S. HRG. 110–953

SHAREHOLDER RIGHTS AND PROXY ACCESS

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

ON

SHAREHOLDER RIGHTS AND PROXY ACCESS

WEDNESDAY, NOVEMBER 14, 2007

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

Available at: http://www.access.gpo.gov/congress/senate/senate05sh.html

U.S. GOVERNMENT PRINTING OFFICE
50–363 WASHINGTON : 2010

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

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C O N T E N T S

WEDNESDAY, NOVEMBER 14, 2007

WITNESSES

SHAREHOLDER RIGHTS AND PROXY ACCESS

WEDNESDAY, NOVEMBER 14, 2007

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:31 a.m., in room SD–538, Dirksen Senate Office Building, Senator Jack Reed, presiding.

OPENING STATEMENT OF SENATOR JACK REED

Senator REED. Let me call the hearing to order. Today we are holding a hearing on shareholder rights and proxy access.

In July, the Commission had issued two distinct proposals regarding proxy access for shareholders. The first proposal, known as the "short rule," would eliminate shareholder access to proxy. The second proposal, referred to as the "long rule," would allow for it, but places what many investor groups and large institutional investors believe are untenable thresholds and excessive hurdles. These proposals were released by the Commission at a time when there was a full complement of five Commissioners, with the Chairman supporting each of the distinct proposals. When the comment period ended on October 2, 2007, the SEC had received over 34,000 comment letters on the proposed rules.

I am deeply concerned about both the process for approving these proposals as well as the substance of the proposals themselves. On November 1, 2007, I joined Chairman Dodd and seven of my colleagues from this Committee in sending a letter to the Commission asking it to refrain from adopting either one of the proposals and, rather, allow shareholders to make proposals pursuant to current standards set forth in the decision of the United States Circuit Court of Appeals for the Second Circuit in *AFSCME* v. *AIG*.

This hearing is an opportunity to discuss shareholder rights, the significance of proxy access to shareholders, and the Commission's two proposed rules, their impact on investors and the Commission's decisionmaking process.

According to the 2006 interim report of the Committee on Capital Markets Regulations, the strength of shareholder rights in publicly traded firms directly affects the health and efficient functioning of U.S. capital markets. Overall, shareholders of U.S. companies have fewer rights in a number of important areas than do foreign companies. This difference creates an important potential competitive problem. Without adequate shareholder rights, rational investors will reduce the price at which they are willing to purchase shares. Public capital markets will be smaller as a result of inadequate shareholder rights. The importance of shareholder rights also af-

fects whether directors and management are fully accountable to shareholders for their actions.

The report further concludes that there is a danger that the United States, compared with other countries, is falling behind best practices in shareholder rights. These findings are further supported by some of the largest global institutional investors, such as Hermes, Barclays Global Investments, and Universities Superannuation Scheme, who have written over the past year to the Commission and to our Committee will similar concerns.

I know the Commission takes the issue of U.S. capital markets' competitiveness seriously and is prioritizing a number of efforts on that front. However, I believe that both of its proposals on shareholder access miss the mark.

The short proposal would overrule the 2006 *AFSCME* v. *AIG* court decision and maintain that a company may exclude a proxy access proposal from its proxy materials. This clearly would take away the fundamental rights of shareholders to have a say in the election of directors unless they filed a separate proxy.

The long proposal, in theory, allows shareholders access to proxies, but it sets a 5-percent ownership, which, according to some of the largest institutional investors, would make any subsequent rule meaningless in its application. As a matter of fact, research completed by the Council on Institutional Investors found that if CalPERS and nine of the other largest public pension funds would have successfully aggregated their holdings of a single public company's securities, those funds combined would likely to be unable to clear the 5-percent threshold. Furthermore, many investors have commented that the proposed disclosure requirements under the long proposal are excessive, and as Commissioner Nazareth recently commented, they are more extensive than that required of someone seeking to take over the company.

Mr. Chairman, in some press reports you have indicated that the Commission plans to finalize the short rule, non-access proposal, before the end of this month and then revisit the issue to fix the proxy access rule in 2008. I am concerned by this process and the speed at which you are rushing to this decision. Particularly, it seems to indicate that you are acknowledging that the transient fix is not the final form.

During the 2007 proxy season, in which the AIG case was the law, only three proxy access shareholder proposals were filed on corporate ballots to adopt bylaw amendments regarding the election of directors. The expectation is that only a handful will be filed in 2008. Thus, given the small number of resolutions expected in this area, it is highly unlikely that those resolutions would create any widespread uncertainty.

Furthermore, as we all know, it is hard to undo rules once they are adopted. There are far more serious consequences for the Commission to enact one set of rules now and then basically go back to the drawing board within months of acting. This will cause far more uncertainty and confusion and result in public companies having to comply with three different regulatory schemes in 2 years. The Commission should take its time and get it right once and for all with the benefit of a full complement of Commissioners to consider the issue.

There are many issues that I hope we have the opportunity to discuss this morning. There are certainly some positive trends, such as the movement by the United States and many of its companies to adopt majority voting in director elections in some companies like AFLAC, whose board approved a resolution giving shareholders the right to a non-binding vote on executive compensation. Nevertheless, we need to do much more to bring shareholder rights in alignment with international best practices. And given what we have seen in the Enron and WorldCom stock options back-dating and executive pay scandals, it seems a sensible idea that long-term investors should have a way to nominate generally independent directors to corporate boards. A company that delivers long-term shareholder value should expect the ongoing support of its shareholders. Shareholder access to proxies should not be viewed as seeking to place new burdens on businesses but as a way to ensure accountability and responsibility by both the shareholders and management. Ultimately, this is an opportunity for the Commission to lead and show the world that it takes shareholder rights and investor protection seriously.

At this point, Senator Menendez, if you have a statement.

STATEMENT OF SENATOR ROBERT MENENDEZ

Senator MENENDEZ. Thank you, Mr. Chairman. And thank you for keeping the room so cool. It might be necessary with the heat that this issue generates.

Welcome, Chairman Cox, and to our other witnesses as well, welcome. I am pleased that you can appear before the Committee on this important issue of shareholder rights and proxy access. As we well know, the SEC stirred up the debate over proxy access back in July when it put forward two very distinct and conflicting proposals on proxy access, a rare move that has puzzled many struggling to figure out the Commission's direction on shareholder rights.

Since then, there has been a great deal of speculation about the rationale behind the proposals, as well as the direction the SEC will ultimately take on this issue. So given that context and the interests clearly that exist on this issue and that has been created, I am particularly glad that we have the chance today to look carefully at what led to two starkly different proposals, and also to talk frankly about the road ahead for shareholder access.

Much of the debate over proxy access comes down to the issue of what role shareholders play and how far their influence should reach. Personally, I believe the right of shareholders to elect directors and have a say in how those directors are chosen is paramount. In my mind, they own the company.

I think it is unfortunate that this debate has opened the door to the potential weakening of shareholder rights, and I hope that at the end of the day this debate will not result in rolling back the right that shareholders already—already—have. That would be a big mistake.

I am also perplexed and deeply disturbed that, despite the amount of debate over these proposals, the Commission has indicated it will move forward with a vote before the end of the year, with possible further review next year. I am one of those that

joined on to the letter Senator Reed referred to. It seems to me that if the objective here is to obtain clarity on what the policy for shareholder access should be, then we should have a sound debate that results in a clear ruling. Issuing one rule for next year and then reconsidering it shortly thereafter would likely lead only to more confusion and uncertainty at the end of the day.

I do welcome the fact that the Commission is treating this issue seriously and is committed to bring about clarity and consensus. I would just submit that we make sure the end result does, in fact, bring about clarity, not more complexity. I do believe that there should be a full Commission to sit to have this vote.

As this is certainly not the first time around in trying to hammer out a workable policy on shareholder access, I hope this time we will be able to find common sensible ground, and I look forward to your testimony.

Thank you, Mr. Chairman.

Senator REED. Thank you very much, Senator Menendez.

Senator Hagel, do you have a statement?

Senator HAGEL. No. Thank you.

Senator REED. I would at this point ask unanimous consent to introduce the statement of Senator Shelby into the record and also to announce that the record will remain open for 5 days, and statements of my colleagues will be accepted, and without objection, so ordered.

Mr. Chairman, thank you. Thank you for joining us. You have just returned from Japan, none the worse from wear, and we thank you for joining us today.

STATEMENT OF CHRISTOPHER COX, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION

Mr. COX. Chairman Reed, thank you very much, and Members of the Committee. Thank you for inviting me to testify. This is a very important issue, and I am pleased to have the opportunity to go into it in some depth. The subject, of course, as you have described, is the Commission's ongoing rulemaking on bylaw proposals to establish director nomination procedures.

As you know, the current rules do not permit shareholders to offer these bylaw proposals. In July I voted for a rule proposal to change that. The Commission has published that proposed rule for comment, along with a companion proposal that would essentially ratify the status quo. The breadth of the territory that was covered between these two proposals and the extensive questions that we submitted for public comment gave the Commission plenty of flexibility to address defects in the proposals or areas for possible improvement that might be identified in the comment process. The comment period on these rule proposals has just closed.

I cannot predict exactly what the Commission will do on this subject this year. Obviously, we are currently reviewing the enormous number of comments that we received, most of them on the last day of the comment period last month. And today I can speak only for myself, since my testimony does not reflect the individual views of the other Commissioners or of the Securities and Exchange Commission. But I am happy to explain why I support

strengthening the proxy rules to better vindicate the fundamental State law rights of shareholders.

Our free enterprise system is built on a foundation of law. The enforcement of private property rights is an essential ingredient of a successful free market. At bottom, a share of stock is a bundle of private property rights—nothing more, nothing less. And the law's enforcement of private property rights is what gives it its value.

America's investors in equities currently entrust over $20 trillion of their assets in exchange for these property rights. It is only the precious few specific rights that the law gives to a common stockholder that undergird the investment of such enormous sums. And so it is of the utmost importance that what the stockholder does have is jealously guarded by our legal system. We cannot have capitalism without capital, and protecting the right of America's shareholders to choose the company's directors is vitally important to ensure a continued flow of capital to our companies and industries. It is also the best way to ensure that boards of directors remain accountable to the interests of investors.

The issue of protecting investors' ownership rights is not a partisan one. As Chairman John Shad put it during the Reagan administration, "The Commission has always encouraged shareholder participation in the corporate electoral process." More recently, commentators from across the spectrum have been making the case, as you, Mr. Chairman, noted in your opening statement. The distinguished group of experts, for example, that comprised the Committee on Capital Markets under the direction of Professor Hal Scott of the Harvard Law School; Glenn Hubbard, President Bush's former Chairman of the Council of Economic Advisers; and John Thornton, the former President of Goldman Sachs, devoted an entire section of their recent report to shareholder rights. In their words, "The strength of shareholder rights in publicly traded firms directly affects the health and efficient functioning of U.S. capital markets." And they pointed out that because shareholders of U.S. companies have fewer rights than do their foreign counterparts, this creates an important potential competitive problem for U.S. companies.

As one way of addressing that need, they recommended that the SEC take the opportunity of the court's decision in the proxy access case to ensure appropriate access by shareholders to the director nomination process, and that is exactly the job we have tackled.

This is a significant undertaking. Rationalizing the potential input of 45 million shareholders while fulfilling the essential Federal role of ensuring disclosure and guaranteeing investors the full protection of the anti-fraud provisions of the securities laws is a complicated matter. If it were easy, my predecessor, who attempted to do it, would have succeeded over the several years that he tried. Indeed, when the Commission previously considered this issue in the 1990's, it determined not to pursue it. And as difficult as the basic proxy access problem is, we have another issue on our hands.

Last autumn, the U.S. Court of Appeals for the Second Circuit invalidated the SEC's interpretation of our existing proxy access rule that had been applied at least since 1990. Indeed, in the staff's view, that interpretation had been in effect since 1976. But the

court found the SEC's view since 1990 to be inconsistent with its prior interpretation. At the same time, the court said that it would take no side in the policy debate regarding shareholder access to the corporate ballot because such issues are the appropriate province of the SEC. This decision applies in only one of the 12 judicial circuits in the United States, and so it has created great uncertainty in our public markets.

This uncertainty is compounded by a subsequent decision of the U.S. Supreme Court which creates doubt about the state of affairs even in the Second Circuit. The Supreme Court reversed another panel of the Second Circuit in a similar case of an agency that changed its interpretation of its rules. Just as in the proxy access case, the Second Circuit rejected the agency's more recent interpretation. Justice Breyer's opinion for the unanimous court held that the agency's interpretation of its own regulations is controlling unless plainly erroneous. As a result of this decision, it is more likely today that even a court in the Second Circuit would uphold the Commission's longstanding interpretation of our proxy access rule.

In this escalating state of legal confusion, the only rule across America at the moment is every litigant for himself. And yet the only legal question is what the SEC's rule means—the SEC's current rule, not the new rules that we have proposed, but the rule that is already on the books and has been for over 30 years.

There can be absolutely no excuse for our continuing to fail to answer that basic question. That is why I have said all year that we are committed to having a clear rule in place for the coming proxy season. The do-nothing alternative that is being urged by some is doubly dangerous. Not only will it provoke more needless litigation about the meaning of our rule, which in light of the recent Supreme Court decision might well be resolved in favor of the SEC's longstanding interpretation, but it will create a law of the jungle for any actual shareholder proposals that are advanced in the meantime. That is because unless we accept the Second Circuit's invitation to clarify the current rule, all of the protections of the proxy contest rules are out the window, including requirements for disclosure of conflicts of interest and possibly even the anti-fraud rules that prevent deliberate lying to investors.

It is obvious that many shareholders support the main effect of the Second Circuit decision, which is that the Commission's existing rule concerning proxy access is called into question because they want to have access to the proxy. You will hear from them on the next panel, and I personally am very attentive to their concerns. But it should be possible to gain the more effective use of the proxy that we all seek without abandoning other important shareholder protections such as our disclosure and anti-fraud rules. So whatever the Commission decides to do, we will restore certainty about the application of our rules. That is our fundamental responsibility.

When Hammurabi erected his stone tablets in the city square of Babylon 3,800 years ago, it made a great advance for civilization. From that moment forward, the law was no longer arbitrary. For the first time, citizens could know in advance the standard to which they should conform their conduct. That is the difference between the rule of law and the rule of men.

In our own time, when we highly prize the rule of law, we face the same risk as our ancient forbears, but for a different reason. All of our laws are written down, thousands of pages of them. On top of that, there are hundreds of thousands of pages of regulations, and beyond that an ever growing case law that interprets both the statutes and the regulations.

The uncertainty generated by competing interpretations in so many gray areas creates a 21st century version of the pre-Hammurabian days. Once again, citizens cannot know in advance the rules by which they should arrange their lives and their business affairs. There is nowhere that certainty in the law is more important than in our markets. Each day investors and businesses in this country and around the world execute make-or-break choices that depend on knowing in advance what the rules are. We owe it to them to provide a clear answer. Each of our rules may not be precisely what a particular player wants, but it should, nonetheless, be precise. A vague or ambiguous rule can be just as bad as no rule at all.

The rule of law that the SEC enforces has given America the most dynamic and vibrant capital markets in the world, and the rule of law includes both certainty in application and commitment to enforcement of the fundamental property rights of every shareholder—above all, the right to choose the directors of the companies in which they invest. So I agree with the many commenters on our two proposals who said we should go back to the drawing board and take a fresh look at this issue. We will do that. Although none of the 22 SEC Chairmen since the agency first looked at this issue in 1942 has successfully taken this step, I am committed to serious work on it, and I am intent on bringing it to a successful resolution. And I will be happy to take your questions.

Senator REED. Thank you very much, Mr. Chairman.

You have described the process in which there is an initial attempt to create a fix as a prelude to a more comprehensive and thorough deliberation in the future, and this is designed, in your words, to address the uncertainty. But how does this eliminate confusion and uncertainty if, you know, you have already advertised that this is a transitory rule, it will be in effect for perhaps a few months, and also, by the way, it will be the product of a Commission that is not at full strength and the whole significant changes could come about with additional members of the Commission being nominated and confirmed. So how does this avoid uncertainty and confusion?

Mr. COX. It simply freezes the status quo. This is the rule that has been in place for at least 17 years, depending on your interpretation, you know, possibly going back to 1976. But, in any case, it is the longstanding and at least 17-year interpretation of the SEC's rule.

Senator REED. Well, the last proxy season, the status quo was the *AFSCME* v. *AIG* case, which allowed for shareholder proposals, the procedure. So the question really is: What is the status quo? I think many would argue the status quo is the decision of the Second Circuit.

Mr. COX. Well, as I said, there has been a subsequent Supreme Court decision that fuzzes up what the legal rule is in the Second

Circuit, and the *AFSCME* v. *AIG* decision applied only in the Second Circuit and not in any of the other dozen judicial circuits in America.

Senator REED. And New York City is located in the Second Circuit.

Mr. COX. Indeed, and in each of the cases where people sought a no-action letter from the Securities and Exchange Commission, they argued that the Second Circuit was not the applicable jurisdiction. The jurisdictional question of whether or not a company which might have substantial contacts with New York is subject to the rule in the Second Circuit or the rule in the Fifth Circuit or the rule somewhere else is at the center of all of this, and it is the reason that our professional staff is seeking guidance from the Commission.

Now, subsequently, the Supreme Court has unanimously decided a very similar case from the Second Circuit rejecting the Second Circuit's decision that the most recent interpretation of the agency should be rejected if inconsistent with a prior interpretation of the same rule without the rule itself having been changed.

Senator REED. Did you appeal the *AFSCME* v. *AIG* case, or did anyone——

Mr. COX. We were not parties in that case, which is one of the reasons, I think, that——

Senator REED. Was it appealed?

Mr. COX [continuing]. The understanding of the view of the SEC was lacking in that case.

Senator REED. So in the Second Circuit, at least, that is the law of the Second Circuit.

Mr. COX. I do not know that that is the case. The Second Circuit is bound, of course, by the decisions of the U.S. Supreme Court, and the Supreme Court decision is subsequent to the AIG case. There is legal uncertainty——

Senator REED. The Supreme Court was—under this specific rule that was adjudicated in the Second Circuit.

Mr. COX. On the Administrative Procedures Act question of whether——

Senator REED. On this specific rule.

Mr. COX [continuing]. The agency's interpretation of its rule subsequent to a prior conflicting interpretation is controlling and——

Senator REED. So your position is that the Supreme Court has overruled the *AFSCME* v. *AIG* case?

Mr. COX. The view of our professional staff at the SEC is that it has made it more likely that a court would reach a different interpretation than it did in the Second Circuit case. But this is a matter of predictions and probabilities. What we are certain about is that there is great uncertainty, first, in the Second Circuit and more so in——

Senator REED. How could there be great uncertainty in the Second Circuit if they have a decision which clearly invalidates your interpretation beginning in 1990 of this rule that has not been appealed to the Supreme Court, that is the law of the Second Circuit, which is the circuit which includes most of the financial institutions and, indeed, that is the Wall Street circuit.

Mr. COX. The reason is that the Second Circuit Court of Appeals is an inferior court and the decision of the Supreme Court is controlling and applicable to the courts of appeal and all the district courts in the Second Circuit. So if, in fact, the proper interpretation of the Supreme Court decision in this case is that the panel decision should be reversed, then a court in the Second Circuit is bound by that.

Senator REED. How many other rules of the SEC have been overturned by this recent Supreme Court case? How many other decisions of the Second Circuit have been overturned by the Supreme Court?

Mr. COX. I do not know the answer to that.

Senator REED. I do not think you can calculate the answer because it is not the same case, but let me just say that if this was so unsettled, why did you allow this proxy season past to operate under the *AFSCME* v. *AIG* case?

Mr. COX. The case came immediately prior to the proxy season last year, and there simply was not time for notice and comment rulemaking.

Senator REED. And the proxy season last year produced no earth-shattering result. There were several proposals. One proposal I presume passed, and there were two other proposals that received significant votes. There is no expectation that this season there is going to be a huge epidemic of proposals by shareholders in this regard, which begs the question: Why are we rushing to judgment for a temporary fix that will be overturned by you, apparently—or by the Commission, I should say—in the spring?

Mr. COX. Well, I have met with representatives of some of the large institutional shareholders, and I take them at their word that they are willing to forbear and to be responsible; and certainly that was the case in the last proxy season, although almost no one had much opportunity to respond to the new legal environment or the changed or questionable legal environment last year.

The problem going forward is that there are 45 million-plus shareholders in the United States, and not all of them are large, responsible, long-term investors. The same rule, or lack of it, would apply, for example, to hedge funds, whether domestic or otherwise domiciled. They would have, if this law of the jungle were allowed to obtain, they would have no requirement to make any of the disclosures that the SEC has always required in the proxy contest situation because of a technicality and because of the fact that there were not two proxy cards but one. They would not perhaps even be bound to tell the truth under Rule 14a–9 because its application is now questions. I think the SEC would assert, if that came up, our full power, and we would want to make an argument to the court that, yes, the anti-fraud rules should apply, but they would be drawn into question. And to a certainty, none of the required disclosures about conflicts of interest and so on——

Senator REED. Why doesn't your proposed rules include these provisions? If that is the problem, why don't you fix it in your proposed rules?

Mr. COX. That is precisely the course, Mr. Chairman, that we would take.

Senator REED. But not now. That is subsequent to these two proposals you have made.

Mr. COX. Well, whatever the Commission chooses to do—and as I say, I cannot predict. I think the Commissioners are all looking at all of these comments with an open mind and that the accounts that everyone's mind is made up in advance are somewhat inaccurate in that respect. So while I cannot predict what we will do, I do know that we all have an interest in making sure that the fundamental disclosure rules and anti-fraud protections of the Exchange Act are there for the benefit of every investor.

Senator REED. Well, Mr. Chairman, let me defer to my colleagues for questions. There might be a second round.

Senator HAGEL. Mr. Chairman, thank you.

Chairman Cox, thank you for appearing this morning. What is your sense then of the process as it goes forward? You have noted in your testimony that the Commission is reviewing the enormous set of comments. These proposals in place before the next proxy season?

Mr. COX. I do not know that we will be able to find agreement on the Commission for a new set of rules that will improve the application of the proxy rules to shareholders' State law rights. I believe, as I have said, that the proxy rules should better vindicate those rights. But what at a minimum I think we will do is establish clarity so that the status quo will be preserved, the status quo that has maintained for the last 17 years uninterruptedly, and indeed, for the most part, since the 1940's.

Senator HAGEL. You noted in your testimony, and I believe as the Chairman introduced you, that you have returned recently from Japan, and you talk a little bit about the international competitiveness factor here. And if you could develop that a little more completely, the effect that these new rules would have on our competitiveness in the world market, and maybe go down a little deeper when we look at Japan, the United Kingdom, continental Europe, their regimes versus ours. Does that enhance the attractiveness of public companies to investors, especially to big funds, with more shareholder rights, less, does it matter? Would you develop those themes a little bit for the Committee?

Mr. COX. Sure. I think that the fundamental strength of America's capital markets is the high level of confidence that investors can have that their rights as investors in those markets will be protected. The certainty that our rule of law provides is very important. The high level of disclosure, the anti-fraud protection, all of these things undergird investor confidence and result, many economists have found, in a premium being placed on investment in this country as opposed to other markets. So as we go forward, we want to be sure that we provide shareholders the full level of anti-fraud and disclosure protection that our securities law provide for.

There is absolutely no question that one difference between our markets and most of the other major markets in the world is our high level of retail investor participation. So it is not just the institutional investors from whom you will hear today, but also all the other millions of investors who are concerned here and who are at risk. Their interests are not always the same as a hedge fund, for example, and so we want to make sure that while we have one or

two popular paradigms in mind, that we recognize that we are making rules to cover a variety of circumstances.

Our shareholder protections and our anti-fraud protections have to be at least as sturdy and probably sturdier than other countries that have a preponderance of institutional investors and not so much retail participation.

Senator HAGEL. As you survey the marketplace, and recognizing your scope of responsibilities as the primary regulator of securities in this country is rather narrowly defined but, nonetheless, you are dealing in the marketplace, as you look down the market pathway, as you are looking at these comments and whatever action the Commission is going to take, do you sense a trend in any direction, take the differences in our regulatory regimes versus Japan, European Union, Great Britain? Or is there no difference as to as the competition gets keener for those investment dollars in these countries, will the regulatory regime that dominates and dictates the behavior and standards and laws, will they be more important, less important, or will it not matter that much?

Mr. COX. Well, I think it is becoming more important because our different regulatory systems are now coming in closer contact every day, and indeed, we are becoming more mutually dependent.

On the enforcement side, for example, we really cannot succeed without the help of our foreign regulatory counterparts; whereas, in years past, we might have had much more of a parochial focus on our own, obviously, largest-in-the-world markets.

So working with other regulators is becoming a big part of my job and the role of the Commission and our professional staff. What we are finding is that other systems that are structurally different, perhaps more principles than rules based, nonetheless in many cases have common objectives, and there are ways for us to harmonize our approach in order to achieve those common objectives while eliminating regulatory friction. We are going to look for every opportunity to do that.

At the same time, when we absolutely have different objectives that we must insist upon, for example, our U.S. insistence on protecting retail investors, then we have got to find a way to accommodate those concerns by ironing out needless differences with these other systems.

So I think that as the world shrinks, which it has been doing for centuries—investing has always been global, but it is doing so at an accelerated pace right now. Our system will probably need to insist upon the high level of disclosure and anti-fraud protection for retail investors to which I have referred in another context this morning, and we will probably be seeking to form a coalition of high-standards countries so that we avoid this race to the bottom that could be the other result of increasingly global markets.

Senator HAGEL. Chairman Cox, thank you.

Mr. Chairman, thank you.

Senator REED. Thank you, Senator Hagel.

Senator Menendez.

Senator MENENDEZ. Thank you, Mr. Chairman.

Mr. Chairman, one of our witnesses to come, Mr. Johnson, on behalf of CalPERS, says the following thing as it relates to why the SEC does not need to act before the 2008 proxy season. He says

"There is no uncertainty about the existing rule, which clearly allows shareowners to file proxy access proposals on corporate bailouts. The Second Circuit Court clarified in the AIG case that the current SEC regulation does not exclude proxy access."

He goes on to say "There is no evidence of uncertainty about the application of the rule following the AIG decision. Since the decision was issued, shareowners have submitted three proxy access proposals in 2007, one non-binding proposal passed Cryo-Cell International. Two others received substantial support, exceeding 42 percent of votes cast, at UnitedHealth Group and Hewlett-Packard Company."

"There will be no 'tsunami' of harm in the marketplace if the AIG decision is left in place through the 2008 proxy season. In fact, the only uncertainty about proxy access comes as a result of the mixed messages from Chairman Cox concerning the SEC's intent to adopt a 'new-and-improved' proxy access proposal next year."

"No company challenged any proxy access proposal in court this year."

If that is the case, having the Commission just lost a member, very likely to lose a member before the end of the year, why this rush on such a complex and yet important issue to come to a decision before? It does not seem to me that we have a real chance of harm here of any considerable magnitude.

Chairman COX. Well, I think you are absolutely right to put the question by saying if that is the case. Because the fundamental disagreement here is whether that is, in fact, the case.

Senator MENENDEZ. So you disagree that that is the case?

Chairman COX. I do. Those who assert that there is no uncertainty, I think, are mistaken. The uncertainty is palpable. Indeed, even with the small number of proposals that we had in the last proxy season, there was palpable uncertainty. In the case of Reliant Energy, for example, there was a proposal submitted by Seneca Capital, an AIG-type proposal. The company asserted to the Securities and Exchange Commission that the rule not of the Second Circuit but of the Fifth Circuit applied. Reliant then filed for a declaration relief in the Federal Courts of Texas and the shareholders then withdrew their proposal.

There is no question, because that was per the Supreme Court's decision in Long Island Care, that there is even more uncertainty now. Indeed, that uncertainty extends to the Second Circuit.

Furthermore, with respect to the question of whether or not there will or will not be a tsunami of new proposals—as I say, I think we can rely on the assurance of responsible long-term institutional shareholders that either they will forbear and not offer these proposals or that, if they do, that even though the disclosure rules of the Exchange Act do not apply to them, and possibly the Antifraud rules do not apply, that they will behave well.

Senator MENENDEZ. But this is——

Chairman COX. I do not think that we could expect that absent the rule of law in this case that hedge funds and other investors, including millions of investors—some 34,000 of whom submitted comments to us on this rule——

Senator MENENDEZ. But there is a rule of law. Is it not true that even if the Federal District Court ruled differently, that there

would be no split between Circuit Courts until another Federal Appellate Court addressed the issue from the Second Circuit?

Chairman COX. That is precisely the point, I think, that every single one——

Senator MENENDEZ. So it would hold——

Chairman COX [continuing]. Of the proposals would have to be litigated for anyone to know what the result is. And obviously litigation is time-consuming——

Senator MENENDEZ. But until that time, the Second Circuit would prevail. It would hold. There is no conflict.

Chairman COX. That is not what happened in the Reliant Energy case.

Senator MENENDEZ. Well, in that case, shareholders may have made a strategic decision to withdraw for whatever their reasons may have been. It may not have been just that decision. There may have been a multitude of reasons.

Let me ask you this. If one of the other concerns that you raise is the fact about disclosure, isn't it true that shareholders primarily vote on the merits of proxy proposals versus what they know about proponents? That background information about proponents is usually secondary? And if disclosure is so crucial, that sort, companies that had proxy access resolutions on their ballots in 2007 surely would have expressed concern. None did.

Chairman COX. I think that it depends on whether or not the background of a proponent is relevant. I mean, let us say that the hidden agenda of a hedge fund that is moving in with one of these proposals—although superficially they are stating about corporate governance—is to put their own directors on the board so that they can strip the assets of the company and manage for the short term. If investors knew that, obviously it would be relevant.

Senator MENENDEZ. Well, let me——

Chairman COX. If you have an environment in which——

Senator MENENDEZ. I think people vote on the——

Chairman COX [continuing]. Does not need to be disclosed——

Senator MENENDEZ. If the merits of the proposal are worthy for a shareholder to support, they will support it. If not, they will not, regardless.

But let me ask you this. Isn't voting to adopt the SEC's short rule a clear and conscious decision to take away shareholder rights?

Chairman COX. Absolutely not.

Senator MENENDEZ. Well, can you explain—I do not understand how you voted for both of them because in the short rule it clearly seems to me that you are, in essence, eviscerating existing shareholder rights.

Chairman COX. Well, we start with the fact that at no time during the 73-year history of the Securities and Exchange Commission, have shareholders been afforded this kind of access that we are working on developing in a rule framework. If adopted, the longer proposal, in the parlance that we are using here, would represent a dramatic reform of the proxy rules.

The rule reflected in the other proposal would be precisely the same policy that the Commission has followed without interruption for the last 17 years.

Senator MENENDEZ. You are saying that—first of all, I do not—Mr. Chairman, I know my time is—can I just finish up here?

Would you agree this much, that the two proposals are diametrically different? Let's start there?

Chairman COX. Indeed. And——

Senator MENENDEZ. And you voted for both of them.

Chairman COX. The same reason animated that decision as animated my decision in many cases as a Committee Chairman in the Congress, to move proposals to full committee when offered by the majority and the minority, so that people could have a look at them. We have a public notice and comment process. The territory between the one proposal and the other was sufficiently broad that it would give the Commission and the Commissioners the opportunity to work out something among ourselves and with our staff and with the public that will cut this Gordian knot.

This is a problem that, as I pointed out in my formal testimony, has perplexed the Commission for a half a century. It is, indeed, a very difficult problem.

Senator MENENDEZ. My time is expired, but let me just say, I hope the Commission returns to its root as an independent protector of shareholder interests. It seems to me that the United States is the only developed economy that does not give shareholders the right to place director nominees on corporate board election ballots. And you know, at the end of the day, you started off on a very eloquent statement, that there can be no capitalism without capital and there can be no capital without guaranteeing the security of your investments as best as can be achieved. And that security ultimately, from those who are the shareholders, who are the owners of an entity, ultimately have to have a say to ensure that corporate governance and malfeasance are at least as controlled as best as possible, humanly possible.

That does not happen unless you have the wherewithal for shareowners to participate. And the proxy process is the best way by which they can aggregate to participate in that process. I hope the Commission takes—does not have to see itself as acting before it has a full body in order to achieve this.

Thank you, Mr. Chairman.

Chairman COX. Senator, I should just add that I strongly agree with what you just said.

Senator REED. Senator Carper.

Senator CARPER. Thanks, Mr. Chairman.

Chairman Cox, welcome. It is good to see you.

I believe that both proposals issued by the SEC have real problems and do not take into account the important role that States play in this matter.

In my own home State of Delaware, the Court of Chancery has jurisdiction over all business and corporate matters and has developed a long history of case law and precedent.

As I mentioned in my earlier statement, my opening statement, Vice Chancellor Leo Strine of the Court of Chancery testified on this very issue before the SEC. Vice Chancellor Strine, in his youth, was my legal counsel when I was Governor and our policy director, and he is someone whose judgment I value a great deal.

But in his testimony before the SEC, Vice Chancellor Strine tried to propose what he thought, and what seems to me maybe, to be a common sense solution. I just want to mention it here today.

That solution would allow, on the ballot, stockholder bylaw ballot proposals related to the election process unless these proposals were clearly prohibited by State law. On first blush at least, I think this seems like a reasonable approach to take.

I understand that some of the Commissioners objected to the proposal, but I would be interested in your thoughts here, in just a moment, on the subject, Mr. Chairman.

Before you answer, you can have a minute to think about it. I just want to say I also wanted to caution the Commission. It is my understanding that if any action is taken on either of the two pending proposals, that action would only be temporary. And I would say, Mr. Chairman, I believe you may have said that you would start a complete review in the new year. I would just hope that the SEC would not approve a temporary rule that would have an adverse impact on my home State's legal system or any State's legal system, just to turn right around and start the process over in the new year.

But if you would just think back to what I outlined as the suggestion of Vice Chancellor Strine and just tell me what your thoughts are on his approach, his recommended approach.

Chairman COX. Vice Chancellor Strine gave us exceptionally useful testimony at our roundtable. I agree with you, or at least I agreed with your implied endorsement of his brilliance, because I think he is really——

Senator CARPER. He is one smart cookie.

Chairman COX [continuing]. An able jurist and a very wise person with excellent judgment on this and other subjects.

Senator CARPER. I was just at a visitation for a funeral, before a funeral today, in Delaware last night with his mother. And he is almost as smart with his mother. And he has a brother who is just about as smart as him. They are quite a family. I do not know what they fed those kids, but we need a few more.

Chairman COX. The approach that he and others on the roundtable described to us was, in fact, the basis for one of the two proposals that we offered. The significant difference between the approach, as you just described it, and the proposal that we published for public comment was that there was, in addition, a 5-percent ownership requirement that attached to the disclosure provisions. That was meant to harmonize the Strine vision, as it were, with the existing 13D–G disclosure regime with which everybody is familiar, so that we could have disclosures that would apply in this context that would not require the invention of a whole new system with uncertainty and so on.

The 5 percent was sought to be, at least in the early drafting, acceptable to the investor community. Five percent was, in fact, the very figure that was in the ill-starred proposal that had been advanced during Chairman Donaldson's tenure before I arrived at the Commission.

The objection to the 5 percent proposals seems not to extend to a 5 percent requirement for nominating directors under a bylaw, if one were in place. So this gets fairly rarified. Nonetheless, we have

received an abundance of comments about the 5 percent provision, so the Commission is not under any illusion that that is not a popular provision of the proposal, as advanced.

As I said, we have ample flexibility under the Administrative Procedure Act, to take into account all of these comments that we received.

With respect to whether or not, going forward, we would adopt a temporary rule, I think our effort would be to try to do substantively something that—if we could not achieve consensus on—at least that the Commission felt was a quality proposal and that would improve the application of the proxy system from the standpoint of all investors. And that the minimum requirement that we would impose upon ourselves in the short run, in the current proxy season, would be to clarify the status quo. That is to say, not to come up with a third way, as some have said, one rule, a second rule, a third rule so that there are all sorts of different legal regimes. But rather, freeze in place the status quo over the last 17 years, including the period of time now when we have this great legal uncertainty but no replacement rule. And then work on this.

We have been urged by commentators on many sides to go back to the drawing board, do not give up on this, and try and get it done. And I think there is a great open-mindedness on the Commission among my colleagues to do that.

Senator CARPER. I would just conclude by saying, Mr. Chairman, as you figure out how to get it done, keep in mind the counsel of my former counsel on this point. And it is my hope that when the new year comes that you do not have to go back and maybe spend a lot of time finding that third way.

Thank you very much.

Senator REED. Thank you, Senator Carper.

Mr. Chairman, I think it is important, since you have put so much reliance upon this recent Supreme Court case, to acknowledge that it is a Department of Labor case, interpreting overtime for health care aides under the laws of the Department of Labor that involved, I am told, two rules of DOL which were not interpreted consistently. And that we all recognize, I mean it is Hornbrook law that deference to regulatory agents is its premise. That deference was specifically rejected by the Second Circuit.

So I think you are putting a lot of weight on a case that does not involve the laws that you are responsible for implementing nor the agency, your agency, which in fact implemented them.

Chairman COX. Senator, if I may clarify here, with respect to that decision, neither Second Circuit case, the Long Island Care case or the AIG case, was an interpretation of the securities laws, per se. The Exchange Act is not really in question here. There is no question about our statutory authority or the meaning of the statute that we are implementing.

Rather, the question is whether or not an agency's subsequent interpretation of a rule that had been interpreted differently previously should be paid deference. So it is, in fact, the same issue that the Court addressed and it is the same statute, the Administrative Procedure Act.

Senator REED. That is an interesting interpretation, but you have a specific Circuit Court looking at what you have done and

finding that it was deficient under the Administrative Procedure Act.

Chairman COX. And it is the same Circuit Court——

Senator REED. It was not appealed to the Supreme Court.

Chairman COX [continuing]. That was reversed on that point.

Senator REED. The Supreme Court has not——

Chairman COX. The Supreme Court, in the Long Island Care at home case.

Senator REED. I think it is important that this Long Island case was not your agency case. I think that makes a difference that would be distinguished. And I think it is the Administrative Procedures——

Chairman COX. Mr. Chairman, I agree with you that because it is not the same case that it raises a question. And all I have said today is that there is now greater legal uncertainty and that uncertainty extends to the Second Circuit. But I am certainly in agreement with you that this is not stare decisis. It is not the rule in this case. And so further litigation would inevitably be the result.

Senator REED. Well, we did not seem further litigation in the last proxy season and we are probably not likely to see a tidal wave this season.

Senator Hagel, do you have any additional comments?

Thank you very much, Mr. Chairman. Thank you.

Chairman COX. Thank you, Senator.

Senator REED. Let me call forward the next panel. This is the most organized panel I have ever seen.

[Laughter.]

I would like to now introduce our second panel. Mr. John Castellani is the President of the Business Roundtable. Prior to joining the Business Roundtable, he was the Executive Vice President of Tenneco. His Washington experience includes service as Vice President for Resources and Technology with the National Association of Manufacturers, and as Vice President of Government Relations for TRW, Incorporated.

Mr. Jeff Mahoney joined the Council of Institutional Investors in 2006 as General Counsel. He also is an adjunct faculty member of the Washington College of Law at American University. Previously, he was counsel to the Chair of the Financial Accounting Standards Board. Before joining FASB, Mr. Mahoney was a corporate securities lawyer at Morgan, Lewis and Bockius. Jeff co-chairs FASB's Investor Technical Advisory Committee, serves on the NASDAQ listing qualifications hearings panel and was recently appointed to the Public Company Accounting Oversight Board's Standing Advisory Group.

Ms. Anne Simpson is the Executive Director of International Corporate Governance Network whose members are located in over 30 countries and hold more than $10 trillion in global assets. Previously, she was head of the Secretariat at the Global Corporate Governance Forum founded by the World Bank and OECD to support reform in developing and emerging markets. Prior to this, she was Joint Managing Director of Pensions and Investment Research Consultants, LTD, a United Kingdom Advisor on governance.

Mr. Dennis Johnson is the Senior Portfolio Manager for the Corporate Governance at the California Public Employees Retirement

Systems, CalPERS. Prior to joining CalPERS, he was a Managing Director of Citigroup Global Markets. Responsibilities throughout his 25-year career have included the development and management of proxy voting policies and advising and counseling clients on corporate governance.

Thank you all very much. Your statements will be included, completely, wholly, entirely in the record. You may summarize and we would ask you to try to observe the 5-minute rule. Since you are so well organized sitting down, I suspect that will be no problem.

So Mr. Castellani.

STATEMENT OF JOHN CASTELLANI, PRESIDENT, THE BUSINESS ROUNDTABLE

Mr. CASTELLANI. Thank you, Mr. Chairman, Senator Hagel.

Thank you for inviting me to share our views on this issue of proxy access.

Business Roundtable has long been a strong supporter of corporate governance reforms. Indeed, we supported the Sarbanes-Oxley Act as it went through, the enhanced listing standards of the exchanges, additional disclosures for executive compensation, and majority voting for directors.

Similarly, we remain committed to promoting the accountability and responsiveness of boards, and enhancing transparency so investors can make informed decisions.

As you know, the issue of proxy access has been debated over the years, and previous Commissioners have struggled with both the realities of state laws that govern election of directors and a host of implementation issues.

There are numerous underlying issues that should be resolved before proxy access is considered. These include the role of proxy advisory firms, the impact of so called "borrowed voting", and the reforms necessary to allow a company to communicate directly with all of their shareholders, rather than going through brokers and third parties.

The heart of the issue involves how a corporate director elections are governed and how a company proxy is used. Director elections are governed by State law where the company is incorporated, and the proxy is a mechanism for shareholders to vote when not attending shareholder meetings. Shareholders do have the right to nominate directors, but not on the company proxy. This has been an important protection against shareholders having to pay for their own hostile takeover. The SEC has consistently recognized this and excluded such proposals.

Proponents of access want to allow individuals or groups with small holdings to place their candidate directly on the company proxy. Our biggest concern is that board members would be forced into a political system, and concentrate on annual election campaigns to the detriment of their most important responsibility—protecting and enhancing the investment of all shareholders.

Imagine a proxy card with multiple candidates, seeking shareholder votes based upon conflicting recommendations. In order to win board elections, nominees would be forced to campaign, run ads, and even seek financing, paid for with shareholder money.

In this day and age of hedge funds, foreign government investment in U.S. corporations, and questions about our market remaining competitive in the global economy, the last thing we believe shareholders need is more politics in the board room, with fractured boards openly arguing and resulting in diminished shareholder confidence.

We also believe that such a process will discourage qualified, independent directors from serving, and undermine the successful model that has produced enormous shareholder returns.

The fact is that company boards and directors have transformed themselves, demanding greater accountability and exercising more oversight, as they should. Indeed, we have seen more governance changes in the past 5 years than we have seen in the previous 50 years.

Each year the Business Roundtable surveys our member companies on governance practices, and the results this year speak for themselves: 91 percent of our boards are made up of at least 80 percent independent directors; 72 percent of our boards meet in executive session at every meeting and all meet at least once a year in executive session; 75 percent of our CEOs are precluded from serving on anymore than one other board than their own; and 84 percent of our boards have voluntarily adopted majority voting for directors in just 2 years.

An interesting example of how boards have responded to shareholder pressure is that the mean tenure of a CEO of a Business Roundtable company is now down to 4 years. Now whether or not this is a trend that is in the best interests of shareholders remains to be seen but clearly it shows that boards are more dominate than ever.

With majority voting, shareholders now have a true yes or no vote on board candidates, and have a meaningful voice in the director election process. Former SEC Commissioner Joseph Grundfest compares this to the "advise and consent" powers of the U.S. Senate. In a speech last week he said "Effective advice and consent mechanisms already exist in our own corporate backyards. Shareholders have the right to veto any candidate to serve on any board."

Companies work to keep shareholders because it is in their obvious best interest to do so. And given these reforms, the challenge we now face is guarding against further erosion of our own competitiveness. Increasingly, we see public companies going private, and new companies listing in foreign exchanges. Indeed, Senator Schumer's commission identified this trend as a challenge facing our capital markets.

In our view, proxy access could contribute to this trend, and rules allowing virtually anyone to force by-law amendments regarding director elections would provide another reason for companies to go private or list elsewhere.

Now more than ever, boards need to attract qualified directors who can work together to innovate, to increase revenues and profits, and to grow shareholder value.

Preserving this current balance between shareholders, boards, and management will allow corporate directors to continue to focus

on what they are there to do: provide critical judgment and oversight, and help create long term value for all shareholders.

Thank you.

Senator REED. Thank you very much, Mr. Castellani.

Mr. Mahoney, please.

STATEMENT OF JEFF MAHONEY, GENERAL COUNSEL, COUNCIL OF INSTITUTIONAL INVESTORS

Mr. MAHONEY. Chairman Reed and Senator Hagel, good morning. I am Jeff Mahoney. I am General Counsel of the Council of Institutional Investors. We are an association of more than 130 public labor and corporate employee benefit plans with assets exceeding $3 trillion.

Appreciate the opportunity to appear before you today on behalf of the Council. I respectfully request that the full text of my statement and all my supporting materials be entered into the public record.

Members of the Council are responsible for safeguarding assets used to fund the retirement benefits of millions of Americans across the country. Our members have a significant commitment to the U.S. capital markets, with the average Council member investing about 75 percent of its portfolio in stocks and bonds of U.S. public companies. And they are long-term, patient investors due to their heavy commitment to passive investment strategies. As a result, U.S. corporate governance issues are of great interest to our members.

A key issue at today's hearing is whether shareowners should continue to have the right to file resolutions requiring or encouraging companies to adopt processes for including shareowner-suggested director candidates on companies' proxy cards.

In our opinion, directors are the cornerstone of the U.S. corporate governance model, and the primary role of shareowners is electing and removing those directors. Thus, we believe shareowners should continue to have the ability to file proxy access resolutions and the marketplace at large should have the opportunity to vote yes or no, up or down, on whether those resolutions are in the best interests of the targeted companies and in the best interests of their investors.

Chairman Cox has repeatedly suggested that the SEC must adopt a final rule prior to the 2008 proxy season that eliminates existing shareowner rights to file access resolutions. Chairman Cox has argued that such action is necessary to protect investors from one, legal uncertainty; and two, inadequate disclosures. The Council believes that Chairman Cox's arguments on this issue are less than convincing.

More specifically, in response to Chairman Cox's concerns about legal uncertainty, we note that the Second Circuit Court of Appeals' 2006 decision in AIG clearly and unanimously set forth the law relating to shareowner resolutions that establish procedural rules governing director elections. In AIG, the Second Circuit concluded that those resolutions cannot be omitted from companies' proxy cards.

Thus, under current law, any public company that would omit an access resolution from their proxy card during the 2008 proxy sea-

son would be acting with the knowledge that they may be violating the Federal securities laws. Those companies would face the risk of litigation whether they were subject to the jurisdiction of the Second Circuit or any other Circuit.

We also note that we have already gone through one proxy season, as you noted, with the AIG decision in place and this great legal uncertainty that Chairman Cox apparently fears never did materialize. In fact, there were only three access resolutions during the 2007 proxy season. And I would add that all of those resolutions received significant shareowner support; in one case a majority. We expect that the 2008 proxy season will yield similar results with only a handful of companies receiving access resolutions.

In response to Chairman Cox's second concern about inadequate disclosures, we note that the three access resolutions brought during the 2007 proxy season that I just mentioned, those resolutions would have fully complied with all existing SEC disclosure requirements. In addition, Council members, and we believe most other investors, would oppose or vote against proxy access resolutions that fail to provide adequate disclosures about the proposing shareowners.

If, as Chairman Cox suggests, adopting the SEC's non-access proposal prior to the 2008 proxy season is critical to ensuring adequate disclosures for investors, you have ask why is it that that proposal does not discuss in any detail, or solicit any comments on, the disclosure issue. We agree with SEC Commissioner Annette L. Nazareth's analysis of this point. She recently stated: "If the problem is one of disclosure—and clearly fulsome disclosure concerning the proposing shareholders is appropriate—the solution is to address the disclosure directly, not to eliminate this bylaw avenue altogether."

Notwithstanding the Council's strong opposition to the SEC's current proposals, we continue to stand ready to work cooperatively with Chairman Cox and the Commission, this Committee, my fellow panelists, and all other interested parties to develop meaningful proxy access reforms that will best serve the needs of investors, companies, and the U.S. capital markets.

Thank you, very much, Mr. Chairman, for inviting me to participate at this hearing. I look forward to the opportunity to respond to any questions.

Senator REED. Thank you very much, Mr. Mahoney.

Ms. Simpson.

STATEMENT OF ANNE SIMPSON, EXECUTIVE DIRECTOR, INTERNATIONAL CORPORATE GOVERNANCE NETWORK

Ms. SIMPSON. Thank you very much.

I hope that what I can contribute to the discussion is some views about how this issue is handled in other markets. There has been an important theme of competitiveness which has been raised by Chairman Cox and in some of the questions, and I think even Mr. Castellani raised a concern that companies under pressure would be listing in other markets or perhaps even going private.

I would comment on both those points, that if companies do go to other markets, they will find that shareholders have the right to appoint, remove, and propose directors to the board. They will

also find, if they go private, that one reason investors put money up for that to happen is so that they can have a closer oversight of the company, and the evidence is in both cases that the motivation is to improve performance. So I think we have to be careful about not trying to have this both ways.

As you rightly said, our members are in many countries worldwide. They are responsible for many trillions. I think the important point is that of those 40 countries and our 500 or so members, they have something on the order of $4.5 trillion invested in the U.S. market. So they take a very close interest in the developments that are being discussed today.

The point has already been made that capital is global and it is also mobile, and I think we see in every region the policymakers are finding that they do need to pay attention to the concerns of shareholders in ensuring an effective and efficient regime for corporate governance. And what we observe internationally is that the U.S. is almost alone in preventing shareholders being able to directly and in simple, effective ways hold boards to account. And such research that there is shows that when shareholders are able to pay attention to boards, there is a resulting improvement in performance, and certainly that is the experience from research in the U.K.

I want to, I think, address two points which come from our international experience, points that have been raised both by Chairman Cox and I think in some of the questioning.

One is that shareholders may put forward proposals which are in some way damaging to the company. We find this a very puzzling proposition because, among all the constituencies with an interest, shareholders are the one group who share the same interest as the company management, which is in building the wealth-creating potential of that organization. Shareholders are the ones who are at the end of the day concerned with value.

So we are simply not persuaded with the notion that allowing shareholders to put proposals forward is in any sense going to undermine enterprise. Enterprise is the name of the game, whether you are a small investor, whether you are a hedge fund, or whether you are a pension fund.

In other words, we want to emphasize that we take the view that shareholders have a core of common interest with the business community in promoting wealth creation. The question is how to make sure that accountability is practical and effective.

The other point that we would like to make is to address the concern about what happens to boards and their ability to deliver on performance when shareholders have been involved in putting them forward. I think that it is important to remember that if a shareholder is about to nominate a director, that person will only be elected if the majority of the shareholders, their fellow shareholders, agree that they should go forward. The right to nominate is not the right to appoint, and the very purpose of having an election is so that shareholders can address a concern, address effectively through the proxy materials of their own company—it is not the company versus the shareholder; the company belongs to them. This is, in effect, their proxy material, in our view—address fellow

shareholders on an issue of mutual concern, and the issue will be judged on its merit.

The other important point to remember is that under the U.S. system, as in many jurisdictions, once a director is elected to the board, they will inherit a fiduciary responsibility to the company and to all its shareholders. There is simply no legal provision which would allow a shareholder to be elected by a majority of the shareholders, but then when he or she is in place, to somehow reflect or pay special attention to particular interests. This is simply in basic conflict with fiduciary duty, and I think it is important to make that point, too.

For that reason, and as you know from our written testimony, and also in our letter to the SEC, we view shareholder rights as a tool kit for ensuring the efficiency of the private system. In other words, it is a capitalist system, and we are not comfortable with the idea that State bodies should attempt to intervene in the dialog between companies and their owners. It is up to owners to decide what is in their collective best interests for the company and for the processes that regulators and policymakers put forth to facilitate that process, not to decide what could or should go forward.

Now, the other question that we are sometimes asked—and it may be helpful in the U.S. to think about this—is if you have this provision in all the other markets, how often is it used? I think the comment was made earlier—perhaps Chairman Cox is concerned about this—that there are 45 million individual investors, does this mean each one of them will want to put forward a proposal to each of the companies where they hold shares? I think not. What our experience says in other markets—and I would just like to quote from one of our members. We did a straw poll on this issue before we wrote our SEC letter because we thought it would be helpful to see how the system really did work and what the view of it was in other markets. And the comment was: How often do shareholders propose directors in other markets? And across the board, the answer was, "Rarely." And this is because it is a reserved power which acts as a powerful incentive for communication, for consultation, and, most importantly, the development of solutions between shareholders and companies. And I would just like to quote from one of our members who is a large investor:

> "These provisions are rarely used, but the fact of their existence is a real spur to proper engagement by companies with their shareholders. And shareholders seem to be very thoughtful in their analysis of shareholder resolutions that do get on the agenda. I am not aware of very many shareholder resolutions having succeeded, but I think that is because the engagement linked to the resolution (both by the proponents and others) has produced from the company commitments to improve the practice or to effectively address the question."

So if I can sort of borrow from an American approach, I think that the right here has been for shareholders to speak softly but carry a big stick. In other words, the Teddy Roosevelt solution was probably the one that we are looking for. For that reason, we really do consider that the two proposals are unnecessary. We think they are confusing in themselves. They are a source of potential uncertainty, and we would advise that both are left quietly on a shelf somewhere to be studied by students of corporate governance in the future, but certainly not implemented. Therefore, we are finished

with Napoleon. "Masterful inactivity" is our counsel to the SEC, and we hope that nothing more happens. We think the judgment from AIG was very sensible, and we look forward to further improvement in the future.

Senator REED. Thank you very much, Ms. Simpson, and suggesting "masterful inactivity" around here is, I think, self-reinforcing. But, anyway——

[Laughter.]

Senator REED. Mr. Johnson.

STATEMENT OF DENNIS JOHNSON, SENIOR PORTFOLIO MANAGER, CORPORATE GOVERNANCE, CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Mr. JOHNSON. Mr. Chairman, Senator Hagel, thank you for the opportunity to comment on the issue of shareholder access to corporate election ballots. I am here for an institutional investor with more than $250 billion in assets under management. I represent the California Public Employees' Retirement System, which provides retirement and health benefits to 1.5 million members in State and local government.

Since we own shares of more than 7,500 publicly traded U.S. companies, regulations affecting corporate governance are vitally important to us. To date, we are concerned that the proposed short rule by the Securities and Exchange Commission would eliminate our present right to place binding and non-binding proposals on corporate ballots. It would also prevent shareowners from filing proposals that request companies to adopt a proxy access provision for director nominations.

The Committee has asked us to comment on whether the SEC needs to change the current practice before the 2008 proxy season, also on the right timing for any rule change, and on a shareowner's right to proxy access.

Chairman Cox says the SEC needs to act soon to address uncertainty about current applications of the rule. Uncertainty is a red herring. In fact, when a court of appeals gives an opinion, there is absolute certainty. The Second Circuit Court clarifies in the AIG case that the current SEC regulations does not exclude proxy access. Shareowners subsequently submitted three proxy access proposals in 2007. No company challenged any proxy access proposal in court.

Chairman Cox also says a change is needed now to safeguard shareowners from the risk of not knowing more about the background of proxy access proponents. He says we need to know, for example, if a proponent had acquired shares to effect or influence a change in a company control. But shareowners have not requested this information and if disclosure of this sort is so crucial, companies that had proxy access resolutions on their ballots this year surely would have expressed concern. None did.

The SEC failed to act on the proxy access issue for years when it had a full Commission. Why rush to judgment now? In fact, the right time to act on such a crucial issue is after the thoughtful deliberation of a full five-member bipartisan Commission. A fundamental right of corporate law is the right of shareowners to protect their interests by ensuring fair director elections and accountability

to the companies' owners. To secure that right, we investors prefer self-government to regulation and legislation, except when reasonable checks and balances are threatened. In such cases, we ask regulators and legislators to do the right thing.

Today we urge this Committee to send a very strong message urging the SEC to reconsider its timing and start anew at the right time when it has a full Commission. If there was a tsunami of harm that needed to be addressed within a month or so, it would be a different matter.

Speaking of harm, the SEC's highest priority should be to do no harm to do no harm to the shareowners in their decisionmaking. This ill-timed proposal before a subset of a Commission is unfair, unwise, and violates the core principle of "do no harm" to shareowners, and is contrary to the very purpose for which the SEC was established.

One final note. We should stand for more democracy, not less. For all the sophistication of our markets in the U.S., we continue to lag other countries in corporate democracy. We are the world's only developed economy that keeps shareowners from placing director nominees on company ballots.

Thank you, and I welcome your questions.

Senator REED. Thank you very much, Mr. Johnson. Thank you all for your excellent testimony.

Let me begin, Ms. Simpson. We have made these comparisons between other countries, but in Great Britain and in other places, shareholders have access to the proxy statement. Is that correct? Could you give us sort of just a quick sketch of access?

Ms. SIMPSON. Yes, how does it work in the U.K., which is where I am from, although I should say I do have to emphasize our members are from 40 countries; 160 of our 500 are here in the U.S.; we are an international group.

In the U.K. the provision has existed since the mid-19th century. This is nothing new. When the company was invented, it was intended that shareholders were the best monitors of corporate activity. It could not be done by Parliament or the Queen or the King. It should be done by those with the economic interest, and this is how it works.

If a shareholder wishes to propose a directive, they put forward a resolution directly to the company, and there were two hurdles. Either you must represent 5 percent of the shares, which is a familiar threshold that has been talked about in this market, or—and this is very important—100 shareholders can come together. And that means that, for example, in a very big market like the U.S., as has been widely said, 5 percent is an impossible hurdle to reach.

The other issue is costs. The company must include the proposals on the paperwork that goes out. We do not call it a proxy, but the paperwork that goes out. And they can legally—I do not think this has happened, but the company could insist that the proposers pay what are called under the law the "reasonable costs of circulation."

Now, the reasonable costs of including 500 words on material that is already going out are obviously pretty minimal, so we do not see that as a barrier.

Something like in the last—since 2000, there is some research that Yale has commissioned, which is not yet published but it is comparing the impact of proposals in the U.K. and the U.S., shows that there has been around 500 proposals in the last 6 or 7 years in the U.K., and they have had a significant impact on performance because they almost exclusively targeted companies where the board is doing a very bad job. Other countries have different proposals. In Germany, an individual shareholder can put forward a directive. In the Netherlands, it is a 1-percent rule, not a 5-percent rule. So I think it is very important, depending on the size of the market, that you find the right balance to ensure that the shareholders are viewed as legitimate, they are properly owners, but at the same time you do not make the hurdle impossible, which would actually mean the rule is effectively not going to work.

Senator REED. Thank you.

A question, Mr. Mahoney, in terms of the issue of disclosure which you raised, and you noted that this is a concern that is not reflected in the Commission's proposed rules. Under the securities laws, if the management had information they thought was significant with respect to a potential candidate proposed by an individual, could they legally include that in the proxy? Could they point out that the individual represents a certain faction? Is there any possibility of doing that?

Mr. MAHONEY. I believe there is. I think that, as I mentioned before, those proposals that have been set forth, there has not been—and Mr. Johnson mentioned it as well. There has not been any concerns expressed from anyone that there was something missing that some party, whether it be the company or other shareholders, felt was necessary.

Senator REED. Mr. Castellani, at present, the rule, at least the one that is before the case, the AIG case, left the selection of directors to other directors, basically, and there is, I think, at least a potential there for too inclusive a group and not reflecting shareholders. Is that a concern that you share?

Mr. CASTELLANI. It is not a concern because of the way the process is structured. First, as you know, under listing standards, the majority of the directors of the board must be independent; and, second, all of the members of the nominating committee or governance committee, the committee that does the nomination of the directors, must be independent directors—that is, independent of the management, which is something that is indeed different in our system than, for example, the U.K. system, which has many more insiders on the board, are allowed on their boards of directors.

All of our companies have processes by which they communicate with shareholders, and they all have processes which are published by which they both set out qualifications of directors and solicit from the shareholders director nominees. They go to the nominating committee. The difference is the nominating committees are independent directors exclusively.

Senator REED. Does it make a distinction—and I think this is a point that perhaps was not made as explicitly as we should have in the first panel with the Chairman. We are not talking about the individual selection of directors. We are talking about a procedure, a general procedure. The individual influencing of an election

would still be prohibited by the SEC interpretation, any interpretation. But we are talking about a procedure. Why would it be difficult for a company to have shareholders introducing a resolution that sets up a procedure, a general procedure that allows much more access by shareholder nominees?

Mr. CASTELLANI. Well, we are focusing on the underlying issue, which is how directors are elected. The procedures that exist are now as you all know and what we had described. What our concern is is that if a board goes through a process—a nominating committee goes through a process of consulting with shareholders, receiving shareholder input, which they do; determines a director nominee and puts that director nominee forward; if that director nominee is going to face a competitive race, then he or she will be less likely to serve, and we will lose the ability to get high-quality people to continue to serve as directors. Or if a nominee is put forward that has an interest that is specific to a particular shareholder group but not representative of the broad base of shareholders to which all directors must be responsible in the fiduciary rights, that it causes distraction in the boardroom and actual erosion in shareholder value.

So we are focusing on the next step after that as opposed to the step which is whether or not the shareholders have a right to put that proposal forward.

Senator REED. Mr. Johnson, your response to these general issues about the—since your organization invests in a broad range of companies and you have experience with the proxy process going back 25 years, what is your comment?

Mr. JOHNSON. Mr. Chairman, the comment is as follows: No. 1, to consult and to receive input from shareowners we believe is not sufficient. We believe shareowners should be directly involved in the process for being able to nominate for consideration by other shareowners the director candidates.

And with regards to a competitive environment for the director nomination process, we have that today. We call it a proxy contest. And we believe that we have not seen any detrimental impact on the value of the firms or the quality of the candidates that are being considered and voted upon to join the board of portfolio companies.

Senator REED. And the previous comments about, you know, the difficulties within the board if this process goes there, you are a shareholder in major companies. You get, presumably, consulted or at least you provide input. But what is your impression in terms of how directors are really selected? I guess that is my question. I know they are independent, but sometimes the independence is one based on just they do not own stock in the company, but they certainly have relationships with other directors.

Mr. JOHNSON. Well, there are two elements here, Mr. Chairman: there is the selection process and the election process. In the selection process, it is clearly our view that directors select directors. There is little tangible evidence of shareowners having direct input if not actually deciding who the actual candidates are that will be voted upon by other shareowners.

Then, second, you do have shareowners voting for directors, and clearly these directors are being held to an even higher standard

as we see higher withhold votes for directors at companies where they are failing to perform and to create value for shareowners.

Senator REED. There is one issue here that we have all talked about, and that is—and, Ms. Simpson, you alluded to it, too—that in specific markets, the 5-percent threshold is much too great; in other markets it might be appropriate. With respect to these proposals by the SEC, the 5-percent threshold in your view would be too high a wall to scale, effectively?

Ms. SIMPSON. Yes, that is our view, and the other market which we know well, the U.K., which has the 5-percent rule, provides an alternative so that 100 shareholders can come together. And I think the U.K. has the highest provision by percentages. So, you know, you have to give more than one practical route.

I just would like to make one quick comment on the issue that Mr. Johnson was just discussing. I think it is highly unlikely that a company in deep trouble where the board is the problem that the board would be looking for, you know, renewal and resurrection and improvement. It is precisely those companies where shareholders need to be able to take matters into their own hands. You know, the companies that are functioning well and the boards are functioning well, this is not where the activity needs to be focused. So I think it is highly unlikely that, you know, boards would fall on their sword when things were going wrong. Those are the circumstances where we need to intervene.

Senator REED. Let me address a final question, and I will give you an opportunity to comment if you have a specific comment. There are two proposals before the SEC, and they seem to, directly or indirectly, exclude meaningful shareholder participation in setting up procedures for the selection of directors. One would deny it outright, basically, and the second would set such a high threshold that literally no large shareholder could comply—no shareholder could comply. So, in effect, we have a situation where there is no real choice here as the Commission goes forward if those two proposals are—either one is adopted. Essentially you have excluded—you have overturned the AIG–AFSCME case, and you have excluded any type of participation by shareholders in establishing a procedure to nominate and elect directors.

Am I missing something? Let's start with Mr. Johnson and go down the line.

Mr. JOHNSON. You are not.

Senator REED. OK. Ms. Simpson?

Ms. SIMPSON. It seems perverse.

Senator REED. Thank you.

Mr. MAHONEY. We agree with you, Mr. Chairman.

Senator REED. Mr. Castellani? And you have other comments, Mr. Castellani.

Mr. CASTELLANI. Well, my other comment relates to the threshold of 5 percent, just as a point of information. We did look at the top 28 largest of our members, and—25 largest of our members, and the top 20 of them have a shareholder of 5 percent or greater, and in the remaining 5 it would take two shareholders to reach 5-percent threshold. So just as a point of information from the perspective of the largest.

Senator REED. Let me, because this is a point—Mr. Johnson, CalPERS is one of the biggest investors. Do you have 5-percent ownership in any major company in the United States?

Mr. JOHNSON. We are the largest public pension fund in the United States, and our average position is between 0.5 and 0.6 percent of the shares outstanding of our portfolio companies.

Mr. CASTELLANI. And, Senator, that is typical for pension funds and funds like CalPERS, State pension funds. They are a very important voice in the systems of corporate governance. We appreciate that they are long-term holders, but the fact of—the ownership profile is that there are 5-percent holders——

Senator REED. No, I do not dispute you, but if you could provide us that information, that would be helpful.

Mr. CASTELLANI. Sure.

Senator REED. Because this is sort of an ongoing debate about is this an effective way to have a threshold or not have a threshold. And your other point, sir?

Mr. CASTELLANI. Well, you asked the question, and thankfully, as you read in my bio, I am not an attorney, but I am told by our counsels that we do need clarification of the AIG–AFSCME case and the SEC's position on it.

Senator REED. Good. Well, thank you all very much for your patience and your participation and your excellent testimony and excellent responses. We will keep the record open for 5 more days. There might be additional questions from my colleagues who are not here at the moment, and we would like you to respond in a very timely manner if you receive such questions.

The hearing is adjourned.

[Whereupon, at 12:06 p.m., the hearing was adjourned.]

[Prepared statements and responses to written questions supplied for the record follow:]

PREPARED STATEMENT OF SENATOR RICHARD C. SHELBY

Thank you Mr. Chairman.

The committee meets today to examine the SEC's proposed rules regarding shareholder access to a company's proxy materials.

Last year, the Second Circuit ruled that corporations can not exclude from their proxy materials shareholder proposals to change the company's bylaws requiring it to include shareholder nominess in its proxy statement.

In reaching this decision, the Second Cirucit overturned the SEC's long-standing position that shareholder proposals relating to the election of directors may be excluded from a company's proxy statement.

As Chairman Cox noted in his testimony during his last appearance before this Committee, the decision created a great deal of uncertainty.

Consequentially, this past July, the SEC proposed two separate and mutually exclusive rules addressing shareholder access to proxy materials.

The first proposal would expressly require corporations to include in their proxy materials certain shareholder proposals for changing a company's bylaws to include shareholder nominated directors in the company's proxy materials.

The second proposal would effectively restore the status quo by clarifying that such shareholder proposals can be excluded from corporation's proxy materials.

Either of these proposals, if adopted, could have a significant impact on the corporate governance of public companies.

I look forward to hearing from Chairman Cox on how the SEC plans to move forward with these proposals and to eliminate the uncertainty created by the Second Circuit's decision.

With the 2008 proxy season fast approaching, it is important that these issues be addressed in a timely, but thorough manner.

Thank you Mr. Chairman.

Statement of SEC Chairman Christopher Cox Concerning Bylaw Proposals to Establish Director Nomination Procedures

Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs
November 14, 2007

Chairman Dodd, Senator Shelby and Members of the Committee:

Thank you for inviting me to testify concerning the Commission's ongoing rulemaking on the subject of bylaw proposals to establish director nomination procedures.

As you know, the current rules do not permit shareholders to offer these bylaw proposals. In July, I voted for a rule proposal to change that. The Commission has published that proposed rule for comment, along with a companion proposal that would essentially ratify the longstanding status quo. The breadth of the territory that was covered between these two proposals, and the extensive questions that we submitted for public comment, gave the Commission plenty of flexibility to address defects in the proposals or areas for possible improvement that might be identified in the comment process. The comment period on those rule proposals has just closed.

I cannot predict exactly what the Commission will do on this subject this year. Obviously, we are currently reviewing the enormous number of comments that we have received, most of them on the last day of the comment period, on October 2. And today I can speak only for myself, since my testimony does not reflect the individual views of the other Commissioners, or of the SEC. But I am happy to explain why I support strengthening the proxy rules to better vindicate the fundamental state law rights of shareholders.

Our free enterprise system is built on a foundation of law. The enforcement of private property rights is an essential ingredient of a successful free market. At bottom, a share of stock is a bundle of private property rights, no more and no less. And the law's enforcement of private property rights is what gives it its value. America's investors in equities currently entrust over $20 trillion of their assets in exchange for these property rights. It is only the precious few specific rights that the law gives to a common stockholder that undergird this investment. And so it's of the utmost importance that what the stockholder does have is jealously guarded by our legal system.

The stockholder is said to own the company. But he or she cannot direct management or the board to do anything. Indeed, as a legal matter, even 100% of the shareholders acting in concert could not do so – instead they must rely on the directors. Only after every unsecured creditor is taken care of does the common shareholder receive a penny of assets on liquidation. A common stockholder can receive dividends, but only if the board of directors decides to declare them. But the shareholders do have the ironclad legal right to do one thing for themselves – and that's to choose the company's directors.

The federal proxy system should protect and enforce that most important legal right, not stand in its way. After all, we cannot have capitalism without capital.

Not only is protecting the private property rights of America's shareholders important to ensure a continued flow of capital to our companies and industries, but it is the best way to ensure that boards of directors remain accountable to the interests of investors. It is the check and balance on boards and management that is built into the corporate form under state law, and its proper functioning is essential to our free enterprise system.

The issue of protecting investor's ownership rights is not a partisan one. As Chairman John Shad put it during the Reagan Administration, "the Commission has always encouraged shareholder participation in the corporate electoral process." And, he added, the SEC's "responsibilities for regulating proxy solicitation have been premised on the need to assure 'fair corporate suffrage' for every securityholder." More recently, several commentators, from all across the spectrum, have been making the case. The distinguished group of experts that comprised the Committee on Capital Markets, under the direction of Professor Hal Scott of the Harvard Law School, Glenn Hubbard, President Bush's former Chairman of the Council of Economic Advisers, and John Thornton, the former President of Goldman Sachs, devoted an entire section of their recent report to shareholder rights. In their words, "the strength of shareholder rights in publicly traded firms directly affects the health and efficient functioning of U.S. capital markets."

They pointed out that "[o]verall, shareholders of U.S. companies have fewer rights in a number of important areas than do their foreign competitors." And they added that "[t]his difference creates an important potential competitive problem for U.S. companies." As one way of addressing that need, the Committee recommended that the SEC take the opportunity of the court's decision in the AIG case to ensure "appropriate access by shareholders to the director nomination process." And that is exactly the initiative we've begun.

But changing the proxy system to address the "collective action" problem while rationalizing the potential input of 45 million shareholders, fulfilling the essential federal role of ensuring disclosure, and guaranteeing them the full protection of the antifraud provisions of the securities laws is a complicated matter. If it were easy, my predecessor, who attempted to do it, would have succeeded over the several years that he tried. Indeed, when the Commission previously considered this issue in the 1990s, it determined not to pursue it. The Commission stated at the time that "Proposals to require the company to include shareholder nominees in the company's proxy statement would represent a substantial change in the Commission's proxy rules. This would essentially mandate a universal ballot including both management nominees and independent candidates for board seats." So despite noting the "difficulty experienced by shareholders in gaining a new voice in determining the composition of the board of directors," they adopted the short slate rules instead.

And as difficult as the basic proxy access problem is, we have another issue on our hands. Last autumn, the U.S. Court of Appeals for the Second Circuit invalidated the SEC's interpretation of our existing proxy access rule that had been applied at least since 1990. Indeed, in the SEC's view, that interpretation had been in effect since 1976. But the court found the SEC's view since 1990 to be inconsistent with its prior interpretation. At the same time, the court said that it would "take no side in the policy debate regarding shareholder access to the corporate ballot," noting that "such issues are appropriately the province of the SEC." This decision applies only in one of the 12 judicial circuits in America. And it has created great uncertainty and danger for every stakeholder in our public markets.

This uncertainty is compounded by a recent decision of the U.S. Supreme Court, which creates doubt about the state of affairs even in the Second Circuit. The Supreme Court reversed another panel of the Second Circuit in a similar case of an agency that changed its interpretation of its rules. Just as in the proxy access case, the Second Circuit rejected the agency's more recent interpretation. Justice Breyer's opinion for the unanimous Court held that the agency's interpretation of its own regulations is controlling unless plainly erroneous. As a result of this decision, it is more likely today that even a Second Circuit court would uphold the agency's longstanding interpretation of our proxy access rule. In this escalating state of confusion, the only rule across America at the moment is every litigant for himself.

And yet the only legal question is what the SEC's rule means – not the new rules that we have proposed, but the rule that is already on the books, and has been for over 30 years. It should be a straightforward matter for the SEC to answer that question. The legal uncertainty does not involve any statutory interpretation, or questions of the agency's authority. But it does involve a great deal of real world risk and litigation. In the wake of the Second Circuit decision, the SEC staff has stopped responding either positively or negatively to inquiries from the public about what our rule means. Officially, the staff has no view on what the rule says or how it applies in any specific case. There can be absolutely no excuse for our continuing to fail to answer that basic question. That is why I have said all year that we are committed to having a clear rule in place for the coming proxy season.

I cannot predict what the Commission will do. It is widely reported that the Commissioners have irrevocably formed their views on what they will do, both now and in the future. But in fact the Commissioners, just like the staff, take this issue very seriously and with an open mind. Though some of my colleagues did not vote to approve the proposed rule to broaden proxy access that we published for comment last summer, it was not because they or any of us thinks the current system could not be improved. Rather, as one of them said, the current framework "is far from perfect," but it has "at least created a framework for dealing with these problems." Another of the Commissioners objected to the proposed rule because it did not consider "other potentially viable alternatives." This bespeaks an open mind and a willingness to seek improvements in the proxy process for the benefit of all investors, which is what I believe each of the members of the Commission brings to this issue. We are still in the process

of evaluating over 34,000 comments from the public on this issue, and we take that job very seriously. The testimony that you will hear today, as well as your own comment that each of you is offering during this hearing, will add very usefully to this public record, and we will be very attentive to it as well.

Our rulemaking is, as I'm sure you know, a work in progress. Even the Commissioners who voted for the broader proposal raised questions about it that were put to the public for comment, and each of us who voted for it explicitly acknowledged the tradeoffs that exist. In the words of one of my colleagues, our challenge is to "balance the rights of shareholders, with the legitimate goal of leaving the management of companies largely to the board and the managers, whose primary focus should be on profit generation."

There is a widespread assumption that having published the two proposals, the Commission has only a binary choice – that we must adopt one of them, or do nothing. But in fact we may also adopt a rule that is different than either of those proposed. The only requirement is that the proposed rule, and the questions the agency has asked, provide fair notice to the public of what the Commission is contemplating and the issues involved. So long as the final rule or rules are a logical outgrowth of what was proposed, we are free to amend the proposals and to consider improvements that the public comment process has brought to our attention.

The "do nothing" alternative is doubly dangerous. Not only will it provoke more needless litigation about the meaning of our rule, which in light of the recent Supreme Court decision might well be resolved in favor of the agency's long standing interpretation in any event, but it will create a law of the jungle for any actual shareholder proposals that are advanced in the meantime. That's because unless we accept the Second Circuit's invitation to clarify the current rule, all of the protections of the proxy contest rules are out the window -- including requirements for disclosure of conflicts of interest, and possibly even the antifraud rules that prevent deliberate lying to investors. It is obvious that many shareholders support the main effect of the Second Circuit decision, which is that the Commission's existing rule concerning proxy access is called into question, because they want to have access to the proxy. You will hear from them on the next panel, and I personally am very attentive to their concerns. But it should be possible to gain the more effective use of the proxy that they seek without abandoning other important shareholder protections, such as our disclosure and antifraud rules.

So whatever the Commission decides to do, we will restore certainty about the application of our rules. That is our fundamental responsibility.

When Hammurabi erected his stone tablets in the city square of Babylon 3800 years ago, civilization made a great advance. From that moment forward, the law was no longer arbitrary. For the first time, citizens could know in advance the standard to which they should conform their conduct. That is the difference between the rule of law and the rule of men.

In our own time, when we highly prize the rule of law, we face the same risk as our ancient forebears, but for a different reason. All of our laws are written down -- thousands of pages of them. On top of that there are hundreds of thousands of pages of regulations, and beyond that an ever-growing case law that interprets both the statutes and the regulations. The uncertainty generated by competing interpretations and so many grey areas creates a 21st century version of the pre-Hammurabian days. Once again, citizens cannot know in advance the rules by which they should arrange their lives and their business affairs.

There is nowhere that certainty in the law is more important than in our markets. Each day, investors in this country and around the world execute make-or-break choices that depend on knowing in advance what the rules are. Businesses large and small need to know how to navigate in a sea of regulation. We owe it to them to provide a clear answer. Each of our rules may not be precisely what a particular player wants, but it should nonetheless be precise. A vague or ambiguous rule can be just as bad as no rule at all.

The rule of law that the SEC enforces has given America the most dynamic and vibrant capital markets in the world. And the rule of law includes both certainty in application, and commitment to enforcement of the fundamental property rights of every shareholder -- above all the right to choose the directors of the companies they own.

So I agree with the many commenters on our two proposals who have said that we should go back to the drawing board and take a fresh look at this issue. We will do that. None of the 22 SEC Chairmen since the agency first looked at this issue in 1942 has successfully taken this step. I nonetheless am committed to serious work on it, and I am intent on bringing it to a successful resolution. And I am happy to take your questions.

Business Roundtable™

Testimony for the Record

of

John J. Castellani
President, Business Roundtable

on

Shareholder Rights and Proxy Access

Before the U.S. Senate Committee on
Banking, Housing, and Urban Affairs

Wednesday, November 14, 2007

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Mr. Chairman and members of the Committee, thank you for inviting me here to share our views on the issue of proxy access. For the hearing record we are also including our comment letter to the SEC.

Business Roundtable has long been a strong supporter of corporate governance reforms. We supported Sarbanes Oxley, the enhanced listing standards of the exchanges, additional disclosures on executive compensation, and majority voting for directors.

Similarly, we remain committed to promoting the accountability and responsiveness of boards, enhancing transparency so investors can make informed decisions, and facilitating communication and understanding between companies and their shareholders.

As you know, the issue of proxy access has been debated over the years, and previous Commissions have struggled with both the realities of state laws that govern director elections, and a host of implementation issues.

There are numerous underlying issues that should be resolved before proxy access is considered, which include the role of proxy advisory firms, the impact of so called "borrowed voting", and the reforms necessary to allow companies to communicate directly with all of their shareholders, rather than going through brokers and third parties.

The SEC is considering two proposed rules, whose issuance followed a lengthy process of testimony by experts from the legal, academic, corporate, and shareholder communities.

The heart of the issue involves how corporate director elections are governed and how a company proxy is used.

Director elections are governed by state law where the company is incorporated, and the proxy is a mechanism for shareholders to vote when not attending shareholder meetings. Shareholders *do* have the right to nominate directors, but *not* on the company proxy. This has been an important protection against shareholders having to pay for their own hostile takeover. The SEC has consistently recognized this and excluded such proposals.

Proponents of access want to allow individuals or groups with small holdings to place their candidate directly on the company proxy. Our biggest concern is that board members would be forced into a political system, and then concentrate on annual election campaigns to the detriment of their most important responsibility – protecting and enhancing the investment of all shareholders.

Imagine a proxy card with multiple candidates, seeking shareholder votes based upon conflicting recommendations. In order to win board elections, nominees would be forced to campaign, run ads, and even seek financing, paid for with shareholder money.

Individual shareholders would be confused by conflicting choices, and institutional investors would be lobbied for votes, determined behind the scenes by a select few fund managers and proxy advisory services.

In this day and age of hedge funds, foreign government investment in US corporations, and questions about our markets remaining competitive in the global economy, the last thing shareholders need is politics in the board room, with fractured boards openly arguing and resulting in diminished shareholder confidence.

We also believe such a process will discourage qualified, independent directors from serving, and undermine the successful model that has produced enormous shareholder returns.

The fact is that company boards and executives have transformed themselves, demanding greater accountability and exercising more oversight, as they should. Indeed, we have seen more governance changes in the past 5 years than during the previous 50.

Each year we survey our members on governance practices, and the results this year speak for themselves:

- 91% of our Boards are made up of at least 80 % Independent Directors.
- 72 % of our Boards meet in executive session at every meeting.
- 75 % of our CEOs serve on no more than 1 other Board.
- 84 % of our Boards have *voluntarily* adopted Majority Voting for Directors in just two years.

An interesting example of how boards have responded to shareholder pressure is that the mean tenure of a CEO of a Business Roundtable company is now down to four years. Whether or not this trend is in the best interests of shareholders remains to be seen. But clearly it shows that boards are more dominate than ever.

With Majority Voting, shareholders now have a true "yes" or "no" vote on board candidates, and have a meaningful voice in the director election process. Former SEC Commissioner Joseph Grundfest compares this to the "advice and consent" powers of the U.S. Senate. In a speech last week he said "Effective advice and consent mechanisms already exist in our own corporate backyards. Shareholders have the right to veto any candidate to serve on any board."

Board members now regularly meet with shareholders, having the benefit of their views on everything from compensation, to mergers, to capital expenditures. Companies work to keep shareholders because it's in their best interest to do so.

Given these reforms, the challenge we now face is guarding against further erosion of our competitiveness. Increasingly we see public companies going private, and new companies listing in foreign exchanges. Senator Schumer's commission identified this trend as a challenge facing our capital markets.

In our view, Proxy Access could contribute to this trend. Rules allowing virtually anyone to force by-law amendments regarding director elections would provide another reason for companies to go private or list elsewhere.

Given our belief that politics and divisiveness have no place in the boardroom, coupled with a strong record of meaningful reforms, we believe the proposal may produce the unintended consequence of eroding shareholder value.

Now more than ever, boards need to attract qualified directors who can work together to innovate, increase revenues and profits, and grow shareholder value.

Preserving the current balance between shareholders, boards, and management will allow corporate directors to continue to focus on what they are there to do: provide critical judgment and oversight, and help create long term value for all shareholders.

Thank you and I'd be happy to answer any questions.

Business Roundtable

October 1, 2007

VIA E-MAIL

Ms. Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re:Shareholder Proposals Relating to the Election of Directors – File Number S7-17-07, Shareholder Proposals – File Number S7-16-07

Dear Ms. Morris:

This letter is submitted on behalf of Business Roundtable, an association of chief executive officers of leading U.S. companies with over $4.5 trillion in annual revenues and more than ten million employees. Member companies comprise nearly a third of the total value of the U.S. stock market and represent nearly a third of all corporate income taxes paid to the federal government. Roundtable companies give more than $7 billion a year in combined charitable contributions, representing nearly 60 percent of total corporate giving. They are technology innovation leaders, with $86 billion in annual research and development spending – nearly half of the total private R&D spending in the U.S.

We appreciate this opportunity to provide our views in response to: (1) the Commission's proposal to revise the "director election" exclusion to reflect the Commission's longstanding interpretative position; (2) the Commission's alternative proposal on "access bylaws" and its proposal on electronic shareholder forums; and (3) the Commission's solicitation of comment on issues related to non-binding shareholder proposals. Due to the importance we place on the issues addressed in the Commission's two releases and the number of issues, we are providing our general comments below and submitting more detailed comments in an enclosure with this letter.

Business Roundtable has long been a strong supporter of good corporate governance. We have issued numerous statements addressing corporate governance, including *The Nominating Process and Corporate Governance Committees: Principles and Commentary*, published in April 2004; *Guidelines for Shareholder-Director Communications*, from May 2005; *Principles of Corporate Governance*, released in November 2005; and *Executive Compensation: Principles and Commentary*, from January 2007. We strongly supported enactment of the Sarbanes-Oxley Act of 2002, implementation of the

Commission's rules related to the Sarbanes-Oxley Act and revisions to the corporate governance listing standards of the New York Stock Exchange and The NASDAQ Stock Market. We share the Commission's belief that corporate boards and management must hold themselves to high standards of corporate governance.

In light of the commitment of Business Roundtable and our members to high standards of corporate governance, we have spent significant time reflecting on the Commission's proposals. Identifying what would best accomplish the paramount goal of preserving and enhancing the director election and shareholder proposal processes in a manner designed to benefit all of a company's shareholders. The processes that we support reinforce core principles that Business Roundtable strongly advocates, including:

- promoting the accountability and responsiveness of boards of directors;
- enhancing transparency to enable shareholders to make informed voting and investment decisions;
- facilitating communications between companies and their shareholders; and
- creating certainty and predictability for companies and their shareholders.

Consistent with these principles, Business Roundtable believes that:

First, the Commission is correct in issuing its interpretation and proposing rule amendments to clarify its longstanding position that company proxy statements are not the appropriate medium for shareholders to nominate directors. This clarification will preserve a carefully constructed regulatory framework designed to promote full and accurate disclosure. The key to this framework is that shareholders seeking to nominate their own directors must do so in their own (rather than the company's) proxy materials, subject to a regulatory scheme governing contested proxy solicitations. In this way, all of a company's shareholders will have an opportunity to make informed decisions in voting for directors in contested situations. In light of the Commission's interpretation, the staff should once again grant no-action relief to companies allowing them to exclude access bylaw proposals under Rule 14a-8(i)(8) even absent further Commission action. Doing so would be consistent with the Second Circuit's decision in *AFSCME v. AIG* and would avoid the disruption and expense of litigation by companies and their shareholders.

Second, allowing access bylaw proposals would have a number of harmful effects. It could lead to the election of "special interest directors" who will disrupt boardroom dynamics and harm the board's decision-making process. The end result will be to jeopardize long-term shareholder value by compromising the

board's ability to act in the long-term best interests of the company and all shareholders. In addition, permitting access bylaws could turn every director election into a contest and discourage qualified, independent directors from serving on boards. It would also increase the costs of director elections and shift the costs of proposing nominees from particular shareholders to companies and ultimately, to all shareholders.

Third, allowing access bylaw proposals is unnecessary given the sweeping changes in the corporate governance landscape that have occurred in recent years. During this time, boards of directors have become more active and independent. For example, our membership figures show that 90 percent of Business Roundtable companies have boards that are at least 80 percent independent. At 71 percent of Business Roundtable companies, the board meets in executive session at every meeting.

Changes in the governance landscape have also transformed the director election process and will continue to do so. The rights of shareholders to elect directors have strengthened. For example, as of August 2007, over 63 percent of S&P 500 companies had provided for a form of majority voting in director elections. Among U.S. publicly traded Business Roundtable companies, the proportion of companies is even higher, at 82 percent as of September 2007, compared to 22 percent as of March 2006. This dramatic increase in the prevalence of majority voting has taken place in the short space of less than two years. Moreover, shareholders have the ability to recommend director candidates to a company's nominating/corporate governance committee, and shareholders have benefited from increased transparency about the director nominations process. Robust communication procedures have enabled shareholders to engage in dialogue with boards about matters related to director candidates and the director election process generally. In addition, shareholders have always had the ability to undertake their own solicitation of other shareholders to elect directors. The Commission's recently adopted "e-proxy" rules will substantially reduce the costs of such an undertaking. Thus, a fundamental shift in the Commission's longstanding position on proxy access is particularly inappropriate and unnecessary at this time given all of these changes.

Fourth, the Commission's proposals to facilitate the use of electronic shareholder forums are a welcome continuation of recent corporate governance and disclosure initiatives that have improved communication between shareholders and boards. Business Roundtable believes that the Commission's proposals strike the appropriate balance by providing the flexibility necessary to create and maintain electronic shareholder forums while limiting liability that could discourage their use.

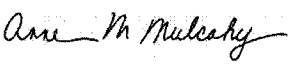
Fifth, in order to avoid what some have called the "tyranny of the 100 share shareholder," the Commission should toughen the requirements on including non-binding shareholder proposals in company proxy statements. Today,

companies and their shareholders, and the Commission and its staff, spend substantial time, effort and other resources on proposals that are not of widespread interest to a company's shareholders. Proposals that cover topics the company has already addressed or that have little to do with matters of economic significance to shareholders and the company. We have included specific recommendations for changes to the current rules in our detailed comments. These changes are appropriate given the recent developments cited by the Commission, including increased opportunities for dialogue and the Commission's proposals on electronic shareholder forums, which have significantly enhanced, and will continue to enhance, opportunities for collaborative discussion among shareholders, boards and management.

In summary, Business Roundtable believes that the Commission can best preserve and enhance the director election and shareholder proposal processes for the benefit of all shareholders by maintaining the existing framework for director nominations, adopting its proposal on electronic shareholder forums and amending its rules to reduce the time and resources spent on non-binding shareholder proposals. Taken together, these actions will benefit companies and all their shareholders.

Thank you for considering our views on this subject. We would be happy to discuss our comments or any other matters that you believe would be helpful.

Sincerely,



Anne M. Mulcahy
Chairman & CEO, Xerox Corporation
Chairman, Business Roundtable Corporate Governance Task Force

Enclosures

cc: Hon. Christopher Cox, Chairman
Hon. Paul S. Atkins, Commissioner
Hon. Annette L. Nazareth, Commissioner
Hon. Kathleen L. Casey, Commissioner
Mr. John W. White, Director, Division of Corporation Finance
Mr. Brian G. Cartwright, General Counsel

Detailed Comments
of
Business Roundtable,
Corporate Governance Task Force

1. The "director election exclusion" should be revised in a manner consistent with the Commission's long-standing interpretive position.

Business Roundtable strongly supports the Commission's interpretation and proposal to revise the "director election exclusion" in Rule 14a-8(i)(8) under the Securities Exchange Act of 1934[1] in a manner consistent with the Commission's long-standing interpretation of the rule. We believe that this interpretation and the proposed revisions are necessary and appropriate in light of the investor protection mandate embodied in the Commission's proxy rules. While the Commission's interpretation addresses the uncertainty created by *AFSCME v. AIG*,[2] we believe that revising the rule will provide additional clarity about its scope and meaning.

As noted in the Interpretive Release, the Commission's proxy rules contain a number of disclosure requirements that apply specifically to contested proxy solicitations for the election of directors. For example, the rules mandate disclosure about the identity of the parties soliciting proxies in a contested election, the methods and costs of solicitation, and, for each soliciting party and director nominee, information about any substantial interest they have in the solicitation, their holdings and transactions in company securities, any related person transactions, and any arrangements involving future employment and transactions with the company. The Commission's requirements for contested solicitations serve the fundamental goal of providing shareholders with full and accurate disclosure so they have an opportunity to make informed decisions in voting

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[1] *See Shareholder Proposals Relating to the Election of Directors,* Exchange Act Release No. 56161 (July 27, 2007) (Proposing Release) (hereinafter, the "Interpretive Release").

[2] *American Fed'n of State, County & Mun. Employees, Employees Pension Plan v. American Int'l Group, Inc.*, 462 F.3d 121 (2d Cir. 2006).

for directors. The requirements also promote accountability, and avoid confusion, by mandating that contestants provide the relevant disclosure in their own proxy materials.

The director election exclusion is an essential element of a carefully constructed regulatory framework intended to further the goal of full and accurate disclosure. As discussed in the Interpretive Release, the Commission and its staff historically have permitted companies to exclude from their proxy materials any shareholder proposal that may result in a contested election.[3] This includes any proposal that would set up a process for shareholders to conduct an election contest in the future, such as an access bylaw. Interpreting the exclusion otherwise would allow shareholders to place their nominees in a company's proxy materials, creating a contested election without a separate proxy solicitation and the attendant disclosures mandated by Commission rules governing contested solicitations.

In view of the Commission's adoption in the Interpretative Release of the interpretation that "a proposal may be excluded under Rule 14a-8(i)(8) if it would result in an immediate election contest (e.g., by making or opposing a director nomination for a particular meeting) or would set up a process for shareholders to conduct an election contest in the future by requiring the company to include shareholders' director nominees in the company's proxy materials for subsequent meetings," its staff should once again grant no-action relief to companies allowing them to exclude access bylaw proposals under Rule 14a-8(i)(8).[4] Doing so is consistent with the Second Circuit's decision in *AFSCME v. AIG*. In that decision, the Court requested that the Commission explain its interpretation of the rule, and the Commission has now done so.

In light of the Commission's interpretation of Rule 14a-8(i)(8) contained in the Interpretive Release, Business Roundtable believes it also is appropriate for the

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[3] *See also* John C. Coffee, Columbia Law School, Transcript of Roundtable on the Federal Proxy Rules and State Corporation Law, May 7, 2007 at 46 ("May 7th Transcript") ("It is Federal law and Federal law for 50 years that says you cannot use the proxy statement to nominate directors . . . .").

[4] *See* Interpretative Release at 18.

Commission to amend the rule to reflect this interpretation. As the Commission observes in the Interpretive Release, the *AFSCME v. AIG* decision has resulted in "uncertainty and confusion" about the appropriate application of the director election exclusion. While the Commission's interpretation eliminates some of this confusion, amending the rule would provide additional guidance to shareholders and companies as well as the Commission staff. With a clearer rule, shareholders and companies will have a better understanding of the types of shareholder proposals that are a proper subject for inclusion in company proxy materials, and the Commission staff will have additional guidance when responding to no-action requests. Greater clarity about the parameters of the exclusion will, in turn, help to reduce inefficiencies and unnecessary costs, as well as the unfortunate prospect of future litigation.[5]

The Commission's proposed change to Rule 14a-8(i)(8) brings additional clarity to the rule, but greater specificity in the rule or an instruction to the rule about the scope of the director election exclusion is warranted. The Interpretive Release states that, if Rule 14a-8(i)(8) is amended, the Commission "would indicate clearly that the term 'procedures' referenced in the election exclusion relates to procedures that would result in a contested election, either in the year in which the proposal is submitted or in subsequent years, consistent with the Commission's interpretation of the exclusion." Business Roundtable agrees with this clarification of the scope of Rule 14a-8(i)(8). We also support the Commission's suggestion to provide further clarification through an illustrative list of some of the specific circumstances in which shareholder proposals may result in an election contest. In order to do so, we recommend defining the term "procedures" in the rule or in an instruction to the rule or at least including the list of circumstances that may result in an election contest in an instruction. To preserve flexibility in interpreting and applying the rule, any such list should be illustrative only.

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[5] *See Reliant Energy, Inc. v. Seneca Capital LP*, 4:07-cv-00376 (S.D. Tex. filed January 29, 2007, dismissed February 27, 2007) (seeking declaratory relief that an access bylaw proposal was excludable under Rule 14a-8(i)(8) because the Second Circuit's ruling in *AFSCME v. AIG* was not applicable to it).

2. The Commission should not adopt rule changes that facilitate the proposal of "access bylaws" as such changes would have a number of harmful effects and are unnecessary.

Business Roundtable recognizes that the right to vote in the election of directors is one of the most significant rights of shareholders. We support an effective and meaningful voice for shareholders in the director election process. However, Business Roundtable does not believe that amending the Commission's rules to facilitate the proposal of "access bylaws" allowing shareholders to place their nominees in company proxy materials is the appropriate way to achieve this goal.[6] As discussed in more detail below, there are significant, negative consequences to permitting widespread shareholder access to company proxy materials to nominate directors. Moreover, such proxy access is unnecessary in light of the sweeping changes in the corporate governance landscape that have occurred in the past several years and that remain ongoing at this time.

As an initial matter, we note the statements in the Shareholder Proposal Release that the Commission "has sought to use its authority" to regulate disclosure and mechanics related to the proxy process "in a manner that does not conflict with the primary role of the states in establishing corporate governance rights." Business Roundtable believes that any Commission rulemaking allowing shareholders to nominate directors in company proxy materials would represent a sea change in corporate governance practice and would inject the Commission into an area traditionally reserved to state law. In this regard, the practical impact of the Commission's "bylaw access" proposed rule, if adopted, would be fundamentally *inconsistent* with the Commission's stated objective of "ensur[ing] that any new rule is consistent with the principle that the federal proxy rules should facilitate shareholders' exercise of state law rights, and not alter those rights." Due to the overwhelming policy and practical factors that weigh against adopting the proposal, we do not at this time address the legal question of whether adopting the proposal would exceed the Commission's rulemaking authority.

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[6] *See Shareholder Proposals*, Exchange Act Release No. 56160 (July 27, 2007) (Proposing Release) (hereinafter, the "Shareholder Proposal Release").

A. Negative consequences of widespread access to company proxy materials.

As noted above, there are a number of significant, negative consequences to permitting widespread shareholder access to company proxy materials to nominate directors. First, permitting proxy access could turn every director election into a proxy contest. This would result in divisive, contested elections and the need to expend significant corporate resources in support of board-nominated candidates. The prospect of an annual contest in connection with a company's director elections also could discourage prospective directors from serving on corporate boards.

Second, permitting shareholders direct access to company proxy materials could lead to the election of "special interest directors" who represent the interests of the shareholders nominating them, not the interests of all shareholders or the company as a whole. The Commission acknowledges in the Shareholder Proposal Release, "electing a shareholder nominee to the board could have a disruptive effect on boardroom dynamics." Business Roundtable believes the potential for disruption is particularly great in the case of directors who may be inclined to use their positions to serve particular agendas or constituencies.

Third, permitting shareholders direct access to company proxy materials is inconsistent with, and would undermine, recent initiatives that have strengthened the role and independence of nominating/governance committees, and indeed the board as a whole. In this regard, as of September 2007, 90% of Business Roundtable companies had boards that were at least 80% independent, according to Business Roundtable's 2007 Corporate Governance Survey. Moreover, under the New York Stock Exchange ("NYSE") corporate governance listing standards, companies must have a nominating/governance committee, made up entirely of independent directors, that is responsible for identifying individuals qualified to become board members, consistent with criteria approved by the board. This is a core function of the nominating/governance committee, and best practices suggest that this committee should lead the director nominations process. In view of its role, a company's nominating/governance committee is best positioned to determine the skills and qualities desirable in new directors in order to maximize the board's effectiveness.

Fourth, in the absence of nominating/governance committee involvement, direct shareholder access to company proxy materials may result in the nomination and election of director candidates who will cause a company to violate federal law; Commission, NYSE or The NASDAQ Stock Market requirements; or provisions in the company's governance documents. For example, a candidate could be elected in violation of the Clayton Antitrust Act, which generally prohibits simultaneous service as a director or officer of competing companies. Similarly, under the NYSE listing standards, boards must have a majority of independent directors, a sufficient number of independent directors to serve on their audit, compensation and nominating/governance committees, and directors with the necessary financial experience for a three-member audit committee. In addition, many boards have adopted specific criteria that directors must satisfy in order to be considered for service on the boards. In this regard, as of 2006, nominating/governance committees at 97% of Business Roundtable companies had established qualifications or criteria for directors, according to our 2006 Corporate Governance Survey.

Although the Commission's proposals would require shareholders to provide information about the independence and other qualifications of their nominees, under the NYSE listing standards, the board must make an affirmative finding that a director is independent. Moreover, the nominating/governance committee and the board are best situated to determine whether a candidate meets the board's membership criteria. Direct shareholder access to company proxy materials would hamper the ability of the nominating/governance committee and the board to perform one of its core functions—nominating directors—and may result in the nomination and election of director candidates who violate the law, are not independent or do not meet applicable board membership criteria.

Fifth, Business Roundtable does not believe that the interests of the vast majority of a company's shareholders would be well served by allowing some shareholders to propose director nominees using the company's own proxy materials. Instead, the Commission's proposal would shift the costs of proposing nominees from particular shareholders to the company and ultimately, to all of its shareholders. In this regard, we

believe that the Commission's proposal to revise the director election exclusion in Rule 14a-8(i)(8) (discussed above) will better preserve and enhance the governance practices of companies for the benefit of all their shareholders. Moreover, if a company's board of directors determines that adopting an access bylaw is not in the best interests of the company and all its shareholders, the company will need to spend time and resources in presenting its views to shareholders before they vote on a bylaw access proposal. As the Commission recognizes in the Shareholder Proposal Release, "[t]he company and the board may spend more time on shareholder relations instead of the business of the company." We do not believe that this is a desirable outcome or an appropriate use of a company's resources.

Finally, even though shareholders would furnish "[t]he bulk of the additional disclosure" required under the Commission's proposal, if the proposal is adopted, it will increase the costs of preparing and disseminating company proxy materials, as the Commission acknowledges in the Shareholder Proposal Release. Among other things, companies will be forced to expend substantial time and resources reviewing information that shareholders provide about their nominees, conducting any necessary follow-up with shareholders, and incorporating the information into the proxy statement. In addition, the Commission staff may find itself in the position of having to resolve disputes between companies and shareholders about wording and content, a situation about which the staff has previously expressed concern in the shareholder proposal area.

B. Absence of need for widespread access to company proxy materials.

Business Roundtable also believes that giving shareholders direct access to company proxy materials to nominate directors is unnecessary for a number of reasons.

First, existing proxy rules already permit meaningful shareholder involvement in the election of directors. Shareholders always may undertake their own solicitation of other shareholders to elect one or more directors, and shareholders with significant stock holdings certainly are in the position to finance these solicitations. Moreover, as discussed below, the Commission's recent adoption of its "e-proxy" initiative will substantially reduce the cost of independent solicitations.

Second, there have been more changes in corporate governance and securities regulation over the past five years than in the previous two decades. These changes have come about through a combination of sweeping reforms enacted by Congress (in the Sarbanes-Oxley Act of 2002), the Commission and the securities markets, and through voluntary action by companies to enhance their corporate governance practices. Collectively, these sweeping changes obviate the need for shareholder access to company proxy materials. Moreover, the governance landscape embodies a delicate balance that has been struck among a host of interrelated requirements and practices—a balance that would be upset through the introduction of a fundamental shift in Commission policy to allow access bylaw proposals.

Survey data from Business Roundtable member companies demonstrate the positive changes in corporate governance over the past five years. Specifically, according to our 2007 Corporate Governance Survey, as of September 2007:

- 90% of companies have boards that are at least 80% independent;
- at 71% of companies, the board meets in executive session at every regular board meeting;
- 97% of audit committees, and 92% of compensation committees, meet in executive session;
- 91% of companies have an independent chairman or an independent lead or presiding director;
- 82% of companies have addressed majority voting in director elections (as discussed below); and
- at almost 40% of companies, one or more board members met with shareholders during the past year (as discussed below).

Corporate governance changes that have transformed the director election process specifically, and will continue to do so, include:

1. *Majority voting*. In 2002-03, shareholder activists began suggesting that companies replace plurality voting in director elections with majority voting. Many companies viewed such a change favorably, and, as of August 2007, over 63% of S&P 500 companies had addressed majority voting in director elections.[7] Among U.S. publicly traded Business Roundtable companies, 82% had addressed majority voting as of September 2007, compared to 22% as of March 2006, a span of less than two years. This trend is likely to continue given recent amendments to Delaware law and the Model Business Corporation Act, as well as other states' corporation laws.[8]

2. *"E-proxy."* The Commission's new "electronic proxy" rules will permit companies and others soliciting proxies from shareholders to deliver proxy materials electronically. "E-proxy" is expected to greatly reduce the costs of distributing proxy materials. This rule change, and the technological advances that facilitated it, will greatly reduce the costs to shareholders of nominating their own director candidates in a traditional proxy contest.

3. *Director nomination procedures*. Shareholders currently have the ability to recommend candidates for the board of directors, and recent years have seen enhancements in disclosure about this process. In 2003, the Commission adopted rules requiring disclosure about companies' nominating/governance committee procedures for shareholders to recommend director candidates. As of 2006, 93% of Business Roundtable companies reported that their nominating/governance committees consider shareholder recommendations for board candidates, and 83% had a process for communicating with and responding to these recommendations, according to Business Roundtable's 2006 Corporate Governance Survey. Results of our 2007 survey indicate

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[7] *See* Joseph A. Grundfest, Stanford Law School, May 7th Transcript at 201 (noting the prevalence of majority voting among S&P 500 companies and stating that majority voting is acting "very powerfully . . . to increase shareholder influence.").

[8] *See, e.g.*, H.B. 134, 127th Gen. Assem. Reg. Sess. (Ohio 2007) (enacted); H.B. 271, 2007 Leg., 57th Sess. (Utah 2007) (enacted); Substitute H.B. 1041, 2007 Leg., 60th Sess. (Wash. 2007) (enacted).

that nominating/governance committees at 36% of Business Roundtable companies received shareholder recommendations for board nominees in the past year.

4. *Enhanced board-shareholder communication.* Many companies also currently provide mechanisms for shareholders to communicate with the board about a range of matters, including those related to director candidates and the director election process generally. In 2003, the Commission adopted rules requiring enhanced disclosure about companies' procedures for shareholders to communicate with the board. In addition, NYSE-listed companies are required to have publicized mechanisms for interested parties, including shareholders, to make their concerns known to the company's non-management directors. As of 2006, 91% of Business Roundtable companies had procedures for shareholders to communicate with directors, according to our 2006 Corporate Governance Survey. At almost 40% of Business Roundtable companies, one or more board members met with shareholders during the past year, according to our 2007 survey. In addition, as the discussion below concerning electronic shareholder forums illustrates, advances in technology are providing additional mechanisms for board-shareholder communications.

As the discussion above indicates, sweeping changes have taken place in the corporate governance landscape over the past five years, and these changes remain ongoing. Accordingly, a sea change in the Commission's longstanding position to facilitate access bylaw proposals is unnecessary and inappropriate at this time.

3. The Commission should adopt its proposals on electronic shareholder forums to facilitate communication among shareholders and to promote continued dialogue between companies and their shareholders.

Business Roundtable supports the Commission's goal of promoting the use of technology to facilitate communication among shareholders and between companies and shareholders. The Commission's proposed rules seek to further this goal by removing "any unnecessary real and perceived impediments" to electronic shareholder forums. Specifically, the proposed rules clarify that companies and shareholders are entitled to establish and maintain electronic shareholder forums and that they will not be liable for

any information provided by another person to the forum as a result of simply establishing, maintaining or operating the forum. In addition, the proposed rules seek to further encourage development of these shareholder forums by exempting from the proxy rules those solicitations on an electronic shareholder forum that do not seek to act as proxy for a shareholder or request a form of proxy from shareholders, and that occur more than 60 days prior to an annual or special meeting.

Business Roundtable believes that the proposed rules provide the flexibility necessary to allow companies and shareholders to establish and maintain electronic shareholder forums. A more prescriptive approach is not advised, as it would unnecessarily constrain that desired flexibility and inhibit innovation and use of new technology. In this regard, several companies already are experimenting with electronic shareholder communications. For example, prior to its 2007 annual meeting, AMERCO created a message board on its website to encourage shareholder communications regarding the upcoming meeting. In the invitation to the 2007 annual meeting, AMERCO's chairman urged shareholders to visit the forum in order to post and exchange thoughts regarding the AMERCO proxy solicitation. Similarly, in connection with its 2007 annual meeting, Exxon Mobil Corporation created an on-line forum to provide its shareholders with a place to ask questions relating to the proxy materials for the 2007 annual meeting.

We also support the Commission's proposal to limit liability for the sponsors of these forums, as it is necessary and appropriate to allay concerns that might hinder the development of the forums. Likewise, the proxy exemption for certain communications within the electronic shareholder forum is necessary to encourage the use of these forums. Business Roundtable agrees with the Commission that it is necessary to limit the use of such forums in the 60-day period prior to a shareholders' meeting (or more than two days after the announcement of a meeting) in order to protect shareholders from unregulated solicitations. We suggest that the Commission prohibit all new postings during the relevant period and require notification on the forum of the upcoming meeting and the proxy statement. In order to enforce this requirement, the final rule should

provide that the protection from liability does not apply to any posts during the relevant period.

These proposals are a welcome continuation of the reforms to the NYSE corporate governance listing standards and the Commission's proxy disclosure rules that have been adopted in the past several years to facilitate communication between shareholders and directors. Business Roundtable has supported these reforms and issued its own *Guidelines for Shareholder-Director Communications*, which support effective procedures for shareholders to communicate with the board. Many of our members currently provide email addresses for board members and committee chairs and regularly respond to shareholder communications. Shareholder communication innovations have not been limited to electronic shareholder forums. Recently, for example, Pfizer Inc. announced that its board will hold a meeting with its largest institutional investors to discuss its corporate governance polices and practices. Other companies' officers and directors are using blogs to enhance communication with interested parties including shareholders. This increased dialogue benefits companies and shareholders alike.

Business Roundtable therefore supports the Commission's proposed rules, which we believe will further the development of electronic shareholder forums and other innovations to facilitate shareholder communications. At the same time, we urge the Commission to address some of the broader shareholder communication issues that were raised at its recent proxy process roundtables and in the rulemaking petition that Business Roundtable filed with the Commission in April 2004 requesting rulemaking concerning shareholder communications. We remain convinced that advances in technology can do much to facilitate communication between companies and their shareholders whose securities are held in street and nominee name. Other participants at the SEC's roundtables expressed similar views concerning the need for the Commission to review the mechanics of the proxy process.[9]

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[9] *See, e.g.*, Lydia I. Beebe, Chevron Corporation, Transcript of Roundtable on Proxy Voting Mechanics, May 24, 2007 at 16-18 ("May 24th Transcript"); Charles V. Rossi, Computershare Inc., May 24th Transcript at 117.

4. The Commission should reexamine certain provisions of Rule 14a-8 for consistency with state law and to reduce the time and resources that companies and the Commission staff expend on shareholder proposals.

Business Roundtable supports the Commission's solicitation of comment on issues relating to the inclusion of non-binding shareholder proposals in company proxy materials under Rule 14a-8. Our member companies received over 361[10] shareholder proposals for consideration at their 2007 annual meetings. These proposals require substantial management and board time and effort, as well as other costs to the company and its shareholders, and, of course, the resources of the Commission and its staff.

A. Eligibility threshold

The Commission has solicited comment on whether it should amend Rule 14a-8 to revise the existing ownership threshold for submitting shareholder proposals. Under current Commission rules, a shareholder is eligible to submit a Rule 14a-8 proposal if the shareholder has continuously held at least $2,000 in market value, or 1%, of the company's shares for at least one year. The Commission has not adjusted this threshold since 1998, when it raised the threshold from $1,000 to the current $2,000 eligibility threshold. Even at that time, many commentators expressed the view that this small increase would do little to reduce the significant time and resources expended by companies and the Commission in dealing with Rule 14a-8 shareholder proposals. Nearly ten years later, this increase has been rendered relatively meaningless given increased investments by shareholders.[11]

As several participants in the Commission's recent proxy process roundtables noted, this low eligibility threshold subjects companies to the "tyranny of the 100 share

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[10] Based on data from Institutional Shareholder Services.

[11] For example, the median value of stock owned by U.S. families with stock holdings increased 35% between 1995 and 2004. *2004 Survey of Consumer Finances*, Board of Governors of the Federal Reserve System (February 28, 2006).

shareholder."[12] Essentially, a shareholder holding a *de minimis* investment has the ability to use the company's resources (and by extension, the resources of all the company's shareholders) to put forth his or her agenda. Every year, companies spend significant time and financial resources responding to shareholder proposals, negotiating with proponents, and deciding whether to adopt proposals, include them in the proxy statement or attempt to exclude them by submitting no-action requests to the Commission. In turn, the Commission staff must respond in a short time frame to each no-action request that it receives from a company. Consequently, the time and expense associated with Rule 14a-8 proposals necessitates a significant increase from the current $2,000 eligibility threshold in order to justify the burden and cost on companies, shareholders and the Commission. Thus, we urge the Commission to increase the eligibility threshold significantly.

B. Resubmission thresholds.

The Commission has requested comment on whether it should amend Rule 14a-8 to alter the resubmission thresholds for proposals that deal with substantially the same subject matter as another proposal that previously has been included in the company's proxy materials. Rule 14a-8(i)(12) currently permits the exclusion of a shareholder proposal concerning substantially the same subject matter as a prior proposal included in the company's proxy materials within the preceding five calendar years where the proposal received: (1) less than 3% of votes cast, if proposed once during such period; (2) less than 6% of votes cast, if proposed twice during such period; or (3) less than 10% of votes cast if proposed three or more times during such period. These resubmission thresholds have not been changed since 1954.[13]

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[12] *See, e.g.*, John C. Coffee, Columbia Law School, May 7th Transcript at 44-45; William J. Mostyn III, Deputy General Counsel and Corporate Secretary, Bank of America Corporation, Transcript of Roundtable on Proposals of Shareholders, May 25, 2007 at 32 ("May 25th Transcript").

[13] The 3% threshold was added in 1948, and the 6% and 10% thresholds were added in 1954. *See Adoption of Amendments to Proxy Rules*, Exchange Act Release No. 4185, § III (November 5, 1948); *Adoption of Amendments to Proxy Rules*, Exchange Act Release No. 4979, § II (January 6, 1954). We note that the thresholds were changed

The average votes cast for shareholder proposals has increased significantly. For example, in 1997, the average vote on all shareholder proposals was 15.1% of votes cast.[14] In contrast, the average vote on all shareholder proposals in 2007 (through early September) was 32%.[15] Nevertheless, while support for non-binding shareholder proposals has increased in recent years, many of these proposals continue to receive a relatively low percentage of votes cast. Our members' experience with the shareholder proposal process indicates that Rule 14a-8(i)(12) fails to prevent repeated shareholder votes on shareholder proposals despite the relatively low support for such proposals. We have attached as Appendix A a chart demonstrating how the resubmission thresholds fail to prevent repeat shareholder votes on shareholder proposals that receive relatively low votes year after year. As the chart indicates, as a result of the low resubmission thresholds currently in place, companies are forced to expend great efforts dealing with issues that shareholders clearly do not support. Consequently, the Commission should amend Rule 14a-8(i)(12) to:

- increase the minimum votes a proposal must receive in order to be resubmitted (*e.g.*, a proposal may be excluded if it receives less than 10% of votes cast the first time it is voted on, less than 25% of votes cast the second time it is voted on and less than 40% of votes cast the third time it is voted on); and

- allow the exclusion of a shareholder proposal for a certain number of years if shareholders repeatedly reject it (*e.g.*, a shareholder proposal that is voted on three

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to 5%, 8% and 10%, respectively, for 1984 and most of 1985 before the current thresholds were reinstated due to litigation regarding rulemaking procedures. *See Reinstatement of Rule*, Exchange Act Release No. 22625 (November 14, 1985); *United Church Bd. for World Ministries v. SEC*, 617 F.Supp. 837 (D.C.D.C. 1985).

[14] Cynthia J. Campbell, Stuart L. Gillan and Cathy M. Niden, *Current Perspectives on Shareholder Proposals: Lessons from the 1997 Proxy Season*, Financial Management (Financial Management Association), Spring 1999. The average vote on corporate governance proposals was 23.6% of votes cast, with votes ranging from 0.8% to 74.5%. *Id.* The average vote on social policy proposals was 6.6% of votes cast, with votes ranging from 1.2% to 19.2%. *Id.*

[15] Based on data from Institutional Shareholder Services.

times but not approved by a majority of the votes cast should be excludable for five years thereafter).

C. "Ordinary business" exclusion.

The Commission has requested comment on whether changes or clarifications should be made to Rule 14a-8(i)(7), the ordinary business exclusion, and its application with respect to shareholder proposals that involve significant social policy issues. Business Roundtable believes that the Commission should eliminate the "significant social policy" exception, as there is no basis for it in state law and the Commission staff has interpreted this exception in an inconsistent manner that shifts with the trends at a given time.[16] This view was echoed by many of the participants at the Commission's proxy process roundtables.[17]

For example, there are a number of situations where an issue that has long been viewed as an ordinary business matter gains popularity and the Commission staff then begins to interpret it as involving significant social policy and therefore requires the proposal to be included in the company's proxy statement.[18] However, there is no

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[16] In fact, in 1998 amendments to the Rule, the Commission state that "some types of . . . social policy issues . . . raise difficult interpretive questions." *Amendments to Rules on Shareholder Proposals*, Exchange Act Release No. 40018 (May 21, 1998) (the "1998 Release").

[17] *See, e.g.*, John C. Coffee, Columbia Law School, May 7th Transcript at 44, 68-69 ("[T]he current system of the ordinary business exclusion under 14a is not working . . . . There is no real standard for what is 'ordinary' versus 'extraordinary.' It shifts with the time."); Cary Klafter, Intel Corporation, May 7th Transcript at 174-75 ("When you look at the universe of no-action letters, it is very oftentimes an imperfect pattern."); James J. Hanks, Jr., Venable LLP, May 7th Transcript at 193 ("[The SEC's] social responsibility exception is ill-conceived and I would urge you to reconsider it if you want to preserve the ordinary business exception.")

[18] *See, e.g., International Business Machines Corp.*, SEC No-Action Letter (Feb. 16, 2000) (decision to convert a traditional defined benefits pension plan to a "cash balance" plan raises significant social policy concerns). Moreover, in an attempt to avoid exclusion under Rule 14a-8, some shareholder proposals focus on ordinary business matters but include references to an issue that the staff has deemed a

standard as to when an issue has gained sufficient popularity to characterize it as invoking significant social policy. As several participants in the proxy roundtables stated, this places both companies and shareholders in a difficult position of not knowing what the standards are.[19] Moreover, as Commissioner Atkins remarked, it also has placed the Commission and the Commission staff "in the unenviable position of being the arbiter of these various proposals."[20]

Many participants in the Commission's proxy roundtables agreed that the significant social policy exception permits and encourages social policy-related shareholder proposals having little to do with the economics of the company, while discouraging proposals dealing with matters of actual economic significance to shareholders and the company.[21] In fact, this arbitrary distinction between ordinary business and significant social policy proposals has no basis in state corporation law. Under state corporation law, shareholders elect the directors, and the business and affairs of the company are managed by or under the direction of the board.[22] As Chairman Cox stated in his introduction to the May 7th proxy roundtable, the Commission's proxy rules were intended to "replicate as nearly as possible the opportunity that shareholders would have to exercise their voting rights at a meeting of shareholders if they were personally present."[23] Instead, the effect of certain of the Commission's proxy rules and interpretations, particularly the significant social policy exception, has been to facilitate

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significant social policy even though the proposal focuses on an ordinary business matter.

[19] *See, e.g.*, Cary Klafter, Intel Corporation, May 7th Transcript at 174-75; Amy L. Goodman, Gibson, Dunn & Crutcher, May 7th Transcript at 176-77.

[20] May 7th Transcript at 173-74.

[21] *See* Stephen Bainbridge, UCLA School of Law, May 7th Transcript at 36-38; Jill E. Fisch, Fordham University School of Law, May 7th Transcript at 91-93; Stanley Keller, Edwards Angell Palmer & Dodge, May 7th Transcript at 142-43; Joseph A. Grundfest, Stanford Law School, May 7th Transcript at 193-94.

[22] *See* Del. Code Ann. tit. 8, § 141 (2007).

[23] May 7th Transcript at 7-8.

shareholder proposals on subjects that are not appropriate for shareholder action under state law. This should not be the role of the federal proxy process.

D. "Substantially implemented" exclusion.

Business Roundtable believes that the Commission also should review it staff's application of Rule 14a-8(i)(10), which permits exclusion of a shareholder proposal that has been "substantially implemented." Although the original interpretation of Rule 14a-8(i)(10) permitted exclusion of proposals only where the action requested by the proposal had been "fully effected," under the 1983 amendments to the proxy rules, companies may omit proposals that have been "substantially implemented."[24] In adopting this interpretation of Rule 14a-8(i)(10), the Commission stated, "the previous formalistic application of this provision defeated its purpose."[25] The 1998 amendments to the proxy rules reaffirmed the position that a proposal may be omitted if it has been "substantially implemented."[26] Consequently, as noted in the Commission's release adopting the 1983 amendments to the proxy rules, in order to be excludable under Rule 14a-8(i)(10), a shareholder proposal does not need to be "fully effected" – it need only be "substantially implemented." In other words, Rule 14a-8(i)(10) was intended to permit exclusion of a shareholder proposal where a company has implemented the essential objective of the proposal, even where the manner by which the company implements the proposal does not precisely correspond to the actions sought by a shareholder proponent. In this regard, the Commission staff has stated, "a determination that the [c]ompany has substantially implemented the proposal depends upon whether [the company's] particular policies, practices and procedures compare favorably" with those requested under the proposal, and not on the exact means of implementation.[27]

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[24] *Amendments to Rule 14a-8 Under the Securities Exchange Act of 1934 Relating to Proposals by Security Holders*, Exchange Act Release No. 20091, § II.E.6 (August 16, 1983).

[25] *Id.*

[26] *See* 1998 Release, note 30 and accompanying text.

[27] *Texaco, Inc.*, SEC No-Action Letter (Mar. 28, 1991) (*emphasis added*).

Despite the Commission's clear intent and the staff's language, it appears that in recent years the staff has applied Rule 14a-8(i)(10) in an increasingly narrow manner. This has resulted in companies spending unnecessary time and expense on no-action requests and shareholders having to vote on issues that their companies already have addressed.[28] For example, in a number of recent letters, the staff has not permitted exclusion of shareholder proposals calling for companies to adopt clawback policies, even where boards have considered and adopted such policies.[29] It appears that the staff has done so because the shareholder proposal covered additional officers or had a somewhat different standard of care. This clearly is a return to a "formalistic" approach to the substantially implemented exclusion that is inconsistent with the Commission's intent. Business Roundtable believes that once a company board has addressed an issue in a manner that it believes to be in the best interest of the company's shareholders, that issue should not be an appropriate subject for a Rule 14a-8 shareholder proposal. This position is consistent with Delaware and other state corporation statutes, which generally provide that "the business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors."

E. Bylaw amendments concerning non-binding shareholder proposals.

The Commission has requested comment as to whether it should adopt rules that would enable shareholders to determine the procedures a company will follow with regard to non-binding shareholder proposals. We agree with the Commission's view that recent developments, including increased opportunities for dialogue between shareholders and company boards and management and the Commission's proposal to remove perceived barriers to shareholder participation in electronic shareholder forums,

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[28] *See* Cary Klafter, Intel Corporation, May 7th Transcript at 175; Amy L. Goodman, Gibson, Dunn & Crutcher, May 7th Transcript at 139-140.

[29] *See, e.g., Bristol-Myers Squibb Co.*, SEC No-Action Letter (Feb. 20, 2006) (reconsideration denied, Mar. 17, 2006).

have significantly enhanced opportunities for collaborative discussion.[30] In light of these other avenues available for shareholders to communicate with each other and with company boards and management, we believe that in limited instances it may no longer be necessary for the Commission to dictate the procedures for non-binding shareholder proposals.

If the Commission chooses to adopt rules that would permit shareholders to propose non-binding shareholder proposal bylaws, given the importance of these bylaws and the need for consistency, the Commission should require such shareholders to satisfy heightened ownership requirements. Moreover, such procedures should not be limited by Rule 14a-8, but by state law and the company's charter or bylaws. This approach would allow flexibility for shareholders to tailor bylaws relating to non-binding shareholder proposals to the specific characteristics of the company and its shareholders.

Business Roundtable believes that the Commission should avoid being overly prescriptive in adopting rules relating to non-binding shareholder proposal bylaws and should leave interpretive matters involving a company's bylaws to the state courts. They are the appropriate forum for interpreting and enforcing bylaw procedures for non-binding shareholder proposals and for resolving disagreements between companies and proponents of non-binding shareholder proposals. Moreover, to the extent a company's board of directors is permitted under the company's governing documents and state law to adopt bylaw amendments without shareholder approval, the board of directors should be permitted to adopt a bylaw establishing a procedure for non-binding shareholder proposals that would supersede the provisions in Rule 14a-8 relating to non-binding shareholder proposals. As noted above and as emphasized by several participants at the

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[30] Several participants in the Commission's proxy roundtables echoed this view. *See* David Hirschmann, President, U.S. Chamber of Commerce Center for Capital Markets Competitiveness, May 25th Transcript at 31-32; Amy L. Goodman, Gibson, Dunn & Crutcher, May 25th Transcript at 63-64; William J. Mostyn III, Deputy General Counsel and Corporate Secretary, Bank of America, May 25th Transcript at 64-65.

proxy process roundtables, the Commission's proxy rules were intended to vindicate state rights, not supplement them.[31]

F. Electronic petition model.

The Commission has requested comment on whether it should adopt a provision to enable companies to follow an electronic petition model for non-binding shareholder proposals in lieu of Rule 14a-8. In light of the many practical difficulties with the electronic petition model expressed by several participants at the Commission's roundtable discussions,[32] Business Roundtable believes that the Commission should not move forward with this concept at this time. Instead, as discussed above, Business Roundtable supports the Commission's proposal to facilitate shareholder communications in electronic shareholder forums.

G. Additional disclosure of voting results.

The Commission has requested comment on whether it should require a company to provide additional disclosure with regard to the voting results for non-binding shareholder proposals. Business Roundtable supports additional disclosure of shareholder proposal results for both non-binding and binding shareholder proposals where the necessary standard for passage is not based on the number of votes cast for or against a particular matter, which is the currently required disclosure (*e.g.*, reporting the vote as a percentage of outstanding shares should be required when that is the standard for approval).

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[31] *See* Christopher Cox, Chairman, U.S. Securities and Exchange Commission, May 25th Transcript at 6–8. *See also* John C. Coffee, Columbia Law School, May 7th Transcript at 42.

[32] *See, e.g.*, Paul M. Neuhauser, University of Iowa College of Law, May 7th Transcript at 167-171; Amy L. Goodman, Gibson, Dunn & Crutcher, May 25th Transcript at 62-64; William J. Mostyn III, Deputy General Counsel and Corporate Secretary, Bank of America Corporation, May 25th Transcript at 64-66.

Appendix A

Examples of Shareholder Proposal Resubmission Abuses

Rule 14a-8(i)(12) currently permits the exclusion of a shareholder proposal concerning substantially the same subject matter as a prior proposal submitted to a shareholder vote within the preceding five calendar years where the proposal received (1) less than 3% of the votes cast, if the proposal was submitted for a vote at only one meeting during such period, (2) less than 6% of votes cast on its last submission to shareholders, if the proposal was submitted for a vote at only two meetings during such period, or (3) less than 10% of votes cast on its last submission to shareholders, if the proposal was submitted for a vote at three or more meetings during such period. Set forth below are examples of how Rule 14a-8(i)(12) fails to prevent repeated shareholder votes on shareholder proposals despite relatively low votes cast for such proposals. These examples are based on data between 1997 and 2004 from the Investor Responsibility Research Center and between 2004 and September 21, 2007 from Institutional Shareholder Services. This data reflects each source's description of each shareholder proposal's subject matter, but does not include shareholder proposals that received 40% or more of the votes cast.

Company	Subject Matter of Proposal	Meeting Date	Votes For
99 Cents Only Stores	Adopt labor standards for vendors	2002	9.5%
		2003	20.5%
		2004	19.0%
Abbott Laboratories	Report on political donations and policy	2004	7.2%
		2005	8.0%
		2006	9.3%
Adobe Systems Inc.	Require option shares to be held	2003	8.9%
		2004	30.3%
		2005	29.1%
American Eagle Outfitters, Inc.	Implement Internal Labor Organization (ILO) standards and third-party monitor	2001	11.4%
		2002	9.0%
		2003	13.0%
		2004	7.4%

Company	Subject Matter of Proposal	Meeting Date	Votes For
American Power Conversion Corp.	Commit to/report on board diversity	2000	30.1%
		2002	24.1%
		2003	28.6%
Anheuser-Busch Companies, Inc.	Independent board chairman	1999	15.6%
		2000	17.6%
		2001	18.8%
		2003	9.8%
AT&T Inc.	Link executive pay to social criteria	2001	13.6%
		2004	9.0%
		2005	10.1%
		2006	11.9%
AT&T Inc.	Drop sexual orientation from equal employment opportunity (EEO) policy	2001	7.4%
		2002	11.5%
		2003	3.3%
AT&T Inc.	Report on political donations and policy	2005	12.5%
		2006	15.2%
		2007	13.3%
Baker Hughes Inc.	Implement MacBride principles	1996	19.1%
		1997	15.9%
		1998	19.7%
		1999	22.9%
		2000	23.7%
		2001	15.7%
		2002	11.2%
		2003	6.4%
Bed Bath & Beyond Inc.	Report on EEO and plans against "glass ceiling"	2002	26.3%
		2003	24.9%
		2004	12.0%
Bellsouth Corp.	Report on political donations and policy	2004	15.1%
		2005	12.2%
		2006	12.1%

Company	Subject Matter of Proposal	Meeting Date	Votes For
The Boeing Co.	Independent board chairman	2003	29.7%
		2005	26.6%
		2006	36.2%
The Boeing Co.	Provide pension choices	2001	9.0%
		2002	12.0%
		2003	12.2%
		2004	10.8%
The Boeing Co.	Adopt comprehensive human rights policy	2003	25.8%
		2004	17.4%
		2005	21.2%
		2006	25.0%
		2007	25.0%
The Boeing Co.	Develop military contracting criteria	1999	6.3%
		2004	7.8%
		2005	7.7%
		2006	8.8%
Brinker International, Inc.	Report on gene-engineered food	2001	9.8%
		2002	7.5%
		2003	8.0%
Citigroup Inc.	Independent board chairman	2004	19.5%
		2005	30.8%
		2006	16.1%
		2007	20.9%
Citigroup Inc.	Link executive pay to social criteria	2001	5.1%
		2002	7.3%
		2003	6.8%
The Coca-Cola Company	Performance/time-based restricted shares	2004	27.8%
		2005	31.9%
		2006	32.3%

Company	Subject Matter of Proposal	Meeting Date	Votes For
Coca-Cola Enterprises	Golden parachutes	2004	30.6%
		2005	26.3%
		2006	32.5%
Colgate-Palmolive Co.	Implement ILO standards and third-party monitor	2001	11.4%
		2002	8.4%
		2003	11.1%
		2004	8.3%
Comcast Corp.	Eliminate dual class stock	2004	31.0%
		2005	34.2%
		2006	28.4%
		2007	31.2%
Consolidated Edison, Inc.	Disclose executive officers entitled to receive in excess of $500,000 annually and their compensation	1997	12.1%
		1998	10.0%
		1999	10.3%
		2000	13.7%
		2001	12.2%
		2002	12.4%
		2003	16.5%
		2004	14.8%
		2005	13.1%
		2006	14.1%
		2007	14.1%
Cooper Industries LTD.	Implement ILO standards and third-party monitoring	2005	8.6%
		2006	6.8%
		2007	12.4%
Crane Co.	Implement MacBride principles	2002	12.9%
		2003	8.4%
		2004	11.6%
		2006	13.4%
		2007	12.1%

Company	Subject Matter of Proposal	Meeting Date	Votes For
Dow Jones & Co., Inc.	Independent board chairman	2003	4.9%
		2004	12.9%
		2005	19.2%
		2006	22.2%
		2007	12.1%
E.I. Du Pont De Nemours & Co.	Implement ILO standards	2001	8.3%
		2002	6.5%
		2004	13.1%
E.I. Du Pont De Nemours & Co.	Report on steps to break "glass ceiling"	2000	8.4%
		2001	8.5%
		2002	20.4%
		2003	5.8%
E.I. Du Pont De Nemours & Co.	Link executive pay to social criteria	2004	11.8%
		2005	8.6%
		2006	8.6%
E.I. Du Pont De Nemours & Co.	Report on gene-engineered plants	2005	6.1%
		2006	7.2%
		2007	7.0%
Emerson Electric Co.	Adopt sexual orientation anti-bias policy	2001	12.8%
		2002	10.6%
		2003	10.1%
		2005	38.9%
Exxon Mobil Corp.	Affirm political nonpartisanship	2003	7.0%
		2004	7.3%
		2005	7.2%
Exxon Mobil Corp.	Develop renewable energy alternatives	2000	6.2%
		2001	8.9%
		2002	20.2%
		2003	21.3%

Company	Subject Matter of Proposal	Meeting Date	Votes For
Exxon Mobil Corp.	Adopt sexual orientation anti-bias policy	1999	5.9%
		2000	8.3%
		2001	13.0%
		2002	23.9%
		2003	27.3%
		2004	28.9%
		2005	29.5%
		2006	34.6%
		2007	37.7%
Ford Motor Co.	Disclose executive officers entitled to receive in excess of $500,000 annually and their compensation	1997	7.7%
		2003	10.3%
		2004	10.5%
		2005	10.0%
		2006	9.4%
		2007	9.8%
Ford Motor Co.	Investigate family/company relationships	2001	15.8%
		2002	16.7%
		2003	18.9%
		2004	16.2%
		2005	18.3%
General Electric Co.	Disclose costs of PCB cleanup delay	2000	9.0%
		2001	10.6%
		2002	21.7%
		2003	25.6%
		2004	12.7%
		2005	27.5%
General Electric Co.	Independent board chairman	2003	10.6%
		2004	18.6%
		2006	15.0%
General Electric Co.	Limit number of directorships	2004	23.6%
		2005	28.1%
		2006	33.8%

Company	Subject Matter of Proposal	Meeting Date	Votes For
General Electric Co.	Report on political donations and policy	2000	7.4%
		2004	9.9%
		2005	10.5%
General Electric Co.	Report on waste storage at nuclear plant	2003	7.1%
		2004	7.2%
		2005	7.7%
General Electric Co.	Adopt cumulative voting	1999	22.9%
		2000	22.4%
		2001	30.5%
		2002	25.3%
		2003	16.6%
		2004	21.0%
		2005	19.7%
		2006	22.3%
		2007	32.4%
General Motors Corp.	Abolish stock options	2004	6.1%
		2005	9.0%
		2006	6.5%
General Motors Corp.	Golden parachutes	2001	19.6%
		2004	23.9%
		2005	16.2%
General Motors Corp.	Increase key committee independence	2001	13.5%
		2002	24.6%
		2003	10.9%
		2004	11.1%
General Motors Corp.	Independent board chairman	1996	14.7%
		1997	7.0%
		2003	8.2%
		2004	13.6%
		2006	18.5%

Company	Subject Matter of Proposal	Meeting Date	Votes For
General Motors Corp.	Report on/reduce greenhouse gas emissions	2003	6.2%
		2004	7.0%
		2005	5.6%
Hasbro, Inc.	Implement ILO standards and third-party monitor	2002	6.9%
		2003	12.6%
		2004	10.1%
		2005	10.2%
		2006	9.8%
Hewlett-Packard Co.	Adopt code of conduct for China operations	2001	8.1%
		2002	7.9%
		2003	8.0%
The Home Depot, Inc.	Affirm political nonpartisanship	2005	9.5%
		2006	12%
		2007	10.5%
The Home Depot, Inc.	Implement ILO standards and third-party monitor	2001	10.4%
		2002	7.7%
		2003	8.0%
		2004	9.5%
The Home Depot, Inc.	Report on EEO	1998	14.4%
		1999	11.5%
		2000	10.4%
		2005	30.0%
		2006	35.9%
		2007	25.6%
International Business Machines Corp.	Provide pension choices	2004	14.0%
		2005	13.1%
		2006	13.7%

Company	Subject Matter of Proposal	Meeting Date	Votes For
Loews Corp.	Adopt cumulative voting	1996	27.6%
		1997	27.5%
		2003	32.5%
		2004	24.5%
		2005	25.7%
		2006	26.8%
		2007	16.2%
Loews Corp.	Issue warnings on secondhand tobacco smoke	2002	4.0%
		2003	13.7%
		2004	13.1%
Lowe's Companies, Inc.	Implement ILO standards and third-party monitor	2001	8.8%
		2002	6.1%
		2003	6.7%
Marriott International, Inc.	Adopt cumulative voting	1997	19.8%
		1998	14.7%
		1999	17.5%
		2000	14.2%
		2001	18.1%
		2002	18.7%
		2003	27.2%
		2004	28.8%
Mattel, Inc.	Report on implementation of global principles	1999	5.0%
		2000	16.4%
		2001	8.1%
		2005	7.6%
		2006	6.7%
		2007	7.4%
Merck & Co., Inc.	Abolish stock options	2004	7.2%
		2005	9.8%
		2006	4.4%

Company	Subject Matter of Proposal	Meeting Date	Votes For
Milacron Inc.	Restrict executive compensation	2001	13.5%
		2002	19.3%
		2003	34.3%
		2004	8.1%
Monsanto Co.	Report on gene-engineered plants	2003	5.9%
		2004	7.5%
		2005	7.6%
Monsanto Co.	Report on pesticides banned in U.S.	2003	13.3%
		2004	13.1%
		2005	13.3%
National Fuel Gas Co.	Take steps to eliminate workplace discrimination	2000	6.4%
		2002	7.5%
		2003	7.0%
Pacific Gas and Electric Co.	Take steps against nuclear accident risk	2002	8.4%
		2003	7.5%
		2004	10.8%
		2005	3.9%
PepsiCo, Inc.	Disclose political contributions in newspapers	2004	4.6%
		2005	8.1%
		2006	3.3%
Pfizer Inc.	Report on drug price restraint efforts	2004	5.0%
		2005	11.1%
		2006	7.0%
Pfizer Inc.	Report on political donations and policy	2004	10.9%
		2005	13.6%
		2006	10.3%
Raytheon Co.	Report on foreign offset agreements	2001	5.9%
		2002	8.2%
		2003	6.8%

Company	Subject Matter of Proposal	Meeting Date	Votes For
Raytheon Co.	Implement MacBride principles	2002	13.1%
		2003	10.3%
		2004	10.1%
		2005	9.8%
Ruby Tuesday Inc.	Report on gene-engineered food	2002	6.3%
		2003	12.1%
		2004	11.6%
		2005	10.6%
Safeway Inc.	Adopt cumulative voting	1997	18.6%
		1998	38.7%
		1999	38.2%
		2000	37.0%
		2001	32.3%
		2004	30.0%
		2005	27.1%
		2006	32.9%
		2007	36.9%
Safeway Inc.	Independent board chairman	2004	33.4%
		2005	20.1%
		2007	13.8%
Stericycle, Inc.	Phase out waste incineration	2004	11.2%
		2005	8.4%
		2006	6.5%
Teletech Holdings, Inc.	Implement MacBride principles	2003	3.5%
		2004	6.1%
		2005	4.9%
Textron Inc.	Report on foreign offset agreements	2002	8.8%
		2003	10.1%
		2004	11.7%

Company	Subject Matter of Proposal	Meeting Date	Votes For
The TJX Companies, Inc.	Implement ILO standards and third-party monitor	2002	6.5%
		2004	10.5%
		2005	8.6%
The TJX Companies, Inc.	Implement MacBride principles	1999	10.1%
		2000	15.9%
		2001	16.4%
		2002	19.2%
		2003	9.3%
Union Pacific Corp.	Independent board chairman	2001	21.4%
		2002	28.3%
		2006	35.6%
United Western BanCorp, Inc	Repeal classified board	2005	23.5%
		2006	28.9%
		2007	13.0%
Verizon Communications Inc.	Increase board independence	2001	30.0%
		2002	27.2%
		2003	22.6%
		2004	20.2%
		2005	24.6%
		2006	24.9%
Verizon Communications Inc.	Report on political donations and policy	2004	15.8%
		2005	15.0%
		2006	33.0%
Visteon Corp.	Review/report on global standards	2002	5.6%
		2003	11.2%
		2004	16.7%
Wal-Mart Stores, Inc.	Issue sustainability report	2004	14.2%
		2005	16.2%
		2006	10.5%

Company	Subject Matter of Proposal	Meeting Date	Votes For
Wal-Mart Stores, Inc.	Report on EEO	2002	11.3%
		2003	13.0%
		2004	16.1%
		2005	18.8%
Wal-Mart Stores, Inc.	Report on stock options by race/sex	2004	13.6%
		2005	15.0%
		2006	10.2%
		2007	10.9%
The Walt Disney Co.	Adopt code of conduct for China operations	2002	6.6%
		2003	9.4%
		2004	8.3%
The Walt Disney Co.	Report on amusement park safety policy	2002	5.3%
		2003	8.6%
		2004	10.5%
The Walt Disney Co.	Review labor standards in China operations	2004	29.0%
		2005	8.9%
		2006	9.1%
Yum Brands Inc.	Issue sustainability report	2003	39.0%
		2004	32.9%
		2005	39.1%
Yum Brands Inc.	Make facilities smoke-free	2002	15.4%
		2003	6.7%
		2004	7.6%
Yum Brands Inc.	Review animal welfare standards	2004	8.0%
		2005	8.8%
		2006	7.3%
Yum Brands Inc.	Urge MacBride on franchisees	2003	12.1%
		2004	13.4%
		2005	14.7%
		2006	10.6%

Testimony of

Jeff Mahoney

General Counsel

Council of Institutional Investors

before the

Committee on Banking, Housing, and Urban Affairs

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Prepared Statement

Chairman Reed, Ranking Member Shelby, and Members of the Committee:

Good morning. I am Jeff Mahoney, General Counsel, of the Council of Institutional Investors, an association of more than 130 public, labor and corporate employee benefit plans with assets exceeding $3 trillion. I appreciate the opportunity to appear before you today on behalf of the Council. I respectfully request that the full text of my statement and all supporting materials be entered into the public record.

Members of the Council are responsible for safeguarding assets used to fund the retirement benefits of millions of Americans throughout the US. Our members have a significant commitment to the US capital markets, with the average Council member investing about 75 percent of its portfolio in stocks and bonds of US public companies. And they are long-term, patient investors due to their heavy commitment to passive investment strategies. As a result, US corporate governance issues are of great interest to our members.

A key issue at today's hearing is whether shareowners should continue to have the right to file resolutions requiring or encouraging companies to adopt processes for including shareowner-suggested director candidates on companies' proxy cards.

In our opinion, directors are the cornerstone of the US corporate governance model, and the primary role of shareowners is electing and removing directors. Thus, we believe shareowners should continue to have the ability to file proxy access resolutions and the marketplace at large should have the opportunity to vote on whether those resolutions are in the best interests of the targeted companies and their owners.

Chairman Cox has repeatedly suggested that the SEC must adopt a final rule prior to the 2008 proxy season that eliminates existing shareowner rights to file access resolutions. Chairman Cox has argued that such action is necessary to protect investors from (1) legal uncertainty and (2) inadequate disclosures. The Council believes that Chairman Cox's arguments on this issue are less than convincing.

More specifically, in response to Chairman Cox's concern about legal uncertainty, we note that the Second Circuit Court of Appeals 2006 decision in *AIG* clearly and unanimously set forth the law relating to shareowner resolutions that establish procedural rules governing director elections. In *AIG*, the Second Circuit held that those resolutions can not be omitted from companies' proxy cards.

Thus, under current law, any public company that would omit an access resolution from their proxy card during the 2008 proxy season would be acting with the knowledge that they may be violating the federal securities laws. Those companies would face the risk of litigation whether they were subject to the jurisdiction of the Second Circuit or any other Circuit.

We also note that we have already gone through one proxy season with the *AIG* decision in place and the great legal uncertainty that Chairman Cox apparently fears never materialized. In fact, there were only three access resolutions during the 2007 proxy season. And I would add that all of those resolutions received significant shareowner support; in one case a majority. We expect that the 2008 proxy season will yield similar results with only a handful of companies receiving access resolutions.

In response to Chairman Cox's second concern about inadequate disclosures, we note that the three access resolutions brought during the 2007 proxy season would have fully complied with existing SEC disclosure requirements. In addition, Council members, and we believe most other investors, would oppose proxy access resolutions that fail to provide adequate disclosures about the proposing shareowners.

If, as Chairman Cox suggests, adopting the SEC's non-access proposal prior to the 2008 proxy season is critical to ensuring adequate disclosures for investors; you have ask why is it that that proposal does not discuss in any detail, or solicit any comments on, the disclosure issue. We agree with SEC Commissioner Annette L. Nazareth's analysis on this point. She recently stated:

> If the problem is one of disclosure—and clearly fulsome disclosure concerning the proposing shareholders is appropriate—the solution is to address the disclosure directly, not to eliminate this bylaw avenue altogether.

Notwithstanding the Council's strong opposition to the SEC's current proposals, we stand ready to work cooperatively with Chairman Cox and the Commission, this Committee, my fellow panelists, and other interested parties to develop meaningful proxy access reforms that will best serve the needs of investors, companies, and the US capital markets.

Thank you, Mr. Chairman for inviting me to participate at this hearing. I look forward to the opportunity to respond to any questions.

Testimony of
Jeff Mahoney
General Counsel
Council of Institutional Investors
before the
Committee on Banking, Housing, and Urban Affairs
November 14, 2007

Full Text of Statement

Chairman Reed, Ranking Member Shelby, and Members of the Subcommittee:

Good morning. I am Jeff Mahoney, General Counsel, of the Council of Institutional Investors ("Council"). I am pleased to appear before you today on behalf of the Council.

My testimony includes a brief overview of the Council followed by a discussion of our views on several of the more significant issues raised by the United States ("US") Securities and Exchange Commission's ("SEC" or "Commission") August 3, 2007: (1) amendments to the rules under the Securities Exchange Act of 1934 ("34 Act") concerning shareholder resolutions and electronic shareowner communications, as well as to the disclosure requirements of Schedule 14A and Schedule 13G ("Amendments");[1] and (2) the interpretative and proposing release to clarify the meaning of the exclusion for shareowner resolutions relating to the election of directors that is contained in Rule 14a-8(i)(8) under the 34 Act ("Release")[2] (Amendments and Release collectively, the "Proposals"). Finally, my testimony concludes with a discussion of the Council's views on whether the Commission should adopt the Release as a final rule prior to the 2008 proxy season in order to protect investors.

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[1] Shareholder Proposals, Exchange Act Release No. 56,160, Investment Company Act Release No. 27,913, 72 Fed. Reg. 43,466 (proposed Aug. 3, 2007) ("Amendments"), *available at* http://www.sec.gov/rules/proposed/2007/34-56160fr.pdf.

[2] Shareholder Proposals Relating to the Election of Directors, Exchange Act Release No. 56,161, Investment Company Act Release No. 27,914, 72 Fed. Reg. 43,488 (Proposed Aug. 3, 2007) ("Release"), *available at* http://www.sec.gov/rules/proposed/2007/34-56161fr.pdf.

The Council

The Council is a nonpartisan, not-for-profit association of more than 130 public, labor and corporate pension funds with assets exceeding $3 trillion. [3] Council members are responsible for investing and safeguarding assets used to fund the pension benefits of millions of participants and beneficiaries throughout the US. Since the average Council member invests approximately seventy (70) percent of its entire pension portfolio in US stocks and bonds,[4] issues relating to US corporate governance are of great interest to our members.

Council Corporate Governance Policies[5]

An important part of the Council's activities involves the development of corporate governance policies. The policies set standards or recommended practices that the Council members believe companies and boards of directors should adopt. They are a living document that is constantly reviewed and updated.

The Council's policies neither bind members nor corporations. They are designed to provide guidelines that the Council has found to be appropriate in most situations.

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[3] *See infra* Attachment 1 for a listing of the general members of the Council of Institutional Investors ("Council").
[4] *See* Council, *Pension Fund Performance Survey 2004*, 2 (Aug. 23, 2004).
[5] *See infra* Attachment 2 for Council's corporate governance policies.

Council staff uses the policies to determine whether and how the Council can respond to certain issues, including regulations proposed by the SEC, accounting standards proposed by the standards setting bodies, and actions taken by publicly traded companies. Council policies also have been used to decide whether the Council should file an *amicus* brief in a lawsuit or help fund litigation. Council staff may without additional approval, take action on an issue that falls within its policies realm and also within budgetary limits, although oversight of those actions by the Council's board is common.

The nine non-officers on the Council's board of directors serve as the policies committee and suggest subjects for policies, review staff policy drafts and decide which policies should be submitted to the full board.[6] All general members of the Council are invited to submit ideas for policies to Council staff or Council directors.

The full board votes on whether to approve a proposed policy. Once approved by the board, the policy is either subject to a vote by the full membership at the next meeting or by mail ballot if the board believes time is of the essence.

[6] *See infra* Attachment 3 for a list of the Council's board of directors.

Council Responses to the Proposals[7]

The Council's corporate governance policies have long stated that "shareowners should have . . . meaningful opportunities to suggest or nominate director candidates and to suggest processes and criteria for director selection and evaluation."[8] We believe that far too many director elections, however, remain a done deal, regardless of how troubled a company may be. As a result, the only way that individual director nominees may be effectively challenged at some companies is if a shareowner is willing and able to assume the risk and expense of nominating a slate of candidates and running a full-blown election contest. Such ventures are onerous and cost-prohibitive—even in today's world of e-proxy.

The Council, therefore, strongly supports reforms that would permit meaningful shareowner access to company-prepared proxy materials relating to the nomination and election of directors. We believe such reforms would make boards more responsive to shareowners, more thoughtful about whom they nominate to serve as directors and more vigilant in their oversight of companies.

The Council has to-date submitted four letters to the SEC providing the Council's views in response to the Proposals.[9] The Council's two most recent letters, dated September 18, 2007, were presented to the Council's general members for a vote at a meeting on September 18, 2007, and were unanimously approved by the general members at that meeting.[10]

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[7] *See infra* Attachment 4 for the Council's responses to the Proposals.
[8] *See infra* Attachment 2, Part I.
[9] *See infra* Attachment 4.
[10] *Id.* at 9-27.

The following are the Council's views on several of the more significant issues raised by the Proposals:

Does the shareholder proposal process need to be changed?

The Council does not believe that the shareholder proposal process needs to be dramatically changed as proposed in the Amendments. On balance, Council members believe the existing federal securities laws and proxy rules generally work quite well with respect to the shareowner proposal process.

According to data provided by Institutional Shareholder Services ("ISS"), over the past three years, Council members have filed approximately forty-six (46) percent of all corporate governance-related shareowner proposals submitted to US companies.[11] The ability to file shareowner proposals is particularly important to Council members and many other long-term investors who—due to their commitment to passive investment strategies—are unable to exercise the "Wall Street walk" and simply sell their shares when they are dissatisfied. Shareowner proposals provide long-term investors the opportunity to present their concerns to management and the board of directors, to communicate with other shareowners, to encourage reforms, and to improve performance.

[11] According to Institutional Shareholder Services ("ISS"), at least 158 separate proponents were responsible for submitting the 688 governance-related shareowner proposals that were filed for the 2006 proxy season at companies in the United States ("US"). Approximately 280 of the 688 resolutions (40.7%) were filed by Council members.

Those Council members who file shareowner resolutions are generally comfortable with the existing federal securities laws and proxy rules, including the thirteen substantive bases for excluding shareowner proposals contained in 34 Act Rule 14a-8.[12] Those exclusions do not prevent Council members from submitting proposals on most of the best practices contained in the Council's corporate governance policies.[13] Council members also appreciate the professionalism and dedication of the SEC staff in handling the related no-action process.

While there is debate from time to time about the scope of the thirteen exclusions in Rule 14a-8, there is little debate about the wisdom of the overall regulatory model that gives shareowners notice as to matters that will come before the meeting without requiring a company to print proposals that violate state law or satisfy one of the other general categories of exclusions. This is a tradeoff that most shareowners find more than acceptable, particularly when the Rule creates a single unified set of standards for all companies. It is difficult to imagine how things would work and how Council members, other shareowners, and the long-term performance of companies and the capital markets would benefit if the Commission were to permit the significantly more complex, less uniform procedures for binding and non-binding proposals suggested by the Amendments.

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[12] Shareholder Proposals, 17 C.F.R 240.14a-8(i) (Jan. 29, 2007), *available at* http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=4fd16addf3b7e8add81721d908e2b4c6&rgn=div8&view=text&node=17:3.0.1.1.1.2.78.199&idno=17.

[13] *See Infra* Attachment 2.

We, however, believe there may be some merit to the Commission reconsidering a potential change to Rule 14a-8 first suggested in a 1997 SEC Proposed Rule.[14] That Proposed Rule provided an "Override Mechanism" requiring a company to include any resolution put forth by shareowners of at least three (3) percent of the company's outstanding voting shares even if the resolution could have been excluded under Rule 14a-8(i)(5)(Relevance) or (i)(7)(Management Functions).[15] As described by the SEC, such a potential change has some appeal because it

> would broaden the spectrum of proposals that may be included in companies' proxy materials where a certain percentage of the shareholder body believes that all shareholders should have an opportunity to express a view on the proposal . . . [and] provide shareholders an opportunity to decide for themselves which proposals are sufficiently important and relevant to all shareholders - - and, therefore, to the company - - to merit space in the company's proxy materials.[16]

[14] Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 39,093, Investment Company Act Release No. 22,828, at 16-20 (proposed Sept. 18, 1997), *available at* http://www.sec.gov/rules/proposed/34-39093.htm.
[15] *Id.* at 16.
[16] *Id.*

Should there be restrictions on the types of shareholder proposals that must be included on a management proxy? Does it make a difference if the proposal is binding or non-binding?

As indicated in response to the previous issue, the Council generally supports the restrictions contained in the existing federal proxy rules that govern binding and non-binding shareowner proposals submitted for inclusion on a management proxy. We do not believe that Council members, other shareowners, and the long-term performance of companies and the capital markets would benefit if the Commission were to permit the significantly more complex, less uniform procedures for binding or non-binding proposals suggested by the Amendments.

Should shareholders be allowed to include matters related to director nominations on a management proxy? Does it make a difference if the proposal is a bylaw amendment regarding nomination process, rather than a director nominee or nominees?

The Council believes that shareowners should be allowed to include matters related to the process for director nominations on a management proxy. As previously indicated, the Council's corporate governance policies have long stated that shareowners should have meaningful opportunities to put forward or nominate director candidates and to suggest processes and criteria for director selection and evaluation.

The Council's support for meaningful proxy access is shared by an impressive number of shareowners. During the 2007 proxy season, three proxy access shareowner resolutions were presented for a vote and all received significant support.

One resolution was approved by the shareowners (Cryo-Cell International, Inc.).[17] According to ISS, the other two resolutions received 45.25 percent (UnitedHealth Group Incorporated ("UnitedHealth")) and 42.95 percent (Hewlett-Packard Company) of the vote, respectively. Those shareowners generally agree with the Council that meaningful proxy access reforms would make boards more thoughtful about whom they nominate, more responsive to shareowners' concerns, and more vigilant in their oversight of companies.

The Council also believes that that companies and shareowners would generally agree that a bylaw amendment regarding the nomination process is very different from running a candidate or candidates for the board of directors. The former simply allows owners to vote on a proposed bylaw provision regarding the procedures by which a board election may be conducted. The latter, however, seeks to replace one or more directors in a specific election—a very significant step given the fact that the board of directors is the centerpiece of the US corporate governance model.

[17] Press Release, Cryo-Cell International Inc., Cryo-Cell Announces Certified Results of Annual Shareholders Meeting (Aug. 1, 2007), *available at* http://www.cryo-cell.com/investor_relations/subpage_noad.asp?ID=204.

Consistent with the Council's view, the SEC Staff has acknowledged a distinction under the federal proxy rules between a shareowner resolution about board of director nomination procedures and a shareowner resolution about a specific election of directors.[18] Under Rule 14a-8(i)(8), the SEC staff has long issued "no-action" letters allowing companies to omit shareowner proposals from their proxy materials that relate to "an election" of directors.[19] In contrast, the SEC staff has frequently (although admittedly, not consistently) denied no-action relief under the Rule with respect to a range of resolutions that would not affect the outcome of a specific election, but that relate to the procedures by which directors are elected.[20]

The Release attempts to reinterpret Rule 14a-8(i)(8) in a way that would eliminate the previously recognized distinction between a shareowner resolution about board of director nomination procedures and a shareowner resolution about a specific election of directors.[21] We strongly oppose the reinterpretation because it would effectively bar shareowners from filing shareowner resolutions about director nomination procedures without providing shareowners an alternative meaningful approach to proxy access.[22]

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[18] *See* Brief for Council as *Amicus Curiae* in support of Plaintiff-Appellant at 15-16, American Federation of State, County & Municipal Employees Pension Plan ("AFSCME") v. American International Group ("AIG"), No. 05-2825 (2nd Cir. Aug. 2005) (on file with Council).
[19] *Id.* at 14.
[20] *Id.* at 15.
[21] Release, 72 Fed. Reg. at 43,490-93.
[22] *See infra* Attachment 4, at 25-27.

Should the proxy rules be changed to exclude non-binding shareholder proposals from management proxies? If there is no such change in the proxy rules, should companies have the ability to "opt-out" of the requirement to include non-binding shareholder proposals on their proxies?

The Council strongly opposes changes to the proxy rules that would exclude non-binding or precatory proposals from management proxies. We would also strongly oppose changes to the proxy rules that would allow companies the ability to "opt-out" of the requirement to include non-binding shareowner proposals on their proxies. As previously indicated, the Council believes that the existing proxy rules generally work quite well with respect to binding and non-binding shareowner proposals.

Also as previously indicated, Council members have filed on average about forty-six (46) percent of all corporate governance-related resolutions submitted to US companies. They have filed shareowner resolutions for many years, and have done so with much success.

For the most part, Council members file non-binding or precatory resolutions. This is consistent with how most resolutions are structured. As indicated in the following chart, according to data provided by ISS, the vast majority of all shareowner resolutions over the last four years (more than ninety-six (96) percent) have been precatory:

	2004	2005	2006	2007
Governance Proposals (# filed)	751	731	690	823
Binding Proposals (# filed)	17	15	19	31
Binding Proposals (# voted)	8	6	13	11*
Percentage (filed)	2.3%	2.1%	2.8%	3.8%

* According to data obtained from ISS on September 10, 2007, vote tallies are currently available on 11 of the 14 binding shareowner proposals that are or will be included on company ballots.

Council members and other shareowners file precatory resolutions for a number of reasons, but perhaps the most important one is that they have been an extremely effective tool for having a dialogue with management about important corporate governance issues.[23] Precatory proposals give the marketplace at large the opportunity to weigh in on an issue and communicate the broader market views to directors and management.

[23] *See, e.g.,* Edward Iwata, *Boardrooms open up to investors' input*, USA Today, Sept. 6, 2007, at 1, *available at* http://www.usatoday.com/money/companies/management/2007-09-06-shareholders-fight_N.htm (shareowner resolutions have resulted in a "new willingness by companies to discuss boardroom topics" with shareowners). Also of note, many Council members have obligations under the Employee Retirement Income Security Act of 1974 ("ERISA") to manage fund assets in accordance with U.S. Department of Labor ("DOL") directives. The DOL has issued interpretative bulletins relating to ERISA that effectively approve pension funds' use of shareowner resolutions as a means of communicating with portfolio companies. *See* Pension and Welfare Benefits Administration, U.S. Dept. of Labor, Interpretative Bulletin No. 94-2, Relating to ERISA 329 (July 29, 1994); *available at* http://a257.g.akamaitech.net/7/257/2422/14mar20010800/edocket.access.gpo.gov/cfr_2002/julqtr/29cfr2509.94-2.htm.

Precatory resolutions have contributed to some very significant governance reforms in recent years, including: majority voting standards for directors; expensing of stock options; and virtually ending classified boards.[24] There are many reasons why precatory proposals have been so effective. One is that they are used by proponents to promote communication rather than to force change.

Many view a precatory proposal as a "door knocker." From our perspective, a precatory proposal is an invitation to a conversation with management that, if successful, could lead to a dialogue on the subject; if not successful, the matter may be raised with shareowners as a group at the annual meeting.

In contrast, in light of their highly prescriptive nature, binding proposals are often viewed as more of a "hammer." Hammers tend to put people on the defensive. That has been the experience of Council members, who have generally found that non-binding proposals tend to lead to more meaningful dialogue with companies. Dialogue is very important for Council members, since they withdraw about a third (1/3) of the resolutions they file following discussions with companies.[25]

Precatory proposals can be useful for another reason as well. Namely, they provide the board with general guidance as to shareowner wishes at a policy level, while leaving questions of implementation and the like to management.

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[24] *See, e.g.,* Patrick McGurn, *Proxy Season 007: Shaken and Stirred,* 33 Directorship 6, at 6-8 (2007) (Commenting on the 2007 proxy season and proposals relating to majority voting and classified boards).
[25] According to ISS, 28.9% of shareowner proposals filed by Council members for the 2006 proxy season were withdrawn.

For example, shareowner resolutions dealing with executive "golden parachutes" are very popular among shareowners and regularly command a majority of the shareowner votes. However, it is very difficult in only 500 words to craft a bylaw on severance packages in the kind of detail that is appropriate for an individual company. The ability of shareowners to submit a precatory proposal, while leaving it up to the board to craft an appropriate bylaw reflecting the approved policy, is often an effective means to improving corporate governance and maximizing shareowner value.

Of note, in a 1982 proposed rulemaking the Commission considered, among several alternatives to Rule 14a-8, whether to permit companies and their security holders to adopt their own procedures "as to what proposals should be included in the . . . proxy statement . . . ."[26] There was significant opposition to that proposal.[27]

The Commission rejected the proposal citing those commentators who had concluded that permitting companies and their security holders to adopt their own procedures governing access to the company's proxy statement

> [w]ould create serious problems of administration as there would be no uniformity or consistency in determining the inclusion of security holder proposals. Exacerbating the problem generated by provisions individual to each issuer would be the effect of the fifty state judicial systems administering the process.[28]

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[26] Proposed Amendments to Rule 14a-8 Under the Securities Exchange Act of 1934 Relating to Proposals by Security Holders, Exchange Act Release No. 19,135, Public Utility Holding Company Act Release No. 22,666, Investment Company Act Release No. 12,734, at 5 (proposed Oct. 14, 1982), *available at* http://content.lawyerlinks.com/default.htm/library/sec/sec_releases/34-19135.htm.
[27] Amendments to Rule 14a-8 Under the Securities Exchange Act of 1934 Relating to Proposals by Security Holders, Exchange Act Release No. 20,091, at 3 (Aug. 16, 1983), *available at* http://content.lawyerlinks.com/default.htm/library/sec/sec_releases/34-20091.htm.
[28] *Id.*

We believe that that conclusion is as valid today as it was in 1983.[29]

Is the proposed 5% ownership threshold reasonable? If not, why not? Should there be other limits on shareholder access to management proxies, such as holding periods or dollar thresholds?

We believe that the more than five (5) percent ownership threshold is too high a barrier for shareowners submitting resolutions. While institutional investors may collectively own more than sixty (60) percent of outstanding US equities, approximately one-half (1/2) of those shares are held by mutual funds and insurance companies.[30] Those institutional investors generally do not sponsor shareowner resolutions, including those they support.

[29] Of note, the Amendments fail to address why the concerns about "administration" that appear to have been the basis for rejecting the alternative approach to Rule 14a-8 in 1982 would not be a "serious problem" if, as suggested in the Amendments, the proxy rules were revised to permit companies the ability to "opt-out" of the requirement to include non-binding shareowner proposals on their proxies. Amendments, 72 Fed. Reg. at 43,478 (Instead discussing "developments in the last 25 years that may have diminished the concerns about shareholders' ability to act as a group . . . .").

[30] *See, e.g.,* The Conference Board, Institutional Investment Report 29 (2007) (Indicating that investment companies and insurance companies hold 22.8% and 7.4%, respectively, of the total US equity market).

Public and union pension funds that currently engage portfolio companies using tools such as shareowner resolutions account for less than ten (10) percent of the total US equity market.[31] As a result of those funds' obligations to diversify their portfolios and manage risk, the level of holdings that those funds may have in any single company is relatively small. For example, one of the Council's largest members—The California State Teachers' Retirement System ($149,008 million in total assets)[32]—generally owns only about 0.3 percent of the outstanding stock of any company in the Russell 3000.[33]

The ability to aggregate individual pension funds for a shareowner resolution is a difficult exercise. For example, earlier this year the Council's largest member—the California Public Employees' Retirement System ("CalPERS") ($218,214 million in total assets)[34]—tried without success to find co-sponsors for its proxy access resolution at UnitedHealth. CalPERS, with approximately 0.5 percent of the company's outstanding shares, ended up as the sole sponsor.[35] Even so, as indicated, the resolution garnered more than 45.25 percent of the shares cast for-and-against—a high rate of shareowner support for a first-time resolution.

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[31] *Id.* (Indicating that state and local pension funds hold 9.8% of the total US equity market).
[32] *Special Report—World's Largest Pension Funds*, Pensions and Investments, Sept. 3, 2007, at 15.
[33] E-mail from Christopher J. Ailman, Chief Investment Officer, CalSTRS, to Justin Levis, Senior Analyst, Council (Sept. 7, 2007, 3:09 PM EST) (On file with Council). Similarly, Council member—The Florida State Board of Administration—typically owns only about 0.33% of the outstanding stock of any company in the Russell 3000. E-mail from Tracy Stewart, Corporate Governance Manager, Florida State Board of Administration, to Justin Levis, Senior Analyst, Council (Sept. 7, 2007, 5:55 PM EST) (On file with Council).
[34] *Special Report—World's Largest Pension Funds*, at 15.
[35] *See* UnitedHealth Group Incorporated, Proxy Statement for Annual Meeting of Shareholders to Be Held May 29, 2007 (Schedule 14A), at 100 (Apr. 30, 2007), *available at* http://www.unitedhealthgroup.com/invest/2007/Proxy_Stmt_2007.pdf.

Our research indicates that even if CalPERS and nine (9) of the other largest public pension funds were to successfully aggregate their holdings of a single public company's securities, those funds combined would likely be unable to clear the more than five (5) percent hurdle. Moreover, the more than five (5) percent threshold would likely be too high a barrier regardless of whether the funds' aggregate holdings are in a large-cap, mid-cap or small-cap company. For example, based on information compiled from FactSet Research Systems, Inc., if the ten (10) largest public pension fund holders of Exxon Mobil Corporation (a large-cap stock), Precision Castparts Corp. (a mid-cap stock), and The Manitowoc Company, Inc. (a small-cap stock) were to aggregate their ownership interests, the resulting percentage holdings for those groups would be approximately 3.01, 3.59, and 3.56, respectively.

Thus, many more funds and other investors would need to collaborate to hit the more than five percent threshold in most circumstances. As indicated, given the small number of investors that traditionally sponsor shareowner resolutions, it is currently difficult to imagine how a sufficiently large coalition could be established.[36]

[36] In Congressional testimony, US Securities and Exchange Commission ("SEC") Chairman Christopher Cox, in response to a question from Committee on Banking, Housing, and Urban Affairs Chairman Christopher J. Dodd, appeared to concede that the more than five percent threshold would be difficult for investors to meet. *The State of the Securities Markets Before the Comm. on Banking, Housing, and Urban Affairs,* 110th Cong. 48 (Jul. 31, 2007) (Draft of hearing transcript). More specifically, Chairman Cox suggested that the proposed amendment to facilitate the use of electronic shareowner forums "would be a way to put together a 5 percent group that does not exist today." *Id.*

The Council has not established any policies regarding whether the federal proxies rules should be changed to provide additional or alternative limits on shareowner access to management proxies. The Council, however, stands ready to work with the Commission to develop meaningful proxy access reforms that include appropriate limits on shareowner access.

Should the Commission adopt the Release as a final rule prior to the 2008 proxy season in order to protect investors?

SEC Chairman Christopher Cox has repeatedly indicated that he intends to have some form of the Release adopted as a final rule in time for the 2008 proxy season.[37] He has suggested that if such a rule is not put in place, investors will be left unprotected from (1) legal uncertainty and (2) inadequate disclosures.[38]

As indicated, the Council strongly opposes the adoption of the Release.[39] Moreover, we believe that there is simply no merit to Chairman Cox's suggestion that investors will somehow be unprotected if the Release is not adopted in time for the next proxy season.

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[37] *See, e.g.*, Judith Burns, *SEC's Cox: Need Clarity on Proxy Access for 2008,* Dow Jones NewsWires, Nov. 2, 2007, at 1, *available at* http://www.easybourse.com/Website/dynamic/News.php?NewsID=331565&lang=fra&NewsRubrique=2 .

[38] *Id.*

[39] *See infra* Attachment 4, at 25-27.

Legal Uncertainty

More specifically, in response to Chairman Cox's concerns about legal uncertainty, we note that the Second Circuit Court of Appeals 2006 decision in *American Federation of State, County and Municipal Employees Pension Plan v. American International Group* ("*AIG*") clearly and unanimously set forth the law relating to shareowner resolutions that would establish procedural rules governing director elections generally.[40] In *AIG*, the Second Circuit held that those resolutions can not be omitted from the proxy under the "election exclusion" of Rule 14a-8(i)(8).[41]

Thus, any public company that omits a proxy access resolution during the 2008 proxy season is acting with awareness that it may be violating the federal securities laws. Those companies would knowingly face the risk of litigation, whether within the Second Circuit or any other jurisdiction.

[40] *AFSCME v. AIG*, 462 F.3d 121, 129-130 (2d Cir. 2006).
[41] *Id.*

We also note that we have already gone through one proxy season with the *AIG* decision in place and the "great uncertainty across the nation"[42] that Chairman Cox apparently still fears never materialized.[43] As indicated, there were only three proxy access resolutions during the 2007 proxy season: (1) Cryo-Cell International, Inc. (received majority support); (2) UnitedHealth (received 45.3% support); and (3) Hewlett-Packard Company (received 43% support).[44] Similarly, we expect that during the 2008 proxy season, at most, only a handful of companies will receive proxy access resolutions.

Inadequate Disclosures

In response to Chairman Cox's concerns about inadequate disclosures, we note that the three proxy access resolutions brought during the 2007 proxy season, and those brought in earlier proxy seasons pre-dating the *AIG* decision, would have complied with the existing SEC disclosure requirements concerning the proposing shareowners. Certainly the Council, and most investors, would not support proxy access resolutions that do not provide adequate disclosures.

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[42] *See* Letter from John W. White, Director, Division of Corporation Finance, SEC, to Jeff Mahoney, General Counsel, Council (Oct. 1, 2007).
[43] Annette L. Nazareth, Commissioner, SEC, Remarks Before the International Corporate Governance Network 6 (Oct. 29, 2007), *available at* http://sec.gov/news/speech/2007/spch102907aln.htm.
[44] *See infra* Attachment 4, at 26.

It is surprising that Chairman Cox appears to believe that adopting the Release is critical to ensuring adequate disclosures for investors when the Release does not even address in any detail, or even solicit comments on, the issue.[45] We agree with the analysis of SEC Commissioner Annette L. Nazareth who recently commented on this point stating:

> If the problem is one of disclosure—and clearly fulsome disclosure concerning the proposing shareholders is appropriate—the solution is to address the disclosure directly, not to eliminate this bylaw avenue altogether.[46]

Notwithstanding the Council's strong opposition to the SEC's current proposals, we stand ready to work cooperatively with Chairman Cox and the Commission, this Committee, my fellow panelists, and other interested parties to develop meaningful proxy access reforms that will best serve the needs of investors, companies, and the US capital markets.

Thank you, Mr. Chairman for inviting me to participate at this hearing. I look forward to the opportunity to respond to any questions.

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[45] Release, 72 Fed. Reg. at 43,488-96.
[46] Nazareth, at 5.

Testimony of
Jeff Mahoney
General Counsel
Council of Institutional Investors
before the
Committee on Banking, Housing, and Urban Affairs
November 14, 2007

Attachment 1

Council General Members

Council of Institutional Investors

General Members*

AFL-CIO Pension Plan
AFSCME Employees Pension Plan
Agilent Technologies Benefit Plans
Alameda County Employees' Retirement Association
Alaska Permanent Fund Corporation
Altria Corporate Services Pension Plan
American Federation of Teachers Pension Plan
Arkansas Public Employees Retirement System
Arkansas Teacher Retirement System
Bank of America Pension Plans
BP America
Bricklayers & Trowel Trades Pension Fund
Building Trades Pension Trust Fund-Milwaukee and Vicinity
California Public Employees' Retirement System
California State Teachers' Retirement System
Campbell Soup Retirement & Pension Plans
Carpenters United Brotherhood Local Unions & Councils Pension Fund
Carpenters Pension Fund Chicago District Council
CERES Defined Contribution Retirement Plan
Chevron
CIGNA Pension Fund
Coca-Cola Retirement Plan
Colgate-Palmolive Employees' Retirement Income Plan
Colorado Fire and Police Pension Association
Colorado Public Employees' Retirement Association
Communications Workers of America Pension Fund
Connecticut Retirement Plans and Trust Funds
Contra Costa County Employees' Retirement Association
CWA/ITU Negotiated Pension Plan
Dallas Employees' Retirement Fund
Delaware Public Employees Retirement System
Detroit General Retirement System
Disney (Walt)
District of Columbia Retirement Board
ELCA Board of Pensions
EMC

*General membership in the Council is open to any employee benefit plan, state or local agency officially charged with the investment of plan assets, or non-profit endowment funds and non-profit foundations. General Members participate in all meetings and seminars sponsored by the Council and are the only voting members of the Council. Annual dues are $1.30 per $1 million in fund assets, but no less than $3,000 and no more than $30,000.

Fairfax County Educational Employees' Retirement System
Florida State Board of Administration
Gap
General Mills Retirement Plan
General Motors Investment Management
Hartford Municipal Employees Retirement Fund
Hewlett-Packard
Houston Firefighters' Relief & Retirement Fund
I.A.M. National Pension Fund
IBEW Pension Benefit Fund
Idaho Public Employee Retirement System
Illinois State Board of Investment
Illinois State Universities Retirement System
Illinois Teachers' Retirement System
Iowa Municipal Fire & Police Retirement System
Iowa Public Employees Retirement System
ITT Industries Pension Fund Trust
IUE-CWA Pension Fund
Jacksonville Police and Fire Pension Fund
Jeffrey Company Pension Plan
Johnson & Johnson
Kentucky Retirement Systems
Kern County Employees' Retirement Association
KeyCorp Cash Balance Pension Plan
Laborers' Central Pension Fund
Lens Foundation for Corporate Excellence
LIUNA Local Union & District Council Pension Fund
Los Angeles City Employees' Retirement System
Los Angeles County Employees Retirement Association
Los Angeles Fire and Police Pension System
Los Angeles Water and Power Employees' Retirement Plan
Lucent Technologies Pension Plan
Maine State Retirement System
Marin County Employees' Retirement Association
Maryland, State Retirement Agency
Massachusetts Bay Transportation Authority Retirement Fund
Massachusetts PRIM
McDonald's Employee Benefits Plan
Microsoft
Milwaukee Employees' Retirement System
Minnesota State Board of Investment
Missouri Public School & Non-Teacher School ERS
Missouri State Employees' Retirement System
Montgomery County Employees' Retirement System
Nathan Cummings Foundation
National Education Association Employee Retirement Plan
Navy-Marine Corps Relief Society
New Hampshire Retirement System

New Jersey Division of Investment
New York City Employees' Retirement System

New York City Pension Funds
New York City Board of Education Retirement System
New York City Fire Department Pension Fund
New York City Police Pension Fund
New York City Teachers' Retirement System
New York State and Local Retirement Systems
New York State Teachers' Retirement System
New York Times Company Pension Plan
North Carolina Retirement System
Ohio Police & Fire Pension Fund
Ohio Public Employees Retirement System
Ohio School Employees Retirement System
Ohio State Teachers' Retirement System
Operating Engineers Central Pension Fund
Orange County Employees Retirement System
Pennsylvania Public School Employees' Retirement System
Pennsylvania State Employees' Retirement System
Pfizer
Pitney Bowes Pension Plan
Plumbers & Pipefitters National Pension Fund
Prudential Employee Savings Plan
Sacramento County Employees' Retirement System
San Diego City Employees' Retirement System
San Francisco City & County Employees' Retirement System
San Jose City Retirement Funds
Santa Barbara County Employees' Retirement System
Schering-Plough Employees' Savings Plan
Sealed Air Retirement Plans
SEIU Union Pension Fund
Sheet Metal Workers' Local 19 Pension Plan
Sheet Metal Workers' National Pension Fund
South Carolina Retirement System
Sunoco
Target
Teamster Affiliates Pension Plan
Tennessee Consolidated Retirement System
Texas Employees Retirement System
Texas Municipal Retirement System
Texas Teacher Retirement System
UAW
UFCW Staff Trust Fund
ULLICO Pension Plan Trust
UNITE HERE Laundry & Dry Cleaning Workers Pension Fund
UNITE HERE National Retirement Fund
UNITE HERE Textile Workers Pension Fund

UnitedHealth Group Retirement Plans
United States Steel and Carnegie Pension Fund
Vermont Pension Investment Committee
Washington State Investment Board
West Virginia Investment Management Board
Wisconsin State Investment Board
World Bank Staff Retirement Plan

Rev. 08/29/07

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November 14, 2007

Attachment 2

Council Corporate Governance Policies

The Council of Institutional Investors
Corporate Governance Policies

CONTENTS:

I. Introduction

The Council expects that corporations will comply with all applicable federal and state laws and regulations and stock exchange listing standards.

The Council believes every company should also have written disclosed governance procedures and policies, an ethics code that applies to all employees and directors, and provisions for its strict enforcement. The Council posts its corporate governance policies on its web site (www.cii.org); it hopes corporate boards will meet or exceed these standards and adopt similarly appropriate additional policies to best protect shareowners' [1] interests.

In general, the Council believes that corporate governance structures and practices should protect and enhance accountability to, and ensure equal financial treatment of, shareowners. An action should not be taken if its purpose is to reduce accountability to shareowners.

The Council also believes shareowners should have meaningful ability to participate in the major fundamental decisions that affect corporate viability, and meaningful opportunities to suggest or nominate director candidates and to suggest processes and criteria for director selection and evaluation.

The Council believes companies should adhere to responsible business practices and practice good corporate citizenship. Promotion, adoption and effective implementation of guidelines for the responsible conduct of business and business relationships are consistent with the fiduciary responsibility of protecting long-term investment interests.

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[1] At the February 2006 meeting of the Council's Policies Committee, it was decided that Council policies should use the term "shareowner" instead of "shareholder," reflecting the Council's belief that the former term is a better descriptor.

The Council believes good governance practices should be followed by publicly traded companies, private companies and companies in the process of going public. As such, the Council believes that, consistent with their fiduciary obligations to their limited partners, the general members of venture capital, buyout and other private equity funds should use appropriate efforts to encourage companies in which they invest to adopt long-term corporate governance provisions that are consistent with the Council's policies.

The Council believes that U.S. companies should not reincorporate offshore because corporate governance structures there are weaker and therefore reduce management accountability to shareowners.

Council policies neither bind members nor corporations. They are designed to provide guidelines that the Council has found to be appropriate in most situations.

II. The Board of Directors

Annual election of directors. All directors should be elected annually (no classified boards).

Director elections: When permissible under state law, companies' charters and by-laws should provide that directors in uncontested elections are to be elected by a majority of the votes cast. In contested elections, plurality voting should apply. An election is contested when there are more director candidates than there are available board seats.

Boards should adopt policies asking that directors tender their resignations if they fail to win majority support in uncontested elections, and providing that such directors will not be renominated after expiration of their current term in the event they fail to tender such resignation.

Independent board. At least two-thirds of the directors should be independent (i.e., their only non-trivial professional, familial or financial connection to the corporation, its chairman, CEO or any other executive officer is their directorship). The company should disclose information necessary for shareowners to determine whether directors qualify as independent, whether or not the disclosure is required by state or federal law. This information should include all financial or business relationships with and payments to directors and their families and all significant payments to companies, non-profits, foundations and other organizations where company directors serve as employees, officers or directors. (See Council definition of independent director.)

All-independent board committees. Companies should have audit, nominating and compensation committees, and all members of these committees should be independent.

The board (not the CEO) should appoint the committee chairs and members. Committees should be able to select their own service providers. Some regularly scheduled committee meetings should be held with only the committee members (and, if appropriate, the committee's independent consultants) present. The process by which committee members and chairs are selected should be disclosed to shareowners.

Board accountability to shareowners

Majority shareowner votes. Boards should take actions recommended in shareowner proposals that receive a majority of votes cast for and against. If shareowner approval is required for the action, the board should submit the proposal to a binding vote at the next shareowner meeting.

Interaction with shareowners. Directors should respond to communications from shareowners and should seek shareowner views on important governance, management and performance matters. All directors should attend the annual shareowners' meeting and be available, when requested by the chair, to answer shareowner questions.

Shareowner – director communication, interaction & meeting conduct. Directors should respond to communications from shareowners and should seek shareowner views on important governance, management and performance matters. To accomplish this goal, all companies should establish a mechanism by which shareowners with non-trivial concerns could communicate directly with all directors, including independent directors. Policies requiring that all director communication go through a member of the management team should be avoided unless they are for record-keeping purposes. In such cases, procedures documenting receipt, delivery to the board and response must be maintained and made available upon request to shareowners.

During the annual general meeting, shareowners should have the right to ask questions, both orally and in writing, and expect answers and discussion where appropriate from the board of directors. Such discussion should take place regardless whether those questions have been submitted in advance. All directors should attend the annual shareowners' meetings and be available, when requested by the chair, to answer shareowner questions. While reasonable time limits to questions asked might be acceptable, the board should not ignore or skip hearing questions because a shareowner has a smaller number of shares or has not held those shares for a certain amount of time.

Independent chair/lead director. The board should be chaired by an independent director. The CEO and chair roles should only be combined in very limited circumstances; in these situations, the board should provide a written statement in the proxy materials discussing why the combined role is in the best interests of shareowners, and it should name a lead independent director who should have approval over information flow to the board, meeting agendas, and meeting schedules to ensure a structure that provides an appropriate balance between the powers of the CEO and those of the independent directors.

Other roles of the lead independent director should include chairing meetings of non-management directors and of independent directors, presiding over board meetings in the absence of the chair, serving as the principle liaison between the independent directors and the chair, and leading the board/director evaluation process. Given these additional responsibilities, the lead independent director should expect to devote a greater amount of time to board service than the other directors.

Board/director evaluation. Boards should evaluate themselves and their individual members on a regular basis. Board evaluation should include an assessment of whether the board has the necessary diversity of skills, backgrounds, experiences, ages, races and genders appropriate to the company's ongoing needs. Individual director evaluations should include high standards for in-person attendance at board and committee meetings and disclosure of all absences or conference call substitutions.

Boards should review the performance and qualifications of any director from whom at least 10 percent of the votes cast are withheld.

Absent compelling and stated reasons, directors who attend fewer than 75 percent of board and board-committee meetings for two consecutive years should not be renominated. Companies should disclose individual director attendance figures for board and committee meetings. Disclosure should distinguish between in-person and telephonic attendance. Excused absences should not be categorized as attendance.

'***Continuing directors***.' Corporations should not adopt so-called "continuing director" provisions (also known as "dead-hand" poison pills) that allow former directors who have left office to take action on behalf of the corporation.

Board size and service. Absent compelling, unusual circumstances, a board should have no fewer than 5 and no more than 15 members (not too small to maintain the needed expertise and independence, and not too large to be efficiently functional). Shareowners should be allowed to vote on any major change in board size.

Companies should establish and publish guidelines specifying on how many other boards their directors may serve. Absent unusual, specified circumstances, directors with full-time jobs should not serve on more than two other boards. Currently serving CEOs should only serve as a director of one other company, and then only if the CEO's own company is in the top half of its peer group. No person should serve on more than five for-profit company boards.

Board operations. Directors should receive training from independent sources on their fiduciary responsibilities and liabilities. Directors have an affirmative obligation to become and remain independently familiar with company operations; they should not rely exclusively on information provided to them by the CEO to do their jobs.

Directors should be provided meaningful information in a timely manner prior to board meetings, and should be allowed reasonable access to management to discuss board issues. Directors should be allowed to place items on board agendas.

Non-management directors should hold regularly scheduled executive sessions without the CEO or staff present. The independent directors should also hold regularly scheduled in-person executive sessions without non-independent directors and staff present.

The board should approve and maintain a CEO succession plan.

Auditor independence. As prescribed by law, the audit committee has the responsibility to hire, oversee and, if necessary, fire the company's outside auditor.

The audit committee should seek competitive bids for the external audit engagement no less frequently than every five years. The company's external auditor should not perform any non-audit services for the company, except those required by statute or regulation to be performed by a company's external auditor, such as attest services.

The proxy statement should also include a copy of the audit committee charter and a statement by the audit committee that it has complied with the duties outlined in the charter.

Companies should not agree to limit the liability of outside auditors.

Audit committee charters should provide for annual shareowner votes on the board's choice of independent, external auditor. Such provisions ought to state that if the board's selection fails to achieve the support of a majority of the for-and-against votes cast, the audit committee should: (1) take the shareowners' views into consideration and reconsider its choice of auditor; and (2) solicit the views of major shareowners in order to determine why broad levels of shareowner support were not achieved.

The audit committee should publicly provide to shareowners a plain-English explanation of the reasons for a change in the company's external auditors. At a minimum, this disclosure should be contained in the same Securities and Exchange Commission filing that companies are required to submit within four days of an auditor change.

Charitable and political contributions. The board of directors should monitor, assess and approve all charitable and political contributions (including trade association contributions) made by the company. The board should ensure that only contributions consistent with and aligned to the interests of the company and its shareowners are approved. The terms and conditions of such contributions should be clearly defined and approved by the board. The board's guidelines for contribution approval should be publicly disclosed as a corporate contributions policy.

The board should disclose on an annual basis the amounts and recipients of all monetary and non-monetary contributions made by the company during the prior fiscal year. If any expenditures earmarked for political or charitable activities were provided to or through a third-party, then those expenditures should be included in the report.

III. Shareowner Voting Rights

The shareowners' right to vote is inviolate and should not be abridged.

Access to the proxy. Companies should provide access to management proxy materials for a long-term investor or group of long-term investors owning in aggregate at least 5 percent of a company's voting stock to nominate less than a majority of the directors. Eligible investors must have owned the stock for at least three years. Company proxy materials and related mailings should provide equal space and equal treatment of nominations by qualifying investors.

One share, one vote. Each share of common stock should have one vote. Corporations should not have classes of common stock with disparate voting rights. Authorized unissued common shares that have voting rights to be set by the board should not be issued with unequal voting rights without shareowner approval.

Confidential voting. All proxy votes should be confidential, with ballots counted by independent tabulators. Confidentiality should be automatic and permanent and apply to all ballot items. Rules and practices concerning the casting, counting and verifying of shareowner votes should be clearly disclosed.

Voting requirements. A majority vote of common shares outstanding should be sufficient to amend company bylaws or take other action requiring or receiving a shareowner vote. Supermajority votes should not be required.

A majority vote of common shares outstanding should be required to approve:

*Major corporate decisions concerning the sale or pledge of corporate assets that would have a material effect on shareowner value. Such a transaction will automatically be deemed to have a material effect if the value of the assets exceeds 10 percent of the assets of the company and its subsidiaries on a consolidated basis.

*The corporation's acquiring 5 percent or more of its common shares at above-market prices other than by tender offer to all shareowners.

*Poison pills.

*Abridging or limiting the rights of common shares to (i) vote on the election or removal of directors or the timing or length of their term of office, or (ii) make nominations for directors or propose other action to be voted on by shareowners, or (iii) call special meetings of shareowners or take action by written consent or affect the procedure for fixing the record date for such action.

*Provisions resulting in the issuance of debt to a degree that would excessively leverage the company and imperil the long-term viability of the corporation.

Broker votes. Broker non-votes and abstentions should be counted only for purposes of a quorum.

Bundled voting. Shareowners should be allowed to vote on unrelated issues separately. Individual voting issues, particularly those amending a company's charter, bylaws or anti-takeover provisions, should not be bundled.

IV. Shareowner Meetings

Corporations should make shareowners' expense and convenience primary criteria when selecting the time and location of shareowner meetings.

Appropriate notice of shareowner meetings, including notice concerning any change in meeting date, time, place or shareowner action, should be given to shareowners in a manner and within time frames that will ensure that shareowners have a reasonable opportunity to exercise their franchise. To promote the ability of shareowners to make informed decisions regarding whether to recall loaned shares: (1) shareowner meeting record dates should be disclosed as far in advance of the record date as possible; and (2) proxy statements should be disclosed before the record date passes whenever possible.

Polls should remain open at shareowner meetings until all agenda items have been discussed and shareowners have had an opportunity to ask and receive answers to questions concerning them.

Companies should not adjourn a meeting for the purpose of soliciting more votes to enable management to prevail on a voting item. Extending a meeting should only be done for compelling reasons such as vote fraud, problems with the voting process or lack of a quorum.

Companies should hold shareowner meetings by remote communication (so-called electronic or "cyber" meetings) only as a supplement to traditional in-person shareowner meetings, not as a substitute.

As noted in Section II, "The Board of Directors," all directors should attend the annual shareowners' meeting and be available, when requested by the chair, to respond directly to oral or written questions from shareowners.

V. Executive Compensation

The Council believes that executive compensation is a critical and visible aspect of a company's governance. Pay decisions are one of the most direct ways for shareowners to assess the performance of the board. And they have a bottom line effect, not just in terms of dollar amounts, but also by formalizing performance goals for employees, signaling the market and affecting employee morale.

The Council endorses reasonable, appropriately structured pay-for-performance programs that reward executives for sustainable, superior performance over the "long-term," consistent with a company's investment horizon and generally considered to be five or more years for mature companies and at least three years for other companies. While the Council believes that executives should be well paid for superior performance, it also believes that executives should not be excessively paid. It is the job of the board of directors and the compensation committee to ensure that executive compensation programs are effective, reasonable and rational with respect to critical factors such as company performance, industry considerations and compensation paid to other employees inside the company.

It is also the job of the compensation committee to ensure that elements of compensation packages are appropriately structured to enhance the company's short- and long-term strategic goals and to retain and motivate executives to achieve those strategic goals. Compensation programs should not be driven by competitive surveys, which have become excessive and subject to abuse. They should recognize that it is shareowners, not executives, whose money is at risk. Since executive compensation must be tailored to meet unique company needs and situations, compensation programs must always be structured on a company-by-company basis. However, the Council believes that certain principles apply to all companies. For example, all companies should provide annually for advisory shareowner votes on the compensation of senior executives.

ROLE OF COMPENSATION COMMITTEE

The compensation committee is responsible for structuring executive pay, evaluating executive performance within the context of the pay structure of the entire company, subject to approval of the board of directors. To best handle this role, the Council believes that compensation committees should adopt the following principles and practices:

Structure

- ***Committee composition***: All members of the compensation committee should be independent. Committee membership should rotate periodically among the board's independent directors. Members should be or take responsibility to become knowledgeable about compensation and related issues. They should exercise due diligence and independent judgment in carrying out their committee responsibilities. They should represent diverse backgrounds and professional experiences.

Responsibilities

- ***Executive pay philosophy***: The compensation philosophy should be clearly disclosed to shareowners in annual proxy statements. In developing, approving and monitoring the executive pay philosophy, the compensation committee should consider the full range of pay components, including structure of programs, desired mix of cash and equity awards, goals for distribution of awards throughout the company, how executive pay relates to the pay of other employees, use of employment contracts, and policy regarding dilution.
- ***Oversight***: The compensation committee should vigorously oversee all aspects of executive compensation for a group composed of the CEO and other highly paid executives, as required by law, and any other highly paid employees, including executives of subsidiaries, special purpose entities and other affiliates, as determined by the compensation committee. The committee should ensure that the structure of employee compensation throughout the company is fair, non-discriminatory and forward-looking, and that it motivates, recruits and retains a workforce capable of meeting the company's strategic objectives. To perform its oversight duties, the committee should approve, comply with and fully disclose a charter detailing its responsibilities.
- ***Pay for performance***: Compensation of the executive oversight group should be driven predominantly by performance. The compensation committee should establish performance measures for executive compensation that are agreed to ahead of time and publicly disclosed. Performance measures applicable to all performance-based awards (including annual and long-term incentive compensation) should reward superior performance—based predominantly on total stock return measures and key operational measures—at minimum reasonable cost and should reflect downside risk.
- ***Annual approval and review***: Each year, the compensation committee should review performance of individuals in the oversight group and approve any bonus, severance, equity-based award or extraordinary payment made to them. The committee should understand all components of executive compensation and annually review total compensation potentially payable to the oversight group under all possible scenarios, including death/disability, retirement, voluntary termination, termination with and without cause and changes of control. The committee should also ensure that the structure of pay at different levels (CEO and others in the oversight group, other executives and non-executive employees) is fair and appropriate in the context of broader company policies and goals and fully justified and explained.
- ***Committee accountability***: In addition to attending all annual and special shareowner meetings, committee members should be available to respond directly to questions about executive compensation; the chair of the committee should take the lead. In addition, the committee should regularly report on its activities to the independent directors of the board, who should review and ratify committee decisions. Committee members should take an active role in preparing the compensation committee report contained in the annual proxy materials, and be responsible for the contents of that report.

- ***Outside advice***: The compensation committee should retain and fire outside experts, including consultants, legal advisers and any other advisers when it deems appropriate, including when negotiating contracts with executives. Individual compensation advisers and their firms should be independent of the client company, its executives and directors and should report solely to the compensation committee. The compensation committee should develop and disclose a formal policy on compensation adviser independence. In addition, the committee should annually disclose an assessment of its advisers' independence, along with a description of the nature and dollar amounts of services commissioned from the advisers and their firms by the client company's management. Companies should not agree to indemnify or limit the liability of compensation advisers or the advisers' firms.
- ***Clawbacks***: The compensation committee should develop and disclose a policy for recapturing unearned bonus and incentive payments that were awarded to senior executives due to fraudulent activity, incorrectly stated financial results, or some other cause. At a minimum, the policy should apply to Named Executive Officers, and boards should require repayment in the event of malfeasance involving the executive.

Proxy statement disclosure

- ***Disclosure practices***: The compensation committee is responsible for ensuring that all aspects of executive compensation are clearly, comprehensively and promptly disclosed, in plain English, in the annual proxy statement regardless of whether such disclosure is required by current rules and regulations. The compensation committee should disclose all information necessary for shareowners to understand how and how much executives are paid and how such pay fits within the overall pay structure of the company. It should provide annual proxy statement disclosure of the committee's compensation decisions with respect to salary, short-term incentive compensation, long-term incentive compensation and all other aspects of executive compensation, including the relative weights assigned to each component of total compensation. Other recommended disclosures relevant to specific elements of executive compensation are detailed below.
- ***Benchmarking***: Benchmarking at median or higher levels is a primary contributor to escalating executive compensation. Although benchmarking can be a constructive tool for formulating executive compensation packages, it should not be relied on exclusively. If benchmarking is used, compensation committees should commit to annual disclosure of the companies in peer groups used for benchmarking and/or other comparisons. If the peer group used for compensation purposes is different from that used to compare overall performance, such as the five-year stock return graph required in the annual proxy materials, the compensation committee should describe the differences between the groups and the rationale for choosing between them. In addition to disclosing names of companies used for benchmarking and comparisons, the compensation committee should disclose targets for each compensation element relative to the peer/benchmarking group and year-to-year changes in companies composing peer/benchmark groups.

SALARY

Since salary is one of the few components of executive compensation that is not "at risk," it should be set at a level that yields the highest value for the company at least cost. In general, salary should be set to reflect responsibilities, tenure and past performance, and to be tax efficient—meaning no more than $1 million. The compensation committee should publicly disclose its rationale for paying salaries above the median of the peer group.

ANNUAL INCENTIVE COMPENSATION

Cash incentive compensation plans should be structured to appropriately align executive interests with company goals and objectives and to reasonably reward superior performance that meets or exceeds well-defined and clearly disclosed performance targets that reinforce long-term strategic goals set and approved by the board and written down in advance of the performance cycle.

Structure

- ***Formula plans***: The compensation committee should approve formulaic bonus plans containing specific qualitative and quantitative performance-based operational measures designed to reward executives for superior performance related to operational/strategic/other goals set by the board. Such awards should be capped at a reasonable maximum level. These caps should not be calculated as percentages of accounting or other financial measures (such as revenue, operating income or net profit), since these figures may change dramatically due to mergers, acquisitions and other non-performance-related strategic or accounting decisions.
- ***Targets***: When setting performance goals for "target" bonuses, the compensation committee should set performance levels below which no bonuses would be paid and above which bonuses would be capped.
- ***Changing targets***: Except in unusual and extraordinary situations, the compensation committee should not "lower the bar" by changing performance targets in the middle of bonus cycles. If performance targets must be lowered, amended or changed in the middle of a performance cycle, reasons for the change and details of the initial targets and adjusted targets should be disclosed.

Proxy statement disclosure

- ***Transparency***: The compensation committee should commit to provide full descriptions of the qualitative and quantitative performance measures and benchmarks used to determine annual incentive compensation, including the weightings of each measure. At the beginning of a period, the compensation committee should calculate and disclose the maximum compensation payable if all performance-related targets are met. At the end of the performance cycle, the compensation committee should disclose actual targets and details on the determination of final payouts.

Shareowner approval

Shareowners should approve the establishment of, any material amendments to, annual incentive compensation plans covering the oversight group.

LONG-TERM INCENTIVE COMPENSATION

Well-designed compensation programs can lead to superior performance. Long-term incentive compensation, generally in the form of equity-based awards, can be structured to achieve a variety of long-term objectives, including retaining executives, aligning executives' financial interests with the interests of shareowners, and rewarding the achievement of long-term specified strategic goals of the company and/or the superior performance of company stock.

But long-term incentive compensation comes at a cost, and poorly structured awards permit excessive or abusive pay that is detrimental to the company and to shareowners.

To maximize effectiveness and efficiency, compensation committees should carefully evaluate the costs and benefits of long-term incentive compensation, ensure that long-term compensation is appropriately structured and consider whether performance and incentive objectives would be enhanced if awards were distributed throughout the company, not simply to top executives.

Companies may rely on a myriad of long-term incentive vehicles—including, but not limited to, performance-based restricted stock/units, phantom shares, stock units and stock options—to achieve a variety of long-term objectives. While the technical underpinnings of long-term incentive awards may differ, the Council believes that the following principles and practices apply to all long-term incentive compensation awards. And, as detailed below, certain policies are relevant to specific types of long-term incentive awards.

Structure

- ***Size of awards***: Compensation committees should set appropriate limits on the size of long-term incentive awards granted to executives. So-called "mega-awards" or outsized awards should be avoided except in extraordinary circumstances, because they may result in rewards that are disproportionate to performance.
- ***Vesting requirements***: Meaningful performance periods and/or cliff vesting requirements—consistent with a company's investment horizon, but no less than three years—should attach to all long-term incentive awards, followed by pro rata vesting over at least two subsequent years for senior executives.
- ***Grant timing***: Except in extraordinary circumstances, such as a permanent change in performance cycles, long-term incentive awards should be granted at the same time each year. Companies should not coordinate stock award grants with the release of material non-public information. The grants should occur whether recently publicized information is positive or negative, and stock options should never be backdated.
- **Hedging**: Compensation committees should prohibit executives and directors from hedging (by buying puts and selling calls or employing other risk-minimizing techniques) equity-based awards granted as long-term incentive compensation or other stock holdings in the company. And, they should strongly discourage other employees from hedging their holdings in company stock.

Proxy statement disclosure

- ***Philosophy/strategy***: Compensation committees should have a well-articulated philosophy and strategy for long-term incentive compensation, which should be fully and clearly disclosed in the annual proxy statement.
- ***Award specifics***: Compensation committees should disclose the size, distribution, vesting requirements, other performance criteria and grant timing of each type of long-term incentive award granted to the executive oversight group and how each component contributes to long-term performance objectives of a company.
- ***Ownership targets***: Compensation committees should disclose whether and how long-term incentive compensation may be used to satisfy meaningful stock ownership requirements. Disclosure should include whether compensation committees impose post-exercise holding periods or other requirements to ensure that long-term incentive compensation is appropriately used to meet ownership targets.

Shareowner approval
Shareowners should approve all long-term incentive plans, including equity-based plans, any material amendments to existing plans or any amendments of outstanding awards to shorten vesting requirements, reduce performance targets or otherwise change outstanding long-term incentive awards to benefit executives. Plans should have expiration dates and not be structured as "evergreen," rolling plans.

DILUTION

Dilution measures how much the additional issuance of stock may reduce existing shareowners' stake in a company. Dilution is particularly relevant for long-term incentive compensation plans since these programs essentially issue stock at below-market prices to the recipients. The potential dilution represented by long-term incentive compensation plans is a direct cost to shareowners.

Dilution from long-term incentive compensation plans may be evaluated using a variety of techniques including, but not limited to, the reduction in earnings per share and voting power resulting from the increase in outstanding shares.

Proxy statement disclosure
- ***Philosophy/strategy***: Compensation committees should develop and disclose the philosophy regarding dilution including definition(s) of dilution, peer group comparisons and specific targets for annual awards and total potential dilution represented by equity compensation programs for the current year and expected for the subsequent four years.
- ***Stock repurchase programs***: Stock buyback decisions are a capital allocation decision and should not be driven solely for the purpose of minimizing dilution from equity-based compensation plans. The compensation committee should provide information about stock repurchase programs and the extent to which such programs are used to minimize the dilution of equity-based compensation plans.
- ***Tabular disclosure***: The annual proxy statement should include a table detailing the overhang represented by unexercised options and shares available for award and a discussion of the impact of the awards on earnings per share.

STOCK OPTION AWARDS

Stock options give holders the right, but not the obligation, to buy stock in the future. Options may be structured in a variety of ways. The Council considers some structures and policies preferable because they more effectively ensure that executives are compensated for superior performance. Other structures and policies are inappropriate and should be prohibited.

Structure—preferred practices
- ***Performance options***: Stock option prices should be indexed to peer groups, performance-vesting and/or premium-priced to reward superior performance based on the attainment of challenging quantitative goals.
- ***Dividend equivalents***: To ensure that executives are neutral between dividends and stock price appreciation, dividend equivalents should be granted with stock options, but distributed only upon exercise of the option.
- ***Stock option expensing***: Since stock options have a cost, companies should include these costs as an expense on their reported income statements and disclose valuation assumptions.

Structure—inappropriate practices

- ***Discount options***: No discount options should be awarded.
- ***Reload options***: Reload options should be prohibited.
- ***Option repricing:*** "Underwater" options should not be repriced or replaced (either with new options or other equity awards), unless approved by shareowners. Repricing programs, for shareowner approval, should exclude directors and executives, restart vesting periods and mandate value-for-value exchanges in which options are exchanged for a number of equivalently valued options/shares.

STOCK AWARDS/UNITS

Stock awards/units and similar equity-based vehicles generally grant holders stock based on the attainment of performance goals and/or tenure requirements. These types of awards are more expensive to the company than options, since holders generally are not required to pay to receive the underlying stock, and therefore should be limited in size.

Structure

Stock awards should be linked to the attainment of specified performance goals and in some cases to additional time-vesting requirements. Stock awards should not be payable based solely on the attainment of tenure requirements.

Proxy statement disclosure

- ***Transparency***: The compensation committee should provide full descriptions of the qualitative/quantitative performance measures and benchmarks used and the weightings of each component. Whenever possible, disclosure should include details of performance targets.

PERQUISITES

Company perquisites blur the line between personal and business expenses. The Council believes that executives, not companies, should be responsible for paying personal expenses—particularly those that average employees routinely shoulder, such as family and personal travel, financial planning, club memberships and other dues. The compensation committee should ensure that any perquisites are warranted and have a legitimate business purpose, and it should consider capping all perquisites at a de minimis level. Total perquisites should be described, disclosed and valued.

EMPLOYMENT CONTRACTS, SEVERANCE AND CHANGE-OF-CONTROL PAYMENTS

Various arrangements may be negotiated to outline terms and conditions for employment and to provide special payments following certain events, such as a termination of employment with/without cause and/or a change in control. The Council believes that these arrangements should be used on a limited basis.

Structure

- ***Employment contracts***: Companies should only provide employment contracts to executives in limited circumstances, such as to provide modest, short-term employment security to a newly hired or recently promoted executive. Such contracts should have a specified termination date (not to exceed three years); contracts should not be "rolling" on an open-ended basis.

- ***Severance payments***: Executives should be entitled to severance payments in non-control change situations only in the event of wrongful termination, death or disability. Termination for poor performance, resignation under pressure or failure to renew the contract should not qualify as wrongful termination.
- ***Change-in-control payments***: Any provisions providing for compensation following a change-in-control event should be "double-triggered," stipulating that compensation is payable only (1) after a control change actually takes place and (2) if a covered executive's job is terminated because of the control change.

Limitations

- ***Gross-ups***: Companies should not compensate executives for any excise or additional taxes payable upon the receipt of severance, change-in-control or similar payments.

Proxy statement disclosure

- ***Transparency***: The compensation committee should fully and clearly describe the terms and conditions of employment contracts and any other agreements/arrangements covering the executive oversight group and reasons why the compensation committee believes the agreements are in the best interests of shareowners.
- ***Tabular disclosure***: The compensation committee should provide tabular disclosure of the dollar value payable, including gross-ups and all related taxes payable by the company, to each member of the executive oversight group under each scenario covered by the contracts/agreements/arrangements, including change-in-control, death/disability, termination with/without cause and resignation.
- ***Timely disclosure***: New executive employment contracts or amendments to existing contracts should be immediately disclosed in 8-K filings and promptly disclosed in subsequent 10-Qs.

Shareowner ratification

Shareowners should ratify all employment contracts, side letters or other agreements providing for severance, change-in-control or other special payments to executives exceeding 2.99 times average annual salary plus annual bonus for the previous three years.

RETIREMENT ARRANGEMENTS

Deferred compensation plans, supplemental executive retirement plans, retirement packages and other retirement arrangements for highly paid executives can result in hidden and excessive benefits. The Council believes that special retirement arrangements, including ones structured to permit employees whose compensation exceeds IRS limits to fully participate in similar plans covering other employees, should be consistent with programs offered to the general workforce, and they should be reasonable.

Structure

- ***Supplemental executive retirement plans (SERPs)***: Supplemental plans should be an extension of the retirement program covering other employees. They should not include special provisions, such as above-market interest rates and excess service credits, not offered under plans covering other employees. Payments such as stock and stock options, annual/long-term bonuses and other compensation not awarded to other employees and/or not considered in the determination of retirement benefits payable to other employees should not be considered in calculating benefits payable under SERPS.

- ***Deferred compensation plans***: Investment alternatives offered under deferred compensation plans for executives should mirror those offered to employees in broad-based deferral plans.

Limitations

- ***Deferred compensation plans***: Above-market returns should not be applied to executive deferrals, and executives should not receive "sweeteners" for deferring cash payments into company stock.
- ***Post-retirement exercise periods***: Executives should be limited to three-year post-retirement exercise periods for stock option grants.
- ***Retirement benefits***: Executives should not be entitled to special perquisites—such as apartments, automobiles, use of corporate aircraft, security, financial planning—and other benefits upon retirement. Executives are highly compensated employees who should be more than able to cover the costs of their retirements.

Proxy statement disclosure

- ***Transparency***: The terms of any deferred compensation, retirement, SERP or other similar plans covering the executive oversight group should be fully disclosed, in plain English, along with a description of any additional perquisites or benefits payable to executives after retirement.
- ***Tabular disclosure***: A single table should be provided detailing the expected dollar value payable to each member of the executive oversight group under any deferred compensation, retirement, SERP or similar plan, along with a dollar value of any additional perquisites of benefits payable after retirement.

STOCK OWNERSHIP

Structure

- ***Stock ownership***: Executives and directors should own, after a reasonable period of time, a meaningful position in the company's common stock. Executives should be required to own stock—excluding unexercised options and unvested stock awards—equal to a multiple of salary, scaled based on position, such as two times salary for lower-level executives and up to six times salary for the CEO.

Limitations

- ***Stock sales***: Executives should be required to sell stock through pre-announced program sales or by providing a minimum 30-day advance notice of any stock sales.
- ***Post-retirement holdings***: Executives should be required to continue to satisfy the minimum stock holding requirements for at least six months after leaving the company.

Proxy statement disclosure

- ***Transparency***: Companies should disclose stock ownership requirements and whether any members of the executive oversight group are not in compliance.

VI. Non-Employee Director Compensation

Given the vital importance of the responsibilities assigned to directors, the Council expects that non-employee directors will devote significant time to their boardroom duties.

The Council believes that policy issues related to director compensation are fundamentally different from executive compensation. The Council is supportive of director compensation policies that accomplish the following goals: 1) attract highly qualified candidates; 2) retain highly qualified directors; 3) align directors' interests with those of the long-term owners of the corporation; and 4) provide complete disclosure to shareowners regarding all components of director compensation including the philosophy behind the program and all forms of compensation.

To accomplish these goals, director compensation should consist solely of a combination of cash retainer and equity-based compensation. The cornerstone of director compensation programs should be alignment of interests through the attainment of significant equity holdings in the company meaningful to each individual director. The Council believes that equity obtained with an individual's own capital provides the best alignment of interests with other shareowners. However, compensation plans can provide supplemental means of obtaining long-term equity holdings through equity compensation, long-term holding requirements and ownership requirements.

The Council believes that companies should have flexibility within certain broad policy parameters to design and implement director compensation plans that suit their unique circumstances. To support this flexibility, investors must have complete and clear disclosure of both the philosophy behind the compensation plan as well as the actual compensation awarded under the plan. Without full disclosure, it is increasingly difficult to earn investors' confidence and support for compensation plans, including both director and executive plans.

Although non-employee director compensation is generally immaterial to a company's bottom line and small relative to executive pay, the Council believes that director compensation is an important piece of a company's governance. Because director pay is set by the board and has inherent conflicts of interest, care must be taken to ensure there is no appearance of impropriety. Companies should pay particular attention to managing these conflicts.

ROLE OF THE COMPENSATION COMMITTEE IN DIRECTOR COMPENSATION

The compensation committee (or alternative committee comprised solely of independent directors) is responsible for structuring director pay, subject to approval of all the independent directors, so that it is aligned with the long-term interests of shareowners. The unique fact that directors are setting their own compensation necessitates additional emphasis on the following practices:

Responsibilities

- ***Total compensation review***: The compensation committee should understand and value each component of director compensation and annually review total compensation potentially payable to each director.
- ***Outside advice***: The Council believes that committees should have the ability to utilize a compensation consultant for assistance on director compensation plans. In cases where the compensation committee does utilize a consultant, it should always retain an independent compensation consultant or any other advisors as deemed appropriate to assist with the evaluation of the structure and value of director compensation. A summary of the pay consultant's advice should be provided in the annual proxy statement in plain English. The compensation committee should disclose all instances where the consultant is also retained (by the committee) to provide advice on executive compensation. In no circumstances should the committee utilize a consultant for director compensation or executive compensation who is also retained by management.

Proxy statement disclosure

- ***Tabular disclosure***: Annual proxy statement disclosure should include a table with columns valuing each component of compensation paid to each director during the previous year. The table should also include a column estimating the total value, including the present value of equity awards, of each director's annual pay package and any other relevant information. The table should include the number of board meetings and committee meetings attended by the director.
- ***Compensation committee report***: The annual director compensation disclosure included in the proxy materials should include a discussion of the philosophy for director pay and the processes for setting director pay levels. Reasons for changes in director pay programs should be explained in plain English. Peer group(s) used to compare director pay packages should be fully disclosed, along with differences, if any, from the peer group(s) used for executive pay purposes. While the Council recognizes the value of peer analysis, we do not believe that peer-relative justification should dominate the rational for (higher) pay levels. Rather, compensation programs should be appropriate for the circumstances of the company. The report should disclose how many committee meetings involved discussions of director pay.

The following sections provide Council policy positions on specific components of director compensation and related issues.

RETAINER

The annual retainer should be the sole form of cash compensation paid to non-employee directors. Ideally, it should reflect an amount appropriate for a director's expected duties, including attending meetings, preparing for meetings/discussions and performing due diligence on sites/operations (which should include routine communications with a broad group of employees.) The Council recognizes that in some combination, the retainer and the equity component combined also reflect the director's contribution from experience and leadership.

The Council opposes meeting attendance fees—whether for board meetings or committee meetings—since meeting attendance is the most basic expectation of a non-employee director.

Retainer amounts may be differentiated to recognize that certain non-employee directors, possibly including independent board chairs, independent lead directors, committee chairs or members of certain committees, are expected to spend more time on board duties than other directors.

The board should have a clearly defined attendance policy. In cases where the committee utilizes any form of financial consequences (loss of a portion of the retainer or equity) as part of the director compensation program, this should be fully disclosed. Financial consequences for poor attendance, while perhaps appropriate in some circumstances, should not be considered in lieu of examining the attendance record, commitment (time spent on director duties) and contribution as integral criterion in director performance and re-nomination decisions.

EQUITY-BASED COMPENSATION

To complement the annual retainer and align director-shareowner interests, non-employee directors shall receive stock awards or stock-related awards such as phantom stock or share units. Equity-based compensation to non-employee directors should be fully vested on the grant date. This point is a marked difference to the Council's policy on executive compensation which calls for performance-based vesting of equity-based awards. While views on this topic have been mixed, the Council believes that the benefits of immediate vesting outweigh the complications. The obvious benefits stem from the immediate alignment of interests with shareowners and the maintenance of independence and objectivity for the director.

The Council believes that equity-based compensation can be an important component of director compensation. These tools are perhaps best suited to accomplish optimal long-term perspective and alignment of interests with shareowners. To accomplish this objective, the Council believes that director compensation should contain an ownership requirement or incentive and minimum holding period requirements.

The Council suggests ownership requirements of at least three to five times annual compensation. However, the Council is sensitive to situations where qualified director candidates may not have financial means to obtain immediate ownership thresholds. For this reason, companies may adopt unique approaches to providing either a minimum threshold for ownership or incentive to build ownership. This concept should be an integral component of the committee's disclosure related to the philosophy of director pay. It is appropriate to provide a reasonable period of time for directors to meet ownership requirements or guidelines.

Separate from ownership requirements, the Council believes companies should adopt holding requirements for a significant majority of equity-based grants. These policies should require that directors retain a significant portion (such as 80% for example) of equity grants until after they are retired from the board. These policies should also prohibit the use of any transactions or arrangements that mitigate the risk or benefit of ownership to the director. The Council believes that these transactions and arrangements will inhibit the alignment of interests obtained from providing equity compensation and ownership requirements.

The Council does not advocate a specific split between equity-based and cash compensation. Rather, we believe that companies should have the flexibility to set and adjust this ratio as may be appropriate for the circumstances. Accordingly, the rational behind this decision is an important element of disclosures related to the overall philosophy of director compensation.

Proxy statement disclosure

- ***Transparency***: The present value of equity awards paid to each director during the previous year and the philosophy and process used in determining director pay should be fully disclosed in the proxy statement.

Shareowner approval

- Current listing standards require shareowner approval of equity-based compensation plans and material amendments to plans (with limited exceptions). The Council strongly supports this concept and advocates that companies adopt conservative interpretations of approval requirements when confronted with choices. (For example, this may include material amendments to the plan).

PERFORMANCE-BASED COMPENSATION

While the Council is a strong advocate of performance-based concepts in executive compensation, we do not support performance measures in director compensation. Performance-based compensation for directors has significant potential to conflict with the director's primary role as an independent representative of shareowners.

PERQUISITES

Aside from meeting-related expenses such as airfare, hotel accommodations and modest travel/accident insurance, the Council believes that directors should receive no other perquisites. Health, life and other forms of insurance, matching grants to charities, financial planning, automobile allowances and other similar perquisites cross the line as benefits offered to employees. The Council believes that charitable awards programs are an unnecessary benefit; directors interested in posthumous donations can do so on their own via estate planning. Infrequent token gifts of modest value are not considered perquisites.

REPRICING AND EXCHANGE PROGRAMS

The Council believes that under no circumstances should directors participate in or be eligible for repricing or exchange programs.

EMPLOYMENT CONTRACTS, SEVERANCE AND CHANGE-OF-CONTROL PAYMENTS

Non-employee directors should not be eligible to receive any change-in-control payments or severance arrangements of any kind.

RETIREMENT ARRANGEMENTS

Since non-employee directors are elected representatives of shareowners and not company employees, they should not be offered retirement benefits such as defined benefit plans or deferred stock awards nor should they be entitled to special post-retirement perquisites.

The Council does not object to allowing directors to defer cash pay via a deferred compensation plan for directors. However, the Council believes that such investment alternatives offered under deferred compensation plans for directors should mirror those offered to employees in broad-based deferral plans. Non-employee directors should not receive "sweeteners" for deferring cash payments into company stock.

DISGORGEMENT

Directors should be required to repay compensation to the company in the event of malfeasance or a breach of fiduciary duty involving the director.

VII. Independent Director Definition

Members of the Council of Institutional Investors believe that the promulgation of a narrowly drawn definition of an independent director (coupled with a policy specifying that at least two-thirds of board members and all members of the audit, compensation and nominating committees should meet this standard) is in the corporation's and all shareowners' ongoing financial interest because:

— independence is critical to a properly functioning board,

— certain clearly definable relationships pose a threat to a director's unqualified independence in a sufficient number of cases that they warrant advance identification,

— the effect of a conflict of interest on an individual director is likely to be almost impossible to detect, either by shareowners or other board members, and

— while an across-the-board application of *any* definition to a large number of people will inevitably miscategorize a few of them, this risk is sufficiently small that it is far outweighed by the significant benefits.

Thus, the members of the Council approved the following basic definition of an independent director:

- an independent director is someone whose only nontrivial professional, familial or financial connection to the corporation, its chairman, CEO or any other executive officer is his or her directorship.

Stated most simply, an independent director is a person whose directorship constitutes his or her only connection to the corporation.

The members of the Council recognize that independent directors do not invariably share a single set of qualities that are not shared by non-independent directors. Consequently, no clear rule can unerringly describe and distinguish independent directors. However, the independence of the director depends on all relationships the director has, including relationships between directors, that may compromise the director's objectivity and loyalty to shareowners. It is the obligation of the directors to consider all relevant facts and circumstances, to determine whether a director is to be considered independent. The notes that follow are supplied to give added clarity and guidance in interpreting the specified relationships.

A director will not be considered independent if he or she:

(a) is, or in the past 5 years has been, or whose relative is, or in the past 5 years has been, employed by the corporation or employed by or a director of an affiliate; An "affiliate" relationship is established if one entity either alone or pursuant to an arrangement with one or more other persons, owns or has the power to vote more than 20 percent of the equity interest in another, unless some other person, either alone or pursuant to an arrangement with one or more other persons, owns or has the power to vote a greater percentage of the equity interest. For these purposes, joint venture partners and general partners meet the definition of an affiliate, and officers and employees of joint venture enterprises and general partners are considered affiliated. A subsidiary is an affiliate if it is at least 20 percent owned by the corporation.

Affiliates include predecessor companies. A "predecessor" is an entity that within the last 5 years was party to a "merger of equals" with the corporation or represented more than 50 percent of the corporation's sales or assets when such predecessor became part of the corporation.

"Relatives" include spouses, parents, children, step-children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, aunts, uncles, nieces, nephews and first cousins, and anyone sharing the director's home.

(b) is, or in the past 5 years has been, or whose relative is, or in the past 5 years has been, an employee, director or **greater-than-20-percent** owner of a firm that is one of the corporation's or its affiliate's paid advisers or consultants or that receives revenue of at least $50,000 for being a paid adviser or consultant to an executive officer of the corporation;

NOTES: Advisers or consultants include, but are not limited to, law firms, auditors, accountants, insurance companies and commercial/investment banks. For purposes of this definition, an individual serving "of counsel" to a firm will be considered an employee of that firm.

The term "executive officer" includes the chief executive, operating, financial, legal and accounting officers of a company. This includes the president, treasurer, secretary, controller and any vice-president who is in charge of a principal business unit, division or function (such as sales, administration or finance) or performs a major policymaking function for the corporation.

(c) is, or in the past 5 years has been, or whose relative is, or in the past 5 years has been, employed by or has had a 5 percent or greater ownership interest in a third-party that provides payments to or receives payments from the corporation **and either (i) such payments account for 1 percent of the third-party's or 1 percent of the corporation's consolidated gross revenues in any single fiscal year, or (ii) if the third-party is a debtor or creditor of the corporation and the amount owed exceeds 1 percent of the corporation's or third party's assets.** Ownership means beneficial or record ownership, not custodial ownership.

(d) has, or in the past 5 years has had, or whose relative has paid or received more than $50,000 in the past 5 years under, a personal contract with the corporation, an executive officer or any affiliate of the corporation;

NOTES: Council members believe that even small personal contracts, no matter how formulated, can threaten a director's complete independence. This includes any arrangement under which the director borrows or lends money to the corporation at rates better (for the director) than those available to normal customers -- even if no other services from the director are specified in connection with this relationship.

(e) is, or in the past 5 years has been, or whose relative is, or in the past 5 years has been, an employee or director of a foundation, university or other non-profit organization that receives significant grants or endowments from the corporation, one of its affiliates or its executive officers or has been a *direct* beneficiary of *any* donations to such an organization;

NOTES: A "significant grant or endowment" is the lesser of $100,000 or 1 percent of total annual donations received by the organization.

(f) is, or in the past 5 years has been, or whose relative is, or in the past 5 years has been, part of an interlocking directorate in which the CEO or other employee of the corporation serves on the board of a third-party entity (for-profit or not-for-profit) employing the director **or such relative**;

(g) has a relative who is, or in the past 5 years has been, an employee, a director or a 5 percent or greater owner of a third-party entity that is a significant competitor of the corporation; or

(h) is a party to a voting trust, agreement or proxy giving his/her decision making power as a director to management except to the extent there is a fully disclosed and narrow voting arrangement such as those which are customary between venture capitalists and management regarding the venture capitalists' board seats.

The foregoing describes relationships between directors and the corporation. The Council also believes that it is important to discuss relationships between directors on the same board which may threaten either director's independence. A director's objectivity as to the best interests of the shareowners is of utmost importance and connections between directors outside the corporation may threaten such objectivity and promote inappropriate voting blocks. As a result, directors must evaluate all of their relationships with each other to determine whether the director is deemed independent. The board of directors shall investigate and evaluate such relationships using the care, skill, prudence, and diligence that a prudent person acting in a like capacity would use.

(updated Sept. 18, 2007)

Testimony of
Jeff Mahoney
General Counsel
Council of Institutional Investors
before the
Committee on Banking, Housing, and Urban Affairs
November 14, 2007

Attachment 3

Council Board of Directors

Council Board

Council Officers

Jack Ehnes
Board Chair
California State Teachers' Retirement System

Peggy Foran
Co-Chair
Pfizer Retirement Annuity Plan

Bruce Raynor
Co-Chair
UNITE HERE National Retirement Fund

Kathy-Ann Reissman
Co-Chair
Employees Retirement System of Texas

Gail Stone
Treasurer
Arkansas Public Employees' Retirement System

Warren Mart
Secretary
I.A.M. National Pension Fund

Ann Yerger
Executive Director (*non-board member)*
Council of Institutional Investors

Board Members

Mary Collins
The District of Columbia Retirement Board

Joe Dear
Washington State Investment Board

Benny Hernandez
Sheet Metal Workers' National Pension Fund

Dennis Johnson
California Public Employees' Retirement System

Richard Metcalf
LIUNA Staff and Affiliates Pension Plan

D. Craig Nordlund
Agilent Technologies Benefit Plans

Jody Olson
Idaho Public Employees Retirement System

Michael Travaglini
Massachusetts Pension Reserves Investment Management Board

Meredith Williams
Colorado Public Employees' Retirement Association

Testimony of
Jeff Mahoney
General Counsel
Council of Institutional Investors
before the
Committee on Banking, Housing, and Urban Affairs
November 14, 2007

Attachment 4

Council Responses to the Proposals

Council of Institutional Investors

Council Responses to the Proposals

1. Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors ("Council"), to The Honorable Christopher Cox, Chairman, Securities and Exchange Commission ("SEC") (Aug. 8, 2007).

2. Letter from Jeff Mahoney, General Counsel, Council, to Nancy M. Morris, Secretary, SEC (Aug. 24, 2007).

3. Letter from Jeff Mahoney, General Counsel, Council, to Nancy M. Morris, Secretary, SEC (Sept. 18, 2007) (File Number: S7-16-07).

4. Letter from Jeff Mahoney, General Counsel, Council, to Nancy M. Morris, Secretary, SEC (Sept. 18, 2007) (File Number S7-17-07).

COUNCIL OF INSTITUTIONAL INVESTORS
Suite 500 • 888 17th Street, NW • Washington, DC 20006 • (202) 822-0800 • Fax (202) 822-0801 • www.cii.org

Via Hand Delivery

August 8, 2007

The Honorable Christopher Cox
Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: July 25, 2007, Securities and Exchange Commission ("SEC" or "Commission") Open Meeting: "Meeting the Competitive Challenges of the Global Marketplace" ("July 25th Meeting")

Dear Mr. Chairman:

I am writing on behalf of the Council of Institutional Investors ("Council"), an association of more than 130 public, corporate, and union pension funds with combined assets of over $3 trillion. As a leading voice for long-term, patient capital, the Council has long advocated a policy that "shareowners should have meaningful opportunities to suggest or nominate director candidates and to suggest processes and criteria for director selection and evaluation."[1] Thus, the SEC's July 25th Meeting and the resulting proposed rules: (1) Shareholder Proposals (File Number S7-16-07) and (2) Shareholder Proposals Relating to the Election of Directors (File Number S7-17-07) are of great interest to our members.

[1] Council of Institutional Investors ("Council"), Annual Report, at 34 (Jan. 2007).

In observing the July 25th Meeting, it was our understanding that, in response to questions raised by Commissioner Roel C. Campos, the SEC staff indicated that they would maintain the status quo and *would not* resume issuing no-action letters permitting the exclusion of shareowner resolutions on proxy statement access for board nominations *unless* a final rule is adopted which makes exclusions of such resolutions permissible. We, therefore, were surprised and concerned by Commissioner Paul S. Atkins' recent remarks on this issue before the Federal Reserve Bank of Chicago. Those remarks include the following statement about the July 25th Meeting:

> We specifically adopted a current interpretation of the director election exclusion that is consistent with the SEC's long-standing interpretation and the interpretation that we put forward to the Second Circuit. As directed by the court, we have provided a thorough explanation for that position. This interpretation, *which now governs our administration of that provision,* will provide the necessary clarity and uniformity for both investors and companies alike *until an amendment is adopted in the future*.[2]

Commissioner Atkins' remarks appear to be in direct conflict with statements made by the SEC staff at the July 25th Meeting. Given the importance of this issue to the Council and its members,[3] we would respectfully request that you please clarify whether the SEC staff will resume issuing no-action letters permitting the exclusion of shareowner resolutions on proxy statement access for board nominations in the absence of a final rule on the Commission's proposals.

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[2] Commissioner Paul S. Atkins, Remarks Before the Federal Reserve Bank of Chicago Seventh Annual Private Equity Conference 6 (Aug. 2, 2007), *available at* http://www.sec.gov/news/speech/2007/spch080207psa.htm (emphasis added).

[3] As you may be aware, the Council filed a brief as *amicus curiae* in support of Plaintiff-Appellant in American Federation of State, County & Municipal Employees Pension Plan v. American International Group, Inc. (2d Cir. 2005) (No. 05-2825).

Thank for your attention to this matter. We look forward to your reply.

Sincerely,

Jeff Mahoney
General Counsel

CC: Commissioner Paul S. Atkins
Commissioner Roel C. Campos
Commissioner Kathleen L. Casey
Commissioner Annette L. Nazareth
Director John W. White, Division of Corporation Finance
General Counsel Brian G. Cartwright, Office of General Counsel
Senator Christopher J. Dodd, Chairman, Committee on Banking, Housing, and Urban Affairs
Senator Richard C. Shelby, Ranking Member, Committee on Banking, Housing, and Urban Affairs
Representative Barney Frank, Chairman, Committee on Financial Services
Representative Spencer Bachus, Ranking Member, Committee on Financial Services

COUNCIL OF INSTITUTIONAL INVESTORS

Suite 500 • 888 17th Street, NW • Washington, DC 20006 • (202) 822-0800 • Fax (202) 822-0801 • www.cii.org

Via Email

August 24, 2007

Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Shareholder Proposals (File Number: S7-16-07) and Shareholder Proposals Relating to the Election of Directors (File Number: S7-17-07)

Dear Ms. Morris:

I am writing on behalf of the Council of Institutional Investors ("Council"), an association of more than 130 public, corporate and union pension funds with combined assets of over $3 trillion. As a leading voice for long-term, patient capital, the Council welcomes the opportunity to provide our initial comments on the Securities and Exchange Commission's ("SEC" or "Commission"): (1) proposed amendments to the rules under the Securities Exchange Act of 1934 ("1934 Act") concerning shareowner resolutions and electronic shareowner communications, as well as to the disclosure requirements of Schedule 14A and Schedule 13G ("Proposed Amendments"); and (2) interpretive and proposing release to clarify the meaning of the exclusion for shareowner resolutions relating to the election of directors that is contained in Rule 14a-8(i)(8) under the 1934 Act ("Proposed Release") (collectively, the "Proposals").

The Council's corporate governance policies have long stated that "shareowners should have . . . meaningful opportunities to suggest or nominate director candidates and to suggest processes and criteria for director selection and evaluation."[4] Unfortunately, far too many director elections remain a *fait accompli,* regardless of how troubled a company may be. As a result, the only way that individual director nominees may be effectively challenged at some companies is if a shareowner is willing and able to assume the risk and expense of nominating a slate of candidates and running a full-blown election contest. Such ventures are onerous and cost-prohibitive—even in today's world of e-proxy. The Council, therefore, strongly supports reforms that would permit meaningful shareowner access to company-prepared proxy materials relating to the nomination and election of directors. We believe such reforms would make boards more responsive to shareowners, more thoughtful about whom they nominate to serve as directors and more vigilant in their oversight of companies.

The Council's support for meaningful proxy access is shared by a growing number of shareowners. During the 2007 proxy season, three proxy access shareowner resolutions were presented for a vote and all received significant support. One resolution was approved by the shareowners (Cryo-Cell International, Inc.).[5] According to Institutional Shareholder Services, the other two resolutions received 45.3 percent (UnitedHealth Group) and 43.0 percent (Hewlett-Packard Company) of the vote, respectively.

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[4] Council of Institutional Investors ("Council"), Annual Report 34 (Jan. 2007).

[5] Press Release, Cryo-Cell International Inc., Cryo-Cell Announces Certified Results of Annual Shareholders Meeting (Aug. 1, 2007), *available at* http://www.cryo-cell.com/investor_relations/subpage_noad.asp?ID=204.

The Council applauds the Commission for again considering the very important shareowner issue of proxy access.[6] Unfortunately, the Council can not support the Proposals as currently drafted.

The following is a brief summary of some of our initial concerns in response to the Proposed Amendments and the Proposed Release, respectively. The Council plans on filing a more detailed comment letter prior to the expiration of the Proposals' comment period.

Proposed Amendments

The Proposed Amendments include provisions providing that shareowner bylaw resolutions would be required to be included in the company's proxy materials if certain conditions are met.[7] Those conditions include:

(1) the shareowner (or group of shareowners) that submits the proposal must file a Schedule 13G that includes specified public disclosures regarding its background and its interactions with the company; and

(2) the proposal must be submitted by a shareowner (or group of shareowners) that has continuously beneficially owned more than 5% of the company's securities entitled to be voted on the proposal at the meeting for at least one year by the date the shareowner submits the proposal.[8]

Setting aside for the purposes of this letter our reservations about the voluminous and burdensome disclosures required of shareowners by the first condition, our initial concern with the Proposed Amendments focuses on the five percent threshold required by the second condition.[9]

In the interest of providing at least some preliminary input for the Commission's consideration, the Council consulted with member funds that have an active governance program that includes regular submission of shareowner resolutions. From that perspective, the five percent threshold appears to be unworkable.[10]

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[6] Shareholder Proposals, Exchange Act Release No. 56,160, Investment Company Act Release No. 27,913, 72 Fed. Reg. 43,466 (proposed Aug. 3, 2007), *available at* http://www.sec.gov/rules/proposed/2007/34-56160fr.pdf; Shareholder Proposals Relating to the Election of Directors, Exchange Act Release No. 56,161, Investment Company Act Release No. 27,914, 72 Fed. Reg. 43,488 (proposed Aug. 3, 2007), *available at* http://www.sec.gov/rules/proposed/2007/34-56161fr.pdf.

[7] Shareholder Proposals, 72 Fed. Reg. at 43,470.

[8] *Id.*

[9] We agree with the comments of Securities and Exchange Commission ("SEC") Roel C. Campos that the "high threshold may make [the rule] useless." Subodh Mishra, *The SEC Splits on Proxy Access*, Institutional Shareholder Services, Corporate Governance Blog, Jul. 30, 2007, at 1, *available at* http://blog.issproxy.com/2007/07/the_sec_splits_on_proxy_access.html. Of note, the Council's policies for *nominating* directors include a five percent threshold. Council, Annual Report at 37. In our view, and as described in more detail in this letter, getting five percent of a company's outstanding shares to nominate a director candidate is far easier to achieve than obtaining five percent of the shareowners to *sponsor* a shareowner resolution since few investors have historically chosen to sponsor resolutions.

[10] According to Institutional Shareholder Services, at least 158 separate proponents were responsible for submitting the 688 governance-related shareowner proposals that were filed for the 2006 proxy season. Approximately 280 of the 688 resolutions were filed by Council members. Those resolutions were submitted by a total of only 16 member funds.

While institutional investors may collectively own more than sixty percent of outstanding U.S. equities, the funds that currently engage portfolio companies using tools such as shareowner resolutions account for a much smaller percent of the total U.S. equity market.[11] To be sure, a fund's willingness to file a shareowner resolution is not a perfect indicator of a fund's willingness to join a group proposing a director nomination bylaw. However, the current record is a useful starting point for assessing the practical impact of establishing a five percent threshold.

More specifically, our preliminary research indicates that even if the ten largest public pension funds were to aggregate their holdings of a single public company's securities, those funds combined would likely be unable to clear the five percent hurdle. Moreover, the five percent hurdle would likely be too high whether the funds' aggregate holdings are in a large-cap, mid-cap or small-cap company. [12] Much of this relates to the obligation of funds to maintain diverse portfolios, as evidenced by internal policies to limit their holdings in an individual company to a small percentage (generally less than 0.5%) of the company's outstanding shares. Thus, many more funds and other investors would need to collaborate to hit the five percent threshold in most circumstances. Given the small number of investors that traditionally sponsor shareowner resolutions, it is currently difficult to imagine how a sufficiently large coalition could be established.[13]

Proposed Release

The Proposed Release includes language that would reinterpret Rule 14a-8(i)(8) under the 1934 Act more broadly to permit exclusion of any shareowner resolutions seeking access to a company's proxy materials to nominate or elect a company's directors.[14] The SEC argues that this broader reinterpretation is "consistent with" the Commission's longstanding view of the purpose of Rule 14a-8(i)(8).[15]

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[11] The Conference Board, Institutional Investment Report 29 (2007).

[12] For example, based on information compiled from FactSet Research Systems, Inc., if the 10 largest public pension fund holders of Exxon Mobil Corporation (a large-cap stock), Precision Castparts Corp. (a mid-cap stock), and The Manitowoc Company, Inc. (a small-cap stock) were to aggregate their ownership interests, the resulting percentage holdings for those groups would be approximately 3.01, 3.59, and 3.56, respectively.

[13] In recent Congressional testimony, SEC Chairman Christopher Cox, in response to a question from Committee on Banking, Housing, and Urban Affairs Chairman Christopher J. Dodd, appeared to concede that the five percent threshold would be difficult for investors to meet. *See The State of the Securities Markets Before the Comm. on Banking, Housing, and Urban Affairs,* 110th Cong. 48 (Jul. 31, 2007) (Draft of hearing transcript). More specifically, Chairman Cox suggested that the proposed amendment to facilitate the use of electronic shareowner forums "would be a way to put together a 5 percent group that does not exist today." *Id.* In our view, it is unclear whether the proposed amendment relating to electronic shareowner forums, if adopted, would assist investors in establishing the five percent threshold. We would also note that the proposal explicitly raises the question whether "shareholders [should] be able to use a forum to solicit other shareholders to form a 5% group in order to submit a bylaw proposal?" Shareholder Proposals, 72 Fed. Reg. at 43,477.

[14] Shareholder Proposals Relating to the Election of Directors, 72 Fed. Reg. at 43,493.

[15] *Id.* at 12.

The Council's analysis of Rule 14a-8(i)(8), contained in our *amicus* brief in support of Plaintiff-Appellant American Federation of State, County & Municipal Employees Pension Plan before the United States Court of Appeals for the Second Circuit, demonstrates that the SEC's current argument might have merit if one only considers how the Commission has interpreted Rule 14a-8(i)(8) since 1990.[16] If, however, one also considers the SEC's interpretation of Rule 14a-8(i)(8) from its initial published interpretation (in 1976) to when it began applying a different interpretation (in 1990), the Commission's argument becomes unconvincing.[17]

It is disappointing that the Commission devotes over two dozen paragraphs of the Proposed Release to constructing a questionable basis for supporting a broader interpretation of Rule 14a-8(i)(8). It is even more troubling when one considers that (1) the broader interpretation, if adopted, would likely shut the door on shareowners' ability to submit binding or advisory resolutions seeking access to the proxy;[18] and (2) shareowner support for meaningful proxy access is strong and continues to grow.[19]

The Council could accept the SEC's analysis of Rule 14a-8(i)(8) if it was accompanied by the promulgation of a new rule providing shareowners an alternative means to meaningfully access the proxy. As described above, however, the proxy access provisions of the Proposed Amendments sadly fail to meet the needs and desires of investors.

* * * *

The Council appreciates the opportunity to provide our initial comments on the Proposals. Please feel free to contact me with any questions.

Sincerely,

Jeff Mahoney
General Counsel

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[16] *See* Brief for Council as *Amicus Curiae* in support of Plaintiff-Appellant at 20, American Federation of State, County & Municipal Employees Pension Plan v. American International Group, No. 05-2825 (2nd Cir. Aug. 2005); *accord* American Federation of State, County & Municipal Employees, Employees Pension Plan v. American International Group, Inc., at 2 (2d Cir. Dec. 15, 2005), *available at* http://www.ca2.uscourts.gov:8080/isysnative/RDpcT3BpbnNcT1BOXDA1LTI4MjVfb3BuLnBkZg==/05-2825_opn.pdf.

[17] *Id.*

[18] We agree with the comments of SEC Commissioner Annette L. Nazareth who described the Shareholder Proposals Relating to the Election of Directors as "the shareholder non-access proposal." Nicholas Rummell, *One body, two minds on proxy access*, Financial Week, Jul. 20, 2007, at 2, *available at* http://www.financialweek.com/apps/pbcs.dll/article?AID=/20070730/REG/70727028/&SearchID=732898 1673323.

[19] *See supra* text accompanying note 2.

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Via Email

September 18, 2007

Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Shareholder Proposals (File Number: S7-16-07)

Dear Ms. Morris:

I am writing on behalf of the Council of Institutional Investors ("Council"), an association of more than 130 public, corporate and union pension funds with combined assets of over $3 trillion. As a leading voice for long-term, patient capital, the Council welcomes the opportunity to provide additional comments on the Securities and Exchange Commission's ("SEC" or "Commission") proposed amendments to the rules under the Securities Exchange Act of 1934 concerning shareowner resolutions and electronic shareowner communications, as well as to the disclosure requirements of Schedule 14A and Schedule 13G ("Proposed Amendments").[20]

First and foremost, the Council applauds the Commission for again taking up the very important investor rights issue of proxy access. We very much appreciate the many hours of hard work that the SEC Staff and Commission have devoted to the development of the Proposed Amendments.

The Council generally supports the Commission's objectives of "vindicating shareholders' state law rights to nominate directors . . . and ensuring full disclosure in election contests . . . ."[21] Unfortunately, for the reasons summarized below and described in more detail in the Attachment to this comment letter, the Council can not support the Proposed Amendments as currently drafted. We, however, stand ready to continue to work with the Commission to develop meaningful proxy access reforms.

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[20] See August 24, 2007, letter from Jeff Mahoney, General Counsel, Council of Institutional Investors ("Council"), to Nancy M. Morris, Secretary, Securities and Exchange Commission, *available at* http://www.cii.org/proxy/pdf/August%2024,%202007%20comment%20letter%20on%20file%20no.%20S7-16-07%20and%20S7-17-07%20_final_.pdf, for the Council's initial comments on the Shareholder Proposals, Exchange Act Release No. 56,160, Investment Company Act Release No. 27,913, 72 Fed. Reg. 43,466 (proposed Aug. 3, 2007), *available at* http://www.sec.gov/rules/proposed/2007/34-56160fr.pdf.

[21] Shareholder Proposals, 72 Fed. Reg. at 43,469.

The Council's corporate governance policies have long stated that "shareowners should have . . . meaningful opportunities to suggest or nominate director candidates and to suggest processes and criteria for director selection and evaluation."[22] Far too many director elections, however, remain a *fait accompli*, regardless of how troubled a company may be. As a result, the only way that individual director nominees may be effectively challenged at some companies is if a shareowner is willing and able to assume the risk and expense of nominating a slate of candidates and running a full-blown election contest. Such ventures are onerous and cost-prohibitive—even in today's world of e-proxy. The Council, therefore, strongly supports reforms that would permit meaningful shareowner access to company-prepared proxy materials relating to the nomination and election of directors. We believe such reforms would make boards more responsive to shareowners, more thoughtful about whom they nominate to serve as directors and more vigilant in their oversight of companies.

The Council's support for meaningful proxy access is shared by a growing number of shareowners. During the 2007 proxy season, three proxy access shareowner resolutions were presented for a vote and all received significant support: (1) a non-binding resolution approved by shareowners of Cryo-Cell International, Inc;[23] (2) a non-binding resolution that, according to Institutional Shareholder Services ("ISS"), received 45.25 percent of the votes cast for-and-against by shareowners of UnitedHealth Group Incorporated ("UnitedHealth"); and (3) a binding resolution, that according to ISS, received 42.95 percent of the votes cast for-and-against by shareowners of Hewlett-Packard Company.

In the face of growing support by shareowners for meaningful proxy access, the Proposed Amendments would permit certain shareowners to include in company proxy materials proposals for amendments to bylaws that would mandate procedures to allow shareowners to nominate board of director candidates. The Proposed Amendments, however, fail to reflect a practical understanding of the ways that institutional investors approach proxy access issues. As a result, the Commission appears to have severely underestimated the workability of the Proposed Amendments.

More specifically, the Council believes that (1) the proposed more than five percent threshold for submitting a bylaw resolution would be too high a barrier; and (2) the proposed related disclosure requirements would be too burdensome. In addition, we note that the Proposed Amendments include a discussion about the potential adoption of new rules that would permit a company to propose—and its shareowners to adopt—a bylaw restricting the ability of shareowners to offer non-binding or precatory shareowner resolutions. If such rules were adopted, we believe they would unduly restrict the use of precatory resolutions—a fundamental shareowner right—with negative consequences for the quality of corporate governance practices and the long-term performance of companies.

More than Five Percent Requirement

The Proposed Amendments include provisions providing that shareowner bylaw resolutions would be required to be included in the company's proxy materials if certain conditions are met.[24] Those conditions include that the proposal must be submitted by a shareowner (or group of shareowners) that has continuously and beneficially owned more than five percent of the company's securities entitled to be voted on the proposal at the meeting for at least one year by the date the shareowner submits the proposal.[25]

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[22] Council, Annual Report 34 (Jan. 2007).
[23] Press Release, Cryo-Cell International Inc., Cryo-Cell Announces Certified Results of Annual Shareholders Meeting (Aug. 1, 2007), *available at* http://www.cryo-cell.com/investor_relations/subpage_noad.asp?ID=204.
[24] Shareholder Proposals, 72 Fed. Reg. at 43,470.
[25] *Id.*

We believe that the more than five percent threshold would be too high a barrier. While institutional investors may collectively own more than sixty percent of outstanding U.S. equities, approximately one-half of those shares are held by mutual funds and insurance companies.[26] The Commission should acknowledge that those institutional investors generally do not sponsor shareowner resolutions, even those they support.

Those institutional investors, largely public and union pension funds, that currently engage portfolio companies using tools such as shareowner resolutions account for less than ten percent of the total U.S. equity market.[27] As a result of those funds' obligations to diversify their portfolios and manage risk, the level of holdings that those funds may have in any single company is relatively small. For example, one of the Council's largest members—The California State Teachers' Retirement System—generally owns only about 0.3 percent of the outstanding stock of any company in the Russell 3000.[28]

The ability to aggregate individual pension funds for a shareowner resolution is a difficult exercise. For example, earlier this year the Council's largest member—the California Public Employees' Retirement System ("CalPERS")—tried without success to find co-sponsors for its proxy access resolution at UnitedHealth. CalPERS, with approximately 0.5 percent of the company's outstanding shares, ended up as the sole sponsor.[29] Even so, as previously indicated, the resolution garnered more than 45.25 percent of the shares cast for-and-against—a high rate of shareowner support for a first-time resolution.

Our research indicates that even if CalPERS and nine of the other largest public pension funds were to successfully aggregate their holdings of a single public company's securities, those funds combined would likely be unable to clear the more than five percent hurdle. For example, based on information compiled from FactSet Research Systems, Inc., if the 10 largest public pension fund holders of Exxon Mobil Corporation (a large-cap stock), Precision Castparts Corp. (a mid-cap stock), and The Manitowoc Company, Inc. (a small-cap stock) were to aggregate their ownership interests, the resulting percentage holdings for those shareowner groups would be approximately 3.01, 3.59, and 3.56, respectively.

Disclosure Requirements

A second condition for submitting a shareowner bylaw resolution under the Proposed Amendments is that the shareowner or group of shareowners that submit the proposal must (1) be eligible to file a Schedule 13G; (2) actually file the Schedule 13G; and (3) include in the filed Schedule 13G the specified public disclosures regarding its background and its interactions with the company.[30]

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[26] The Conference Board, Institutional Investment Report 29 (2007) (Indicating that investment companies and insurance companies hold 22.8% and 7.4%, respectively, of the total U.S. equity market).
[27] *Id.* (Indicating that state and local pension funds hold 9.8% of the total U.S. equity market). Of note, according to Institutional Shareholder Services, at least 158 separate proponents were responsible for submitting the 688 governance-related shareowner proposals that were filed for the 2006 proxy season. Approximately 280 of the 688 resolutions were filed by Council members.
[28] E-mail from Christopher J. Ailman, Chief Investment Officer, CalSTRS, to Justin Levis, Senior Analyst, Council (Sept. 7, 2007, 3:09 PM EST) (On file with Council). Similarly, Council member—The Florida State Board of Administration—typically owns only about 0.33% of the outstanding stock of any company in the Russell 3000. E-mail from Tracy Stewart, Corporate Governance Manager, Florida State Board of Administration, to Justin Levis, Senior Analyst, Council (Sept. 7, 2007, 5:55 PM EST) (On file with Council).
[29] *See* UnitedHealth Group Incorporated, Proxy Statement for Annual Meeting of Shareholders to be Held May 29, 2007 (Schedule 14A), at 100 (Apr. 30, 2007), *available at* http://www.unitedhealthgroup.com/invest/2007/Proxy_Stmt_2007.pdf.
[30] Shareholder Proposals, 72 Fed. Reg. at 43,470.

The Council does not object to the imposition of additional filing and disclosure requirements for shareowners accessing the proxy. The level of disclosure, however, required by the Proposed Amendments appears overly burdensome going beyond even those disclosures that would be required of shareowners filing a Schedule 13D who may be attempting a hostile takeover of a company.

As indicated above, the practical effect of the more than five percent requirement would be that numerous institutional investors would have to aggregate their holdings to form a qualifying shareowner group. To the extent that the Proposed Amendments contemplate detailed disclosures about each and every member of that group, there would be a corresponding increase in the amount of recordkeeping that would be required regarding each investor's contacts with a given company.

There would also be significant efforts required in terms of compiling the proposed disclosures into an initial Schedule 13G filing, not to mention the burden of the additional requirements that appear to be contemplated for amended Schedule 13G filings. We simply do not believe that the Commission has provided an adequate basis justifying what would appear to be an extraordinary level of detailed disclosure resulting from the exercise of a fundamental shareowner right.

Precatory Proposals

Finally, the Proposed Amendments include an inquiry into whether the Commission should consider adopting new rules under which the existing federal proxy rules that govern the ability of shareowners to offer precatory proposals would be replaced by a generally more restrictive regime governed by state law and a company's governing documents.[31] The Proposed Amendments suggest that such restrictions are appropriate "in light of developments in the last 25 years that may have diminished the concerns about shareholders' ability to act as a group . . . ."[32] The Council disagrees.

We believe the "developments in the last 25 years" evidence the growing number of shareowners willing to vote for precatory resolutions and that many such resolutions are being adopted. We are concerned that the Proposed Amendments could hinder the ability of shareowners *as a whole* to communicate with management and the board at the only forum each year where such communication is possible. We are surprised and disappointed that at a time when companies are improving their corporate governance policies in response to shareowner precatory resolutions in record numbers,[33] the Proposed Amendments appear designed to inhibit shareowners from pursuing those proposals.

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[31] *Id.* at 43,477-78.
[32] *Id.* at 43,478.
[33] *See, e.g.*, Edward Iwata, *Boardrooms open up to investors' input*, USA Today, Sept. 6, 2007, at 1, *available at* http://www.usatoday.com/money/companies/management/2007-09-06-shareholders-fight_N.htm (Noting that a record 23% of shareholder resolutions proposed in 2007 "were withdrawn by shareowners after companies agreed to adopt new policies, or to sit down and discuss the issues").

We appreciate the opportunity to express our views on this matter. Please feel free to contact me with any questions.

Sincerely,

Jeff Mahoney
General Counsel

Attachment

Attachment: Responses to Selected Questions from SEC Shareholder Proposals

As proposed, a bylaw proposal may be submitted by a shareholder (or group of shareholders) that is eligible to and has filed a Schedule 13G that includes specified public disclosures regarding its background and its interactions with the company, that has continuously held more than 5% of the company's securities for at least one year, and that otherwise satisfies the procedural requirements of Rule 14a-8 (e.g., holding the securities through the date of the annual meeting). Are these disclosure-related requirements for who may submit a proposal, including eligibility to file on Schedule 13G, appropriate? If not, what eligibility requirements and what disclosure regime would be appropriate? (page 43,470)

We do not believe these disclosure-related requirements are appropriate. The requirements would appear to be overly burdensome for many members of the Council of Institutional Investors ("Council") and other institutional investors in a number of ways. Perhaps most significantly, the requirements contemplate a highly detailed set of disclosures of participants in a shareowner group filing a proxy access bylaw. There is a paradox here: The Securities and Exchange Commission ("SEC" or "Commission") is proposing to use Schedule 13G as the template, yet the proposed disclosures go far beyond what is currently required of passive investors who must file on Schedule 13G, and, more startling, they appear to require far more detail than would be required of shareowners filing a Schedule 13D who are attempting a hostile takeover of a company. This defies logic.

Proponents of proxy access seek to do nothing more than offer a shareowner resolution (as has been their right for over sixty years) and to do so in the form of a bylaw, a right generally conferred upon shareowners under state law. While some additional disclosures would be appropriate, the proposal does not explain why such a high level of detailed disclosure is required, particularly as to institutional shareowners who may be proposing such a bylaw consistent with their fiduciary obligations to their funds' participants.

The disclosure-related requirements also appear to lack the specificity necessary to properly evaluate whether some elements of the eligibility requirements and the disclosure regime are appropriate. As one example, the requirements are confusingly vague as to the timing of an institution's filing because the proposal appears to be inconsistent with current deadlines for Schedule 13G filings.

More specifically, the disclosure-related requirements appear to contemplate the filing of an initial Schedule 13G no later than the filing of a proxy access bylaw proposal. However, the requirements do not explicitly amend the rule setting out Schedule 13G filing requirements. As a result, the disclosure-related requirements would appear to impose a requirement different from the normal schedule for institutional investors, who under Rule 13d-1(d) are otherwise not required to file a Schedule 13G until forty-five days after the end of the year in which the five percent holding was acquired. Amendments to that Schedule 13G are under Rule 13d-2(b) normally filed forty-five days after the end of the calendar year in which the change occurs. Thus, under the disclosure-related requirements, it would appear that an amendment to Schedule 13G might not be filed until after the annual shareowner meeting has been held.

The disclosure-related requirements also fail to provide sufficient information about some other potentially important aspects of the requirements including: (1) what would trigger the need to file an amendment to Schedule 13G?; (2) would the requirements be equally applicable to all members of a shareowner group?; (3) would there be a materiality requirement?; (3) would a single incident be a triggering event?; (4) What would be the period of time covered by a filing? We believe that the proposal's lack of specificity with respect to those and other issues may make it difficult for commentators to provide meaningful input, particularly in response to the SEC's request for comments on issues relating to the Paperwork Reduction Act,[34] the Cost-Benefit Analysis,[35] the Consideration of Burden on Competition and Promotion of Efficiency, Competition and Capital Formation,[36] and the Initial Regulatory Flexibility Act Analysis.[37]

If the Commission plans to further pursue the disclosure-related requirements, we believe consideration should be given to issuing a supplemental notice for public comment. That notice should include revisions to the requirements to address some of the above issues, including, if necessary, revised estimates of the compliance costs.

For example, should the 5% ownership threshold be higher or lower, such as 1%, 3%, or 10%? Is the 5% level a significant barrier to shareholders making such proposals? Does the impediment imposed by this threshold depend on the size of the company? Should the ownership percentage depend on the size of the company? For example, should it be 1% for large accelerated filers, 3% for accelerated filers and 5% for all others? Should an ownership threshold be applicable to all? (page 43,470)

We believe that the five percent ownership threshold is too high a barrier for shareowners submitting resolutions. While institutional investors may collectively own more than sixty percent of outstanding U.S. equities, approximately one-half of those shares are held by mutual funds and insurance companies.[38] The Commission should acknowledge that those institutional investors generally do not sponsor shareowner resolutions, even those they support.

Those institutional investors, largely public and union pension funds, that currently engage portfolio companies using tools such as shareowner resolutions account for less than ten percent of the total U.S. equity market.[39] As a result of those funds' obligations to diversify their portfolios and manage risk, the level of holdings that those funds may have in any single company is relatively small. For example, one of the Council's largest members—The California State Teachers' Retirement System—generally owns only about 0.3 percent of the outstanding stock of any company in the Russell 3000.[40]

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[34] Shareholder Proposals, Exchange Act Release No. 56,160, Investment Company Act Release No. 27,913, 72 Fed. Reg. 43,466, 43,480-82 (proposed Aug. 3, 2007), *available at* http://www.sec.gov/rules/proposed/2007/34-56160fr.pdf

[35] *Id.* at 43,482-83.

[36] *Id.* at 43,483-84.

[37] *Id.* at 43,484-85.

[38] *See, e.g.*, The Conference Board, Institutional Investment Report 29 (2007) (Indicating that investment companies and insurance companies hold 22.8% and 7.4%, respectively, of the total U.S. equity market).

[39] *Id.* (Indicating that state and local pension funds hold 9.8% of the total U.S. equity market).

[40] E-mail from Christopher J. Ailman, Chief Investment Officer, CalSTRS, to Justin Levis, Senior Analyst, Council (Sept. 7, 2007, 3:09 PM EST) (On file with Council). Similarly, Council member—The Florida State Board of Administration—typically owns only about 0.33% of the outstanding stock of any company in the Russell 3000. E-mail from Tracy Stewart, Corporate Governance Manager, Florida State Board of Administration, to Justin Levis, Senior Analyst, Council (Sept. 7, 2007, 5:55 PM EST) (On file with Council).

The ability to aggregate individual pension funds for a shareowner resolution is a difficult exercise. For example, earlier this year the Council's largest member—the California Public Employees' Retirement System ("CalPERS")—tried without success to find co-sponsors for its proxy access resolution at UnitedHealth Group Incorporated. CalPERS, with approximately 0.5 percent of the company's outstanding shares, ended up as the sole sponsor.[41] Even so, the resolution garnered more than 45.25 percent of the shares cast for-and-against—a high rate of shareowner support for a first-time resolution.

Our research indicates that even if CalPERS and nine of the other largest public pension funds were to successfully aggregate their holdings of a single public company's securities, those funds combined would likely be unable to clear the more than five percent hurdle. Moreover, the more than five percent threshold would likely be too high a barrier whether the funds' aggregate holdings are in a large-cap, mid-cap or small-cap company. For example, based on information compiled from FactSet Research Systems, Inc., if the 10 largest public pension fund holders of Exxon Mobil Corporation (a large-cap stock), Precision Castparts Corp. (a mid-cap stock), and The Manitowoc Company, Inc. (a small-cap stock) were to aggregate their ownership interests, the resulting percentage holdings for those groups would be approximately 3.01, 3.59, and 3.56, respectively.

Thus, many more funds and other investors would need to collaborate to hit the more than five percent threshold in most circumstances. As indicated, given the small number of investors that traditionally sponsor shareowner resolutions, it is currently difficult to imagine how a sufficiently large coalition could be established.[42]

Moreover, the problem would be compounded by the proposed disclosure-related requirements, particularly if they were to be applied to each and every member of a shareowner group. As indicated, those requirements would appear to be far more detailed than are currently required of shareowners who file a Schedule 13D.

Proposals to establish a procedure for shareholder nominees would be subject to the existing limit under Rule 14a-8 of 500 words in total for the proposal and supporting statement. Is this existing word limit sufficient for such a proposal? If not, what increased word limit would be appropriate? (page 43,471)

The existing word limit under Rule 14a-8 often makes it difficult to draft a bylaw and a related supporting statement given the level of detail that may be necessary. We, therefore, believe that increasing the word limit would be appropriate.

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[41] *See* UnitedHealth Group Incorporated, Proxy Statement for Annual Meeting of Shareholders to be Held May 29, 2007 (Schedule 14A), at 100 (Apr. 30, 2007), *available at* http://www.unitedhealthgroup.com/invest/2007/Proxy_Stmt_2007.pdf.

[42] In recent Congressional testimony, SEC Chairman Christopher Cox, in response to a question from Committee on Banking, Housing, and Urban Affairs Chairman Christopher J. Dodd, appeared to concede that the more than five percent threshold would be difficult for investors to meet. *See The State of the Securities Markets Before the Comm. on Banking, Housing, and Urban Affairs,* 110th Cong. 48 (Jul. 31, 2007) (Draft of hearing transcript). More specifically, Chairman Cox suggested that the proposed amendment to facilitate the use of electronic shareowner forums "would be a way to put together a 5 percent group that does not exist today." *Id.*

In seeking to form a group of shareholders to satisfy the 5% threshold, shareholders may seek to communicate with one another, thereby triggering application of the proxy rules. In order not to impose an undue burden on such shareholders, should such communications be exempt from the proxy rules? If so, what should the parameters of any such exemption be? (page 43,471)

We believe that shareowner communications with one another in seeking to form a group to satisfy any proxy access threshold should be exempt from the proxy rules. Some form of communication between shareowners is almost inevitable before one will even know whether there is enough support to propose a proxy access bylaw. If proponents of such a bylaw at a given company are able to muster a sufficient level of support, then appropriate disclosure requirements at that point should be sufficient to protect investors. We fail to understand the regulatory purpose or public policy basis for imposing disclosure requirements on passive non-control oriented shareowner groups prior to the time such a group is prepared to file a shareowner resolution.

The proposed disclosure standards relate to the qualifications of the shareholder proponent, any relationships between the shareholder proponent and the company, and any efforts to influence the decisions of the company's management or board of directors. To assure that the quality of disclosure is sufficient to provide information that is useful to shareholders in making their voting decisions and to limit the potential for boilerplate disclosure, we have proposed that the disclosure standards require specific information concerning these qualifications, relationships, and efforts to influence the company's management or board of directors. Is the proposed level of required disclosure appropriate? Are any of the proposed disclosure requirements unnecessary to shareholders' ability to make an informed voting decision? If so, which specific requirements are not necessary? Should we require substantially similar disclosure from both the proponent and the company as proposed or should the company be allowed to avoid duplicating disclosure relating to the proponent where the company agrees with the disclosure provided? Is any additional disclosure appropriate? (page 43,474)

As indicated, we believe the proposed level of required disclosure would appear to be too burdensome. As also indicated, we believe the proposed disclosure standards are too vague in some cases making it difficult to fully evaluate what is being proposed.

As one example, suppose that a pension fund's governance staff identifies a poorly performing company that the staff believes might benefit from a proxy access resolution; the proxy access resolution is developed and presented to the fund's board of trustees; the trustees authorize the staff to take steps to identify other investors who might be interested in achieving the requisite ownership threshold and, if there is sufficient interest, to file the proposal. This fairly typical scenario is rife with questions that the proposed disclosure standards never answer, for example: Who are the "person or persons" about whom each of the five enumerated categories of information must be disclosed?[43] The staff person who first formulated the idea? All the members of a fund's board of trustees? Or only those who voted to undertake the action?

[43] Shareholder Proposals, 72 Fed. Reg. at 43,473.

Regardless of what individuals may have to report, what does the proposed disclosure standards mean when they say that there must be disclosure of the "qualifications and background" of those individuals that are "relevant to the plans or proposals"?[44] Is election to a fund's board of trustees by fund participants a "qualification"? Does that confer the relevant "background" necessary for a trustee to endorse a proxy access proposal? If not, what does? And how much about one's "background" must be provided?

Whatever might be the answer to the aforementioned questions, we question the SEC's assumption that shareowners need additional disclosures about the qualifications of proponents in order to make voting decisions on shareowner resolutions. The Commission should identify who these shareowners are and why they need such information.

Would the proposed Schedule 13G disclosure requirements for shareholder proponents be useful to other shareholders in forming their voting decisions? Are the requirements practical? Is any aspect of the proposed disclosure overly burdensome for shareholder proponents to comply with? (page 43,474)

As indicated, the proposed Schedule 13G disclosure requirements would appear to require extensive recordkeeping duties that may be impractical or overly burdensome for shareowner proponents to comply with. As one example, suppose that a pension fund representative speaks with a director of Company A in May 2007 about matters affecting Company A. Suppose too that this director serves on the board of Company B. In March 2008, ten months after the encounter, the fund in question helps file a proxy access proposal at Company B in time for that company's September 2008 annual meeting. Given this fact pattern, under the proposed disclosure requirements it would appear that the following disclosure obligations would be triggered: (a) the pension fund would have to disclose the conversation with the director in "reasonable detail" in a Schedule 13G, which is filed ten months after the conversation took place;[45] and (b) the director would have to recall the conversation in order to assist Company B in preparing its proxy in August 2008 – even though the conversation had nothing to do with Company B.

To take another example, it would appear that the proposed disclosure requirements would require that every participant in a shareowner group calculate not only its holdings in the company being considered for a proxy resolution, but also every other enterprise in the same Standard Industrial Classification Code and add up those figures; if the total exceeds more than five percent on the date the plan to submit a bylaw is formulated, that holding would have to be reported.[46] Finally, we note that the proposed disclosure requirements would appear to be impractical or overly burdensome in some circumstances because the requirements do not appear to be limited to "material" items. For example, there does not appear to be any exceptions to the required disclosure in "[r]easonable detail" of "any meetings or contacts, including direct or indirect communication" with management or a director.[47]

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[44] *Id.*
[45] *Id.* at 43,472.
[46] *Id.* at 43,472 n. 50.
[47] *Id.* at 43,472.

As proposed, the disclosures concerning the shareholder proponent and the company's relationship must be provided for the 12 months prior to forming any plans or proposals, with regard to an amendment to the company bylaws. Is this the appropriate timeframe? If not, should the timeframe be shorter (e.g., 6 or 9 months) or longer (e.g., 18 or 24 months)? Is any federal holding period requirement appropriate? (page 43,474)

The vagueness of the proposed disclosures again makes it difficult to determine whether the timeframe for the disclosures concerning the shareowner proponent are appropriate, particularly when the shareowner group includes pension funds. For example, is the date a plan is "formed" for purposes of determining the timeframe the first date that a representative of a single fund advises management of an intent to file a proxy access proposal? If yes, the result would not appear to be realistic, given that the actual filing of a proposal will occur only if that fund is successful in enlisting numerous other holders with enough shares to meet the more than five percent threshold.

In addition, it would appear that there may be multiple "formation" dates for a single proposal. The provision requiring background information on responsible individuals at a fund appears to require disclosure of the identity of the person at a fund "responsible for the formation of any plan or proposals."[48] That is presumably a different person at each fund. Is the "formation" date the earliest date upon which any fund representative had a conversation with a company official? Would it not make more sense to key any "formation" date to the date that a shareowner group obtains enough participants to exceed the more than five percent threshold and definitively resolves to move forward?

The confusion over the proposed timeframe for disclosures is compounded by references to the "formation" date including the date upon which a shareowner or shareowner group says that it will *not* submit a proxy access bylaw if the company takes certain action. For example, suppose that a shareowner not owning the required threshold makes the following statement to a company: "If this company does not adopt a policy on golden parachutes, then we'll try to round up enough support to submit a proxy access bylaw." Presumably there is no need to file a Schedule 13G if no proxy access bylaw is ultimately filed. Or is there? Or suppose that the shareowner makes the aforementioned statement, but cannot find enough support until two years later. Are shareowners – and directors – required to search their memories and records going back that far?

As indicated, the lack of specificity with respect to the proposed disclosures makes it difficult for affected parties to submit substantive comments in response that do more than point out the many inconsistencies and ambiguities. Part of the problem may be the fact that the Commission is attempting to use Schedule 13G in a manner that it has not previously been used.

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[48] *Id.* at 43,473.

We propose to amend Regulation 14A to encourage the development of electronic shareholder forums that could be used by companies to better communicate with shareholders and by shareholders to better communicate both with their companies and among themselves. In addition, the electronic shareholder forum concept could offer shareholders a means of advancing referenda that might otherwise be proposed as non-binding shareholder proposals under Rule 14a-8. Is this appropriate and, if so, how can we further encourage the development of electronic shareholder forums? (page 43,477)

The Council generally supports the continued development of electronic shareowner forums. We do not agree with some of the comments expressed during SEC roundtables in May 2007 indicating that such forums would not do anything more than generate new corporate "chat rooms," and fail to produce significant communications on governance or other issues.[49]

We are optimistic that electronic shareowner forums will prove to be a valuable supplement to the current Rule 14a-8 process by providing shareowners with a means to determine the level of interest with regard to various governance issues and gauge support for potential proposals and initiatives. At this time, however, we would strongly oppose as premature the use of electronic shareowner forums as a substitute for the existing requirements for submitting precatory proposals under Rule 14a-8.

Would it be appropriate for the Commission to provide that the substance of the procedure for non-binding proposals contained in a bylaw amendment would not be defined or limited by Rule 14a-8, but rather by the applicable provisions of state law and the company's charter and bylaws? For example, the Commission could provide that the framework could be more permissive or more restrictive than the requirements of existing Rule 14a-8 (e.g., the framework could specify different eligibility requirements than provided in current Rule 14a-8, different subject matter criteria, different time periods for submitting non-binding proposals to the company, or different submission thresholds; or it could specify that non-binding proposals would not be eligible for inclusion in the company's proxy materials or alternatively that all non-binding proposals would be included in the company's proxy materials without restriction, if these approaches were consistent with state law and the company's charter and bylaws). (page 43,478)

We believe that all shareowner resolutions, whether binding or precatory, should continue to be uniformly regulated under Rule 14a-8. Thus, we believe it would be inappropriate for the Commission to provide that the substance of the procedure for precatory proposals contained in a bylaw amendment be defined or limited by the provisions of state law and the company's charter and bylaws.

According to Institutional Shareholder Services ("ISS"), over the past three years, Council members have filed on average about forty-six percent of all corporate governance-related resolutions submitted to U.S. companies.[50] They have filed shareowner resolutions for many years, and have done so with much success.

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[49] *See, e.g.*, L. Reed Walton, *Online Communication Grows,* Institutional Shareholder Services ("ISS"), Corporate Governance Blog, June 8, 2007, http://blog.issproxy.com/2007/06/online_communications_growssub.html.

[50] Of note, according to ISS, at least 158 separate proponents were responsible for submitting the 688 governance-related shareowner proposals that were filed for the 2006 proxy season. Approximately 280 of the 688 resolutions (40.7%) were filed by Council members.

For the most part Council members file precatory resolutions, which is consistent with how most resolutions are structured. As indicated in the following chart, according to ISS, the vast majority of all shareowner resolutions over the last four years (more than ninety-six percent) have been precatory:

	2004	2005	2006	2007
Governance Proposals (# filed)	751	731	690	823
Binding Proposals (# filed)	17	15	19	31
Binding Proposals (# voted)	8	6	13	11*
Percentage (filed)	2.3%	2.1%	2.8%	3.8%

* According to data obtained from ISS on September 10, 2007, vote tallies are currently available on 11 of the 14 binding shareowner proposals that are or will be included on company ballots.

Council members file precatory resolutions for a number of reasons, but perhaps the most important one is that they have been an extremely effective tool for having a dialogue with management about important corporate governance issues.[51] Precatory proposals give the marketplace at large the opportunity to weigh in on an issue and communicate the broader market views to directors and management.

Precatory resolutions have contributed to some very significant governance reforms in recent years, including: majority voting standards for directors; expensing of stock options; and ending classified boards. There are many reasons why precatory proposals have been so effective. One is that they are used by proponents to promote communication rather than to force change.

Many institutional investors view a precatory proposal as a "door knocker." From our perspective, a precatory proposal is an invitation to a conversation with management that, if successful, could lead to a dialogue on the subject; if not successful, the matter may be raised with shareowners as a group at the annual meeting.

In contrast, in light of their highly prescriptive nature, binding proposals are viewed as more of a "hammer." Hammers tend to put people on the defensive. That has been the experience of Council members, who have generally found that non-binding proposals tend to lead to more meaningful dialogue with companies. Dialogue is very important for Council members, since they withdraw about a third of the resolutions they file following discussions with companies.[52]

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[51] *See, e.g.,* Edward Iwata, *Boardrooms open up to investors' input*, USA Today, Sept. 6, 2007, at 1, *available at* http://www.usatoday.com/money/companies/management/2007-09-06-shareholders-fight_N.htm. Also of note, many Council members have obligations under the Employee Retirement Income Security Act of 1974 ("ERISA") to manage fund assets in accordance with U.S. Department of Labor ("DOL") directives. The DOL has issued interpretative bulletins relating to ERISA that effectively approve pension funds' use of shareowner resolutions as a means of communicating with portfolio companies. *See* Pension and Welfare Benefits Administration, U.S. Dept. of Labor, Interpretative Bulletin No. 94-2, Relating to ERISA 329 (July 29, 1994); *available at* http://a257.g.akamaitech.net/7/257/2422/14mar20010800/edocket.access.gpo.gov/cfr_2002/julqtr/29cfr2509.94-2.htm.

[52] According to ISS, 28.9% of shareowner proposals filed by Council members for the 2006 proxy season were withdrawn.

Precatory proposals can be useful for another reason as well, namely, to provide the board with general guidance as to shareowner wishes at a policy level, while leaving questions of implementation and the like to management. For example, shareowner resolutions dealing with executive "golden parachutes" are very popular among shareowners and regularly command a majority of the shareowner votes. However, it is very difficult in 500 words to craft a bylaw on severance packages in the kind of detail that is appropriate for an individual company. The ability of shareowners to submit a precatory proposal, while leaving it up to the board to craft an appropriate bylaw reflecting the approved policy, is often an effective means to improving corporate governance and maximizing shareowner value.

The interaction of federal and state laws clearly provides shareowners with rights and opportunities exceeding those available only under state law. From the perspective of Council members who file resolutions and most shareowners, that is a positive result.

At the most basic level, we are not aware of any state laws that compel companies to print shareowner proposals in their proxies. That result is not surprising, given that this is an area where federal rules have held sway for over sixty years. We believe the existence of federal rules provides clarity and uniformity that would not be available under state law alone.

The Commission considered similar proxy access questions in a 1982-83 rulemaking.[53] In that rulemaking the Commission proposed three options:

(1) make certain revisions to Rule 14a-8, notably the adoption of minimum holding requirements ($1000 for one year);

(2) allow companies and shareowners to adopt their own procedures for what goes into the proxy, subject to certain minimum standards; and

(3) require companies to include any proposal that was lawful under state law, except those involving the election of directors, with limitations on the number of proposals to be offered by one shareowner and hold a lottery to avoid duplication of proposals.

There was significant opposition to the latter two options. The Commission ultimately concluded that those two options would create serious problems of administration as there would be no uniformity or consistency in determining the inclusion of proxy proposals. Exacerbating the problem generated by provisions individual to each issuer would be the effect of the fifty state judicial systems administering the process. Those conclusions are as valid today as they were in 1983. We believe that any gains in terms of permitting additional resolutions that might be valid under state law would be offset by the significant complexity and transactional costs in chartering a new system based on state law.

[53] *See* Shareholder Proposals, 72 Fed. Reg. at 43,478 n. 71.

In summary, we believe that the existing federal proxy rules continue to fulfill the original intent of the Commission in promulgating those rules: (1) providing shareowners (a) with adequate notice as to important matters that will come before the annual meeting so shareowners can cast an informed vote; and (b) a voice on major policy decisions of the companies in which they have an investment; and (2) preventing management from using discretionary voting authority to effectively shut out shareowners from being able to propose alternative courses of company action. That first essential element—notice to shareowners about what will come before the meeting—is qualified by the exclusions in Rule 14a-8 that permit a company to omit proposals that are contrary to state law, that are impossible to implement, that are moot or duplicative, that are beyond a shareowner's powers (such as declaring dividends) or that are not deemed to have sufficient policy significance to warrant inclusion.

While there is debate from time to time about the scope of the exclusions in Rule 14a-8, there is little debate about the wisdom of the overall regulatory model that gives shareowners notice as to matters that will come before the meeting without requiring a company to print proposals that violate state law or satisfy one of the other general categories indicated above. This is a tradeoff that most shareowners find more than acceptable, particularly when, as indicated, the Rule creates a single unified set of standards for all companies. It is difficult to imagine how things would work and how Council members, other shareowners, and the long-term performance of companies would benefit if the Commission were to permit significantly more complex, less uniform procedures for precatory proposals than are currently required by Rule 14a-8.

Are there additional changes to Rule 14a-8 that would improve operation of the rule? If so, what changes would be appropriate and why? For example, should the Commission amend the rule to change the existing ownership threshold to submit other kinds of shareholder proposals? If so, what should the threshold be? Would a higher ownership threshold, such as $4,000 or $10,000, be appropriate? Should the Commission amend the rule to alter the resubmission thresholds for proposals that deal with substantially the same subject matter as another proposal that previously has been included in the company's proxy materials? If so, what should the resubmission thresholds be—10%, 15%, 20%? Are there any areas of Rule 14a-8 in which changes or clarifications should be made (e.g., Rule 14a-8(i)(7) and its application with respect to proposals that may involve significant social policy issues)? If so, what changes or clarifications are necessary? (page 43,479)

As indicated, Council members generally are comfortable with Rule 14a-8, including the existing substantive bases for exclusion of resolutions. Those exclusions have generally not hampered members'ability to submit resolutions on issues of importance to them. Council members also appreciate the professionalism and dedication of the SEC staff in handling the no-action process.

We, however, believe there may be some merit to the Commission reconsidering a potential change to Rule 14a-8 first proposed in a 1997 SEC Proposed Rule.[54] That Proposed Rule provided an "Override Mechanism" requiring a company to include any resolution put forth by shareowners of at least three percent of the company's outstanding voting shares even if the resolution could have been excluded under Rule 14a-8(i)(5)(Relevance) or (i)(7)(Management Functions).[55] As described by the SEC, such a potential change has some appeal because it

> would broaden the spectrum of proposals that may be included in companies' proxy materials where a certain percentage of the shareholder body believes that all shareholders should have an opportunity to express a view on the proposal . . . [and] provide shareholders an opportunity to decide for themselves which proposals are sufficiently important and relevant to all shareholders - - and, therefore, to the company - - to merit space in the company's proxy materials.[56]

[54] Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 39,093, Investment Company Act Release No. 22,828 (proposed Sept. 18, 1997), *available at* http://www.sec.gov/rules/proposed/34-39093.htm.
[55] *Id.* at 16.
[56] *Id.*

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Via Email

September 18, 2007

Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Shareholder Proposals Relating to the Election of Directors (File Number: S7-17-07)

Dear Ms. Morris:

I am writing on behalf of the Council of Institutional Investors ("Council"), an association of more than 130 public, corporate and union pension funds with combined assets of over $3 trillion. As a leading voice for long-term, patient capital, the Council welcomes the opportunity to provide additional comments on the Securities and Exchange Commission's ("SEC" or "Commission") interpretive and proposing release to clarify the meaning of the exclusion for shareowner resolutions relating to the election of directors that is contained in Rule 14a-8(i)(8) under the Securities Exchange Act of 1934 ("Release").[57]

The Council strongly opposes the Release. The Release effectively bars shareowner proxy access resolutions without providing investors any meaningful alternative approach to proxy access. As the "investor's advocate" the Commission should not adopt the Release unless and until a proxy access approach can be developed and adopted that protects rather than erodes investors' rights.[58]

The Council's corporate governance policies have long stated that "shareowners should have . . . meaningful opportunities to suggest or nominate director candidates and to suggest processes and criteria for director selection and evaluation."[59] Unfortunately, far too many director elections remain a *fait accompli,* regardless of how troubled a company may be. As a result, the only way that individual director nominees may be effectively challenged at some companies is if a shareowner is willing and able to assume the risk and expense of nominating a slate of candidates and running a full-blown election contest. Such ventures are onerous and cost-prohibitive—even in today's world of e-proxy.

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[57] See August 24, 2007, letter from Jeff Mahoney, General Counsel, Council of Institutional Investors ("Council"), to Nancy M. Morris, Secretary, Securities and Exchange Commission ("SEC"), *available at* http://www.cii.org/proxy/pdf/August%2024,%202007%20comment%20letter%20on%20file%20no.%20S7-16-07%20and%20S7-17-07%20_final_.pdf, for the Council's initial comments on the Shareholder Proposals Relating to the Election of Directors, Exchange Act Release No. 56,161, Investment Company Act Release No. 27,914, 72 Fed. Reg. 43,488 (Proposed Aug. 3, 2007) ("Release").

[58] SEC, The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation, http://www.sec.gov/about/whatwedo.shtml (last visited Sept. 9, 2007).

[59] Council, Annual Report 34 (Jan. 2007).

The Council, therefore, strongly supports reforms that would permit meaningful shareowner access to company-prepared proxy materials relating to the nomination and election of directors. We believe such reforms would make boards more responsive to shareowners, more thoughtful about whom they nominate to serve as directors and more vigilant in their oversight of companies.

The Council's support for meaningful proxy access is shared by a growing number of shareowners. During the 2007 proxy season, three proxy access shareowner resolutions were presented for a vote and all received significant support: (1) a non-binding resolution approved by shareowners of Cryo-Cell International, Inc;[60] (2) a non-binding resolution that, according to Institutional Shareholder Services ("ISS"), received 45.25 percent of the for-and-against votes cast by shareowners of UnitedHealth Group Incorporated;[61] and (3) a binding resolution, that according to ISS, received 42.95 percent of the for-and-against votes cast by shareowners of Hewlett-Packard Company.

In the face of growing shareowner support for meaningful proxy access, the Release reinterprets Rule 14a-8(i)(8) to exclude any shareowner resolutions seeking access to company-prepared proxy materials relating to the nomination and election of directors.[62] The SEC argues that this broader reinterpretation is "consistent with" the Commission's longstanding view of the purpose of Rule 14a-8(i)(8).[63] We disagree.

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[60] Press Release, Cryo-Cell International Inc., Cryo-Cell Announces Certified Results of Annual Shareholders Meeting (Aug. 1, 2007), *available at* http://www.cryo-cell.com/investor_relations/subpage_noad.asp?ID=204.

[61] Of note, the resolution was filed by the California Public Employees' Retirement System as beneficial owners of approximately 0.5% of the shares of the common stock of UnitedHealth Group Incorporated. *See* UnitedHealth Group Incorporated, Proxy Statement for Annual Meeting of Shareholders to be Held May 29, 2007 (Schedule 14A), at 100 (Apr. 30, 2007), *available at* http://www.unitedhealthgroup.com/invest/2007/Proxy_Stmt_2007.pdf.

[62] Release, 72 Fed. Reg. at 43,493.

[63] *Id.* at 43,488. Of note, by hand delivered letter dated August 8, 2007, the Council requested that SEC Chairman Cox "clarify whether the SEC staff will resume issuing no-action letters permitting the exclusion of shareowner resolutions on proxy statement access for board nominations in the absence of a final rule . . . ." Letter from Jeff Mahoney, General Counsel, Council, to Nancy M. Morris, Secretary, SEC 2 (Aug. 8, 2007), *available at* http://www.cii.org/proxy/pdf/August%208,%202007%20Letter%20to%20Chairman%20Cox%20_final_%20WORD.pdf. We have not received a response to the letter.

The Council's analysis of Rule 14a-8(i)(8), contained in our 2005 *amicus* brief in support of Plaintiff-Appellant American Federation of State, County & Municipal Employees Pension Plan before the United States Court of Appeals for the Second Circuit, demonstrates that the SEC has had anything but a "consistent" view of Rule 14a-8(i)(8).[64] It, therefore, is disappointing that the SEC devotes over two dozen paragraphs of the Release attempting to manufacture a basis for the broader interpretation.[65] It is even more troubling when one considers that the broader interpretation, if adopted, would likely shut the door on shareowners' ability to submit binding or precatory resolutions seeking access to the proxy.[66]

The Council is aware that the Commission has issued a separate proposal that, if adopted, would permit shareowners to request access to the company-prepared proxy under certain circumstances.[67] As, however, we and many other commentators to that proposal have concluded,[68] the proposal's requirements have sadly failed to meet the needs and demands of investors for meaningful proxy access reforms.

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The Council appreciates the opportunity to provide our views on this matter. Please feel free to contact me with any questions.

Sincerely,

Jeff Mahoney
General Counsel

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[64] Brief for Council as *Amicus Curiae* in support of Plaintiff-Appellant at 18-25, American Federation of State, County & Municipal Employees Pension Plan v. American International Group, No. 05-2825 (2nd Cir. Aug. 2005) (on file with Council); *accord* American Federation of State, County & Municipal Employees, Employees Pension Plan v. American International Group, Inc., at 2-3 (2d Cir. Dec. 15, 2005), *available at* http://www.ca2.uscourts.gov:8080/isysnative/RDpcT3BpbnNcT1BOXDA1LTI4MjVfb3BuLnBkZg==/05-2825_opn.pdf.

[65] Release, 72 Fed. Reg. at 43,491-93. We also note that, notwithstanding that most shareowners oppose the Release, the Commission's "Cost-Benefit Analysis" indicates that shareowners receive a number of benefits from the Release, including "that they would not incur additional costs to determine the appropriate scope of the exclusion." *Id.* at 43,494. The SEC's analysis reminds us of the story of the teenager who takes an unauthorized joyride with their parent's new car and carelessly crashes into a telephone pole. In an effort to put the best spin on the careless act, the teenager explains that the accident actually benefits the family by lowering their monthly fuel costs.

[66] We agree with the comments of SEC Commissioner Annette L. Nazareth who described the Release as "the shareholder non-access proposal." Nicholas Rummell, *One body, two minds on proxy access*, Financial Week, Jul. 20, 2007, at 2, *available at* http://www.financialweek.com/apps/pbcs.dll/article?AID=/20070730/REG/70727028/&SearchID=732898 1673323.

[67] Shareholder Proposals, Exchange Act Release No. 56,160, Investment Company Act Release No. 27,913, 72 Fed. Reg. 43,466 (proposed Aug. 3, 2007), *available at* http://www.sec.gov/rules/proposed/2007/34-56160fr.pdf.

[68] *See* Letter from Jeff Mahoney, General Counsel, Council, to Nancy M. Morris, Secretary, SEC 1 (Sept. 18, 2007) (on file with Council).

Testimony to a Hearing of the United States Senate Committee on Banking, Housing & Urban Affairs

"Shareholder Rights and Proxy Access"
14th November 2007

Anne Simpson
Executive Director, International Corporate Governance Network
Senior Faculty Fellow, Yale School of Management

1.1

The International Corporate Governance Network (ICGN) is a global membership organization of institutional and private investors, corporations and advisors. Our membership spans 40 countries and our investor members are responsible for global assets of US$15 trillion, US$4.5 trillion of which are invested in US markets.[1]

1.2

Capital is global, and it is also mobile. Competition among markets requires that policy makers pay attention to the concerns of shareholders in ensuring an effective and efficient regime for corporate governance. An element in considering the competitiveness of markets is undoubtedly the framework for shareholder rights. US provisions are increasingly judged by the standards in other markets. In many areas the US system is considered highly effective, but in the realm of shareholder rights it is viewed as relatively weak. The alternatives routes for investor protection, such as trading or litigation (the adage being "sue or sell" for investors with complaints) have been viewed as expensive, reactive and inefficient.

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[1] As the Committee will know the ICGN Shareholder Rights Committee has submitted a comment letter to the SEC which sets out our concerns with the proposals as drafted regarding shareholders' access to the proxy. This written note should be viewed as supplemental to that letter, which is attached for convenience.

1.3

Overseas investors hold close to one in five shares in US public companies and this globalisation of capital markets has set the stage for investor concern with cross border standards of corporate governance. As a group with such significant shareholdings in the US, both from domestic and overseas sources, we welcome the opportunity to provide testimony to this Senate hearing on shareholder rights and access to the proxy. Please note that due to the short notice, this statement has been developed by the Secretariat and not been subject to consultation with our Board.

1.4

Shareholders have the right to appoint, dismiss and propose directors in other markets, and in ICGN's experience this contributes to investor confidence in the efficiency and effectiveness of the corporate governance regime. For example, our Members reported in a recent poll[2] that in the UK, Australia and other Common Law countries outside North America, shareholders may propose a director by ordinary resolution, and this requires that 100 shareholders or those representing 5% of the share capital put the resolution forward. A similar provision exists in major Civil Law countries, such as Japan or in Germany where a single shareholder may propose a director for election to the supervisory board, although to call a special meeting for this to take place requires 5% of shares. Each market has found the balance between ensuring a legitimate threshold and allowing shareholders to put forward proposals which their fellow shareholders can

[2] A poll of opinion on these issue was conducted in September 2007 of ICGN members by RD:IR the research firm.

consider on merit. We note in our SEC letter that in the US market due to its size that a 5% threshold is too high to allow for meaningful access, and should be tempered as in other markets, by a lower threshold or number of shareholders which is practical to attain.

1.5

We consider that US capital markets would be strengthened by shareholders being provided with the tools to both promote enterprise through ensuring accountability by the board. It is recognised that there are provisions via proxy contests for introducing new board members, but it was remarked in our poll of members that these are "complex and prohibitively expensive". One ICGN member in our poll commented "New rules in the USA should be kept simple."

1.6

We consider that shareholder rights in relation to the board of directors are the lynchpin of corporate governance. Shareholders have an economic interest which gives them a unique incentive to ensure boards fulfil their responsibilities to promote enterprise and ensure accountability. We are not persuaded that regulatory agencies and other bodies could or should attempt to substitute for this. Shareholders have a core of common interest with the business community in promoting wealth creation. Both sides need a corporate governance framework which is efficient and effective that promotes dialogue and allows flexibility in developing practical solutions. Law and regulation play an important role in setting the framework for rights and responsibilities but should not attempt to substitute for this direct contracting.

1.7

We are not convinced that the current SEC proposals as drafted meet the tests of efficiency and effectiveness. We also do not see consensus among the share owning community whose interests the SEC is mandated to protect. For that reason, we counsel a pause in proceedings. It is more important to make rule changes which command respect and reflect shareholders' concerns, than rush to implement in haste, what will surely be repented at leisure.

1.8

ICGN regards the right of shareholders to nominate directors to the board as fundamental. It is a right which has existed since the origins of company law in Europe over 150 years ago, and is a feature of major markets outside the USA to this day. The corporate governance paradigm is simple: shareholders provide capital to companies; boards are given the task of overseeing the deployment of that capital; shareholders ensure that their interests are protected through being able to hold the board to account. To ensure this, shareholders need the ability to appoint, remove and propose directors to the board. The mechanisms for this should be simple and practical. In a straw poll of the ICGN membership conducted recently, 82% stated that shareholders should have the right to propose directors for the board of the company. 76% thought the rules and requirements for proposing directors should be no different to that for introducing other resolutions to the agenda. One ICGN member respondent to our survey commented. "Shareholders

own the company and Boards and/or the SEC should not obstruct their access to this basic right. US directors are not sufficiently accountable to shareholders."

1.9

In our poll we also asked ICGN Members how often the provisions to propose directors were used in other markets, and in most cases, the answer was "rarely". This is because the "reserve power" acts as a powerful incentive for communication, consultation and the development of solutions between shareholders and companies. One ICGN Member commented from the UK "These provisions are rarely used, but the fact of their existence is a real spur to proper engagement by companies with their shareholders. And shareholders seem to be very thoughtful in their analysis of shareholder resolutions that do get on the agenda. I am not aware of very many shareholder resolutions having succeeded but I think that is because the engagement linked to the resolution (both by the proponents and others) has produced from the company commitments to improve practice." Another reflected that (having the ability to propose directors through a resolution "is why companies prefer to engage with real effort on issues that might become a shareholder resolution."

1.10

There has also been concern that allowing shareholders to put forward candidates to the board in the US via the proxy process would leave companies vulnerable to special interests. If nomination were the same as election, perhaps this would be a consideration. However, all resolutions must be passed by a majority of shareholders and all elected

directors would still have fiduciary duties to the company, not to any particular group. The majority of shareholders share the same interest as the company: the growth of long term value. As one respondent to the ICGN member poll commented "Shareholder proposals will only pass if at least 50% of shareholders share similar concerns. Directors who have their shareholders' confidence need not worry!". It is notable that some recent efforts by hedge funds and private equity groups to pressurise companies into new strategies have foundered as the shareholder majority has not provided support to the minority proposals. A healthy dialogue around those proposals has in fact strengthened communication between owners and boards, and improved understanding of strategy which is all to the companies' (and their owners, and it goes without saying, their stakeholders') long term gain.

1.11

To sum up, ICGN considers that shareholders need the right to hold directors to account, and that the rights to appoint, remove and propose members to the board are an essential part of their corporate governance 'toolkit'. The US market will come under increasing pressure to compete, and shareholder rights are a vital element in capital market competitiveness. For that reason, we urge that the SEC proposals be put to one side, whilst a further round of consultation takes place to find solutions which are simple and practical. We do not see a disadvantage in postponing the decision. The current climate in our view is suitably stable to allow for this reflection. Shareholders may well make proposals, but only if they command majority support can they have real influence. That in itself is the inbuilt check and balance to the system.

Dennis Johnson
Senior Portfolio Manager, Corporate Governance
California Public Employees' Retirement System
Written Testimony Prepared for the
U.S. Senate Committee on Banking, Housing and Urban Affairs
November 14, 2007

Chairman Dodd and members of the Committee, I am pleased to provide the perspective of an institutional investor on the important issue of proxy access, and to represent the California Public Employees' Retirement System.

CalPERS is the largest public pension plan in the nation with more than $250 billion in assets under management. We provide retirement and health benefits to 1.5 million members who work in state and local government.

Since we own shares of more than 7,500 publicly-traded U.S. companies, regulations affecting corporate governance are vitally important to us. We thank the Committee for the opportunity to comment on this issue of shareowner access to company election ballots.

Presently, shareowners have the right to place director election proposals on corporate ballots. The proposed SEC "short rule" would eliminate this existing right and prevent shareowners from filing proposals that request companies to adopt a proxy access provision for director nominations.

The Committee asked us to respond to three questions related to this potential rule change for the 2008 proxy season:

1. Does the U.S. Securities and Exchange Commission need to act before the 2008 proxy season on a new rule affecting shareowner proposals on corporate election ballots?
2. What is the right timing for the SEC to adopt a new rule relating to proxy access?
3. Do shareholders have the right to proxy access?

1. Why the SEC does not need to act before the 2008 proxy season:

"Uncertainty" is a red herring

The Chairman of the Securities and Exchange Commission has told this Committee that the SEC needs to act very quickly to address uncertainty about the current application of the proxy access rule. He argues that he is only doing what is necessary to provide clarity to this process.

However, he can address any alleged uncertainty just as easily by codifying the *AFSCME v. AIG* ruling as by reversing it.

There is no uncertainty **about** the existing rule, which clearly allows shareowners to file proxy access proposals on corporate ballots. The Second Circuit Court clarified in the AIG case that the current SEC regulation does not exclude proxy access.

There is no evidence of uncertainty about **the application** of the rule following the AIG decision. Since the decision was issued, shareowners have submitted three proxy access proposals in 2007. One non-binding proposal passed at Cryo-Cell International, Inc. Two others received substantial support exceeding 42 percent of votes cast at UnitedHealth Group and Hewlett-Packard Co.

There will be no "tsunami" of harm in the marketplace if the AIG decision is left in place through the 2008 proxy season. In fact, the only uncertainty about proxy access comes as a result of the mixed messages from Chairman Cox concerning the SEC's intent to adopt a "new-and-improved" proxy access proposal next year.

No company challenged any proxy access proposal in court this year. The odds are low that another circuit court would question the sound reasoning of the AIG case. Even if a federal district court ruled differently, no split between circuit courts would occur until another federal appellate court addressed the issue differently from the Second Circuit.

In the meantime, the SEC has lost at least one commissioner. We expect that it will lost another by the end of the year. On an issue as significant as this one, we believe it is important that the Commission be fully staffed before it takes

action. Otherwise, its decisions will lack credibility with investors and the marketplace.

No risk from lack of disclosure about proponents of proxy proposals

The Chairman has also told this Committee that the SEC needs to act soon to protect investors who might be put at risk by lack of disclosure about shareowners who file proxy access proposals.

For example, a proposed disclosure requirement seeks to determine if a shareowner acquired shares to effect or influence a change in control of the company, or had some conflict of interest involving the company or a company affiliate.

However, shareowners primarily vote on the merits of proxy proposals rather than on what they know about proponents. Background information about proponents is usually secondary.

If disclosure of this sort is so crucial, companies that had proxy access resolutions on their ballots in 2007 surely would have expressed concern. None did.

Requiring background information about the proponents of proxy access proposals never came up until the SEC raised it this year. Neither companies nor shareowners have previously requested such information -- even in the most hotly contested proxy campaigns.

2. Why this is the wrong time for a proxy access rule change

Too important to leave to a sub-set of a full Commission

The Chairman says it is important to wait until next year to pursue expanding shareowner rights, yet he would take present rights away before this year ends.

In doing so, he is ignoring the advice of two former SEC commissioners, this Committee, the House Financial Services Committee, and many institutional investors. The proposed rule change also fails to adequately reflect the input received at three SEC roundtables on the issue this year.

The five-member SEC failed to move on the proxy access issue for years when it had a full commission. Today, one of those five commissioners has vacated a seat, and another will leave soon. Yet suddenly there seems to be an emergency, in the Chair's view.

A decision of this importance warrants the attention of a full commission. The current "short proposal", if adopted, would shut shareowners out of the most important and democratic governance process at their companies.

There is no compelling reason for this rush to judgment. Instead, the record shows that companies that allow shareowners to place director candidates on their election ballots have presented no cause for concern.

Apria Healthcare Group has had proxy access procedures in place for several years, with no adverse impact on share value or any tyranny of a minority of special interest directors who exploit the election process. Comverse Technology voluntary adopted a proxy access provision this year with no ill effect. Companies in both developed and emerging markets around the world have a proxy access provision for shareowners to use to submit director nominees. We are unaware of any examples where this provision has caused any harm to these companies.

3. Why shareholders have the right of proxy access

Right given by law

The right to participate in the governance of the corporations we own is a fundamental aspect of corporate law, and an invaluable tool to help preserve and enhance investments we made for our plan participants.

Yet the Chairman would have the Commission roll back the clock to effectively overturn last year's court ruling in *AFSCME v. AIG.* Such unprecedented anti-investor action by the SEC would deny shareowners the right to protect their interests by ensuring fair director elections and director accountability to the owners of the company.

For 16 years, the SEC held shareowners had a basic right to use the company ballot to nominate directors. It reversed itself in 1990 for reasons never publicly given. State and federal law and regulations widely recognize investors' right to a voice in the corporate governance and voting process.

Federal law authorizes the Commission to reinforce these state law rights, as it currently does under current practice. As the Commission itself noted in July 2007 (the "Shareholder Proposal Release"), the proxy rules "have been designed to facilitate the corporate proxy process so that it functions, as nearly as possible, as a replacement for an actual, in-person gathering of security holders, thus enabling security holders to control the corporation as effectively as they might have by attending a shareholder meeting."[1]

Proxy access allows shareowners to communicate their concerns when a Board of Directors fails to provide the oversight required to protect shareowner

[1] See *Shareholder Proposals,* SEC RE. No. 34-56160 (Jul. 27, 2007) (citing to *Business Roundtable v. SEC,* 905 F.2d 406 (D.C. Cir. 1990)).

interests. Such failures have contributed to option backdating, the issuance of incorrect financial statements, and executive compensation policies that fail to adequately align the interests of shareowners and management.

Proxy access gives shareowners an economically efficient manner to communicate directly with other investors, with the board of directors, and management. Under the corporate law of most jurisdictions, a shareowner has the right to make nominations from the floor of the annual meeting unless prohibited by a company's bylaws or certificate of incorporation.

Conclusion

American investors cannot afford to lose an important tool of checks and balances to prevent company train wrecks caused by poor governance practices. Checks and balances might have prevented the WorldCom and Enron accounting scandals, stock option backdating, and overly-generous compensation packages for the executives of failed companies.

Fears that a minority of shareowners might abuse proxy access to degrade share value are unwarranted. Shareowner majorities would always be required to adopt bylaw changes and elect board directors. It is unlikely that a majority of shareowners would go against the economic self-interest that they share with company boards and managers.

We believe that the status quo on the proxy access issue does no harm to shareowners, as would an ill-considered change in the rules that would take away the rights investors have now.

We prefer self-government to regulation and legislation – except when reasonable checks and balances are threatened. In such cases, we turn to regulators and lawmakers to do the right thing. In this regard, we appreciate this Committee's interest and oversight role in this matter.

We also appreciate the opportunity to express our opinion on the issue before this Committee for the good of corporate America, investors, and the workers whose earnings we hold in trust.

The Commission should return to its roots as an independent protector of shareowner interests. Yet as it stands now, the SEC is contemplating less democracy, not more, and for all the sophistication of our markets in the U.S., we lag behind other countries in this area. The United States is the world's only developed economy that does not give shareowners the right to place director nominees on company election ballots.

Now is the time for the SEC to show it truly stands up for shareowners, to allow the AIG rule to stand until a full and truly bipartisan Commission can make a fresh start, and to avoid destabilizing confidence in our financial markets.

Make no mistake: voting to adopt the SEC's "short rule" is a clear and conscious decision to take away shareowner rights. Furthermore, promising to advance new shareowner access proposals once the Commission has a full compliment of Commissioners – whenever that might be – only serves to underscore the harm that Chairman Cox recognizes this impending SEC action would create.

Maintaining the status quo while a fair, comprehensive approach to proxy access can be fashioned and approved by a five-member, balanced SEC is a reasonable approach that will do no harm.

We urge this Committee to send the strongest possible message that the Commission reconsider its timing and start anew when a full Commission is again a reality. A fundamental principle of the SEC's mission is to "do no harm" to the shareowners it is charged with protecting. This ill-timed proposal that could be acted on by a subset of a full Commission is unfair, unwise, and contrary to the very purpose for which the SEC was established.

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RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM CHRISTOPHER COX

Q.1. The Commission appears sharply divided over its "long proposal," which would require companies to include in their proxy materials shareholder proposals to change a company's bylaws on shareholder nominated directors. In the past you have expressed your hope that the Commission could operate on a consensus basis. Because the long proposal would enact a dramatic change in corporate governance, it would seem that reaching a consensus on the proposal would be particularly valuable.

If a consensus can not be reached on the "long proposal," what are the circumstances, if any, under which you would support moving forward with the proposal?

A.1. I believe there is a consensus on the Commission, as presently constituted, that the federally regulated proxy system should vindicate and not supplant the rights of shareholders under state law to determine the directors of the companies they own. The extensive and informative comments we received on the "long proposal," particularly with respect to the concerns surrounding the proposed new disclosure requirements tied to the existing 13D/G regime and the 5% ownership threshold, mirrored the growing concerns of various Commissioners with aspects of the proposal. The result is that while there is consensus in the general principle, the specific approach of any reforms will have to be given further thought. I intend to work toward building support on the Commission for a new rule proposal that will strengthen the proxy rules to better facilitate the fundamental state law rights of shareholders.

Q.2. If the Commission adopts its "long proposal" would it be opening the door for shareholders seeking to include in companies' proxy materials proposals for bylaw amendments involving matters other than the election of directors? And if all shareholder proposals for bylaw amendments do not need to be included in companies' proxy materials, by what principle would you determine whether or not shareholder proposals for bylaw changes could be excluded?

A.2. The answer to the first part of your question is no. Adoption of the "long proposal" would not have any impact on other types of bylaw amendment proposals and would affect only those proposals that companies traditionally have been permitted to exclude pursuant to the election exclusion. Currently, under Rule 14a–8 shareholders are permitted to submit proposals regarding bylaw amendments to be included in a company's proxy materials, so long as the shareholder meets certain eligibility requirements and the proposal does not fall within one of the thirteen bases for exclusion in the Rule. Rule 14a–8(i)(8), commonly known as the "election exclusion," is one of these thirteen bases for exclusion and is the subject of the proposed rule amendments. So the answer to the second part of your question is that whether shareholders may submit proposals for bylaw amendments on other subjects and companies would be required to include such proposals will continue to depend on whether the proposal did not fall within one of the other bases for exclusion in Rule 14a–8.

Q.3. The Commission has historically permitted companies to exclude from their proxy materials shareholder proposals that relate to the election of directors.

Could you please explain the rationale for this policy?

A.3. The election of directors is of fundamental importance to shareholders and to the company. For this reason, Rule 14a–8(i)(8) provides that a proposal that relates to an election may be omitted from a company's proxy materials in order to prevent the circumvention of proxy rules that are carefully crafted to ensure that investors receive adequate disclosure and an opportunity to make informed voting decisions in election contests. Allowing shareholders to include their nominees in company proxy materials would create what is, in fact, a contested election of directors, but without the numerous protections of the federal proxy rules that are triggered only when there are opposing solicitations. As the Commission explained when it proposed the election exclusion in 1976, its principal purpose "is to make clear, with respect to corporate elections, that Rule 14a–8 [governing other kinds of shareholder proposals] is not the proper means for conducting campaigns or effecting reforms in elections of that nature, since other proxy rules, including Rule 14a–11 [governing proxy contests], are applicable thereto."

Q.4.a. During the 2007 proxy season the Commission received only three requests for no-action relief by companies seeking to exclude shareholder access proposals. In testimony submitted for the hearing, it is argued that the lack of requests for no-action relief demonstrates that there is no uncertainty about the application of the Commission's proxy access rules.

How do you interpret the lack of requests for no-action relief?

A.4.a. The small number of no-action requests was directly related to the small number of shareholder bylaw proposals governing director election procedures that were submitted during the 2007 proxy season. The legal uncertainty regarding the appropriate interpretation of Rule 14a–8(i)(8) resulting after the Second Circuit's decision in *AFSCME* v. *AIG,* may have contributed to the small number of such proposals to companies. Shareholders may have decided not to incur the costs of submitting these proposals, particularly since a shareholder can submit only one proposal to a company, until there was more certainty as to whether such a proposal would be required to be included in a company's proxy materials or whether a company could exclude the proposal. Additionally, the Second Circuit's decision was issued in September 2006, which may not have afforded shareholders enough time to prepare and submit these types of proposals to companies before each company's deadline for submitting proposals for the 2007 proxy season.

Q.4.b. Could you please elaborate on your testimony that the Second Circuit's *AIG* decision could undermine the Commission's proxy disclosure rules?

A.4.b. The Second Circuit's decision in *AFSCME* v. *AIG* would have permitted a bylaw proposal to establish director election procedures without the disclosures and clear antifraud protections that have long been required by the proxy rules governing contested elections.

Several Commission rules regulate contested proxy solicitations so that investors receive adequate disclosure to enable them to make informed voting decisions in elections. The rules, which would not have applied under the Second Circuit approach, require disclosure regarding the participants in the solicitation, as well as disclosure regarding the nominee for director. Because the inclusion of shareholder nominees for director in a company's proxy materials normally would create a contested election of directors, the protections of the proxy solicitation rules designed to provide investors with full and accurate disclosure are of vital importance in this context. The numerous protections of the federal proxy rules are triggered only by the presence of a solicitation made in opposition to another solicitation. The proper functioning of Rule 14a–8(i)(8) is critical to assuring that investors receive adequate disclosure in election contests, and that they benefit from the full protection of the antifraud provisions of the securities laws.

Q.5. Presently, most directors of public companies are selected by boards of directors' nominating committees. Directors serving on a nominating committee have a fiduciary duty to act in the best interest of the company and all its shareholders when they select directors. In contrast, a shareholder in a public company does not generally owe a fiduciary duty to other shareholders.

Do you have any concerns that including shareholder nominees for directors in the proxy materials of public companies will undermine the role of nominating committees and reduce the quality of the directors elected?

A.5. State law, not federal law, governs this question. State laws generally allow shareholders to nominate candidates for director at a company's annual meeting. State law also generally allows shareholders to present proposals for a vote at the annual meeting, including nominations for director, subject to compliance with requirements contained in a company's bylaws. The federal proxy rules already permit any shareholder to conduct a separate proxy solicitation for votes in favor of the shareholder's director nominee. If a shareholder-nominated candidate is elected, that person will be subject to the same fiduciary duties as a board-nominated candidate who wins a seat on the board. The Commission's interest in the nomination process is to ensure full and fair disclosure to shareholders so that they can make informed voting decisions, not to change the prevailing state-law rule that shareholders can nominate directors. Regardless of whether a nominee is nominated by a shareholder or a nominating committee, it is of the utmost importance that shareholders receive the disclosures required by the federal proxy rules. Armed with this information, shareholders can choose whether to vote for a nominee put forth by the nominating committee or to vote for a nominee put forth by a shareholder.

Q.6. Chairman Cox, you recently spoke on the topic of Sovereign Wealth Funds and raised questions about the ability of the Commission to carry out its enforcement and regulatory responsibilities when dealing with sovereign actors who also happen to be participants in our securities markets.

Could you expand on these concerns and discuss the implications associated with regulating sovereign investment entities?

A.6. The rise of sovereign wealth funds and state-owned corporations with minority public ownership ("sovereign business") portends a greater degree of state ownership in the economy, raising many of the same questions that any program of state ownership entails. In my view, government ownership is very different from foreign ownership: the former is often a threat to free markets, and the latter completely consistent with them. Both the Commission and the Congress need to inquire where this trend will lead and what the logical outcomes of growth in state ownership in the economy might be. There are possible good and ill effects of increased direct participation in the world's capital markets by governments. In the short run, governments and regulators, in the U.S. and throughout the world, need to help in the process of structuring norms and practices to maximize the potential benefits and minimize the risks. This important work is well underway in a number of venues, including the President's Working Group on Financial Markets, of which the SEC is a member, as well as in the G–7, the World Bank, and the IMF.

Enforcement: In theory, the Commission has the power to pursue sovereign businesses for violating U.S. securities laws. Neither international law nor the Foreign Sovereign Immunities Act renders these funds immune from the jurisdiction of U.S. courts in connection with their commercial activity conducted in the United States. Today, when a foreign private issuer is suspected of violating U.S. securities laws, the SEC's experience working with our overseas regulatory counterparts indicates that the SEC could almost always expect the full support of the foreign government in investigating the matter. But if the same government from whom we sought assistance were also the controlling person behind the entity under investigation, there is reason to expect that the same level of cooperation might not be forthcoming.

Conflicts of Interest: A related issue is the conflicts of interest that arise when government is both the regulator and the regulated. Rules that might be rigorously applied to private sector competitors will not necessarily be applied in the same way to the sovereign who makes the rules. A corollary of such conflicts of interest is that the opportunity for political corruption increases. When individuals with government power also possess enormous commercial power and exercise control over large amounts of investable assets, the risk of misuse of those assets, and of their conversion for personal gain, rises markedly.

Market Efficiency: Investors and regulators have to question whether government-controlled companies and investment funds will always direct their affairs in furtherance of investment returns, or rather will use business resources in the pursuit of other government interests. And if the latter is the case, what will be the effect on the pricing of assets and the allocation of resources in the domestic economies of other nations?

Transparency: In many industrial countries today, the ability of journalists and citizens to inquire into government affairs, or to criticize the conduct of government, is severely limited. Is it reasonable to expect that these same governments will be fully forthcoming with investors?

Information Disparities: If ordinary investors—an estimated 100 million retail customers in America who own more than $10 trillion in equities and stock funds in U.S. markets—come to believe that they are at an information disadvantage when they compete head to head in markets with government, confidence in our capital markets could be seriously eroded. It is for this reason that so much of the SEC's effort is focused on full and fair disclosure to all market participants, and the prevention of fraud and unfair dealing such as insider trading. There are significant disparities in the information that is available to government as compared to private marketplace actors. Unlike private investors and businesses, for example, the world's governments have at their disposal the vast amounts of covert information collection that are available through their national intelligence services. Current legal restrictions in some countries on the domestic collection and use of such information might serve to protect the civil liberties of that nation's citizens. But there are normally no concomitant protections for foreign nationals, or for intelligence collection activities conducted in other countries. Unchecked, this could be the ultimate insider trading tool.