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Prepared Statement of Professor Jill E. Fisch
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Thank you for the invitation to participate in the Commission's Roundtable on Security Holder Director Nominations. My name is Jill Fisch. I am Alpin J. Cameron Professor of Law and Director of the Center for Corporate, Securities and Financial Law at Fordham University. As an academic I have written and lectured on federal proxy regulation.¹ I also regularly teach the federal proxy rules in my courses on corporations and securities regulation. The following statement contains a brief summary of my views and supplements my oral statement before the Commission. I appear as a scholar and do not represent the views of any client or organization.

To briefly summarize my position, I believe that the current proposal is consistent with both state and federal law. Specifically, I believe that proposed Rule 14a-11 falls within the Commission's rule-making authority under Securities Exchange Act section 14(a). I also believe that, by predicating the rights of security holders under the rule on their pre-existing state law voting rights, the proposed rule strikes an appropriate balance between state and federal law.

I reach these conclusions based on my review of the background to and legislative history of section 14(a) and on the history of the Commission's regulation of the proxy solicitation process through the federal proxy rules. This review is detailed in my article, *From Legitimacy to Logic, Reconstructing Proxy Regulation*,² and I will not repeat the details of my findings here. In short, I conclude that section 14(a) affords the Commission extensive authority to regulate the proxy solicitation process. The text of section 14(a) is itself broader than many other provisions in the statute and contains no language such as "fraudulent" or "deceptive" that might be construed as

¹ My recent publications on shareholder voting and proxy regulation include *How to Fix Wall Street: A Voucher Financing Proposal*, 113 Yale L.J. 269 (2003) (with Stephen Choi), *Teaching Corporate Governance Through Shareholder Litigation*, 34 Ga. L. Rev. 743 (2000), and *From Legitimacy to Logic: Reconstructing Proxy Regulation*, 46 Vand. L. Rev. 1129 (1993).

² 46 Vand. L. Rev. 1129 (1993).

limiting the Commission to regulation of disclosure. The legislative history demonstrates that Congress was specifically concerned with insider domination and abuse of the proxy machinery, and that Congress responded to that concern by promulgating section 14(a).³

The background to section 14(a), and the history of the Commission's regulation of proxy solicitation pursuant to that section, distinguish proposed Rule 14a-11 from the one share-one vote rule, Rule 19c-4, at issue in the Business Roundtable decision.⁴ Proposed Rule 14a-11, like Rule 14a-8 and the Commission's regulation of proxy solicitation in general, is grounded in state law. State law creates the obligation for issuers to hold an annual meeting and provides for the election of directors at that meeting.⁵ State law determines the issues on which shareholders have the authority to vote and specifies the structure of those voting rights. State law supplies the quorum requirement that creates the need for management to solicit proxies. Proposed Rule 14a-11 does not displace state regulation of any of those issues; it merely provides that, where shareholders have a pre-existing right to nominate director candidates, the fact of that nomination must be disclosed to all shareholders on the issuer's proxy statement. The law of Delaware, which is the source of corporate law for more than half of all publicly traded companies, explicitly recognizes the right of shareholders to nominate directors.⁶ Thus, like Rule 14a-8, proposed Rule 14a-11 incorporates state

³ *Id.*, at 1184-86.

⁴ *The Business Roundtable v. SEC*, 905 F.2d 406 (DC Cir. 1990) .

⁵ *See, e.g.*, Del. Gen. Corp. L. § 211(b) (providing for the election of directors at the annual meeting).

⁶ As Delaware Vice-Chancellor Leo Strine has explained:

Put simply, Delaware law recognizes that the “right of shareholders to participate in the voting process includes the right to nominate an opposing slate.” And, the unadorned right to cast a ballot in a contest for [corporate] office . . . is meaningless without the right to participate in selecting the contestants. As the nominating process circumscribes the range of choice to be made, it is a fundamental and outcome-determinative step in the election of officeholders. To allow for voting while maintaining a closed selection process thus renders the former an empty exercise.

Harrah's Entertainment Inc. v. JCC Holding Co., 802 A.2d 294, 310-11 (Del. Ch. 2002) (Citations omitted). Similarly, Vice-Chancellor Jack Jacobs has explicitly stated that “The right of shareholders to participate in the voting process includes the right to nominate an opposing slate.” *Linton v. Everett*, 1997 Del. Ch. LEXIS 117, *29 (Del. Ch. 1997). Delaware's protection of shareholder's nominating rights is consistent with its policy of providing the highest level of protection to shareholder voting. *Blasius Industries, Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988). Delaware decisions reason that shareholder voting is the statutorily authorized mechanism by which shareholders can hold directors accountable. Indeed, it is the ability of shareholders to choose and replace directors with whom they are dissatisfied that, in part, justifies the substantial judicial deference to board decisions accorded by the business judgment rule. As a result, Delaware courts apply the highest level of judicial scrutiny to board actions that infringe upon shareholder voting rights. *Id.* This same protection is extended to nominating rights. *See Harrah's*, 902 A.2d at 310 (“Because of the obvious importance of the nomination right in our system of corporate governance, Delaware courts have been reluctant to approve measures that impede the ability of stockholders to nominate candidates.”).

law as the defining source of shareholders' nominating and voting rights.⁷

Indeed, contrary to the suggestion of some commentators, the proposition that shareholders should have access to the issuer's proxy statement for the purpose of disclosing the identity of their director nominees is not a new proposal. The Commission has been considering the subject since 1942, when it first proposed a rule that would have required the issuer to disclose all director nominees on its proxy statement.⁸ Although the Commission failed to adopt the rule, it has continuously revisited the issue – for example, the Commission held extensive hearings on the issue in 1977,⁹ and the Commission again considered shareholder access as part of its “comprehensive review” of the federal proxy rules in the early 1990s.¹⁰

Although the explanation of the Commission's failure previously to adopt such a rule may be partially political, it appears that the Commission has failed to act primarily out of a desire to promulgate a rule that is precisely tailored to generate the optimal level of shareholder responsiveness. Indeed, the same concerns that have been raised in recent months about proposed Rule 14a-11 were raised back in 1977. Although the desire to craft a perfect rule is an admirable objective, it seems to have resulted in an unduly complex rule that attempts to micro-manage the nominating process through the inclusion of triggers, thresholds, and director independence criteria. Personally I am not in a position to predict the effects of proposed Rule 14a-11 with sufficient precision to determine the optimal rule structure, and I am not sure that the Commission has the capacity to make this determination either. It would be most unfortunate if the Commission were to allow critics of the proposal to entangle it in a type of administrative gridlock under the premise of seeking perfection. A record of proxy solicitations conducted under proposed Rule 14a-11 would provide the Commission with the experience to engage in any necessary fine-tuning of the rule.

More generally, the exercise of attempting to draft the optimal shareholder access rule should indicate to the Commission the desirability of enhancing greater state involvement in the regulation of the proxy solicitation process. We have a system of enabling state law, subject to variation among different states and subject to firm-specific tailoring through charter and bylaw provisions in which issuers can experiment with different levels of shareholder access and in which the market

⁷ Additionally, although the Supreme Court has warned that it is inappropriate to federalize corporate law “particularly where established state policies of corporate regulation would be overridden,” *Santa Fe Industries Inc. v. Green*, 430 US 462, 479 (1977), the Commission's long history of regulating proxy solicitation has had the effect of preventing the formulation of established state policies. Consequently, proposed Rule 14a-11 will not have the effect of displacing established state law.

⁸ *See* Exchange Act Release No. 3347, 1942 SEC LEXIS 44 (Dec. 18, 1942) (proposing rule requiring corporations to include shareholder-nominated candidates on the company's proxy statement).

⁹ These hearings culminated in the preparation of an 800 page report. *See* Staff of the SEC Div. of Corporation Finance, Report on Corporate Accountability, 96th Cong., 2d Sess. (1980).

¹⁰ *See, e.g.*, Regulation of Securityholder Communications, Exchange Act Release No. 29315, 1991 SEC LEXIS 1204, *5 (June 17, 1991).

can evaluate the consequences.¹¹ To date, much of this experimentation has been limited because the Commission has dominated the regulation of proxy solicitation through the provisions of the federal proxy rules. This domination has largely displaced the development of state law.¹² Indeed, the Commission has directly frustrated firm-specific experimentation along the lines of proposed Rule 14a-11 through its application of Rule 14a-8(i)(8).¹³ Particularly in light of this history, it may be desirable for the Commission affirmatively to encourage state or issuer-specific rules and especially to clarify that rules affording greater shareholder access are not pre-empted by proposed rule 14a-11.

Finally, I believe that proposed Rule 14a-11 is properly characterized as concerned primarily with disclosure. Importantly, although much of the commentary focuses on the effect of the rule on those shareholders who wish to nominate a director candidate, the powers conferred by the proposal on those shareholders are quite limited. The right of ballot access is predicated on pre-existing nominating rights created by state law and, in any event, nominating shareholders will have to convince a majority of the shareholders in order to obtain board representation. The analysis overlooks, however, the manner in which disclosure of *all* director candidates,¹⁴ on the issuer's proxy statement, empowers minority shareholders who gain from this proposal the power to vote for shareholder nominees without personally attending the annual meeting. Thus the proposal offers minority shareholders a new opportunity to have some voice in who gets elected to the board of directors. I should note that this new opportunity is at the core of the legislative objective which was, through the federal proxy rules, to replicate for the absent shareholder the rights associated with personally attending the annual meeting.¹⁵

¹¹ See, e.g., Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. Cin. L. Rev. 1061 (2000) (describing advantages of regulatory structure of state corporate law and, in particular, Delaware's regulatory structure).

¹² See Fisch, *supra* note 2, at 1191-93 (explaining how federal law has constrained the development of state and issuer-specific rules governing the solicitation of proxies).

¹³ See, e.g., Merck, SEC No-Action Letter, 2004 SEC No-Act LEXIS 185 (Jan. 25, 2004) (permitting Merck to exclude, pursuant to Rule 14a08(i)(8) proposal permitting ten largest shareholders to nominate a slate of director candidates to be published in the Company's proxy materials); Citigroup, Inc., SEC No-Action Letter, 2003 SEC No-Act LEXIS 534 (Apr. 14, 2003) (permitting exclusion of proposed bylaw amendment to permit nomination of candidates by 3% shareholders).

¹⁴ See Regulation of Communications Among Shareholders, Exchange Act Release No. 31,326, 1992 SEC LEXIS 2470, *75 (Oct. 16, 1992) (characterizing shareholder access to the issuer's proxy as resulting in a universal ballot).

¹⁵ See *Business Roundtable*, 905 F.2d at 410 ("The goal of federal proxy regulation was . . . to enable proxy voters to control the corporation as effectively as they might have by attending a shareholder meeting."), citing S. Rep. No. 792, 73rd Cong., 2d Sess. 12 (1934).