State of Connecticut

DENISE L. NAPPIER
TREASURER

Hartford

August 17, 2009

Via Email

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F St. N.E., Washington D.C. 20549-1090

Re: Facilitating Shareholder Director Nominations (File No. S7-10-09)

Dear Ms. Murphy:

As principal fiduciary of the $20 billion Connecticut Retirement Plans and Trust Funds ("CRPTF"), I am writing to comment on the Commission's Proposed Rule *Facilitating Shareholder Director Nominations* (the "Proposed Rule"). I strongly support the Proposed Rule with some clarifications and commend the Commission for taking steps to make shareholder proxy access a fundamental right. The Proposed Rule will increase the accountability of corporate boards to shareholders, thereby improving the quality of decision making, and help restore investor confidence in our markets.

I have always supported giving significant long term shareholders the right to nominate directors using a company's proxy card, known as shareholder access to the proxy. Electing the board of directors is the most important stock ownership right that shareholders can exercise. However, that right can be weakened almost to the point of no use when director nominees are controlled by the board itself, and in many cases *de facto* controlled by management—the CEO.

During the past year we have seen many corporate boards making significant changes in their membership. These changes did not occur in an election by shareholders. Rather, it has been the federal government that has forced the board shake up at companies such as AIG, Bank of America, Citigroup, General Motors, and others. Shareholders should not have to sit on the sidelines and watch underperforming board members being replaced only after the damage has been done and shareholder value has been lost.

Attached are my comments on the Proposed Rule. In addition, as a member of the Council of Institutional Investors, I would like to associate myself with the detailed comments they have submitted.

One issue I will also highlight concerns the requirement for continuous ownership in the context of share lending. Our pension fund derives significant income for our beneficiaries from our share lending program. When we lend shares we retain the economic interest in the company—and will continue to hold the shares after they are returned. We are long term investors, with long term interests in these companies. To recognize this, we recommend that the rule clarify that continuous ownership be defined as including shares on loan where there is a contractual obligation that those shares will be returned, and an intention that they continue to be held.

I appreciate the opportunity to express my views on this matter to the Commission. Please feel free to contact Assistant Treasurer for Policy Meredith Miller with any questions at (860) 702-3294 or meredith.miller@ct.gov .

Sincerely,

Denise

Denise L. Nappier
State Treasurer

Attachment

Comments of Connecticut State Treasurer Denise L. Nappier
Facilitating Shareholder Director Nominations (File No. S7-10-09)

The CRPTF's Track Record of Promoting Board Accountability Reforms

Consistent with the premise that a well-functioning, high-quality board can enhance corporate performance, the $20 billion Connecticut Retirement Plans and Trust Funds ("CRPTF") has pressed over the past ten years for reforms designed to promote more independent, accountable boards. In some cases, these reforms have been pursued on a company-by-company basis through the shareholder resolution process. For example, the CRPTF's shareholder proposal to the Walt Disney Company spurred that company to separate the chairman and CEO roles in 2004. And in 2007, the CRPTF co-sponsored a shareholder proposal advocating a proxy access procedure at Hewlett-Packard Co., overcoming a company effort to keep the proposal off the ballot; the proposal was supported by 43% of shares voted.

Another way the CRPTF has pursued corporate governance reforms has been by urging the Commission to empower shareholders to oversee their investments. The CRPTF's comments on this rule are similar to comments submitted by the CRPTF to the Commission in support of other regulatory reforms aimed at improving corporate boards. In 2003, the CRPTF submitted a comment supportive of the Commission's rulemaking—later abandoned—seeking to establish a proxy access process, although the CRPTF and a number of other public fund fiduciaries were critical of onerous requirements imposed on shareholders seeking to use the rule. In 2007, Connecticut Treasury staff joined other institutional investors in separate meetings with three Commission members (including then Chairman Christopher Cox) and testified before the House Committee on Financial Services in support of proxy access. The CRPTF also opposed the Commission's proposal which was ultimately adopted, which amended the shareholder proposal rule to allow exclusion of proxy access shareholder proposals.

The Case for Shareholder Access to the Proxy

Shareholders in large public corporations depend on the board of directors to work on shareholders' behalf by overseeing strategic decision making and by holding management accountable. The right to vote for the directors who carry out this function goes hand in hand with the right to nominate director candidates; the relationship between these two rights has been recognized in case law from key corporate law jurisdictions such as Delaware.

But where voting is carried out by proxy prior to the meeting of shareholders, nominating candidates cannot be accomplished by showing up at the meeting and persuading other shareholders to vote for alternative nominees. Under the current system, a shareholder must bear the costs of distributing a separate proxy statement and card to shareholders in advance of the meeting and tabulating the results. As well, the shareholder is responsible for the many kinds of expenses—printing, mailing, legal, advertising, public relations and solicitation—associated with ensuring legal compliance and conducting outreach to other shareholders voting by proxy.

It is thus unsurprising that director challenges that are not part of a contest for control are rare. A 2003 study by Lucian Bebchuk found that only 77 contests focused on who should serve on the board of a stand-alone firm were waged between 1996 and 2002. Of those, 10 occurred at firms with market capitalizations in excess of $200 million.[1]

The net result of the barriers created by the system of proxy voting and the proxy rules themselves is to make directors virtually impossible to replace. Such extreme job security for directors, especially when coupled with social norms encouraging consensus and the continuing role of the CEO in selecting directors, translates into reduced accountability to shareholders.

This lack of accountability is costly to shareholders. Recent years have seen tremendous destruction of shareholder value by companies whose boards of directors failed to discharge their oversight responsibilities. Among other things, boards allowed managements to pursue overly risky business strategies, permitted misleading accounting, and adopted compensation policies that encouraged executives to focus too much on short-term performance.

Giving significant long-term shareholders access to the company proxy statement to nominate directors would promote greater board accountability to shareholders and improve corporate performance. Opponents of proxy access have argued that existing corporate governance mechanisms can address board accountability concerns. They point to independent nominating committees of the board and majority voting for director elections as two such avenues.

However neither independent nominating committees nor majority voting in director elections are adequate substitutes for shareholder access to the proxy. Independence does not necessarily mean that a director will be accountable to shareholders, or that a committee will necessarily select a nominee who will be accountable; even if it did, the independence definitions currently in use are sufficiently permeable that some directors who are not able to faithfully represent shareholder interests because of some relationship with the company or its management will slip through the cracks. Majority voting, while useful in sending a negative message to the board, has no utility when it comes to promoting alternative shareholder-focused candidates.

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[1] Lucian A. Bebchuk, "The Case for Shareholder Access to the Ballot," 59 Business Lawyer 43, (2003).

Some commenters have favored a company-by-company approach to proxy access in lieu of a market-wide access procedure.[2] While the CRPTF has pursued a company-specific approach in the past at Hewlett Packard, a uniform federal rule is superior.

Most institutional investors' holdings of U.S. equity securities are very well-diversified. As a result, in a world where each company adopted its own version of proxy access, such investors would face enormous administrative burdens in keeping track of and using many different proxy access schemes.

Moreover, the companies that need proxy access the most are least likely to adopt it without a fight. Some such companies have or would adopt supermajority requirements to amend the bylaws, and could even, if incorporated in some states, eliminate altogether shareholders' right to amend the bylaws to implement proxy access. Companies could also use litigation to tie up proxy access proposals and impose additional costs on proponents. Ultimately, this process would be time-consuming and inefficient.

The Proposed Rule

In drafting the Commission's Proposed Rule, *Facilitating Shareholder Director Nominations* (the "Proposed Rule"), the Commission has done a commendable job crafting a procedure that will facilitate shareholder nominations at the same time as it deters frivolous nominations and avoids imposing excessive burdens on companies.

The Proposed Rule should apply to all public companies with a class of registered equity securities. Because the Proposed Rule will be used infrequently and would primarily operate in the background when companies and shareholders engage on board-related matters, the costs it imposes will not be substantial.[3] It is not the case that smaller companies are less likely to have dysfunctional boards than larger companies; indeed, the higher incidence of majority voting at larger companies suggests that smaller companies may lag in this area. The Commission should not exempt or delay implementation for smaller companies.

The Commission's 2003 proposed access rule required that a "triggering event" occur before shareholders gained access to a company's proxy materials. Those triggering events involved the approval of a shareholder proposal granting access or the registering of a "withhold" vote of at least 35% against one or more directors. Proxy access would then have been available at the annual meeting following the occurrence of the triggering event.

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[2] See, e.g., "Comment of the Delaware State Bar Association filed on July 24, 2009," at 2 (arguing that a federal rule would "unnecessarily deprive Delaware corporations of the flexibility state law confers to deal effectively with myriad different circumstances that legislators and rulemakers cannot anticipate . . . .").

[3] See "Comment of International Corporate Governance Network filed on July 15, 2009" (noting that it is rare for UK shareholders to use their rights to bring proposals and to call a special shareholders' meeting).

In the release containing the Proposed Rule, the Commission asked whether triggering events should be required now. As the CRPTF commented in 2003, triggering events create additional delay; it generally would have caused a year to elapse between the triggering event and the election at which proxy access would be available. Such delay could cause additional loss of value at an already-troubled company.

The triggering events themselves would add significant complexity to the rulemaking. Issues related to establishing, updating and interpreting the triggering events would need to be resolved throughout the life of an access rule. The Proxy Access Rule should operate without triggering events.

The Proposed Rule uses a graduated ownership threshold in which proxy access is available at lower percentage ownership levels as company size increases. For companies that are non-accelerated filers, a shareholder (or group) must own 5% of outstanding shares; at accelerated and large accelerated filers, the thresholds are 3% and 1%, respectively.

A 5% threshold would be challenging for long-term shareholders like the CRPTF to satisfy because they are heavily indexed and thus holdings of stock in any particular U.S. company will likely be under 1%. Applying a 5% threshold only to smaller companies is acceptable; however, because such companies tend to have more concentrated ownership, shareholders should be allowed to join with other shareholders in order to meet the threshold. Regardless, the Commission should permit aggregation of holdings; not doing so will allow the Proposed Rule to be used almost exclusively by hedge funds.

The one-year holding period is long enough to ensure that the Proposed Rule benefits only those with a real interest in a company's long-term performance. An even longer holding period, such as the two-year period found in the Council of Institutional Investors' policy on proxy access, would be acceptable as well.

The Commission should clarify the Proposed Rule in two respects to reflect the realities of share ownership by institutional investors.

First, the Commission should specify that the lowest number of shares held by a nominating shareholder or each member of the a shareholder group during the one-year period will be used to calculate the percentage of securities owned and entitled to vote on the election of directors for purposes of the eligibility threshold. This baseline is easy to calculate and to maintain during the period leading up to the annual meeting. The shareholder or each member of the group would then be required to represent that it will hold no less than that amount through the date of the annual meeting.

Second, shareholders or each group member should be allowed to include shares that have been loaned to a third party, so long as the participant represents that it has the legal right to recall those shares for voting purposes, will vote the shares at the shareholder meeting, and will hold those shares through the date of the meeting. A shareholder may, consistent with its fiduciary obligations, lend shares to third parties, while retaining the right to recall and vote those shares. Loaned shares should be counted as belonging to a nominating shareowner if the conditions outlined above are met.

Finally, the Proposed Rule would use a first-in-time approach to resolving competing claims to use the proxy access procedure at a given company. This approach would lend itself to opportunism of the type that has occurred in the shareholder proposal context, where certain proponents whose interests may not be well aligned with most other shareholders submit proposals the day after the annual meeting for presentation at the following year's meeting. Instead, the Commission should follow the approach it used in its 2003 rulemaking, which gave preference to the shareholder or group with the largest holdings.

Proposed Amendments to the Shareholder Proposal Rule

The Proposed Rule would amend the Election Exclusion to permit shareholders to submit proposals addressing proxy access pursuant to Rule 14a-8. Allowing generic proposals that would establish a proxy access regime for future elections gives fullest expression to shareholders' state-law rights to bring proposals and amend corporate by-laws and is thus consistent with the Commission's own stated objective of facilitating state-law governance rights. Moreover, letting shareholders set these kinds of procedural rules for future elections makes sense because, more than either the board or management, shareholders have the strongest interest in how corporate elections are conducted.

In all likelihood, shareholders will benefit from the revised Election Exclusion infrequently if the basic access procedure outlined in the Proposed Rule is adopted. There are certainly times, though, when shareholders will wish to create a more expansive proxy access procedure at a company. For example, at a large accelerated filer, the pattern of institutional holdings, combined perhaps with a lack of responsiveness on the part of the board, might convince shareholders that the 1% ownership threshold is too high and should be lowered.

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