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Via Electronic Transmission

Elizabeth Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-0609

Re: Facilitating Shareholder Director Nominations;
Release Nos. 33-9046; 34-60089; IC-28765;
File No. S7-10-09 (June 10, 2009)

Dear Ms. Murphy:

We appreciate the opportunity to comment on the June 10, 2009 proposal: "Facilitating Shareholder Director Nominations" (the "Release"). Please note the views expressed in this letter are those of certain partners of the Firm who have participated in the preparation of this letter and not necessarily the views of our clients.

We recognize and appreciate the efforts of the Securities and Exchange Commission (the "Commission") and its Staff to address this challenging issue at a time of great economic crisis. We agree that the Commission's rules should not thwart shareholders' abilities to exercise their fundamental rights. While the recent economic crisis has implicated corporate governance practices of some institutions, we urge the Commission to take care not to disrupt unduly the corporate governance balance at the thousands of public companies whose corporate governance practices are not implicated in the current crisis. If, however, it is necessary for the Commission to act, we believe that proposed Rule 14a-11 raises serious concerns and we therefore recommend that the Commission amend 14a-8(i)(8) and adopt Rule 14a-19 but not adopt Rule 14a-11.

Impact on State Law

We commend the Commission for its stated goal of removing perceived impediments to the exercise of shareholders' rights to nominate and elect directors to company boards of directors. It appears, however, that proposed Rule 14a-11 goes far beyond that goal by setting the terms of a proxy access system that would apply in all cases where a corporation's jurisdiction of incorporation and/or governing documents do not prohibit access. In other words, it both applies and preempts state law and a corporation's governing documents when those authorities do not go so far as to prohibit access but merely conflict with proposed Rule 14a-11 by requiring more stringent standards. The proposed rule thus limits the ability of other jurisdictions to construct, or to allow their domestic corporations to construct, proxy access regimes that are specifically tailored to the particular circumstances of individual companies. Further, without an explanation for the preference, the proposed rule also limits the ability of other jurisdictions and shareholders to choose reimbursement over 14a-11's direct access to a company's proxy as a reasonable means to enable shareholders' rights to nominate directors.

Proposed Rule 14a-11 would have the presumably unintended effect of reversing positive changes in corporate governance undertaken by issuers (as permitted by state law) and state legislatures in the last several years. For example, many issuers have adopted a majority vote standard for directors, often at the request or vote of shareholders. A shareholder nomination under proposed Rule 14a-11 would result in an election contest and an automatic imposition of a plurality vote standard. Similarly, the proposed rule may constrain a company's ability to establish other qualifications for directors that apply equally to all nominees. This includes independence standards as well as other qualifications such as diversity or expertise that may be particularly relevant to an individual company. For example, the qualifications for board membership for a multi-national corporation operating in a highly technical industry held largely by diverse retail investors may legitimately not be the same as those for board membership for a regional company held largely by control persons and its employees' investment or pension funds. Shareholder nominations should not be held to stricter standards than other nominations, but their nominees also should not be held to more lenient standards than other nominees, particularly if those nominees, if elected, expect to be equal members of the board on which they serve. Unfortunately, Rule 14a-11 imposes its standards on companies and negates standards designed by companies over time to address their specific facts and circumstances. An amendment to Rule 14a-8(i)(8) coupled with the adoption of Rule 14a-19 better addresses these issues.

This preemption of a state law's ability to be more flexible than the proposed rule will almost certainly expose the Commission to litigation based on claims that it goes beyond the Commission's statutory authority to "control the conditions under which proxies may be solicited"[1] by regulating the substance of corporate governance standards which is traditionally a matter for state corporation law.[2] It could also be "jumping the gun," given that Congress is currently considering whether expressly to direct the Commission to require proxy access.[3] At a time when the Commission is under heightened scrutiny, but is also clearly reinvigorated in its mission to regulate the capital markets and protect investors, we urge the Commission to consider carefully its statutory mandate before exposing the agency to charges that it has again overstepped its authority.

[1] *See* Facilitation of Shareholder Director Nominations, Securities Act Release No. 9046, Exchange Act Release No. 60089, 74 Fed. Reg. 29024, 29025 (proposed June 18, 2009).
[2] *See e.g. CTS Corp. v. Dynamics Corp*, 481 U.S. 69 (1987); *Business Roundtable v. SEC*, 905 F.2d 406 (D.C. Cir. 1990).
[3] *See, e.g.* S. 1074, 111th Cong. § 4 (2009).

Shareholder Eligibility Threshold

Although we believe that the Commission should not adopt proposed Rule 14a-11, if the Commission chooses to do so, we believe that several important modifications should be made in any final rules. Under the current proposal, shareholder eligibility requirements are based upon minimum ownership levels, whereby a nominating shareholder (or group of shareholders) owning at least 1% of the voting securities of a large accelerated filer, at least 3% of the voting securities of an accelerated filer or at least 5% of the voting securities of a non-accelerated filer would become eligible to have its director nominee or nominees included in the company's proxy materials. We do not believe that the threshold requirements serve the Commission's stated purpose of "seeking to balance shareholders' ability to participate more fully in the nomination and election process against the potential cost and disruption to companies subject to the proposed new rule,"[4] as they do not ensure that "only holders of a significant, long-term interest in a company" would be able to have their nominees included in a company's proxy materials.

It is not clear that a shareholder's ownership of 1% of a large accelerated filer's securities for a minimum of one year is an effective representation of that shareholder's commitment to the long-term performance of the company, nor will it necessarily represent the views regarding current management of the other 99% of the company's shareholders. Yet under the proposed rule, a holder (or group of holders) of 1% of the securities of a large accelerated filer would be eligible to submit director nominees for up to 25% of the company's board of directors. Under this scenario, a shareholder's ability to influence the composition of the company's board is largely disproportionate to its economic interest in the company. The Commission's threshold proposal is particularly troubling given the "first-in" method whereby a shareholder (or group of shareholders) whose ownership meets only the minimum standards for access could trump a larger shareholder or shareholder group who have held their shares longer simply by beating them by seconds in the race to submit nominees.

Ownership tied to more significant threshold and duration requirements, such as at least 5% ownership by a single holder (and a higher threshold for a group of holders) for 2 or 3 years would mitigate the risk that relatively short-term shareholders would use the proposed proxy access process to pressure the company into making decisions designed to yield short-term gains instead of decisions based upon long-term shareholder interests. Perhaps more importantly, if the Commission chooses to tie the right to nominate under Rule 14a-11 to ownership thresholds, it is critical that the Commission define share ownership for the purposes of this rule. The right to elect directors is premised on the notion that voting decisions will be based on a shareholder's economic interests. Recent cases and Commission actions have highlighted the many ways in which an investor's voting rights can be unconnected to that investor's economic

[4] *See* Facilitation of Shareholder Director Nominations, Securities Act Release No. 9046, Exchange Act Release No. 60089, 74 Fed. Reg. 29024, 29035 (proposed June 18, 2009).

interests.[5] In addition, there is a growing body of literature documenting the prevalence of the separation of voting power and economic ownership[6] and hedged positions have played a prominent role in recent proxy contests and merger transactions.[7] We urge the Commission to reconsider whether or not creating a new right based on a percentage ownership is appropriate without that further clarification.

At the very least, in order to address concerns regarding the separation of economic and voting interests, the Commission should amend the ownership criteria to ensure that a nominating shareholder actually does have an economic interest equivalent to at least the minimum ownership threshold. Specifically, the proposed rules should be amended to ensure that the eligibility test is satisfied only if ownership levels are based on ownership net of any short or hedged positions. This unhedged position must be maintained for the entire requisite time period. An ownership test that is based on an unhedged position will help ensure that a nominating shareholder's interests are aligned with the issuer and other shareholders.

Finally, the Commission should amend the eligibility requirement to require that the nominating shareholder hold the securities through the annual meeting. This is consistent with the current requirement for Rule 14a-8 proposals. Furthermore, a nominating shareholder should not be permitted to nominate a director, require the company to put the director on the proxy, and then not have the ability to vote on the election of such director. If the nominating shareholders sell shares before the meeting, then nominees should be disqualified. This will help ensure that nominating shareholders are not motivated by something other than the long-term good of the company.

"First In" Model for Shareholders' Nominees

While we understand and agree with the need to provide a limitation on the number of shareholder nominees that the company should be required to include in its proxy statement, the proposed method is arbitrary and unlikely to yield a result that would be in the best interests of shareholders. The speed with which a financial printer can submit a form and the vagaries of the EDGAR system should not be the reason for exclusion of qualified nominees with strong shareholder support in favor of the first to submit nominees who meet the minimum standards. Moreover, there is no question that proposed Rule 14a-11 creates a powerful right for whoever manages to win this race. This right will be an influential tool that could be used by the winner to extract concessions from the company unrelated to the interests of the entire shareholder body. Meanwhile, the proposal creates a new and specific Staff review process that will put an additional strain on the Division of Corporation Finance's resources. Also, the proposal does not contemplate how the process will work in the event of a withdrawal of

[5] *CSX Corporation v. The Children's Investment Fund Management (UK) LLP, et al.*, 562. F. Supp. 2d 511 (S.D.N.Y. 2008); *In re Perry Corp.*, Exchange Act Release No. 60351, Administrative Proceeding File No. 3-13561 (July 21, 2009).
[6] *See* Hu & Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 So. Calif. L. Rev 811 (2006); Martin & Partnoy, *Encumbered Shares*, 2005 U. Ill. L. Rev. 775 (2005).
[7] *See supra* note 5.

nominations, perhaps close in time to the mailing date of proxy materials. Thus, shareholders who win the race could misuse this aspect of the proposed rule.

Rather than a "first-in" approach, we propose that companies be able to choose how they will decide which shareholder nominees be included if nominees representing more than the 25% threshold of the board are timely submitted. The "first in" model could be the standard, but companies could also elect other non-substantive ways to determine which shareholder nominees would be included in the event more than 25% are submitted. The manner of selection would have to be disclosed in the previous year's proxy statement (or in a Form 8-K for the first year). These other approaches might include determinations based on length of ownership, size of holding, a combination of those factors, or whether the shareholder had previously submitted a nominee, for example.

Phase-In Adoption

The Commission has once again proposed a system of shareholder access at a time of significant changes in proxy process and disclosure. In the 2010 proxy season, companies will have to adapt to amended NYSE Rule 452 and quite possibly to new Commission rules regarding shareholder voting on compensation practices. In addition, the Commission has proposed new rules regarding disclosure on compensation and corporate governance in areas such as companies' overall compensation policies and their impact on risk taking; stock and option awards of executives and directors; director and nominee qualifications and legal proceedings; company leadership structure; the board's role in the risk management process; and potential conflicts of interest of compensation consultants that advise companies. Also, the Commission has proposed to allow changes in the ability of participants in proxy contests to reference other shareholders' short slates as well as to increase the ability of shareholders to mount "vote no" campaigns. All of these changes may impact, in unforeseen ways, the 2010 proxy season, which is fast approaching. Thus, there are sound reasons to delay the effectiveness of any rule that is adopted as part of this proposal.

At the very least, the Commission should consider adopting a phase-in approach, whereby companies would be permitted to follow a phase-in schedule for mandatory compliance based on their size, similar to the Commission's rules regarding internal controls reporting and XBRL. Because the adoption of the proposed rule will likely require substantial consideration and deliberation by issuers and shareholders alike, and will cause companies to incur additional expenses to comply with the rule, mandatory compliance by all public companies in time for the next proxy season is impractical and largely unrealistic. As the Commission stated in the most recent XBRL release, "additional phase-in time for all but the largest accelerated filers is intended to permit companies to plan and implement [the rule] with the benefit of the experience of year one filers," and "also is intended to enable us to monitor implementation and, if necessary, make appropriate adjustments during the phase-in period." If that is true of the XBRL rules, it is certainly true regarding proxy access, which the Commission has considered since the 1940s.

Content Requirements of Schedule 14N

We believe that the disclosure requirements of Schedule 14N are generally appropriate. Further, we believe the disclosure requirements related to the proposed director and nominating shareholders are generally appropriate to the extent they mirror required disclosures for company director nominees and required disclosures for participants in a proxy contest.

We suggest that an additional representation be required with respect to short positions, securities lending and other hedging transactions related to a company's voting securities. Since any threshold ownership requirement should take into account a shareholder's actual economic interest in the issuer, additional disclosure and representations regarding any hedging activities is appropriate. The Commission should require disclosure regarding any contracts or arrangements with respect to the subject company's securities, similar to Item 6 of Schedule 13D. Additionally, in recent months, many companies have been amending the advance notice provisions of their bylaws to require disclosure regarding derivative positions for those submitting a director nominee. A similar requirement in Schedule 14N would harmonize the proposed rules with the current trend of advance notice bylaws.

One disclosure of Schedule 14N that we believe is unnecessary, however, is the proposal for disclosure of a nominating shareholder's ownership intentions after the annual meeting. Although it is appropriate to confirm that the shareholder intends to own shares through the annual meeting, disclosure related to the shareholder's post-meeting ownership intentions does not provide relevant information with respect to the election of the nominee or the shareholder's ownership intentions at the time the proposal is voted on. In the analogous situation of a Rule 14a-8 proposal, a shareholder is not required to make representations with respect to its ownership following a vote on a proposal. Further, if the shareholder owns less than 5% of the company's registered equity securities, it would not have disclosure obligations related to its share ownership. If the shareholder has further intentions with respect to the company, it should only be subject to the disclosure obligations of Schedule 13D or Schedule 13G, as applicable. Otherwise, this requirement could expose the nominating shareholder to potential liability related to this disclosure that they would not otherwise have without a filing obligation.

Finally, the proposal requests comment on whether shareholder nominees should be required to make a representation with respect to their understanding of state law fiduciary duties. We believe that such a representation would not be an appropriate requirement, as company nominees are not subject to the same requirements. Presumably shareholder nominees would be sophisticated enough to understand the requirements of board service on a public company prior to agreeing to be a nominee. If a director violates his or her fiduciary duties, he or she would be subject to shareholder derivative lawsuits in the same manner as a company nominee would be.

Filing Requirements of Schedule 14N

A nominating shareholder should be required to file the Schedule 14N on the same day as he or she provides notice to the company of the shareholder nominee. As discussed below, the "first-in" model, as well as the public filing requirement, discourages dialogue with the company on the matter. However, it is necessary to determine the time of notice as well as to inform other shareholders whether there is a shareholder nomination. In addition, the filing requirement is important to make a public record of the information provided by the nominating shareholder that will be included in the proxy materials and gives the appropriate incentive to the nominating shareholder to do reasonable diligence on the director nominee.

We would suggest keeping the Schedules 13D, 13G and 14N filing requirements separate. It would be much easier to track on EDGAR and the dual requirements would not be unduly burdensome to the extent they call for substantially similar disclosure.

Sections 13(d) and 13(g) Requirements

Permitting a shareholder or group who nominates one or more directors under proposed Rule 14a-11 to continue to report beneficial ownership on Schedule 13G is not appropriate because such shareholder or group cannot continue to certify as required by Item 10(a) of Schedule 13G that they do not hold their securities for the purpose or effect of changing or influencing control of the company when they are nominating a candidate for director.

The Commission and the Staff have long interpreted the phrase "purpose or effect of changing or influencing control of the issuer" as it applies to Section 13(d) reporting and Schedule 13G eligibility as broadly as possible to capture any activity that could arguably have an influencing effect on control of the company. This has included the view that even one director's seat has a controlling effect since the director can attend board meetings and is privy to all information about the company that the board receives. To allow all investors to use Schedule 13G despite nominating directors is in direct conflict with the reasons the Commission allows passive investors to use Schedule 13G.

A passive investor who would otherwise be eligible to file a Schedule 13G under Rule 13d-1(b) or Rule 13d-1(c) should be required to use Schedule 13D. This will help ensure that the proposed rules will not be used to control or influence the control of a company without disclosure of such purpose. The burden of requiring additional disclosure of a Schedule 13D is minimal when compared to giving additional valuable information to shareholders to enable them to make a decision with respect to the election of directors. Additionally, an otherwise passive investor who is required to file a Schedule 13D to utilize the proposed rules could switch back to a Schedule 13G under current Rule 13d-1(h) once they have ceased their control-related activities. The Commission adopted Rule 13d-1(h) in 1998 to ease the burden on investors that engage in activities that cause them to lose Schedule 13G eligibility by permitting them to simply switch back to Schedule 13G when they cease those disqualifying activities. The Commission believed in 1998 that Rule 13d-1(h) would help provide a "clearer indicator of investors that currently have a disqualifying purpose or effect."[8] Rule 13d-1(h) makes it easy for such investors and the rule works well today. Rule 13d-1(h) would also work well in conjunction with the proposed rules if the shareholder or group nominating under the proposed Rule 14a-11 were required to file a Schedule 13D. Shareholders submitting nominations pursuant to an applicable state law provision or a company's governing documents should also be required to file a Schedule 13D. The proposing release correctly notes that applicable provisions of state law or a company's governing documents may not contain the limitations contained in proposed Rule 14a-11 on the number of persons who may be nominated. In those instances, it will be easier for a shareholder to use such provisions to influence control of the company, thus justifying the additional disclosures required by Schedule 13D.

If the Commission chooses to allow a passive investor to continue to utilize Schedule 13G, the Commission should require additional disclosure in Schedule 14N similar to that required by Schedule 13D so that the full disclosure of Schedule 13D is given to investors.

Finally, any rules that are adopted should not create an exclusion from Section 13(d) for groups that are formed for the purpose of nominating a director under the proposed rules. Such a provision is unnecessary. If, under the facts and circumstances test that has always applied to the definition of a group, a group is formed and the group holds enough securities to exceed the 5% threshold and therefore require a Section 13(d) filing, they should not receive an automatic exemption. Such exclusion would serve more to reduce the information provided to fellow investors and the issuer rather than remove any burden on the nominating shareholders.

Section 16 Requirements

The proposed rules do not provide for an exemption from Section 16 for shareholder groups formed for the purposes of shareholder nominations. We support this position and do not believe an exemption is necessary. Section 16 group ownership should not be a disincentive for shareholders forming groups simply to solicit for shareholder nominees. The 10% threshold under Section 16 is far above the proposed ownership requirements to nominate a director. Thus, forming a group that would own above 10% for the purpose of nominating a director for election should be unnecessary. If under a facts and circumstances test the nominators form a group at or above the 10% level, their lack of influence over the company is not without question, and application of the Section 16 reporting requirements is appropriate.

With respect to Section 16(b), disgorgement only applies to the individual member's transactions, that is, a group member's transactions are not matched against other group member's transactions. Expecting shareholders who nominate directors to refrain from short swing profits and from short sales under Section 16(c) does not appear to be unreasonable. If an exclusion were created, it would be appropriate for the

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[8] Amendments to Beneficial Ownership Reporting Requirements, Exchange Act Release No. 39,538, 63 Fed. Reg. 2854, 2856 (adopted January 12, 1998).

Commission to require a certification from the shareholder that they do not have access to inside information.

Groups formed under the proposed rules should not be treated differently than shareholder groups formed to nominate directors under state law or charter provisions. The applicability of the reporting requirements of Sections 16 and 13 should apply equally to those groups nominating under state or federal law or under charter provisions. In either case the issuer and other investors should be able to receive the same disclosure.

There should not be limitations on affiliations between nominees and nominating shareholders or groups. If there are affiliations, then a facts and circumstances analysis regarding whether or not the doctrine of director deputization will deem them directors is as appropriate in these circumstances as in any other. The Supreme Court recognized the doctrine of directors by deputization in its 1962 decision *Blau v. Lehman*.[9] The court found that a shareholder, such as a partnership or corporation, could be a director for Section 16 purposes "if the investor actually functioned as a director" and "had been deputized to perform a director's duties not for himself" but for the firm. In subsequent rulemaking, the Commission did not include deputization in its definition of a director. According to the Commission in 1988, it did not propose to codify case law relating to deputization. Under the deputization theory, a corporation, partnership, trust or other person can be deemed a director for purposes of Section 16 where it has expressly or impliedly "deputized" an individual to serve as its representative on a company's board of directors. In determining whether a person has been deputized for purposes of Section 16, the courts have looked at a variety of factors, focusing primarily on the alleged deputy's position of control within the deputizing entity and the deputy's independent qualifications to serve on the board of the issuing corporation. This fact-intensive analysis appears best left to a case-by-case determination.

[9] *Blau v. Lehman*, 368 U.S. 403 (1962).

Conclusion

We urge the Commission not to adopt Rule 14a-11. If action is necessary at this time, we suggest further consideration of Rule 14a-8(i)(8) and Rule 14a-19. We appreciate the opportunity to submit this letter and look forward to a concept release and eventual rule-making proposals.

Very truly yours,

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