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August 18, 2009

Via E-Mail: rule-comments@sec.gov

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: SEC File No. S7-10-09
Release Nos. 33–9046; 34–60089; IC–28765
Proposed Rules under the Securities Act of 1933 and the Securities Exchange Act of 1934
"Facilitating Shareholder Director Nominations"

Dear Ms. Murphy:

The Corporations Committee (the "**Committee**") of the Business Law Section of the State Bar of California is pleased to submit this comment letter concerning the above-referenced release (the "**Release**")[1] issued by the Securities and Exchange Commission (the "**Commission**"). The rule proposed by the Release (the "**Proposed Rule**") would require most public companies to include certain shareholder nominations for director in the companies' proxy materials and would prevent companies from excluding from their proxy materials many shareholder proposals related to nomination procedures. As explained below, the Committee opposes the adoption of a mandatory proxy-access rule by the Commission and submits that affording companies the flexibility to adopt proxy access regimes tailored to their own needs as permitted under state law better serves the interests of shareholders generally.

The Committee

The Committee is composed of attorneys regularly advising California corporations and out-of-state corporations transacting business in California regarding securities law matters. The Committee is directed by its mission statement to "study, consider, discuss, take a position and advocate that position with respect to . . . changes to federal laws or regulations that substantively impact California corporate practitioners." The Committee has concluded that it is consistent with our mission statement to submit these comments to the Proposed Rule.

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[1] Facilitating Shareholder Director Nominations, Securities Act Release No. 33-9046, Exchange Act Release No. 34-60089, 74 Fed. Reg. 29,024 (published June 18, 2009) (to be codified at 17 C.F.R. pts. 200, 232, 240 and 249).

Summary of the Committee's Comments

The Committee does not take a position on the merits of proxy access in general; for some corporations, mandatory inclusion of shareholder nominees in the company's proxy materials may be a salutary instrument of corporate governance, depending on the corporation and the wishes of its shareholders. The Committee's comments focus, instead, on the effects of the Proposed Rule on the established system of corporate governance under state law and the danger that the Proposed Rule will undermine, rather than facilitate, the exercise of shareholders' rights.

Just as in other states, shareholders of California corporations generally enjoy the right to elect directors, but it is not their only right or a right superior to others. Shareholders also have the right to amend bylaws to fix rules and procedures for conducting a corporation's affairs, including its shareholders' meetings and use of proxies. The Committee believes that imposing a uniform proxy-access rule on all reporting companies is an unnecessary federal restriction of the right of shareholders under state law to determine the manner in which corporate governance is conducted. Accordingly, the Committee urges the Commission not to adopt the new Rule 14a-11 proposed by the Release. However, the Committee believes that the simple proposed amendment to Rule 14a-8(i)(8) would facilitate a private-ordering approach to proxy access that preserves shareholders' rights under state law.

Regulatory and Commercial Backdrop

In evaluating the Proposed Rule, the Committee is mindful of the traditionally distinct functions of state and federal corporate regulation and recognizes that many changes in corporate governance that already are underway are intended to improve communications between issuers and their shareholders and encourage boards of directors to be more responsive to shareholder concerns.

Responsibility for setting the terms on which corporations may be created, organized and governed traditionally is the domain of state law, and matters of corporate governance have been largely isolated from the reach of the federal securities laws.[2] Indeed, there is a long and successful history of states serving as laboratories for discovering the most equitable and efficient means of regulating corporations.[3] Notwithstanding its recent advances along the

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[2] "Corporations are creatures of state law." Burks v. Lasker, 441 U.S. 471 (1979) (*quoting* Cort v. Ash, 422 U.S. 66, 84 (1975); *see also* CTS Corp. v. Dynamics Corp. of Amer., 481 U.S. 69, 89-91 (1987) ("No principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations, including the authority to define the voting rights of shareholders. . . . [S]tate regulation of corporate governance is regulation of entities whose very existence and attributes are a product of state law. . . . It thus is an accepted part of the business landscape of this country for states to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares.")

[3] Writing at an earlier time of economic crisis, Justice Brandeis famously warned against the undue suppression of state law regarding commercial matters:

periphery of state corporate law, federal securities regulation has been primarily concerned with matters of disclosure in connection with the offer, sale and trading of securities, without regard to the merits of any particular offering or the internal affairs of any particular issuer.[4] Therefore, the Commission's adoption of a mandatory proxy-access rule for all reporting companies would constitute a significant incursion into an area of corporate regulation traditionally reserved to the states.

Determining whether a federal proxy-access rule is workable or appropriate requires understanding the current environment in which companies operate. Corporate governance practices are undergoing rapid change, and the combined effect of recent reforms has yet to be felt. It is difficult, therefore, to accurately assess whether mandating further changes in director elections will be effective or necessary to improve corporate governance. The significant reforms already under way include the following:

- The composition of boards of directors and their committees has changed significantly in response to the Sarbanes-Oxley Act of 2002 and revised listing standards of the New York Stock Exchange (NYSE) and NASDAQ;[5]
- The Commission has required greater disclosure from issuers regarding procedures for nominating directors and communications between shareholders and boards of directors;[6]
- "Withhold vote" campaigns have become a more popular, and more effective, tool to communicate shareholder disapproval with the performance of a board of directors or individual directors;

> There must be power in the states and the nation to remould, through experimentation, our economic practices and institutions to meet changing social and economic needs. . . . Denial of the right to experiment may be fraught with serious consequences to the nation. It is one of the happy incidents of the federal system that a single courageous state may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.

New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).

[4] "[T]he 1934 Act and its companion legislative enactments embrace a 'fundamental purpose . . . to substitute a philosophy of full disclosure for the philosophy of caveat emptor.'" Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, 151 (1972) (*quoting* SEC v. Capital Gains Research Bureau, 375 U.S. 180, 186 (1963)). "Securities laws do not guarantee sound business practices and do not protect investors against reverses." DiLeo v. Ernst & Young, 901 F.2d 624, 627 (7th Cir. 1990) (citations omitted). With respect to proxy regulation under section 14(a) of the Exchange Act, "it is not seriously disputed that Congress's central concern was with disclosure." Business Roundtable v. SEC, 905 F.2d 406, 410 (D.C. Cir. 1990).

[5] *See* Order Approving Proposed Rule Changes Relating to Corporate Governance, Exchange Act Release No. 34-48745, 68 Fed. Reg. 64,154 (published Nov. 12, 2003).

[6] Disclosure regarding Nominating Committee Functions and Communications Between Security Holders and Boards of Directors, Exchange Act Release No. 33-8340, 68 Fed. Reg. 69,204 (published Dec. 11, 2003).

- Most of the largest corporations have adopted majority voting, or equivalent procedures, without a statutory or regulatory requirement to do so;[7]
- Delaware and North Dakota have each adopted statutes that expressly permit shareholders to determine whether proxy-access is appropriate for their company and under what conditions;[8]
- The Committee on Corporate Laws of the American Bar Association Section of Business Law has proposed amendments to the Model Business Corporation Act that will permit shareholder access to the company's proxy materials as well as reimbursement of reasonable shareholder expenses;[9] and
- After publication of the Release, the Commission approved changes to NYSE Rule 452 to further limit broker discretionary voting, beginning with shareholder meetings held on or after January 1, 2010.[10]

Corporations are scrambling to adapt to these evolving changes, some of which have not yet taken effect, and the combined effect of these changes on the dynamics of director elections is not yet known. The Proposed Rule, therefore, is aimed at a moving target.

Shareholders' Rights Under California law

One of the fundamental rights of shareholders in California, as elsewhere, is the right to elect directors, a right which California law has preserved for nearly 160 years.[11] Although the California statutes do not specifically address the inclusion of shareholder nominees in a company's proxy materials, shareholders are given wide latitude to determine for themselves the internal organization of the company and its governing procedures.

California corporations may include in the articles of incorporation any "provision, not in conflict with law, for the management of the business and for the conduct of the affairs of the corporation, including any provision which is required or permitted . . . to be stated in the bylaws."[12] The bylaws, in turn, are expressly permitted to include provisions regulating the annual meeting and the proxy process:

> The bylaws may contain any provision, not in conflict with law or the articles for the management of the business and for the conduct of the affairs of the

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[7] *See* Release at 29,029, n. 69 (noting that more than two-thirds of companies in the S&P 500, according to a recent report, have either switched to majority voting or required the resignation of directors who fail to receive majority support).

[8] *See* DEL. CODE ANN. tit. 8, §§ 112, 113 (effective August 1, 2009); N.D. Cent. Code § 10-35-01 *et seq.*

[9] Press Release, Cmte. on Corp. Laws of the Amer. Bar Ass'n, *Corporate Laws Committee Takes Steps to Provide for Shareholder Access to the Nomination Process*, (June 29, 2009), available at http://www.abanet.org/abanet/media/release/news_release.cfm?releaseid=688.

[10] Order Approving Proposed Rule Change to NYSE Rule 452, Exchange Act Release No. 34-60215, 74 Fed. Reg. 33,293 (July 1, 2009).

[11] *See* CAL. CORP. CODE § 301; Smith v. San Francisco & N.P.Ry. Co., 115 Cal. 584, 589 (1897).

[12] CAL. CORP. CODE § 204(d).

> corporation, including but not limited to: . . . (2) The time, place and manner of calling, conducting and giving notice of shareholders', directors', and committee meetings. (3) The manner of execution, revocation and use of proxies.[13]

Although the issue apparently has not been presented to the California appellate courts, such broad statutory authority could be read to encompass the adoption of a proxy-access provision in a company's articles of incorporation or bylaws. Thus, California shareholders may be permitted to decide for themselves whether their interests would be best served by adopting a proxy-access bylaw and, if so, shareholders could tailor the bylaw to their company's unique circumstances.

If a board is unresponsive to shareholder concerns, it is within the power of the shareholders of California corporations to remove a director without cause,[14] elect new directors,[15] and adopt remedial bylaw provisions.[16] Shareholders also may mount a non-binding "withhold vote" campaign, which is persuasive in all cases and can effectively scuttle the election of the management candidate in a corporation that has adopted majority voting or an equivalent procedure.[17] Directors who commit a gross abuse of discretion are also subject to removal by court order if holders of at least ten percent of the outstanding shares of any class bring suit.[18] California law, therefore, provides several ways to hold boards of directors accountable to shareholders, a traditional function of state law and the primary motivation behind the Proposed Rule.[19] Notably, however, operation of the Proposed Rule is not limited to companies with unresponsive boards of directors.[20] The responsive board and the obdurate

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[13] CAL. CORP. CODE § 212(b). The default rule under California law is that shareholders and the board of directors each have the power to adopt, amend or repeal bylaws. CAL. CORP. CODE § 211. Despite such concurrent power, however, shareholders have the upper hand, given that the articles or bylaws may restrict or eliminate the board's power over the bylaws. *Id.* The shareholders' power does not extend, however, to routine policy decisions regarding the business and affairs of the company, which are made by the board. CAL. CORP. CODE § 300.

[14] CAL. CORP. CODE § 303.

[15] CAL. CORP. CODE §§ 301, 305(a), (b).

[16] CAL. CORP. CODE § 211.

[17] A listed corporation may eliminate cumulative voting, which is the default rule under California law. CAL. CORP. CODE §§ 301.5(a), 708. Thereafter, the corporation may adopt a bylaw provision providing for majority voting in uncontested elections. CAL. CORP. CODE § 708.5(b). If a director does not then garner majority support, the director must resign or such director's term will automatically end 90 days after the election results are determined. CAL. CORP. CODE § 708.5(b).

[18] CAL. CORP. CODE § 304.

[19] Release at 29,025. Chairman Shapiro recently affirmed that director accountability is the principle that animates the Proposed Rule. *See* SEC Oversight: Current State and Agenda: Hearing before the Subcomm. on Capital Markets, Ins. and Gov't Sponsored Ents. of the House Comm. on Fin. Svcs., 111th Cong. (July 14, 2009) (statement of Mary L. Shapiro, Chairman, SEC) ("Public companies and their boards of directors should be accountable to their shareholders. To this end, in May we proposed rules that would remove obstacles to shareholders exercising their rights to nominate company directors.")

[20] By contrast, in its 2003 proxy-access proposal the Commission conditioned proxy access on the occurrence of certain triggering events in an effort to limit the rule to only "those instances where criteria

board would be equally subject to the disruptive effects of contested elections made possible by the Proposed Rule.

A Mandatory Federal Proxy-Access Rule Would Frustrate the Exercise of Shareholders' Rights Under State Law

In the Release, the Commission has requested comments in response to hundreds of questions regarding choices of policy and procedure for a proxy-access regime. The answers to many of these questions may depend on the size of the corporation, the number of shareholders, the level of concentration of ownership, the size and composition of the board, regulatory requirements and myriad other factors. The Committee believes that shareholders deserve an opportunity to answer such questions in the way that makes most sense for their corporation under existing state law or under a bylaw adopted under new enabling state legislation. The Commission, however, proposes to answer each of those questions the same way for all reporting companies and impose the resulting rule across the board.[21] In this way, the Proposed Rule restricts the right of shareholders under state law to fashion bylaws that meet the unique needs of their corporation.

The Proposed Rule would essentially impose a new bylaw provision on every reporting company without approval of the company's shareholders and without regard to shareholders' rights under state law.[22] In California, shareholders would lose the right they would otherwise enjoy to regulate shareholders' meetings and the use of proxies.[23] For example, in the absence of the Proposed Rule shareholders might rationally choose not to adopt a proxy-access bylaw for a variety of reasons, including the following:

- The shareholders prefer a bylaw amendment requiring the company to reimburse shareholders who nominate directors through the distribution of independent proxy materials;[24]
- A shareholder or group of controlling shareholders has sufficient power to elect directors, so including a dissident nominee in the proxy would be a futile, but no less costly, exercise; or

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suggest that the company has been unresponsive to security holder concerns as they relate to the proxy process." Security Holder Director Nominations, Exchange Act Release No. 34-48626, 68 Fed. Reg. 60,784 at 60,787 (proposed Oct. 23, 2003) (not adopted) [hereinafter 2003 Release].

[21] Other than the ownership threshold, which would depend on company size. Release at 29,083.

[22] The Proposed Rule makes a nominal accommodation for state law: the rule would not apply if state law prohibits shareholders from nominating directors. Release at 29,082 (proposed Rule 14a-11(a)(1)). As discussed above, that is not the case under California law.

[23] CAL. CORP. CODE §§ 211, 212(b).

[24] Such a reimbursement scheme is expressly authorized by a recent amendment to the Delaware General Corporation Law and may be implicitly allowed under California law. *See* DEL. CODE ANN. tit. 8, § 113; CAL. CORP. CODE § 212(b). *Cf.* Johnson v. Tago, Inc., 188 Cal. App. 3d 507 (1986).

- The shareholders conclude that the risks of disrupting board operations and politicizing the nominating process outweigh any benefits offered by proxy access.

Similarly, if shareholders do choose to adopt a proxy-access bylaw, they might rationally choose one with features different from those in the Proposed Rule. For example, the shareholders might choose to adopt a proxy-access bylaw that is more restrictive than that provided in the Proposed Rule, with higher ownership thresholds, a longer holding period or the kind of triggers that the Commission previously advocated.[25] The Proposed Rule, however, permits only those variations that offer less-restrictive criteria for proxy access.[26] If the Commission adopts the Proposed Rule as written, therefore, shareholders would lose the right to reject proxy access or to adopt a more restrictive bylaw which, in their informed judgment, would better serve their corporation.

At a minimum, therefore, any final rule adopted by the Commission should allow shareholders to opt-out of the operation of the federal rule if they have made an affirmative choice to adopt a different proxy-access bylaw under state law or if they have affirmatively voted against proxy access.[27] Such a private-ordering alternative would preserve shareholders' rights under state law. Accordingly, the Committee opposes adoption of proposed Rule 14a-11, but supports the relatively simple proposed change to Rule 14a-8(i)(8), which could facilitate shareholders' ability to affirmatively opt-out of proxy-access or adopt custom proxy-access bylaws under state law.[28]

Conclusion

The Committee greatly appreciates the Commission's long and thoughtful approach to the issue of proxy access. After reviewing the Release, however, the Committee urges the Commission not to adopt the mandatory proxy-access procedure described in proposed Rule 14a-11. The Committee believes that, in the fullness of time, an adaptive, private-ordering approach under state law will give greater voice to the rights of shareholders than a blanket rule imposed on all reporting companies. In contrast, the proposed change to Rule 14a-8(i)(8) is

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[25] *See* 2003 Release at 60,787 (the 2003 rule would have applied "only in those instances where criteria suggest that the company has been unresponsive to security holder concerns as they relate to the proxy process.").

[26] *See* Release at 29,031, which provides:

> [S]tate law or a company's governing documents may provide for nomination or disclosure rights in addition to those provided pursuant to Rule 14a-11 (e.g., a company could choose to provide a right for shareholders to have their nominees disclosed in the company's proxy materials regardless of share ownership—in that instance, the company's provision would apply for certain shareholders who would not otherwise have their nominees included in the company's proxy materials pursuant to rule 14a-11.

[27] The ability of shareholders to opt-out of the federal proxy-access rule is suggested by Question B.7 of the Release. Release at 29,033.

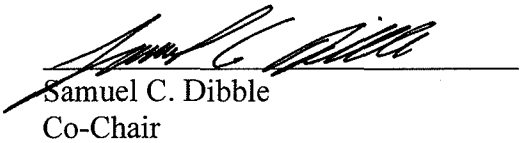
[28] Release at 29,082.

consistent with shareholders' rights under state law and could enhance the ability of shareholders to decide for themselves what level of proxy access is appropriate and under what conditions. Accordingly, the Committee supports the adoption of the proposed change to Rule 14a-8(i)(8).

Please note that the views and positions set forth in this letter are only those of the Committee. As such, they have not been adopted by the State Bar's Board of Governors, its overall membership or the overall membership of the Business Law Section, and are not to be construed as representing the position of the State Bar of California. Membership in the Business Law Section, and on the Committee, is voluntary and funding for their activities, including all legislative activities, is obtained entirely from voluntary sources.

Very truly yours,

W. Derrick Britt
Co-Chair



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