January 19, 2010

Via email: rule-comments@sec.gov

U.S. Securities and Exchange Commission
One Station Place
100 F Street, NE
Washington, DC 20549

Attention: Elizabeth Murphy, Secretary

Re: File No. S7-10-09; Release Nos. 33-9086; 34-61161; IC-29069
Facilitating Shareholder Director Nominations

Ladies and Gentlemen:

On behalf of the seven law firms listed below, we are writing in response to the request by the Securities and Exchange Commission (the "SEC" or the "Commission") for additional comments on its releases entitled "Facilitating Shareholder Director Nominations" (the "Proposal").[1] In light of the additional data and analyses cited in the December Release, as well as the recent comments by some of the commissioners regarding the possibility of permitting shareholders to approve a more restrictive proxy access standard,[2] we write to elaborate on our earlier recommendation that shareholders should have the opportunity to modify or opt-out entirely from the SEC's proxy access regime if Rule 14a-11 were adopted. The means to effect shareholder choice could be by shareholders directly adopting an amendment to a company's by-laws, approving a by-law amendment submitted by the board or ratifying a board-adopted by-law amendment. Although not the focus of this comment letter, we continue to stand by the other comments expressed in our

[1] Facilitating Shareholder Director Nominations, Securities Act Release No. 9086, Exchange Act Release No. 61,161, Investment Company Act Release No. 29,069, 74 Fed. Reg. 67,144 (proposed Dec. 14, 2009) [hereinafter December Release]; *see also* Facilitating Shareholder Director Nominations, Securities Act Release No. 9046, Exchange Act Release No. 60,089, Investment Company Act Release No. 28,765, 74 Fed. Reg. 29,024 (proposed June 10, 2009) [hereinafter June Release].

[2] Mary Schapiro, Chairman, SEC, Address to the Practising Law Institute's 41st Annual Institute on Securities Regulation (Nov. 4, 2009), *available at* http://sec.gov/news/speech/2009/spch110409mls.htm ("We received considerable comment about . . . whether shareholders should be given a choice to approve a proxy access standard that conflicts with the rule – and we are evaluating these comments carefully."); Elisse B. Walter, Comm'r, SEC, Speech at 48th Annual Corporate Counsel Institute: SEC Rulemaking – "Advancing the Law" to Protect Investors (Oct. 2, 2009), *available at* http://www.sec.gov/news/speech/2009/spch100209ebw.htm ("Many comment letters also suggest strongly that . . . shareholders should be permitted to approve provisions that may be more restrictive than those we've set in proposed Rule 14a-11 . . . . I am giving careful consideration to whether our rule needs any adjusting to address these concerns.")

letter dated August 17, 2009, including our preferred approach that the SEC pursue a more incremental approach by adopting only the proposed amendment to Rule 14a-8 at this time.[3]

I. Introduction and Overview

The Proposal would require that public companies provide proxy access in accordance with SEC established standards. The Proposal allows companies to provide for less restrictive provisions, but does not permit more restrictive provisions. Nonetheless, the SEC initially sought comment as to whether the Proposal should be revised to provide companies with the opportunity to provide more restrictive provisions and whether that right should be limited to shareholders.[4]

The Group of Seven Letter advocated reliance on private ordering rather than adoption of Rule 14a-11. Our concern was that the SEC's proposed Rule 14a-11 would have the practical effect of foreclosing much of the potential utility of private ordering in an area of great variation and complexity. Accordingly, we contended that the SEC can achieve its goal of removing impediments in the proxy rules to shareholders electing directors not nominated by the board by amending Rule 14a-8(i)(8) to permit shareholder proposals relating to the election of directors with far less complexity and disruption than a prescriptive one-size-fits-all rule. Nonetheless, the Group of Seven Letter made the point that if the SEC adopts proposed Rule 14a-11, then shareholders should at least have the opportunity to modify or entirely opt-out of proposed Rule 14a-11.

Since the SEC comment period ended in late August, there has been significant additional commentary with respect to the subject of private ordering.[5] As

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[3] Letter from Group of Seven Law Firms to Elizabeth Murphy, Sec'y, SEC (Aug. 17, 2009), *available at* http://www.sec.gov/comments/s7-10-09/s71009-212.pdf [hereinafter Group of Seven Letter]. We believe the positions expressed in our earlier letter have been strengthened by the additional data and analyses that have been included in the public comment file after that date. For example, a detailed study submitted by the Business Roundtable suggests that the Commission may have underestimated the costs of the Proposal as well as overestimated its need. *See* ELAINE BUCKBERG & JONATHAN MACEY, NERA ECON. CONSULTING, REPORT ON EFFECTS OF PROPOSED SEC RULE 14A-11 ON EFFICIENCY, COMPETITIVENESS AND CAPITAL FORMATION (2009), available at http://www.sec.gov/comments/s7-10-09/s71009-267.pdf. In addition, empirical evidence now in the comment file suggests that corporate governance mechanisms designed to make boards more accountable to shareholders may actually have contributed to the poor performance of some companies during the recent credit crisis. *See* Andrea Beltratti & René M. Stulz, Why Did Some Banks Perform Better During the Credit Crisis? A Cross-Country Study of the Impact of Governance and Regulation (Charles A. Dice Ctr. Working Paper, No. 2009-12, 2009), available at http://www.sec.gov/comments/s7-10-09/s71009-528.pdf. Such a result undermines the rationale that the Proposal is needed "[i]n light of the current economic crisis" and that proxy access would result in "potential improved board performance." June Release, *supra* note 1, at 29,025, 29,072.

[4] June Release, *supra* note 1, at 29,033.

[5] *See, e.g.*, Joseph A. Grundfest, The SEC's Proposed Proxy Access Rules: Politics, Economics, and the Law (Rock Ctr. for Corp. Governance Working Paper No. 64, 2009), *available at*

referred to in this letter, the two principal forms of private ordering that are the subject of debate are the following:

- **Opt-in:** Rule 14a-11 would not be adopted by the SEC and the "default" rule would be no proxy access. Shareholders would, however, be permitted to implement proxy access by directly adopting a by-law amendment, by approving a by-law amendment submitted by the board or by ratifying a board adopted by-law amendment. A shareholder initiated by-law could be adopted by being included in the company's proxy statement pursuant to an amended Rule 14a-8 or by being brought before a shareholder's meeting through advance notice by-laws and an independent proxy solicitation. Although the focus of the discussion has been on opt-in by shareholders, an opt-in regime also contemplates a board unilaterally adopting a proxy access by-law.

- **Opt-out:** Rule 14a-11 would be adopted by the SEC and the "default" rule would be proxy access. In contrast to the proposed SEC rule whereby shareholders would only be permitted to adopt less restrictive provisions to facilitate proxy access (a "one-way" opt-out), shareholders would be permitted to adopt either more or less restrictive provisions (a "two-way" opt-out), including an alternative regime or a complete exemption. Two-way opt-out could be implemented by shareholders directly adopting a by-law amendment, approving a by-law amendment submitted by the board or ratifying a board adopted by-law amendment. Generally, commentators did not suggest permitting boards unilaterally to opt-out from proxy access.[6]

As described in more detail below, if the SEC adopts Rule 14a-11 (rather than implementing an opt-in system, as we have recommended in the Group of Seven Letter), we recommend the inclusion of a two-way opt-out for the following reasons:

- A two-way opt-out (compared to the Proposal's one-way opt-out) is fundamentally more consistent with the SEC's goal of enfranchising shareholders.

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http://ssrn.com/abstract=1491670; Stanley Keller, Robert Todd Lang & Charles M. Nathan, Shareholder Choice in a World of Proxy Access, Dec. 31, 2009, *available at* http://sec.gov/comments/s7-10-09/s71009-585.pdf; Letter from Julie Gresham, Shareowner Education Network & Ann Yerger, Council of Institutional Investors, to Mary Schapiro, Chairman, SEC (Nov. 18, 2009), *available at* http://sec.gov/comments/s7-10-09/s71009-568.pdf (responding to "current public debate over private ordering and proxy access" and providing Corporate Library study on private ordering); *see also supra* note 2.

[6] *See, e.g.*, Walter, *supra* note 2 ("I must say, however, that I have a less favorable reaction to those who suggest that directors should also have that unfettered choice.").

- Given the diverse nature and needs of the over 12,000 companies that would be subject to a proxy access rule, uniform proxy access would not be effective or workable without the safety valve of a two-way opt-out.

- A two-way opt-out is widely endorsed by the SEC's constituencies, with only narrow opposition.

Moreover, there are serious issues with the criticism of a two-way opt-out:

- Proxy access is not fundamentally a "disclosure" regime and concerns regarding its modification by shareholders cannot be properly analogized to weakening disclosure requirements or to permitting shareholders to opt-out of a disclosure regime.

- In contrast to the potential impact on proxy access that impediments to shareholder by-law amendments may pose under an opt-in regime, concerns regarding such impediments, to the extent applicable, under a two-way opt-out regime are misplaced because any such impediments will only make the achievement of a two-way opt-out more difficult and therefore lead to greater prevalence of the default rule.

Finally, we believe a two-way opt-out could most effectively be implemented as follows:

- Shareholders should have complete flexibility to opt-out without the imposition of SEC parameters (*e.g.*, ownership thresholds within selected bands).

- Any final rule should allow shareholders to approve an opt-out from proxy access through a by-law amendment adopted in accordance with state law and the company's provisions for such an amendment. Such action could be effected through a shareholder proposal to amend a company's by-laws, shareholder approval of a by-law amendment submitted by the board of directors or by shareholder ratification of a by-law amendment adopted by the board of directors. We would prefer that the Commission leave the opt-out process to private ordering. Nonetheless, the Commission may ultimately determine to address the potential asymmetry between a lesser shareholder vote requirement for a shareholder resolution ratifying a board-adopted opt-out by-law compared with a higher vote requirement for a subsequent shareholder-adopted by-law to reverse the opt-out and opt-back-in (or otherwise modify the default proxy access rule). If this were the case, then such asymmetry could be addressed by requiring that any opt-out be effected by means of a shareholder-adopted by-law amendment.

- The SEC should defer the application of proxy access until 2012 in order to allow shareholders an opportunity at the 2011 annual meeting to tailor proxy access to their company's individual circumstances. Otherwise, companies could be subject to a type of ping pong effect of being subject to the status quo in 2010, to the default proxy access rule in 2011 and to a privately ordered modified (or eliminated) proxy access rule in 2012. In addition, the transition year would allow each company and its shareholders to assess any workability issues and determine how to address them using an opt-out. As an alternative means to minimize confusion and address workability, Rule 14a-11 could include a board-approved opt-out (without a requirement for shareholder approval) solely for the transition year of 2011.

II. Any Final Rule 14a-11 Should Include a Two-Way Opt-Out

We recommend that any final Rule 14a-11 include a two-way opt-out provision whereby shareholders would retain their rights under state law to alter the scope of proxy access, to modify its terms to address workability issues, or even to exempt their company from proxy access altogether. We recommend a two-way opt-out if Rule 14a-11 is adopted because (i) it is consistent with the basic premise of proxy access in seeking to enfranchise shareholders, (ii) it would mitigate the worst aspects of a "one-size fits all" approach and (iii) it has broad support among a wide range of the SEC's diverse constituencies.

A. Incorporating a Two-Way Opt-Out in Rule 14a-11 Is More Consistent with the Goal of Enhancing Shareholders' Rights

The SEC's adoption of a two-way opt-opt would be more consistent with the SEC's goal in proposing proxy access in order to facilitate the nominating and voting rights of shareholders.[7] In the June Release, the Commission expressed a desire to enhance the "ability for shareholders and companies to adopt their preferred shareholder nomination procedures."[8] We commend this goal, but it would not be served by the imposition of a mandatory proxy access rule (or a one-way opt-out) that prevents shareholders from approving an alternative or more restrictive nomination procedure. Indeed, such an approach reflects an internal inconsistency as it suggests faith in the ability of shareholders to use proxy access to identify and elect better qualified directors while at the same time having a lack of faith in the ability of shareholders to determine the scope of proxy access necessary to best serve their interests.

In addition, if Rule 14a-11 were adopted as proposed with respect to a one-way opt-out that only allows shareholders to adopt less restrictive provisions, there would be inherent uncertainty as to whether shareholder-adopted provisions are more or less

[7] This consistency would also reduce significant administrative law issues with the Proposal. *See* Grundfest, *supra* note 5.

[8] June Release, *supra* note 1, at 29,072.

restrictive. For example, would a by-law that reduced the ownership threshold to 0.5% for a single shareholder, but increased the threshold to 2% for a group of shareholders, be more or less restrictive than the Proposal? Another example would arise if shareholders approved a by-law amendment providing for additional disclosure regarding the relationship between nominating shareholders and nominees. Such a provision could be viewed as "more" restrictive because additional disclosure would be a potential impediment to nominating shareholders. Ironically, if the SEC does not modify the Proposal to allow for shareholders to adopt more restrictive provisions, then it could be in the perverse position of preventing shareholders from adopting provisions that provide for enhanced disclosure.

B. One-Size-Fits-All Approach is Inappropriate

A two-way opt-out provision would provide companies with at least some ability to address the workability issues presented by applying proposed Rule 14a-11 to each of the approximately 12,000 companies that would be covered by proposed Rule 14a-11.[9] The June Release itself raised well over one hundred questions related to proposed Rule 14a-11, most of them addressing concerns about the Proposal's workability as applied to diverse types of companies. These questions demonstrated an awareness that imposing proxy access will have different effects on companies depending upon a wide variety of company specific factors, size, capital structure,[10] ownership patterns, and the basis of the SEC's authority over each company.[11] In that connection, many investment companies noted that the Proposal is not workable given their structure, compliance requirements, and other considerations.[12]

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[9] *See* Smaller Reporting Company Regulatory Relief and Simplification, Securities Act Release No. 8876, Exchange Act Release No. 56994, 73 Fed. Reg. 934, 935 (Jan. 4, 2008), *available at* http://www.sec.gov/rules/final/2008/33-8876fr.pdf (stating that there were "11,898 reporting companies that filed annual reports with [the SEC] in 2006").

[10] *See, e.g.*, Letter from Jeffrey W. Rubin, Chair, Comm. on Fed'l Reg. of Sec., ABA, to Elizabeth Murphy, Sec'y, SEC 10 (Aug. 31, 2009), *available at* http://sec.gov/comments/s7-10-09/s71009-456.pdf (describing problems applying proposed rule to given variations in capital structures).

[11] *See, e.g.*, June Release, *supra* note 1, at 29,033, 29,077–80 (raising issue of disparate impact on smaller reporting companies); *id.* at 29,038 (seeking input on rule's application to companies with multiple classes of securities); *id.* at 29,035 (using data samples on current ownership make-up to select varying qualifying ownership thresholds for different types of companies); *id.* at 29,033 (requesting comment on whether proposed Rule 14a-11 should apply to investment companies, companies subject to proxy rules solely because of registered debt, and any other particular group of companies).

[12] *See, e.g.*, Letter from Paul Schott Stevens, Pres. & CEO, Investment Company Institute, to Elizabeth Murphy, Sec'y, SEC (Aug. 17, 2009), *available at* http://sec.gov/comments/s7-10-09/s71009-360.pdf [hereinafter ICI Letter] (recommending "that the current proposal exclude investment companies"); Letter from Heidi Stam, Managing Dir. & Gen. Counsel, Vanguard, to Elizabeth Murphy, Sec'y, SEC (Aug. 18, 2009), *available at* http://sec.gov/comments/s7-10-09/s71009-326.pdf ("[T]he Proposed Rules could disrupt the corporate governance model that the Commission has developed for investment companies.").

Among both critics and supporters of proxy access, there was wide disagreement on the most appropriate terms.[13] For example, although a minority of comments to the June Release that addressed the issue supported the SEC's proposed 1% ownership eligibility threshold for large accelerated filers, most supported thresholds ranging from 3% to 15%.[14] There was also widespread disagreement on the appropriate minimum holding period—a minority of those comments addressing the issue supported the SEC's proposed one year period while others argued for periods ranging from zero to three years.[15] Interestingly, RiskMetrics, the influential proxy advisory firm that strongly supports proxy access, has adopted proxy access provisions in its by-laws that are significantly more restrictive than the Proposal, including: (i) a limitation on the number of proxy access nominees to one rather than 25% of the board, (ii) a holding period of two years rather than one; and (iii) an ownership threshold of 4% rather than 1%.[16]

Empirical evidence also confirms that no single proxy access rule would be appropriate for every company. The study by Professors Andrea Beltratti and René M. Stulz, which is now part of the administrative record, suggests that the same corporate governance mechanisms that are generally perceived to have a positive effect at some

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[13] For a helpful summary of representative comments, *see* ALTMAN GROUP, SPECIAL REPORT: PROXY ACCESS, A STUDY OF 500+ LETTERS SUBMITTED TO THE SEC ON "FACILITATING SHAREHOLDER DIRECTOR NOMINATIONS (November 30, 2009), available at http://www.altmangroup.com/pdf/ProxyAccessAltmanGroupRpt.pdf; DAVIS POLK, 2009 PROXY ACCESS PROPOSAL: REPRESENTATIVE SEC COMMENT LETTERS (Oct. 1, 2009), available at http://www.davispolk.com/files/uploads/Documents/Proxy_access_comment_letter_matrix.pdf.

[14] *See, e.g.*, Letter from Judy Schub, Managing Dir., Committee on Investment of Employee Benefit Assets, to Elizabeth Murphy, Sec'y, SEC (Aug. 13, 2009), *available at* http://sec.gov/comments/s7-10-09/s71009-123.pdf (suggesting at least 3% threshold for accelerated filers and higher thresholds for other companies); Letter from Allison Bennington, Gen. Counsel, ValueAct Capital, to Elizabeth Murphy, Sec'y, SEC (Aug. 17, 2009), *available at* http://sec.gov/comments/s7-10-09/s71009-488.pdf (suggesting flat 10% threshold); Letter from Abe M. Friedman, Managing Dir., Barclay's Global Investors, to Elizabeth Murphy, Sec'y, SEC (Aug. 14, 2009), *available at* http://www.sec.gov/comments/s7-10-09/s71009-172.pdf (suggesting 5-15% threshold).

[15] *See, e.g* Letter from 26 Companies to Elizabeth Murphy, Sec'y, SEC (Aug. 17, 2009), *available at* http://sec.gov/comments/s7-10-09/s71009-472.pdf (suggesting two or three years); Letter from Chris DeRose, CEO, OPERS, to Elizabeth Murphy, Sec'y, SEC (Aug. 17, 2009), *available at* http://sec.gov/comments/s7-10-09/s71009-208.pdf (proposing two year holding period); Letter from Robert W. Goldman, Governance Comm. Chair, Tesoro Corp., to Elizabeth Murphy, Sec'y, SEC (Aug. 19, 2009), *available at* http://sec.gov/comments/s7-10-09/s71009-489.pdf (proposing three year holding period); Letter from Michael O'Sullivan, Pres., Australian Council of Superannuation Investors, to Elizabeth Murphy, Sec'y, SEC (Aug. 14, 2009), *available at* http://sec.gov/comments/s7-10-09/s71009-195.pdf (suggesting no holding period requirement).

[16] Second Amended and Restated By-Laws of RiskMetrics Group, Inc. § 2.7, *available at* http://www.sec.gov/Archives/edgar/data/1295172/000104746908000146/a2181888zex-3_2.htm. RiskMetrics has a market capitalization of nearly $1 billion, so it would be subject to the Proposal's least restrictive ownership threshold.

companies may have a negative effect at other companies.[17] This study is consistent with past empirical research suggesting one size does not fit all in the world of corporate governance.[18] Another study suggesting that the SEC has seriously underestimated the costs of proxy access buttresses the claim that shareholders, with respect to their own company, should be left to decide whether the costs associated with proxy access outweigh the benefits.[19] Similarly, shareholders may decide that alternative mechanisms, such as expense reimbursement for proxy contests, are preferable.

Even Rule 14a-8, the SEC's existing shareholder proposal rule, is applied to companies in a manner that takes into account their individual circumstances. Current Rule 14a-8 allows a company to exclude a shareholder proposal that it would otherwise be required to include in its proxy statement depending upon the governing state law, the proportion of the company's business that relates to the proposal or the existence of other past or present proposals on the same topic.[20] The extent to which an issuer is empowered under Rule 14a-8 to exclude shareholder proposals is a recognition that one size does not fit all.

C. Two-Way Opt-Out Is Widely Supported

While there is certainly a range of opinion on all aspects of the Proposal, we note that there is broad agreement among a diverse group of constituencies that a two-way opt-out is preferable or at least an acceptable feature of a proxy access regime. Support for some form of private ordering has come from investors,[21] businesses,[22] corporate counsel,[23] prominent academics,[24] and at least one union.[25] The opposition to a two-way opt-out is

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[17] *See* Beltratti & Stulz, *supra* note 3 (finding statistically significant evidence that financial institutions with more shareholder friendly boards performed worse during financial crisis).

[18] Jeffrey L. Coles, Naveen D. Daniel & Lalitha Naveen, *Boards: Does One Size Fit All?*, 87 J. FIN. ECON. 329 (2008) (finding that restrictions on board size and management representation on board have different effects on companies depending on size, reliance on debt financing and nature of business).

[19] *See* BUCKBERG & MACEY, *supra* note 3. Their findings also raise questions about the need for proxy access, as their study demonstrates that engaging in a traditional proxy contest is relatively inexpensive. *Id.* at 5–7.

[20] Shareholder Proposals, 17 C.F.R. § 240.14a-8 (2009).

[21] *See, e.g.*, ICI Letter, *supra* note 12, at 5-6.

[22] *See, e.g.*, Letter from Alexander M. Cutler, Chair of Corp. Leadership Initiative, Business Roundtable to Elizabeth Murphy, Sec'y, SEC (Aug. 17, 2009), *available at* http://sec.gov/comments/s7-10-09/s71009-267.pdf.

[23] *See, e.g.*, Letter from Arden T. Phillips, Chair, Corp. & Sec. Comm. of the Assoc. of Corp. Counsel, to Elizabeth Murphy, Sec'y, SEC (Aug. 17, 2009), *available at* http://sec.gov/comments/s7-10-09/s71009-337.pdf.

[24] Lucian A. Bebchuk & Scott Hirst, Private Ordering and the Proxy Access Debate (Harvard John M. Olin Discussion Paper No. 653, 2009), *available at* http://ssrn.com/abstract=1513408; Grundfest,

primarily limited to certain unions and public employee pension funds,[26] which may be acting, in part, on the basis of motives unrelated to the SEC's stated purposes for proxy access.[27]

III. Criticisms of a Two-Way Opt-Out Are Misplaced

Despite the broad base of support for a two-way opt-out provision, a limited number of comments contend that a two-way opt-out is inadvisable because (i) proxy access is a disclosure matter and should not be weakened by shareholders just as other SEC disclosure requirements are not subject to shareholder amendment, (ii) impediments to shareholder amendment of by-laws would prevent shareholders from initiating private ordering of proxy access, and (iii) a two-way opt-out regime would result in a "hodge-podge" of applicable standards for proxy access.

A. Allowing Shareholders to Exercise a Two-Way Opt-Out to Proxy Access Is Not Analogous to Allowing Shareholders to Exempt Themselves from Proxy Disclosure.

We strongly disagree with commentators who suggest that proxy access requires a uniform federal approach because proxy access is at its "core" a disclosure matter.[28] To the contrary, the Proposal is at its "core" a new substantive right that is being created by means of the SEC's authority over the proxy rules. As is the case with the North Dakota proxy access statute,[29] the Proposal is wholly unlike traditional disclosure rules and

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supra note 5; Letter from 10 Harvard Law Sch. & Harvard Bus. Sch. Professors. to Elizabeth Murphy, Sec'y, SEC (Aug. 13, 2009), *available at* http://sec.gov/comments/s7-10-09/s71009-164.pdf.

[25] *See* Letter from Edward J. Durkin, Dir. Of Corp. Affairs, United Bhd. of Carpenters, to Elizabeth Murphy, Sec'y, SEC (Aug. 17, 2009), *available at* http://sec.gov/comments/s7-10-09/s71009-492.pdf (supporting private ordering by means of opt-in).

[26] Georgeson & Latham and Watkins, Corporate Governance Commentary: Proxy Access Analysis No. 4, at 2, Nov. 3, 2009, available at . http://www.georgeson.com/usa/download/reports/CorpGovCommentary_110309.pdf (finding only fourteen comments opposed to opt-out, nearly all from labor unions and public employee pension funds).

[27] As Professor Grundfest notes, shareholders with special interests may abuse proxy access to generate attention through "megaphone externalities" or to extract special interest concessions through "electoral leverage." *See* Grundfest, *supra* note 5, at 16–21.

[28] Council of Institutional Investors, *Submitting Comments Supporting the SEC's Proxy Access Proposal*, Dec. 18, 2009, http://www.cii.org/UserFiles/file/Documents/Submitting%20Comments%20Supporting%20the%20SEC%20Proxy%20Access%20Proposal.pdf [hereinafter CII, *Submitting Comments*].

[29] N.D. Cent. Code § 10-35-08 (2009).

instead creates substantive shareholder rights on internal governance issues.[30] It regulates the procedures of the nomination and election process, including the number and qualifications of shareholder nominees included on the proxy card. This is analogous to *state* laws, such as the North Dakota statute, that create and give power to corporations on issues of internal governance, particularly fundamental provisions regarding the election of directors. The Proposal also is unlike existing disclosure rules because it contemplates a shareholder modification for less restrictive proxy access provisions which is not analogous to customary disclosure regulations.[31]

B. Perceived Barriers to Shareholder Action Would Not Obstruct Proxy Access Under a Two-Way Opt-Out Rule

A number of commentators oppose a two-way opt-out regime based upon a study by the Corporate Library[32] which concludes that private ordering for proxy access is problematic because (i) at a significant number of companies, shareholders are subject to supermajority voting requirements to amend the by-laws, or in a few cases do not have the power to amend by-laws, (ii) dual class voting provides disproportionate influence to insiders, and (iii) the broker voting rule may bolster the influence of management.[33] For example, ShareOwners.org concludes from this study that an "opt-in/opt-out" approach is a "non-starter."[34]

Although we have reservations as to various aspects of the Corporate Library study,[35] the basic problem is that, with respect to impediments to shareholder amendments of by-laws, it inappropriately conflates the implications for opt-out and opt-in regimes. Under an opt-in regime, no proxy access would be the default rule and shareholders could only initiate opt-in to proxy access by amending the by-laws. Under these circumstances, by-law impediments, like supermajority provisions, could make shareholder adoption of proxy access more difficult. These impediments, however, would not impede the adoption

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[30] For arguments that the Proposal is not related to disclosure and therefore exceeds the SEC's authority, *see* Letter from Wayne Watts, Gen. Counsel, AT&T, to Elizabeth M. Murphy, Sec'y, SEC, at 2–6 (Aug. 17, 2009), *available at* http://www.sec.gov/comments/s7-10-09/s71009-209.pdf.

[31] Keller, Lang & Nathan, *supra* note 5.

[32] Beth Young, Corporate Library, The Limits of Private Ordering (Nov. 2009), available at http://www.sec.gov/comments/s7-10-09/s71009-568.pdf.

[33] *See, e.g.*, CII, *Submitting Comments*, *supra* note 28.

[34] Press Release, ShareOwners.org, Report: Shareowners at 4 out of 10 U.S. Companies Would Be Disenfranchised Under Alternative to SEC Access Rule (Nov. 16, 2009), *available at* http://216.250.243.12/so/111609release.html.

[35] The study's statistics improperly lump together various governance provisions, thus obscuring important differences between the types of restrictions on shareholders' ability to amend by-laws and between types of supermajority votes. For example, it does not distinguish between those by-laws that require a supermajority vote for amendments to a limited set of specified provisions and those that require a supermajority vote for any amendment or new by-law.

of proxy access under a two-way opt-out if proxy access were the default rule. Indeed, supermajority provisions would facilitate proxy access in the form of the default rule because it would be more difficult for the shareholders to initiate opt-out of the default rule. Accordingly, there is no basis for the suggestion in the Corporate Library study that impediments to amending by-laws would discourage the use of proxy access in a two-way opt-out regime.[36]

The Corporate Library study is also conceptually flawed in citing the presence of high vote/low vote capital structures at some companies as undermining the case for a two-way opt-out provision. The study makes the point that there would be "essentially" no choice for shareholders under such circumstances because the votes would be controlled by insiders rather than the investing public.[37] Similarly, the Corporate Library suggests that brokers voting shares for customers who do not provide instructions may also distort the vote on an opt-out proposal because the brokers often vote in accordance with management recommendations.[38]

The problem with both of these contentions is that they are more of a critique of dual class capitalizations or broker voting than of a two-way opt-out provision. With respect to high vote stock, a shareholder who purchases low vote shares accepts that a majority vote is a function of voting power and not economic power.[39] The "distortion" of the relationship between voting power and economic exposure in companies with dual class capital structures that is decried in the Corporate Library study applies to all matters submitted to a shareholder vote at those companies; using it to argue against shareholder choice regarding proxy access is akin to arguing that shareholders should not vote on the

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[36] In addition, even taking the study's claims about the prevalence of "impediments" to shareholder voting, recent experience indicates that shareholders are nonetheless remarkably successful at effecting corporate governance change despite such "impediments." The percentage of S&P 500 companies with classified boards declined from over 60% in 2002 to 33% in 2009, despite the prevalence of supermajority voting requirements to amend such provisions. Indeed, the Corporate Library study found that 85% of management proposals to declassify the board that required supermajority shareholder votes were approved.

[37] The study assumes that the holders of high vote stock and a majority of the board are in lockstep which, of course, may not be the case.

[38] NYSE Rule 452 authorizes member organizations holding shares in "street name" to vote those shares on routine matters when the beneficial owner has failed to return a proxy. At present, a management proposal to opt-out of proxy access would be viewed as a routine matter, while a shareholder proposal to opt-out of proxy access that is opposed by management would not be a routine matter.

[39] In any event, the issue of proxy access is largely moot for most companies with high vote stock and high inside ownership because there is little practical ability for proxy access nominees to be elected, and the cost/benefit analysis of requiring proxy access at such companies is shifted even further. For similar reasons, we previously recommended that Rule 14a-11 should not apply to companies that are majority-owned by one or more shareholders. *See* Group of Seven Letter, *supra* note 3, at 11.

election of directors at all since the same dual class capital structures would "distort" that vote.

Similarly, to design a proxy access system based on perceived flaws in broker voting seems a case of the tail wagging the dog. If the current rule regarding the specific application of broker voting to a two-way opt-out vote on proxy access is flawed, then it should be addressed directly rather than using a flaw in Rule 452 as a pretext to scuttle shareholder choice. For example, Rule 452 could be modified to provide that a vote on whether to opt-out of proxy access would be treated as a "non-routine" matter whether or not supported by management and thus would not be subject to broker discretionary voting.

C. Concerns About "Hodge-Podge of Standards" Ignores the Essence of Corporate Law

The Council of Institutional Investors has argued that private ordering would result in a burdensome and unacceptable "hodge-podge of standards" and that a "uniform, federalized approach" is needed.[40] However, under a two-way opt-out approach, all regulated companies would start with the default rule of proxy access, resulting in substantial uniformity even when some companies choose to opt-out. More fundamentally, these comments ignore the essence of American corporate law, which has always been fundamentally based upon disparate state laws, each with an enabling approach to corporate governance, and ultimately resulting in a vibrant and diverse range of approaches by different businesses. The flexibility afforded by this approach is crucial for allowing shareholders and companies to meet their particular needs and adapt to changes in the global marketplace. Indeed, the *reduction ad absurdum* of this argument would be the imposition of a federalized uniform corporate law that does not enable shareholders to choose charter or by-law provisions.

IV. Implementation

As suggested above, given the impossibility of crafting a rule that will work for all the wide range of companies governed by the proxy access rules, we believe any effective proxy access rule must allow for private ordering.[41] Our recommendation for how the Commission should implement two-way opt-out in the event the Commission adopts Rule 14a-11 consists of (i) allowing shareholders to opt-out without being limited by Commission-mandated parameters, (ii) limiting any special federal voting requirements for shareholders to approve an opt-out, and (iii) providing for an appropriate transition to allow shareholders to decide whether an opt-out is appropriate before the default rule becomes effective. In addition, the rule should enable boards to take certain limited actions without prior shareholder action.

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[40] CII, *Submitting Comments*, *supra* note 28, at 2.

[41] We previously recommended private ordering through "opt-in" and continue to stand by that as our primary recommendation. *See* Group of Seven Letter, *supra* note 3, at 7 (recommending SEC permit proxy access proposals rather than impose uniform proxy access regime). We also note Professor's Grundfest's contention that some form of private ordering is necessary for the Proposal to meet the demands of the Administrative Procedure Act. *See* Grundfest, *supra* note 5.

A. Opt-Out with Full Range of Shareholder Choice

The principle underlying a two-way opt-out provision is that the SEC would adopt a default rule of proxy access but also empower shareholders to choose the optimum level of proxy access for each company, including the ability of shareholders to exempt the company from proxy access altogether. Such a provision should not limit the full range of options that shareholders have the right to choose. Accordingly, the Commission should not adopt "opt-out lite" by specifying parameters or permissible ranges (e.g., minimum and maximum ownership thresholds) on the ability of shareholders to impose greater or lesser restrictions on proxy access. The establishment of parameters will also inevitably raise some of the same "one size fits all" problems that can only be mitigated by shareholder choice, as well as pose an administrative law challenge for the Commission to provide an appropriate basis for its determination of the specific boundaries of such ranges.

B. Shareholder Vote on Opt-Out Should Be Subject to Minimal Intrusion from SEC

Any final rule should allow shareholders to approve an opt-out from proxy access through a by-law amendment adopted in accordance with the standards set by state law and the company's governing documents.[42] Such action could be effected through a shareholder proposal to amend a company's by-laws,[43] shareholder approval of a by-law amendment submitted by the board of directors or by shareholder ratification of a by-law amendment adopted by the board of directors. So long as the opt-out is approved by shareholders, we believe the best approach would be for the SEC to respect the form of approval that is arranged by a company's board and shareholders in conformity with the company's governing documents and applicable state law.

Under circumstances where a company's by-laws could impede adoption of a shareholder-initiated by-law because of a required supermajority vote, we anticipate that the Commission may be concerned about the potential asymmetry between the shareholder vote required in connection with shareholder ratification of a board-adopted opt-out by-law compared with the shareholder vote required if the shareholders subsequently seek to initiate a by-law amendment to opt-back-in (or otherwise modify the default proxy access rule).[44] We would, however, urge the Commission to be cautious in modifying such potential asymmetry because of the risk of unduly intruding into internal corporate matters and

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[42] Many states, including Delaware, guarantee shareholders the right to amend by-laws. *See, e.g.*, DEL. CODE tit. 8, § 109 (2009). The vast majority of companies (approximately 96% of companies in the Russell 3000 and Russell 1000 indices and 97% of S&P 500 companies) allow shareholders to amend by-laws. *See* Young, *supra* note 32, at 6. For the few companies in which shareholders do not have the power to amend by-laws, shareholder approval of an opt-out could take the form of a charter amendment.

[43] The proposed amendments to Rule 14a-8 would ensure that such a proposal and its rationale would be included in the company's proxy statement if properly submitted.

[44] *See, e.g.*, Bebchuk & Hirst, *supra* note 24, at 33. This scenario could occur, for example, if a shareholder resolution to approve a board by-law amendment effecting an opt-out requires a lesser vote (e.g., a majority vote) than the vote required to approve a subsequent shareholder-initiated modification to the proxy access by-law (e.g., a supermajority vote).

applicable state corporate law. For example, many charters contemplate the asymmetry of permitting the board to amend the by-laws without shareholder action, while concurrently requiring a supermajority vote for shareholders to amend the by-laws. Our view, however, is that any private ordering asymmetry resulting from such supermajority shareholder by-laws is best addressed by boards and shareholders rather than by the SEC. Indeed, the SEC should take comfort from the fact that shareholders have been quite successful in forcing the repeal of supermajority provisions in the past few years.[45]

Nonetheless, if the SEC ultimately determines to modify this asymmetry, we believe the best alternative would be to require that an opt-out or opt-in (or other modification to the default proxy access rule) be approved by means of a shareholder-adopted by-law amendment. That is, the board could not simply opt-out by means of amending the by-laws subject to shareholder ratification (pursuant to a board-specified voting threshold). This requirement would ensure that any opt-out initiated by the board and approved by shareholders would be subject to the same vote as required for a subsequent shareholder proposal to reverse the opt-out and opt-back-in (or otherwise modify the default proxy access rule). While this approach involves an incremental intrusion into internal corporate matters and state corporate law, it has the advantage of addressing any concerns about asymmetry while also respecting the existing charter and by-law requirements (and applicable state law) for shareholder-initiated by-laws.[46]

Our suggestion is in contrast to the approach proposed in an article by Lucian Bebchuk, who calls for a uniform majority voting standard, by means of shareholder resolution, for both an opt-out and an opt-in. Professor Bebchuck suggests that any such resolution would be accompanied by a separate by-law amendment, if shareholders seek to provide any alternative access rights.[47] We disagree with such an approach because reconfiguring applicable state law and preexisting charters and by-laws with a uniform majority voting standard would be an inappropriate and unnecessary federal intrusion into internal corporate matters and applicable state corporate law. Moreover, it is cumbersome to separate the vote to opt-out from the vote for an alternative regime set forth in a by-law amendment. Most companies will probably not opt-out without providing an alternative and thus the resolution will typically be subject to a by-law amendment. Indeed, Delaware law expressly contemplates that proxy access provisions will be included in the by-laws.[48] Finally, we believe the suggestion to impose a uniform majority voting standard may be driven more by a general objection to supermajority voting standards than by concerns about the proxy rules. Such concerns should properly be addressed at the company or state level, and in any event, not as part of the debate on proxy access.

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[45] GEORGESON, 2008 ANNUAL CORPORATE GOVERNANCE REVIEW 4 (2008).

[46] As noted above in note 42, we recognize that some states do not allow shareholder-initiated by-law amendments. In these cases, opt-out could be effected via a charter amendment with the same requirements as to symmetrical voting thresholds.

[47] *See, e.g.,* Bebchuk & Hirst, *supra* note 24, at 33.

[48] DEL. CODE tit. 8, §§ 112–113 (2009).

C. Transition

We believe an appropriate transition is important to the implementation of a rule that includes private ordering. Companies will need to devote a significant amount of time, money, and attention to the implementation of any proxy access rule, whether or not private ordering is permitted. If the final rule includes an opportunity for private ordering by shareholders, it should also include an adequate opportunity for shareholders to exercise that right before imposition of the default rule of proxy access. Given the timing of the proxy calendar, it will likely be impractical for companies to propose alternatives at their 2010 annual meetings, and we think it is neither appropriate nor practical to create a timing regime that would require companies to incur the trouble and expense of calling a special meeting of shareholders later in 2010 for the sole purpose of considering an alternative proxy access regime.[49] Accordingly, as a practical matter, the first time shareholders would be able to consider an opt-out proposal would be at their 2011 annual meeting. As a result, the transition would be unnecessarily complicated and confusing if companies are required to adjust from the status quo in 2010, to the default proxy access rule in 2011, and again to any alternative rule adopted via private ordering at the 2011 annual meeting for 2012 and subsequent years. In addition, a transition period of one proxy period (*i.e.*, with the default rule not taking effect until 2012) would also provide companies with a greater opportunity to address workability issues. Accordingly, we recommend that effectiveness of a default proxy access rule be deferred to the 2012 proxy season in order to allow shareholders the opportunity to vote on alternatives at the 2011 annual meeting before implementation of the default rule. As a related matter, we recommend that the proposed amendment to Rule 14a-8 become effective as soon as possible in order to ensure its applicability for the 2011 proxy season so that shareholders will be able to propose their version of proxy access if their boards fail to do so.

As an alternative to delaying implementation of proxy access for a year, the Proposal could include the ability for a board opt-out (without a shareholder approval requirement) solely for the transition year of 2011. This would allow implementation of proxy access at most companies sooner, while still accommodating private ordering. Our expectation is that many boards would adopt the same proxy access provision for the 2011 transition year that they would propose to shareholders at the 2011 annual meeting.[50] Cynicism with respect to possible board action with respect to the 2011 transition year would be unjustified because for a board simply to opt-out on a basis that would not be expected to be acceptable to shareholders would be shortsighted. In addition to the practicability of dealing with shareholder objections, boards could be disciplined by the voting policies of influential proxy advisory firms if, as we would expect, such firms adopt

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[49] As we have previously explained, it is unlikely that companies will hold a special meeting to address proxy access. *See* Group of Seven Letter, *supra* note 3, at 10.

[50] As an alternative, to reinforce this point and limit scope of board opt-out, the Commission could amend the proposal to require any interim board opt-out be limited to the terms of any proposal that it submits for shareholder approval at the 2011 annual meeting.

policies to address unilateral board action that does not comply with their recommended guidelines.[51]

D. Limited Role for Board Action

As noted above, we expect many boards to actively engage with their shareholders about the best proxy access regime for their company and consider submitting a proposed by-law for a shareholder vote. In addition, there are instances where adoption and implementation of proxy access would be streamlined if the board of directors were authorized to act without prior shareholder approval for specified limited purposes. Boards should be able to correct mistakes, ambiguities, and other non-substantive problems in shareholder-proposed access provisions. For example, a company may wish to amend the mailing address to which nominations should be sent or correct a typographical error. We do not believe such minor amendments necessitate shareholder approval, but the Commission could require that such minor amendments be approved by a majority vote at the next annual meeting.

V. Conclusion

The Proposal has generated passionate debate among commentators, particularly with respect to whether shareholders should be entitled to privately order proxy access and adopt alternative governance rules. A subset of the debate on private ordering has been whether an opt-in or opt-out approach is more desirable. While we would prefer an opt-in approach, as articulated in the Group of Seven Letter, we view an opt-out as bridging the gap between those who prefer an opt-in and those who prefer the more restrictive provisions that the SEC has proposed. This compromise would balance the SEC's desire to facilitate proxy access with deferring to the views of shareholders if they prefer an alternative.

We appreciate this opportunity to submit, and the SEC's consideration of, our additional comments on the proposed proxy access rules. As in our prior letter, we ask the SEC to contact any of the following firm representatives should it have any questions: Richard Hall from Cravath, Swaine & Moore LLP at 212-474-1293; Phillip R. Mills from Davis Polk & Wardwell LLP at 212-450-4618; Charles M. Nathan from Latham & Watkins, LLP at 212-906-1730; John G. Finley from Simpson Thacher & Bartlett LLP at 212-455-2583; Marc S. Gerber from Skadden, Arps, Slate, Meagher & Flom LLP at 202-371-7233; James C. Morphy from Sullivan & Cromwell LLP at 212-558-4000; and Eric S. Robinson from Wachtell, Lipton, Rosen & Katz at 212-403-1220.

[51] If Rule 14a-8 were amended to permit shareholder proposals on proxy access, this would serve as an additional motivation to restrain boards from acting contrary to the anticipated wishes of a shareholder majority.

Respectfully,

/s/Cravath, Swaine & Moore LLP
Cravath, Swaine & Moore LLP

/s/Davis Polk & Wardwell LLP
Davis Polk & Wardwell LLP

/s/Latham & Watkins, LLP
Latham & Watkins, LLP

/s/ Simpson Thacher & Bartlett LLP
Simpson Thacher & Bartlett LLP

/s/Skadden, Arps, Slate, Meagher & Flom LLP
Skadden, Arps, Slate, Meagher & Flom LLP

/s/ Sullivan & Cromwell LLP
Sullivan & Cromwell LLP

/s/Wachtell, Lipton, Rosen & Katz
Wachtell, Lipton, Rosen & Katz

CC: The Honorable Mary L. Schapiro, Chairman
The Honorable Kathleen L. Casey, Commissioner
The Honorable Elisse B. Walter, Commissioner
The Honorable Luis A. Aguilar, Commissioner
The Honorable Troy A. Paredes, Commissioner

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