



DELAWARE STATE BAR ASSOCIATION

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July 24, 2009

Via Email: rule-comments@sec.gov

Ms. Elizabeth M. Murphy, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

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

Dear Ms. Murphy:

The Delaware State Bar Association (the "Association" or the "DSBA"), by the Council of its Section of Corporation Law (the "Council"), welcomes the opportunity to comment on the amendments to the proxy rules under the Securities Exchange Act of 1934 (the "Exchange Act") that the Securities and Exchange Commission (the "Commission" or "SEC") has proposed in the referenced release (the "Access Proposal").

The Delaware State Bar Association and the Section of Corporation Law

For more than 80 years the Association, which currently consists of over 4,000 members, has organized and united the lawyers who practice in the State of Delaware and served as their professional association. Through the work of its many sections and committees, the Association is regularly involved in matters pertaining to the profession, to the enforcement of our laws and to assuring equal access to the justice system for every citizen. To that end, the Association is strongly committed to educating the public about the law and the proper administration of justice.

With a membership of nearly 500 Delaware attorneys, judges and academics, the Section of Corporation Law promotes the objectives of the Delaware State Bar Association within the fields of law governing

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corporations and alternative business entities.¹ Responsibility for leading the Section rests with the Section's Council and officers. The Council and the Section's Alternative Entities Subcommittee are responsible for formulating and recommending to the Delaware General Assembly, after approval by the DSBA, amendments to the Delaware General Corporation Law, the Delaware Limited Liability Company Act, the Delaware Revised Uniform Limited Partnership Act and the Delaware Revised Uniform Partnership Act.

Overview

To the best of our knowledge, this is the first time that the Delaware State Bar Association or any of its membership groups has ever submitted a formal written comment to the Commission. We do so in this instance because we believe that the Access Proposal significantly implicates what the Commission properly notes is "the traditional role of the states in regulating corporate governance."²

While we do not advance any view about the merits of any particular system of proxy access, or whether to adopt any such system at all, we believe that recent changes to the Delaware General Corporation Law reflect a view that such a system may be beneficial to corporations that choose it.³ However, the thrust of our comment is that a single rule would unnecessarily deprive Delaware corporations of the flexibility state law confers to deal effectively with myriad different circumstances that legislators and rulemakers cannot anticipate, and would thereby undermine a key element of the state system of corporate governance that has been largely successful for decades.

Delaware law confers broad power upon stockholders to adopt bylaws establishing the terms and conditions of rights relating to the election of directors. In light of this power, and judging by the recent trend toward adoption of bylaws

¹ The Section's web site (http://dsba.org/sections/corporation_law.htm) contains additional information about the Section, and identifies the Section's officers and members of the Council of the Section.

² Access Proposal at 8. *See also CTS Corp. v. Dynamics Corp. of America*, 481 U.S. 69, 89 (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."); *Business Roundtable v. SEC*, 905 F.2d 406, 412 (D.C. Cir. 1990) ("corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law *expressly* requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation." [quoting] *Santa Fe Industries [v. Green]*, 430 U.S. [462] at 479 [(1977)] (emphasis in original, quoting *Cort v. Ash*, 422 U.S. 66, 84, 45 L. Ed. 2d 26, 95 S. Ct. 2080 (1975))).

³ By "proxy access," we mean any framework of rules under which a stockholder may require the corporation to include in its proxy statement and proxy card a person nominated by the stockholder, but not by the board of directors, for election to the board of directors.

prescribing a majority voting standard in the election of directors, we expect that stockholders and boards of directors will – if unconstrained by a mandatory, universally applicable rule like proposed Rule 14a-11 – widely adopt proxy access bylaws that implement their own preferences on a basis tailored to the circumstances of the individual corporation. Indeed, by adopting a bylaw that requires a supermajority vote of the board of directors to amend or repeal it, stockholders can significantly limit the ability of boards of directors to override the stockholders’ expressed preferences in regard to proxy access or proxy reimbursement bylaws.

Proposed Rule 14a-11, however, would substantially limit the ability of stockholders and boards of directors to set the terms of a proxy access system, or to choose a system of proxy expense reimbursement in lieu of a proxy access regime. In addition, the costs and uncertainties that would accompany this impairment of stockholder choice are considerable:

- If it adopts Rule 14a-11, the Commission would be establishing a new and complex administrative system to resolve disputes over the interpretation of an undeniably complex set of proxy access rules. Moreover, even with that administrative system in place, such disputes could proceed in federal courts, with attendant potential for conflicting interpretations of the Rule and for further burdens on the federal court system.
- If it adopts Rule 14a-11, the Commission would be establishing a complex set of rules that would inevitably require further refinement. Such refinement, however, will be more readily accomplished through an incremental process guided by broad stockholder consensus rather than through continual rulemaking intervention by the Commission.
- If it adopts Rule 14a-11, the Commission would effectively cut short an evolutionary process of refining proxy access systems that would facilitate stockholder choice and be most likely to lead to the adoption of systems suited to the diverse conditions and needs of individual corporations.

Because of our interest in promoting what we believe are the sound substantive policies of our state’s corporate law, and our belief that the judgments of stockholders and boards of directors of individual corporations in establishing (or rejecting) a proxy access system are likely to give better effect to investor preferences than a set of choices imposed by Commission rule, we urge the Commission not to adopt Rule 14a-11.⁴

⁴ We note, as does the Access Proposal, that other states will likely soon follow Delaware by enacting statutes expressly authorizing proxy access bylaws. *See, e.g.*, American Bar Association Section of Business Law, Committee on Corporate Laws, June 29, 2009 press release (available at https://www.abanet.org/abanet/media/release/news_release.cfm?releaseid=688) (announcing approval of “proposed amendments to the Model Business Corporation Act

Sections 112 and 113 of the Delaware General Corporation Law

One year ago, in a notable example of cooperation between federal and state bodies aimed at developing and clarifying the law, the Delaware Supreme Court responded in a matter of days to the Commission's request for guidance on the validity under Delaware law of a proposed bylaw requiring the corporation to reimburse proxy solicitation expenses incurred by stockholders seeking to elect director nominees not approved by the existing board of directors.⁵ The Delaware Supreme Court confirmed that stockholders, as well as boards of directors, have broad statutory power under state law to adopt bylaws that promote and define procedural rights, particularly in regard to the election of directors.⁶

New Sections 112 and 113 of the Delaware General Corporation Law, effective on August 1, 2009, emerged from the Council's effort to clarify further the validity and flexibility of bylaws establishing both proxy access and rights to reimbursement of proxy solicitation expenses.⁷ It is important to understand what those statutes – particularly Section 112 – do and do not do.

Section 112 permits stockholders to adopt bylaws that require the corporation to include in its proxy materials stockholder nominees for election as directors. Such bylaws may condition inclusion upon (1) minimum levels or duration of share ownership, (2) submission of background information, (3) restrictions on the number or proportion of directors nominated, (4) restrictions on acquisitions of shares of the corporation, (5) a requirement that the stockholder indemnify the corporation for losses arising from information submitted by the stockholder, or (6) any other lawful condition.

Section 113 permits stockholders to adopt bylaws that require the corporation to reimburse expenses incurred by a stockholder in connection with the solicitation of proxies for the election of directors. Such bylaws may condition reimbursement upon (1) the number or proportion of persons nominated by the stockholder seeking reimbursement, (2) whether the stockholder has previously requested reimbursement, (3) the proportion of votes cast for one or more nominees proposed by the stockholder seeking reimbursement, (4) the amount spent by the corporation in soliciting proxies for

regarding proxy access for director nominations and reasonable reimbursement for shareholder expenses incurred in proxy contests for director elections.”).

⁵ *CA, Inc. v. AFSCME Employees Pension Plan*, 953 A.2d 227 (Del. 2008).

⁶ *Id.* at 234-235 (“a proper function of bylaws is not to mandate how the board should decide specific substantive business decisions, but rather, to define the process and procedures by which those decisions are made.”) and 237 (“The context of the Bylaw at issue here is the process for electing directors--a subject in which shareholders of Delaware corporations have a legitimate and protected interest.”).

⁷ H.B. 19, 145th Gen. Assem. (Del. 2009). The text of the legislation that added Sections 112 and 113 to the Delaware General Corporation Law is available at <http://legis.delaware.gov/LIS/LIS145.nsf/2bede841c6272c888025698400433a04/f97681d196d4872385257571004e64f1?OpenDocument>.

the election, (5) limitations related to the election of directors by cumulative voting, or (6) any other lawful condition.

Sections 112 and 113 do *not*, however, mandate, or even prescribe default parameters for, rights to proxy access or proxy solicitation expense reimbursement. The Council considered developing such parameters, but concluded that they would be inconsistent with the overall philosophy of the Delaware General Corporation Law: to enable stockholders and boards to establish their own corporation's internal rules in light of the wide variety of circumstances in which Delaware corporations function, rather than to limit their ability to do so.⁸

Thus, the substantive state law policy reflected in Sections 112 and 113 is to promote the flexibility to adopt electoral arrangements (including proxy access) best suited to the corporation as determined by its stockholders and directors. By setting forth a non-exclusive list of conditions that bylaws governing proxy access may contain, Section 112 clarifies the extent of stockholder choice in regard to proxy access, through their power (concurrent with that of the board of directors⁹) to adopt bylaws governing the process by which directors are elected. Thus, the new provisions recognize that stockholders (or directors) may determine that a proxy access system may indeed be beneficial, and expressly authorize them to adopt such a system; at the same time, the statute gives stockholders the flexibility to determine that, with respect to any particular corporation, such a system would not be beneficial, or that a reimbursement system might provide a better alternative.

How Proposed Rule 14a-11 Would Impair the Substantive State Law Rights of Stockholders and Boards of Directors

In a recent proclamation, President Barack Obama articulated his Administration's deference to state law and urged federal agencies to be cautious in adopting regulations that preempt state law:

[It is] the general policy of my Administration that preemption of State law by executive departments and agencies should be undertaken only with full consideration of the legitimate prerogatives of the States and with a sufficient legal basis for preemption.¹⁰

⁸ See, e.g., Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 Colum. L. Rev. 1749, 1782-1786 (2006) (describing a "legislative preference for flexibility and private ordering").

⁹ Under Delaware law, the board of directors only has the power to adopt, amend or repeal bylaws if the corporation's certificate of incorporation confers such power upon it. 8 *Del. C.* § 109(a). Certificates of incorporation of Delaware corporations routinely confer such authority.

¹⁰ Memorandum for the Heads of Executive Departments and Agencies, dated May 20, 2009 (available at http://www.whitehouse.gov/the_press_office/Presidential-Memorandum-Regarding-Preemption/). It is noteworthy in this regard that proposed

The Commission has acknowledged the important role of state law in corporate governance rules. Proposed Rule 14a-11 would not require proxy access if state law prohibits stockholders from nominating candidates for election to the board of directors.¹¹ As the Commission's proposal also acknowledges, however, this particular form of deference lacks genuine content, since no state, to our knowledge (and certainly not Delaware), precludes stockholders from nominating directors.¹²

On the other hand, and as explained more fully below, proposed Rule 14a-11 will prohibit stockholders and boards of directors from adopting a variety of flexible governance rules, including proxy access provisions, to the extent that such privately adopted provisions would limit substantive access rights conferred by proposed Rule 14a-11. Thus, Rule 14a-11 would deprive stockholders and boards of directors of significant rights and powers under state law, in at least the following ways:

1. *Preventing Stockholders from Exercising Their State Law Rights to Structure Proxy Access*

The Access Proposal establishes that “[a] shareholder proposal would conflict with Rule 14a-11 . . . to the extent that the proposal would purport to prevent a shareholder or shareholder group that met the requirements of proposed Rule 14a-11 from having their nominee for director included in the company’s proxy materials.” Thus, proposed Rule 14a-11, if adopted, would prevent stockholders from exercising their state law right, codified in Section 112, to adopt a variety of terms for proxy access that differ from the terms prescribed in proposed Rule 14a-11. Some illustrative examples follow:

- Level of Ownership. Proposed Rule 14a-11 conditions proxy access on a level of beneficial ownership that is pegged to the size of the corporation (*i.e.*, 1% of the corporation’s outstanding voting securities for large accelerated filers; 3% for accelerated filers; and 5% for non-accelerated filers). The “great deal of comment” on this issue when a mandatory proxy access rule was proposed by the Commission in 2003 (*see* Access Proposal at 44) suggests that stockholders may prefer utilizing their rights under Section 112 to establish a higher (*e.g.*, 2% in the case of a large accelerated filer) minimum ownership requirement. Similarly, stockholders might wish to limit the allowable size of the sponsoring group (*i.e.*, the stockholders aggregating their shares to meet the requisite level of ownership) to a specified

Rule 14a-11 would preempt North Dakota’s proxy access statute, which requires nominating stockholders or groups to have owned 5% of the company’s stock for at least two years. *N.D. Cent. Code* §§ 10-35-02(8), 10-35-08 (2009). Those minimum holding size and duration requirements are considerably more restrictive than the counterpart provisions of proposed Rule 14a-11 and, as we read it, the Access Proposal (at n.152) would not permit those more restrictive state law requirements to stand.

¹¹ Access Proposal at 27.

¹² Access Proposal at 181 n.339.

number of members. Proposed Rule 14a-11 would prohibit stockholders from exercising their state law right to adopt a bylaw incorporating any of these more demanding eligibility requirements.

- Duration of Ownership. Proposed Rule 14a-11 conditions proxy access on (i) maintaining the requisite level of ownership for at least one year and (ii) certifying that the requisite ownership level will be maintained through the relevant annual meeting. Clearly, these choices are not universally embraced: when the Commission in 2003 proposed a two-year minimum holding period as a requirement for proxy access, “the majority of commenters that addressed the topic support[ed] the proposed holding period.”¹³ In light of those comments, it is not unreasonable to expect that, if permitted, stockholders of many corporations would choose a minimum holding period longer than the period that proposed Rule 14a-11 would establish. Similarly, stockholders may believe that a nominating stockholder should represent that, if their nominee is elected, they will hold the requisite amount of shares through the term of the nominee’s board service.¹⁴ If adopted, however, proposed Rule 14a-11 would prohibit stockholders from exercising their state law right to give effect to such preferences.
- Type of Ownership. Proposed Rule 14a-11 does not define “beneficial ownership.” This gap leaves unanswered whether derivative positions such as total return swaps should be counted in determining whether the minimum share ownership eligibility requirement is satisfied.¹⁵ Under state law, stockholders could craft proxy access eligibility requirements to account for any such derivative positions. Because adopting such requirements could in some instances deny proxy access rights to a person who would otherwise be entitled to them under proposed Rule 14a-11, that Rule would deprive stockholders of their state law right to establish eligibility requirements that account for derivative positions in their definition of beneficial ownership.
- Maximum Number of Nominees. Proposed Rule 14a-11 limits the number of proxy access nominees to a *percentage* of the corporation’s authorized board seats. Stockholders could sensibly prefer a different rule – indeed, the Commission’s 2003 proposal itself contemplated a fixed number of access nominees. Suppose, for example, that a corporation has a 12-member board of directors and two classes of outstanding stock: Class A, held by a controlling person or group, entitled to elect

¹³ Access Proposal at 51.

¹⁴ See Access Proposal at 52 n.144.

¹⁵ See Access Proposal at 59, question C.15. As discussed by the court in *CSX Corp. v. The Children’s Investment Fund Management (UK) LLP*, 562 F. Supp. 2d 511 (S.D.N.Y. 2008), there are “substantial reasons for concluding that” such derivative positions would impute beneficial ownership to an entity since they provide a person with “the ability to influence voting, purchase or sale decisions of its counterparties” to a derivative position. *Id.* at 545-46. Conversely, there may be substantial reasons to conclude that a stockholder’s short position should be deducted from its nominal share ownership level, to reflect net economic interest in the corporation.

75% of the total number of directors, and Class B, held by the public, entitled to elect the remaining 25%. Under the proposed Rule, the corporation would be required to include in its proxy materials as many as three proxy access nominees – the maximum number that the public stockholders are entitled to elect. It is conceivable, however, that the stockholders (either the public stockholders or the stockholders as a whole) would prefer to limit the number of proxy access nominees to one or two, rather than all three of the board seats elected by the stockholders at large.¹⁶ The proposed Rule, however, would foreclose stockholders from exercising their state law rights to establish such a limitation.

- Determining Priority Among Nominees. Proposed Rule 14a-11 establishes a “first in” standard of priority where there are more eligible proxy access nominees than the Rule permits.¹⁷ Again, the Commission’s 2003 proposal differed from the current proposal, and would have accorded priority based on share ownership. Furthermore, “[T]he limited number of shareholders that commented [on this proposed rule] did not generally object to such a standard.”¹⁸ In light of those comments, it is not unreasonable to expect that, if permitted, stockholders in many corporations would exercise their state law rights to adopt a priority rule based on share ownership. But proposed Rule 14a-11 would deprive them of that state law right, because a share ownership priority rule could deny some stockholders an access right that Rule 14a-11 would otherwise provide. Similarly, stockholders would lose their state law right to adopt a proxy access bylaw that prevents a stockholder or group from making a nomination for consecutive years if the stockholder’s or group’s previously sponsored nominee were not elected or did not receive a minimum number of votes.
- Relationships Between Nominator And Nominees. As the Access Proposal observes, there is a concern that mandatory access to a corporation’s proxy materials may facilitate the election of “‘special interest’ or ‘single issue’ directors that would advance the interests of the nominating shareholder over the interests of shareholders as a group.”¹⁹ In 2003, the Commission proposed combating this potential consequence of a mandatory proxy access right by including a “limitation on relationships between a nominating shareholder or group and the director nominee that is included in company proxy materials” – for example, by prohibiting the nominee from being a member of the immediate family, or an employee of, the nominating shareholder or group.²⁰ Rational stockholders may prefer limitations that the Commission previously proposed to require. By omitting such limitations, however, proposed Rule 14a-11 prohibits stockholders from exercising their state law right to adopt such limitations.

¹⁶ See Access Proposal at 79, question E.9.

¹⁷ Access Proposal at 76.

¹⁸ Access Proposal at 77.

¹⁹ Access Proposal at 67.

²⁰ *Id.* at 68

- Proxy Access Rights and Election Contests. Under proposed Rule 14a-11, the proxy access rights it prescribes would be available regardless of whether a “traditional” election contest (*i.e.*, an election contest in which the insurgent is not seeking to use the corporation’s proxy materials) is otherwise under way. Stockholders may wish to preclude proxy access where such a contest occurs, especially if it involves the contested election of a majority of the directors. Again, however, proposed Rule 14a-11 would deprive stockholders of their state law right to adopt a proxy access bylaw implementing such a choice.

2. *Preventing Stockholders from Exercising Their State Law Rights to Adopt Alternative Governance Rules They Deem Appropriate*

- a. Prohibiting Selection of a Reimbursement Scheme in Lieu of Proxy Access.

Proposed Rule 14a-11 *mandates* proxy access. As discussed in the Access Proposal, however, there are many potential costs to a corporation, and indirectly its stockholders, associated with such a mandate, including:

- Quantifiable costs of internal company or shareholder time and “for the service of outside professionals” (*see* Access Proposal at 148);
- Costs arising from “potential changes to corporate behavior and potential lower board quality” (*id.* at 189);
- Costs related to “the potential complexity of the proxy process” (*id.* at 192); and
- Costs related to “preparing disclosure, printing and mailing and costs of additional solicitations” (*id.* at 194-95).

Under Delaware law, stockholders and boards of directors have the right to decide that these potential costs of a mandatory proxy access procedure outweigh the potential benefits to that particular corporation. They may prefer, instead, to adopt a proxy expense reimbursement bylaw under Section 113 of the Delaware General Corporation Law as a means to provide stockholders greater influence in the election of directors. Proposed Rule 14a-11 would forbid stockholders and boards of directors from exercising the right to make this choice conferred upon them by controlling state law.

- b. Effectively Lengthening the Notice Period Under Advance Notice Bylaws.

Proposed Rule 14a-11 may also effectively deprive stockholders and boards of directors of their state law right to adopt advance notice bylaws with a short notice period. Under the proposed Rule, the nominating stockholder or group must provide notice of its intent to include a nominee in the corporation’s proxy materials by the deadline in the advance notice bylaw. If the corporation seeks to exclude an access

nominee, however, it must inform the Commission “no later than 80 days prior to the company filing its definitive proxy statement.” Because the proposed Rule allows for up to 28 calendar days for correspondence between the corporation and nominating group or stockholder before the corporation informs the Commission of its decision to exclude a nominee, a nomination bylaw that requires less than 108 calendar days (80 plus 28) notice prior to filing a definitive proxy statement could effectively preclude a registrant from seeking to exclude an access nominee from its proxy materials. Accordingly, the proposed Rule could have the consequence of eliminating the state law option to require notice of a nomination less than 108 calendar days before filing a definitive proxy statement.²¹

* * *

In proposing that stockholders be afforded the ability to use the corporation’s proxy materials to submit for adoption bylaws that expand proxy access beyond what proposed Rule 14a-11 would prescribe, the Access Proposal invokes “the importance of facilitating shareholders’ ability to exercise their rights to determine their own additional shareholder nomination proxy disclosure and related procedures.”²² To the contrary, proposed Rule 14a-11, if adopted, would actually impede the exercise of important stockholder rights available under existing state law. As discussed above, the proposal would prohibit stockholders and boards of directors from exercising their state law power to adopt a wide range of bylaws (including bylaws that impose more stringent requirements for proxy access than proposed Rule 14a-11), or to reject proxy access altogether.

The State Law Bylaw Approach Offers a Viable Means to Proxy Access

What rationale, then, could support proposed Rule 14a-11’s one-sided curtailment of stockholder and director rights under state law? A possible rationale is that existing processes for stockholder action require prohibitive, or at least undue, transaction costs for adopting a proxy access bylaw. We respectfully suggest, however, that this rationale is unpersuasive, for several reasons.

First, model forms of proxy access bylaws have already been developed: in addition to access bylaws already adopted,²³ an American Bar Association task force has

²¹ Such a period is common among advance notice bylaw provisions. According to a recent RiskMetrics Group study, an indicative sample of advance notice bylaws revealed that all 11 corporations reviewed “have a timeframe of not less than 90 days or more than 120 days, generally measured from the first anniversary of the preceding year’s annual meeting.” Stephanie Mulette, 2009 Governance Background Report: Advance Notice Requirements (RiskMetrics Group Apr. 1, 2009).

²² Access Proposal at 123.

²³ From the time of the company’s initial public offering, Section 2.7 of the bylaws of RiskMetrics Group, Inc., a Delaware corporation, has authorized proxy access for stockholders who have owned 4% or more of the company’s stock for at least two years. See RiskMetrics Group, Inc., Amendment No. 3 to Registration Statement (S-1/A), at

created a flexible form of bylaw that addresses many of the difficult mechanical issues associated with proxy access.²⁴ In short, legally sound drafting alternatives are currently available, and more will be forthcoming.

Second, recent evidence establishes that governance rules widely sought by stockholders can be adopted with remarkable speed. The Access Proposal acknowledges that a significant majority of S&P 500 companies, in the space of just three years, have adopted a majority voting rule for the election of directors, in lieu of the state law default rule of plurality voting.²⁵ This trend toward adoption of majority voting has occurred without significant controversy, or even a need for formal stockholder action. Thus, there is good reason to expect that boards of directors, with their concurrent power to adopt bylaws, will systematically attempt to promote, rather than undermine, proxy access bylaws that would satisfy stockholders and avoid contested votes on conflicting bylaw proposals.

Third, if the Commission were to amend Rule 14a-8 to permit stockholders to use that rule to propose proxy access bylaws, formal stockholder action to adopt such bylaws would not be prohibitively expensive. As the Commission notes, “the proposed amendment to Rule 14a-8(i)(8) also may facilitate shareholders and companies working together to tailor companies’ governing documents to suit the specific interests of the company and its shareholders.”²⁶ Elsewhere, moreover, the Commission estimates that participation in the shareholder proposal process requires about 40 hours of outside professional time (including 10 hours to prepare the proposal), at an estimated \$400 per hour.²⁷ If proxy access were truly value-enhancing in a meaningful way, and even if formal stockholder initiative were necessary to promote a proxy access bylaw, it is hard to see why \$16,000 would preclude stockholders from putting an access proposal to a

Ex. 3.2 (Jan. 8, 2008), *available at* <http://investor.riskmetrics.com/phoenix.zhtml?c=215573&p=irol-secText&TEXT=aHR0cDovL2NjYm4uMTBrd2l6YXJkLmNvbS94bWwvZmlsaW5nLnhtbD9yZXBvPXRlbmsmaXBhZ2U9NTM3Nzk5MCZkb2M9NA%3d%3d>. That bylaw has also provided that a nominator whose candidate receives less than 25% of the votes cast may not nominate further candidates for four years thereafter. Proposed Rule 14a-11 would invalidate these provisions.

²⁴ June 15, 2009 Comment to the Commission from Robert Todd Lang and Charles M. Nathan, co-chairs, on behalf of the Task Force on Shareholder Proposals of the Committee on the Federal Regulation of Securities, Section of Business Law of the American Bar Association (available at <http://www.sec.gov/comments/s7-10-09/s71009-29.pdf>).

²⁵ Access Proposal at 20, n. 69. In 2006, when Delaware amended its statutes to clarify the operation of majority voting rules, all but a very small number of S&P 500 companies followed the default plurality voting rule. See Claudia Allen, Survey of Majority Voting in Director Elections, February 20, 2006 (available at http://www.ngelaw.com/files/tbl_s47Details/FileUpload265/176/survey_callen.pdf).

²⁶ Access Proposal at 188.

²⁷ *Id.* at 160-161.

stockholder vote, especially in the case of a 1% stockholder of a large accelerated filer whose investment is presumably worth at least \$7 million.

Fourth, it is unlikely that a board of directors would significantly frustrate stockholders' efforts to adopt a proxy access bylaw satisfactory to them. Stockholders can adopt such bylaws without board approval, of course. Moreover, such stockholder-adopted bylaws may include procedural requirements that limit the board's ability to amend or repeal the bylaw. For example, stockholders have the power to adopt bylaws that require a supermajority vote of the board of directors to amend or repeal a bylaw, including one adopted by stockholders.²⁸ There are also significant equitable limitations on the power of the board of directors to frustrate stockholder electoral efforts.²⁹

As the majority voting experience demonstrates, it is likely that, as companies increasingly adopt proxy access bylaws, formal stockholder initiatives will be largely unnecessary. As discussed in the next section, moreover, this incremental approach has much to commend it in terms of avoiding institutional costs and uncertainties.

The State Law Bylaw Approach to Proxy Access Avoids Significant Costs and Uncertainties

Declining to adopt proposed Rule 14a-11, and instead allowing stockholders and boards of directors to develop flexible proxy access arrangements on a company by company basis, will facilitate stockholder choice, avoid conflicts with substantive state law, and avoid many significant institutional costs and uncertainties, as discussed below.

1. *Optimizing Dispute Resolution*

The Commission's Access Proposal recognizes the possibility that disputes will arise regarding whether particular access nominations comply with Rule 14a-11, and addresses that possibility by proposing a detailed system of dispute resolution in which disputes proceed initially through informal staff review.³⁰ The Commission's many questions acknowledge, however, that the proposed dispute resolution system is novel in many respects and uncertain as to its workability.³¹ In particular, the Commission notes that the discretionary staff determination that is the linchpin of the system would not constitute a dispositive adjudication of the conflict and "would not preclude an interested person from pursuing a judicial determination regarding the application of Rule 14a-

²⁸ 8 Del. C. § 216; see also *Frantz v. EAC Indus., Inc.*, 501 A.2d 401 (Del. 1985); *Hollinger Int'l, Inc. v. Black*, 844 A.2d 1022, 1079-1080 (Del. Ch. 2004).

²⁹ See, e.g., *MM Co's, Inc. v. Liquid Audio, Inc.*, 813 A.2d 1118 (Del. 2003); *Chesapeake Corp. v. Shore*, 771 A.2d 293 (Del. Ch. 2000); *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988).

³⁰ Access Proposal at 100-107.

³¹ See, e.g., Access Proposal at 108-113.

11.”³² Presumably, any conflict over the application of Rule 14a-11 would have to be resolved in a federal court.³³

We respectfully submit that this jurisdictional outcome would disserve stockholders, corporations and the judicial system at large. Steering disputes over proxy access to the federal court system could place a significant additional burden on an already over-burdened federal judiciary, which has historically sought to find ways to contract, rather than expand, its very heavy case load. It is foreseeable, moreover, that centering proxy access disputes in federal court would, through the exercise of supplemental jurisdiction,³⁴ also sweep into federal court election-related disputes that have traditionally been adjudicated in state court. For example, proposed Rule 14a-11(a)(2) requires that an access nominee’s election comply with “the registrant’s governing documents.” Disputes over whether nominees satisfy director qualification provisions, including advance notice provisions, will inevitably involve state law issues of bylaw and charter interpretation.

Steering such disputes to the federal court system would also be likely to impair clarity and predictability. It is common in the federal court system to have varying, and sometimes conflicting, decisions addressing the same or similar issues. It may take many years before the United States Supreme Court is in a position to bring clarity to the often varying and sometimes conflicting opinions of the lower courts.³⁵

By contrast, if the issues addressed by the proposal are left to development under state law – as has traditionally been the case – controversies can be definitively and efficiently resolved in one set of courts – namely, the courts of the corporation’s state of incorporation. For example, disputes over the operation of a Delaware corporation’s proxy access bylaw could (and in most instances probably would) be presented to and quickly resolved by the Delaware Court of Chancery.³⁶ As has been widely observed, that court has a well-earned reputation for prompt, sophisticated and efficient resolution

³² Access Proposal at n.215.

³³ Exchange Act §27, 15 U.S.C. §78aa.

³⁴ 28 U.S.C. §1367(a).

³⁵ Indeed, the Commission confronted this problem in its most recent rulemaking addressing proxy access. Shareholder Proposals Relating To The Election Of Directors, SEC Release No. 34-56914, at 9-12 (Dec. 6, 2007) (“To permit this escalating state of confusion to continue for the 2008 proxy season and beyond would effectively require shareholders and companies to go to court to determine the meaning of the Commission’s proxy rules, and it could take years before the U.S. Supreme Court resolved any resulting conflicts between the circuits.”).

³⁶ 8 *Del. C.* § 111(a) (“Any civil action to interpret, apply, enforce or determine the validity of the provisions of: (1) The certificate of incorporation or the bylaws of a corporation; ... may be brought in the Court of Chancery, except to the extent that a statute confers exclusive jurisdiction on a court, agency or tribunal other than the Court of Chancery.”).

of specialized corporate law disputes.³⁷ If one were to choose between Rule 14a-11 and the state law proxy access bylaw approach we advocate, based solely on which approach had the better dispute resolution mechanism, it would be difficult, we submit, to favor Rule 14a-11.

The Commission's preliminary preference to avoid state court resolution of proxy access disputes, however, appears to stem from a concern (reflected in question G.18 in the Access Proposal) that litigation over proxy access rights may delay shareholder meetings. For Delaware corporations, this concern is unjustified. The Delaware courts have a long record of attempting to avoid delays of shareholder meetings, in the absence of disclosure violations that threaten the integrity of the vote.³⁸ The Delaware corporation law gives our courts jurisdiction to allow voting for directors to go forward and determine later (and very promptly) which nominees have been elected.³⁹ The Delaware courts, in fact, have stressed their particular commitment to prompt resolution of electoral disputes.⁴⁰ Again, we respectfully suggest that Delaware state courts are

³⁷ See, e.g., Omari Scott Simmons, *Branding the Small Wonder: Delaware's Dominance and the Market for Corporate Law*, 42 U. Rich. L. Rev. 1129, 1163-1164 (2008); Marcel Kahan & Edward Rock, *Symbiotic Federalism and the Structure of Corporate Law*, 58 Vand. L. Rev. 1573, 1605, 1612 (2005) ("Delaware has taken great care in developing a first-rate system for private enforcement. It is the only state in the nation that has a specialized corporate court, the Court of Chancery. This court is well-funded, enjoys wide respect, resolves disputes speedily, and probably accounts for the fact that Delaware's overall court system is ranked first among all states."; "Delaware's judiciary is less politicized and has greater claims to expertise in corporate law than the federal judiciary"); William H. Rehnquist, *The Prominence of the Delaware Court of Chancery in the State-Federal Joint Venture of Providing Justice*, 48 Bus. Law. 351 (1992).

³⁸ See, e.g., *Steel Partners II, L.P. v. Point Blank Solutions, Inc.*, 2008 Del. Ch. LEXIS 107 (Del. Ch. Aug. 12, 2008) (declining corporation's request to defer annual meeting); *Union Pac. Corp. v. Santa Fe Pac. Corp.*, 1994 Del. Ch. LEXIS 188 (Del. Ch. Oct. 18, 1994) (refusing to order expedited proceedings on application to enjoin a shareholder vote on merger where a negative vote would obviate the need for any judicial review and an affirmative vote, if later shown to be tainted by proxy disclosure violations, could be judicially nullified); see also *Newcastle Partners, L.P. v. Vesta Insurance Group, Inc.*, 887 A.2d 975 (Del. Ch. 2005), *aff'd*, 2005 Del. LEXIS 463 (Del. Nov. 16, 2005) (compelling convening of annual meeting of stockholders despite incumbent directors' inability to solicit proxies under SEC requirements).

³⁹ 8 Del. C. § 225 (providing for summary proceedings to determine results of elections of directors).

⁴⁰ *Box v. Box*, 695 A.2d 395, 398 (Del. 1997); see also *Levitt Corp. v. Office Depot, Inc.*, 2008 Del. Ch. LEXIS 47 (Del. Ch. Apr. 14, 2008) (determining interpretation of advance notice bylaw and nominee eligibility, with suit filed on March 17, 2008, opinion issued on April 14, 2008, and annual meeting held on April 23, 2008); *JANA Master Fund, Ltd. v. CNET Networks, Inc.*, 954 A.2d 335 (Del. Ch. 2008), *aff'd* 947 A.2d 1120 (Del. 2008) (determining interpretation of advance notice bylaw and nominee eligibility, with suit

institutionally far more capable than federal adjudicative bodies to resolve issues of proxy access bylaw interpretation promptly and authoritatively.

2. Minimizing Regulatory Choices

The Commission's Access Proposal presents a formidable number of questions about how Rule 14a-11 should operate.⁴¹ If the Commission adopts a mandatory proxy access rule the Commission will necessarily have to answer most if not all of those knotty mechanical and policy questions, and its determinations will apply uniformly and inflexibly to all public corporations.

In contrast, if the Commission withdraws proposed Rule 14a-11 and allows stockholders and directors to develop their own proxy access regimes under state law bylaw provisions, all of these intricate policy judgments can be left to those whose economic relationships and rights will be affected by them, and the Commission can justifiably avoid making all of those judgments.⁴²

There nonetheless remains an important Commission role in regulating proxy access, because public companies will likely develop proxy access systems using the state bylaw mechanism. For example, the Commission must address, as it has in proposed Rule 14a-19, what disclosures should be required in connection with exercise of proxy access rights. Likewise, the Commission should address, as the Access Proposal does, the question of liability under the federal securities laws for material misrepresentations in information supplied in connection with the exercise of any proxy access right. Finally, the Commission is considering, as it should, whether to (i) relax the election exclusion in Rule 14a-8 so as to permit submission of bylaw amendment proposals relating to proxy access, and (ii) exempt certain actions relating to access nominations from certain of the proxy rules.

filed January 7, 2008, opinion issued on March 13, 2008, affirmed May 13, 2008, and annual meeting originally anticipated for June 2008).

⁴¹ Such issues include choosing an ownership eligibility threshold, determining how such a requirement should operate if the company has multiple classes of stock, how to determine whether the ownership requirement has been satisfied, how to handle sales of stock for purposes of that requirement, whether to require a nominee to satisfy independence requirements, what role the board's nominating committee should play, whether to require nominees to be independent of stockholders nominating them, how to prioritize access nominations in excess of the permitted number, and whether advance notice bylaws should determine the deadline for making access nominations.

⁴² Specifically, withdrawal of proposed Rule 14a-11 would, as we read it, obviate the need to resolve the following questions in the Access Proposal: C.1-C.24, D.1-D.8, D.13-D.16, E.1-E.13, F.8-F.11, G.2, G.7-G.10, and G.12-G.20.

3. *Enhancing Flexibility to Deal with Diverse Circumstances*

Given the complexity of proxy access systems, it is certain that practical problems will arise with any new rule of proxy access, particularly an untested one like Rule 14a-11. Problems that will inevitably crop up under such a rule would have to be addressed by further Commission regulatory action. If proposed Rule 14a-11 is complex in its current form, one can be certain that the Rule will only become more complex as new questions emerge upon application of the Rule in unanticipated circumstances.

Perhaps the Commission will make the institutional commitment to keep Rule 14a-11 up to date as it encounters unanticipated circumstances. We suggest, however, that Delaware's approach provides a considerably more flexible and responsive solution, permitting proxy access bylaws to evolve fluidly and efficiently with experience. Any unanticipated problems can be fixed by simple board of directors action to amend the proxy access bylaw.⁴³ In contrast, a rigid regulatory regime like proposed Rule 14a-11 will prevent stockholders and boards of directors from developing a reliable and tested proxy access system that is compatible with the particular needs and circumstances of their corporation.

Indeed, a universal provision would fail to accommodate the fact that public corporations differ greatly, in both their businesses and their corporate structures. For example, a corporate board may be classified or elected annually. A corporation may or may not have majority voting (in fact, the Release itself notes that the absence of majority voting may drive the need for proxy access). Some corporations may be controlled by a single stockholder or may have different classes of voting stock. These different corporate governance constructs may well call for different access regimes. On the other hand, as noted above, some stockholders and directors may prefer a reimbursement regime to an access regime. Rather than recognizing these differences, Rule 14a-11 would impose a universal rule on all publicly traded corporations, regardless of the needs of the corporation or the wishes of its stockholders. While the Rule would not preclude corporations from opting into additional access regimes, the efficacy of such an opt-in would be questionable if the corporation were nevertheless subject to the universal rule as well. Indeed, the adoption of Rule 14a-11 is likely to cut off all innovation in this area, as it seems unlikely that stockholders and directors would choose to subject corporations to multiple access regimes given the cost and confusion that would likely be entailed.

Conclusion

We urge the Commission to decline to adopt proposed Rule 14a-11. It should instead allow proxy access systems to develop under the framework of private ordering and shareholder choice created by state law. The one-sided inflexibility of proposed Rule

⁴³ We would expect that unanticipated mechanical issues would involve uncontroversial amendments, although in light of stockholders' concurrent power to amend the bylaws, boards of directors must exercise caution in adopting any amendments that might be viewed as contrary to stockholder interests.

14a-11 impairs that scope of choice, and with it, significant substantive rights under state corporate law.

We appreciate the Commission's invitation to submit these comments. We are grateful for the opportunity to provide our views as the Commission completes its evaluation of the proposed proxy access rules.

Respectfully submitted,



Council of the Corporation Law Section
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