SEC PROXY ACCESS PROPOSALS: IMPLICATIONS FOR INVESTORS

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COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

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SEC PROXY ACCESS PROPOSALS: IMPLICATIONS FOR INVESTORS

Thursday, September 27, 2007

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:03 a.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Members present: Representatives Frank, Kanjorski, Maloney, Moore of Kansas, McCarthy, Baca, Scott, Cleaver, Davis of Tennessee, Klein; Pryce, Feeney, Hensarling, Neugebauer, and Campbell.

The CHAIRMAN. This hearing of the Committee on Financial Services will come to order. This is a hearing on the question of proxy access, a matter of some interest to various members of the committee, on both sides of the aisle.

The gentleman from California, Mr. Campbell, is someone who has raised this consistently, as have others. We touched on this in a couple of earlier hearings. It became relevant when we talked about executive compensation, because you can talk about shareholder involvement either issue-by-issue or in a more generic way.

We are appreciative of the fact that the SEC has now promulgated some proposals. They are—I guess I've heard, as a lawyer, of pleading in the alternative; regulating in the alternative is a new concept to me, but as I have chaired this committee, I have learned some things.

And it is an opportunity to have some input. It's a matter on which this committee has a great deal of interest, and we have a panel that I think is fairly representative of the range of views, so we look forward to the hearing. And I'm going to get right to that.

I'll now turn—let me just announce that the ranking member was called back home to Alabama by some very important family business involving both his own family, and more sadly, the family of someone very close to him. He is going to be returning today, but the vice chair of the committee, Mr. Neugebauer, will be here in his absence, and I will now recognize the gentleman from Texas who has, I believe, a unanimous consent request to make.

Mr. NEUGEBAUER. That's correct. Mr. Chairman, I have a unanimous consent request that—I have some recorded testimony by the U.S. Chamber of Commerce and a letter from the Business Roundtable to the Securities and Exchange Commission on shareholder proposals relating to the election of directors, and would ask unanimous consent that—

The CHAIRMAN. If there is no objection, those will be entered into the record. Let me, at this point, give general leave, if there are other statements that members would like—from any interested parties—to enter into the record, without objection, that will be granted.

And the gentleman is recognized for his statement.

Mr. NEUGEBAUER. Well, thank you, Mr. Chairman. I am actually reading this on behalf of Deborah Pryce who could not be with us again today.

"Thank you, Chairman Frank, for calling this morning's hearing to review the Securities and Exchange Commission's two very different proposals to amend the SEC's rules governing shareholder proxy access.

"This hearing may be a little premature, however. With the comment period for both proposals ending in 4 days, the committee should allow the SEC time to review the comment letters and reach a thoughtful decision. I hope that the committee will have an opportunity to hear from Chairman Cox once the SEC reaches its decision.

"Earlier this year the committee considered executive compensation legislation, as the chairman just mentioned, with the premise that it would increase shareholder democracy. It is unclear what is undemocratic about the current structure of the proxy voting, though. Every publicly traded company has a nominating process that allows shareholders to recommend qualified candidates to serve on the board.

"The real question is whether including the outside nominees in the country's own proxy statement rather than in separate proxy statements somehow improves the process.

"There are real questions about who pays for adding more candidates to the proxy statement and whether it actually weakens the quality of disclosure available to shareholders. Since Sarbanes-Oxley, boards of directors are smaller and far more responsive to shareholders. Their independence from management is also increasing and CEO tenure is decreasing as boards are no longer beholden to management and more companies are adopting majority voting to elect directors.

"All of these governing changes are welcome and market driven, which is always a better solution. Successful companies are those who value and invite shareholder input and are able to balance companies' competing constituencies.

"Open communications between boards and shareholders on a wide variety of corporate matters makes companies more responsive to all shareholders and not simply those who speak with the loudest voice. Shareholders already have the power to change the board. Large institutions like union pension funds and foundations mutual funds can easily afford to challenge the nominees put forward by the company.

"What special interest shareholders such as labor unions really want to do is circumvent the company's nominating process and have direct access to the proxy statement. If this happens, the proxy statement will look like a preliminary parliamentary election ballot with potentially hundreds of names indistinguishable from one another. This will only cause confusion.

"The board's role will diminish and along with it good governments. It is not the best way to run a company, increase shareholder value or add jobs. Allowing the politicization of the boardroom could very easily lead to concessions from boards that are not supported by a majority of the shareholders or as workers.

"In closing, I would like to thank the witnesses for their testimony and I yield the balance of my time."

The CHAIRMAN. Are there any other requests for opening statements?

The gentleman from California.

Mr. CAMPBELL. Thank you, Mr. Chairman.

What we're talking about here today is that we have all seen over time that sometimes companies have been operated for the benefit of the executives rather than for the benefit of the shareholders. We have also seen companies that are operated poorly, it can happen, not getting good results; and in some cases where perhaps the company believes they're operating well but the shareholders believe they're not achieving the shareholders' expectations based on the industry and the market at the time.

So what can shareholders do? What are their remedies when they see one of these things happen where a company is not operated in what they believe is their best financial interest?

There was a proposal earlier this year which passed this committee and this House which effectively was direct democracy within a corporation, that allowed shareholders to vote specifically on one specific thing, which was executive compensation. Now I happen to think that's a very dangerous road to go down.

If we have shareholders approve executive compensation do we have them approve union contracts, do we have them approve marketing budgets, do we have them approve every acquisition, do we have them approve other executives? You know, what do we have them approve? The correct way for shareholders to express their disapproval with a company is through the board rather than through direct democracy.

But others would say that they have another remedy, that shareholders have another remedy, which is to sell the stock. And yes, that remedy, in fact, does exist. But that remedy has severe limitations. Some stockholders are semipermanent holders in companies. We have those that are large pension funds or large investment organizations or large mutual funds. There are certain companies in which they are just generally not going to disinvest.

Or if someone is trying to replicate or hold either through a SPDR or directly the Dow industrials or the Fortune 100 or the S&P 500 then they also, unless they are removed from that list, have essentially a semi-permanent investment in that company. And furthermore, even individual investors, because of the Capital Gains tax, if they have a gain in a stock and they sell it, or a dollar, they are unlikely to be reinvesting a dollar. They may be reinvesting 99 cents or, in my State, if they've held the stock for a long time, they could be reinvesting as little as 75 cents.

So to say the only remedy I have for a company that's not being run in the way I think it should be run is to give up 5 or 10 or 15 or 25 percent of my investment to reinvest in another company is, at best, a very imperfect solution. No, the correct solution or the best solution, I think, for shareholders who are displeased with what's going on is to express that displeasure by changing the board.

So what do we have now? Now we have a system under which the alternatives for board members are nominated only by the board. Now if you want to change something that's going on in a company you don't ask the people who you want to change to offer up that change. You generally would like to have some other alternative to that.

So as you can probably tell by this I am someone who believes that having shareholders have the opportunity to nominate alternative directors to a board is something that shareholders in public companies ought to have the right to do. Now private companies are an entirely different matter, but when one goes public, and therefore submits themselves to the regulation of the SEC amongst other things, it seems that giving shareholders that opportunity is something that should be a part of being a public company.

There are a few questions that I have that I hope that even though I obviously believe that having shareholders have opportunities to nominate directors is something which—I believe there are several questions I have, and I hope to hear from the panel today on some of these things.

First of all, you don't want, as was mentioned in the previous opening statement, a small percentage of the shareholders, whether it is 1 percent or 2 percent or 5 percent, to be able to dictate the operations of that company if the other 95 percent don't want that to happen.

That is no better than executives running a company for their own behalf and ignoring the interests of the shareholders. So I suggest that there be, in conjunction with proxy access, a majority vote requirement so that for anybody to be seated on a board you have to have over 50 percent of those voting shareholders vote for it or they don't get on the board. If there are other remedies for that, I would appreciate hearing them.

And what is the correct percentage? You certainly don't want someone with one share or 100 shares or whatever to be able to make a nomination to the board. That would create the kind of chaos that was discussed in the previous opening statement, but what is the correct percentage?

I know the SEC in one of their proposals has proffered up 5 percent. Is that right? Should it be less? Should it be more?

Should there be a difference in the percentage required for the market capitalization of a company? Obviously someone of any institutional holder or any other holder is considerably less likely to hold a large percentage of Google or General Electric or ExxonMobil than they are of some hundred million dollar small cap company where you could easily have shareholders, institutional or otherwise, owning 10 percent or 20 percent or so forth. And so should there be a different percentage there?

And lastly, what disclosures and what procedures would be correct to make sure that this is done or can be done in the proper manner?

I look forward to hearing from the panel on those issues, and also your opinions generally on the issue, and I yield back the balance of my time.

The CHAIRMAN. Are there any further opening statements? If not, we will—oh, the gentleman from Texas.

Mr. HENSARLING. Thank you, Mr. Chairman.

As we approach this very important subject, I hope that we will approach it with a certain amount of caution. I once again hope that as the SEC looks at this issue, as do we, that first we do no harm.

I certainly believe that the corporate structure and our corporate governance laws have a lot to do with the creation of jobs, hope, wealth, and opportunity in America and the type of very systemic change that we are looking at with this particular issue. I'm concerned about the adverse consequences it might have on the wealth and job creation that we see coming out of our corporate structure in America today.

I look at other countries, particularly in the European Union, that appear to have a system of proxy voting that is perhaps being contemplated today. I don't think I see as much robust wealth creation as what I see in America, and I do think this is an issue that goes to the heart and the ability of corporations to remain profitable. I also note that this Nation has a long history of allowing our State law to govern the corporation's ability in many respects to manage its own affairs.

And so I think that although the issue is meritorious, it's one that we should be very, very careful about how we proceed. It also may be somewhat premature as the SEC has yet to take action. As I listen carefully to my good friend from California there is also another option for people who are unhappy with corporate governance. They don't only have the option to sell, they also have the option to buy, and they can always buy more stock and gain even a greater influence in the corporate affairs of that particular corporation.

With that, Mr. Chairman, I look forward to hearing the testimony of our panelists, and I yield back.

Mrs. MALONEY. Mr. Chairman.

The CHAIRMAN. Yes, the gentlewoman from New York.

Mrs. MALONEY. I, first of all, would like to thank you for following up on the June meeting we had with all five SEC Commissioners. There was a general agreement for a follow-up hearing on the issue of the proxy access; it is tremendously important.

Since our hearing, the SEC has published for comment two proposals to amend its rules and the comment period on both of these proposals will end on October 2nd. I believe many Members of Congress and the public will be commenting on it and I'd just like to counter some of the statements saying that this is premature.

I think it's very important that we hear the perspectives of the witnesses on these proposals prior to the end of the comment period and have their judgment as we formulate possibly our own comments that we may want to put into the comment period.

In any case I'm interested in what they have to say. I have an opening statement, but in the interest of time I'm going to put it in the record. Thank you.

The CHAIRMAN. We will now begin with the testimony and let me start just on my left with Donald Kirshbaum, who is the principal investment officer in the Office of the Treasurer of the State of Connecticut.

STATEMENT OF DONALD A. KIRSHBAUM, PRINCIPAL INVESTMENT OFFICER, OFFICE OF THE TREASURER, STATE OF CONNECTICUT

Mr. KIRSHBAUM. Thank you very much, Chairman Frank, and members of the committee. I'm Donald Kirshbaum, and as said, I am an investment officer in the Office of the Connecticut State Treasurer, Denise Nappier. Treasurer Nappier is the principal fiduciary of our $26 billion State pension fund, which manages the retirement assets of our 160,000 pension beneficiaries.

I have a brief oral statement here and I have submitted a longer statement, which I—

The CHAIRMAN. Without objection, all of the statements and supporting documents of all of the witnesses will be made part of the record.

Mr. KIRSHBAUM. Great, thank you.

Since taking office in 1999, Treasurer Nappier has been actively involved in corporate governance. She particularly believes that shareholder activism is a plan asset and uses communication with companies in which we invest, including proxy voting and shareholder resolutions, as a mechanism to protect and enhance the long-term value of pension fund assets.

And again, pension funds by their nature are long-term investors, so we're really talking about the long-term issue here. Today's hearing addresses the two pending rules at the SEC. Our office has extensive experience working with and within these rules, and I'm pleased to share our experience with you today.

There are essentially three issues in these rules. Proxy access we have talked about, and there also are some issues regarding advisory shareholder resolutions and electronic forums. I'll spend most of my time on the first and then I'll briefly touch on the other two.

Now we've talked about shareholder access to the proxy, so I really won't go into details of what that is, but the issue is for us that the board of directors is elected by the shareholders and oversee the management of the corporation on behalf of the shareholders who are the owners.

Most board members and boards perform their job very well. However when shareholders believe the boards are not acting in the best interests of the shareholders there are some things we can do, but nominating directors on a company's ballot is not one of them.

The existing mechanism for replacing directors is to run a proxy contest on a challenge slate with a separate proxy card. So there is a mechanism right now where shareholders can nominate directors, but it is onerous and expensive.

It's a mechanism geared more toward corporate takeovers than to improving the performance of the existing board. SEC Chairman Cox agrees that a new mechanism is needed and has put forward the access to the proxy proposals. We support the concept here and also the—we continue to work with the SEC to come up with a rule that is actually workable for shareholders, and we'll go into some details of that in a minute.

Last year the second circuit court in *AFSCME* v. *AIG* ruled that the SEC had been improperly allowing companies to exclude access to the proxy resolutions. And we joined State pension funds in North Carolina and New York and the AFSCME employees pension fund filing such a resolution against Hewlett Packard.

The resolution received broad shareholder support; 43 percent of shareholders supported this resolution. This is not a special interest or fringe—it's not something that only special interests are interested in—that 43 percent represents the core investors.

There were resolutions filed at two other companies which received 45 percent in a majority vote, so this is mainstream investors who are interested in access to the proxy. The large vote led us to continuing discussions with the company, which we are hoping will result in a productive conclusion.

Now one of the SEC rules, note it's a short rule, would close this avenue to shareholders to file access to the proxy resolutions. We believe that the adoption of this rule is not necessary or appropriate and we would oppose the implementation of this. With respect to the directors and goals on behalf of their owners, when it's not happening this mechanism of access to the proxy is needed.

There are two issues that have been highlighted in the SEC rule. One is the 5 percent rule and the other is the disclosure issues. As a pension fund investing for the employees, we're a long-term investor. Also our asset allocation is spread over a number of asset classes, and with respect to investments in public equity we are very diversified and have a significant portion of assets in core index funds.

This means that not only do we have long-term investments in the broad economy but we do not build up a large holding in any one specific company. Most public pension funds also have the same type of investment strategy, and it's really mandated by the nature of what a public pension fund is.

Because of that, the 5 percent ownership threshold really does not work for long-term investors. The fact that—for example, we hold over 3 million shares of Exxon-Mobil worth over $330 million. However, 5 percent of Exxon-Mobil's outstanding stock right now is worth $25 billion.

The 5 percent—we would have to invest our entire pension fund in Exxon-Mobil to reach the 5 percent level. As it is, we hold—even this large holding is only .07 of 1 percent. So we need a mechanism in terms of the 5 percent rule that really is workable, and that is one that we would hope that we can continue to work with the SEC and others on.

The disclosure requirements in this rule also go far beyond anything that shareholders would find useful in voting proxy access proposal. As with the ownership threshold, it's not clear that any additional disclosure is warranted, simply because the proposal concerns proxy access.

The proposal itself would not change the board's composition, which would only occur if the resolution were adopted by a majority of shareholders and then the ensuing year there would be the opportunity to nominate candidates for the board.

So these disclosures are really overly onerous and really—we don't see the benefit to the level of disclosure in the rule, and again, would be happy to work with others to try to come up with something that would be appropriate.

Let me just quickly say that there are two other issues. One is the advisory shareholder resolutions. The SEC rule requests comments on possible changes to the advisory resolution process currently available under rule 14a-8. Without going into detail, Treasurer Nappier opposes any limitation to current shareholder rights to submit nonbinding proposals.

This is—for 65 years these proposals have promoted effective communication between shareholders, management, and board members and I know that others will be testifying on this, so I will let my comments for the record talk about the detail on that.

The other issue, quickly, is the electronic forums which are in the proposal. With regard to electronic forums we can support them as a potential enhancement to the existing avenues of communication. However were these electronic forums in any way to substitute for any shareholder rights currently in place, well, we would oppose those.

In conclusion, on behalf of Treasurer Nappier, I would like to thank you for this opportunity to share our views with the committee on these important issues. I would be happy to answer questions and be of further assistance to the committee.

[The prepared statement of Mr. Kirshbaum can be found on page 44 of the appendix.]

The CHAIRMAN. Thank you.

Next we'll hear from Ms. Ann Yerger, who is the executive director of the Council of Institutional Investors.

STATEMENT OF ANN L. YERGER, EXECUTIVE DIRECTOR, COUNCIL OF INSTITUTIONAL INVESTORS

Ms. YERGER. Good morning. Thank you for the opportunity to be here on behalf of the Council.

By way of introduction, the Council of Institutional Investors is an association of more than 130 public, union, and corporate employee benefit plans with more than $3 trillion in assets. They are responsible for safeguarding the assets used to fund retirement benefits of millions of individuals throughout the United States.

They have a very significant commitment to the U.S. capital markets with the average fund investing about 75 percent of its portfolio in the stocks and bonds of U.S. public companies, and they are long-term investors due to their heavy commitment to passive investment strategies.

As a result, U.S. corporate governance issues are of great interest to members of the Council. The ability to file shareowner proposals is particularly important to Council members because they are unable to exercise the "Wall Street walk" and sell their shares when they are dissatisfied.

Shareowner proposals provide an opportunity to present their concerns to management and directors, to communicate with other investors, to encourage reforms, and to improve corporate performance. And over the past several decades, these resolutions have motivated profound improvements to boardroom performance in particular and the U.S. governance model in general.

Under debate today at the SEC is whether the shareowner proposal rule in general should be changed and in particular whether shareowners should have the right to file resolutions suggesting or mandating processes to include shareowner-suggested director candidates on company proxy cards.

I'm going to tackle the second issue first. Because directors are the cornerstone of our U.S. corporate governance model, and the primary role of share owners is limited to electing and removing directors, the Council believes owners should have the ability to file access resolutions and the marketplace at large should have the opportunity to vote on whether those resolutions are in the best interests of the companies and the owners.

The legality of any approved mechanisms ultimately and appropriately should be determined by State courts and not preempted by a new Federal mandate.

The Council applauds the SEC for again taking up the very important issue of proxy access. We appreciate the many hours the SEC staff and the Commission have devoted to developing the two most recent proposals. Unfortunately, the Council strongly opposes both proposals as currently drafted.

The Commission's shorter proposal would obliterate the current rights of shareowners to submit binding or nonbinding access resolutions. The only circumstance in which the Council could possibly support the adoption of this flawed proposal would be if it was accompanied by the adoption of another rule that provided an alternative, meaningful approach to access.

Unfortunately this hasn't happened. The Commission's longer proposal imposes such onerous requirements on proponents of access resolutions that the proposal is empty and unworkable. More specifically, the proposed 5 percent threshold for submitting a proposed bylaw amendment is too high a barrier for owners who routinely file resolutions.

Even the 10 largest public pension funds combined would be unlikely to meet this threshold at a public company of any size, be it a large, mid-size, or small cap company. In addition, the proposed disclosures are unnecessary and overly burdensome, and for some inexplicable reason are far more expensive than currently required, even for shareowners planning a hostile takeover of a public company.

Also inexplicable are the Commission's reasons for imposing such excessive requirements on proposals that ultimately would have to face the test of the marketplace and be approved by a majority or even in some cases the super majority of the outstanding shares.

The Council believes the end result of these onerous requirements would be that few if any shareowners would ever again have the ability to exercise what we believe is a fundamental right, the right to sponsor resolutions addressing the processes involving the election of directors.

Speaking of fundamental rights, the Council strongly opposes any shift from the current SEC rules governing shareowner proposals in general to a State-by-State, company-by-company model. We believe the uniformity and consistency provided by the current

Federal oversight model is in the best interests not only of Council members but of other owners, companies, and the capital markets at large.

Notwithstanding our very strong opposition to both of the SEC's proposals we stand ready to work cooperatively with the Commission, this committee, my fellow panelists, and other interested parties to develop meaningful proxy access reforms that best serve the needs of investors in the capital markets.

Thank you.

[The prepared statement of Ms. Yerger can be found on page 94 of the appendix.]

The CHAIRMAN. Thank you.

Mr. John Castellani is next, the president of the Business Roundtable.

STATEMENT OF JOHN J. CASTELLANI, PRESIDENT, BUSINESS ROUNDTABLE

Mr. CASTELLANI. Mr. Chairman, and members of the committee, thank you for inviting me here to talk about this important topic.

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

And as these reforms demonstrate, we are committed to the highest standards of transparency and governance. Similarly we remain committed to promoting the accountability and responsiveness of boards, enhancing the transparency so investors could make informed decisions, facilitating communications between companies and shareholders, and creating certainty and predictability for companies and their shareholders.

As you know, the issue of proxy access has been debated over the years and previous Commissions have concluded that changing the current system is inconsistent with State law and unworkable from a practical standpoint. Currently the SEC is once again receiving comments about the two proposed rules whose issuance followed a lengthy process of testimony by experts from the legal, academic, corporate, and shareholder communities.

The heart of these issues involved 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 management mechanism for shareholders to vote when not attending shareholder meetings.

Shareholders do have the right to nominate directors and run campaigns but not on the company proxy. The SEC has consistently recognized this and excluded director election proposals from the company proxy.

Proponents of proxy access want to turn the system on its head by creating a Federal rule which allows virtually any board candidate to be placed directly on the proxy. As you might expect, we're concerned with this for several reasons.

First and foremost, it represents a fundamental change to the successful corporate model that has produced enormous returns for all shareholders. Nominating committees of boards exist for a specific reason, to identify qualified candidates with expertise in judgment who represent all shareholders, not one particular group.

We believe the proxy access proposal will result in special interest board candidates and will politicize the director election process. In this day and age of short-term holdings, hedge funds and foreign government investment in U.S. corporations, the last thing shareholders need are fractured boards representing divergent constituencies or single-issue board members.

Further, we believe such a process will discourage qualified independent directors from serving. And finally, as some proponents have suggested, we do not want the cost of the special interest nominees to shift to companies and ultimately to that company's shareholders.

Proponents of proxy access often cite the need for additional reforms in the boardroom. The fact is, however, that our companies have dramatically changed during the past 5 years. 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 its own members on governance practices, and the results this year speak for themselves: 90 percent of our boards are made up of at least 80 percent independent directors; 71 percent of our boards meet in executive sessions at every meeting; and 100 percent meet at least once a year.

Seventy-four percent of our CEOs serve on no more than one board other than their own, and 82 percent of our boards have adopted majority voting for directors, coming up from zero in just 2 years. Indeed that has been manifested, as was said earlier, in the fact that the average tenure of a chief executive officer is now down to 4 years, and 10 years ago, it was 8 years.

These numbers demonstrate that company boards and executives have transformed themselves and are demanding greater accountability and exercising more oversight as they should. Shareholders now have a true "yes" or "no" vote on board candidates and these votes provide a meaningful voice in the director election process.

And now there is enhanced dialogue. Board members regularly meet with shareholders, answering questions and discussing everything from compensation to mergers to capital expenditures.

Companies desire to attract and retain shareholders because it is in their best interests to do so. In light of these reforms, the challenge now is to ensure that boards can attract and retain qualified directors and leaders who are able to innovate, increase revenues and profits, and ultimately increase shareholder value.

Given the record of reforms and our belief that politics and narrow agendas have no place in the boardroom, we believe that the SEC is correct in reaffirming its exclusion of director election proposals from the proxy. Simply put, proxy access is a bad idea whose time has passed.

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

Thank you, Mr. Chairman.

[The prepared statement of Mr. Castellani can be found on page 39 of the appendix.]

The CHAIRMAN. Next we have Mr. Timothy Smith, who is the senior vice president and director of social investing at Walden Asset Management, and also the chair of the Social Investment Forum.

Mr. Smith.

STATEMENT OF TIMOTHY SMITH, SENIOR VICE PRESIDENT–DIRECTOR OF SOCIAL INVESTING, WALDEN ASSET MANAGEMENT

Mr. SMITH. Thank you, Mr. Chairman, and members of the committee. It is an honor to provide testimony today. As you have heard, I work with an investment firm in Boston, Walden Asset Management. I also serve as the chair of the board of the Social Investment Forum. But in my testimony today, I'm also going to refer to my 30 years of experience working for the Interfaith Center on Corporate Responsibility, which is a coalition of religious investors with approximately $110 billion in assets.

Together we have decades of experience in addressing companies and have used the shareholder resolution process to good effect as an essential tool for over 35 years.

My comments today are going to focus on the shareholder resolution process, part of the SEC concept releases rather than on the access issue. If you look at the three major parts of the SEC concept, if adopted, these concepts would either eliminate entirely or severely limit the ability of any investor to sponsor a shareholder proposal. The result would be a curtailment of shareholder rights and, I would suggest, the elimination of meaningful investor input to corporate boards and management.

The SEC has proposed three things for us to think about, one they call the opt-out approach.

The SEC asked for comments on whether companies should have the right to withdraw from the shareholder resolution process. An opt-out option would have significant negative consequences. The most unresponsive companies would be likely to opt out.

Just imagine a scenario where a board is criticized for poor governance, irresponsible behavior for example, backdating of options that leads to legal action against the company. They simply decide they don't like the criticism and decide to opt-out, a disaster.

The second proposal the SEC offers is the electronic forum or chat room. Should the Commission provide a provision whereby the electronic forum exists instead of the shareholder resolution process?

We strongly support new forms of electronic communication between investors and the board and management, not as a substitute for, but as a supplement to, the existing resolution process. The present proposal about the electronic forum has many unanswered questions. For example, what if you're an institutional investor, as the State of Connecticut is; maybe you own 500 companies. How are you expected to monitor 500 electronic forums, and what if there is a vote of some sort or a poll? Who is really in the forum to participate and what does the poll result mean? So at present the idea of an electronic forum as a substitute for shareholder resolutions is fatally flawed.

The third part of the proposal or concept rather that the SEC raises is increasing the thresholds for resubmitting resolutions. They suggested you needed to get a 10 percent vote the first year, 15 percent the second year, and 20 percent the third year. It's important to assess who is affected by the present shareholder resolutions and who needs relief. In the year 2007 there were fewer than 1,200 resolutions filed at about under 1,000 companies, and this represents less than 20 percent of companies on the stock market.

Clearly the business community is not burdened significantly by the resolution process. And let's add to the fact that often when resolutions are sponsored, the companies negotiate dialogue, have discussions with the proponents and they're withdrawn because agreements are reached.

I would suggest, in summary, that the shareholder resolution process is not a burden on companies, but changing the thresholds would be a real burden on proponents. On issues over the years, as varied as apartheid in South Africa to corporate governance reforms like majority vote for directors or climate change, sometimes investors need a couple of years to study an issue before they start voting for it. If you raise the threshold, you will cut off many of these issues before they even get started.

For example, the Institutional Shareholders Services reminds us that this last year only under 200 shareholder resolutions on social and environmental issues came to a vote but 81 percent of them got the votes to come back. With the new rule, only 36 percent of them would come back. This would negatively impact the ability to raise important social governance and environmental issues.

So I conclude, Mr. Chairman, by saying the impact of these shareholder petitions, these resolutions, is demonstrable, it's clear, it has a track record over close to 40 years, and it makes a difference in corporate thinking, in corporate behavior, in corporate policies. The SEC should not be allowed to take steps that would disadvantage the ability of investors to petition the companies in which they are owners through the shareholder resolution process.

Thank you.

[The prepared statement of Mr. Smith can be found on page 59 of the appendix.]

The CHAIRMAN. Next, Mr. Paul Schott Stevens, who is the president and chief executive officer of the Investment Company Institute.

STATEMENT OF PAUL SCHOTT STEVENS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, INVESTMENT COMPANY INSTITUTE

Mr. STEVENS. Thank you, Chairman Frank, Congressman Neugebauer, and members of the committee. I'm pleased to be able to take part in today's hearing.

Mutual funds and other registered investment companies that are represented by the Investment Company Institute have a unique position in the debate over shareholder proxy access. Our members offer the investment vehicles of choice for millions of Americans saving for retirement, education, and other goals. They hold approximately 25 percent of the outstanding shares of U.S. companies and they have an obligation to vote those shares in the best interests of fund investors.

But funds are also issuers of stock with their own shareholders, their own boards of directors, and their own proxies, so we understand the importance of the SEC striking the right balance when changing longstanding rules on shareholder access to and use of a company's proxy.

In considering this issue we asked, what is the right result here for the fund shareholders that our members serve and for other long-term investors? Our conclusion was that under prescribed circumstances, corporate shareholders should be able to place their proposals or bylaw amendments related to director nomination procedures on a company's proxy.

Nonetheless, the ability to piggyback on a company's proxy should not be granted lightly. Care must be taken to ensure that the Federal securities laws do not inadvertently facilitate efforts to use a company's proxy machinery at the company's expense in the service of narrow interests or in a way that redounds to the detriment of the company and its shareholders as a whole.

How can the SEC craft a rule that achieves this balance? We believe the Commission has rightly identified four areas in which standards must be set. Let me briefly give you the institute's view on each.

The first concerns the intent of the shareholders seeking access to the proxy. We strongly agree with the Commission that access should be limited to proponents who do not intend to change or influence control of the company. Shareholders seeking to challenge corporate management or to exert control over the company have recourse to the existing mechanisms for proxy contests. They should not be granted license to pursue their objectives at the companies' and other shareholders' expense.

The second criterion involves the ownership threshold. It is entirely appropriate to limit the privilege of access to the proxy machinery to shareholders with a significant ownership interest. The SEC has proposed that proponents must be required to hold collectively a 5 percent stake. Our research shows it is not uncommon for even a single institution to hold 5 percent or more of a public company.

In the fourth quarter of 2006, we estimate that 87 mutual fund complexes had a total of almost 1,900 holdings of 5 percent or more of U.S. companies, and mutual funds are not alone in this regard. Many kinds of institutional investors have holdings concentrated at this level, among them, some public pension funds.

For example, based on its most recent 2007 filings with the SEC, it appears that the State of Wisconsin Investment Board has 5 percent or more of the stock of 28 U.S. public companies. All of them, I should note, small cap firms.

Hedge funds very commonly seek to assemble large positions in public companies for their own "activist purposes." We believe the Commission should study the shareholding patterns and establish a threshold sufficiently high, 5 percent or even more, to ensure that the process will be used to advance interests common to many shareholders.

Third and similarly, access to the proxy machinery should be limited to long-term shareholders who meet a minimum holding period for their shares. The Commission has proposed that proponents be required to have held their shares for one year or longer. We believe that is a minimum acceptable threshold and expect to recommend that the SEC consider requiring a longer holding period.

Again, the standard here should work to ensure that shareholder proponents are committed to the company's long-term interests.

Finally, we support the requirements of the SEC proposal that shareholder proponents disclose their background, intentions, and course of dealing with the company. This information will be highly material to other shareholders and to the marketplace in general in considering a proposed bylaw amendment.

In sum, according shareholders access to a company's proxy for these purposes is appropriate subject to the conditions I have described. Generally we believe the Commission's proposed approach will advance the interest of investors, including millions of mutual fund shareholders. We stand ready to work with the Commission and this committee and the Congress on these important issues, and I thank you for the opportunity to present our views.

[The prepared statement of Mr. Stevens can be found on page 78 of the appendix.]

Mr. KANJORSKI. There seems to be quite a clash as to the panel. Who would make the argument, just leave the status quo as it is and forget the two proposals by the SEC?

Yes.

Ms. YERGER. Certainly, I think from the Council's perspective, and our members' perspective, we would prefer the status quo to what has been proposed by the SEC. I sort of explained the key reasons why we oppose the proposals.

The status quo would enable owners to continue to present proposals on and submit them for consideration by the owners at large and let the marketplace make a determination about what the appropriate access mechanism is. And indeed if it runs into a problem with State law constraints then the issue would be challenged in State court.

Mr. KANJORSKI. Yes.

Mr. SMITH. Yes, sir. We would also agree that the present situation is better than the two proposals as they are presented. The second longer proposal, even with the 5 percent access clause, takes away shareholder rights, as I described in my testimony. And we feel the 5 percent actually makes it a rather unworkable proposal.

And of course the first, shorter proposal just doesn't give the right of access at all, which we would disagree with. So both of them I think as presented have enough flaws that we hope they will not be passed.

Mr. KANJORSKI. Is there any State in the union in their corporate law that allows no access for voters or do they all have methodologies in which to reach their—

Mr. CASTELLANI. I'm not aware of one. I believe they all have some form of access.

Mr. KANJORSKI. What are the most restrictive States? Is it reasonable to assume the great State of Delaware would be very restrictive or not?

Mr. CASTELLANI. No.

Mr. KANJORSKI. How—obviously this didn't just come about. I'm rather surprised. I sort of thought the people's argument would be on the side that you're looking at greater access and a new rule, but apparently you're looking at this as infringement upon the existing capacity to be heard.

Mr. KIRSHBAUM. The issue of what is currently permitted based on the decision of the second circuit court of appeals that last year for the first time permitted—in a long time, the proxy access resolutions to appear. Previously the Securities and Exchange Commission had permitted companies to not put these resolutions on their proxy, granting them no actions.

And so last year was the first year that there were these three shareholder resolutions on access to the proxy. We believe that process worked well during 2007 and also that there was very significant shareholder support for these resolutions, and we think that the—if the SEC just took no action at all this newly returned right to file these shareholder resolutions would be a good—good to continue next year.

Ms. YERGER. And I should note that in 2003, the SEC did release a rule that would have mandated an access procedure at all companies, and the Council indeed would support such an approach. We believe, and we agree with fellow panelists it should be a limited tool. In fact, the Council's policy is that access to the corporate proxy card to actually put someone on the card should be limited to 5 percent owners or groups who have held for at least 3 years.

So we agree that this should be a tool for long-term owners. It should not be used for control purposes and it should be very limited in scope. But what's on the table right now at the SEC isn't an access proposal that would be mandated for every company. It's an issue about whether owners can file proposals suggesting these mechanisms.

During the past proxy season three such proposals, as John summarized, were presented. They were very limiting and I think restraining. I think they proposed 3 percent owners or groups could put one or a few candidates on a proxy card, and there was very strong market support for that.

So I think the Council's perspective is yes, we would love to see a rule that's mandated that applies to all companies, but if we're—looking at the current situation, what we want is at least access to the card to submit proposals recommending different kinds of procedures and let the marketplace vote on those.

The CHAIRMAN. Thank you. Apparently Mr. Campbell has been designated the Republican spokesman on this issue, which is fine with me, so I'll recognize the gentleman from California.

Mr. CAMPBELL. I can't say, Mr. Chairman, that I speak for all Republicans on this committee necessarily on this issue, but—

The CHAIRMAN. Do you meet the 5 percent threshold?

Mr. CAMPBELL. Yes, I probably do meet—are there more than 20? I may meet the 5 percent threshold. But let me ask—Mr. Stevens I think raised some very interesting points, that a number of these mutual funds have more than 5 percent holdings, but I also understand from the pension fund side that many of you have restrictions in order to have diversity where regardless of the market cap for the company you want to keep your interests at 1 percent or below.

But it would seem to me that it would be unwise to have 5 percent if that means a Fidelity, for example, just to pick something out of the air, some big mutual fund has the opportunity to go on 60 or 70 different companies and have access to that proxy for—unilaterally without any other shareholders being involved.

Do the rest of you agree with that? I sense that Mr. Stevens thinks the threshold should be higher than 5 percent. Do the rest of you agree with that and/or if so do you have an alternative idea?

Mr. SMITH. Mr. Campbell, I think that you raise a very good theoretical question, but in fact we should be clear that the right of access to nominate directors is probably only going to happen in a company that is dysfunctional and whose board is not serving the share owners.

I think proponents are only going to seek to nominate directors in such companies. Secondly, if there was a frivolous nomination, it wouldn't pass because the vast majority of investors, the Fidelities of the world would say, "This has no meaning, I am voting against it." It would go nowhere.

So the third thing to say is that in theory you are right that the Fidelities of the world could be proactive, but they, in their corporate governance guidelines on their Web site, have not defined their role to be an active, engaged proponent, more an active proxy voter. And there's a very real difference between a pension fund or a proponent who thinks that engagement of companies is an appropriate thing to do and a mutual fund who feels, as we heard Mr. Stevens say, it's their fiduciary duty to vote the shares, but they don't feel it's appropriate to go further.

Mr. CAMPBELL. Mr. Stevens, I think, and then we'll go to Mr. Kirshbaum.

Mr. STEVENS. Yes, I just respond that in the situation that Mr. Smith describes, if the company is truly dysfunctional, will it be so hard to get a group of shareholders that are like minded at a 5 percent level or so to say, "We need to fix this," because the SEC's proposal does not limit it to one shareholding. It's a group of shareholders who can get together.

In fact, the electronic forum is intended to extend to all shareholders an opportunity that now exists for institutional shareholders to communicate freely about matters affecting a company whose shares they hold. So it would facilitate that process.

But the question we ask ourselves is, should a single institution at whatever level is chosen, be able to exercise that, and will there be the appropriate restraint. I hope that the proposal, if in fact it is adopted, would only be used in exceptional circumstances. But I agree with Mr. Castellani that it is a significant intrusion into the normal way in which corporations are and frankly should be managed.

Mr. CAMPBELL. What do you think is the right solution? You are now chairman of the SEC, so what—

Mr. STEVENS. Well, you know, I said in my testimony that I think we need to study the shareholding levels because I just don't think that there is enough understanding about the aggregations at different market capitalization. And perhaps a refinement along the lines of what you suggested—very large companies, perhaps a smaller threshold, smaller ones, a different one.

So I think that's something that ought to be studied in the proposal process. Our instinct is that 5 percent is not an unreasonable threshold for this purpose.

Mr. CAMPBELL. Mr. Kirshbaum, and then we'll go to Mr. Castellani again.

Mr. KIRSHBAUM. The 5 percent is a little confusing because we're really talking about four different steps of a process here of which we're sort of—we have to clarify the 5 percent on two of those steps. The first is that in the proposed SEC rule the 5 percent refers to the number of shareholders that would be necessary to file a resolution changing the bylaws of the company to permit access to the proxy.

Under the previous rule put forth under Chairman Donaldson, the 5 percent had to do with how many shareholders would be necessary to actually nominate somebody. So the 5 percent in the current rule has to do with just getting the shareholder resolution out there.

The second step is, of course, the shareholders themselves voting on that resolution where a majority would be needed to make that change to the bylaws. The third step would be the nomination itself. And again under the process in the proposed rule, that level would be determined in the actual bylaw amendment that was filed for access to the proxy.

Again, under the Donaldson proposal that was more clearly set out in the rule. And then of course the fourth piece is the actual election itself. No one is going to be elected to the board unless the shareholders, all the shareholders pass the vote saying the majority of them support the nominee.

So I think that the 5 percent rule needs to be, at least in terms of the putting the issue in front of all the shareholders, that level is too high. And because a majority of shareholders have to both support the change in the bylaws to put the access to the proxy in place and then the shareholders—again, the majority of them have to vote to elect new members of the board, we think that that addresses the issue that was raised about the narrowness or the special interests. You can't be a narrow special interest candidate and get a 50 percent vote on either of these.

Mr. CAMPBELL. My time is up, but Mr. Chairman, could Mr. Castellani and Ms. Yerger respond? Thank you.

Mr. CASTELLANI. Just a point of information and two comments. One, information. Of the Business Roundtable's 25 largest companies, 20 of them have a single shareholder that holds at least 5 percent. The remaining five companies would take two shareholders to meet the 5 percent threshold.

Two comments. In my own corporate experience, certainly in my company and certainly with our members, if this is an issue of communications, we spend our time trying to get Mr. Stevens's members and Ms. Yerger's members to buy 5 or 10 percent of our companies. Indeed, anybody who owns that gets the attention—or could potentially own it gets the attention of the board and the management. We are trying to sell our shares to the members that are represented here.

The second is that in the comments that came as a part of the roundtables that the SEC held in proposing these two alternative rules, a number of issues were raised about who the shareholders are, the voting process, what do you do with broker-dealer held accounts, which could represent a significant portion of the shares, and what is the role of the proxy advisory services? There are lots of things—what is the role, indeed, of the process by which we now count shares, which does indeed present some problems?

There are lots of issues that have not been resolved that were raised in the hearings at the SEC, the roundtables of the SEC that bear on this election process, some of which can bear very significantly on them, so that it is not a very true and clean vote of all of the shareholders voting for or against any one of the proposals that are on the proxy.

Ms. YERGER. I just want to note quickly that I'm not a lawyer, so maybe I'm naive when I think about rules and regulations, but I think they should be grounded in reality. And what we're talking about here is again how many share owners need to be—to get together. What is the shareownership to actually file a proposal that people would end up voting on about a mechanism to then put a candidate on management's proxy card?

And the fact is that the 10 largest institutional money managers, and many of them are not just institutional money managers but also mutual fund companies, have never, at least in our research in the past 10 years, sponsored a shareowner resolution. So we need to be thinking practically about who actually would be filing these proposals.

Even though Mr. Stevens' members may be supporting these proposals when they come on management's proxy card, they tend not to sponsor them.

Mr. CAMPBELL. Thank you.

The CHAIRMAN. The gentlewoman from New York.

Mrs. MALONEY. Thank you, Mr. Chairman.

Mr. Stevens, the SEC proxy access proposal will also allow the establishment of electronic shareholder forums that could potentially greatly increase interaction among shareholders and make it easier for them to organize and to push management to pursue shareholder interests.

Given the fact that so many investors today use the internet to monitor their portfolios and to make their investment decisions, I personally think this would be a useful tool, and you have testified in support of them.

Do you think that investment companies would establish or take advantage of the electronic shareholder forums discussed in the SEC proposal?

Mr. STEVENS. We've discussed the proposal with our membership and they are very supportive of it. It extends authority that has existed for some time for institutional investors to engage in a dialogue about matters that concern a company whose shares they hold. This would now extend it to rank and file investors so that there would be an even broader opportunity for an exchange of views.

More generally we think the SEC's rules should make the maximum possible use of the new technologies like the internet, and this is a good step in that direction.

Mrs. MALONEY. Thank you. I'd like to ask all of the panelists this same question. Much of this debate centers around the rights of the minority versus the rights of the majority and looks at the 5 percent shareholder threshold and the one-year holding period, and I'd like each of you to comment on where you stand on those two proposals.

I believe, Mr. Kirshbaum, you support, you think the 5 percent is too high. Do you support the 1-year holding period? Is that too long or too short?

Mr. KIRSHBAUM. The 1-year holding period we do support and we do feel that the—as long-term investors and as—that the holding period is a more appropriate approach to this than the number of shares that you own, the long-term shareholders are really the ones who are looking for the long-term interests of the company. They are not in and out, they are not looking for a short-term gain. And if we're looking for a measure of interest in the long-term interest of the company, the holding period is much more important than the number of shares.

Mrs. MALONEY. Ms. Yerger, could you testify whether you think that 5 percent is too high or too low and the 1-year holding period?

Ms. YERGER. Five percent level to file a shareowner proposal is too high in our opinion. We don't think it's too high to actually put a candidate on the proxy card. We think the one-year holding period is appropriate.

Mrs. MALONEY. Okay. And Mr. Castellani, your position on the two proposals?

Mr. CASTELLANI. We don't feel that the proposal is necessary in light of the reforms in majority voting that are already in place and becoming more prevalent across publicly traded companies.

So as to the holding period, it should be significant. Long-term shareholders are hard to find and come by these days.

Mrs. MALONEY. And Mr. Smith?

Mr. SMITH. I would also agree that at least a 1-year holding period, perhaps longer. We're trying to act on behalf of long-term owners here, and I would reiterate what Ann Yerger said, to get 5 percent of the shares to present an idea for a vote by shareholders that then has to be voted on and then nominating a director is plenty of safety valve, a 2-year period in the process.

So I think a normal process for putting the resolution and then looking at a 3 percent, for example, group of shareholders to nominate the director would be appropriate.

I would just add to your very good comment about the electronic forum; this is an electronic age. I think most of us would support the SEC moving in this direction and we'd be thrilled to have a discussion on, say, executive pay, online with companies.

Mrs. MALONEY. I think the chairman would like to chair that discussion.

Mr. SMITH. But as you know, the SEC proposal is to substitute the forum for the resolution process, and you're getting across-the-board opposition by investors on that.

Mrs. MALONEY. And Mr. Stevens, 5 percent and the year?

Mr. STEVENS. We have not supported the notion, Congresswoman, of substituting the forum for the process that's now in rule 14a-8, just to be clear. But no, we believe that the SEC ought to carefully study the holding patterns.

I do not believe 5 percent is an unreasonable threshold even for advancing a bylaws amendment of that significance to allow shareholders to put nominees on the corporate ballot. And I think that if there is a situation within a company that requires such a move, 5 percent will not be difficult to achieve.

Mrs. MALONEY. My time is up, but the one-year holding period, what is your position on that?

Mr. STEVENS. We would support a minimum of one year.

Mrs. MALONEY. Thank you. My time is up. Thank you.

The CHAIRMAN. The gentlewoman from Ohio.

Ms. PRYCE OF OHIO. Thank you, Mr. Chairman. I want to thank the panel. I'm very sorry that I missed your testimony. It has been summarized very adequately by my staff however, and so I appreciate the hard work that went into preparing for this.

Let me ask a question that occurs to me. Boards composed of directors with fractious and conflicting interests is probably, currently the norm in Europe, and they have proven to be ineffective governance models that don't really yield improved shareholder returns. Now the reforms that we made through Sarbanes-Oxley were designed to generate boards that are more independent, not beholden to management or any interests other than those of the shareholders.

And so given that, why do you think the SEC should take a u-turn from the board independence reforms that we so painstakingly enacted and open the door for this European-style special interest-laden board structures that don't seem to be having the desired effect in Europe. Does anybody have an opinion on that?

Mr. KIRSHBAUM. I don't think that we are looking toward a European model at all. What we're looking toward here is just a way to add one or two additional board members to the ballot and to have them be elected with—on a slate with majority support from all of the shareholders.

I think that the issue of having a fractious board based on small special interests is not going to happen here, again, because of the protections in place from the majority vote to elect the board members.

In addition, we are not talking about turning independence on its head at all here. We are looking at an opportunity to nominate more independent board members for the board. The non-independent board members are usually those that either work for the company or have some financial relationship with the company.

The access to the proxy rule I don't think would result in any further nominees of insider directors. I think what we should be looking at, again, is a strengthening of the independent directors on the board.

Ms. PRYCE OF OHIO. Does any panel member disagree with that?

Mr. CASTELLANI. Boards operate best when they are independent, when they are informed, when they are inquisitive, when they are engaged, and when they are cohesive.

Right now, State law which governs this area requires all directors to represent all shareholders, so it is a very different process than, for example, this body. Decisions in corporate boards are not made by split votes or votes along lines. They are generally made by discussion and consensus so that the company can move forward very clearly. Our concern is that if that was made to be the equivalent, functional equivalent of a legislative body, then they would be unable to take the kinds of risks and make the kinds of decisions that in fact create shareholder value. So we would be concerned about this turning it into a fractionated board that was divided similar to some of the European models, if you're talking about codetermination in particular.

Mr. SMITH. I'd love to respond to this. The words Mr. Castellani uses about a cohesive board and then a fractionated board is setting up a strawman here. In fact, a good board today should be a board that has vigorous debates. They should work together with the shareholder interests in mind, so I agree with him if that's the benchmark for a cohesive board. But what we need is boards that are more independent, think independently, and are willing to challenge the CEO or the top management, not in a destructive way, but in a creative way.

And those create good board decisions. The kinds of board members who are being discussed to be put on the Hewlett Packard board, which I think we admit has some degree of dysfunction, or the Home Depot board, which has changed; it has two new board members on it. This is not bringing in people who represent a "special interest" and are trying to push one issue. These are people who feel that the company needs to make some changes in its direction. The Home Depot board is responding very, very positively, under new management leadership by the way as well as new voices on the board.

So we would support the idea of having a board that is working together for shareowners. But I think the great fear that the Business Roundtable brings up, that bringing in some independent, new voices on a board is somehow going to make a board dysfunctional is a myth. Some of our boards are dysfunctional already. Bringing in new people might be a breath of fresh air that would get a company going down a new track.

Mr. CASTELLANI. Could I respond to that, because that is a mischaracterization of my position. Of course we want vigorous debate in boards. And the two examples that were cited, Hewlett Packard and Home Depot are examples of what I am saying is occurring across all of the large companies and across corporate America, and that is the boards responded in and of themselves after discussions with the shareholders, to improve their governance.

Mr. SMITH. After discussions with the shareholders?

Mr. CASTELLANI. After discussions with the shareholders, which we very much support. You know, communications with the shareholders are key to this and key to ensuring that the board is acting in all of the shareholders' best interests. So no, we're not asking for diminished communications; in fact, quite the opposite. And now we're not saying boards shouldn't have vigorous discussion about important issues for the company. But ultimately what boards need to do is act cohesively on behalf of all shareholders.

Ms. PRYCE OF OHIO. My time has expired. Thank you, Mr. Chairman.

The CHAIRMAN. I'm going to take off from there, Mr. Castellani, because I'm glad you clarified it, but I must say in your original statement there was one thing you said that did trouble me, which was that you didn't like to see split votes.

Now it's one thing to say you don't want people being representative of different issues, but split votes are a sign of rational thought going on. The absence of split votes means group think. I am struck by Warren Buffett's note that he has now been excluded from the compensation committees of the boards that he was on. Mr. Buffett has written that he has been on 32 boards and after he dissented on one compensation committee he was never again on the compensation committee.

So I am troubled by your dislike of split votes. People are—well, that's what you said.

Mr. CASTELLANI. No, my description is that boards operate. Boards don't operate by votes and then move forward. Boards operate by discussion, disagreement but then ultimately the best boards operate by coming to a consensus and moving forward.

The CHAIRMAN. Well, I just think that's not the way human decisions go forward, and the notion that you never have a split vote is an invitation to group think. Now it is possible to have different votes without there being a dysfunction, and the notion—I really think—and it's what Mr. Buffett seemed to me to be suggesting.

The view that in the end we all have to vote the same, that's not a requisite for anybody to function well. And a notion that a dissenting vote is somehow a bad thing or a sign of dysfunction really does trouble me.

Mr. CASTELLANI. Well, Mr. Chairman, I'm certainly not trying to give that opinion, but I would point, for example, to an example that we—both sides of this issue use as a reason why you should take our position, which was what happened at the Hewlett Packard board.

A very, very substantial portion of that dysfunction occurred when board members went outside the normal—

The CHAIRMAN. Right, which is not what we're talking about, so it's irrelevant to whether or not you said split votes. Leaking outside is—no, Mr. Castellani, that's simply not even remotely comparable.

We're talking about of course you shouldn't then go and leak and distort other people's vision and wiretap them, and if you think that when you vote "no," you have to go out then and be wiretapped, that's not any voting process I've ever seen.

It's your dislike of split votes. I think you make a grave error and you—but let me ask you this then. You say boards have gotten better?

Mr. CASTELLANI. Absolutely.

The CHAIRMAN. I have to say, and I am struck by the people—I've been around this committee for a while, and the people who are now telling me that boards are much better, never acknowledged that they weren't good before, so they went from good to perfect.

And if you have any comments from the Business Roundtable or anybody else prior to the period of the last 5 years in which people acknowledge problems I'd be glad to see them. I don't think they're there, but the question would be what has made them better, why have they improved?

Mr. CASTELLANI. Well, those boards—and again—

The CHAIRMAN. You said that in general boards have gotten better. What's been—

Mr. CASTELLANI. Here are the fundamental things that we believe have improved the board process.

The CHAIRMAN. No, I'm looking at the causality. I'm not talking about the examples of improvement. But when things are going along a certain way and then there's a significant change I think it's relevant to look at the causality. What caused those improvements in the last 5 years?

Mr. CASTELLANI. Well, in large part the boards reexamining, companies reexamining how those boards operated in light of some of the scandals. Obviously no board, no company, no management wanted to be in a circumstance where shareholder value was destroyed because of improper behavior. So I think we learned from all of the scandals and went back and improved our processes, just as we daily improve our products and services based on what we see going wrong, to ensure that that wasn't going to happen in the preponderance of the U.S. corporations.

The CHAIRMAN. I understand, but was the increase a result of outside agitation of shareholder activism, of even politicians raising questions, did that have any impact in the change to the board?

Mr. CASTELLANI. I'm sure it had an impact, but for example in our own companies, and within the Business Roundtable, it was the chief executive officers themselves right after the Enron scandals who stood up at our meeting subsequent—

The CHAIRMAN. Because of the scandals.

Mr. CASTELLANI. —and said, "That cannot happen to us."

The CHAIRMAN. Let me just say, and I'll get to you in a second, Mr. Smith. But I was struck—Sarbanes-Oxley has not been the favorite act of a number of business people although you have cited your support for it.

Mr. CASTELLANI. I do support it.

The CHAIRMAN. But I was struck that we did get a letter from the Chamber of Commerce of the United States in which they gave Sarbanes-Oxley a lot of the credit for the improvement in board performance. They did it in a context of saying that therefore we didn't have to do anything about executive compensation, but the Chamber did give Sarbanes-Oxley some of that credit.

Mr. Smith, you wanted to say something?

Mr. SMITH. I do, Mr. Chairman. Certainly Mr. Castellani is absolutely right that the scandals woke up boardrooms but also woke up investors, investors who lost virtually trillions of dollars as the market started losing confidence, woke up, became more active owners, became more engaged owners, and became much more actively involved in pressing for certain forms of board accountability.

Now often, as Mr. Castellani and I would agree, boards readily responded positively to those calls, for example, majority vote for directors or even some companies that were expensing stock options before it was required. So it's not always a confrontation when there's a disagreement, but certainly the input—I wouldn't necessarily always call that agitation, but the input from investors has been key from our point of view in fertilizing this process and sometimes stimulating it.

And on other occasions when companies don't seem to get it, when resolutions are sponsored on issues like majority vote for directors and get a 50 percent vote, to their credit the Exxon board, the Exxon-Mobil board and the Home Depot board, within 3 or 4 months puts that reform in place.

Now we needed to have shareholder leverage there to encourage the board to take a stand. And I'd just get on my soapbox again and say without the right to file shareholder resolutions that the shareholder—

The CHAIRMAN. I appreciate that. I would just say you took a little exception to my saying "agitation" but you substituted "fertilization." I think I'd rather have my activity characterized as agitation than as fertilizer.

The gentleman from Kansas.

Mr. CAMPBELL. Mr. Chairman, if I can just comment, I am pleased to know that split votes can represent rational thought, because you're likely to see a lot of rational thought relative to the flood insurance bill later today.

The CHAIRMAN. Oh, I have never tried not to have split votes. I think they are a very good idea.

Mr. MOORE OF KANSAS. Thank you, Mr. Chairman. Mr. Stevens, in your written testimony, you have discussed the uniqueness of mutual funds as institutional investors being subject to disclose their proxy votes. Today we're talking about access to the corporate proxy, but I'm also interested in your views as to whether other institutional investors should disclose proxy votes as well. Would shareholders and companies benefit from those disclosures by the others?

Mr. STEVENS. Thank you for the question. It is true we had reservations about the SEC uniquely applying regulations to us. They went into effect several years ago. We have learned to live with them, and every vote we cast with respect to every company whose shares we own in our portfolios across our industry are now there for all the world to see.

I think it would be very beneficial for other institutional investors, particularly those in a fiduciary relationship to their customers, to be required to make a similar disclosure.

Mr. MOORE OF KANSAS. Thank you, sir. Thank you, Mr. Chairman.

The CHAIRMAN. The gentlewoman from New York.

Mrs. MCCARTHY. Thank you, Mr. Chairman. I'm sitting here and I'm wondering, when you were starting to talk about dysfunctional boards, what is your opinion on some of the boards that did not react fast enough or didn't know it was coming when we had the mortgage crisis? Did those boards know that what their CEOs were doing as far as putting the monies out to people who shouldn't have been getting mortgages? I'm just curious.

I mean, obviously, the proxy voters wouldn't have known anything about it, because a lot of people didn't know about it until it hit the fan. And then obviously it affected the whole stock market, so that had to have a trickle-down effect. And I was just curious if you had any thoughts on that. I mean, it was going on. It didn't hit one company; it hit many companies. Germany, from what I understand, the German bank was the one that really started it rolling.

Mr. CASTELLANI. Certainly any board, any board member should know the breadth and extent of the company's activities, and the consequences of the activities.

Mrs. MCCARTHY. Do they actually, though? I mean, do a lot of the board members actually—they meet how many times a year?

Mr. CASTELLANI. Indeed. Board meetings vary, but typically—well, some meet every month. Typically, it's 8 or 10 times a year. Though what we've seen also in our data consistently through the years that board members and board meetings are taking more time, getting more information. Committees are meeting more and more often for greater periods of time getting in more and more information about the company, so.

Mrs. MCCARTHY. Who gives them the information to make the decisions when they're meeting?

Mr. CASTELLANI. It comes from a variety of sources. It depends on the committees and depends on the activity. But typically, it comes from the company, committees, particularly audit committees and compensation committees, but any committee of a board is free and does avail themselves of outside information, particularly those sensitive areas. For example, the audit committee, the auditors report to the audit committee, not to the management of the company.

Mrs. MCCARTHY. Again, I'm going to follow up with a curiosity. Because when we saw a number of hedge funds get in trouble, certainly mortgage companies getting in trouble, which was a chain reaction, if the accountants, you know, when times were good, they were making a lot of money, but didn't anybody, you know, put forward or is it not the responsibility of the board or the CEO to put forward, you know, we're making good money, but we're taking a lot of risks here? I'm just—

Mr. CASTELLANI. Oh, absolutely. I mean, risk assessment, having had the responsibility for risk management in my company, risk assessment is an important part of a board's function. Absolutely.

Mrs. MCCARTHY. So they all failed?

Mr. CASTELLANI. Well, you know, if they understood the consequences of it and understood that it was coming forward, I can't comment on the specifics of it because I'm not knowledgeable about the industry in and of itself. But I would make the general comment is that in some cases, companies will fail with their products, with their services, and we want them to fail. Because if there aren't failures, there aren't risks being taken.

Now clearly that doesn't mitigate the impact of the consequences of the failure in the case that you're describing, but we want boards and we want companies to take risks. Otherwise, they're not going to develop new products, new services, and greater shareholder value. I don't think anyone here would—

Mrs. MCCARTHY. I understand that, but it seems from the Enron episode that we went through, then the mortgage bankers, it's the little guy who has actually gotten hurt more than anybody else. And I think that is something that should be a concern to every corporation.

Mr. CASTELLANI. Well, it is a concern, and I would point out that it is the exception and not the rule. I mean, all the scandals that we are talking about, Enron, whatever, however many you want to mention, are horrible, and that they affected a lot of people and caused trillions of dollars of damage.

They affected all of us, every other corporation, because we exist to—and we prosper when we have an environment of investor trust and public trust in what we do, and we suffered when that trust was eroded. However, those are still a handful companies against the 15,000 publicly traded companies that—

Mrs. MCCARTHY. Well, I agree with you, and I was the first one defending a lot of companies, but I still think we on this committee handled it in a fair-minded way. Mr. Smith?

Mr. SMITH. Mrs. McCarthy, I think this is a case where a cohesive board from 5 or 10 years ago who played by the rules of the game then on subprime lending and didn't ask hard questions, therefore didn't serve the company and the shareholders well in the long term.

So how do you get voices from the outside who are canaries in the coal mine or just raising a different point of view? Shareholders actually were sponsoring resolutions with companies like Countrywide, raising questions about subprime lending before it was considered—well, unfortunately, the disaster we see today.

Or the issue that's very much on the front pages today on climate change; 10 or 15 years ago, investors began knocking on companies' doors and raising questions about the risk related to climate change. Happily, today you'll see hundreds of companies acknowledging that risk, speaking out about it, and day-by-day changing their policies.

But the boards had to be stimulated, activated to think outside the box, whether you were an insurance company, whether you're British Petroleum or not. That's not to say that the boards did a bad job. It's just to say they played by the expected rules of the road in their board meetings. And when you have outsiders through the shareholder resolution process saying why don't you think about it this way, it does—that agitation does pay off.

Mrs. MCCARTHY. Thank you. I yield back the balance of my time.

The CHAIRMAN. The gentleman from Missouri.

Mr. CLEAVER. Thank you, Mr. Chairman. Mr. Castellani, thank you very much for being here. Thank all of you for being here today. In your prepared remarks, you said, given the strong record of reforms and our belief that politics and narrow agendas have no place in the boardroom, what do you—can you break that down? What—I mean, politics and what narrow agendas? Give me some examples.

Mr. CASTELLANI. Sure. There are a number of narrow agendas that exist, and in fact, one of the things that Mr. Smith has addressed is a good example of them. When you talk about various proxy proposals, they range in their attention from things that are directly related to the governance of the company—how is the board structured? Is it an annually elected board or is it a staggered board? How are nominees brought forth? Does the board have change of controls, circumstances, and thing that relate to governance.

And then you get at the other end of the spectrum, well meaning shareholders who have specific interests that may have been frustrated somewhere else. For example, in my own company, we had a group of shareholders who every year asked us to get out of the nuclear shipbuilding business. Well, that was fine. But it was 40 percent of our cashflow and of substantial value to our shareholders.

Mr. CLEAVER. Okay. But—

Mr. CASTELLANI. Because they were against nuclear power.

Mr. CLEAVER. Okay. What about the politics?

Mr. CASTELLANI. Well, if those particular interests and specific interests are represented on the board and that is the only purpose of a board member to come to, for example, I've used my company, which doesn't exist any more. We took it apart—to come to every board meeting and say I'm not going to support investment in the shipbuilding business because it is nuclear powered shipbuilding, we should get out of it and push that agenda, then it would be to the detriment of the shareholders because they were benefitting greatly from the profitability and the cashflow of that operation.

Mr. CLEAVER. Now, I'm a United Methodist pastor, and we own—the Methodist Church owns substantial stock in Coca-Cola. And we went through the very same process you did by getting—some years back—by trying to force Coca-Cola to divorce itself from South Africa. And so you're saying that if—in a situation like that, those individuals who are single-minded should not have access?

Mr. CASTELLANI. No. Because you did it from the standpoint of a shareholder. What I'm saying is if the director, if a director had that as his or her only—

Mr. CLEAVER. Yes.

Mr. CASTELLANI. —and disrupts all of the other operations, then that's the concern we have.

Mr. CLEAVER. But that's the whole point I'm making. You don't want them to be directors, right?

Mr. CASTELLANI. We want voices—

Mr. CLEAVER. I know. But you don't want them to be directors, right?

Mr. CASTELLANI. We want diverse voices in the directorship, but we want boards ultimately to reach consensus in operation.

Mr. CLEAVER. Okay. So, if the wolfman and his friends are on the board and people are investing in the silver bullet factory, you don't want them on the board because—I mean, they want the silver bullets produced at a much higher rate, because they have a direct interest.

Mr. CASTELLANI. If they hurt the interests of the other shareholders of the company—

Mr. CLEAVER. You don't want them on the board.

Mr. CASTELLANI. —the majority of the shareholders, then, no, they should not be on there.

Mr. SMITH. Mr. Cleaver, Mr. Castellani and I are not too far apart on this.

Mr. CLEAVER. Well, we are. He and I are.

Mr. SMITH. And I just wanted to explain that if the person only had one issue and was on the board, that would be disruptive. But as you know, sir, Dr. Leon Sullivan—

Mr. CLEAVER. Yes.

Mr. SMITH. —and Clifton Wharton were on General Motors and Ford boards. They spoke out strongly on the South Africa issue, and they were convincing. In the end, they helped bring the board's decision around to the position held by the United Methodist Church.

Mr. CASTELLANI. Clifton Wharton was on our board.

Mr. SMITH. That's right. And this is creative discussion within the boardroom rather than—

Mr. CLEAVER. My problem is—and maybe these are just words that were not—that were put in your—that you wrote into your report, and I shouldn't focus in on it. You said we believe proxy access will result in special interest board candidates and will politicize the director election process.

And I'm not saying people, you know, who purchase stock 2 weeks before a board meeting, and I think all of you agree that they should be long term. But, I mean, I'm wondering when you say special interest, are you talking about organized labor? Are you talking about—I'm sorry?

Mr. CASTELLANI. Could be. Could be. Any shareholder—

Mr. CLEAVER. I mean, since AFSCME—

Mr. CASTELLANI. Any shareholder who comes with a single agenda that would be to the detriment of the other shareholders of the—

Mr. CLEAVER. Who determines whether they have a single agenda?

Mr. CASTELLANI. They do.

Mr. CLEAVER. No, no, no, no. They may be speaking to an issue, but they may have other reasons for being on the board, and so, the board members—I mean, so you're saying that the people on the board decide whether or not you are a single agenda stockholder?

The CHAIRMAN. Would the gentleman yield?

Mr. CLEAVER. Yes.

The CHAIRMAN. Because it's very relevant to two bills that have come out of this committee. We've authorized and we talked to the ICI about this as well as others, the Council of Institutional Investors—we have authorized a suspension of the potential of a lawsuit on fiduciary responsibility with regard to Darfur and Iran. We have in this committee, and overwhelmingly in the House, gotten more than 400 votes for each bill. This made it easier for people to push for divestiture either from Darfur in connection with their activity, or the nuclear weapons in Iran. Would you characterize people seeking to push for any kind of disengagement in either Iran or Darfur, would they be in the special interest category?

Mr. CASTELLANI. Not if it was determined to be in the best interest of all shareholders.

The CHAIRMAN. Well, but no. Excuse me. The "if" doesn't work for now, Mr. Castellani. We're not in a hypothetical. If resolutions were now put forward saying, cut off your activities with the companies doing business in Darfur, cut off Iran, would you characterize those as special interests?

Mr. CASTELLANI. Boards have, boards and management have the utmost responsibility to comply with the laws of the United States. They will comply. If you make a law—

The CHAIRMAN. Well, Mr. Castellani—please answer the question. I don't mean to be rude.

Mr. CASTELLANI. No, I—

The CHAIRMAN. You're not answering the question. If it were the law—we're not—there are things that people can be doing that are investing that don't violate the law. Yes, I'm not accusing people of breaking the sanction. But there are people who want to go beyond the sanctions and say, yes, it's illegal to do this. But we want to go beyond that. I'm not talking about the sanctions bill. I'm talking about legislation that allows people to say, I don't want my money being used to deal with—to help these people in Darfur who are in power or Iran where it's not legally required. And the question is—it seems to be a fair question—would people seeking to get companies to divest beyond what the law absolutely required with regard to Darfur or Iran, be in that special interest category?

Mr. CASTELLANI. If the board of directors determined it was in the interest of all of the shareholders. If it—

The CHAIRMAN. You're not answering the question, Mr. Castellani. I didn't ask you what the board—I'm asking your characterization. You say there are these special interests. It's an intellectual issue. You're just dodging the question.

Mr. CASTELLANI. There are—

The CHAIRMAN. Do you characterize people who come and say look—there's no if's here—I don't want my company, I don't care how profitable it is. I don't want my company making money off genocide. I don't want my company helping nuclear weapons. Is that a special interest or not?

Mr. CASTELLANI. Is it a special interest if I come forward and I say I don't want my company investing in Massachusetts because I don't like the Boston Red Sox? I'm a Yankees fan.

The CHAIRMAN. I would say that that was kind of silly. Having answered your question, will you answer mine? I mean, why do you refuse to answer the question? And do you really—excuse me, Mr. Castellani, you know what? And I understand this is off the top of your head, but equating dislike of the Red Sox to equating a dislike of genocide, really it doesn't advance serious discussion.

Mr. CASTELLANI. No, sir, I—

The CHAIRMAN. I'm asking you the question and your refusal to answer it frankly is more revealing than your answer.

Mr. CASTELLANI. I can't answer a question that can't be answered in the context of what is in the best interest of all of the shareholders.

The CHAIRMAN. Here is the context.

Mr. CASTELLANI. The board of directors makes that decision.

The CHAIRMAN. You know—I'm not—it isn't hypothetical. It's Darfur today. In other words, you think it would be a special interest and you'd be embarrassed to say so in your characterization.

Mr. CASTELLANI. No, sir.

The CHAIRMAN. Yes.

Mr. CASTELLANI. There are specific issues that come before any board of directors. A board of directors' deliberation is to ensure that those specifics, whether it's an individual product or an individual market or an individual political circumstances are in the interest of all shareholders. That is their fiduciary responsibility.

The CHAIRMAN. That's not the question I asked you. Mr. Smith, did you want to—

Mr. SMITH. Well, I'll try to answer it, not for Mr. Castellani, but indeed the U.S. Chamber of Commerce says this all the time about advocates who are raising questions about subprime lending, about climate change, about diversity, about corporate governance—

The CHAIRMAN. They say what all the time?

Mr. SMITH. We are special interest groups who have no interest in shareholder value. And it's a transparent myth used of course to marginalize proponents. Mr. Castellani has not said that today, but the business community too easily falls into, I don't like the position you're raising, therefore, you're a special interest group, rather than I just disagree with the position you're raising.

The CHAIRMAN. Let me go back to the gentleman from Missouri. I captured his time, and I apologize.

Mr. CLEAVER. That was the point I was trying to make. You said it perhaps more articulately. The problem I have is, you know, somebody sitting on a board has the distinct and exclusive power to determine what a special interest is, and that troubles me.

Let me ask my final question. Has there been any evidence—this is for anybody—any evidence in the United States or anywhere else that would indicate that direct shareholding—shareholder voting has destroyed a corporation?

Mr. CASTELLANI. No, because it doesn't exist.

Mr. CLEAVER. I'm sorry?

Mr. CASTELLANI. No, because it doesn't exist.

Mr. CLEAVER. You are absolutely right. We now agree. And so since it doesn't exist, how do you know that it's evil?

Mr. CASTELLANI. We're making our best judgment based on—

Mr. CLEAVER. But your best judgment is prejudiced.

Mr. CASTELLANI. On a model that works pretty darn well.

Ms. YERGER. If I can make one comment, I think that we don't want to lose sight of the fact that when it comes to the board of directors, they are elected by the owners. And anyone who is sitting in the boardroom has been elected by the owners. I have a lot of confidence in our marketplace. I have a lot of confidence in the sophistication of our institutional investors and our investors, and I don't think they would elect anyone with a special interest only to represent them on a board. And once they're sitting in the boardroom, they have a fiduciary duty to represent all share owners. So I think we should remember that this is about giving owners the power they actually have, which is to elect directors.

The CHAIRMAN. Let's finish up with Mr. Kirshbaum.

Mr. KIRSHBAUM. Thank you. In terms of the special interests, I think that anybody on the board, if someone happens to be a member of a union, doesn't mean that they represent the union. If they are a lawyer, it doesn't mean they represent all lawyers. If they're a university president, it doesn't mean that they're only there representing universities.

I think that picking out somebody just because of what their background is, and saying that they have a special interest, is just a false way of addressing this issue. Everybody comes from some background, but they're all elected by the majority of the shareholders to serve the interests of all of the shareholders, and they act accordingly.

The CHAIRMAN. The hearing is adjourned.

[Whereupon, at 11:39 a.m., the hearing was adjourned.]

A P P E N D I X

September 27, 2007

Statement of Congresswoman Carolyn B. Maloney
SEC Proxy Access Proposals
Financial Services Committee
September 27, 2007
10:00am
2128 RHOB

I would like to thank Chairman Frank for holding this morning's hearing.

Back in June when we had all five of the SEC Commissioners before us, there was general agreement for a follow-up hearing on the issue of proxy access.

Since our hearing, the SEC has published for comment two proposals to amend its proxy rules.

The regulatory proposals were adopted by split votes of the Commissioners, with Chairman Cox casting the deciding vote on both proposals.

The comment period on both of these proposals will end on October 2nd.

Given the significance of these issues, which will affect the continued ability of shareholders to participate in the corporate governance of the companies they own, I know that many of us are interested in the perspectives of the witnesses on the proposals prior to the end of this comment period.

The pending proxy rule amendments were precipitated by the 2006 case of *AFSCME v. AIG.*

In that case, the Second Circuit Court of Appeals nullified an SEC staff interpretation allowing companies to exclude shareholder proposals that would establish procedures for shareholder-nominated candidates to be included on the corporate ballot.

The first (or short) proposal, adopted on a 3-2 vote, would codify in regulation the pre-*AFSCME* staff position, thus reversing the *AIG v. AFSCME* decision.

I have concerns that since the short proposal is a reaffirmation of the SEC staff position pre-AFSCME, if it were to be adopted it would continue to create uncertainty for both corporations and shareholders, and could lead to another round of litigation on the issue in the next proxy season.

The second (or long) proposal would establish procedures allowing shareholder proposals regarding director elections, subject to eligibility requirements, enhanced disclosure, and other requirements. This proposal was also adopted on a 3-2 vote.

Ultimately whatever is decided, I believe it will come down to a debate on the rights of the minority versus the rights of the majority.

Critics of the shareholder proposal process worry about the "tyranny of the minority" and that minor shareholders with a narrow agenda will drive up the costs of proxy solicitations and detract from the conduct of more relevant business at annual meetings.

Shareholder proponents question the characterization of all non-binding proposals as illegitimate and observe that even if socially-oriented proposals do not produce immediate results, they have played a useful role in the proxy process and in corporate governance.

In any case, I am certainly interested in hearing from our witnesses today on their thoughts and opinions on both of the proposals.

Again, I thank the Chairman for holding this morning's hearing and I yield back.

Opening Remarks of the Honorable Maxine Waters (CA-35)

On a Hearing of the Financial Sevices Committee on

"SEC Proxy Access Proposals: Implications for Investors"

September 27, 2007

2128 Rayburn House Office Building

10:00 a.m.

Thank you, Mr. Chairman for holding this hearing on this important topic.

Corporate responsibility and the ability of shareholders to enforce that responsibility are critical in today's financial markets. Recent corporate scandals—coupled with skyrocketing executive compensation packages—highlight the need for shareholders to have more of a say in how the companies in which they have invested are run and by whom they are run.

Current SEC rules limit the ability of shareholders to nominate their own candidates or to submit their own proposals to the Board of Directors. In fact, in the official proxy submitted to shareholders the only candidates that appear are those selected by the Board's nominating committee. In addition, because, in most cases, the CEO influences who the Board nominates, if there are corruptions or other inefficiencies in the corporation, those will continue unchecked and unabated. We need only look to WorldCom, Enron, and Hewlitt-Packard as examples of what can happen when shareholders are locked out of the process.

Although state laws allow shareholders to try to run their own candidates, these campaigns are expensive and can oftentimes be a losing battle as the CEO and the Board have full access to the company's treasury. One estimate places the cost for shareholders to mount their own campaign for alternate candidates at a minimum of $250,000. As a result, in many cases, shareholders' participation in the companies they own is reduced to merely rubberstamping a proxy that comes from the Board.

Proxy access is widely supported by unions, institutional investors, investor associations, and pension funds, including the California Public Employees Retirement System, the largest pension fund in the country with $246 billion in assets.

I am pleased that the SEC has a proposal that would open up this relatively closed process to long-term shareholders. However, I am concerned about which proposal will move forward as the SEC has put forth two different proposals.

I look forward to hearing the witnesses' views on the merits and shortcomings of these two proposals.

Thank you, Mr. Chairman. I yield back the balance of my time.

Business Roundtable™

Testimony for the Record

Of

John J. Castellani
President, Business Roundtable

On

SEC Proxy Access Proposals: Implications for Investors

Before the U.S. House of Representatives
Committee on Financial Services

On

Thursday, September 27, 2007

Business Roundtable
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Mr. Chairman and members of the Committee, thank you for inviting me to be here. We appreciate the opportunity to provide our views on the issue of proxy access, and for the hearing record we will also submit our detailed 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. As these reforms demonstrate, we are committed to the highest standards of transparency and governance.

Similarly, we remain committed to promoting the accountability and responsiveness of boards; enhancing transparency so investors can make informed decisions; facilitating communications between companies and shareholders; and creating certainty and predictability for companies and their shareholders.

As you know, the issue of proxy access has been debated over the years, and previous Commissions have concluded that changing the current system is inconsistent with state law and unworkable from a practical standpoint. Currently, the SEC is once again receiving comments about 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 management mechanism for shareholders to vote when not attending shareholder meetings. Shareholders do have the right to nominate directors and run campaigns, but not on the company proxy. The SEC has consistently recognized this and excluded director election proposals from the company proxy.

Proponents of Proxy Access want to turn the system on its head by creating federal rules allowing virtually any board candidate to be placed directly on the proxy.

As you might expect, we are concerned with this for several reasons. First and foremost, it would represent a fundamental change to the successful corporate model that has produced enormous returns for shareholders.

Nominating Committees exist for a specific reason - to identify qualified candidates with expertise and judgment who will serve to represent ***all*** shareholders, not one particular group.

We believe proxy access will result in special interest board candidates, and will politicize the director election process. In this day and age of short term holdings, hedge funds, and foreign government investment in US corporations, the last thing shareholders need are fractured boards representing divergent constituencies, or "single issue" board members.

Furthermore, we believe such a process will discourage qualified, independent directors from serving. And finally, as some proponents have suggested, we do not want the cost of special interest nominees to shift to companies and, ultimately, to shareholders.

Today's corporations have millions of shareholders, often represented by thousands of institutional investor groups. Imagine a proxy card with hundreds of board candidates, each with their own agenda. This is not a formula for stability and long-term growth in shareholder value.

Proponents of proxy access often cite the need for additional reforms in the boardroom. The fact is, however, that our companies have dramatically changed during the past few years. 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 CEO serve on no more than 1 other Board.
- 84 % of our Boards have adopted Majority Voting for Directors in just two years.
- The average tenure of a CEO is down to 4 years.

These numbers demonstrate that company boards and executives have transformed themselves, and are demanding greater accountability and exercising more oversight, as they should.

Shareholders now have a true "yes" or "no" vote on board candidates. These votes provide a meaningful voice in the director election process.

And now there is enhanced dialog - board members regularly meet with shareholders, answering questions and discussing everything from compensation to mergers to capital expenditures. Companies desire to attract and retain shareholders because it is in their best interest to do so.

In light of these reforms, the challenge now is to ensure that boards can attract and retain qualified directors and leaders who are able to innovate, increase revenues and profits, and increase shareholder value.

Given the strong record of reforms and our belief that politics and narrow agendas have no place in the boardroom, we believe that the SEC is correct in reaffirming its exclusion of director election proposals from the proxy. Simply put, proxy access is a bad idea whose time has passed.

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 judgment and oversight, and help create long term value for ***all*** shareholders.

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

State of Connecticut
Office of the Treasurer

DENISE L. NAPPIER
TREASURER

HOWARD G. RIFKIN
DEPUTY TREASURER

Testimony of Donald A. Kirshbaum, Investment Officer for Policy
Connecticut State Treasurer's Office
Before the Committee on Financial Services, U.S. House of Representatives
Hearing on Pending Proposed Rulemakings Issued by the Securities and Exchange Commission to Amend the Proxy Rules Relating to Shareholder Proposals
September 27, 2007

Good morning, Chairman Frank, Ranking Member Bachus, and Members of the Committee on Financial Services. My name is Donald Kirshbaum. I am Investment Officer for Policy in the Office of Connecticut State Treasurer Denise L. Nappier. Treasurer Nappier is the principal fiduciary of the $26 billion Connecticut Retirement Plans and Trust Funds (CRPTF), and is responsible for prudently managing the retirement funds for approximately 160,000 teachers and state and municipal employees who are pension plan participants and beneficiaries. I am pleased to appear before you today on behalf of Treasurer Nappier. I have brief prepared remarks and would respectfully request that the full text of my statement and all supporting materials be entered into the public record.

The voters of Connecticut have elected Treasurer Nappier to this office three times. Since taking office in January 1999, the Treasurer has been actively involved in corporate governance issues through engagement with companies and in the public policy arena. Treasurer Nappier considers proxy voting a plan asset, and uses communication with companies in which the CRPTF invests – including proxy voting and filing shareholder resolutions – as one mechanism to protect and enhance the value of the pension fund's assets. The Investment Policy Statement of the CRPTF, adopted by our Investment Advisory Council, states, "Plan fiduciaries have a responsibility to vote proxies on issues that may affect the value of the shares held in a portfolio since proxies are considered plan assets and have economic value."

Today's hearing addresses two pending proposed rulemakings issued by the Securities and Exchange Commission (SEC) to amend the proxy rules relating to shareholder proposals – specifically File No. S7-16-07, and File No. S7-17-07. Treasurer Nappier has submitted comments to the Commission on these proposed rules, and they are attached as part of this testimony.

These proposals address an aspect of the election of corporate directors. The election of directors is one of the most important stock ownership rights that shareholders can exercise, and it reverence for that right that is the context for the comments I will make here this morning.

Before addressing specific questions relating to the two specific SEC proposals, let me provide a little background that will help explain the context for Treasurer Nappier's comments on these two rules.

As a pension fund – investing for the benefit of employees who will be collecting benefits many years from now – we are a long term investor. Our asset allocation is spread over a number of asset classes. With respect to investments in public equity, we are very diversified, and have a significant portion of these assets in core index funds. This means that we are long term investors in many of the companies in which we invest – and that includes all of the companies in the S&P 500, for example.

Most other public pension funds also take this approach – which has a direct impact on the questions before the committee this morning.

The two rules that the SEC is currently soliciting comments on – and are the subject of today's hearing – address the concept known as "Access to the Proxy", and several other related issues. This is not a new issue. The Commission has tried to address the issue in the past, most recently under Chairman Donaldson. However, we are no closer to a new workable rule today than we were back then.

While the proposed rules are long and complex, the concept of Access to the Proxy is a simple one. Access to the proxy would provide a mechanism for an investor – or group of investors – who meet certain ownership criteria, to nominate several members for election to the Board of Directors, and those nominees would appear in the company's proxy and on their proxy card.

Why do we need this mechanism?

In general, under state corporate law (and each state has its own different laws), shareholders can run a challenge slate to a company's nominees for the Board of Directors. This slate can present a challenge for each board seat being elected, or be a "short slate" of only a few challengers. In the first case, the challenge slate could take over the running of the company, and in the second the challengers, if elected, would join other board members nominated by the company.

The problem is that this challenge must be run on a separate proxy card, with significant costs involved. This can work for an investor whose goal is to gain control of or change the direction of the company or a hedge fund that is building a large financial stake in the company – often looking for a short term financial gain, that justifies this expense.

For investors such as the CRPTF our goals are different, and this process doesn't work for us – thus the concept of access to the proxy. With respect to the Board of Directors our goals are a well functioning board that oversees management and the operation of the company on behalf of its owners. In cases where this is not happening, we need a mechanism to elect some new board members to move the company back in the right direction. The goal is NOT to take over the company – thus access to the proxy is for a small number of board seats – one to three, depending on the size of the board.

The other side of the issue is cost. We are long term investors, we have small stakes in many companies, and we are not looking for short term gain that could justify the large cost of running a proxy contest.

Treasurer Nappier is encouraged that SEC Chairman Cox agrees with us in concept. However, the precise mechanism contemplated by the long rule would be unworkable (in ways I will later address) and ultimately would be of little benefit to shareholders such as the CRPTF – or for that matter even the largest public pension funds such as CalPERS. Treasurer Nappier is hopeful about working with the Commission to create an access to the proxy rule that can work.

Boards of Directors are elected by shareholders and oversee the management of the corporation on behalf of the shareholders. Most board members perform their jobs very well and most boards do a good job on behalf of the shareholders who elect them. However, when shareholders believe boards are not acting in the best interests of shareholders there are some things we can do – but nominating replacement directors is not one of them.

The Office of the Connecticut State Treasurer has had extensive experience with access to the proxy, and related shareholder activity. For example, you are all aware of the problems on the Hewlett-Packard board several years ago. To say the board members were not working well as a team is an understatement. When the opportunity arose to file an access to the proxy resolution (after the court ruled the SEC could not permit such a resolution to be excluded), Treasurer Nappier joined with state pension funds from North Carolina and New York, and the AFSCME Employees Pension Plan in filing such a resolution. The resolution received broad shareholder support – 43% of shareholders voting supported the resolution. That size vote shows that this is not a fringe idea – it is a concept that is being supported by mainstream investors.

Two other proposals were also submitted in the 2007 season—one received majority support, while the other was supported by 45% of shareholders voting. There has not been a tidal wave of resolutions; the focus is on companies where the board needs attention. This shows shareholder moderation in filing resolutions, and foreshadows what we believe will be a limited, responsible use of this prospective shareholder right.

There some other ways Treasurer Nappier is working to make board members more responsive to their shareholders. Treasurer Nappier has been promoting majority vote for election of directors in non-contested elections, and many companies are moving toward this standard. Treasurer Nappier is also promoting "Say on Pay", a concept embraced by this committee in legislation which passed the House this year by a 2-1 margin, and has been introduced in the Senate.

We can, and have, withheld votes – or voted against - re-election of specific board members. We have been doing that to express our lack of confidence in the performance of some compensation committee members, and with some CEOs (some of whom have been replaced). What we cannot do is vote yes – for a new replacement board member. That is the access to the proxy initiative.

In addition to access to the proxy, one of the pending proposals also asks a series of questions relating to advisory shareholder resolutions, as well as proposes electronic company-shareholder forums. Let me now speak to some questions posed in your invitation to testify, which addresses these other issues, and some broader questions as well.

> *Does the shareholder proposal process need to be changed?*
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> While the shareholder proposal process in general is working well, there are a number of areas where it could be changed to better protect shareholder rights. One is the implementation of a workable access to the proxy rule. Another would be to limit the SEC staff's ability to permit companies to omit certain resolutions. There are many issues that should be brought to shareholders that are routinely excluded under an exclusion called "ordinary business". Another area has already been addressed by this committee – and the full House – regarding say on pay. Another area (with a pending proposed solution being considered by the SEC) is eliminating broker votes, where brokers vote when the shareholder has not submitted their proxy.
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> *Should the types of shareholder proposals that can be included on a management proxy be expanded, or should there be restrictions beyond those in the current rules? Does it make a difference if the proposal is binding or non-binding?*
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> As mentioned above, Treasurer Nappier supports including annually a resolution that asks shareholders to cast an advisory vote on the company's compensation plan – say on pay. Also, many resolutions requesting evaluation of risks are currently excluded under the "ordinary business" rule.
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> The "short rule" would essentially restrict the ability of shareholders to file shareholder resolutions on access to the proxy. Treasurer Nappier opposes this proposal.
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> The "long rule" would be an expansion of the types of shareholder resolutions permitted on the proxy and would provide, under certain conditions, that shareholders could file access to the proxy resolutions. Treasurer Nappier supports the intent of this proposal. However, the precise mechanism contemplated by the proposal would be unworkable and ultimately of little benefit to shareholders, and we therefore oppose its adoption.

The "long rule" also poses questions for comment about imposing new restrictions on advisory shareholder resolutions in general. Treasurer Nappier opposes any limitation on shareholders' ability to file such resolutions. Please see the attached letter to the SEC for a discussion of our rationale.

Addressing the question on the difference between binding and non-binding resolutions, yes, there is a significant difference between binding and non-binding resolutions. Binding resolutions can address structural issues, such as amendments to the by-laws. Non binding resolutions – which are the vast majority of those filed by shareholders - address a myriad of important issues, and are an avenue of communication. These resolutions are a way to bring to all shareholders of a company an issue that some of the company's shareholders believe is important to the value of their investment. It is also an avenue to opening of useful dialogue between shareholders and corporate management and board members.

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?

Treasurer Nappier supports shareholders being allowed to include matters related to director nominations on a management proxy.

There are two steps to make this happen – first setting the rules for shareholders to nominate directors, then the nomination process itself. That rules could be set out in the proxy rules (as proposed under SEC chairman Donaldson), or could be set out in the by-laws of each company. The current proposal is for shareholders (meeting certain criteria) to propose a by-law amendment that would permit access to the proxy. If this amendment is approved by shareholders, then the process would be in place. Then that amendment would govern the nomination process.

Is it reasonable 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?

With respect to the first question, Treasurer Nappier opposes any limitation to shareholders rights to file non-binding shareholder resolutions under section 14a-8.

With regard to the "opt-out" provision, it would take a change in the proxy rules to permit companies to "opt out". Treasurer Nappier opposes any such change in the proxy rules that would permit companies to opt-out of this process. Please see the attached letter to the SEC for a discussion of our rationale.

Is the 5% ownership threshold proposed by the SEC for submission by shareholders of director nomination proposals reasonable? If not, why not? Should there be other limits on shareholder access to management proxies, such as holding periods or dollar thresholds?

The 5% ownership threshold for submission of director nomination proposals is unworkable. As a pension fund – investing for the benefit of employees who will be collecting benefits many years from now – we are a long term investor. As mentioned above, our asset allocation is spread over a number of asset classes, we are very diversified, and have a significant portion of these assets in core index funds. We are long term investors in many companies.

Also as mentioned above, most other public pension funds take this approach. The fact that we are long term investors in the broad US equity market means that even a significant group of investors will not hold 5% of the outstanding stock of any company. For example, our largest holding currently is Exxon Mobil 3,674,864 shares with market value $338,418,225. However Exxon Mobil's market capitalization is $514 billion. Our holdings represent 0.07% - that is seven one-hundredths of one percent. Another way to look at this is that 5% of ExxonMobil stock is worth over $25 billion – which is the size of our entire pension fund.

The only investors who would be able to use the rule would be the large investment managers – such as Barclays Global Investors which owns 4.57% of Exxon Mobil Shares.[1], hedge funds, or an investor who builds a significant stake in the company looking to either take over the company, or put pressure on the company to make certain operational or financial changes, resulting in a short term gain.

Holding periods are a much better indicator of shareholders who are interested in the long term performance of the company, and the one year holding period in the proposed rule is reasonable.

On behalf of Treasurer Nappier, thank you for this opportunity to share our views with the Committee on these important issues. If we may be of further assistance to the Committee, please do not hesitate to contact us.

[1] Yahoo Finance website as of September 21, 2007.

State of Connecticut
Office of the Treasurer

DENISE L. NAPPIER
TREASURER

September 25, 2007

Nancy M. Morris, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File No. S7-16-07
File No. S7-17-07

Dear Ms. Morris,

As principal fiduciary of the $26 billion Connecticut Retirement Plans and Trust Funds ("CRPTF"), I herewith submit comments concerning Proposed Rules S7-16-07 and S7-17-07 which would amend certain provisions of the Securities Exchange Act of 1934 governing shareholder proposals related to director elections.

I very much appreciate the opportunity to share with the Commission the perspective of an institutional investor with holdings in more than 2,100 publicly-traded companies. The election of directors is one of the most important stock ownership rights that shareholders can exercise -- and it is with reverence for that right that I express my concerns over key elements of the proposed rules, as summarized below and explained in more detail in the attachment.

- Proposed Rule S7-17-07 (a.k.a. the "short rule") would deny shareholders the ability to use the shareholder proposal rule to communicate with other shareholders regarding access to the company proxy statement, and would essentially close the avenue opened to shareholders in *AFSCME v. AIG.*[1] For this reason, I oppose this rule.

- The concept of shareholder access to the proxy, as set forth in Proposed Rule S7-16-07 (a.k.a. the "long rule") is a sound one. I oppose, however,

[1] *American Federation of State, County and Municipal Employees, Employees Pension Plan v. American International Group, Inc.*, 462 F.3d 121 (2d Cir. 2006).

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the precise mechanism contemplated by the long rule because it would be unworkable and ultimately of little benefit to shareholders.

- Electronic Shareholder Forums, as described in the long rule, is a similarly sound concept that can augment existing shareholder-corporate communication. The rule as currently drafted, however, if combined with other changes to the proxy rules, could potentially limit the rights that shareholders currently enjoy. If this rule were to be construed as replacing existing shareholder rights currently allowed under the proxy rules, I would oppose this provision.

- The limitation of shareholders' ability to file non-binding advisory resolutions under Rule 14a-8, as discussed in the long rule, is of great concern to institutional funds such as ours. This aspect of the long rule could pose a major setback in the more than 65-year history of communications between shareholders and management. It is on these grounds that I oppose any limitation to shareholders' ability to file shareholder resolutions under Rule 14a-8.

Thank you very much for affording investors the opportunity to share their views with the Commission on these important issues. If I may be of further assistance to you or the Commission, please do not hesitate to contact me.

Sincerely,

Denise L. Nappier
State Treasurer

Enclosure
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The Following Statement Accompanies the 9-25-07 letter from Connecticut State Treasurer Denise L. Nappier to Nancy M. Morris, Secretary, U.S. Securities and Exchange Commission (SEC)

Re: File No. S7-17-07
File No. S7-16-07

Summary of Comments

File S7-17-07 (the "short rule") would essentially close the avenue opened to shareholders in AFSCME vs. AIG. We oppose this proposal. The proposal would deny shareholders the ability to use the current shareholder proposal rule to communicate with other shareholders regarding the desirability of affording shareholders access to the company proxy statement. In our corporate governance system, which places so much authority and discretion in the hands of the board of directors, the accountability of the board to shareholders is of paramount importance. The SEC should not prohibit shareholders from putting forward reasonable proxy access proposals at companies where shareholders believe such a reform would enhance long-term value.

The SEC's other proposal S7-16-07 (the "long rule") would permit holders of over 5% of a company's shares to submit a binding proxy access proposal and represents an improvement over its proposal simply to ban these resolutions. We support the intent of this proposal. However, the precise mechanism contemplated by the proposal would be unworkable and ultimately of little benefit to shareholders, and we therefore oppose its adoption. We encourage the SEC to work with shareholders to craft a workable rule that permits meaningful shareholder communication and the ability to implement proxy access while ensuring that the Commission's other proxy rules are not circumvented.

With regard to the SEC's request in the long rule for comment on possible changes to the advisory shareholder resolution process currently in place under Rule 14a-8, we urge the Commission not to limit in any way shareholders' rights to submit non-binding proposals under this rule. For 65 years, non-binding proposals have effectively promoted communication between shareholders and management (as well as among shareholders) and facilitated nuanced, market-driven changes in corporate governance practices. The elimination of outside director pensions and the adoption of majority voting standards for director elections are two examples of significant changes in the governance landscape effected by non-binding shareholder proposals.

With regard to the proposal to change the proxy rules to permit companies to create electronic forums for its shareholders, we can support this as a potential enhancement to existing communication avenues. However, we would oppose it if it were to substitute for any shareholder rights currently in the proxy rules.

Advisory Shareholder Resolutions—The Long Rule

In the long rule the SEC is soliciting comments on possible changes in the proxy rules with respect to advisory shareholder resolutions currently governed by rule 14a-8.

The current Commission's Rule 14a-8, the shareholder proposal rule, requires companies to include in the company proxy statement, shareholder resolutions submitted by shareholders who satisfy the rule's procedural and substantive requirements. The rule is intended to ensure that shareholders' state-law rights to put shareholder resolutions before other shareholders remain intact in a system of proxy voting in which shareholder voting takes place before the meeting. The rule was intended "to give true vitality to the concept of corporate democracy," according to the Court of Appeals for the D.C. Circuit.[1]

The shareholder proposal rule has contributed a great deal to the dialogue over corporate governance and to the proliferation of value-enhancing governance reforms during the 65 years of its existence. The company-specific nature of shareholder resolutions affords some important advantages: first, it allows both shareholder resolutions and settlements to be tailored to individual companies' circumstances. For instance, at a company where unreasonably high CEO compensation is driven by stock options, a proponent might submit a shareholder resolution asking that options be performance-based; another company where CEO compensation consists primarily of a large annual bonus might receive a shareholder resolution aimed at making performance targets more challenging. In addition, company-specific shareholder resolutions allow the shareholders of a particular company—the group with the strongest incentives to favor value-maximizing reforms—to decide whether a proposed reform makes sense at the company.

Further, the non-binding nature of most shareholder resolutions confers benefits. It is not unusual for proponents and companies to discuss the subject of a shareholder resolution, sometimes at length, before or after the shareholder resolution comes to a vote. This process can be educational for both parties, and a proponent may realize that a compromise solution is superior to the original shareholder resolution formulation. With a non-binding shareholder resolution, even a shareholder resolution that is passed by shareholders need not be implemented precisely as drafted.

The Connecticut Retirement Plans and Trust Funds' (CRPTF) own experience with shareholder resolutions illustrates these broader points. In the past three proxy seasons, the CRPTF was the primary filer of 11 shareholder resolutions and co-filed 24 shareholder resolutions. A number of these shareholder resolutions led to dialogue with the companies, and the CRPTF withdrew some of the shareholder resolutions before the proxy statements were issued. At Walt Disney Company, for example, the company agreed to formalize its policy regarding the separation of the chairman and CEO positions following a 2004 shareholder resolution submitted by the CRPTF. Similarly, both

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1 Medical Committee for Human Rights v. SEC, 432 F.2d 659, 676 (D.C. Cir. 1970).

American Electric Power and Ford Motor Company agreed to produce reports to shareholders on climate change in response to shareholder resolutions submitted by the CRPTF.

As a result, we view with concern any effort by the Commission to limit shareholders' ability to submit shareholder resolutions. Shareholder resolutions serve as the vehicle for promoting constructive dialogue and yields governance reforms that increase shareholder value. We are concerned that eliminating advisory shareholder resolutions could create an unintended consequence where the only option open to shareholders would have inflexible consequences, such as voting against director nominees, or submit more binding shareholder resolutions that take effect immediately upon adoption rather than after negotiation. This outcome that would not be desirable from the corporate or shareholder perspective. There is no reason to believe that the process, as currently constituted, has broken down to such an extent that this kind of change is warranted.

Proxy Access Shareholder Proposals—The Short and Long Rules

The concept of access to the proxy is addressed in both the short rule, and the long rule.

Shareholder access to the company proxy statement for the purpose of nominating director candidates has emerged in the past several years as a compelling solution to the collective action problem common to widely-held public corporations. By allowing significant, long-term shareholders to nominate director candidates using the company's proxy materials, proxy access decreases the cost of mounting such challenges. Facilitating short slate challenges, but not efforts to obtain control of the board, also reduces reliance on control contests as a means of addressing underperforming boards. For these reasons, we supported the Commission's 2003 rulemaking proposal that would have created a limited proxy access right for significant long term shareholders of public corporations.

Since the Commission abandoned that rulemaking, shareholders have sought to promote proxy access at specific companies using the shareholder proposal rule. These proposals would establish generic procedures for use in future elections and have been submitted in binding and non-binding forms. We joined with other investors, including state pension funds in North Carolina and New York and the AFSCME Employees Pension Fund in submitting such a resolution at Hewlett Packard (HP). The resolution was supported by 43% of HP's shareholder. Two other proposals were also submitted in the 2007 season—one received majority support, while the other was supported by 45%. This shows that proxy access is not a fringe or radical issue – but one supported by large main stream investors.

Prior to the 2007 proxy season, the Staff of the Division of Corporation Finance permitted exclusion of such resolutions using an interpretation of Rule 14a-8(i)(8) (the "Election Exclusion") that the court found inconsistent with SEC rules, and therefore improper. It is this Staff interpretation the Commission has now proposed to codify in the "short rule" in response to the holding in AFSCME v. AIG. Doing so does not make sense as a matter of interpretation or policy, and therefore adoption of the short rule is unnecessary. We therefore oppose adoption of the short rule.

A proxy access regime need not conflict with the proxy rules. Indeed, the proposal at issue in the AFSCME v. AIG case required that shareholders availing themselves of the access right comply with all of the Commission's rules, including the proxy rules. This fact, along with the requirement that company proxy statements (including those containing shareholder-nominated candidates) comply with the proxy rules, led the AFSCME v. AIG court to question the existence of a conflict between a proxy access right and the proxy rules, as had been alleged by both AIG and the Commission in its brief. Moreover, the Commission's solution to this perceived conflict in the short rule is far broader than necessary: The concern could be addressed by amending the Election Exclusion to provide that companies may exclude proxy access proposals that do not contain language requiring the nominating shareholder to comply with the proxy rules, and/or provide whatever information the Commission deems necessary.

It is worth noting that Comverse Technology, Inc. has amended its bylaws to create a shareholder proxy access right requiring that nominating shareholders agree to comply with all laws and regulations. Developments like this suggest that amendment of the proxy rules to reflect the possibility of shareholder-nominated directors on the company proxy statement—independent of any process under Rule 14a-8--would be useful.

The Commission has stated in the context of these rulemakings that one of its goals is facilitating shareholders' exercise of their state-law rights. The interpretation of the Election Exclusion proposed in the short rule is less, not more, faithful to shareholders' state-law rights than the interpretation advanced in the 1976 Release and by the court in AFSCME v. AIG. The law of most states, including Delaware, allows shareholders to amend the bylaws absent a limitation in the charter or bylaws. The permissible subject matter of bylaw amendments depends on state statutory and case law delineating the scope of the board's power vis a vis shareholders. The bylaw proposed in the AFSCME v. AIG case was supported by an opinion of Delaware counsel stating that a Delaware court would likely hold that the bylaw was proper under state law. It is not appropriate to suggest that prohibiting shareholders from submitting proxy access proposals that would otherwise be proper under state law somehow protects shareholders' state-law rights.

The 5% Proposal – The Long Rule

In the long rule, the Commission has proposed to prohibit all proxy access proposals except those that satisfy a set of stringent criteria, including ownership of more than 5% of the company's outstanding stock for one year, submission of a binding proposal and compliance with extensive disclosure requirements. The rule as currently proposed would be unusable by long-term, diversified shareholders such as the CRPTF and would impose recordkeeping and disclosure burdens well beyond any informational benefits to shareholders.

As an initial matter, the logic for requiring greater ownership for proxy access proposals is unclear. A proxy access proposal, if successful, would not have any different level of impact on a company's governance arrangements than a bylaw amendment dealing with a poison pill, supermajority voting requirement or majority voting for director election. Moreover, other shareholders respond not to the holdings of the proponent but to the merits of the proposal when voting on it.

But even assuming that a higher threshold is appropriate, the requirement proposed by the Commission is too high. Especially at larger public companies, the requirement that proponents own more than 5% of a company's outstanding shares ensures that diversified shareholders like the CRPTF would not be eligible to submit a proxy access proposal, even if it joined with several other similar holders. For example, the CRPTF's largest holding is ExxonMobil – where the value of ALL of the CRPTF assets - $25 billion – is equal to 5% of the current value of Exxon Mobil. More broadly, 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 shareholder groups would be approximately 3.01, 3.59, and 3.56, respectively.

The Commission should study the pattern of institutional shareholdings before settling on a threshold, rather than adopting a threshold that fits into an existing (but unrelated) regulatory structure.

<u>Disclosure Requirements – The Long Rule</u>

The disclosure requirements proposed in the long rule go far beyond anything shareholders would find useful in voting on a proxy access proposal. As with the ownership threshold, it is not clear that any additional disclosure is warranted simply because a proposal concerns proxy access. The proposal itself would not change the board's composition, that could only occur if the resolution were adopted, and then candidates were nominated by shareholders for the board the ensuing year. Also, submission of a proxy access proposal does not indicate an intention to use the proxy access right. Thus, disclosures aimed at shedding light on the motivation, history and relationships with the company and other similar matters of those filing a resolution to enact access to the proxy are not warranted. Institutional proxy voting guidelines, which focus on the substance of the proposal, suggest that this kind of information would not be used by institutional shareholders in making voting decisions on proxy access proposals.

We are concerned that the disclosures as currently drafted could impair the dialogue and negotiation process between companies and shareholders that currently take place and which both shareholders and corporate leaders have found to be very beneficial. One element of the long rule proposal would require a shareholder that files a proxy access proposal to disclose details regarding each communication with the company for a 12-month period before the proposal was filed. Thus, a shareholder that has not foreclosed the possibility of filing a proxy access proposal – or participating with other shareholders in such a filing - at any company at any time would face the burden of documenting every communication with every company with which it is communicates. The long rule would require companies to make similar disclosure in its proxy statement regarding communications and relationships with proxy access proposal proponents. In addition, we are concerned that the potential liability for even minor errors in the required 13G disclosure filings would be a significant disincentive to participation in this process.

The proposal to disclose ownership of a competitor's stock fails to recognize that diversified shareholders like the CRPTF, which use passive as well as active investment strategies, usually are required by their asset allocation plans to own the stock of several companies in the same line of business. The disclosure requirements relating to ownership in competing companies will not provide any useful information to shareholders voting on a access to the proxy resolution. Like the requirement to disclose communications with the company, this requirement would be too burdensome and would not give shareholders information of any value in the voting process.

Finally, the proposed requirement that proponents disclose information about individuals "associated with" the plan to submit a proxy access proposal has no relationship to the voting process. This requirement, which includes disclosures regarding the selection process for and qualifications of the person(s) who participated in the decision to submit the proposal, is overly intrusive and would not provide information of value to shareholders making voting decisions. The proposal is to be voted on based on its merits, not a particular educational credential or fiduciary duties to beneficiaries of the proponent. Indeed, considering such information, which has no bearing on the merits of the proposal, might itself violate fiduciary duties to which an institutional shareholder is subject.

Electronic Forum – The Long Rule

The long rule also proposes changes to the proxy rules to facilitate electronic fora. We believe that electronic fora could serve a useful function by enhancing communication between companies and their shareholders, as well as communication among a company's shareholders. For that reason, we support efforts to develop electronic forums and to clarify the Commission's rules to remove regulatory barriers to participation.

However, there are a number of weaknesses in the electronic forum when compared directly to the advisory resolution process. Voting proxies is a fiduciary duty. Participating in the forum is not. The forum will not be a solicitation to all shareholders to address every issue, while the proxy statement is an opportunity (and a fiduciary duty) for all shareholders to vote. The beginning paragraphs of this section of the proposed rule note the goal of "efficient means of shareholder communication with management".

Shareholder resolutions are a communication with the Board. The Board issues statements in opposition, and therefore reviews all issues raised in the proxy. The forum, while it could involve board input, does not require it. It is the board – not management – who are elected by shareholders to represent their interests. The rule suggests tabulating certain comments. Without a specific request to ALL shareholders to weigh in on an issue, a tabulation only shows the results of a self-selected subset of shareholders. While communication throughout the year is a good thing,it is not a substitute for an annual vote on issues, such as election of the board, and voting on resolutions. The annual proxy (with specific lead time for review of issues) continues to be the best way to solicit the opinion of ALL shareholders on any issue.

For these reasons, substituting electronic fora for inclusion of proposals in proxy statement would curtail shareholders' rights and remove the leverage of a shareholder vote without which some companies will refuse to act.

TESTIMONY OF TIMOTHY SMITH
SENIOR VICE PRESIDENT, WALDEN ASSET MANAGEMENT
CHAIR, SOCIAL INVESTMENT FORUM

BEFORE THE COMMITTEE ON FINANCIAL SERVICES

U.S. House of Representatives

SEC PROXY ACCESS PROPOSALS: IMPLICATIONS FOR INVESTORS

September 27, 2007

Mr. Chairman and Members of the Committee, it is an honor to provide testimony on the important issues contained in the Securities and Exchange Commission's (SC) Releases No. 34-56160 and 34-56161 dealing with the questions of access and concepts related to Rule 14a-8, the sponsorship of shareholder resolutions.

I am Senior Vice President and Director of Socially Responsive Investing at Walden Asset Management[1]. I also serve as Chair of the Board of the Social Investment Forum[2]. In addition to these positions, my testimony today is informed by the nearly 30 years of experience gained serving as executive director of the Interfaith Center on Corporate Responsibility (ICCR).[3] And, of course, some of my remarks are personal views based on close to 40 years of experience working in this arena.

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[1] A division of Boston Trust & Investment Management Company, Walden is a Boston, MA-based firm that manages approximately $1.7 billion for individual and institutional investors who are committed to integrating environmental, social and governance issues with their investment decisions.

[2] The Social Investment Forum (http://www.socialinvest.org) is the national membership association for the social investment industry. It is dedicated to the concept, practice and growth of socially responsible investing. The Forum's 500-plus membership include financial planners, banks, mutual fund companies, research companies, foundations and community investing institutions.

[3] ICCR is a coalition of approximately 300 religious and socially concerned investors. Their religious members, including Protestant, Jewish and Roman Catholic groups, have over $110 billion in assets under management. With more than 35 years of experience, religious investors often are considered the pioneers of shareholder advocacy. ICCR and its religious members and social investment firm affiliates have addressed scores of issues over this 35 years, including apartheid in South Africa, diversity in employment, violence in video games, executive compensation, codes of conduct and vendor standards in the supply chain, drug pricing, climate change and the environment, among others.

At Walden Asset Management, we take our rights and responsibilities as shareowners seriously and actively engage companies on environmental, social and governance issues through proxy voting, letter writing, meetings with management and sponsorship of shareholder resolutions.

We have decades of experience in addressing companies on issues such as:

- Executive compensation
- Improved corporate governance
- Climate change
- Sensitivity to the environment and recycling
- Advocating for strong global supply chain policies and practices
- Encouraging expanded corporate transparency to investors

The ability to utilize shareholder proposals has been an essential tool in this process. For example, in 2007 Walden sponsored or co-sponsored more than 25 shareholder resolutions. Fortunately, we often come to agreements after submitting these resolutions and dialoguing with these companies, and more than 50 percent of the resolutions were withdrawn in light of these agreements.

We believe that companies with a strong governance record and leadership on environmental and social issues create long term shareholder value and thus protect investor interests.

Many investors, including representatives on this panel today, will testify to the importance of a reasonably crafted “access rule.” Walden Asset Management and the Social Investment Forum also support the right of access and oppose the SEC proposal prohibiting access to the proxy for the purpose of nominating Directors.

While other witnesses will explain in greater detail the problems with the SEC releases dealing with access to the proxy, my comments today will focus on the test questions raised by the Commission in Release No. 34-56160
File S7-16-07.

Simply put, if adopted, these concepts would either eliminate entirely or severely limit the ability of any investor to sponsor a shareholder proposal. The result would be both a curtailment of shareholder rights AND the elimination of meaningful investor input for corporate boards and management. These concerns are being reflected as well by the commentssubmitted to the SEC by thousands of individual and hundreds of institutional investors.

Our primary concerns are with three of the major concepts released for comment by the SEC, including:

1. Opt-Out Provision
2. Electronic Forum
3. Threshold for Resubmission of Non-binding Shareholder Resolutions

<u>The Opt-Out Approach</u>

The SEC asks for comments on the right of a company to "opt-out" of the shareholder resolutions process, either by obtaining approval from shareholders through a proxy vote, or, if sanctioned under state law, by having a Board vote authorizing the company to opt-out.

An opt-out option would have significant negative consequences. The most unresponsive companies would be more likely to opt-out because resolutions are an important mechanism to strengthen corporate accountability. Companies with relatively poor investor communications would be empowered to isolate themselves further. Imagine a scenario where a Board criticized for poor governance and irresponsible behavior (e.g. backdating of options resulting in legal action against the company), simply decides it doesn't like the criticism and decides to opt-out. A company that had received a number of resolutions garnering strong shareholder votes – the company whose long-term value one

would think would best be served by Rule 14a-8 – would be the company most likely to accept the Commission's invitation to opt-out of the process, and an important tool of accountability to investors evaporates overnight.
The lack of uniform rules that would result from an opt-out optionalso would be a complicating factor for both investors and companies.

We also cannot support an opt-out rule implemented through a shareholder vote. Far from an appropriate democratic process, this more accurately reflects the anti-democratic notion of *one share, one vote, one time*. Future shareholders will have no such voice.

This concept is particularly puzzling. The logic for allowing a company to withdraw from the resolution process is not explained and the motives of the Commission in presenting this option are unclear. The concept of allowing a board of directors or a company's current shareholders to vote to disenfranchise future shareholders would seem to run contrary to the Commission's commitment to universal shareholder suffrage.

We believe that the SEC should actively encourage companies to embrace checks and balances, and strong accountability mechanisms, rather than encourage them to take advantage of State laws that may enable them to disenfranchise and ignore their shareholders. We urge the SEC to drop the opt-out concept.

The Electronic Petition Model or "Chat Room"

The release asks, "Should the Commission adopt a provision to enable companies to follow an electronic petition model for non-binding shareholder proposals in lieu of 14a-8?" This question builds on the SEC Roundtable discussion of "electronic chat rooms" and suggests that such a forum could substitute for the right to file shareholder resolutions.

While we support new forms of electronic communication between investors and the Board and management, we view it as a supplement to, not a substitute for, the existing shareholder resolution process.

For example, a number of companies have set up e-mail boxes for Directors in their capacity as Chair of the Governance Committee or Compensation Committee and correspondence is encouraged. We are pleased the SEC is open to examining such new electronic communication approaches. We also support creative new concepts of future forums for exchange of views or even informal polls of those investors who are signed into the forum.

Regrettably, it is not at all clear in the Release what the Commission intends with respect to electronic "chat rooms." Certainly, the Commission has not articulated any clear rationale for replacing the current orderly and successful accountability mechanism of the shareholder process with an untested forum that is likely to be ignored by serious investors at best, and open to a wide range of fraudulent activity at worst. A wide range of credible concerns were raised during the Commission's public roundtable discussions on the proxy process in May. The concept is fraught with logistical difficulties and unanswered questions.

Presently, shareholder resolutions assure that management and the Board focus on the issue at hand since it is included in the proxy and debated at the annual stockholder meeting. Additionally, each and every investor receiving a proxy has the opportunity to consider the proxy item and cast a vote. Substituting a chat room or other form of electronic petition for the current proxy process would eliminate a valuable fiduciary tool.

The process today guarantees that all shareholders have equal access to the same information. A chat room or electronic forum with a daily (if not more frequently) exchange of information would create an information environment that no single shareholder could adequately monitor. Assuming this forum hosts valuable discussions – a debatable assumption considering the current electronic forums that exist today – technologically savvy investors, or those with a large staff to monitor these exchanges, would be placed at an advantage over other shareholders.

We believe that responsible fiduciaries would be unable or unlikely to monitor a "chat room" on a daily basis in order to weed through the variety of random shareholder concerns raised to find the information that is material to their decisions. The rise in shareholder votes on advisory shareholder resolutions over the past few years attests to the fact that these fiduciaries are taking these issues seriously, and are finding value in the proxy statement as currently utilized and regulated.

In addition, there is no assurance that a significant percentage of investors will utilize the Forum, thus any "poll" would be only of those investors who signed up, providing no reasonable assessment of the range of investor views on a topic, and no clearly established universal method for counting the votes. In fact, it is unclear whether companies would even be required to disclose the results of these periodic 'straw polls.'

It also is unclear how investors who recently sold their shares or added to their holdings would be treated. In the proxy process there is a date of record when the clock stops and investor shares are counted. Will there need to be a series of "dates of record" with proof of ownership provided for each poll that is taken on the Forum? Will an unregulated forum simply exacerbate the influence of short-term investors?

Finally, as noted above, there are many investors who may be unable to join the Forum, thus creating two classes of investors, some disenfranchised.

Chat rooms and electronic forums are welcome approaches for enhancing communication with investors. They are not a substitute for a shareholder's right to file resolutions.

Resubmission Thresholds

The Commission asks whether the voting thresholds for resubmitting resolutions should be increased. Presently, the resubmission thresholds stand at 3% to re-file resolutions after the first year, 6% after the second year and 10% thereafter. The SEC is testing the concept of increasing the thresholds to 10%, 15% and 20%, respectively.

In responding to this question, it is important to assess the business community's and SEC's need for "relief" from the resolution process, and to evaluate the impact of the suggested change on shareholder proponents.

Impact on Companies

Recent experience shows that a small minority of publicly traded companies receive shareholder resolutions. In 2006 and 2007, there were fewer than 1,200 resolutions filed at less than 1,000 companies. This represents fewer than 20% of companies. Clearly, the business community is not burdened significantly by the resolution process. Resolutions overwhelmingly are filed with large cap companies with the greatest resources. Mid cap and small cap companies rarely, if ever, receive resolutions. We have seen no data that supports the argument that corporations are overwhelmed by this process, and we can very clearly document the numerous and substantial long-term benefits to shareholder value that has been created through the non-binding resolution process.

Companies with a number of resolutions, such as Exxon Mobil or Home Depot, seem to have developed an orderly process for addressing them. Moreover, companies with multiple resolutions are frequently embroiled in significant public controversies, thereby reinforcing the resolution process as an important vehicle for shareholders to address their concerns.

In fact, according to publications issued by Institutional Shareholder Services (ISS) and the Interfaith Center on Corporate Responsibility (ICCR), about one-quarter to one-third of resolutions are withdrawn each year. These never appear on proxy statements because mutually acceptable agreements are struck between investor proponents and companies. Hence, by being responsive to investor concerns, companies usually have opportunities to avoid proxy resolutions.

Impact on the SEC

We understand the significance of the SEC's role as arbiter when companies petition for *No Action* letters to omit resolutions from their proxy statements.

Fortunately, the number of such requests decreased to 237 in 2007 from 259 in 2006. Also, we believe the SEC workload is mitigated to the extent that many *No Action* requests address pro forma decisions (e.g. late submissions or challenges with respect to proof of ownership), or issues previously raised at other companies.

Nonetheless, we know that *No Action* letters are a seasonal pressure for the SEC. But as investor proponents and companies indicated 10 years ago when this question was last debated and comments submitted to the SEC, there is a strong desire and mutual need to have the SEC act as an arbiter of the *No Action* process. It has been the experience of our members that SEC staff has been able to effectively handle numerous no-action requests over the years.

There is no other means to ensure that both proponents and issuers are treated fairly and consistently. We conclude that Rule 14a-8 has evolved into a critically important check on corporate behavior and there may be no practical substitute for a lengthy and somewhat burdensome no-action process.

Impact on Shareholder Proponents

From the viewpoint of proponents, it is clear that a major increase in resubmission thresholds would have a significant chilling effect on a range of resolutions on important topics. Looking back to the 1970s and 1980s, the early days of shareholder advocacy, we saw that new proxy issues often took time to develop traction among large groups of investors. On topics as diverse as apartheid in South Africa, corporate governance reform or climate change, investors needed time to gain knowledge and evaluate a corporation's response in fulfilling their fiduciary duty to vote proxies conscientiously. Raising resubmission thresholds as suggested would stifle this engagement that we believe is in the long term interests of companies and their shareholders.

It would further enhance the current short-term perspective of our capital markets to exclude those issues that have not yet become "material" to a majority of institutional investors. Unfortunately, by the time many of these risks, such as climate change, do garner widespread support; it may be too late to address them. The current vote thresholds are sufficiently low to permit these issues to return year after to year and gradually build support. The current thresholds serve those fiduciaries who wish to take a more prudent approach to risk, preferring to encourage boards to begin to address risks now that are not yet recognized by less forward-looking investors. The SEC should be seeking to enhance these fiduciaries' abilities to fulfill their duties.

If we focus on the 2006 resolutions addressing environmental and social issues, about 14% of the total number of resolutions filed, it seems clear that the suggested new thresholds would negatively impact emerging shareholder concerns. According to the ISS Social Issues Service in its final report on the

2006 season (*Social Policy Shareholders Resolutions in 2006: Issues, Votes and Views of Institutional Investors*), 198 shareholder proposals came to votes on social and environmental topics at U.S. companies, of which 160 (81%) earned enough support (under the 3-6-10 percent rule) for resubmission. Had the resubmission thresholds been 10-15-20 percent in 2006, only 71 of resolutions (36%) would have earned enough support for resubmission – a dramatically negative change for shareholder proponents (see table below).

Effect of Resubmission Thresholds on 2006 Resolutions

Effect of Resubmission Thresholds on 2006 Social/Environmental Proposals		
Resubmission Threshold	**Proposed: 10-15-20%**	**Curent: 3-6-10%**
• First Year	53	119
• Second Year	13	29
• Third Year	5	12
Total (as percent of 198 resolutions)	**71 (36%)**	**160 (81%)**
Source: Institutional Shareholder Services		

Consolidated data on all shareholder proposals from 2000-2006 in the next table confirms the substantial impact on investor proponents, albeit less dramatic for resolutions addressing corporate governance topics.

Support for Shareholder Proposals 2000-2006		
Shareholder Proposals	**Social Issues**	**Governance Issues**
• Total Voted on	1168	2551
• With support of at least 10%	350	2041
• With support of at least 15%	180	1797
• With support of at least 20%	138	1655
Note: Support percentage is calculated as percent of shares cast "for" out of shares cast "for" and "against." Source: Institutional Shareholder Services		

Clearly, management of some companies may want to limit or eliminate social and environmental resolutions because they are viewed as frivolous or not significant business matters. Yet, increasingly the evidence suggests, and major institutional investors believe, that strong performance on environmental and social concerns such as climate change, water scarcity or global supply chain management, among others, has an impact on with long term business success. Given their importance, we believe that the relatively small number of shareholder resolutions on environmental and social issues does not present a significant burden to companies or the SEC.

In considering the impact on investors it is important to understand that many proponents view the proxy resolution as a “last resort” attempt at engagement, an avenue that helps ensure concerns are heard by top management and board members. TIAA-CREF, for example, describes this philosophy in its recently updated Governance Policy. If a company repeatedly refuses to respond to correspondence or requests for meetings with its investors, the shareholder resolution often acts as impetus for improved communications. Adding more restrictive thresholds on resubmitting resolutions simply makes it more difficult for investors who seek constructive engagement with companies.

In positing this question, it should be noted that the SEC has not made a case for why this change is warranted, what the impact on shareholder proposals would be and how such a change would advance the public interest. The new threshold numbers are presented without any discussion of the criteria used to select them.

THE IMPACT OF RESOLUTIONS

Volumes of evidence demonstrate the clear, effective and positive impact of shareholder engagement and resolutions on company policies and behavior. While the shareholder resolutions process may result in a handful of frivolous resolutions in proxies, the vast majority raise issues that are important for shareowners and provide constructive input to the corporate decision making process.

In fact, some resolutions actually stimulate a market wide trend. For example, the resolutions requesting that Directors be elected with a majority vote or that stock options be expensed (before it was required), have prompted changes in company policies. Resolutions alerting companies to the financial and environmental dangers of climate change also served as an important early warning system with companies by the hundreds moving forward on these issues.

The recent headlines on the problems with toy manufacturers in China with lead paint are a powerful reminder of the fact that supply chain issues can and do affect brand reputation and stock price, highlighting the crucial role investors have played in encouraging companies to have strong codes and comprehensive auditing and disclosure.

The positive effect of shareholder resolutions is evident today in the thousands of companies that have spoken out embracing good governance as essential for long term value. It is found in the statements of the hundreds of CEO's who have stated that leadership in social and environmental issues is important for the long term success and value of the company.

From Colgate Palmolive to Coca-Cola, from Intel to Ford and General Motors, from Pfizer to IBM, from BP to Hershey, companies are embracing many of the changes presented by shareholder proponents and see these reforms as "good for business."

The state and city pension funds, the mutual funds and investment firms, the foundations and labor union pension funds, and the religious investors who are resolution sponsors, all share a profound and deep concern for protecting and creating shareholder value. For many, it is a legal and fiduciary duty.

The importance of integrating environmental, social and governance factors into the investment process to long term protect shareholder value is articulated clearly and succinctly in the recently adopted Policy Statement on Corporate Governance of TIAA-CREF . TIAA-CREF's policy also reminds investors that it is impossible to separate governance, social and environmental issues from their fiduciary responsibility.

Far from representing a "special interest," shareholder proponents seek to advance broad investor interests AND the long-term interests of the corporation.

These proponents include substantial investors with literally trillions of dollars of invested assets. They include TIAA-CREF, state and city pension funds in California, Connecticut New York State and City, Maine, Wisconsin and Minnesota. They include the Sisters of Charity, the Sisters of Mercy, Catholic Healthcare West, the Presbyterian, American Baptist and United Methodist Churches.

They include mutual funds and investment managers such as Walden Asset Management, Domini Social Investments, the Calvert Group, Trillium Asset Management, F & C Asset Management. And of course, small individual investors.

Far from advancing a narrow special interest these investors have a broad long-term interest in mind.

CONCLUSION

Hundreds of organizations and thousands of investors have urged the SEC to reject these attempts to eliminate or curtail shareholderrights under existing Rule 14a-8. We encourage this Committee and Congress to voice its opposition as well and to remind the SEC of its mandate to protect the rights and interests of investors.

STATEMENT OF PAUL SCHOTT STEVENS

PRESIDENT AND CEO

INVESTMENT COMPANY INSTITUTE

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

ON

"SEC PROXY ACCESS PROPOSALS: IMPLICATIONS FOR INVESTORS"

SEPTEMBER 27, 2007

Executive Summary

- ICI generally supports the SEC's proposal to afford certain shareholders direct access to a company's proxy materials for director-related bylaw amendments.

- As major, long-term investors in securities of public companies, and as issuers with their own shareholders and boards of directors, investment companies have a valuable perspective to offer on the topic shareholder access and the need to appropriately balance the interests of shareholders with those of company management.

- The SEC's proposal would represent a significant change in longstanding rules and practices. ICI agrees that long-term shareholders with a significant stake in a company have a legitimate interest in having a voice in the company's corporate governance. The ability to submit bylaw amendments concerning director nomination procedures could be an effective additional tool for use by investment companies and others to enhance shareholder value.

- At the same time, the privilege of proxy access should not be granted lightly. The federal securities laws should not facilitate efforts to use a company's proxy machinery – at company expense – to advance parochial or short-term interests not shared by the company's other shareholders.

- Limits on the ability to use company resources to propose changes to a company's governing documents are critically important to assure that the interests of shareholder proponents are aligned with those of the company's other shareholders. ICI strongly supports the SEC's proposal to limit the privilege of proxy access to shareholders who do not acquire or hold the company's securities for the purpose of changing or influencing control of the company.

- ICI also supports requiring shareholder proponents to demonstrate that they are long-term stakeholders with a significant ownership interest and will strongly encourage the SEC to consider instituting thresholds greater than the five percent ownership and one-year holding period proposed.

- Disclosure that shareholder proponents and shareholders that nominate director candidates are required to provide will be important to allow a company's other shareholders to make informed voting decisions. To bring additional discipline to the shareholder proposal process, the SEC's rules should hold shareholder proponents and nominating shareholders – and not companies – responsible for the information these shareholders provide.

- ICI supports the SEC's proposal to facilitate greater interaction among shareholders and between shareholders and companies through the use of electronic shareholder forums.

I. INTRODUCTION

My name is Paul Schott Stevens. I am President and CEO of the Investment Company Institute, the national association of U.S. investment companies. ICI members include 8,803 open-end investment companies (mutual funds), 671 closed-end investment companies, 457 exchange-traded funds (ETFs), and 4 sponsors of unit investment trusts. As of June 30, 2007, our members had total assets of nearly $12 trillion.

In addition to their role as the investment vehicle of choice for millions of Americans, registered investment companies are major investors in securities and participants in the marketplace. At the end of 2006, investment companies held approximately 25 percent of the outstanding stock of U.S. companies.[1]

Based on their dual roles as major investors in securities of public companies acting as fiduciaries on behalf of millions of individual investors, and issuers of securities with their own shareholders and boards of directors, investment companies offer a valuable perspective on the subject matter of today's hearing. I greatly appreciate the opportunity to appear before the Committee to share the Institute's views on shareholder access to company proxy materials and related issues.

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[1] Investment Company Institute, 2007 Investment Company Fact Book, at 10-11.

II. SHAREHOLDER ACCESS TO COMPANY PROXY MATERIALS

The topic of shareholder access to company proxy materials historically has been a polarizing one, seemingly pitting shareholders' rights against corporate management's interests. Unlike a proxy contest, in which the contesting party pays the costs of soliciting proxies, providing access to the company's own proxy imposes on the company and all shareholders the costs of a cause being advanced by a minority. Given these considerations, the question becomes when – if ever – is it appropriate to grant this privilege?

The Securities and Exchange Commission has proposed rule amendments that would enable shareholders to include in company proxy materials their proposals for bylaw amendments regarding the procedures for nominating candidates for the board of directors.[2] If the company's shareholders at large vote to approve the bylaw amendments, then shareholders could nominate directors on a subsequent company proxy, to the extent the new procedures so provide.[3] If adopted, the SEC's proposal would represent a significant change in longstanding rules and practices. Currently, companies are permitted to exclude shareholder proposals relating to a director election.

[2] SEC Release Nos. 34-56160; IC-27913 (July 27, 2007), 72 FR 43466 (August 3, 2007). The Institute expects to file a comment letter on the proposal with the SEC by the October 2, 2007 comment deadline. The SEC also issued a contrary rule proposal that would deny such access. SEC Release Nos. 34-56161; IC-27914 (July 27, 2007), 72 FR 43488 (August 3, 2007). For the reasons expressed in this testimony, the Institute does not support that proposal.

[3] As discussed below, the SEC's proposal would require shareholders who nominate directors to provide the disclosure that is currently required in the case of a proxy contest.

Unlike those stakeholders who may fall clearly on one side of the proxy access debate or the other, Institute members have one foot in each camp. Funds are significant shareholders of public companies. They also are public companies with their own shareholders and boards of directors. They fully appreciate the importance of quality governance. They also are conscious of the need to avoid unreasonable interference with the responsibility of a company's directors and officers to manage the company. By attempting to balance these perspectives, our views are likely to draw criticism from both sides. But while our vantage point may make us a target for critics, it gives us a special appreciation for the need to tread cautiously to achieve an appropriate balance in addressing this matter. And in determining how to strike that balance, we have asked ourselves, what is the right answer for the fund shareholders our members serve and other long-term investors?

A. The Privilege of Proxy Access

The Institute believes that the interests of investors will be served by allowing shareholders, under certain circumstances, to have their proposals for bylaw amendments concerning procedures for nominating directors included in a company's proxy materials. We agree that long-term shareholders with a significant stake in a company have a legitimate interest in having a voice in the company's corporate governance.

Institute members serve as stewards for the interests of fund shareholders and use a variety of methods to seek to enhance shareholder value. These methods include, among others, voting proxies for the securities funds hold in a manner consistent with the funds' objectives and engaging in ongoing dialogue with management of the companies in which they invest. To have in reserve the ability to submit bylaw amendments concerning director nomination procedures could prove to be an effective additional tool for enhancing shareholder value.

At the same time, providing access to a company's proxy as the SEC has proposed would represent a dramatic change in existing rules with significant implications for the relationship between public companies and their shareholders. The privilege of proxy access should not be granted lightly. Great care must be taken to ensure that the federal securities laws do not facilitate efforts to use a company's proxy machinery to advance parochial or short-term interests not shared by the company's other shareholders. The SEC should not make it easier, for example, for short-term opportunists or minority shareholders with their own agendas to seek changes – at company expense – that do not redound to the benefit of the company's long-term shareholders. Instead, the regulatory scheme should be crafted to afford access to a company's proxy only when the interests of shareholder proponents are demonstrably aligned with those of long-term shareholders.

Our recommendations for achieving these objectives are discussed below.

B. Eligibility Criteria

The SEC's proposal would require a shareholder (or group of shareholders) proposing bylaw amendments concerning director nominations ("shareholder proponents") to meet specified eligibility criteria. The bylaw amendments would have to be submitted by shareholder proponents who:

(i) did not acquire or hold the securities for the purpose of changing or influencing control of the company;

(ii) have continuously held more than five percent of the company's securities entitled to be voted on the proposal for at least one year by the date the shareholder submits the proposal; and

(iii) make certain disclosures, including its background and relationships with the company.

Appropriate limits such as these on the ability to use company resources to propose changes to a company's governing documents are critically important. Such limits should be designed to assure that long-term shareholders do not bear the costs of advancing the narrow or short-term interests of minority shareholders. Including shareholder proposals in company proxy materials involves not only out-of-pocket costs, but also opportunity costs for long-term shareholders if the ultimate effect is to change the fundamental character of the company or its policies in a manner inconsistent with those shareholders' original investment intent. Eligibility criteria thus should avoid opening the floodgates to those who might seek to accumulate positions in companies only to "smash and grab" short-term profits or other benefits at the expense of such companies and their other shareholders.

1. Intent to Change or Influence Control

The SEC has proposed that, to be eligible to submit a shareholder proposal, shareholder proponents must be eligible to file (and must file) a statement of beneficial ownership on Schedule 13G. To be eligible to file on Schedule 13G, a shareholder may not acquire or hold the securities for the purpose of changing or influencing control of the company. In our view, this criterion goes to the heart of the proposal and the Institute strongly supports it. Proponents seeking to change or influence control of the company should not be granted license to do so at the company's expense. They should be required to follow the regulatory framework already in place for proxy contests and bear the related costs. The Institute believes that this factor will significantly curb abusive use of a company's proxy machinery, providing necessary protections for long-term shareholders and reducing management distractions.

2. Ownership Threshold

Under the SEC's proposal, shareholder proponents must have continuously and beneficially held more than five percent of the company's securities entitled to be voted on the proposal for at least one year by the date the proposal is submitted. For the reasons outlined above, it is entirely appropriate to limit the availability of this proposed avenue for advocating change to a company's governing documents to shareholders with a significant ownership interest.

Defining the appropriate ownership threshold for the proposal presents a classically difficult line-drawing exercise of the type that legislators and regulators engage in on a regular basis. There is no "correct" level of ownership that should entitle shareholders to the privilege of proxy access. Some will claim that the five percent level proposed by the SEC is much too high and will serve as a significant impediment to shareholder participation. Others will argue that five percent is much too low and will subject companies to unwarranted and expensive distractions and disruptive activity.

It is our sense that, given the significant change in approach that the SEC's proposal represents, the SEC would be well-advised to proceed cautiously by starting with a relatively high minimum ownership threshold. We note that it is not uncommon for one institutional investor to hold five percent or more of a company.[4] Under the proposal, such an investor potentially could single-handedly get proposed bylaw amendments included in a company's proxy materials. A five percent threshold to gain access to a company's proxy statement could work to the advantage of opportunists whose activities and motives may not be transparent to other shareholders and the marketplace and who have no fiduciary obligation to act in the interests of other shareholders.

The Institute therefore will strongly encourage the SEC to consider instituting an ownership threshold higher than five percent. To inform its decision, the SEC should study holdings information to determine, for example, the frequency of large holdings of companies and the identity of the holders.

[4] For example, some Institute members report that they often have holdings of five percent or more of companies in which they invest. In far fewer instances do they hold 10 percent or more of a portfolio company. Based on data from © CRSP University of Chicago and the Institute, we were able to examine portfolio holdings of 2,409 domestic equity mutual funds for 276 complexes as of the fourth quarter of 2006. Based on this analysis, we estimate that 87 mutual fund complexes had a total of 1,887 holdings of 5 percent or more of the U.S. companies in which they invest. At a 10 percent threshold, we estimate that 33 mutual fund complexes had a total of 314 holdings that met or exceeded the threshold.

A higher threshold likely would mean that in most cases, a single shareholder, including an investment company or other institutional investor, would need to collaborate with one or more other shareholders to reach the applicable threshold. A higher threshold thus would encourage shareholders to come together to effect change, and would better assure that the company's proxy machinery would be used to advance the common interests of many shareholders in addressing legitimate concerns about the company. And it would help guard against efforts by one or a few shareholders to use a company's proxy to achieve their own narrow ends.

We will also strongly recommend that the SEC make explicit that shareholder proponents who borrow stock of an issuer may not count those shares toward meeting the ownership threshold or the holding period (discussed below). Beneficial ownership of the securities should be required to assure that the proponents' interests truly are aligned with those of other shareholders.

3. Holding Period

Shareholder proponents should be required to demonstrate that they are long-term stakeholders. Most investment companies are long-term holders of the securities in which they invest.[5] Indeed, the assets of registered investment companies whose investment strategies are index-based have been growing. By year-end 2006, assets in registered ETFs and index mutual funds reached a little more than $1.1 trillion, and accounted for 10 percent of the total assets managed by all registered investment

[5] Based on the Institute's analysis, we estimate that 233 fund complexes held shares of 3,763 U.S. companies for at least two years over the period from the fourth quarter of 2004 to the fourth quarter of 2006.

companies.[6] These funds by definition are committed to holding the securities in the relevant index, as their disclosed investment policies indicate.

The one-year period proposed by the SEC strikes us as the minimum acceptable threshold and we expect to recommend to the SEC that it consider requiring a longer holding period. A longer holding period, such as two years, would provide greater assurance that shareholder proponents are have been committed to the long-term mission of the company, rather than seeking the opportunity for personal gain and quick profits at the company's and other shareholders' expense. As with the ownership threshold, there is no "right" answer. The SEC should examine holding periods along with ownership levels to arrive at well-reasoned criteria that will encourage would-be shareholder proponents to work together to achieve goals that benefit all shareholders.[7]

C. Disclosure Requirements

The disclosure that shareholder proponents and shareholders that nominate director candidates ("nominating shareholders") would be required to provide is another key consideration

[6] Over the past decade, assets in these indexed products have increased more than tenfold – with much of the growth occurring in funds that track broad market indexes. ETFs and index mutual funds that track large-blend domestic equity indexes, such as the S&P 500, now manage 40 percent of all assets invested in mutual funds and ETFs that focus on large-blend domestic stocks. Investment Company Institute, 2007 Investment Company Fact Book, at 35.

[7] Based on the Institute's analysis, we estimate that 56 mutual fund complexes had 966 holdings that were 5 percent or more both in the fourth quarter of 2005 and in the fourth quarter of 2006. At a 10 percent threshold and one-year holding period requirement, we estimate that 17 complexes had 114 holdings of U.S. companies. For a two-year holding period (2004-2006) and 5 percent threshold, we estimate that 37 complexes had 552 holdings. For a two-year holding period and 10 percent threshold, we estimate that 10 complexes had 45 holdings. These figures demonstrate the effect of increasing the thresholds on the need for shareholders to work in a collaborative manner to obtain access to a company's proxy – a laudable goal that will protect the interests of long-term shareholders.

related to proxy access. For example, under the SEC's proposal, shareholder proponents would have to provide disclosure about their background, intentions, and course of dealing with the company. The Institute agrees with the SEC's assessment that disclosure plays an especially important role "when individual shareholders or groups or shareholders, who do not owe a fiduciary duty to the company or to other shareholders, use company assets and resources to propose changes in the company's governing documents."[8] The information the SEC proposes to require will be relevant to shareholders when they are asked to consider a shareholder-proposed bylaw amendment setting forth procedures for director nominations and to the marketplace at large.

Similarly, we support the SEC's proposal to require nominating shareholders to provide the same disclosure that would otherwise be required under the rules applicable to proxy contests.[9] This information is necessary to allow a company's other shareholders to make informed voting decisions. Importantly, the SEC's proposal would hold nominating shareholders liable for any materially false or misleading statements in the disclosure provided to the company and included by the company in its

[8] 72 FR at 43471.

[9] *See* Items 4(b) and 5(b) of Schedule 14A under the Securities Exchange Act of 1934. Disclosures required in proxy contests include, among other things: who is making the solicitation and by what means; the costs of the solicitation and who will bear them; any substantial interest of each participant in the solicitation; the name, address, and principal occupation or business of any participant; the amount of securities of the company owned by each participant and its associates; information about purchases and sales of the securities by such persons within the past two years; whether a participant is a party to any contract, arrangements or understandings with any person with respect to the company's securities; certain related party transactions between the participant or its associates and the company; any arrangement or understanding with respect to future employment or future transactions with the company or its affiliates. A "participant" for this purpose is (i) any person who solicits proxies, (ii) any director nominee for whose election proxies are being solicited, and (iii) any committee or group, any member of a committee or group, and other persons involved in specified ways in the financing of the solicitation. Additional information is required about shareholder nominees for director, including: any arrangement or understanding with a nominating shareholder pursuant to which the nominee was selected; the nominee's business experience; other directorships in Exchange Act reporting companies; involvement in certain legal proceedings; transactions between the nominee and the company; and whether the nominee complies with independence requirements. *See* Item 7 of Schedule 14A.

proxy materials. It also would make clear that the company is not responsible for that disclosure. The Institute strongly supports holding nominating shareholders, and not companies, accountable for the accuracy of the disclosure these shareholders provide. This will bring additional discipline to the shareholder proposal process.

For the same reason, similar treatment should apply to information provided by shareholder proponents. Shareholders contemplating submitting bylaw proposals need to understand that they will be held liable for providing materially false or misleading information, whether in Schedule 13G filings, in a bylaw proposal included in a company's proxy statement, or in company proxy disclosure based on information provided by shareholder proponents. It is critically important that companies be shielded from liability for disclosure that relies on information provided by shareholder proponents.

III. ELECTRONIC SHAREHOLDER FORUMS

The SEC took steps 15 years ago to facilitate communications among institutional shareholders.[10] More recently, many have observed the tremendous potential of the Internet and other technological developments to expand and enhance opportunities for communication among *all* shareholders as well as between shareholders and companies. The SEC recognizes that the current proxy rules may create unnecessary impediments to fully realizing this potential. To facilitate greater interaction among shareholders and between shareholders and companies through electronic media,

[10] *See* Rule 14a-2(b)(1) under the Securities Exchange Act of 1934.

the SEC has proposed a new rule that would clarify that both companies and shareholders may establish and maintain electronic shareholder forums.

The Institute has consistently supported SEC efforts to facilitate greater use of electronic media to better serve investors,[11] and we support the electronic shareholder forum proposal. Electronic forums are an innovative and relatively inexpensive way to foster communications among shareholders and between shareholders and companies. In its proposal, the SEC wisely declined to devise an approved regulatory version of an electronic shareholder forum. We applaud the decision to encourage individuals and entities to use creativity in designing and utilizing this communication mechanism. The SEC's approach also provides necessary flexibility to take advantage of future technological advances.

Another important aspect of the SEC's proposal is the clarification that neither a company nor a shareholder would be liable for independent statements made by others on its electronic forum. This protection is vital if the SEC wishes to encourage the establishment and use of shareholder forums.

[11] *See, e.g.,* Letter from Elizabeth Krentzman, General Counsel, Investment Company Institute, to Nancy M. Morris, Secretary, U.S. Securities and Exchange Commission, dated March 14, 2007 (regarding extension of interactive data voluntary reporting program on the EDGAR system to include mutual fund risk/return summary information); Letter from Elizabeth Krentzman, General Counsel, Investment Company Institute, to Nancy M. Morris, Secretary, U.S. Securities and Exchange Commission, dated February 13, 2006 (regarding Internet availability of proxy materials).

IV. PROXY VOTE DISCLOSURE

The SEC's proposals discussed above seek to expand the means through which shareholders can have a voice in the governance of companies whose shares they own and communicate with each other and with management. These mechanisms would supplement the existing opportunities that shareholders have to express their views through the current proxy system.

Like other shareholders of public companies, mutual funds and other registered investment companies are entitled to vote proxies for the securities they hold. Funds, their investment advisers and directors take their responsibilities with respect to proxy voting very seriously. Unlike any other shareholder, however, funds are required to publicly disclose each and every proxy vote they cast. By singling out funds, this requirement has created unintended consequences for fund firms. Among other things, this regulatory disparity means that only fund firms are subjected to scrutiny and criticism for the manner in which they voted, thereby uniquely politicizing fund portfolio management.

To the extent that disclosure of proxy voting records is considered to achieve important public policy purposes, these requirements should be applied to all institutional investors. The Institute appreciates Chairman Frank's expression of interest in having the Committee consider this issue.[12] We

[12] *See* Siobhan Hughes, *Rep. Frank Plans Hearing on Disclosure of Proxy Votes,* Dow Jones News Service, March 22, 2007.

would welcome the opportunity to participate and stand ready to assist the Committee and its staff in any way possible.

V. CONCLUSION

On behalf of the Institute's members and the millions of individual shareholders they serve, I very much appreciate the opportunity to share the Institute's views with you today. We look forward to working with the SEC and the Committee on these important issues.

COUNCIL OF INSTITUTIONAL INVESTORS

Testimony of

Ann Yerger

Executive Director

Council of Institutional Investors

before the

Committee on Financial Services

September 27, 2007

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COUNCIL OF INSTITUTIONAL INVESTORS

Testimony of
Ann Yerger
Executive Director
Council of Institutional Investors
before the
Committee on Financial Services
September 27, 2007

Prepared Statement

Chairman Frank, Ranking Member Bachus, and Members of the Committee:

Good morning. I am Ann Yerger, Executive Director, 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 throughout the US. They 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.

The ability to file shareowner proposals is particularly important to Council members and others who are unable to exercise the "Wall Street walk" and sell their shares when they are dissatisfied. Shareowner proposals provide investors an opportunity to present their concerns to management and the board, to communicate with other investors, to encourage reforms, and to improve performance. And these resolutions have motivated profound improvements to boardroom performance in particular and the US corporate governance model in general.

Under debate today is whether the shareowner proposal rule, in general, should be changed and whether, in particular, shareowners should have the right to file resolutions suggesting or mandating processes to include shareowner-suggested director candidates on company proxy cards.

I'll tackle the second issue first. Because directors are the cornerstone of the US corporate governance model, and the primary role of shareowners is limited to electing and removing directors, the Council believes owners should have the ability to file access resolutions and the marketplace at large should have the opportunity to vote on whether those resolutions are in the best interests of the companies.

It is important to note that the Council isn't alone in its support for meaningful proxy access. So far in 2007, three shareowner-sponsored access resolutions came to votes and all received significant support exceeding 40 percent of the votes cast for and against. These results are proof positive of broad marketplace support for proxy access.

The Council applauds the Securities and Exchange Commission for again taking up the very important issue of proxy access. We very much appreciate the many hours of hard work that the SEC Staff and Commission have devoted to developing the two most recent proposals. Unfortunately, the Council strongly opposes both proposals as currently drafted.

The Commission's "shorter" non-access proposal would obliterate the current rights of shareowners to submit binding or non-binding access resolutions. The only circumstance in which the Council could possibly support the adoption of this flawed proposal would be if it was accompanied by the adoption of another rule that provided an alternative meaningful approach to proxy access. Unfortunately, this hasn't happened.

The Commission's "longer" proposal imposes such onerous requirements on shareowners simply interested in sponsoring access resolutions that the proposal is empty and unworkable.

More specifically, the proposed five (5) percent threshold for submitting a proposed bylaw amendment is too high a barrier for shareowners who routinely file resolutions. Even the ten (10) largest public pension funds combined would be unlikely to meet this threshold at a public company of any size—whether it be a large-, mid-, or small-cap company.

In addition, the proposed disclosures are unnecessary and overly burdensome and for some inexplicable reason are far more extensive than currently required even for shareowners planning a hostile takeover of a public company.

Also inexplicable are the Commission's reasons for imposing such excessive requirements on proposals that ultimately would have to face the test of the marketplace and be approved by a majority or even, in some cases, a supermajority of the outstanding shares.

The Council believes the end result of these onerous requirements would be that few, if any, shareowners would ever again have the ability to exercise what we believe is a fundamental shareowner right.

Speaking of fundamental rights, the Council strongly opposes a shift from the current SEC rules governing shareowner proposals in general to a state-by-state, company-by-company model. We believe the uniformity and consistency provided by the current federal oversight model is in the best interests not only of Council members, but also other shareowners, companies, and the capital markets.

Notwithstanding our strong opposition to both of the SEC's proposals, we stand ready to work cooperatively with the Commission, this Committee, my fellow panelists, and other interested parties to develop meaningful proxy access reforms that 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.

COUNCIL OF INSTITUTIONAL INVESTORS

Testimony of
Ann Yerger
Executive Director
Council of Institutional Investors
before the
Committee on Financial Services
September 27, 2007

Full Text of Statement

Chairman Frank, Ranking Member Bachus, and Members of the Subcommittee:

Good morning. I am Ann Yerger, executive director, 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 the Council's views on 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").

[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 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 the Council 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]

[7] *See infra* Attachment 4 for the Council responses to the Amendments and the Release.
[8] *See infra* Attachment 2, Part I.
[9] *See infra* Attachment 4.
[10] *Id.* at pp. 9-27.

The following are the Council's views on those specific issues or questions that the staff of the Committee on Financial Services has indicated that we should address in connection with our testimony:

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 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.

[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]

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[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 question, 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) and 43.0 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]

[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 v. American International Group, 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, pp. 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.

As previously indicated, Council members have filed on average about forty-six (46) percent of all corporate governance-related resolutions submitted to U.S. 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]

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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.

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. 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]

[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.

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]

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 U.S. 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.

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[28] *Id.*

[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 U.S. 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 U.S. 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 Group Incorporated. 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 U.S. 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*, *supra*, 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]

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[36] 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.*

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.

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
Ann Yerger
Executive Director
Council of Institutional Investors
before the
Committee on Financial Services
September 27, 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
Fairfax County Educational Employees' Retirement System
Florida State Board of Administration

*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.

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

COUNCIL OF INSTITUTIONAL INVESTORS

Testimony of
Ann Yerger
Executive Director
Council of Institutional Investors
before the
Committee on Financial Services
September 27, 2007

Attachment 2

Council Corporate Governance Policies

The Council of Institutional Investors
Corporate Governance Policies

CONTENTS:

- **I. Introduction**
- **II. The Board of Directors**
- **III. Shareowner Voting Rights**
- **IV. Shareowner Meetings**
- **V. Executive Compensation**
    - **Role of Compensation Committee**
    - **Salary**
    - **Annual Incentive Compensation**
    - **Long-Term Incentive Compensation**
    - **Perquisites**
    - **Employment Contracts, Severance and Change-of-Control Payments**
    - **Retirement Arrangements**
    - **Stock Ownership**
- **VI. Non-Employee Director Compensation**
- **VII. Independent Director Definition**

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.

<u>**Proxy statement disclosure**</u>

- ***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)

COUNCIL OF
INSTITUTIONAL
INVESTORS

Testimony of
Ann Yerger
Executive Director
Council of Institutional Investors
before the
Committee on Financial Services
September 27, 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

COUNCIL OF INSTITUTIONAL INVESTORS

Testimony of
Ann Yerger
Executive Director
Council of Institutional Investors
before the
Committee on Financial Services
September 27, 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

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

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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

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.

<u>More than Five Percent Requirement</u>

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]

[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.

<u>Precatory Proposals</u>

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

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.

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[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]

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[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.

* * * *

The Council appreciates the opportunity to provide our views on this matter. Please feel free to contact me with any questions.

Sincerely,

Jeff Mahoney

Jeff Mahoney
General Counsel

[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).

Revised Draft September 25, 2007

September [ ], 2007

VIA E-MAIL

Ms. Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street N.E.
Washington, DC 20549-1090

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% 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 attachment to 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. We have done so with a view toward 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% of Business Roundtable companies have boards that are at least 80% independent. At 71% 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% 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% as of September 2007, compared to 22% 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, 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 and Chief Executive Officer
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 Casey, Commissioner
Mr. John W. White, Director, Division of Corporation Finance
Mr. Brian G. Cartwright, General Counsel

Draft September 25, 2007

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 longstanding 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 longstanding 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 for directors. The requirements also promote accountability,

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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).

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 Commission to amend the rule to reflect this interpretation. As the Commission observes in the Interpretive

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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.

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. <u>*Majority voting*</u>. 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 reduce greatly 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 that nominating/governance committees at 36% of Business Roundtable companies received shareholder recommendations for board nominees in the past year.

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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).

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 online 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]

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

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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.

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 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

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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).

[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").

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. <u>Resubmission thresholds</u>.

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]

The average votes cast for shareholder proposals has increased significantly. For example, in 1997, the average vote received by all shareholder proposals was 15.1% of votes

[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, at § III (November 5, 1948); *Adoption of Amendments to Proxy Rules*, Exchange Act Release No. 4979, at § II (January 6, 1954). We note that the thresholds were changed 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).

cast.[14] In contrast, the average vote received by all shareholder proposals in 2007 (through early September) has been 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 times but not approved by a majority of the votes cast should be excludable for five years thereafter).

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[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 received by corporate governance proposals was 23.6% of votes cast, with votes ranging from 0.8% to 74.5%. *Id.* The average vote received by 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.

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 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 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

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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 195 ("[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 (Jan. 6, 2000) (decision to convert traditional defined benefits pension plan to a "cash balance" plan has an age discriminatory impact and, thus, 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 significant social policy even though the proposal focuses on an ordinary business matter.

difficult position of not knowing what the standards is.[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 governance-related 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 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.

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[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; Larry E. Ribstein, University of Illinois College of Law, May 7th Transcript at 195-98.

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

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

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]

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

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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, at § II.E.6 (August 16, 1983).

25 *Id.*

26 *See* 1998 Release at n. 30 and accompanying text.

27 *Texaco, Inc.* (avail. Mar. 28, 1991) (*emphasis added*).

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. 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."[29]

E. <u>Bylaw amendments concerning non-binding shareholder proposals</u>.

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, have significantly enhanced opportunities for collaborative discussion.[30] In light of these other avenues available for shareholders to

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28 *See* Cary Klafter, Intel Corporation, May 7th Transcript at 175.

29 *See* James J. Hanks, Jr., Venable LLP, May 7th Transcript at 193; Joseph A. Grundfest, Stanford Law School, May 7th Transcript at 193-94; Larry E. Ribstein, University of Illinois College of Law, May 7th Transcript at 195-98; Jill E. Fisch, Fordham University School of Law, May 25th Transcript at 118-19.

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 &

[Footnote continued on next page]

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

[Footnote continued from previous page]
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.

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; Stephen Bainbridge, UCLA School of Law, May 7th Transcript at 57.

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).

[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.

Draft September 25, 2007

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, if the proposal was submitted for a vote at only two meetings during such period, or (3) less than 10% of votes cast 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 ("IRRC") 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	9.30%
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%
American Power Conversion Corp.	Commit to/report on board diversity	2000	30.1%
		2002	24.1%
		2003	28.6%

Company	Subject Matter of Proposal	Meeting Date	Votes For
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	12.50%
		2006	15.20%
		2007	13.30%
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%
The Boeing Co.	Independent board chairman	2003	29.7%
		2005	26.6%
		2006	36.2%

Company	Subject Matter of Proposal	Meeting Date	Votes For
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	20.90
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%
Coca-Cola Enterprises	Golden parachutes	2004	30.6%
		2005	26.3%
		2006	32.5%

Company	Subject Matter of Proposal	Meeting Date	Votes For
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	34.20%
		2006	28.40%
		2007	31.20%
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	12.40%
Crane Co.	Implement MacBride principles	2002	12.9%
		2003	8.4%
		2004	11.6%
		2006	13.4%
		2007	12.10
Dow Jones & Co., Inc.	Independent board chairman	2003	4.9%
		2004	12.9%
		2005	19.2%
		2006	22.2%
		2007	12.1%

Company	Subject Matter of Proposal	Meeting Date	Votes For
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	25.60
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	20.10%
		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%
The TJX Companies, Inc.	Implement ILO standards and third-party monitor	2002	6.5%
		2004	10.5%
		2005	8.6%

Company	Subject Matter of Proposal	Meeting Date	Votes For
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%
Wal-Mart Stores, Inc.	Report on EEO	2002	11.3%
		2003	13.0%
		2004	16.1%
		2005	18.8%

Company	Subject Matter of Proposal	Meeting Date	Votes For
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%

Statement of the U.S. Chamber of Commerce

ON: SEC PROXY ACCESS PROPOSALS: IMPLICATIONS FOR INVESTORS

TO: U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES

BY: DAVID T. HIRSCHMANN, SENIOR VICE PRESIDENT, U.S. CHAMBER OF COMMERCE AND PRESIDENT, U.S. CHAMBER CENTER FOR CAPITAL MARKETS COMPETITIVENESS

DATE: SEPTEMBER 27, 2007

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

Statement for the U.S. House of Representatives Committee on Financial Services

"SEC Proxy Access Proposals: Implications for Investors"

Statement by David T. Hirschmann
Senior Vice President, U.S. Chamber of Commerce and
President, U.S. Chamber Center for Capital Markets Competitiveness

September 27, 2007

Chairman Frank, Ranking Member Bachus, and members of the Committee:

The U.S. Chamber of Commerce is the world's largest business federation, representing more than three million businesses and organizations of every size, sector, and region. The Chamber is pleased to submit the following statement for the record, and commends the Committee for holding hearings on Securities and Exchange Commission ("Commission") Release No. 34-56161, IC-27914, "Shareholder Proposals Relating to the Election of Directors" (the "Short Release"), and Release No. 34-56160, IC-27913, "Shareholder Proposals" (the "Long Release"), dated July 27, 2007.

The Chamber appreciates the efforts of the Commission to fashion new shareholder access rules, but has fundamental concerns with any proposal that facilitates greater shareholder access to proxy materials. The Chamber believes that greater proxy access would not advance the financial interests of individual investors. Instead, it would allow labor unions and other special interest groups to gain seats on corporate boards and/or use the threat of a director nomination to leverage their own narrow agendas. The Chamber will continue to vigorously oppose any plan that allows special interest shareholders to promote initiatives that do not serve the long-term goals of a company and its investors.

Unions and other special interests are already abusing the proxy process. The AFL-CIO, for example, recently announced that it intends to use shareholder proxy resolutions to obtain support for national health care and to force disclosure of corporate directors' and officers' personal political contributions to candidates who allegedly "oppose" universal health care legislation. As the Chamber stated in its letter to Commission Chairman Chris Cox on this matter, regardless of how one views the challenges of the U.S. health care system, it is clear that the proxy process is simply the wrong forum for addressing this incredibly complex issue. This issue, along with many others that are put forth in proposals by special interests, belongs in the political arena and not in the boardroom where the focus should be on increasing shareholder value.

The Commission was compelled to address the issue of shareholder access following the decision of the U.S. Court of Appeals for the Second Circuit, which stated that the current Commission and staff interpretation of Rule 14a-8(i)(8) was not accompanied by a sufficient reasoned analysis.[1] The Second Circuit invited the Commission to confirm the interpretation and the Chamber agrees with the Commission's decision to do so. The two subsequent releases advanced by the Commission are an effective means to address existing uncertainty and obviate the need for congressional involvement.

The Chamber strongly supports the guidance set forth in the Short Release, which reaffirms the Commission's view that companies may exclude shareholder proposals relating to director election procedures from their proxy. Conversely, the Chamber strongly opposes the Long Release, which if adopted, would overturn the existing interpretation and require the inclusion of these types of shareholder proposals if specified criteria are met.

The Short Release reaffirms the Commission's interpretive guidance that has been an integral and well-accepted component of proxy rules. The guidance has been consistently applied and reaffirmed by the staff and has endured numerous proposed and adopted changes to proxy rules. This interpretation does not, as some have suggested, prevent shareholders from exerting significant influence on the corporate governance of reporting companies, but has appropriately prevented the company's proxy from being the battleground for public policy issues advanced by unions and other specials interests. This a particular concern as in recent years, shareholder activists have introduced numerous resolutions that may have little to do with a company's performance such as adherence to the conventions of the International Labor Organization, reporting of political contributions, drug reimportation, fair lending practices, and affirmative action.

While the Chamber believes the guidance in the Short Release is intended to take effect immediately, the Chamber urges the SEC to take steps to reaffirm this interpretation to avoid additional confusion. A reaffirmation will eliminate any doubt as to the effect of the release, as well as ensure compliance with the notice and comment requirements of the Administration Procedures Act.

The Chamber strongly opposes the adoption of the Long Release and believes that it exceeds the Commission's authority under Section 14 of the Securities Exchange Act of 1934. Under the guise of disclosure and facilitation of existing state rights, the Commission would effectively adopt federal corporate governance standards that would provide certain shareholders with a new federal substantive right of proxy access that does not generally exist under state law. Mandating shareholder access to proxy statements for the purpose of advancing a shareholder access proposal would create a substantive federal requirement under which a company, in effect, must solicit proxies for the establishment of director election procedures that it does not support, and that will lead to future proxy contests in opposition to the company's own candidates. Such substantive regulation is clearly inconsistent with congressional intent, as it goes far beyond the central and process-based purpose of the proxy rules; namely to ensure a fully informed and orderly vote on matters coming before the shareholders.[2]

[1] *American Federation of State, County & Municipal Employees, Employees Pension Plan v. American International Group, Inc.*, 462 F.3d 121 (2d Cir. 2006).

[2] See *Business Roundtable*, 905 F.2d at 410 ("The goal of federal proxy regulation was to improve [the company's board] communications [with potential absentee voters] and thereby enable proxy voters to control the corporation as effectively as they might have by attending a shareholder meeting.")

Adoption of the Long Release would also be costly and disruptive to companies and ultimately to shareholders and retirees, whose pension plans hold company stock. The potential negative effects of the proposed rule changes on the corporate election process and functioning of boards of directors needs to be carefully considered. If the Long Release is adopted, it is likely that proxy contests, in which the company is required to solicit proxies on behalf of shareholders, will ensue and may become customary. These proxy contests would be at two levels; first, an initial proxy contest over a shareholder proposal to permit shareholder access to the proxy and, second, upon the approval of any such proposal, perennial proxy contests over particular shareholder nominees. Such contests are inevitably a disruptive event for a company that will divert vast amounts of time, energy, and funds away from the company's operations and towards defending the company.

The Chamber believes the Long Release would rearrange the incentives so that these sorts of full-scale proxy contests would become much more common and perhaps even a perennial feature of director elections. The company's resources would be expended to the detriment of shareholders generally, but for the benefit of the large, but still minority, shareholders whose proxy solicitation would be funded by the company. The fact that the company (in effect, the shareholders) will be forced to fund the proxy solicitations of certain shareholders is particularly worrisome because of the likelihood that some large shareholders will abuse a system that does not force them to internalize the costs of their behavior.

If the Long Release were to be adopted, it is likely that most proposals to permit shareholder access and to advance shareholder nominees will be put forth by the types of activist shareholders that traditionally have used the shareholder proposal mechanism for the promotion of parochial interests or political or social issues having little to do with the company's business. To the extent that such shareholders are successful in gaining shareholder access and ultimately electing special interest or "protest" directors may create divided boards of directors that will have a diminished capacity to function effectively. If management or directors feel that certain other directors are working with an agenda other than the best interests of the company, this could actually cause management to limit discussion with the board, or could cause the board to create working committees that exclude the special interest directors.

The potential adverse consequences of the proposal in the Long Release could, in theory, be justified if there were a clear, demonstrable need for the introduction of such a rule. But the Long Release does not advance any objective basis for believing that shareholder access to company proxy statements would be a benefit to shareholders or an improvement to the director election process. The Long Release indicates that intent of the proposal is "vindicating shareholders' state law rights to nominate directors," but does not indicate what the proposal would vindicate these rights against. The extent and manner to which shareholders may nominate directors or amend the by-laws to permit shareholder nominations are established and delineated by state law, and these rights are in no way under attack or in need of federal vindication.

Finally, the Chamber believes that corporate governance developments and advances in recent years on a number of fronts have indicated that there is no need for the new rules. The Chamber notes, in particular the following:

Changes in state law. State law defines the rights of shareholders, including the extent to which shareholders can propose by-law amendments and nominate directors, as well as the extent to which they have access to the company's proxy to do so. States can and do modify their laws to adjust the balance of power between companies and shareholders as they see fit, and give more or less discretion to companies as to what rights shareholders have. For example, North Dakota has recently modified its corporate law to permit corporations to offer a suite of enhanced rights to shareholders, including proxy access for 5% shareholders, majority voting for directors, advisory shareholder votes on compensation reports, reimbursements of costs for successful proxy contests and separation of the role of chief executive officer and chairman.[3]

In 2006, Delaware modified its corporation law to better accommodate majority voting standards (as opposed to plurality voting standards) for director elections. In particular, the Delaware law amendments permit irrevocable agreements by directors that they will resign if they do not receive a specified vote for reelection and provide that a corporation's board of directors cannot unilaterally amend or repeal a stockholder-approved by-law amendment which specifies the vote that is necessary for the election of directors. In July 2007, Ohio passed a similar law making it possible for corporations to adopt majority voting standards.

State law is the traditional and appropriate forum for defining the rights of shareholders with regard to director elections, by-law amendments and other fundamental corporate matters. The recent revisions in state law in these areas illustrate that states are appropriately responsive to shareholder concerns and able to balance the competing interests. The laws of the various states provide flexible environments in which new corporate governance ideas can be tested, refined and applied. There is no reason for the Commission to override state decision-making in this area and impose a one-size-fits-all federal solution.

Corporate responsiveness to shareholder concerns. In recent years, a growing number of corporations have revised their corporate governance practices in significant ways in response to shareholder concerns, including director elections. Surveys indicate that nearly two-thirds of companies in the S&P 500 index have adopted board election reforms in recent years, in some cases affirmatively requiring election of directors by majority vote (as opposed to a mere plurality) and in other cases imposing a requirement that directors who do not receive a majority vote will, as a matter of policy, offer to resign. In 2007 alone, 140 companies received shareholder proposals relating to majority voting, most of which were withdrawn after the companies decided to voluntarily adopt director election reforms. Of those that were opposed by management and submitted to a vote, the average level of support received, according to Institutional Shareholder Services, was approximately 50%.

SEC and stock exchange rule-making. In recent years, the New York Stock Exchange, the Nasdaq Stock Market and other major stock exchanges, acting in response to a Commission request, adopted significant changes to their corporate governance listing standards. Under these

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[3] *See* N.D. Cent. Code § 10-35 (2007), *available at* http://www.legis.nd.gov/cencode/t10c35.pdf.

standards, the independent directors, generally, in the form of an independent nominating committee, have greater involvement in the director nomination process. In addition, these standards heightened the requirements for determining whether a director is "independent" of management and the company. Numerous additional corporate governance changes have been imposed by the stock exchanges, as well as by the Commission under the Sarbanes-Oxley Act of 2002 and in its executive compensation rule changes in 2006. The 2006 rule changes require increased proxy disclosure relating to director compensation, transactions between the directors and the company, and director independence determinations.

In conclusion, the Chamber strongly supports the Short Release that would reaffirm the Commission's long-standing interpretation and would permit companies to exclude shareholder proposals relating to director election procedures. The Chamber strongly opposes the Long Release and believes it is unnecessary, overreaching, and potentially disruptive to companies and shareholders alike.

The Chamber thanks the Committee for holding the hearing and would be pleased to answer any questions with respect to our comments.

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