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**HELPING PUBLIC COMPANIES – AND THEIR SUPPLIERS – TO DELIVER BETTER, AND MORE COST-EFFECTIVE SERVICES TO INVESTORS…SINCE 1992**
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## RE: File Number S7-10-09

**Dear ladies and gentlemen at the SEC;**

I wish to offer a few comments on the subject of your most recent release on FACILITATING SHAREHOLDER DIRECTOR NOMINATIONS - from a very *practical* and a very *practice-oriented* perspective; that of someone who has served as the Inspector of Election at well over 400 annual and special shareholder meetings, and at well over 50 shareholder meetings where non-management shareholders had nominated director candidates of their own.

I should begin by saying that as I have written to you before, I am in favor of the ability of non-management-affiliated shareholders to nominate director candidates – and to use the company proxy and the company's proxy machinery to do so – strictly as a matter of principle.

Clearly, if shareowners are allowed to use the proxy card and proxy materials to force a vote on as many mostly immaterial issues as they have been doing for decades now, they should, of course, be allowed access to the company proxy in order to facilitate the very serious matter of nominating director candidates.

Let me start by pointing out, however – as I and several other writers on this subject have pointed out in earlier comment letters – that most truly serious nominators of director candidates will surely produce their own proxy materials, and take control of their own "electioneering" with materials and proxy cards of their own, if they want to stand a reasonable chance to win.

That said; let me add that in roughly half of the 50 or so election contests I've been involved in over the past few years, the proponents of short-slates did NOT make a full-blown solicitation of the entire shareholder population, because of the very high costs involved in doing so.

Very important to note, however, the overwhelming majority of these 50-odd contests were driven by factors that most disinterested observers would say were really about the conduct of the ordinary business of the company, or, even more commonly, were motivated by "personal grievances" or "personal pique" concerning one or more of the management candidates, rather than by serious strategic or investment issues.

**Thus, as you draft your final rules, and work with the Congress on rules that some in the Congress are looking to put in place with new legislation, you need to be keenly aware, I believe, that…**

**(a) the number of such "proxy contests" will increase dramatically if Direct Access to the nominating machinery is implemented, as now seems likely** (my own prediction is for a four or five-fold increase, which would translate to 200 – 250 proxy fights a year to seat one or more shareholder nominated directors vs. the current 50 or so per year) and

**(b) that the vast majority of the new contests will occur at *small companies*:** At large, high-profile companies, most "serious activists" will surely run their own slates on their own proxy cards…and will run "short slates" of alternative candidates only where they believe there are truly serious "issues"…although, for sure, a few "opportunists" and "professional noisemakers" will take advantage of the low-cost route you will be opening up to simply "make noise"…and maybe run up the stock price temporarily, as usually happens when a proxy contest is announced.

While all of these new proxy fights will be great fun for the proponents, and for the law firms, proxy solicitors, advisors, tabulators and other providers – including myself – that the target companies will have to hire, it is very important to note how expensive such fights usually prove to be for the companies that are targeted – and what a major "strategic distraction" they prove to be for them when it comes to managing the company's ordinary business at the same time.

**Accordingly, and as I have written to you before, I think it is *imperative* to have "reasonably-high ownership thresholds" before allowing dissidents to nominate director candidates of their own:** In my own long-considered opinion, I think that 10% ownership – whether by an individual or by a "group" should be the absolute minimum level. Based on my many experiences as the Inspector of Election in proxy contests, I can attest that a 10% ownership stake is at the *very low end* of what a sensible proponent would want to have in hand before launching a proxy contest, unless their only objective is to "make noise" – and maybe attract potential bidders for the company as a whole.

I would ask you to note especially that 10% is at the low end of the ownership thresholds that most activist investors ask for, in order to permit shareholders to call a Special Meeting of shareholders. And I would also point out that this has been a "winning number" at most public companies these days, when this proposal is put to a shareholder vote. This is a percentage that is clearly a "*reasonably*-high number" to them – and one that it is, demonstrably, a very "reasonable" number for serious investors with "serious issues" to achieve. If a proponent, or a group of them, can not demonstrate this very modest number of votes already in favor, they should not be allowed to inflict the costs and disruptions of ordinary business that an election contest imposes on all shareholders.

**Equally important for the SEC to address in its final rules, are the thresholds for resubmission of shareholder nominees:** Given the costs, the distractions to the conduct of ordinary business – and the highly questionable benefits to long-term shareholders as a group that these campaigns typically produce – I feel strongly that any individual or group that nominates one or more directors under any new rules you promulgate should

be prohibited from nominating one or more candidates for three full years following the election, unless the candidate(s) they nominate in year-one receive at least 25% of the vote in year-one and 35% in year-two.

**There is another set of very practical concerns that I would like to bring to your attention. These revolve around the dangers of potentially making State laws – and State precedents totally moot – unless your final rules, and any enabling federal laws, are specifically crafted to make it clear that once there IS an election contest, existing State laws will continue to apply.**

The current rules as to what is a valid proxy and what is not have evolved over 200+ years – in State model business codes, in the Articles of Incorporation and Bylaws of State-Chartered companies and in hundreds of decisions that have been handed down by State courts. *Numerous* variations exist among our 50 States as to exactly what constitutes a valid signature on a proxy, and what distinguishes a valid proxy from an invalid one – and as to what, exactly, the proper procedures should be if there are "gray areas" with respect to specific proxies, or to specific procedural aspects concerning the conduct of the meeting itself - as there so often are in proxy contests.

A very high percentage of proxy fights end up in court because (a) so often, the outcomes are extremely close and (b) almost always, there are arguably "gray areas" in terms of the way the rules of procedure at a meeting and the "rules of proxy" may be interpreted and applied. The last thing the SEC should want, in my opinion, is for the SEC to suddenly become the arbiter of such disputes, or to see Federal courts forced to reinvent the wheel where the "rules of proxy" are concerned, or to decide which of the many State court precedents should decide the outcomes of specific cases.

**One last comment on the importance of a State-Regulated system before I move on to some additional areas that must urgently be improved upon before more proxy contests are unleashed upon us – concerning "private ordering" and the calls by some observers for companies to be able to "opt out" of Direct Access:**

I believe that any SEC action should simply (a) establish that shareowners, as *owners*, DO have a basic right to nominate directors and (b) establish some reasonable ownership levels in order to initiate such actions, to prevent too-small groups from wasting the valuable time and money of shareholders at large.

Ironically, it has been the SEC's own rule that has been preventing holders from freely exercising this right, and this rule should indeed be repealed.

But, as many other writers have pointed out, it flies in the face of logic to pass a new rule – especially under the guise of improving "shareholder democracy" – that does not allow the share owners themselves to democratically place reasonable limits of their own choosing on the thresholds for access to the company's proxy machinery. Here, it seems crystal clear that a 5% minimum threshold is at the *very low end*…and that 25% is probably at the very high end of what would actually "fly" with reasonable voters, should experience prove that a 10% ownership threshold was too low or two high at a particular company…in the view of a majority of the share owners.

**Now for some comments on some of the major deficiencies that exist with the proxy system itself, and which *absolutely must be fixed* before activist investors are allowed to so greatly ratchet up the number of proxy contests we will undoubtedly see, following any efforts to facilitate easier and essentially cost-free "proxy access" for minority shareholders:**

***First and foremost, the current system for issuing proxies – a system that currently allows both the borrower and the lender of a security to cast a vote when there should be only one vote per share, and which, as the CSX proxy fight demonstrated in 2008, allows activists, arbitrageurs and speculators to cast "extra votes" via derivatives and other "synthetic securities" – is an unconscionable scandal – and one that makes a mockery of the idea of "shareholder democracy".***

*Whenever* there are close election contests, and especially when there are high voter turnouts, as is typically the case in proxy contests, there are instances of "over-voting".

And, although the number of over-votes has *appeared* to decline in recent years, this is largely because a duplicate vote or over-vote is not visible to anyone under the current system - unless the vote of an individual bank or broker, casting votes both for themselves and for their clients, goes over 100%.

In formal proxy contests, the slight decline in the number of duplicate or over-votes I have witnessed as an Inspector of Election over the past year or two is largely because banks, brokers and tabulators are "making adjustments" in their back offices when their votes go over 100%. These adjustments are often totally arbitrary; they are not subject to any outside review, and they are often dead wrong. (Typically, for example, it is the *last vote* – which "created" the over-vote – that gets thrown out by these self-appointed and self-governed arbiters, which is exactly the *opposite* of what should happen.)

**I believe, however, that there is a relatively simple solution to this problem:**

If securities are lent out in order to settle a *trade*, the ownership – *and* the associated voting rights – must pass to the buyer when the trade is settled. (This procedure will also assure that the number of *shares*, as well as the number of votes that are actually outstanding, do not exceed the *legally authorized number of shares outstanding* and the number of shares that are properly entitled to vote.) The lenders' agents will simply have to bite the bullet here, and do the right thing…which is to associate the loan with one or more *specific lenders*, and reduce their voting rights in proportion to what they have lent out…and disclose to such lenders that they have "lent out" the vote too…and ideally, since votes DO have value, pay the lender not just for making a loan of stock, but for the added value of the voting rights that have passed to the borrower if that is the case.

If securities are lent out NOT to settle a trade, but simply as a way for the borrower to acquire the voting rights, the owner's agent must be obliged to follow the same process. Here, the lender's agent will have to cancel the lenders' voting rights for the number of shares lent out, and issue an irrevocable proxy to the borrower…since in these cases, the shares are still recorded as being *legally owned* by the lender.

A bit of extra bookkeeping, yes…and maybe the need for a mini-system to keep tabs on shares lent and borrowed, but a very small price to pay to restore integrity to the proxy voting system.

**There is a second and much needed "fix" to the proxy system that must be made; the very clear need for shareholder education, both about the value of their votes and about the mechanics of casting a vote:** The SEC has been promising to address this issue since 2006, when a NYSE committee was formed to address this issue, along with the "proxy plumbing" issues. But so far, there has been no action at all - other than the appointment of new committees in 2009, to study these problems yet again.

Indeed, the SEC's own actions – to *prohibit* the inclusion of educational materials with the Notice that is sent to shareholders under the "Notice & Access" system – has *contributed* to the shockingly large decline in voting by ordinary investors that we have seen since N&A was first introduced. To unleash a barrage of election contests when ordinary investors are so ill informed would also be unconscionable in my opinion.

**This leads to a third and very disturbing development that needs immediate SEC attention: There is an urgent need for a concerted effort to understand and address the huge decline in voting by *ordinary investors* – at the very time when we are about to give *activist investors* a powerful new weapon with which to wage proxy contests.**

My own almost daily observations of proxy voting tell me that yes, the lack of shareowner education is part of the problem. And yes, the Notice and Access system has contributed to the problem in at least two respects; (1) the absence of a clear "roadmap" as to what comes next and what to do with the Notice in hand and (2) the fact that N&A is based on a "pull model" – where the recipient must take the time and trouble to go to yet another place to take action – vs. the pre-N&A "push model" where the materials needed for recipients to take action are automatically "pushed" to them, which, as one should be easily able to understand, always increases response rates vs. pull-models.

**But there are two, much larger problems behind the falloff in shareholder voting:**

**The first problem, and one the SEC needs to address with the most urgency in my opinion, is the extent to which ordinary voters have become overwhelmed by, and turned-off by the literal explosion of proxy disclosures over the past few years:** As a consequence, ordinary investors have difficulty even *finding*, much less understanding, the information they need to have to make an informed voting decision.

Yes, shareholder education will help here, but what is really needed is a major paring-down and re-ordering of the "proxy package" itself. What is most needed, if the goal is to improve shareholder understanding, and shareholder action, is a much shorter, up-front presentation of the information that would allow most shareholders to make a voting decision, most of the time, without having to wade through 200 pages of text, charts and footnotes, which, of course, should always be available to shareholders who feel that more information, and more investigation may be warranted before they cast a vote.

**The second problem, related to the prior one – and one the SEC must recognize, I believe, as it reflects on the information that average investors need to make voting decisions – is that all the evidence of late seems to reinforce the idea that the "agency**

**theory" of corporate governance works just fine for most ordinary share owners – most of the time. As long as they are reasonably happy to BE shareholders, most investors seem to be perfectly willing to let the company management, and the company's board of directors, make most of the governance decisions.**

Clearly, ordinary shareowners have been literally "voting with their feet" – by walking away from prior habits of voting their proxies…in droves. This is not to imply that good corporate governance is not important to average investors, but it does indicate that *most of the time*, the governance issues that are so important to activist investors fail to resonate with ordinary shareowners…And frankly, there is a very real danger that truly important issues will be ignored due to the current information overkill.

In any event, I firmly believe that if the SEC develops a greatly condensed version of the essential information that most investors need to cast a vote on most proxy issues…most of the time…and allows issuers to include it with the Notice, shareholder voting will indeed rebound to and may well *exceed* long-term historical levels.

**There is one last practice-oriented area I believe the SEC needs to address, and that is the need for a completely fresh look at, and, almost certainly, a totally fresh approach to the so called NOBOs and OBOs:** The need here has become *much more urgent* as the number of proxy contests continues to increase – and especially since the number of individual investors who vote their proxies continues to fall.

**Astoundingly, this system has not been looked at critically since it was first put in place in 1986 – following the Shareholder Communication Act.**

And ironically (and exactly what has happened with the SEC's N&A rules, that were also designed with the goal of making it easier and less expensive to communicate more effectively with shareholders) the system that the SEC approved in 1986 had the effect of greatly *reducing* corporate communications with shareowners. Almost immediately after the NOBO/OBO rules went into effect, public companies began to eliminate the longstanding practice of sending quarterly and semi-annual reports to shareholders, for example, because of the increased costs of communicating with them.

**I believe that a totally new and much clearer definition is needed as to exactly WHO is "objecting"…and exactly what they are objecting to under the NOBO/OBO "system":**

I am not at all sure that *anyone* knows the answer to these questions anymore - or that the need to *be* an OBO, that banks, brokers and some investors too articulated way back in 1985, when these designations were devised - is relevant anymore. But clearly, as we stand poised to dramatically ramp up the number of proxy contests that shareowners will be confronted with, and asked to vote on, the need to have robust and more transparent systems for communicating with shareholders will be more important than ever.

It also seems clear to me that with the enormous advances that have been made in *ways* to communicate with investors since 1985 - and in the *costs* of communicating, thanks to the Internet - there are potentially enormous improvements that can be made here, both in terms of allowing investors to self-select the kinds of communications they *want* to have – and in terms of the overall cost structure.

I believe that more than ever before, investors will *welcome* well-crafted and well-targeted messages from the companies they have invested in. I also believe that public companies will be smart enough to respect the wishes of their shareowners with respect to the *kinds* of communications they want to have *and* to properly guard the privacy of their own share owners. I also believe that thanks to the many technological advances that have been made since 1985 and '86, there are many safe and sound ways to satisfy the "privacy issues" that proponents of "OBO status" made back then.

When I last wrote to you about these subjects – in the context of repealing the NYSE Rule that allowed brokers to cast votes for directors in the absence of specific shareowner instructions, I took issue with the assertions of so many of my colleagues that all the problems of the "proxy plumbing system" needed to be addressed all of a piece before any rule-changes were made. I felt then, that if we were to wait until all the problems were solved, we would never solve any of them.

But the adoption of a new Proxy Access rule will change the entire landscape in a very dramatic way: Giving minority shareholders such broad new powers – at a time when ordinary investors seem so ignorant about the proxy system, so unconvinced as to the value of their vote, and maybe convinced that the system is "rigged" anyway - and where there is evidence that *they are right about this* to some degree – is simply untenable.

If the Commission acts in the first quarter of 2010 to grant minority shareowners direct access to the proxy system for the purpose of nominating directors, as it seems ready to do, there is ample time, I feel certain, to correct all the technical, procedural and educational deficiencies that currently exist where "proxy plumbing issues" are concerned *before* direct access takes effect…as long as the Commission resolves to tackle these issues immediately, and with vigor.

As always, if there are any questions I might answer, of if there are any ways I might be of assistance in helping to improve the shareholder communications system, and the proxy voting process in general, please do not hesitate to contact me.

Sincerely,

Carl T. Hagberg

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