IBM International Business Machines Corporation

Office of the Chairman, President and Chief Executive Officer

Armonk, New York 10504-1783

August 20, 2010

The Honorable Mary L. Schapiro
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Dear Chairman Schapiro:

Re: Pending Proxy Access Proposal

I understand that the SEC is scheduled to meet next week to consider adopting final rules with respect to proxy access. When the SEC invited public comment on those rules last year, IBM submitted a detailed comment letter explaining our opposition to this proposal. I am attaching a copy of that letter, and we repeat those arguments.

IBM is one of the most widely held stocks in the United States, with more than two million stockholders and a market capitalization in excess of $160 billion. Next June, we will celebrate our centennial, marking the 100th year of IBM. We know what it means to manage a corporation for the long-term best interests of its owners.

While I understand that your intent is to improve corporate governance, the proxy access proposal the SEC is considering would have the opposite effect. Because of its extremely low thresholds, the Commission's proposed rule would mainly benefit very short-term investors. To take just one example, under the Commission's proposal, a highly-leveraged corporate raider or hedge fund could easily propose a slate of directors focused on bleeding a company's balance sheet through the payment of special one-time dividends, to the detriment of job-creating investments with a longer pay-back period, such as new R&D laboratories or manufacturing plants. While this might be good for the returns of a hedge fund, it would certainly not be good for ordinary shareholders, employees, customers, or consumers.

In short, the Commission's proxy access proposal will distort and distract the behavior of management and boards. As noted above, it will have a significant, adverse impact on companies' business strategies as they respond on a repeated basis to short-term concerns. I urge you and your fellow Commissioners to reject the proxy access proposal. This issue should only be addressed after seriously considering fundamental changes to the original proposal to substantially increase both the ownership requirements and the holding period, in an effort to ensure that proxy access is not misused by smaller holders or groups of smaller holders who are working in concert to leverage a single issue or concern.

If the Commission does not reject the proposed rule, it should, at a minimum, significantly increase the requirements (e.g., a minimum 5% ownership requirement and a minimum two-year net long holding requirement).

Sincerely,

Samuel J. Palmisano

Attachment

cc: The Honorable Luis A. Aguilar, Commissioner
The Honorable Kathleen L. Casey, Commissioner
The Honorable Troy A. Paredes, Commissioner
The Honorable Elisee B. Walter, Commissioner

Office of the Vice President,
Assistant General Counsel and Secretary

New Orchard Road
Armonk, NY 10504

August 12, 2009

File Reference No. S7-10-09
Facilitating Shareholder Director Nominations
Release Nos. 33-9046; 34-60089

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

Dear Ms. Murphy:

We are writing to comment on the proposed rules (the "Proposal") and rulemaking release (the "Release") published by the U.S. Securities and Exchange Commission (the "Commission" or the "SEC") on June 18, 2009, entitled *Facilitating Shareholder Director Nominations*. For the reasons we discuss below, we strongly urge the Commission not to adopt proposed Rule 14a-11 and respectfully request that the SEC redirect its efforts to address the issues related to the director elections and proxy voting matters set forth in Section III of this letter.

I. Introduction.

International Business Machines Corporation (the "Company" or "IBM") has been incorporated in the State of New York for almost 100 years and has been listed on the New York Stock Exchange since 1915. IBM has almost 400,000 employees, does business in more than 170 countries, and its 2008 revenue was over $103 billion. IBM has about 2.2 million shareholders in over 100 countries, including 1.6 million shareholders who beneficially own their shares through brokers (so-called "street" shares), constituting 23% of the Company's shareholder base.

IBM supports the Commission's commitment to the protection of investors and the furtherance of responsible corporate governance practices at public companies and acknowledges the difficulty of the work with which the Commission has been entrusted. We have decided to submit this detailed comment letter to the Commission because of the importance of the issues raised by the Proposal.

A. Summary of IBM's Position on the Proposal.

We set forth below for the Commission's consideration the reasons underlying our belief that the Proposal, if adopted, would not be in the best interests of shareholders or the companies they own. First, the Proposal does not cite any empirical evidence to support the notion that the lack of federal proxy access had any causal connection to the current economic crisis -- in fact, the Commission has been debating the issue of proxy access for years, with multiple proposals on point in the last six years. Further, in many other contexts, including proxy disclosure of executive compensation, the Commission has implemented rules designed to promote and emphasize the importance of long-term investment, recognizing that short-term investment horizons often create incentives, risks and rewards that run counter to longer-term, sustainable growth. Most commentators agree that an inappropriate focus on short-term gains contributed to the current crisis. But nowhere in this Proposal does the Commission recognize or address the fact that many of the terms of the Proposal itself, including the required length of investment by nominating shareholders, will encourage that very same focus on short-term results and rewards. In short, the Proposal is neither supported by the empirical evidence nor does it support the Commission's policy statements regarding the need to incentivize a longer-term outlook.

Furthermore, the Proposal fails to address any of the flaws and shortcomings in the director election process today -- including the role and influence of proxy advisory firms, the difficulty companies have getting information about their investors because of the current, confusing NOBO/OBO shareholder designations, and problems related to "empty voting" (i.e., voting by investors who have legal ownership of shares but no economic interest in the company). These are very real and considerable problems, and the Proposal simply overlooks them. Expanding access to the proxy system without addressing these underlying and significant problems would exacerbate these concerns, increase the potential for short-term motivated behavior, and would not be in the best interests of shareholders or our economy at this critical time.

In addition, the Proposal fails to respect the role played by the states in matters of director elections, and it does not give adequate consideration to recent and important corporate governance developments. Rule 14a-11 as proposed would create a one-size-fits-all federal mandate in an area better left to the states, where companies and shareholders can consider the appropriateness of a proxy access process best suited to their particular facts and circumstances. Therefore, we urge the Commission not to adopt Rule 14a-11 but instead to amend Rule 14a-8 to allow private ordering by individual companies and their shareholders.

B. Detailed Table of Contents.

Our arguments may be summarized in the following points, as developed in more detail in the body of this letter:

- Federal Proxy Access Is Not Needed to Protect Shareholder Interests in Light of Existing Law and Procedures at Both the Federal and State Level. (Section II, Pages 5-11)
  - The stated need for the SEC's proxy access proposal is not supported by empirical evidence.
  - Under existing state and federal law, shareholders currently have meaningful opportunities to participate in the process for the nomination of directors.
    - Although the Proposal claims to be merely removing "federal obstacles" to state rights, that assertion ignores shareholders' ability to mount proxy contests pursuant to Rule 14a-4 and the cost savings and efficiencies of the SEC's recent E-Proxy rules.
    - Proposed Rule 14a-11 appears drafted to encourage annual proxy contests for all companies – solely because of the actions of a single shareholder or a very small group of shareholders; this clearly would not be in the best interests of shareholders as a whole.
  - The Proposal ignores the private ordering nominating procedures that currently exist under state law.
    - It also assumes that companies and their shareholders cannot be entrusted to establish their own proxy access standards appropriately suited for the company at issue.
  - The Proposal fails to recognize recent, significant developments in corporate law and corporate governance.
    - In recent years, American companies -- often after successful shareholder campaigns conducted through Rule 14a-8 proposals -- have empowered shareholders by adopting corporate governance practices such as majority voting and by-laws requiring the annual election of directors. The Proposal does not give credit to these movements and may preclude their full development.

- The Proposal ignores the fundamental premise of existing corporate law -- that directors -- not shareholders -- have well-established and understood fiduciary duties to act in the best interests of the company and its shareholders.
    - The Proposal would shift power to differing factions of shareholders, many of which have their own contradictory goals and none of whom have any obligation to consider shareholder interests at large.

- Significant Problems in the Current Director Election System in the United States Should Be Addressed by the Commission Before Considering Proxy Access. (Section III, Pages 11-18)
    - The SEC needs to address the problematic situation of proxy advisory firms.
        - Proxy advisory firms wield tremendous power over corporate elections, with a meaningful percentage of votes for directors often being made in lockstep with the proxy advisory firms' recommendations, even though those firms do not disclose their voting power and are not subject to adequate regulatory oversight.
    - The SEC should allow companies easier access to information about their investors through a reform of the NOBO/OBO system and more frequent disclosures about meaningful beneficial holdings by investors.
    - The SEC should address the issue of borrowed shares.
        - The SEC must pay serious and immediate attention to the problem posed by investors who may have indicia of legal ownership, and who accordingly may vote in director elections, but who do not have any economic interest in the companies in question.

- Even If Federal Proxy Access Could Be Supported, the Proposed Rules Would Need to Be Significantly Modified. (Section IV, Pages 18-24)
    - The Proposal has substantive and mechanical problems that need to be addressed before any federal proxy access should be mandated.
        - If Rule 14a-11 is adopted, it should be a default provision that only applies if a prescribed trigger event has occurred. Moreover, the eligibility thresholds for shareholders to submit nominations must require higher share ownership and longer holding periods. The "25% cap" on how many nominees must be included on a company's ballot also needs to be reconsidered, and the "first-in priority" standard the SEC has proposed is unworkable.

- Rather Than Adopting Rule 14a-11, the SEC Should Amend Rule 14a-8 to Allow Companies and Their Shareholders to Craft the Proxy Access Regime Appropriate to Their Own Circumstances. (Section V, Pages 24-26)
    - Companies should be able to adopt their own proxy access provisions prior to or absent any shareholder proposals for such under Rule 14a-8(i)(8).
    - The Commission should reconsider and revise the proposed eligibility standards for Rule 14a-8(i)(8).
- A 60-Day Comment Period Is Not Long Enough for a Matter of This Magnitude. (Section VI, Page 26)

II. Federal Proxy Access Is Not Needed to Protect Shareholder Interests in Light of Existing Law and Procedures at Both the Federal and State Level.

A. The stated need for the SEC's proxy access proposal is not supported by empirical evidence.

As a preliminary matter, we note that in the Release, the Commission identifies two main arguments for why it must take up the question of proxy access today. The Release begins by stating that "[t]he nation and the markets have recently experienced, and remain in the midst of, one of the most serious economic crises of the past century," suggesting that the lack of a federal entitlement to proxy access may have played some role in these crises.[1] The Proposal, however, does not cite any support for the suggestion that creating federal proxy access would address any of the causes of the current financial crisis. Nor does the Proposal explain how imposing additional regulatory burdens on public companies will help those companies, and thus their investors, enjoy improved performance.[2]

Further, there is little clear empirical support for the suggestion that contested director elections of the type envisioned by the Proposal lead to the creation of shareholder value. In the Release, the SEC cites the IRRC Institute report on the "Effectiveness of Hybrid Boards" as support for the notion that companies perform better when dissident directors are

[1] SEC Release No. 33-9046, "Facilitating Shareholder Director Nominations," June 18, 2009, 74 Fed. Reg. 29,025, *available at* http://www.sec.gov/rules/proposed/2009/33-9046fr.pdf.

[2] In contrast, the Division of Corporation Finance has recognized the importance of efficient administration of the existing securities laws in an effort to promote economic recovery. *Cf.* comments of Shelley Parratt, Deputy Director, Division of Corporation Finance, at the *Ray Garrett Institute*, Chicago, Illinois, April 30, 2009 (highlighting the Division's efforts to expedite reviews of registration statements to facilitate capital raising).

added to the board.[3] The statistics cited in that report, however, do not support the Commission's claim, and the only conclusion that could fairly be drawn from the data is that some companies perform better, and many perform worse, under such circumstances.[4] While some cuts of data may seem to support the Release's argument, others clearly do not. At best, the data presented are a mixed bag and not conclusive evidence that a dissident director helps to improve the performance of a company. This ambiguity clearly fails to justify the disruptions and costs associated with allowing proxy access to 1% holders at the possible expense of the other 99%.

Given the serious consequences of the Proposal, the Commission should only take action based on clear and convincing evidence that the assumed problems that underlie the Proposal are real and that the consequences of implementing the Proposal decisively outweigh the inherent risks. To that end, we suggest that the Commission establish a blue ribbon panel, as it has done on other occasions,[5] composed of responsible representatives of all relevant perspectives, and charge it with considering related issues including those discussed in Section III of this letter.

B. Under existing state and federal law, shareholders currently have meaningful opportunities to participate in the process for the nomination of directors.

The SEC asserts that via the Proposal, it is "merely removing" a federal obstacle to meaningful proxy access under state laws. As explained below, this argument ignores existing state and federal law and fails to recognize how corporate governance has evolved in recent years in response to shareholder concerns, without intervention by the federal government. In essence, the SEC's proxy access proposal is an effort to preempt state law on the issue of director nominations, stripping states of their traditional role as the laboratories for innovation in corporate law and governance.[6]

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[3] Release, 74 Fed. Reg. at 29,074, n.349.

[4] In fact, of the companies with dissident directors studied for three years after the contest period, share performance averaged just 0.7%, which is 6.6% less than peer companies. IRRC Institute for Corporate Responsibility, May 2009, *available at* http://www.irrcinstitute.org/pdf/IRRC_05_09_EffectiveHybridBoards.pdf, at p. 38-39. We also note that the data paints an even starker picture in cases where the dissident shareholder owned less than 5% of the company's stock (which thus further calls into question the Proposal's chosen threshold of 1% share ownership).

[5] *See, e.g.,* Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committee Reports (1999), reprinted in 54 Bus. Law. 1067 (1999) (advisory committee on adequacy of audit process oversight by independent directors and related potential adverse effects on the U.S. capital markets); and Report of the Advisory Committee on the Capital Formation and Regulatory Process (1996), *available at* http://www.sec.gov/news/studies/capform.htm (advisory committee on informational needs of investors and regulatory costs imposed on the U.S. securities markets).

[6] *See New State Ice Co. v. Liebmann*, 285 U.S. 262, at 386-87 (1932) (Justice Brandeis on the role of states as laboratories to try "novel social and economic experiments").

It is simply not true that shareholders today are handicapped by the lack of a federal proxy entitlement. Today, shareholders can mount a proxy contest if they wish to be heard in opposition to a company or its management, and they can seek the election of their own nominees under Rule 14a-4. Like the 14a-8 shareholder proposal process, the processes and requirements for 14a-4 proxy contests, which have been in effect for decades, are well-known and understood in the marketplace. The principal criticism of proxy contests is that they can be expensive to the party launching the contest, with the belief that the costs have served as an impediment to smaller firms and individuals pursuing this avenue to address their concerns. It is important to note that proxy contests involve significant costs on both sides -- for the shareholder and the issuer -- and that the level of investment required for a proxy contest is indicative of the seriousness of the issues raised, and remedies sought, in those contests.

Moreover, the SEC has taken a number of steps in recent years to reduce the costs of proxy solicitation and enhance the ability of shareholders to share concerns and engage in concerted activity. The SEC's 2007 E-Proxy rules allow shareholders to utilize electronic proxy delivery when mounting a proxy contest. The SEC noted that the E-Proxy rules would likely "decrease significantly the printing and mailing costs associated with a proxy solicitation," as opposed to printing and mailing a lengthy proxy statement as well as additional proxy soliciting materials to shareholders.[7] Also, in 2008, the SEC adopted new Rule 14a-17 and amended Rule 14a-2 to allow shareholders to establish and participate in on-line forums with other investors, to facilitate discussions with respect to a particular company. These forums make it easier for shareholders with common concerns to organize and communicate in a cost-effective way.

In addition to or in conjunction with a proxy contest, shareholders may also submit binding by-law proposals under Rule 14a-8 that would require the company to reimburse its shareholders for the costs they shouldered if the shareholders' proxy contest solicitation efforts were successful.[8] While this approach helps fund successful -- and presumably needed -- proxy contests, it also has the benefit of requiring the investors launching the effort to carefully consider their chances of success, which again is a recognition of the seriousness of the matter.

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[7] SEC Release No. 34-55146, "Internet Availability of Proxy Materials," January 22, 2007, *available at* http://sec.gov/rules/final/2007/34-55146.pdf.

[8] AFSCME Employees Pension Plan Announces 2009 Shareholder Proposals, January 27, 2009, *available at:* http://www.afscme.org/press/24815.cfm (summarizing shareholder proposals that would allow certain shareholders who nominate candidates for the board to recoup their solicitation costs from the company should one or more of their nominated candidates win a seat).

In fact, the likely result of proposed Rule 14a-11 will be to disrupt cohesive, efficient and responsible corporate governance practices and turn every director election into a proxy contest. The Release itself points to a study showing that 99% of large accelerated filers have a shareholder that meets the minimum proposed Rule 14a-11 eligibility thresholds. In addition, the Proposal makes it easy for smaller shareholders to aggregate their holdings to meet such thresholds. In short, Rule 14a-11, as drafted, appears structured to encourage annual proxy contests for all companies because of the actions of a single shareholder or a very small group of shareholders. Due to the importance that companies rightly place on board composition, Rule 14a-11 could then be expected to result in a substantial drain on company resources, particularly at senior levels. The rule would also result in an increase in company costs as a result of proxy solicitation efforts and legal fees associated with, among other things, assessing a shareholder's compliance with the rule. Moreover, an increase in the regularity of proxy contests may very well result in a chilling effect on the ability of companies to attract the most experienced and talented individuals to serve as directors.

C. The Proposal ignores the private ordering nominating procedures that currently exist under state law.

On its terms, Rule 14a-11 would essentially impose a "one-size-fits-all" approach that would preempt any effort at privately ordering an access procedure different than that provided under the Proposal, even a procedure sought or expressly approved by shareholders. Indeed, this is a fundamental contradiction inherent throughout the Proposal -- namely that shareholders must be presumed to be intelligent and thoughtful enough to elect directors nominated pursuant to the SEC's imposed access standards, but those same shareholders cannot be trusted to establish their own access standards that are more appropriately suited to individual circumstances and individual companies.

Allowing the Proposal to effectively supersede state law and governing documents goes far beyond the stated purpose in the Release of facilitating the exercise of state law rights. A better approach, one that is respectful of private ordering[9], would be to permit shareholder access through the amendment of Rule 14a-8(i)(8). Allowing shareholders to propose and adopt binding by-law proposals providing for access would encourage companies to consider carefully their particular circumstances, consult with shareholders and adopt reasonable access by-laws setting out shareholder eligibility thresholds, director eligibility requirements and other nomination procedures and disclosures that would be amenable to a majority of that particular company's shareholders. This approach would be

[9] For example, Section 112 of the Delaware General Corporation Law, which became effective on August 1, 2009, expressly allows companies and shareholders to adopt their own company-specific access procedures. Moreover, even jurisdictions that do not have express enabling provisions such as Delaware's may allow for the adoption of access by-laws via more general enabling provisions. For example, under Section 601(b) of New York's Business Corporation Law ("BCL"), by-laws can contain any provision relating to the rights or powers of shareholders not inconsistent with the BCL, state law or the certificate of incorporation.

deferential to company and shareholder decisions to adopt access thresholds appropriate for the company, and would promote a balance of power by tempering a company's ability to deny access altogether with the ability of shareholders to propose by-laws overriding such decisions.

D. The Proposal fails to recognize recent, significant developments in corporate law and corporate governance.

The case for federal proxy access should not be evaluated in a vacuum, and must be considered in light of the many recent and significant developments in key areas of corporate governance.

For example, according to a recent study, about 75% of the companies in the S&P 500 have adopted a majority vote standard for the election of their directors,[10] compared to only 16% of the S&P 500 having such a voting standard less than two years earlier.[11] Further, shareholder concern regarding staggered or classified boards has resulted in a significant change in director elections, with a majority of the S&P 1,500 (64%) now holding all director elections annually, compared to only 41% doing so five years ago.[12]

A further example of the evolution in corporate governance over time can be seen in IBM's own reaction to issues of concern to shareholders. In response to recent shareholder proposals achieving support of more than a majority of the votes cast at annual meetings, the IBM Board of Directors has implemented majority voting for directors and established a mechanism for shareholders to call special meetings, notwithstanding the precatory nature of those proposals.

All of these changes in corporate governance were accomplished without federal intervention and represent an evolution of corporate governance in response to particular shareholder concerns. These are compelling examples of how shareholders can effect fundamental changes in corporate governance through the mechanisms and processes available today, and belie the need for radical, untested and potentially damaging changes in the balance of power between shareholders and boards.

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[10] *See* Business Roundtable Fact sheet, "Business Roundtable Corporate Governance Survey Trends," December 2008, *available at* http://www.businessroundtable.org/sites/default/files/2008%20Corp%20Gov%20Survey%20Trends.pdf.

[11] *See* Neal, Gerber & Eisenberg LLP, "Survey of Majority Voting in Director Elections," February 20, 2006, *available at* http://www.ngelaw.com/files/upload/survey_callen.pdf.

[12] *Cf.* RiskMetrics Group, "Board Practices: Trends in Board Structure at S&P 1,500 Companies," December 17, 2008, with ISS, "Background Report: Classified Boards of Directors," April 2007.

E. The Proposal ignores the fundamental premise of existing corporate law -- that directors -- not shareholders -- have well-established and understood fiduciary duties to act in the best interests of the company and its shareholders.

It is axiomatic that directors have fiduciary duties to which they need to adhere in their discharge of their responsibilities. As Commissioner Troy A. Paredes said in a recent speech,

> State corporate law imposes upon directors and officers fiduciary duties of care and loyalty. Directors and officers are obligated to act in what they honestly believe is the best interests of the enterprise and its shareholders. More particularly, state corporate law, from which the shareholder vote originates, defends the shareholder franchise.[13]

Enforcement of fiduciary duties by the courts has, over time, increased accountability and transparency by boards, while respecting the latitude necessary to oversee management and protect shareholder value. Indeed, in the wake of recent and past corporate scandals, courts have strengthened the demands placed by fiduciary duties on corporate leaders.[14] As long as states hold directors accountable through the fiduciary duties of care and loyalty, shareholder interests and the value of their investments will be protected without federal incursion into state law rights.

By way of contrast, shareholders do not have any fiduciary obligations to the company or their fellow shareholders. Shareholders are allowed to be self-interested in ways that directors, bound by the duties of care and loyalty, cannot be. This can be seen for example in the proliferation of different types of investors, with different aims and different goals. While certain investors favor the return of gains to investors through share repurchases, others favor dividends, share appreciation or reinvestment in the company through R&D or capital projects. Further, other investors, for example "socially responsible" investors, seek to leverage their investment to achieve goals other than financial returns, promoting platforms premised on a variety of concerns, such as resource sustainability and other "green" initiatives, implementing labor codes such as supply chain codes of conduct, and establishing mechanisms for the oversight of human rights issues. Each of these investors has its own time horizon for achievement of its goals, and each is pressured to meet and report achievement against its performance goals on a periodic -- usually quarterly -- basis. Furthermore, each such investor will pursue different avenues to encourage management and a company's board to meet its investment profiles. Not only are these shareholders allowed to be self-interested -- they are expected to be so. All institutional holders, including mutual

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[13] Troy A. Paredes, Commissioner, U.S. Securities and Exchange Commission, Remarks at Conference on "Shareholder Rights, the 2009 Proxy Season, and the Impact of Shareholder Activism," June 23, 2009, *available at* http://sec.gov/news/speech/2009/spch062309tap.htm.

[14] *See, e.g., In Re Citigroup Inc. Shareholder Derivative Litigation*, 964 A.2d 106 (Del. Ch. 2009) (strengthening good faith demands placed on executive compensation committees); *cf. In re Caremark Int'l Deriv. Litig.*, (698 A. 2d 959 (Del. Ch. 1996) (considering directors' duty of oversight).

funds and public and private pension systems, have investment guidelines and goals they market or promote to their various investors and participants, and those investors and participants are entitled to rely on those holders enforcing their investment goals through whatever means are available.

In this light, there is a legitimate concern that certain investors may seek to exploit any federal access entitlement to further their own particular agenda and investment thesis. To ignore this would be a naïve dismissal of the ways in which investments are made, and resources are allocated. Proxy access as demanded in the Proposal would dramatically shift power from the board to differing factions of shareholders, many of which will have contradictory goals, and none of whom have any obligation to consider shareholder interests at large.

III. Significant Problems in the Current Director Election System in the United States Should Be Addressed by the Commission Before Considering Proxy Access.

We believe that there is a series of significant problems with the current proxy and voting systems that should be addressed before the Commission considers moving forward with a proxy access proposal. Solving the problems described below would allow for a truly robust exercise of voting rights by shareholders and for improved communication between shareholders and companies.

A. The SEC needs to address the problematic situation of proxy advisory firms.

Shareholder votes today are affected to an unsettling and inappropriate degree by the growing and unchecked power of so-called "proxy advisory firms." In fact, the Commission recently invited comments to address the growing influence of proxy advisory firms in its rule release regarding broker discretionary voting -- "[I]ssues relating to the use of proxy advisory services...[are] a matter that will be considered by the Commission as it examines broader proxy issues."[15] Given the importance of federal proxy access, the SEC should address these issues before any access rules are adopted.

It is an open secret that certain proxy advisory firms control a meaningful portion of shareholder votes at many public companies. As explained below, these firms wield unmatched influence over the election of directors and other votes at U.S. public companies.[16] If proposed Rule 14a-11 is adopted, the influence of proxy advisory firms will

[15] SEC Release No. 34-60215 (approving amendments to NYSE Rule 452), July 1, 2009, p. 26, *available at* http://www.sec.gov/rules/sro/nyse/2009/34-60215.pdf (hereinafter "Rule 452 Release").

[16] Of course, it is unfortunate that institutional investors, many of whom are extremely sophisticated themselves, appear to be blindly outsourcing their voting decisions to a third party that does not bear any responsibility for, or share any economic risk with regard to, the issuer in question. As recently noted by the Commission, "[I]nstitutional investors, whether relying on proxy advisory firms or not, must vote the

only increase. For the reasons discussed below, we submit that investors and companies alike need the SEC to increase its oversight of proxy advisory firms.[17]

1. The SEC should investigate the dangers of allowing proxy advisory firms to continue to amass decision-making power over the votes of shareholders.

Certain proxy advisory firms have too much control over the voting decisions of shareholders. The proxy advisory industry remains largely unregulated, and the influence of these firms over the voting choices of shareholders continues to grow without the necessary checks or safeguards. Because proposed Rule 14a-11 would facilitate proxy access without addressing the problems with proxy advisory firms, the Proposal's piecemeal approach to proxy reform has the potential to exacerbate these concerns.

(a) Empirical Evidence of Control by "Lock-Step Voting"

The significant influence of proxy advisory firms such as RiskMetrics Group ("RMG") (formerly known as Institutional Shareholder Services ("ISS")) is felt by companies in all industries almost immediately upon release of the RMG report on the company's proxy statement. Specifically, within one business day after RMG releases its report on a particular company, a significant number of shares held by institutions are voted in a lock-step manner (i.e., 100% in accordance) with the RMG recommendation. We submit that this phenomenon is evidence of de facto control by RMG of these votes and of how institutional holders outsource their voting decisions to RMG.[18]

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institutions' own shares and, in doing so, must discharge their fiduciary duties to act in the best interest of their investors and avoid conflicts of interest; institutions are not relieved of their fiduciary responsibilities simply by following the recommendations of a proxy advisor." Rule 452 Release at page 26. We encourage the SEC to consider whether institutional investors are fulfilling their responsibilities for voting matters. *See also* Department of Labor Interpretative Bulletin Relating to Exercise of Shareholder Rights, October 17, 2008, *available at* http://www.dol.gov/federalregister/HtmlDisplay.aspx?DocId=21630&AgencyId=8 (noting that when pension plan fiduciaries vote, they have a duty to consider only the factors that relate to the economic value of the plan's investment and "shall not subordinate the interest of the participants and beneficiaries in their retirement income to unrelated objectives").

[17] We note in this regard that the Commission's recently formed Investor Advisory Committee is considering this very question. *See* SEC Press Release 2009-175, *Announcement from the SEC Investor Advisory Committee*, July 29, 2009, *available at* http://www.sec.gov/news/press/2009/2009-175.htm (including in a series of questions to be asked, "What is the role of proxy advisory firms, and should they be subject to more oversight by the Commission?").

[18] It is important to note that we believe that RMG's influence is far greater than is shown in the "one business day" amounts in the table; however, that additional influence is difficult to quantify because institutional investors are not required to publicly disclose when they in essence "outsource" decision-making over proxy matters to third parties.

The table below shows a cross-section of companies of different sizes and industries in the 2009 proxy season, each of which had more than 10% of its total votes cast lock-step with RMG's recommendations within one business day after the RMG report was released.[19]

Company	**Approximate Percent of Votes Cast Lock-Step Within One Business Day after RMG Recommendations**
IBM	13.5%
Company A	17.8%
Company B	15.7%
Company C	12.9%
Company D	12.4%
Company E	11.9%
Company F	11.6%

For IBM in 2009, an estimated 13.5% of the votes were cast in lock-step with RMG's recommendations within one business day after the release of RMG's report on IBM. By comparison, for the previous five business days, no more than 0.20% of the IBM vote was cast in any one day. To put that into proper perspective, the IBM voting block essentially controlled by RMG is almost two and one-half times more powerful than IBM's largest shareholder. And this voting block is controlled by a proxy advisory firm that has no economic stake in the company and has not made any public disclosures about its voting power.

This influence directly and significantly affects the election of directors. For example, in 2006, RMG recommended a "withhold" vote against one of IBM's directors because a family member of the director was employed by IBM in a non-officer capacity. As a result, 22.59% of the votes cast were "withheld" for this director in 2006. In 2007, RMG flipped its voting recommendation on this director, and he instead received a "for" recommendation from RMG; as a result, that year this director received only an 8.78% "withhold" vote. The underlying facts had not changed nor had the make-up of IBM's institutional shareholders changed significantly. This nearly 14% swing vote is clearly attributable to RMG's changed recommendation and is consistent with the information above regarding RMG exercising control over approximately 13.5% of the IBM votes cast.

[19] Data provided by one of the Company's proxy service providers.

(b) Given the level of voting control by proxy advisory firms, consideration needs to be given to further regulation of these firms

Given the level of de facto control over voting exercised by proxy advisory firms such as RMG, the SEC should consider whether that level of control renders the advisors beneficial owners of the shares in question. "Beneficial owner" is defined in Rule 13d-3 under the Securities Exchange Act of 1934 as having sole or shared voting and/or dispositive power over the shares in question. At the very least, the evidence of lock-step voting set forth above supports the case that proxy advisory firms "share" voting power with certain of their clients. This then would appear to raise serious and troubling questions about whether the advisor is violating Section 13 of the Exchange Act and the rules thereunder by not disclosing that it holds voting power over more than 5% of a class of registered equity securities. We would urge the Commission to look into this possible gap in how the spirit and letter of the law and rules with which it is entrusted are being applied and upheld.

Further, over the last few years, there has been a growing concern about the reliability of the voting services provided by proxy advisory firms. In fact, in an article last year about a material voting tabulation error by another service provider, RMG's special counsel admitted that voting errors are not rare and that "[t]here's plenty of room for slippage."[20] Against that backdrop, firms that provide advisory and voting services should be required to have their work audited periodically by independent audit firms to assess the accuracy of the votes they have cast on behalf of their institutional investor clients, and to publish those audit reports. Just as public companies are subject to strict auditing requirements and assurances regarding internal controls, so should proxy advisory firms be required to provide more assurances and public disclosure regarding the reliability and accuracy of the voting services they provide.

Moreover, proxy advisory firms may have conflicts of interest that affect their voting recommendations, but which are not disclosed to shareholders or companies. As Commissioner Kathleen Casey recently noted, "[P]roxy advisory firms often face conflicts of interests arising from providing corporate governance advisory services to registrants and providing voting recommendations to their institutional investor clients, and have been reported on occasion to make voting recommendations based on inaccurate analyses of registrant corporate governance or other data."[21]

In short, given the tremendous influence that proxy advisory firms hold over corporate elections and the problems with how that influence is exercised, the SEC should seriously consider reforming this system before moving forward with any other changes to the voting processes, particularly before creating a federal mechanism for proxy access.

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[20] Nicholas Rummell, *Institutional Investors Chafe Under Power of Big Shareholder Vote Counter*, PENSIONS AND INVESTMENTS (August 26, 2008).

[21] Kathleen L. Casey, Commissioner, U.S. Securities and Exchange Commission, Statement at SEC Open Meeting, July 1, 2009, *available at* http://sec.gov/news/speech/2009/spch070109klc.htm.

Otherwise, federal proxy access will become another tool with which proxy advisory firms will wield their unreasonable and undisclosed power.

B. The SEC should allow companies easier access to information about their investors through a reform of the NOBO/OBO system and more frequent disclosures about meaningful beneficial holdings by investors.

Communication is necessary to ensure that shareholders can responsibly exercise their voting rights. Indeed, one of the best ways to achieve increased accountability and transparency of boards is to better facilitate or enable corporations to communicate directly with shareholders. Unfortunately the current system prevents companies from understanding who their shareholders are in two ways.

1. The NOBO/OBO system should be reformed.

A significant percentage of company shares are not registered in the name of the beneficial owners, but instead are held in "street" name through brokers. The names of beneficial owners are thus maintained not by companies, but by the brokers. The names of objecting beneficial owners (OBOs) are not released to companies. Companies instead must rely on brokerage firms to communicate with those shareholders on their behalf, which is expensive, time-consuming and ineffective.[22] Because this system -- which grew out of the takeovers of the 1970s and 1980s and concern about information available for corporate raiders -- left companies without the ability to contact their shareholders directly, the SEC adopted rules in 1983 requiring brokers to provide companies with the names of non-objecting beneficial owners (NOBOs). Shareholders who opt to register as NOBOs can be identified and contacted on behalf of companies, but even then only at great expense.

Before seriously considering implementing federal proxy access, the capital markets -- corporations and shareholders alike -- need the SEC, either directly or through the appropriate self-regulatory organization, to resolve the NOBO/OBO situation. A federally mandated proxy access regime would highlight the need for robust and reliable communications between companies and their shareholders, and yet maintenance of the current NOBO/OBO system will simply ensure the persistence of an unworkable status quo that makes those important communications extremely difficult. At a minimum, because of the importance of shareholder communications, the SEC should require that all brokerage

[22] In addition to limiting communication between shareholders and companies, the NOBO/OBO distinction is poorly understood by investors. According to a 2006 Investor Attitude Study conducted by the Opinion Research Corporation, only 20% of investors interviewed remember being asked if they wanted their contact information provided to the companies whose stock they had purchased so that companies could communicate directly with them. Of that 20%, 79% provided their contact information. 71% of those who say they were not asked or do not remember being asked said that they would have given their contact information if they had been asked. *See generally* John C. Wilcox, "Shareholder Nominations of Corporate Directors: Unintended Consequences and the Case for Reform of the U.S. Proxy System," *available at* http://www.law.upenn.edu/academics/institutes/ile/CCPapers/040507/Wilcox,%20Shareholder%20Nominations.pdf.

accounts have a default NOBO provision, with clients allowed to expressly opt-in to OBO status if they so choose.

2. The current system provides insufficient disclosure about significant beneficial owners.

In addition to reforming the NOBO/OBO system, the SEC should take steps so that companies and their shareholders are better informed about the holdings of institutional investors, particularly given that institutional investors may more actively trade their shares than individual shareholders registered under "street" name.

Currently, registered institutional investment managers are required to submit a Form 13F filing on a quarterly basis. We suggest that the SEC require more frequent Form 13F filings to allow companies to identify their major shareholders more accurately. It is our view that a monthly reporting mechanism would strike the appropriate balance without causing undue burden on money managers, given advances in technology and the bookkeeping requirements already in place for broker-dealers and investment advisers.

There also needs to be a more level playing field between institutions with obligations to submit Form 13F filings and unregistered institutions such as hedge funds. This is consistent with SEC Chairman Mary Schapiro's recent testimony before the House Capital Markets Subcommittee on July 14, 2009, where she noted the SEC's continued focus on increasing transparency of meaningful market transactions.[23]

In addition, before the SEC creates a mechanism for shareholders of a particular size to be given proxy access, the SEC should also impose a requirement on those shareholders to provide information to the market and to their fellow shareholders with regard to the companies at which they may exercise proxy access. Therefore, we suggest that the Commission mandate that any person holding shares sufficient to meet the requirement for proxy access -- 1% under the Proposal -- be required to publicly identify itself as such on a regular basis.

C. The SEC should address the issue of borrowed shares.

As explained below, the issue of borrowed shares has serious implications for director elections. It can lead to votes being cast by shareholders who have no economic interest in the company and can also result in the same shares being voted more than once. The ability of voters to influence the election of directors without holding an economic stake, as well as the over-voting of shares, seriously undermines the integrity of director elections and should be addressed by the SEC before considering federal proxy access.

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[23] SEC Chairman Mary L. Schapiro, "Testimony Concerning SEC Oversight: Current State and Agenda, July 14, 2009, *available at* http://sec.gov/news/testimony/2009/ts071409mls.htm; *see also* SEC Press Release 2009-165, *SEC Charges Perry Corp. With Disclosure Violations in Vote Buy Scheme*, July 21, 2009, *available at* http://sec.gov/news/press/2009/2009-165.htm (regarding hedge fund failure to disclose beneficial ownership in public company).

1. The practice of borrowed shares results in a separation between voting rights and economic ownership.

The practice of borrowing company stock in order to influence company elections undermines the voting rights of all shareholders. Share lending arrangements, used by institutional investors such as hedge funds, decouple economic ownership of shares from the voting rights of those shares. As Professors Henry Hu and Bernard Black of the University of Texas Law School have explained:

> The assumption that votes are tightly linked to economic interest has become increasingly fragile over the past few years. The derivatives revolution in finance, especially the growth in equity swaps and other privately negotiated ("over the counter" or "OTC") equity derivatives, and related growth in the stock lending market, are making it ever easier and cheaper to decouple economic ownership from voting power. Both company insiders and outside investors can take advantage of this opportunity. Hedge funds, the emblematic opportunistic investors, have been at the vanguard; the rapid growth of hedge fund assets has coincided with the increase in decoupling. Sometimes they hold more votes than shares--a pattern we call "empty voting" because the votes have been emptied of an accompanying economic interest. In an extreme case, an investor can vote despite having *negative* economic ownership, which gives the investor an incentive to vote in ways that *reduce* the company's share price.[24]

Professors Hu and Black underscore the danger of allowing this status quo to persist when they note that "[t]he shareholder vote is a central means by which corporate governance systems constrain managers' discretion over other people's money. The vitality of that constraint, however, depends on a connection between votes and economic interest."[25] Before considering proxy access, the Commission should take steps to ensure that shareholder votes are appropriately aligned with economic interests.

2. The issue of borrowed shares may also result in over-voting of the same shares.

Another problem with empty voting is that it may promote over-voting. Share lending frequently takes place between institutional investors and brokerage firms. A brokerage firm, which holds shares for a beneficial owner, may lend shares to a hedge fund, and the hedge fund may choose to vote. However, because the brokerage firm will not likely notify a beneficial owner that his particular shares were lent, the beneficial shareholder may

[24] Henry T.C. Hu and Bernard Black, "Empty Voting and Hidden (Morphable) Ownership, Taxonomy, Implications, and Reforms," 61 Bus. Law. 1011, 1014 (2006) (*internal citations omitted*).

[25] *Id.* at 1069.

vote his shares as well. Stopping such errors, while possible, is cumbersome and can make the proxy process more time-consuming and expensive than it already is. The problem of over-voting was stated well in a press release from the New York Stock Exchange in 2006. According to Susan L. Merrill, Chief of Enforcement, NYSE Regulation: "Inadequate processing and supervision of customer proxies undermine a fundamental principle of stock ownership." She continued by reminding "member firms that they must ensure that shareholders' votes are not threatened by inattention, careless systems, or insufficient reviews, and that outsourcing of the proxy function does not lessen a firm's responsibilities."[26] The consequences of over-voting are expensive for companies, brokerages, and enforcement bodies. Ensuring that votes cast by shareholders are legitimately cast should be a priority before expanding proxy access rights.

IV. Even If Federal Proxy Access Could Be Supported, the Proposed Rules Would Need to Be Significantly Modified.

For the reasons discussed above, the Company submits that the Commission should decline to adopt Rule 14a-11 as proposed. Instead, the Commission should consider revising its proposed approach to facilitate proxy access through Rule 14a-8. We discuss below specific problems presented by the Proposal.

A. The Proposal has substantive and mechanical problems that need to be addressed before any federal proxy access should be mandated.

We discuss below a number of significant problems we see with proposed Rule 14a-11 that should be addressed in the event a new Rule 14a-11 is adopted in some form.

1. The SEC should reevaluate eligibility requirements in the Proposal.

(a) If Rule 14a-11 is adopted, it should be a default provision with trigger events

Because private ordering should trump a federal proxy access entitlement, any default proxy access regime adopted under Rule 14a-11 should only be available where the company has not adopted its own proxy access provision and a trigger event has occurred. Trigger events that would capture the reasons for applying the default rule include (i) if a company does not already provide for the election of directors by majority vote in uncontested elections, or (ii) if, in the case of a company that provides for the election of directors by majority vote, the board does not accept the resignation of a director that had

[26] NYSE Regulation, Inc. Fines UBS Securities, Goldman Sachs Execution & Clearing, and Credit Suisse Securities (USA) $1.35 Million for Proxy-Handling Violations in Corporate Elections, June 13, 2006, *available at* http://www.nyse.com/press/1150107128723.html. *See also* Memorandum from Grace Vogel, Executive Vice President, Member Firm Regulation, New York Stock Exchange on Supervision of Proxy Activities and Over-Voting, November 5, 2004, *available at* http://apps.nyse.com/commdata/PubInfoMemos.nsf/AllPublishedInfoMemosNyseCom/85256F09007311B485256F3F00645587/$FILE/Microsoft%20Word%20-%20Document%20in%2004-58.pdf.

tendered his or her resignation after failing to receive a majority vote. In each case, the company in question would not already have a by-law in place providing for a company-specific proxy access procedure.

(b) Higher ownership thresholds are in the best interests of shareholders

If Rule 14a-11 is adopted, ownership thresholds must be higher. As currently drafted, for large companies, Rule 14a-11 would allow shareholders or groups owning in the aggregate at least 1% of the outstanding shares to nominate a director. According to the Release, the 1% threshold was chosen so that at most companies there would be at least one shareholder able to invoke proxy access by itself. This threshold level would also encourage activist shareholders with relatively small holdings to combine forces in order to reach the 1% mark and then pursue their own agendas through proxy access.

A better approach would be to establish a minimum ownership level so that, in a substantial number of cases, at least a few significant shareholders would need to work together to submit a nomination. Accordingly, the Commission should provide for a minimum percentage ownership threshold of at least 5% or 10% so that a dissident shareholder would need to convince at least a few other substantial investors to support a campaign, serving as a valuable "testing the waters" function. A dissident shareholder who is unable to attract a few co-sponsors is highly unlikely to be successful with regard to the election of its director nominee, and conducting a proxy contest and the related efforts in connection with that nominee would not be a productive use of company resources. Such a higher threshold would also help prevent contests that might be initiated by a shareholder with a unique political, economic, or other agenda not shared by shareholders at large.

(c) Longer holding periods are in the best interests of shareholders

A period longer than 12 months -- for example, at least two years (as proposed by the SEC in its 2003 proxy proposal) -- would appear to be a more appropriate indication of long-term interest in the context of an entitlement to have nominees included in a company's proxy statement.

(d) Any eligibility requirement should be conditioned on the shareholder owning a net long ownership position during the required time period

In addition to our comments on the specific ownership levels that the SEC should require before allowing proxy access, we cannot emphasize enough the importance of making clear that all eligibility criteria should be conditioned on the nominating shareholder having held a net long position reflecting the required ownership threshold for the requisite period. So-called shareholders who have economically divested themselves of ownership interest in a company, through derivative transactions or otherwise, do not represent the true interests of the company's shareholders and should not be allowed by the SEC to drain resources from the company as they promote their disconnected agendas.

(e) Clarifications regarding continued eligibility of nominating shareholders and director nominees are in the best interests of shareholders

We also submit that the Commission should expressly provide some additional clarifications regarding the continued eligibility of nominating shareholders and director nominees to have access to the company proxy under certain circumstances.

- Companies should be spared the time and expense of accommodating shareholder proponents or their nominees who are not capable of galvanizing substantial support from other shareholders. Therefore, nominating shareholders that have previously proposed for election at any of the previous three annual meetings a nominee who received the support of less than 35% of the votes cast at the meeting should be disqualified. Likewise, nominees proposed for election at any of the previous three annual meetings who received support from less than 35% of the votes cast at the meeting should be disqualified.

- Secondly, companies should not have to include nominees where there is a fundamental question about the honesty, integrity or competence of the nominating shareholder, group or nominee. Therefore, shareholders that have nominated directors pursuant to disclosure that the board has subsequently determined to be materially false or misleading, as well as the nominees who were the subject of such nominations, should be permanently barred from eligibility under Rule 14a-11.

- Finally, if a shareholder or group of shareholders succeeds in having one or more of its nominees elected to the board, that same shareholder or any shareholder in that group should not be eligible to nominate additional directors unless and until the previously nominated and elected directors have left the board.

2. The 25% cap for director nominees is too high.

Rule 14a-11 would require a company to include one shareholder nominee or the number of shareholder nominees equal to 25% of the company's board of directors, whichever is greater. The Commission states in the Release that given the novelty and significance of the rule change, the Commission believes that "it is appropriate to take an incremental approach as a first step and reassess at a later time to determine whether additional changes would be appropriate."[27] In contrast to the high 25% cap proposed, with regard to director actions, state law generally contemplates as a default a majority vote where a quorum is present, which quorum is itself a majority of the entire board. If the 25% cap is

[27] Release, 74 Fed. Reg. at 29,043.

adopted, where only a quorum is present, Rule 14a-11 directors could have a significant, if not controlling, influence on company affairs. The Company therefore suggests, in line with the Commission's stated desire to take an incremental approach, requiring inclusion of a maximum of one shareholder nominee or the number of shareholder nominees equal to 10% of a company's board of directors, whichever is greater. To avoid any ambiguity, the rule should be clarified to say that the 10% cap is with reference to the number of directors sitting during the period in which shareholder proposals under Rule 14a-11 may be received.

The Commission's stated intent is that Rule 14a-11 not become a means of effecting a change of control of a company. To further this purpose, the Company recommends that the number of shareholder nominees that a company must include in its proxy statement pursuant to Rule 14a-11 be reduced under certain circumstances.

- If a solicitation in opposition arises after the mailing of proxy materials including Rule 14a-11 nominees, the company should be able to amend its proxy materials to exclude access nominees.

- Shareholders' director nominees nominated under other procedures pursuant to state law or governing documents should proportionally reduce the number of shareholder nominees that must be included in a proxy statement pursuant to Rule 14a-11.

Without these added changes, directors elected under Rule 14a-11 could easily tip the balance of control of companies who have directors elected as a result of federal proxy nominations.

3. The "first-in" priority standard is not workable.

Rule 14a-11 would give priority to nominating shareholders and groups according to the order in which nominations are received by companies. Many companies, including IBM, have advance notice by-law windows (e.g., 30 days) during which shareholders are permitted to submit proposals. The "first-in" priority standard will likely result in multiple nominations being received in the company's mail on the first day of such windows, and it will be impossible for companies to determine which proposals were received "first" for purposes of the rule. The Proposal provides no guidance on how companies might determine priority in this very likely situation.

A different objective standard for determining priority would be more workable. For example, priority could be given to the shareholder or group with the greatest percentage ownership, or to the eligible shareholder that has held its shares the longest.

4. The SEC should respect companies' reasonable nominee eligibility standards.

As drafted, Rule 14a-11(a)(2) states that companies will not be required to include in their proxy materials nominees whose candidacy or board membership would violate the company's governing documents. This language, on its face, appears to mean that

companies could exclude nominees not meeting minimum director eligibility standards set forth in their governing documents or incorporated by reference therein (for example, criteria relating to levels or years of experience). The Commission's commentary on the rule, however, states that companies will not be permitted to exclude shareholder nominees as a result of their failure to meet eligibility requirements set forth in governing documents that are more restrictive than those established by Rule 14a-11. This ambiguity should be corrected in favor of the right of companies to prescribe reasonable director eligibility standards that any nominees -- whether shareholder nominees or board nominees -- must meet.[28]

More fundamentally, nominating committees establish minimum eligibility thresholds with a view to selecting directors who can best serve the interests of companies and their shareholders. The Commission should respect the exercise of this business judgment, which is consistent with state law. Allowing shareholders to propose nominees not meeting company-established director eligibility thresholds would preempt state law and favor the wishes of a constituency that does not bear the fiduciary duties of nominating committees and boards.[29]

Furthermore, proposed Schedule 14N requires a representation from nominating shareholders or groups that the nominee meets the objective criteria for independence of the applicable national securities exchange. The Commission must go further by allowing companies to exclude shareholder nominees determined by the company's board not to be independent under company's independence standards established in accordance with the stock exchange rules. While Rule 14a-11 would create an additional process for proposing director nominees, it does not follow that nominating committees and boards should be precluded from applying the same considerations regarding independence to Rule 14a-11 nominees that they do in respect of nominees proposed by management and other shareholders.

5. <u>The SEC should reevaluate the disclosure requirements in the Proposal.</u>

Certain additional disclosures, many related to the foregoing discussion, should be required of both nominating shareholders or groups and nominees themselves.

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[28] One of the arguments the Commission looks to in support of not proposing limitations on the nature of the relationships between nominating shareholders or groups and director nominees is that it would be unfair to subject shareholder nominees for director to a different standard than board nominees. *Id.* at 29,042. This reasoning, however, supports not overriding the power companies have under state law to prescribe reasonable eligibility requirements for all directors, whether nominated by the board or by shareholders.

[29] We also note that there has been concern in the investor and corporate communities for several years about so-called "overboarding" -- when a director serves on more than an optimal number of boards -- and it would be incongruous if Rule 14a-11 were allowed to operate such that companies that have taken steps to disqualify overboarded directors found those efforts circumvented by shareholders who could directly nominate directors not meeting those standards.

(a) Nominees should provide the following additional disclosures

- Representation that the nominee's election would not violate state or federal law or applicable independence standards set by the relevant national securities exchange.

- Representation that the nominee will provide the company on a timely basis with all requested information necessary to assess independence, to assess compliance with applicable laws, and to make necessary related-party transaction disclosures.

- Representation that the nominee has not entered into any agreements with any third parties regarding the nomination.

- Representation that the nominee is not controlled by the nominating shareholder or group.

(b) Proponents should provide the following additional disclosures

- Disclosure about any agreements or relationships with the Rule 14a-11 nominee other than those relating to the nomination of the nominee.

- Representation that the proponent will continue to hold the required net long position during the nominee's initial term, if elected, and that the holdings of such shareholder or group will not exceed 20% of the company's voting securities during that period.

- Representations that proponents will not (i) nominate any candidates for directors other than those named in their own Schedule 14N, (ii) engage in solicitations in support of any shareholder-nominated candidates not named in their own Schedule 14N, or (iii) distribute a form of proxy other than the company's.

- Representation that the proponent has not entered into any agreements with any third parties regarding the nomination.

- Representation that the nominee is not controlled by the proponent.

6. The Proposal should not allow secondary nominations by shareholders.

The determination by a company that a nominating shareholder or group or nominee is ineligible, or the withdrawal of a nominee, should not open the door to other nominations during that proxy season, whether from the same nominating shareholder or other nominating shareholders or groups. In such circumstances, the time in which to consider other nominations and to seek no-action relief will likely be significantly compressed. Requiring companies to consider secondary nominations would constitute an undue burden on company resources, and, very likely, Commission resources. The Proposal should therefore clarify that a company will not be required to consider a second nominator's proposal under Rule 14a-11 in the event of ineligibility or withdrawal.

V. Rather Than Adopting Rule 14a-11, the SEC Should Amend Rule 14a-8 to Allow Companies and Their Shareholders to Craft the Proxy Access Regime Appropriate to Their Own Circumstances.

While we believe it would be inappropriate to adopt a one-size-fits-all proxy access rule as contemplated by proposed Rule 14a-11, we believe the SEC would achieve its stated goal of fostering greater shareholder participation in director elections through amendment of Rule 14a-8. This approach could incentivize companies and their shareholders to work together for purposes of adopting company-specific access by-laws that are reasonably tailored to the needs of a company and its shareholders alike. We see several key revisions that the Commission would need to make to its proposal, however, if these goals are to be met.

A. Companies should be able to adopt their own proxy access provisions prior to or absent any shareholder proposals for such under Rule 14a-8(i)(8).

Although on its most basic terms, Rule 14a-8(i)(8) contemplates a shareholder-driven process by which proxy access would become part of a company's governing documents, we also believe that companies should be able to amend their by-laws to provide proxy access even *without* a shareholder proposal having been submitted. That exercise of corporate authority must be respected, and we would urge the Commission to acknowledge this fact in any rule amendments it adopts.

If a subsequent shareholder proposal, or a continuous series of shareholder proposals, could overrule the standards already adopted at the company, private ordering along with simple business functions at the company could be seriously undermined. Accordingly, we would urge the Commission to put appropriate safeguards in place against such a possibility. It seems to us that the right answer to these competing pressures is to establish a high, but not unreasonably high, threshold for shareholder proposals to modify an existing set of proxy access provisions in place at a company. For example, the Commission might consider increasing the ownership standards required for such proposals.

B. The Commission should reconsider and revise the proposed eligibility standards for Rule 14a-8(i)(8).

We also believe the Commission needs to consider seriously what the appropriate eligibility requirements are even for an initial proxy access proposal under a revised Rule 14a-8(i)(8). The considered process of private ordering that a revised rule could provide would be undermined if companies were required to include virtually any such proposal in their proxy statements, since the devotion of substantial time and expense will be required to address even those proposals that are frivolous.

- The SEC should set the share ownership requirements for a final Rule 14a-8(i)(8) substantially higher than the current ownership threshold under Rule 14a-8(b). The current ownership thresholds -- continuously holding at least $2,000 in market value or 1% of a company's voting securities for a year as of the date of the proposal -- are too low for a matter of this magnitude.

  Higher ownership thresholds, of both amount of stock and duration of ownership, would compel companies to seriously consider the views of significant shareholders, including those below the threshold but capable of aggregating their holdings to meet it. Such standards would, however, also lessen the potential threat of perennial proposals providing for virtually no restrictions on access to the company's proxy statement.

- Another alternative would be to impose a higher threshold for shareholder proposals that are binding in nature (*e.g.*, a binding proposal for a by-law amendment to provide for proxy access) as opposed to those that are precatory.

- Proponents must have economic risk as well as legal ownership claims. In our opinion, the Commission's rationale that a federal guarantee of direct access under proposed Rule 14a-11 should only be available to "holders of a significant, long-term interest in a company"[30] also applies in the context of amending Rule 14a-8(i)(8), as the Commission acknowledged in 2007 in its unadopted Release No. 34-56160.[31] The opportunity to alter a company's governance structure should only be available to significant shareholders that are in fact residual risk-bearers of the company. Therefore, shareholders that have reduced their economic exposure below the required ownership thresholds should not be able to avail themselves of Rule 14a-8(i)(8). Shareholders should

[30] Release, 74 Fed. Reg. at 29,035.

[31] SEC Release No. 34-56160, *Shareholder Proposals*, August 3, 2007, 72 Fed. Reg. 43472.

have to certify that they have held net long positions for the required period in an amount of securities meeting the required ownership threshold in order to be able to make proposals under Rule 14a-8(i)(8).

- Eligibility should be further restricted by allowing companies to disqualify proponents that have submitted a by-law amendment proposal at any of the previous three annual meetings that has received less than 35% shareholder support. Companies should not have to include proposals from shareholders that in the recent past have shown an inability to muster significant shareholder support. Just as companies should be incentivized to consult their constituents in order to arrive at reasonable access by-laws, so should shareholders be required, in making counterproposals, to demonstrate to fellow shareholders that their counterproposals will further a company's interests.

VI. A 60-Day Comment Period Is Not Long Enough for a Matter of This Magnitude.

Aside from the substance of the Proposal, we note that a 60-day public comment period is far too short for such a weighty matter as proxy access, particularly a proposal that is so far-reaching compared to the Commission's prior proposals in this area. The Commission notes that it has been grappling with these issues for almost 70 years, including several aborted rulemaking efforts in the past decade alone. Moreover, the complexity of the issues is so great that the Commission did not publish the Release until almost one month after the Open Meeting at which the Commissioners voted to issue the Proposal. The Federal Administrative Procedures Act (5 U.S.C. Section 553) requires that "interested persons" be provided the opportunity to participate in a proposed rule making through the submission of written data, views or arguments. Clearly that opportunity would be meaningless if the duration of the comment period is not sufficient to allow thoughtful consideration and analysis of the myriad complicated and significant issues raised by the Proposal, as well as a reasonable opportunity to gather appropriate data and submit written comments explaining views or arguments intended to assist the Commission.

While IBM has the resources and ability to submit this comment letter within the prescribed period set forth by the Commission, we believe that a 60-day period during the summer is inadequate for other, smaller institutions and groups to provide meaningful input on a 250-page release that poses over 500 questions. We believe it is essential that all voices be heard when the Commission is attempting to move forward on a matter like proxy access. We therefore join others in urging the Commission to extend significantly the public comment period for the Proposal.

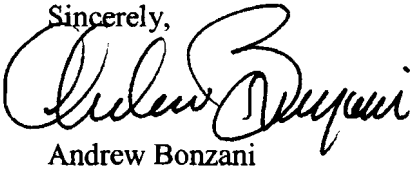
VII. Conclusion.

In summary, while we recognize the complexity of the issues and the serious public attention that has recently been given to matters concerning corporate proxies, we do not believe that the Proposal represents an appropriate resolution of the issues before the Commission. In our opinion, the Proposal fails to respect the important and effective role played by the states in matters of director elections, and it does not give adequate consideration to recent and important developments in corporate governance at American public companies. Rule 14a-11 as proposed would create a one-size-fits-all federal mandate in an area better left to the states, where companies and shareholders alike can craft proxy access regimes that are best suited to their particular facts and circumstances. We urge the Commission not to adopt Rule 14a-11. Instead, the Commission should amend Rule 14a-8 to allow private ordering by individual companies and their shareholders.

We also are very concerned about a number of proxy related matters that the Commission did not address in the Release -- including the role of proxy advisory firms, NOBO/OBO shareholder designations, and the serious problems posed by share borrowing. We urge the Commission to address these matters before moving forward on the question of federal proxy access.

As the Commission proceeds with its next steps, we would be pleased to discuss with the Commission or its staff any questions you might have about this letter or to provide you with any other assistance. Please feel free to contact me at 914-499-6118.

Sincerely,



Andrew Bonzani
Vice President, Assistant General
Counsel and Secretary

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