In my opinion there is no good reason under the U.S. system of corporate governance why shareholders may vote on directors, but not have a meaningful ability to participate in the director- nomination process. It is within the jurisdiction of the Commission and commendable that it seeks through these proposed rules to facilitate communications among shareholders by providing a method by which shareholder nominations may be practically brought to the attention of other shareholders. It is only through the proxy process that shareholders of public companies can effectively exercise their fundamental right to elect directors. The U.S. system of corporate governance has never endorsed a system of self-perpetuating boards of directors, but has relied on the shareholders’ election of directors to provide a measure of corporate accountability. And that accountability is sorely needed considering the financial crisis and recurring corporate scandals.

I set forth below my views on a number of questions raised by the Commission’s release on facilitating shareholder director nominees.

Long-term shareholders and disclosures. The research I am currently doing on short termism and the public shareholder confirms the philosophy of the Commission in focusing eligibility on long-term shareholders or groups of shareholders because they are “less likely to use the rule solely for short-term gain.” However, my research indicates that it is transient institutions that should be ineligible to use the proposed nomination process. There is a burgeoning literature regarding the effect of transient institutional ownership on markets, earnings management and corporate misreporting. Unfortunately, the ownership-duration limit

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proposed by the Commission will not necessarily exclude transient institutions from using the proposed nomination process. A typical transient institution, for example, may hold 25% of its portfolio stock for two years, but turn over 70% of its portfolio each quarter. In addition, the proposed-duration requirement would permit transient momentum traders who have high trading sensitivity to current earnings news to make nominations under the proposed rules. In my opinion the eligibility criteria should, therefore, include eligibility tests that take into account portfolio turnover and momentum trading strategies of nominating institutions. In any event


2 Bushee, The Right Investors, supra note 1, at 30 (2004) (Table 1).

3 Bushee, R & D Investment Behavior, supra note 1, at 325-326.

4 Bushee, The Right Investors, supra note 1, at 30 (2004) (Table 1) (calculating portfolio turnover by dividing the market value of sales by the beginning total portfolio market value).
the Commission should amend its disclosure rules concerning nominating institutions to require the disclosure of these material facts to shareholders.  

**Significance of recent developments in corporate governance.** The developments in corporate governance in recent years, while important to the shareholder franchise do not adequately substitute for the nomination process provided in the proposed rules. There is no reason why shareholders who have the affirmative right to elect directors should be limited to the negative option of opposing board candidates through majority voting or “just say no” campaigns. These negative options relegate shareholders to the status of supplicants seeking to influence indirectly the choice of director nominees. Moreover, it is too soon to tell what effect other developments in corporate governance, such as the possibility of election-cost reimbursements and bylaw-nomination provisions, will have. At this time they do provide a meaningful substitute for the Commission’s proposed nomination process.

**Importance of diverse perspectives to the functioning of corporate boards.** While opponents of the Commission’s proposed rules are concerned with the “disruption” of the functioning of the board by the inclusion of shareholder nominees, it is important to acknowledge the failings of many boards of directors in monitoring their companies. The monitoring role of boards of directors is furthered by diversity of perspectives on corporate boards which “may promote the airing of different perspectives and reduce the probability of complacency and narrow mindedness in a board’s evaluation of executive proposals.” Such a

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5 Bushee, *R & D Investment Behavior, supra* note 1, at 324-326 (considering three variables to measure the institution’s trading sensitivity to current earnings: “the interaction between changes in an institution’s holdings in a firm over a quarter and that firm’s seasonal change in quarterly earnings announced during the quarter”; “the difference between the average earnings change of firms in which the institution increased its holdings and the average earnings change of firms in which the institution reduced its holdings”; and “the difference between the total change in holdings of firms with positive earnings changes and the total change in holdings of firms with negative earnings changes.”

6 The ownership duration requirement of one year also does not seem long enough even though the average holding period of stock has declined, from two years in 1993 to seven and one-half months in 2007. Yvan Allaire & Mihaela E. Firsiotu, *Hedge Funds as Activist Shareholders: Passing Phenomenon or Grave-Diggers of Public Corporations*, http://ssrn.com/sol13/papers.cfm?abstract_id=961828 (2007). A holding period of eighteen months seems more appropriate given the intent of the proposed eligibility requirements to empower long-term investors and discourage the use of the proposed nomination process for short-term profit-making purposes.

7 This section responds to Request for Comment A.8.

board can produce a wider range of solutions for problems and decision criteria for evaluating corporate strategies. In addition, diverse perspectives on corporate boards can improve board functioning by mitigating conformity pressures among board members, the polarization phenomena, and improving the quality of decision making and information gathering and processing by boards of directors. Normative and informational influences on board members engender conformity among board members which are diminished by a board member’s identification with outside shareholders and his dependence on outside shareholders for his nomination. The group polarization phenomena is also diminished. This phenomena may lead to boards gravitating towards more risky decisions as seen in the recent financial crisis. Group polarization is “the tendency for groups to take more extreme positions following group discussion than the position originally held by individual members.” The degree of initial consensus in the group affects the polarization dynamic. That is, “group polarization represents intensification of preexisting initial group preferences.” Diversity in groups decreases polarization by depolarizing attitudes and opinions of the group through disagreements that create “ambiguity as to the correctness and social desirability” of initial inclinations of group members.

Diversity of perspectives on corporate boards also serves to improve informational processes on boards. It counters the distortion of informational search processes caused by the confirmation bias where group members tend to seek information that confirms their initial opinions and also caused by the inclination of group members to focus on information they

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11 Dallas, *New Managerialism, supra note 7*, at 1401-1402.


13 Baron et al., *supra* note 10, at 73; see also Dallas, *New Managerialism, supra note 7*, at 1401.

14 Williams & Taormina, *supra* note 10, at 203 (finding that groups composed of members who initially unanimously agreed were more extreme than groups in which only a majority of the group initially agreed); see also Dallas, *New Managerialism, supra note 7*, at 1401-1402.

have in common which limits the information considered by the group.\textsuperscript{16} Diverse groups are also less prone to overconfidence which refers to unrealistic optimism in understanding risk-related facts,\textsuperscript{17} which implicates board decision making that contributed to the recent financial crisis. Moreover, diversity in groups has been shown to increase the quality of decision making when decisions involve matters of judgment and creative decision making which are the kinds of decisions made by corporate boards of directors.\textsuperscript{18} Cognitive conflict is said to explain this finding: diverse groups share conflicting opinions, knowledge, and perspectives that result in a more thorough consideration of a wide range of interpretations, alternatives and consequences.\textsuperscript{19}

Diversity can also diminish the possibility of boards becoming out of touch with the constituencies they serve. It counters the “false consensus effect”, in which people view their “own knowledge, beliefs, attitudes and actions as more representative of those of others than they really are.”\textsuperscript{20} Many shareholders were not pleased with the risks their companies took, although these risks were often willingly assumed for them by corporate executives.

\textbf{Maximum number of director nominees.} I recommend that shareholders be permitted to nominate “two” directors or “one third” of the board, whichever is greater, under the proposed rules. Research on social influences indicates that a group member will often not express a solution even when it is verifiably correct, unless at least one other person in the group agrees


\textsuperscript{16} Dallas, New Managerialism, supra note 7, at 1396; Schulz-Hardt et al., supra note 13, at 656 (citing F.C. Brodbeck et al., The Dissemination of Critical Unshared Information in Decision-Making Groups: The Effect of Prediscussion Dissent, 32 European Journal of Social Psychology 35 (2002)).

\textsuperscript{17} Dallas, New Managerialism, supra note 6, at 1403; Janet A. Sniezek, Groups Under Uncertainty: An Examination of Confidence in Group Decision Making, 53 Organizational Behavior & Human Decision Processes 124, 149 (1992)(finding “a decrease in confidence but an improvement in decision quality if there is variance in the information held by group members [heterogeneity] and all information is shared and processed”).

\textsuperscript{18} Dallas, New Managerialism, supra note 7, at 1363, 1391-1392 n.129 & 130, 1399-1400( citing studies).

\textsuperscript{19} Dallas, supra note 7, at 1391.

\textsuperscript{20} Raymond S. Nickerson, How We Know – And Sometimes Misjudge – What Others Know: Imputing One’s Own Knowledge to Others, 124 Psychological Bulletin 737, 747-50 (1999); see also Dallas, supra note 7, at 1392, note 131. For a discussion of the egocentrism bias which is a tendency to overestimate that one’s own perspectives and knowledge is shared by others, see Nicherson, supra this note, at 738-741; Dallas, supra note 7, at 1402.
with his/her solution. This finding suggests that a critical mass of at least two like-minded group members is necessary to overcome group socio-psychological influences and to encourage the use of expertise. Moreover, the tendency of groups to search out information confirming the majority viewpoint (rather than searching out information which may raise questions about its wisdom) is more likely when the minority is small relative to the majority. The rounding down of the number of directors that shareholders may nominate also suggests that a one-third rule is more appropriate. For companies with nine directors, which is the average number of directors on boards of U.S. public companies, the shareholders would be able to nominate three of those directors under this proposed rule change.

Degree of flexibility in proposed rules and disclosures. Whether the Commission’s proposed nomination process would prevail, if challenged, in the face of an inconsistent company nomination bylaw or state-enacted nomination process raises difficult jurisdictional issues. My recommendation is for the Commission to provide for a flexible rule that permits companies and states to modify the nomination process to make it easier – or more difficult – for shareholders to make nominations. I recommend that the Commission make this flexible rule subject to a future study of the impact on investors of any modifications of the proposed nomination process based on a study of actions actually taken by companies and states. In the meantime a description of any modifications in the proposed nomination process, including how it differs from the proposed process, should be prominently displayed in the company’s proxy statement along with disclosure of any method that shareholders may use to change the modified process. In addition, the proposed disclosure rules regarding nominating shareholders and nominees should remain applicable. My main reason for recommending a flexible rule to the Commission is so that the proposed rules may become operational and not become tied up in the court system and other future uncertainties.

Statement of intent to hold stock after the election. I am in favor of this requirement. In my opinion this requirement seeks to address the situation where the nominating shareholder is interested in facilitating changes at the company but plans to take the money and run once those changes are made. In this situation there would appear to be a high probability that the changes this nominating shareholders favors would not serve the long term interests of the company.

Economic stake: Net long provision, individual shareholder eligibility criteria, and eligibility criteria for shareholders of non-accelerated filers. In my view the proposed rule should calculate the 1% ownership requirement based on net-long positions to assure the desired economic stake in the corporation. In addition, in my opinion the Commission should adopt different eligibility requirements for individual shareholders. It is much harder for an individual shareholder to achieve the share ownership that institutions achieve by aggregating the funds of

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21 Susan E. Jackson, Consequences of Group Composition for the Interpersonal Dynamics of Strategic Issue Processing, 8 Advances in Strategic Management 345, 357 (1992); Dallas, supra note 7, at 1394.

22 Schultz-Hardt et al., supra note 13, at 656.
many investors. Moreover, one percent of a company’s stock will most likely constitute a much higher percentage of an individual shareholder’s wealth than that of an institution.\(^{23}\) I propose that an individual shareholder or group of individual shareholders be able to use the proposed nomination process if they own either some dollar value of shares, such as $250,000, or some lower percentage of shares, such as .25%.\(^{24}\) Lastly, I believe that the ownership requirement for shareholders of non-accelerated filers is too high considering the size of these filers and the facts set forth in the Commission’s release: Depending on the database used, from forty-one to fifty-nine percent of non-accelerated filers have no shareholder that meets the ownership-eligibility threshold; and twenty-nine to fifty-one percent of them do not have two or more shareholders that each meet one-half of the ownership-eligibility threshold.

*First-in standard.* In my view a specific range of two weeks (adequately publicized) should be provided for a shareholder to submit nominations which would simplify the process and allow nomination slots to be allocated based on aggregate length of ownership and/or ownership amount.

*Miscellaneous provisions.* Given the importance of the nomination process, in my opinion nominating shareholders should be entitled to include supporting statements consisting of 1000 words. Prompt communications between the company and nominating shareholder (that are required by the proposed rule) should be facilitated by requiring mailings for next day delivery or both ordinary mailings and e-mail transmissions.

Thank you for the opportunity to comment on the Commission’s proposed rules.

Respectfully submitted,

Professor Lynne L. Dallas

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\(^{23}\) When motivation to further the well being of the company is considered, it is the percentage of wealth of an individual or institution that is invested in a particular company’s stock that matters. Criteria based on a wealth test, however, would probably be too complex and costly to administer.

\(^{24}\) Of course, this provision would not apply to individual shareholders who are affiliated with or acting on behalf of institutions.