management biases are so strongly ingrained that, absent only the most extraordinary circumstances, they do not even posses the power or authority to support alternative candidates.

To the extent that shareholder proxy access prompts the institutional shareholder community to reassess these policies and to adopt new policies that focus on attracting and electing the best directors possible, we believe that the initiative is worthwhile. Given that shareholder proxy access effectively requires a universal ballot and therefore lends itself to a director-by-director analysis, we believe that its enactment will cause institutional holders to begin this process. This is at least a first step toward universal ballots in all contested elections.

Our hope is that, outside the control context, selection of the best nominees in a contest will be based more on character, competency, and relevancy of their experience rather than the identity of the person nominating the candidate.

## Areas of Concern

Current shareholder proxy access proposals set ownership thresholds as low as 1% of a company's outstanding stock and as such there is a risk that the threshold is too low and may encourage wasteful proxy contests. Because of the significant campaign costs other than the printing and distribution of proxy statements and ballots (like the associated opportunity cost of time and direct legal, travel and solicitation expenses), we are hopeful that this risk remains unrealized. If not, the system will need to be reexamined.

The SEC's proposal and request for comment has a number of specific provisions that merit reconsideration. Generally, the system should provide incentives to the largest shareholders to take the most active roles given that they are disproportionately impacted by virtue of their relatively outsized stock ownership. Accordingly, we are apprehensive of a "first-to-file" system where the first shareholder (rather than the largest shareholder or group of shareholders) has priority access to the proxy statement.

As part of the SEC's current proposal (and contrary to its approach in 2003 on the same issue), it chose not to provide any relief from Section 16 of the Exchange Act of 1934 to groups of shareholders who collectively seek shareholder proxy access. Generally, Section 16 triggers disgorgement of profits by holders of 10% or more of a company's stock for purchases and sales within a 6-month period. If the whole point of shareholder proxy access is to encourage shareholder engagement, the introduction of an element that chills shareholder collective action seems counterproductive. This is particularly the case in situations where the policy reasons that underlie Section 16 (namely apprehension of inside access by individual large holders by virtue of the size of their stakes) are not apparent in this context.

In its proposal, the SEC requested comment on whether nominees proposed by shareholders seeking proxy access should be required to be independent of the shareholders that nominate them. In our view, such a requirement would greatly dampen the benefit of direct shareholder involvement in corporate governance and create yet another artificial separation between stock ownership and governance. While it may be the case that a wholly independent candidate is the best person for the job in any given circumstance, we see no reason why this should be imposed as a matter of law. So long as full and fair disclosure of affiliations and business relationships remains the standard in proxy disclosures, this is a variable that should be left up to the contestants.

Separately (and importantly), we urge the SEC to extend the right to a universal ballot outside the limited context of shareholder proxy access. Non-control, minority slate contests happen. There is no reason to prejudice shareholders' right to choose among all the candidates just because the sponsoring shareholders choose to finance the campaign without taking advantage of shareholder proxy access. The inability to choose from among the individuals nominated from all parties shields individual directors from accountability and robs shareholders of the opportunity to choose the best person for the job. Those who claim this is not the case because of impractical and often theoretical alternative voting mechanics are disingenuous (at best). The appeal of allowing shareholders to easily choose directors from amongst all nominees is obvious.

## Conclusion

While the fear of overreaction is oftentimes well placed after extraordinary market events, we do not believe that the long-discussed concept of shareholder proxy access falls into that category. We support shareholder proxy access and believe that it can have a meaningful, albeit only incremental, impact of enhancing corporate democracy. By lowering costs and giving shareholders an enhanced ability to monitor their portfolio companies, shareholder proxy access attempts to use market forces to improve corporations. At a time of extraordinary governmental intervention into private enterprise, we would urge critics to give this market-based policy a chance.