Comments of the Competitive Enterprise Institute

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

Re: Facilitating Shareholder Director Nominations
Release Nos. 33-9046; 34-60089; IC-28765
File No. S7-10-09

Dear Ms. Murphy:

Thank you for allowing me the opportunity to submit comments on the proposed rule governing shareholder nominations of corporate directors on behalf of the Competitive Enterprise Institute (CEI) and its Center for Investors and Entrepreneurs, of which I serve as director.

Celebrating its 25th anniversary this year, CEI is a widely recognized voice on a broad range of national issues – from the environment and technology to finance and public health. If the government has written a regulation, we most likely have some opinions as to its effectiveness, costs, and impact on American liberty and prosperity. In 2006, CEI created its Center for Investors and Entrepreneurs educate policy makers and the public about the important roles of the entrepreneurs who build public companies and the investors – from ordinary shareholders to venture capitalists – who fund these firms, taking informed risks in exchange for a chance to grow wealthy with the company. We ask the simple question that if Bill Gates, Sam Walton, and Meg Whitman were starting out today, what would be the barriers to building, respectively, the next Microsoft, Wal-Mart and eBay?

Unfortunately, the proposed rule at hand amending the proxy rules under the Securities Exchange Act of 1934 for the purpose of “facilitating shareholder director nominations,” could become one of those barriers to entrepreneurs and investors building successful, vibrant American companies. The rule would usurp state corporate law and force public firms of all sizes to include in their proxy materials the board of director nominees of shareholders representing as little as one percent of the company, allowing small groups with agendas unrelated to a firm’s performance an opportunity to put other shareholders’ interests at risk. Yet for investors who now devote their own resources to launch campaigns to improve companyies’ prospect with new directors, the rule would impose a host of new requirements that go beyond current law in most states. In other words, the rule would benefit certain special interest groups with agendas, but would be the worst of all worlds for the vast majority of shareholders with their paramount concern of the company’s bottom line.

The Center supports investors voicing their opinions to management to better a company’s performance. But public policy should not encourage interest groups who use their shares in companies to further their political or social agendas. These are issues to be debated in the halls of democracy and not in a company’s boardroom.

In essence, there are two types of shareholder activism: one beneficial and one detrimental to the interests of the majority of investors and entrepreneurs. Every year, hedge funds and other activist investors launch proxy fights to hold management’s feet to the fire to make changes to corporate governance that they think will be beneficial for all shareholders. Examples include the proxy fights launched by investors such as Carl Icahn and William Ackman, which, though not always completely successful, often result in management instituting changes to business practices – from pursuing mergers to selling off divisions -- that bring long-term improvement to a company’s return to its shareholders.[1]

At the other side of the shareholder spectrum, however, are “investors” like People for the Ethical Treatment of Animals (PETA), who have no interest in improving corporate performance and often want to hinder a company’s prospects in order to further a social agenda. As PETA explains on its web site, StopAnimalTests.com, PETA makes a practice of purchasing shares in companies involved in what PETA deems “the inhumane treatment of animals.”[2] Under provisions of Exchange Act Rule 14a-8, issued by the SEC a decade ago, PETA introduces resolutions addressing – in its own words – “the replacement, protection, and humane treatment of animals used in pharmaceutical testing, in the food industry, in pet-food testing, and in chemical testing, to name a few.”[3]

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[1] Rick Konrad, “Carl Icahn and Time Warner – Defeat or Victory,” *SeekingAlpha.com*, 18 February 2006, http://seekingalpha.com/article/7191-carl-icahn-and-time-warner-defeat-or-victory-twx; Jonathan Stempel “Ceridian Merger On Track; Ackman Ends Proxy Fight,” *Reuters*, 08 September 2007, http://www.reuters.com/article/mergersNews/idUSN0825969320070908.

[2] “PETA’s Shareholder Resolution Campaign,” *StopAnimalTests.com*, http://www.stopanimaltests.com/f-shareRes.asp

[3] Ibid.

Other 14a-8 resolutions of questionable relation to shareholder return are proposals against the use of biotechnology in food crops and against trade with various foreign countries from China to Israel. Emerging empirical evidence indicates that the time and resources public companies spend dealing with these resolutions is hurting shareholder return.[4] Yet the flaws in this process would be compounded if these interest groups, or an "aggregate" of them as the current proposal specifically allows, reach the small threshold of shares to have their own director candidates included in a company's proxy materials.

Even the threat of "protest" or special interest directors could encourage backroom deals with management that would be detrimental to most shareholders. Liberal interest groups could use this new-found power could buy shares in media companies to protest conservative personalities such as Rush Limbaugh and Glenn Beck, while conservative groups could purchase stock to inveigh against liberal personalities and sexually explicit programming. At the very least, management would be distracted by these side issues from achieving the best returns for shareholders.

State rules regarding shareholder nominations aren't perfect, but they do serve an important function. By making it so that shareholders have to spend their own resources to campaign for their nominees, they discourage frivolous director campaigns unrelated to a company's performance, and help ensure that the proxy fights that are launched are related to serious issues of corporate performance. Unfortunately, for many of the true shareholder advocates concerned with improving a company's bottom line, this rule will put in new impediments to their efforts.

For shareholders allowed to have nominees in corporate proxy materials, the rules also put in a host of new requirements that exceed state law. The shareholder would be required to have held the stock for at least one year, limited to nominating no more than 25 percent of a company's board, and forced to certify that he or she is not holding the stock for changing control of the company. True shareholder advocates interested in improving investor return may chafe at these restrictions and still nominate candidates the old-fashioned way and out of their own pockets. However, these nominations may be devalued precisely because they are seen as not having the SEC "seal of approval" and being included in a company's official proxy materials.

State governments are already modernizing proxy laws make shareholder involvement easier in the age of the Internet. Delaware, for instance, recently clarified a company's ability to amend its bylaws to provide for shareholder access to the proxy and reimburse shareholders for soliciting proxies in election of directors. These are options, but not one-size-fits-all rules, and are subject to negotiation between a firm and its shareholders. This is as it should be, as buying a stock in a competitive market is a choice. Shareholders should have access to full information about the companies they buy, but the level of participation allowed in a company's operations is a factor to be weighed in the purchase of the stock. If shareholders care about ease of nominating directors, companies will

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[4] Joao Dos Santos and Chien Song, "Analysis of the Wealth Effects of Shareholder Proposals," monograph, 18 May 2009, http://www.uschamber.com/assets/wfi/analysis_wealth_effects_volume2.pdf

respond. But to many investors, other things are more important, such as overall shareholder return.

There are many things the SEC could also do to remove government barriers to shareholders making their voices heard. It can offer clarification that shareholder actions such as talking to each other over the Internet about a company's governance do not constitute proxy solicitation that must be registered with the SEC. The agency can also encourage Congress to repeal the Williams Act of 1968, which forces investors who acquire more than 5 percent of a stock to make a public disclosure of the holdings and whether they intend to launch a takeover effort. This simply helps entrenched management resist takeover efforts, making them less accountable to all shareholders.

Finally in regard to the criticism that U.S. companies will lose competitive advantage to foreign firms whose governments force them to allow more "proxy access" for shareholders, precisely the opposite is true. The flexibility in corporate strucure and level of shareholder participation is one of the last advantages the U.S. offers in incorporating here. If proxy access proponents were truly concerned about competitive advantage, they would push for overhaul of or exemptions to the Sarbanes-Oxley Act of 2002, the burdensome accounting mandates of which have caused foreign firms to make a mad dash away from U.S. exchanges. The fact that these "shareholder advocates" don't recommend this, or even champion Sarbanes-Oxley itself, shows that may interests other than shareholder return in mind.

Thank you again for allowing the Competitive Enterprise Institute's Center for Investors and Entrepreneurs to weigh in on this important issue.

Sincerely,

John Berlau
Director, Center for Investors and Entrepreneurs
Competitive Enterprise Institute