December 19, 2003

Mr. Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549

Re: File No. S7-19-03

Dear Mr. Katz:

The American Federation of State, County and Municipal Employees ("AFSCME") is the nation’s largest public service employees’ union representing more than 1.4 million members. Most of them participate as members and plan beneficiaries in over 150 public pension systems whose assets total $1.5 trillion. The AFSCME Employees’ Pension Plan is a long-term shareholder that manages $500 million in assets for its participants, who are staff members of AFSCME. We write in response to your request for comment on proposed amendments to the Commission’s proxy and other rules entitled “Security Holder Director Nominations” (the “Proposed Rules”).

State and local retirement funds in aggregate hold about 13 percent of all publicly held stock. These funds operate as fiduciaries responsible for the retirement benefits of public employees. As such they are the quintessential long-term stockholders with actuarial benefit obligations ranging up to thirty years. The consequences of corporate malfeasance and the subsequent fall in investor confidence has been dramatic for public funds and the state and local governments that are obligated to make up any investment shortfall so that benefits can be paid. In fact, there has been a dramatic decline in public funds assets of $300 billion between January 1, 2001 and December 31, 2002 based on Federal Reserve Flow of Funds reports. Nearly all of this decline is attributed to losses in public equities, and does not include the additional $30 billion in public contributions made during this period. The impact on AFSCME members is palpable. A spring 2003 report by the Wilshire Associates pension consultants discusses the “rapidly deteriorating financial health” of public retirement systems whose funding ratios have fallen by more than 20 percent.

The particular characteristics of public pension funds make corporate governance reform, generally, and proxy access, specifically, essential to asset stewardship. Public systems by nature of their immense size must achieve their diversification requirements by
essentially owning the market. Therefore, these funds on average have more than 70 percent of their public equity assets allocated to passive market indexes. Improved corporate governance and the ability to hold failed or non-performing boards accountable becomes a key approach to creating long-term value in these assets.

As a result, we feel a real sense of urgency about restoring accountability to our system of corporate governance. The Proposed Rules would help substantial, long-term shareholders do just that, though we believe that some changes to the Proposed Rules, discussed below in more detail, would make them more effective. We thus applaud the Commission for proposing this important change in the face of well-organized, well-funded and vigorous opposition from corporate managements and those who serve them.

It is critical to state up front what this debate is really about. It is not, as some opponents of the Proposed Rules have argued, about dramatically increasing the number of contested elections at well-run companies out of some misguided notion that proxy contests are themselves beneficial to individual companies or our economy. Nor is it about forcing boards to be even more attuned than they already are to short-term financial metrics and the demands of investors who follow the “Wall Street Walk” and communicate dissatisfaction by selling their stock. Finally, it is not simply about increasing the number of directors who possess “resume” or formal independence from companies, a task that has already been accelerated by Sarbanes-Oxley and the stock exchange listing standards but which we view as a starting point rather than an end in itself.

Rather, the debate currently under way over shareholder access to the company proxy statement is about whether it makes sense as a matter of public policy to provide a mechanism for substantial, long-term responsible owners to effect limited change at the board level in a cost-effective way when there is a consensus among those owners and other shareholders that such change would, on balance, be more helpful than damaging to shareholder value. We think the obvious right answer to that question is yes.

Two recent surveys commissioned by AFSCME confirm the importance to investors of a strong right of proxy access. In September 2003 AFSCME commissioned Lussier, Gregor, Vienna & Associates to survey the 50 largest public pension funds to determine how they view the importance of such a rule and how they might use it.¹ The results show that 80 percent think that it’s important (30% extremely important; 37% very important; and 13% important) to empower groups of shareholders to use a corporation’s proxy to nominate directors as a method to improve corporate governance. These funds represent 1.187 trillion dollars in assets. Nearly 70 percent of the funds that administer their own proxy voting policy can foresee a situation in which their fund, either individually or with a group, would seek to nominate candidates on the company proxy card. Seventy eight percent of the funds would consider voting for a shareholder nominated slate.

These views go well beyond the nation’s largest institutional investors and are, in fact, embraced broadly by America’s individual investors. The key findings of an August 2003 HarrisInteractive survey of more than 1,000 individual investors reveals the following: Eighty percent of survey participants think there should be a process to allow shareholders to nominate candidates for boards of directors; Ninety percent agree that corporate misconduct has weakened

² Views of Corporate Governance, HarrisInteractive Market Research, September 12, 2003.
investor confidence in the stock market; More than half of the shareholders agree that corporate management is not in the best position to decide who should be nominated to the board of directors.

A shareholder access right, circumscribed in the ways we discuss more fully below, would accomplish three important objectives. First, it would give shareholders with the right set of incentives a tool that would allow a significant intervention—the inclusion of a small number of director candidates on the company proxy statement—in those cases in which the proxy process has broken down and the value of shareholders’ investment is in serious peril. By the “right” incentives, we mean that a well-crafted shareholder access right would, as the Proposed Rules do, exclude shareholders bent on a takeover of the company, short-term holders and those whose economic stake in the company, aggregated with other like-minded shareholders, does not rise to a significant level.

Second, a shareholder right of access would promote meaningful communication between shareholders and boards of directors. We anticipate that the access right would be used sparingly, at companies with the most persistent and severe problems. In the vast majority of cases, shareholders and boards would engage in dialogue as a way to understand one another’s perspectives and arrive at mutually agreeable solutions. The existence of an access right would form part of the background to these discussions, and would require resistant, entrenched boards and managements to come to the table or face shareholder nominated board candidates in the future. At a recent conference, Peter Clapman, who heads TIAA-CREF’s corporate governance program—known for its “quiet diplomacy”—stated that his efforts would be aided by negotiating in the shadow of a shareholder access right.

Finally, shareholder intervention using a proxy access right would be a substitute for blunter, more costly, and less efficient means of redress. The last several years have seen, in addition to heightened shareholder activism, an increase in class action securities litigation, derivative litigation and corporate bankruptcies. Although the hostile takeover market has been relatively quiet of late, and bidders are constrained both by state law and corporate takeover defenses, a revitalized market for hostile takeovers has been recently reproposed as a method of disciplining poorly performing and unresponsive boards and managements. All of these mechanisms involve more substantial costs, both financial and in terms of distraction and disruption of corporate functioning, than the occasional contested election which the Proposed Rules would permit.

The Triggering Events

We are concerned that the shareholder access right laid out in the Proposed Rules would fall short of accomplishing these important goals because it would not allow timely intervention by shareholders. The proposed triggering events would interpose a delay of at least a year and, in the case of an access proposal submitted under Rule 14a-8, a year and a half or more. Such a delay would reduce the utility of the access right and would increase the likelihood that intervening events such as bankruptcy, stock exchange delisting or criminal prosecutions would moot the access right for all practical purposes.

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3 Many institutional investors rely to a large extent on a passive indexing strategy; when a company’s stock is delisted from a national exchange it is dropped from any stock index of which it was a component.
Accordingly, we urge that the Commission establish a “fast track” to shareholder access, perhaps with a higher ownership threshold, longer ownership period, or both, to permit shareholders to take immediate action where circumstances warrant without the occurrence of a formal triggering event. Such a regime would parallel the right provided by Rule 14a-8, which does not require a triggering event, and would not exceed the broad authority conferred on the Commission by section 14(a) of the Securities Exchange Act of 1934. If a triggering event is necessary, we suggest that the Commission condition immediate access on a trigger event involving unambiguous, measurable misconduct such as certain kinds of Commission enforcement actions, financial statement restatements resulting from particular kinds of accounting fraud, or criminal prosecution of an officer or director for conduct related to his or her duties.

With respect to the more deliberative track, assuming that triggering events are employed, the thresholds contained in the Proposed Rules create excessively high barriers to use of the access right. One proposed triggering event is the withholding of votes from at least one of the company’s director nominees by holders of more than 35% of votes cast. An analysis by the Council of Institutional Investors of a random sample of 2003 director votes at 308 companies included in S&P’s three major stock indices found only six companies—2% of the group—at which the 35% threshold was obtained. We believe that a withhold vote of 20% or more indicates profound shareholder dissatisfaction with a director and should provide the grounding for shareholder proxy access.

The second triggering event in the Proposed Rules is the approval of a proposal seeking implementation of a shareholder access regime (a “Triggering Proposal”) by a shareholder or group owning more than 1% of the company’s stock for at least a year. Since a Triggering Proposal would not bring about an access right unless approved by holders of a majority of votes cast, we see no reason to impose an additional obstacle by limiting the submission of the Triggering Proposal to 1% holders. An analysis of average holdings of the 123 largest public pension funds indicates that it would take no less than three of the largest funds and as many as 31 funds to reach 1% (see Exhibit).

Some contend that this requirement is necessary to deter frivolous submission of a Triggering Proposal at well-run, high-performing companies. We are confident that shareholders would be sufficiently discerning to defeat Triggering Proposals under those circumstances. After all, shareholders would recognize that the shareholder access right entails costs, and would grant it only when they believe the benefits outweigh those costs. Institutional Shareholder Services has indicated that it would evaluate Triggering Proposals on a case-by-case basis, and would subject them to rigorous analysis. There is thus no basis for the characterization of the Triggering Proposal as a “freebie” whose passage is assured.

The Nominating Shareholder or Group

The Proposed Rules restrict shareholders eligible to include candidates on the company proxy statement to shareholders or groups owning more than 5% of a company’s stock for a period of two years. We agree with the Commission that it is important to limit application of the access right to substantial shareholders or groups. However, we continue to believe that 3%, the threshold we proposed in our letter to the Commission in May, is sufficiently high to ensure

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4 This threshold, as well as any others contained in the final rule, should be calculated from votes cast, not shares outstanding.
seriousness but not so onerous that the rule is not used. Especially in light of the long lead times required by the triggering events, and the need for extensive outreach to assemble even a small coalition, we believe that the proposed 5% threshold is too high.

Our analysis of public pension fund equity holdings indicates the great difficulty in reaching the 5% nominating group requirement, making the threshold nearly impossible to attain through public combinations. By our estimates, the 17 largest public pension systems hold in the aggregate 3.83% of each large cap stock (see Exhibit). The National Coalition for Corporate Reform also pointed out in its letter to the Commission, the combined ownership of the California Public Employees Retirement System, the California State Teachers’ Retirement System and the New York State Common Retirement Fund—which together represent one-third of public pension fund holdings—exceeded 2% in only one instance out of their one hundred largest domestic equity holdings. Setting the threshold at 5% would require the participation of corporate pension funds and mutual funds, which for a variety of reasons—including conflicts of interest—have not been willing to engage in shareholder activism. For similar reasons, allowing aggregation is crucial to making a shareholder access right even remotely useful, since only a few, non-activist institutional investors would meet the threshold by themselves.

Nor is the 5% threshold necessary, as some urge, to reduce the danger that so-called “special interest” directors, who aim to advance an agenda not shared by the bulk of a company’s shareholders, will be elected to the board. Any candidate included in the company proxy statement must be elected by holders of a plurality, and in a few cases a majority, of votes cast. There is no doubt that the incumbent board would inform shareholders, at company expense, of its opinion that a candidate was unworthy of their vote because he or she would pursue a special interest agenda. Voting patterns on shareholder proposals show clearly that shareholders vote in favor of proposals, like those dealing with takeover defenses and a few other issues, that they believe would enhance the value of a company if adopted, and vote down proposals that appear to be motivated by a non-shareholder agenda.

Limit on Number of Nominees

The Proposed Rules limit the number of nominees who can be included in the company proxy statement, allowing only one nominee at companies with the smallest boards. While we agree that a shareholder access right should be designed to prevent its use to effect a change of control, we are concerned that a single shareholder-nominated director would be too isolated on a board to be effective. Therefore, we urge the Commission to permit shareholders to include a minimum of two nominees, unless two would constitute a majority of the board. In any event, it is simpler to allow shareholders to include any number of nominees in the proxy statement that would make up less than half of the board.

Independence Standards

We support the Commission’s proposal to require director nominees included in the company proxy statement to be independent from the company and to satisfy any listing standards or other requirements applicable to the company. But the proposed requirement that the nominee(s) be independent from the nominating shareholder or group is puzzling and, in our opinion, unnecessary.

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5 Plurality voting presents no problems in the shareholder access context not also present today, where it is possible that multiple candidates would vie for the same board seat by mounting independent proxy campaigns.
Currently, directors with ties to a company—be they employment, familial or economic—are not precluded from serving as directors, provided the company complies with legal requirements and listing standards relating to boards and key committees. The Commission’s solution has been to give shareholders the information they need to decide whether a particular nominee’s ability to serve effectively is compromised by relationships with or dependency on the company. Shareholder-nominated candidates should be on the same footing.

Other Matters

We encourage the Commission, when crafting the final rules, to ensure that liability concerns do not frustrate use of the proxy access right. We support the creation of safe harbors under Rule 13(d), the federal proxy rules and other securities laws and rules to protect shareholders seeking to exercise their access right from liability. The Commission should apply these safe harbors to negotiated settlements as well, since settlements without actual election contests are likely to follow the adoption of an access regime.

Finally, under the Proposed Rules, once a triggering event has occurred, the period during which shareholders are eligible to include nominees is two years. We are concerned that such a short period might cut short the time in which shareholders and the incumbent board could engage in informal dialogue and negotiation. Accordingly, that period should be increased to five years.

We appreciate the opportunity to make our views known to the Commission on this reform of major importance to shareholders.

Sincerely,

GERALD W. McENTEE
International President

GWMcE:rf

enclosure

cc: Hon. William H. Donaldson, Chairman
    Hon. Paul Atkins, Commissioner
    Hon. Roel Campos, Commissioner
    Hon. Cynthia A. Glassman, Commissioner
    Hon. Harvey Goldschmid, Commissioner
    Giovanni P. Prezioso, General Counsel
    Alan L. Beller, Director, Division of Corporation Finance
Exhibit

Average Holdings of Public Pension Funds for Large Cap Companies

<table>
<thead>
<tr>
<th>Fund Size</th>
<th>Number of Funds</th>
<th>Range of Holdings</th>
<th>Average Holdings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greater than $100B</td>
<td>2</td>
<td>0.26% to 0.48%</td>
<td>0.4058%</td>
</tr>
<tr>
<td>$75B to $100B</td>
<td>3</td>
<td>0.22% to 0.42%</td>
<td>0.3933%</td>
</tr>
<tr>
<td>$50B to $75B</td>
<td>2</td>
<td>0.08% to 0.44%</td>
<td>0.245%</td>
</tr>
<tr>
<td>$25B to $50B</td>
<td>10</td>
<td>0.02% to 0.26%</td>
<td>0.1354%</td>
</tr>
<tr>
<td>Less than $25B</td>
<td>106</td>
<td>0.003% to 0.08%</td>
<td>0.033%</td>
</tr>
</tbody>
</table>

Summary: Most public funds hold a substantial portion of their positions through broad market indices. The size of public fund ownership positions generally correlates to the asset size of the funds, according to our analysis of data from Wilshire Associates. From this assembled data, we are able to reasonably estimate public fund ownership positions.

Reaching the one percent submission threshold: Public funds in excess of $50 billion can only reach a one percent ownership threshold through combination with at least two other public funds in excess of $50B. Seven public funds exceed $50B, meaning that a $50B fund must combine with two of the other six funds to reach one percent.

Public funds smaller than $50B comprise the vast majority of public pension funds. Of the 123 funds in the Wilshire survey, 116 fall within this category. Ten funds fell in between $25B and $50B. Eight of these funds would be required to reach the one percent threshold based on their average holdings. These funds fall are among the 20 largest funds. Public funds below $25B, based on average holdings, would require far greater numbers in combination to reach one percent. We estimate that 31 such funds would be required to reach the one percent threshold based on their average holdings.

Reaching the five percent nominating threshold: The aggregate ownership of the average holdings of the 17 public funds in excess of $25B fails to reach five percent, reaching a total of only 3.83 percent. To reach a five percent threshold would require the 17 largest public funds, in combination with 36 funds with assets less than $25B, to reach a total of 5.018 percent. In other words, it would take a combination of 53 funds to attain five percent.

Methodology: The companies reviewed for ownership levels were CalPERS' six largest holdings as of 9/30/03, and each fund's individual holdings reviewed are as of 9/30/03.

The holdings of all of the funds in excess of $50B were reviewed. Of the ten funds between $25B and $50B, the holdings of four were reviewed (Ohio PERS, Ohio STRS, Virginia RS, and Colorado PERA). Of the funds less than $25B, the holdings of two were reviewed (Kentucky Teachers and Missouri State Employees).