CORPORATE GOVERNANCE

August 17, 2009 VIA EMAIL: Rule-Comments@SEC.gov

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F St. NE
Washington DC 20549-1090

Re: *File No. S7-10-09 Release No. 34-60089, Facilitating Shareholder Director Nominations: Support with Amendments*

Dear Ms. Murphy:

This is in response to the Commission's invitation to comment on the above referenced proposed rules that would, subject to a variety of conditions, require companies to include in their proxy materials shareowners nominees for election to corporate boards. The proposed rules would also amend the shareowner proposal rules to permit proposals related to such nominations. This response supplements a letter I co-signed with Robert Monks, John Harrington, John Chevedden, Glyn Holton and others under letterhead of the United States Proxy Exchange.

About Me

I am the publisher of CorpGov.net (http://www.corpgov.net) and PERSWatch.net (http://perswatch.net). Both focus on the need for director accountability. CorpGov.net is aimed at helping individual and institutional investors ensure that corporate directors can be held accountable by long-term investors and that corporations tap the sustainable wealth generating capacity of employees, customers and investors. PERSWatch.net is aimed at ensuring fair elections and the highest ethical standards at the California Public Employees Retirement System (CalPERS) to ensure good governance also applies to the nation's largest pension fund. Additionally, I am a consultant on corporate governance and an active individual investor in a long list of companies, having filed many proxy resolutions.

Background on Proxy Access Issue

The framework of corporate law, much of which developed in reaction to the stock market crash of 1929, restored public confidence by separating or limiting the power of bankers, insurance companies and mutual funds. They also gave broad powers to the SEC to develop rules "under which proxies may be solicited with a view to preventing the recurrence of abuses which have frustrated the free exercise of the voting rights of stockholders."

Although the framework subsequently developed has the appearance of being democratic (one share, one vote), it lacks the basic mechanisms to provide anything more than a mere illusion. Shareowners are nominally empowered to elect directors to oversee management but lack any right to participate in the nomination of candidates. While the corporation laws of every state solemnly recite that shareowners elect the board of directors, each year shareowners are asked to participate in an exercise which bears little resemblance to the word "election" as commonly used in any democratic country.

Shareowners are free to vote but generally have no real choice in the election of directors. Even if an overwhelming majority opposes a corporate sponsored nominee, that person will serve as director, unless an expensive proxy contest is undertaken. The real election for directors occurs within the boardroom, with shareowners relegated to a rubber-stamp process of affirmation.

Other potential means to achieve accountability of directors are ineffective. The threat of potential litigation, through class-action lawsuits and/or derivative actions brought by shareowners, is highly overrated as a deterrent to corporate malfeasance. Corporations themselves and/or the SEC generally reveal corporate improper acts before civil litigation is commenced. Shareowner lawsuits rarely result in the perpetrators, themselves, paying damages. If damages are recovered, it is paid out of insurance policies and out of corporate assets. In the end, shareowners bear the cost of both sides and must cover the expenses of both plaintiff and defense attorneys, diluting the value of their shares.

Proxy contests to force change are hardly ideal. Often they are initiated only after a great many shareowners sell the stock and depress the price. Of course, sale of the stock does nothing to directly remove assets from management control. It simply passes the stock to another buyer who must suffer the same management abuses. In the process, shareowners can see considerable wealth destroyed by inept management and defensive measures. There are often also very heavy transaction costs for employees in the form of layoffs, lost wages, increased divorce and suicide rates, as well as to communities in the form of lost taxes and charitable contributions. Even after much of the wealth has been destroyed, the takeover and transition back to profitability is also expensive. Patrick McGurn, of the RiskMetrics Group, estimated that, whereas professional fees and expenses from buyouts and takeovers averaged between 2 and 4% of transaction value, charges for proxy driven changeovers have run "considerably below" 1%.

In civil society, democratic transitions have long been recognized as preferable to war or armed revolution. The same principles should apply to corporate governance transitions. Current SEC rules are an impediment to peaceful transitions in corporate governance and encourage short-term speculators, rather than committed long-term investors. Even the Commission's currently proposed Rule 14a-11, while taking a small step in the right direction, would do little to foster democratic transitions in corporate governance.

Two Examples of Shareowner Struggles

Sears

In 1991 business leaders surveyed by Fortune magazine rated Sears at 487th out of 500 companies for the reputation of its management. Dale Hanson, then chief of the California Public Employees Retirement System (CalPERS) said, "from 1984 on, Sears went to hell in a handbag."

In May of 1991, Robert A. G. Monks indicated he would engage in a proxy contest for a single seat on the board, something no one had ever done before at any company. Sears hired renowned takeover lawyer Marty Lipton, brought a lawsuit to stop Monks and budgeted $5.5 million dollars over and above Sears' usual solicitation expenses to ensure his defeat. That allocation represented one out of every seven dollars made by the retail operation during the previous year. Sears also assigned 30 employees to spend their time working to defeat Mr. Monks.

With cumulative voting and five Directors up for election, Monks might have won a seat. But Sears shrunk its board by eliminating three director seats, which meant that he needed a higher proportion of the vote to win. About 25 percent of the vote was held by Sears employees (and voted by Sears trustees); much of the rest was held by individuals, who were impossible to solicit without spending millions of dollars.

In 1992, Sears shrunk their board again. Instead of running again, Monks supported shareowner proposals submitted by others and ran his now famous full-page ad in the Wall Street Journal declaring the board "non-performing assets." Two of the resolutions he supported, confidential voting and annual election of directors, got over 40 percent of the vote. The proposal to separate the CEO and chairman positions got 27 percent. Sears went on to implement several of the reforms that Monks had advocated, including restructuring its operations, which helped it rebound financially but it was clear that management retained full control.

Luby's

The Committee of Concerned Luby's Shareholders, predecessor to the Committee of Concerned Shareholders, met on an Internet Yahoo! finance message board and became the first grass-roots shareowners to conduct a formal proxy contest using that medium.

Luby's Inc., headquartered in San Antonio, Texas, was a 230-unit cafeteria chain with annual sales of approximately $500 million. The company had traded over $25 a share but dipped below $4 was trading in the $8 to $4 range in the months when shareowners rallied around a plan by Les Greenberg to try and win four seats on the company's 11-member board of directors at its annual meeting in January 2001.

Their efforts were given a boost when former Luby's executives joined the dissidents. They didn't want the firm they had spent decades building to crumble further. The daughter of a co-founder also signed on. The four candidates nominated by shareowners held a grand total of 0.3% of Luby's stock. Greenberg, a semi-retired attorney drafted the documents, allowing the Committee to wage its battle on the cheap.

Patrick McGurn, of the RiskMetrics Group (then ISS), indicated his belief that the efforts of the Committee influenced several positive company reforms. After a new CEO at Luby's recruited a retiree for the board, the Committee's support began to slip. The RiskMetrics Group didn't support them, convinced that Luby's was "back on track."

The dissidents received 25% of the vote, an astonishing turnout for such a low cost effort. Two of their shareowner proposals (removal of all anti-takeover defenses and annual election of all directors) did even better, receiving approximately 60% of votes cast. Share price rebounded, briefly hitting $10. However, management didn't implement the measures that won a majority vote and never explained their inaction. Shares have now fallen to around $2.

Near Insurmountable Hurdles

SEC regulations denying shareowners the right to place the names of director-nominees, or even resolutions concerning the election process on the corporate ballot, have become the largest impediment to democratic change in corporate governance. The assets of all shareowners are expended by management to distribute those ballots and to campaign for the company's candidates. Dissident shareowners can expect to expend at least $250,000 to run even a single candidate. Shareowners must: locate nominees, conduct related due diligence, draft a committee charter for a committee; and obtain and digest corporate bylaws and articles of incorporation, applicable state and federal laws and regulations.

Since corporations and their transfer agents will often stall and request thousands of dollars for a copy of the shareowners list, shareowners must be willing to file court actions. They must also be prepared to use the complex EDGAR filing system, to defend against frivolous legal actions and to lobby proxy advisors and institutional investors. Then, they need to verify that proxy statements have actually been mailed to "beneficial holders" of the stock and that votes have been counted properly.

It is well known that until recently the vast majority of board vacancies were filled via recommendations from CEOs who also are typically chairmen of the boards. The result is that management of America's corporations are not accountable to their owners but only to an increasingly burdensome labyrinth of laws and regulations that governments are too understaffed to enforce. Recent requirements for an "independent" nominating committee provide little assurance against continued management domination. These "independent" board members serve at the pleasure of the CEOs and the other board members; they have no independent base of power.

The Commission proposed giving shareowners access to the proxy to nominate directors in 1942 but sloppy language and World War II got in the way. In 1976 the nation was rocked by business scandals (see Corporate Morality -- Whose Business Is It? – Address by Roderick M. Hills, SEC Chairman, April 13, 1976 at http://www.sec.gov/news/speech/1976/041376hills.pdf). In response, the Business Roundtable (BRT) in 1977 recommended "amendments to Rule 14a-8 that would permit shareowners to propose amendments to corporate bylaws, which would provide for shareowner nominations of candidates for election to boards of directors." Their memo noted that such amendments "would do no more than allow the establishment of machinery to enable shareowners to exercise rights acknowledged to exist under state law."

In 1978 SEC staff recommended that if sufficient progress wasn't made by companies in considering shareowner nominations during the 1980 proxy season, the Commission should grant shareowners "access to issuer proxy material for the purpose of making shareowner nominations."

Although nothing was done explicitly to address access, in 1976 the SEC had affirmed the exclusion in Rule 14a-8(i)(8) applied only to "…shareholder proposals that relate to a particular election and not to proposals that… would establish the procedural rules governing elections generally." (AFSCME v. AIG at
http://www.ca2.uscourts.gov:8080/isysnative/RDpcT3BpbnNcT1BOXDA1LTI4MjVfb3)
Numerous proposals on elections were submitted during the following decade and were increasingly well received.

Professor Jane W. Barnard documented some them in "Shareholder Access to the Proxy Revisited," Catholic University Law Review, Volume 40, Fall 1990, Number 1. For example, in 1980 a shareowner of Unicare Services proposed permitting any three shareowners be able to nominate board candidates and have them placed on the proxy. A similar proposal at Mobil allowed a "reasonable number of stockholders" to place candidates on the proxy statement. In

1981 Union Oil was forced to include a proposal permitting 500 or more shareowners to place nominees on the corporate ballot, with no threshold on the number of shares they held individually or collectively. SEC staff rejected management's argument that rule 14a-8(c)(8) allowed exclusion. They held the proposal did not relate to "the election of directors at a particular meeting, but rather to the procedure to be followed to select nominees in general."

Interestingly, during this period at least one corporation, Unocal, argued that placing a minimum threshold on access to the company's proxy would discriminate "in favor of large stockholder and to the detriment of small stockholders," causing the company to violate the equal treatment principle. Apparently, the SEC feels free to ignore that principle in its current proposal but provides no research or historical precedent to support its proposed 1%, 3% and 5% thresholds.

In 1988, CalPERS submitted a shareowner proposal to Texaco providing for the establishment of a Stockholder's Advisory Committee made up of nine of the company's largest shareowners. CalPERS saw the Committee as an avenue to influence director nominations but withdrew the proposal when Texaco agreed to nominate a candidate recommended by CalPERS.

After years of allowing shareowner proposals concerning elections, the SEC suddenly issued a series of no-action letters in 1990 ruling that proposals concerning board nominations could be excluded under rule 14a-8(c)(8). Professor Barnard speculates the SEC probably changed its position because proposals being put forth by institutional investors were getting majority votes. In 1990 more shareowner proposals passed than in the proceeding 40 years combined. Proposals to allow shareowner nominees on corporate ballots would soon have real consequences.

Professor Barnard's insights as to why the SEC changed course carries weight, since she was assisted in her research by Virginia Rosenbaum, then with the Investor Responsibility Research Center, Jamie Heard, then with Analysis Group, Richard Koppes and Kayla Gillan, then with CalPERS, and Nell Minow, then at Institutional Shareholder Services… all respected authorities familiar to shareowners and the SEC.

On August 1, 2002, the Committee of Concerned Shareholders (represented by Les Greenberg) and I petitioned the SEC to permit corporate shareowners to nominate director-candidates and cause the names of those candidates to appear on the corporate proxy. The Council of Institutional Investors (CII), which primarily represents large pension funds, indicated that our petition "re-energized" the "debate over shareholder access to management proxy cards to nominate directors and raise other issues." (Equal Access - What Is It? at http://www.concernedshareholders.com/CalPERS_EqualAccess.pdf)

The scandals of Enron, WorldCom, Global Crossing and so many others, which triggered our petition in 2002 petition, as well as the SEC's proposals in 2003, 2007, and 2009 might have been averted if shareowners had been able to continue to propose changes to the election process under the SEC's 1976 interpretation. Directors would have been more independent of management and more dependent on shareowners. They would have been more vigilant, even without the reforms of Sarbanes Oxley (http://www.soxlaw.com)

When the Commission took up the proxy access issue in 2003, the shelved measure, even as complex as it was, got more comments, almost all in support, than any rulemaking in SEC

9295 Yorkship Court Elk Grove, CA 95758
e-mail: jm@corpgov.net http://www.corpgov.net

history. Obviously, the topic holds great interest and potential. CII's former executive director, Sarah Teslik, said it was "the biggest thing that has come out of the Commission in my 20-year career." Patrick McGurn, of proxy advisor RiskMetrics Group, said the movement for an open ballot was the "Holy Grail of corporate governance."

Rather than the Holy Grail, proxy access is more like the Magna Carta. The first clause of that document guaranteed "freedom of elections" to clerical offices of the English church. This was designed to prevent the King from making appointments and siphoning off church revenues. A shareowner's Magna Carta by the SEC could prevent managers and entrenched boards from having what amounts to a lock on who sits on corporate boards and could substantially reduce use of corporate coffers as the personal bank accounts of management.

Experience with more democracy at the top, especially when found profitable, may lead companies to make better use of employees. A 1986 study by the National Center for Employee Ownership (NCEO) found that firms with significant employee ownership and participation in decision making grew 8 to 11% faster than their counterparts. A year later the General Accounting Office found that such firms experienced a 52% higher annual productivity growth rate.

Scientists have known for years that such organizations would generate more wealth. For example, even back in the 1970s a panel of experts, after reviewing the extensive findings of 57 field experiments in job satisfaction and productivity for the National Science Foundation, concluded:

> Human involvement at the work place in all facets of the work is a prerequisite for the enhancement of quality life as well as performance and satisfaction.... The organizational policy, therefore, should work towards enhancing such aspects of work which encourage people's ownership of the work place as well as the work itself, collaborative efforts among coworkers, and decision-making processes based on participate models.
>
> It is paradoxical that the standard justification for autocratic practice in industry is its alleged efficiency, since the empirical research results do not support that conclusion. In fact, increased rank-and-file responsibility, increased participation in decision-making and increased individual autonomy are associated with greater personal involvement and productive results.

Why, against the findings of so many studies, do organizations continue to allow workers so little control over their jobs? Our best guess is that most decision-making structures, including those now governing corporations, are designed around status needs related to dominance and control over others. They are not designed to maximize the creation of wealth for shareowners or for society at large. In order to gain higher status, individuals seek to dominate more and more people. This dynamic moves the locus of control inappropriately upward. In order to generate more wealth, we need to take advantage of all the brains in our companies, as well those of concerned shareowners. We can do so by making corporations more democratic, top to bottom.

The keys to creating wealth and maintaining a free society lie primarily in the same direction. Both require that broad based systems of accountability be built into the governance structures of corporations themselves. By accepting the responsibilities that come with ownership, pension funds and other institutional investors have the potential to act as important mediating

9295 Yorkship Court Elk Grove, CA 95758
e-mail: jm@corpgov.net http://www.corpgov.net

structures between the individual and the dominant institutions of our time, the modern corporation.

The letter I signed from the United States Proxy Exchange contains most of my suggested amendments covering the need to lower threshold from the unsupported 1%, 3% and 5% to the time-tested $2,000 level; remove the proposed 25% cap on board positions subject to proxy access; eliminate the current confusing system of dueling proxy cards; and many others. However, I neglected to coordinate on three additional suggestions outlined below, which I hope the Commission will also consider.

1. With regard to changes proposed to amend Rule 14a-8(i)(8), the current "relates to an election" provision has been used to prevent proxy monitoring proposals from appearing on the corporate proxy if the proposals might result in a proxy monitoring firm, hired by the company as a result of a vote by shareowners, that would provide information or advice on director candidates. See proposals primarily submitted by Mark Latham at Bristol-Myers Squibb, Pfizer, Citigroup, General Electric, Gillette and Warner-Lambert in 1999. The text and a portion of the correspondence between Latham and corporate representatives has been archived at http://votermedia.org/proposals.

   Even with access to the ballot for shareowner nominees, a "free-rider" problem would still limit intelligent analysis. Currently, institutional investors hire the RiskMetrics Group, Glass Lewis and others to advise them on the issues surrounding resolutions and director elections. Most individual shareowners can't afford such services.

   Yet, Latham estimates that even RiskMetrics only spends about $2,000 worth of time analyzing the average proxy for institutional investors subscribing to their service. The result is often "cookie cutter" advice that may not take into account sufficient industry and firm-specific information. Monitoring and choosing candidates takes time, money and expertise, as does voting intelligently among competing candidates. His proposals offer an opportunity for additional information based on hiring proxy-monitoring firms paid with corporate funds. The approach would solve the collective action problem and would allow shareowners to spend much larger sums to obtain more refined information.

   When Mark Latham and I modified such a proposal a year later to exclude advice on director elections, it won 18% of the vote at Equus II. I have no doubt the vote would have been higher if the proposal would have allowed the proxy monitoring firm to also provide advice on the future election of directors, since board elections are the most critical issue on the proxy and shareowners are given little useful information concerning how nominees will vote on issues facing the company.

   In sum, the SEC wrote no-action letters allowing companies to bar the corporate monitoring proposals on the basis that they could be excluded under rule 14a-8(i)(8) "as relating to an election for membership on its board of directors." This exclusion should be amended to not only allow for proposals proposing terms for shareowner nominations to appear on the corporate proxy but should also allow resolutions for collectively hiring proxy advisors.

2. SEC Rule 14a-8(h)(3) requires that a proponent or representative of a resolution contained in the company proxy must not only attend the annual meeting, but must

9295 Yorkship Court Elk Grove, CA 95758
e-mail: jm@corpgov.net http://www.corpgov.net

actually present the proposal. If they fail to do so, the company can exclude all of the proponent's proposals from its proxy materials for any meetings held in the following two calendar years. However, there is no clear rule requiring companies to allow shareowners to present their proposals. Shareowners are in a "Catch 22" situation. Whole Foods Markets, for example, refused the right of shareowners to present their resolutions during the business portion of their annual meeting in March 2006. The Commission should amend its rules to clearly require companies to allow shareowners time during the business portion of the meeting to present their resolutions.

3. The Commission should also adopt an "override mechanism" for Rule 14a-8, as was recommended in the proposed Amendments to Rules on Shareholder Proposals in 1997 that were not adopted and as raised in their comments on this current rulemaking by John C. Wilcox and Hye-Won Choi for TIAA-CREF (see http://www.sec.gov/comments/s7-16-07/s71607-199.pdf). This approach would permit shareowners or groups representing 3% or more of a company's outstanding shares to override a decision by the Commission staff to exclude a shareowner proposal under Rule 14a-8(i)(5) (Relevance) and (i)(7) (Management Functions). However, the previously recommended 3% threshold should be lowered to 1% or 100 endorsers, since that would be less burdensome but would still represent a significant hurdle and would ensure "real" "ordinary business" is kept off the proxy.

   Rule 14a–8(i)(7), for example, has been used to justify excluding resolutions to allow shareowners to put forth a resolution to specify the procedure for shareowners to select the auditor. (see 2003 correspondence concerning USG Corporation and HRPT Properties re proposals from Mark Latham at http://votermedia.org/proposals) After what Arthur Anderson was accused of in the Enron case, I don't know how selection of an auditor that may have conflicts of interests can be considered "ordinary business." An "override mechanism" would at least allow such proposals to move forward if they have significant shareowner support.

Again, thank you for attempting to address the vitally important issue of proxy access. I hope you will carefully consider my recommendations, as presented here and as part of the group signed by the United States Proxy Exchange, submitted earlier today.

Sincerely,

James McRitchie