

WEBMASTER NOTE: This is the unedited transcript of the Roundtable on Federal Proxy Rules and State Corporation Law held on May 7, 2007, which we received directly from the court reporter. We are posting the transcript in this form to make it available as soon as possible.

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ROUNDTABLE DISCUSSIONS REGARDING THE
FEDERAL PROXY RULES AND STATE CORPORATION LAW

MONDAY, MAY 7, 2007

BEFORE: CHAIRMAN AND COMMISSIONERS OF THE
SECURITIES AND EXCHANGE COMMISSION

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6 Division of Corporation Finance

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11 Court of Chancery, Delaware

12 Donald C. Langevoort

13 Georgetown University Law Center

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21 Moderators: John White and Martin Dunn

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23 Participants:

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Division of Corporation Finance

Participants:

Joseph A. Grundfest
Stanford Law School
James J. Hanks, Jr.
Venable LLP
Larry E. Ribstein
University of Illinois College of Law
William Underhill
Slaughter and May

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Ann Yerger

Council of Institutional Investors

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P R O C E E D I N G S

OPENING REMARKS

CHAIRMAN COX: Good morning. I want to welcome people as you are still coming into the auditorium to the Securities and Exchange Commission's Roundtable on Shareholder Rights and the Federal Proxy Rules.

This is the first of three roundtables that we are going to be having on this subject, and those three roundtables will all take place this month.

The purpose of having three of them is so that we can very thoroughly elicit comments and opinions that will help us on the Commission to inform our thinking as we develop a proposal to amend our proxy rules, which we expect to have in proposed form ready early this Summer.

This is an important rule-making that involves fundamental questions of what shareholders get to do and how they get to do it.

In these roundtables, we are starting with the legal framework underlying the proxy rules, both in state and Federal law. That is today's topic.

In the next roundtable, we will get into the mechanics of the voting process, including such questions as broker voting and over voting and empty voting.

In our third roundtable, we will listen to stakeholders and other knowledgeable parties about what works

1 now and what can be made to work better.

2 We have a truly broad scale in these three
3 roundtables. Today is just the beginning, although as you
4 will see from the distinguished panel that we have assembled,
5 it is a very powerful beginning.

6 I want to begin by welcoming our distinguished
7 panelists today, who include two vice chancellors of the
8 Delaware Court of Chancery; eight law professors; practicing
9 lawyers who are expert on corporate laws, including Delaware
10 and Maryland, as well as the Model Business Corporation Act
11 and the U.K. Companies Act, and representatives of the
12 individual and institutional investor communities.

13 We are bringing these different perspectives to
14 bear on all of these questions before us because our
15 objective for this and for the other roundtables is to take a
16 thorough top to bottom look at what is and what should be the
17 SEC's role in regulating the proxy solicitation process.

18 In 1934, when Congress enacted the Securities and
19 Exchange Act, it charged the Commission with regulating the
20 proxy process. At that moment, 73 years ago, there began a
21 Federal role in vindicating shareholders' state law rights.

22 The system that Congress authorized the SEC to
23 devise was meant to replicate as nearly as possible the
24 opportunity that shareholders would have to exercise their
25 voting rights at a meeting of shareholders if they were

1 personally present.

2 As SEC Chairman Ganson Purcell put it in 1943, the
3 rights that we are endeavoring to assure to the stockholders
4 are those rights that he has traditionally had under state
5 law, to appear at the meeting, to make a proposal, to speak
6 on that proposal at appropriate length, and to have his
7 proposal voted on.

8 Just how that should be done, however, has been the
9 subject of extensive debate and real life experience over the
10 many ensuing decades.

11 Since 1934, the proxy rules have been amended many
12 times, most recently in 1992. Today, they comprise a complex
13 set of procedural and substantive requirements that
14 shareholders have to follow.

15 Whether today's system is what Congress intended
16 when it created a Federal role for the vindication of
17 shareholders' state law rights is a key question that our
18 roundtable panelists will be asked to address today.

19 Today's roundtable is comprised of four panels.
20 The first panel will address the Federal role in upholding
21 shareholders' state law rights. Among other things panelists
22 will discuss will be the scope of shareholders' voting rights
23 under applicable state law, the limitations that state law
24 might impose on the shareholders' ability to govern the
25 corporation, and the core authorities that state law gives

1 shareholders to choose the directors of the corporation, to
2 propose by-law amendments and vote on them, and to vote on
3 charter amendments.

4 The second panel will focus on the purpose of the
5 Federal proxy rules and their effect on the exercise of
6 shareholders' state law rights.

7 Panelists will discuss how the Federal proxy rules
8 have affected the ability of shareholders to make proposals
9 on subjects that fall within the rights of shareholders under
10 state law, and on subjects that fall within the province of
11 the Board of Directors and management.

12 In the afternoon, the third panel will address
13 non-binding shareholder proposals and explore the benefits
14 and shortcomings of our current system of allowing some
15 non-binding proposals but not others.

16 The final panel of the day will address binding
17 shareholder proposals under the Federal proxy rules.
18 Panelists will discuss the important question of whether the
19 Federal proxy rules fully vindicate shareholders' rights in
20 those areas which are most clearly the responsibility of
21 shareholders under state law, proposing and voting on by-law
22 and charter amendments, and nominating and voting on
23 directors.

24 On behalf of the Commissioners and the Commission
25 staff, I would again like to thank our distinguished

1 panelists for their participation in today's roundtable.

2 We look forward to listening to and learning from
3 our discussions today, so let's have at it. John?

4 INTRODUCTION OF ISSUES

5 MR. JOHN WHITE: Thank you, Chairman Cox. Good
6 morning. I'm John White, Director of the Division of
7 Corporation Finance, and I am also very pleased to welcome
8 you to the SEC Roundtable on the Federal proxy rules and
9 state corporation law.

10 As Chairman Cox explained, we have three
11 roundtables planned for this month with regard to the proxy
12 process. Today, the first Roundtable, we hope to be able to
13 basically step back from all of the discussion that has
14 occurred to date regarding the proxy process and focus on the
15 basic concept of shareholder rights.

16 We will do that by looking at the relationship
17 between the Federal proxy rules and state corporation law.

18 We have a terrific set of panelists to help us do
19 that. I would certainly like to echo Chairman Cox's remarks
20 of welcoming all of you to today's proceedings, and to extend
21 the thanks of the Commission and of the staff for taking your
22 time to be here today. We are all looking forward to
23 learning a great deal.

24 As Chairman Cox outlined, we have four different
25 panels. I will not go through again what we are planning on

1 doing with each of those panels. We are going to have two in
2 the morning, two in the afternoon, and we have an one hour
3 break for lunch at 12:30. We hope to conclude by 5:30. We
4 have a long day ahead of us.

5 MR. DUNN: 4:45. We are not going to be here until
6 5:30.

7 MR. JOHN WHITE: I am sorry. I got the time wrong
8 already. We are going to be done by 4:45. That was Marty
9 Dunn, the Deputy Director of Corporation Finance, who is
10 going to be moderating the panels with me, including the last
11 panel.

12 MR. DUNN: Including the one until 4:45.

13 MR. JOHN WHITE: We have prepared a number of
14 questions for the panelists. We are hoping that we will get
15 interaction from the Commissioners and the Chairman, and they
16 are certainly welcome to ask questions when they would like.

17 We have asked the panelists all day long not to
18 present any formal opening statements. We are hoping they,
19 like any of you here today, any of you watching on the
20 webcast, will submit written statements. We are certainly
21 encouraging everyone to do that.

22 We actually have a single file, Commission file,
23 set up for all three Roundtables to collect written
24 statements.

25 Even though we are not going to have people give

1 opening statements, we are planning at the end of each panel
2 to reserve 10 or 15 minutes so each of the panelists can give
3 us their maybe two minutes of closing thoughts on things they
4 would like the Commission to go away with from this whole
5 endeavor.

6 Normally, at this point, I would explain that if
7 you wish to be called on, that you should turn your tent card
8 up on end, like this.

9 I feel like we are all close enough here and I
10 think eye contact will probably be able to work. If people
11 get out of hand, then we will go to the tent cards.

12 Marty and I will try to do it by eye contact in
13 terms of calling on people and trying to call on everybody at
14 the appropriate time.

15 With that in terms of introduction, let us go to
16 panel one. I will introduce the panelists.

17 First, we have Stephen Bainbridge, Professor of Law
18 at UCLA. Next to him, Frank Balotti, one of the Deans of the
19 Delaware Bar with Richards, Layton & Finger. Jack Coffee,
20 Professor of Law at Columbia University Law School. Roberta
21 Romano, Professor of Law, Yale Law School, and Leo Strine,
22 Vice Chancellor, Court of Chancery of the State of Delaware.

23 If you noticed from the five of our panelists,
24 there is somewhat of a tilt, maybe I should say a heavy tilt
25 towards academics and the judiciary on this first panel. I

1 understand Frank is also an adjunct professor at the
2 University of Miami School of Law. I think that makes us
3 five for five on academics and the judiciary.

4 That was not actually a coincidence as we were
5 putting this panel together because we really want to return
6 to basics as we get started.

7 What I wanted to do, I am not sure we can stay on
8 topic, but I am hoping to break this first panel up into two
9 separate topics. The first topic we will examine is the
10 scope of shareholder voting rights under state law today,
11 particularly with respect to the election of directors and
12 proposing and amending by-laws.

13 In a moment, I will ask Mr. Balotti to lead off
14 that discussion and then turn to Vice Chancellor Strine.

15 I will initially be looking for each of them for us
16 to outline what is the scope of state law rights, at least in
17 Delaware, today.

18 At this initial stage, if we can, I would like to
19 stay away from the Federal side of it, and just focus on
20 state law rights.

21 Our second topic, which we can move to in half an
22 hour or so, will be the relationship between Federal law and
23 state law in this area.

24 If we can just start laying the ground rules, the
25 basics, on state law.

1 Mr. Balotti, if you could lay out the law in
2 Delaware for us, particularly as I say, focusing on
3 shareholder rights to adopt and amend by-laws and to nominate
4 and vote on the election of directors.

5 PANEL ONE

6 THE FEDERAL ROLE IN UPHOLDING SHAREHOLDERS' STATE LAW RIGHTS

7 MR. BALOTTI: Thank you very much, John.

8 MR. JOHN WHITE: I think you need to turn on your
9 mike. Hit the button on your mike.

10 MR. BALOTTI: Thank you very much. It is a real
11 pleasure to be here. I very much appreciate having been
12 invited to participate in this seminar. I am going to be
13 very general as one must be in describing shareholder rights
14 in Delaware, because there are a lot of specifics that we
15 just do not have time to reach.

16 To my mind, the most basic shareholder right in
17 Delaware is shareholders have the right to elect directors.
18 In that process, shareholders can nominate whomever they
19 please at a meeting of the stockholders to vote on the
20 election of directors.

21 The division of power between stockholders and
22 directors is also a very basic concept. The shareholders
23 elect the directors and the directors run the business and
24 affairs of the corporation.

25 I submit to you that you cannot have any other

1 system in a public corporation. The shareholders simply
2 cannot run the business and affairs of the corporation.

3 Now, under the statutory scheme in Delaware, and
4 this is again very general, there are nine votes contemplated
5 by the statute where shareholders must have the opportunity
6 to vote. Then there are four other votes contemplated by the
7 statute where shareholders have permissive rights to vote.

8 I put by-law amendments in the permissive area
9 because while shareholders always have the right to amend the
10 by-laws of the corporation, that is not the only way as a
11 practical matter because that power can also be given to
12 directors and in just every public corporation I know of,
13 that power has been given to directors, but it is still
14 reserved to the shareholders.

15 Shareholders can propose and pass any by-laws which
16 relate -- that's a magic word in Section 109(a) of the
17 corporation law -- which relate to the business of the
18 corporation and to the powers of the shareholders and the
19 directors, so long as these by-laws do not conflict with the
20 Certificate of Incorporation or applicable law, and
21 applicable law is both statutory and case law.

22 Provisions which define or limit -- again, magic
23 words -- the powers of shareholders and directors must be
24 included in the Certificate of Incorporation. There is
25 nothing in Delaware law, no case law yet, that tells us what

1 the difference between "defining and relating to" on the one
2 hand -- I'm sorry -- "defining and limiting" on one hand and
3 "relating to" on the other hand means, and where the
4 distinction between the two is.

5 Where does this leave us? It leaves us that
6 shareholders vote on all basic questions facing the
7 corporation, mergers, amendments to the Certificate of
8 Incorporation, et cetera.

9 The directors, on the other hand, run the business
10 and affairs.

11 We get into questions as to how far the
12 shareholders can go in adopting by-laws that get into the
13 basic business and affairs of the corporation.

14 This is the basic conflict -- it's not a
15 conflict -- the basic question between Section 109, which I
16 said, allows shareholders to pass by-laws which relate to the
17 powers of directors, and the statutory power of directors to
18 run the business and affairs of the corporation given to the
19 directions in Section 141(a).

20 The real question in this area is how far into the
21 business and affairs of the corporation the shareholders can
22 venture by way of by-law amendment.

23 I guess the underlying question there is how
24 important it is and to whom is it important. It is certainly
25 important to hedge funds that they have the right to impinge

1 upon the power of the directors to run the business and
2 affairs of the company, but I submit to you it is for all the
3 wrong reasons, the reasons being short term benefit of the
4 hedge funds and not the long term interest of the corporation
5 or the shareholders.

6 Just by way of closing this up, let me point out
7 that we now have a perfect opportunity, I think, to find out
8 how important all of the shareholder rights are to
9 shareholders.

10 As you all know, North Dakota now has a very
11 shareholder friendly law. We now have the state laboratory
12 at work. If this is very important, all the IPOs will be for
13 North Dakota corporations. If that happens, perhaps Delaware
14 and Maryland will have to change their ways.

15 Now, as I say, we have an opportunity to find out
16 how important shareholder rights are and whether they trump
17 the benefits of the Delaware and Maryland system.

18 That is a general outline of shareholder rights. I
19 am sure we will get into many more specifics as we go
20 forward.

21 MR. JOHN WHITE: Thank you. Vice Chancellor
22 Strine, would you like to elaborate on that?

23 VICE CHANCELLOR STRINE: Yes. I would actually
24 like to talk about the relationship between global warming
25 and North Dakota's initiative. I think they are not

1 coincidental.

2 MR. JOHN WHITE: We had something about staying on
3 topic.

4 VICE CHANCELLOR STRINE: I am actually going to
5 sort of concentrate on the question that was asked, which is
6 what are the rights under state law. I think a couple of the
7 pertinent things is what do stockholders vote on.

8 In Delaware, they vote on real things, which is you
9 get the opportunity to vote annually for directors, major
10 transactions, including sales of substantially all the
11 assets, you get to vote on.

12 We do not have imaginary voting. We do not have
13 therapy for whoever. I promised Marty I would get this in.
14 We do not have what I call "pizza on the wall." That is
15 precatory proposals.

16 In fact, I could have a proposal, I wish we would
17 cure male pattern baldness in a real way that will protect
18 me. We do not authorize votes on that. Motive things, we do
19 not do.

20 What do we do? By-laws. There are very real
21 things you can do with by-laws, and stockholders are starting
22 to realize them.

23 Delaware passed a law this year, a very critical
24 law in the last year, indicating in an area of particular
25 sensitivity to stockholders, which is the voting process,

1 stockholders could actually pass a particular form of by-law
2 that could not be amended by the directors.

3 I do not believe there is any implication in this
4 that this by-law could not have been passed in the first
5 instance under the existing law, but the idea here was to
6 make clear that in this area when stockholders
7 spoke -- frankly, there is a misnomer.

8 What this does is it requires you to get a majority
9 of votes for yourself to get elected. It is sometimes called
10 "majority voting," which is a really imprecise and silly way
11 of talking about an issue. Usually, in an election, we use
12 plurality voting because if there are three candidates, the
13 candidate that gets the most votes usually wins.

14 Most of our presidents would not have been elected,
15 you know, if you have majority voting in close elections,
16 because literally, somebody could get 47.8 percent of the
17 popular votes, someone else could get 45 percent, and some
18 other candidate gets 2 percent, and no one gets elected.

19 We passed a law in Delaware that says now that
20 stockholders can adopt a by-law requiring that for a director
21 to get re-elected, you essentially have to get a majority of
22 the votes cast.

23 This essentially turns a withhold or proxy vote,
24 which is essentially no vote at all, just we are not giving
25 someone a proxy, into a no vote. That kind of a by-law

1 cannot be amended now by the directors.

2 There are also other tools. For example, I do not
3 think that Frank mentioned that with respect to setting the
4 required number of votes for the Board to take certain
5 actions, that has historically been also something that
6 by-laws can do.

7 I think my friend, Professor Bebchuk, who is
8 extremely creative, has picked up on this in some of his
9 proposals, to say that a Board of Directors to do X or Y have
10 to have a certain number or percentage of the Board to vote.
11 That is also something that is within the by-laws' power.

12 Our law, as you know, in terms of the case law,
13 there is nothing that is probably protected more vigorously
14 than the stockholders' ability to exercise free choice.

15 There is a very symbiotic relationship, I think,
16 between the Securities and Exchange Commission and the
17 Federal law and our law in the area of disclosure.

18 We try, particularly in the Court of Chancery, to
19 not expand invariable disclosure requirements. That is
20 really the job of the Commission. It is expert in
21 determining what should be in quarterly reports.

22 Where fiduciary duty law comes into play is
23 protecting stockholders' ability to make informed decisions,
24 in particular, in situations when they are asked to exercise
25 voting rights.

1 We will often make materiality decisions about that
2 because it is the law under Delaware that when your
3 stockholders vote, you have to give them the material
4 information in order to make an informed judgment.

5 We are very vigorous about protecting that. There
6 is also the so-called "Blasius" line of cases, which actually
7 goes back to something more fundamental, a case called Schnel
8 vs. Chris-Craft, which is the idea that simply because
9 something is legal, it does not mean it's equitable.

10 We give a lot of discretion to people, but Schnel
11 was really an electoral manipulation case about moving an
12 annual meeting to up state New York at a cold time of year
13 and not giving people a fair opportunity to run a proxy
14 fight.

15 The Delaware Supreme Court said that was
16 inequitable and set that aside.

17 There is no tighter scrutiny in our law than when
18 there is a situation where there is a manipulation of the
19 voting process. That is a very historically important part
20 of our law.

21 I think one of the things I welcome and I
22 appreciate the Chairman and all the Commissioners inviting us
23 to talk about is there is a careful balancing between these
24 various rights, and we do have a system in Delaware where it
25 is essentially a republic plus.

1 What do I mean by that? In a republic, the people
2 who are elected are the people who are responsible. They
3 have to be given the freedom to make choices. They are the
4 fiduciaries.

5 What is the "plus" aspect? Well, in a normal
6 republic, you do not get to vote on so many important things.
7 When Congress does something really important, they do not
8 always give a vote to the public.

9 We have a lot of situations where if there's a
10 transformational decision by the Board, you actually do get
11 to vote, but the people who are the fiduciaries propose it in
12 the first instance.

13 One of the issues for today is to talk about how
14 selective intrusions into a system can disrupt the balance of
15 power in a way that isn't necessarily good for everyone. I
16 would ask everybody to keep in mind, when you talk about in
17 the language of politics, of republic's, what is your concept
18 of citizenship?

19 We do not have a lot of high thresholds. We let
20 stockholders buy in and begin to exercise important rights
21 almost right away, ask for books and records, run a proxy
22 fight.

23 That is on the assumption that the old model is the
24 separation of ownership and control, that the stockholders
25 are diverse, that they do not get involved every day. That

1 is now changing. If we are going to talk about stockholder
2 democracy, we talked about rights.

3 What usually comes with rights? Some
4 responsibilities. If essentially what you are building is a
5 republic of transients, and I said to Marty beforehand, hedge
6 funds, there was an SEC program five years ago, and the
7 estimate was hedge funds turned their portfolio's three times
8 a year, median turnover in mutual funds, including index
9 funds, is 60 percent. That is annually.

10 If you are going to increase the voice of these
11 kind of folks, and you realize they are conflicted
12 intermediaries, too, they are not the end user investor,
13 there is a balance to be struck.

14 The state law has struck this balance in terms of
15 access and other things. I would just ask people to keep
16 that in mind. These are the rights under the old law.

17 I will finish with this. There is a lot untested
18 here. One of the things I hope we talk about is to some
19 extent the ability of stockholders to present by-laws is
20 determined by the Federal Government, and some of the
21 unanswered questions under state law is because of the
22 inability of stockholders to actually get real proposals on
23 the table, and it is kind of amusing to us in Delaware to see
24 fights about precatory stuff and a bottleneck about
25 presenting by-laws that might actually have a binding effect

1 under our law.

2 I think today is a good forum to discuss that kind
3 of interaction.

4 MR. JOHN WHITE: Why don't we still stay on the
5 basics of state law rights? We will turn to the academics on
6 the panel. Ms. Romano, you want to start with your
7 reactions?

8 PROFESSOR ROMANO: Thank you, John. Thanks very
9 much. I thank you for inviting me to speak.

10 I would like to take the questions a bit more
11 narrowly and more broadly in thinking about this. Just to
12 put the academic gloss on thinking about the voting rights of
13 shareholders, I tend to think of it as fundamental changes in
14 your investment is what you are voting on, whether it is
15 mergers, sale of the assets, the charter itself, changing it,
16 which under state law requires you to specify all your stock
17 rights, whether it is economic, dividend, liquidation rights,
18 voting rights, so changes to that are things that you get to
19 vote on, and the election of directors, which is important.

20 You are not voting on the managers, but the
21 directors are picking them, and you can affect them in that
22 way.

23 I thought it would be helpful to think about sort
24 of the question that was phrased in terms of shareholders
25 governing, what rights do they have to govern the corporation

1 and should they be expanded or eased.

2 In thinking of this, my responses have differed.

3 If I was talking to the state legislature, I would be saying
4 something other than the SEC, so I want to sort of answer
5 this question by talking a little bit about my view of what
6 state law is in terms of its approach, the substantive
7 approach, and then focus this a little more narrowly on the
8 issue of shareholder election or nomination or shareholder
9 access to by-laws, which I think is underlying some of the
10 reason for this Roundtable with the AIG decision.

11 Even though it is narrower, I think it will help to
12 illuminate more broadly the general issue concerning the SEC
13 regulation on shareholder proposals, whether
14 precatory/mandatory.

15 I want to take a look at that compared to the way
16 this works with state law, in terms of proxy fights and why
17 there is this difference in state law.

18 State law recognizes the proxy process, but it does
19 not specifically put in that proxy process shareholder
20 nominations for directors as opposed to thinking of them
21 doing it more actively in a challenge. I want to talk a
22 little bit about that.

23 My view of the changed facts, which is a little
24 different from Frank and Leo's view about activist investors
25 as hedge funds, but how I think that changes some of the

1 things, when this was thought about a few years ago, under
2 access.

3 Let me just say this very briefly. State law is an
4 enabling approach. It is a set of default rules. Sometimes
5 firms opt out of them and sometimes they opt in, and I think
6 that reflects the essential variation in firms about what
7 they think is the best governance structure, the best Board
8 of Directors for each firm, so we tailor it.

9 When we think of SEC regulation or wanting national
10 laws, it is because we think there is a need for uniformity,
11 and we really don't want variation across the states or the
12 firms within our jurisdiction.

13 You have to be thinking about that in these terms.
14 I think sort of the reason is there is vast empirical
15 literature that has now been looking at various forms of
16 corporate governance, who is on the Board and performance.

17 It is hard to find direct connections between what
18 we think of as good corporate governance and performance in
19 this literature. This is the literature that sort of
20 combines all these things into one measure or take individual
21 things like boards of directors and performance being
22 measured by stock or account, and we do not find direct
23 connections.

24 Part of that is because what we think are good
25 practices independently, when they are all combined, it may

1 not be the same. We think it is good to have independent
2 directors and good to have take over defenses, but we find in
3 the constellation of firms, we often find the more
4 independent the board is, the higher the number of defensive
5 tactics.

6 There is a paper by several finance professors that
7 looks at that.

8 Part of this is related to the nature of the firm's
9 assets, whether they are intangible, business and the like.
10 I just want to sort of emphasize in this variation how these
11 things -- the constellation of these types of
12 provisions -- that is a reason why we sort of like the
13 approach of state law to be enabling.

14 In the SEC, when we are thinking about this, in
15 some sense, the exemptive power allows there to be variation,
16 but it has not really been taken in that approach.

17 That is one of the reasons why when we are thinking
18 about should we expand or ease what the states have done, it
19 is more complicated when we do it at the national level
20 because at the state level, if a state expands it or
21 subtracts it, another state can respond or it is easier to
22 change that, and it permits firms to adapt to what looks the
23 best for them.

24 When we are thinking of the SEC's role, I want to
25 emphasize the need to have disclosure so the shareholders can

1 make informed decisions about fundamental impacts on their
2 investment, and also the distribution and accessibility of
3 that information to shareholders. That is something that is
4 within what the SEC can do compared to what the states have
5 been doing.

6 More concretely, let me sort of talk a little bit
7 about the relationship between state law and the shareholder
8 access or nomination proposals and proxy fights.

9 The access/nomination type of by-law or proposal
10 really inflates Rule 14a-8 proposal and proxy fights. I
11 think it is valuable to keep those things different or it is
12 a mistake to want to keep them the same.

13 I think it is not fortuitous that the states have
14 not combined these two. That is because of the incentive
15 effect that the reimbursement systems differ.

16 So, 14a-8 or shareholder nominations of directors
17 in the proxy process takes the proxy fight and makes the cost
18 basically zero.

19 I think the objective should not be to make proxy
20 fights cost a trivial amount. I think it is important to
21 have proxy fights be expensive. That is because if we think
22 about the incentives of people to behave, people who have
23 financial risk, sort of the old proverb of put your money
24 where your mouth is or having skin in the game, those people
25 have more of an incentive to want to have a victory that will

1 improve stock value. Otherwise, it is not working, making
2 the expenditures.

3 In the 14a-8 approach, there is no financial risk.
4 You bear no costs in putting up your nominee. It is free but
5 it is subsidized by all the other shareholders in the firm.

6 If we think about wanting to give people
7 incentives, and people who have the resources that they can
8 devote to, sort of thinking about how can we approve a
9 business plan. You want a system where you are not
10 subsidizing that completely, where they pay their fees.

11 In state law, what happens if you succeed in a
12 contest, your fees are reimbursed. It is not like you win
13 and you have paid costs out of pocket and you can't get it
14 back, so state law, there is case law that makes it very
15 clear you can be reimbursed for that expenditure. If you
16 lose, you are not. That may sort of have some impact on how
17 many proxy fights are undertaken. I am going to come back to
18 that point in a minute.

19 If we look at the empirical literature that says
20 what value is added by proxy fights, and we compare that to
21 14a-8 proposals, all of the literature finds in proxy fights
22 is improved performance thereafter. We find stock price
23 returns are positive about these announcements.

24 We do not find any effects of that in the 14a-8
25 process. I think that is partly because of the investment of

1 the people who are making these proposals, whether the proxy
2 fight is to elect the board or change policy, because they
3 have had to invest their own resources, they spend more time
4 and they are more informed, and they are also more creditable
5 to get support of other people to change the policies.

6 We are noting you bear some financial risks. That
7 might affect how much you do when you undertake these
8 transactions.

9 Then we have to sort of note the realities of the
10 marketplace and the proxy process are dramatically and
11 profoundly different from what they were a few years ago when
12 these access proposals first came to the Commission's
13 attention, and I guess when academics were writing articles
14 saying shareholders are completely powerless or when the
15 public pension funds were proposing this.

16 The number of hedge funds has dramatically
17 increased. They are very active in the proxy process.

18 I was at a conference yesterday where we were
19 starting to see the first of empirical papers where people
20 are looking at what these funds do and are they successful.

21 We find they are very successful in having their
22 policies, suggestions for strategies, to replace the
23 directors, to fire the CEOs, to lower their salaries, they
24 have very high success rates compared to sort of the other
25 types of proposals or proponents of change.

1 There was one paper that found over 60 percent of
2 the times when they engage in a proxy fight, they win, or
3 they get their proposals adopted. They don't even have to
4 engage in the fight. There is a deterrent effect.

5 When one of these funds gets a position in a firm,
6 we find like within a day, there is a huge turnover in the
7 shares and other funds are involved in this.

8 You do not have sort of these powerless
9 shareholders.

10 They also have the resources to devote to being
11 more informed, like to find out what is going on in these
12 firms. I think this is just changes to what we are thinking
13 about if we are thinking about sort of an access proposal.

14 You have investors who have real resources who are
15 involved in this. It changes the whole marketplace. They
16 can take any firm. Some of them specialize in industries.
17 When you have this going on, it makes a difference in terms
18 of thinking about are shareholders unable to do anything in
19 this context of elections.

20 Let me stop there. I think even though we are
21 saying proxy fights are more expensive than having a
22 nomination process, we found these costs are going down, and
23 we have a new set of investors who are engaging in this
24 practice in an active way.

25 MR. DUNN: Thank you. I would like to take one

1 step back on something Vice Chancellor Strine said. Two
2 things. One, you said we don't authorize precatory voting,
3 that was something you had mentioned under Delaware law.

4 The question in 14a-8 land that we always deal with
5 when we get shareholder proposals, one of the first basis to
6 exclude it is it is inappropriate under state law.

7 Whenever we get a precatory proposal, nobody ever
8 argues to us that they don't have authority to raise it under
9 state law, which I find interesting.

10 Every time we get a binding one, we get competing
11 state law opinions, one of which says from the company that
12 141 doesn't allow this, and then we get one that says 109
13 does allow this. We sit there and go we don't know. We are
14 going to say you haven't met your burden of proof because we
15 have competing opinions.

16 If in fact Delaware law doesn't authorize precatory
17 proposals, why do we not get that argument, and the second
18 thing, and this is for everybody, how far does 109 push past
19 141? I know there are no decisions on it. Just in theory,
20 at least.

21 VICE CHANCELLOR STRINE: In terms of the why don't
22 you get the argument, you all made it up. We are fine with
23 it. It is kind of a prisoner litigation for stockholders
24 sort of thing. Maybe it has societal value of therapy.

25 We are not quibbling with it. Here's the reason

1 why no one cares in Delaware. It's precatory.

2 What matters now is the tools you give with it,
3 which is the reason why people are giving in now is not
4 because they have passed a precatory proposal, it is because
5 stockholder influence is real under the rules of state law,
6 and people can replace boards.

7 Maybe it is a form of dialogue. We don't
8 contemplate it, but nobody is sitting there -- we are not
9 John C. Calhoun. You guys are doing it. It's fine. If you
10 want to run Fantasy Island, that's cool.

11 I think the real issue is when you get to things
12 that are real, and this has been a frustration. 109 and 141,
13 there is an interplay between them, and I would tell you
14 this. I think in Delaware, people have often thought that
15 things that are more process oriented, that get at how the
16 corporation does its business, is more likely to pass muster
17 than something that says you must do X, Y and Z when you are
18 the directors.

19 One of the prime areas where you could have -- I
20 think the recent statute indicates it -- is things dealing
21 with the electoral process. No one has proposed a by-law to
22 my knowledge dealing with reimbursement of expenses. I won't
23 speak to that.

24 I think where we have had some frustration, and I
25 think the Commission has been more reticent to exclude

1 proposals, there was a time where there were some people who
2 got things excluded on the grounds that state law made them
3 clearly improper when there was no decision of the Delaware
4 Supreme Court or even the Delaware Court of Chancery.

5 I think those of us from Delaware would say one of
6 the things the Commission could do to facilitate this is to
7 make clear that if it's uncertain under state law and it's a
8 by-law proposal, then it shouldn't be excluded and they
9 should be able to put it on absent some showing, and then
10 leave it to us, hold us accountable, and if we make the wrong
11 decisions, you can bet we are going to hear about it from the
12 institutional investor community and from the management
13 community.

14 I would advocate for the Commission to look at John
15 Coates' article from a few years ago in Business Lawyer,
16 which is a very good exploration of what you might do through
17 a by-law that wouldn't get into the core of management, but
18 the more it is about things like you're talking about, which
19 is the electoral process or things like that, I think the
20 more the Delaware lawyers would tend to admit that's more the
21 proper province of a by-law than no, you can't build a widget
22 plant in Des Moines.

23 MR. BALOTTI: Let me take a crack at that, Marty,
24 if you would. I think precatory resolutions are authorized
25 by 211, which says that a stockholder can bring before a

1 meeting anything that is proper for a stockholder to act on.

2 I believe that it is proper for stockholders to ask
3 directors to do whatever, as opposed to telling directors to
4 do whatever.

5 The 109 and 141, as I mentioned, it is an
6 unresolved question, how far stockholders can get into the
7 business and affairs of the corporation.

8 I ask Vice Chancellor Strine to correct me, but
9 isn't there before the legislature the second leg of a
10 constitutional amendment which will allow the Commission to
11 certify questions to the Delaware Supreme Court?

12 VICE CHANCELLOR STRINE: Yes.

13 MR. BALOTTI: It is expected that will pass, and
14 when that passes, perhaps some of the ambiguity will be
15 eliminated because there will be the ability of the
16 Commission to have these questions of state law resolved by
17 the Delaware Supreme Court.

18 Of course, the Court doesn't have to accept every
19 question which is certified, but I expect there will be some
20 more certainty in the near future.

21 PROFESSOR ROMANO: There is a legal precedent for
22 precatory proposals, and that is the New York case, Auer vs.
23 Dressel, where the shareholder wants to sort of -- it is
24 really a contested proxy fight, but the president was taken
25 out of office and he was a shareholder, and they litigated

1 this because he wants to put up a proposal that says he
2 should be the president and the Court says, well, they can't
3 make him be the president but there is nothing wrong with
4 saying we think Auer is a swell guy and we are giving you
5 advice to think of him.

6 There is one case. It is not a Delaware case. I
7 have always thought that was how you got the justification
8 for saying at all that you could put these things up that
9 they want to vote on in an advisory format.

10 That was done in an actual meeting that these
11 people were putting up.

12 VICE CHANCELLOR STRINE: We have always had people
13 come and pop off at meetings. We have no case law on it.
14 The idea is this.

15 PROFESSOR ROMANO: I agree.

16 VICE CHANCELLOR STRINE: You put up something real.
17 For example, you pass a by-law and then the directors amend
18 it back to the way it was. The ordinary point at that point
19 is kick the bastards out of office; right?

20 That's the way it works. That is familiar to most
21 of us who took civics class. I think that is the ordinary
22 thing.

23 If you do a real by-law amendment, the directors
24 then use their power, you run the election.

25 PROFESSOR BAINBRIDGE: One of the questions that I

1 think the Commission might want to consider with regard to
2 precatory proposals would be to re-visit not only
3 14a-8(i)(1), but also (i)(5) and (i)(7).

4 When I taught 14a-8 in my business associations
5 class a few weeks ago, besides the usual discussion of sort
6 of is there an SEC exemption to the First Amendment, we got
7 into the whole question of well, would we really want to see
8 sort of our least favorite political cause using 14a-8 as a
9 soap box for getting attention.

10 One of the students suggested, and I was happy to
11 see this, the SEC ought to adopt a rule that would limit
12 shareholder proposals, that would exclude shareholder
13 proposals unless a reasonable shareholder of the specific
14 company in question would regard the proposal as having
15 material economic importance for the value of the shares.

16 This, I think, would get us away from cases like
17 the old Lovenheim case, where the foie gras proposal comes
18 in, even though it was clear that it had no material economic
19 impact on the company.

20 It would help us solve cases like the Dole case
21 from the 1990s on whether or not proposals relating to
22 national health care came in.

23 Basically, if we are going to continue to have
24 precatory proposals, and I agree with Leo's analysis of sort
25 of why precatory proposals and Frank's analysis of sort of

1 why precatory proposals are not invalid under Delaware law,
2 but it was the Commission, right, that really set up this
3 model to make it easy to have precatory proposals that have
4 relatively little to do with the economics of the company.

5 It seems to me that you would have to do fairly
6 explicitly, but you could go back and take on cases like
7 Medical Committee for Human Rights and Lovenheim and Dole and
8 some of these other cases that have given 14a-8(i)(5) and
9 (i)(7) very limited ability to exclude proposals, and really
10 tie proposals to something whether it is social or governance
11 or what have you, but having to do with a material impact on
12 the value of the shares.

13 To my mind, one of the solutions that solves is it
14 may get you away from interpreting state law. Right now, you
15 have to sort of say or you may be asked to say 109, 141,
16 which trumps.

17 If, however, you had a preliminary requirement that
18 you assess the materiality of the proposal, which is
19 something the SEC is very good at, you might find that a lot
20 of these questions about 109 versus 141 would fall out
21 because the proposals would fall out.

22 CHAIRMAN COX: Would you feel just as comfortable
23 with such an SEC proposal that state law were explicit on the
24 point that proposals such as that were allowed?

25 PROFESSOR BAINBRIDGE: I'm sorry.

1 CHAIRMAN COX: What if state law said a proposal
2 that hasn't any necessary material impact on the value that a
3 reasonable shareholder would attach to the value of his
4 investment were explicitly --

5 PROFESSOR BAINBRIDGE: And then the Commission
6 would allow that?

7 CHAIRMAN COX: The Commission would disallow it
8 because it doesn't meet your standard. You are saying the
9 value of this is we don't have to look to state law, but if
10 state law were explicit on the point?

11 PROFESSOR BAINBRIDGE: If state law were explicit
12 on the point, you might have a problem. As far as I know,
13 there is no state law that is so explicit, and my guess is
14 Delaware would not rush to adopt such a law.

15 As long as I have your attention, as a fellow
16 Californian, Leo used a metaphor that he's used in a number
17 of his writings, "republic plus." We live in a "republic
18 plus" land, where we have a governor, we have a legislature,
19 and we can have 14, 15, 20 propositions on the ballot.

20 I would ask you if we think of those propositions
21 as the functional equivalent of shareholder proposals under
22 14a-8, whether that process has made our government in
23 California more functional or less functional.

24 If you agree with me it's the latter, maybe the
25 Commission ought to think about that analogy as it applies to

1 14a-8.

2 CHAIRMAN COX: Unfortunately, I don't, but that is
3 only for analogous purposes. It doesn't get to what we are
4 doing here.

5 MR. BALOTTI: A thought on the question of whether
6 14a-8 ought to permit proposals that state law specifically
7 endorses. It seems to me there is a real difference whether
8 a shareholder can get up at a meeting and make a proposal,
9 and the question of who is going to pay for the solicitation.

10 Maybe a way to resolve it is adopt Steve's point of
11 view as to who is going to pay for the solicitation. It has
12 to be something that relates to the economic well being of
13 the enterprise versus what nut can stand up at a meeting and
14 make what proposal, different question, and state law might
15 allow that.

16 CHAIRMAN COX: I was just a little bit flip with
17 Professor Bainbridge. I understand your point. If your
18 point is the voters are getting these big, thick books to
19 look through, and happily, that is not the case with our
20 proxy solicitations thus far. I take the point entirely.

21 MR. JOHN WHITE: I guess I would like to move us
22 towards our second topic, as we started this panel, which is
23 the Federal role. I realize we have touched on that a little
24 bit already. I knew we could never stay on topic anyway.

25 Going back to the very beginning, Mr. Balotti

1 described I guess what I will at least characterize as
2 several of the core rights under Delaware law with respect to
3 director elections and by-law changes.

4 We obviously have the Federal proxy rules that have
5 disclosure requirements and procedural requirements that have
6 an impact on these core rights or exercising these core
7 rights under Delaware law.

8 Professor Coffee, I guess I would like you to give
9 us your insight on where we are on the Federal side.

10 PROFESSOR COFFEE: Thank you. I will do that, and
11 I will try to maintain some continuity with what has been
12 said already, because I think there are some interesting
13 points of contact, and I agree with some of the comments that
14 have been made, but where they lead you is an interesting
15 question.

16 First of all, Section 14a authorizes the Commission
17 to adopt any rule that is either in the public interest or
18 for the protection of investors in connection with a proxy
19 solicitation.

20 A proxy solicitation is a jurisdictional
21 prerequisite but that is a very broad grant of power. It has
22 been put to very broad use over the years, not only do the
23 Federal proxy rules cover the obvious disclosure and
24 anti-fraud elements, they have regulated for 50 years or more
25 the following things:

1 The form of proxy, and in a very mandatory way,
2 because state law says next to nothing about the form of
3 proxy, whereas 14a virtually prescribes every element of the
4 standard form of proxy.

5 It also governs access to the shareholder list,
6 14a-7, trying to establish rules of equal playing field for
7 the contestants in a proxy fight.

8 It also regulates the term of the proxy and the
9 amount of discretionary authority. All of this is generally
10 not dealt with very prescriptively by state law.

11 Finally, it covers this special field of
12 shareholder proposals. There, state law, as we have just
13 heard, basically says the shareholder may exercise voice.
14 The shareholder may have a vote at the meeting or may make a
15 proposal. It is Federal law that sort of underwrites that
16 and says and we are going to reduce the cost of all this by
17 making it mandatory that these proposals will be included in
18 the shareholder proxy statement sent out by the corporation,
19 and that does vastly expand shareholder voice, because it
20 reduces the costs.

21 The Commission's two major initiatives, besides
22 just addressing disclosure, have been to reduce costs and try
23 to level the playing field in shareholder fights.

24 How has the Commission done in this area? I'm
25 going to suggest to you, picking up on what has been said

1 already, that the Commission has essentially in some areas
2 given us a little too much democracy and in some areas, a
3 little too little democracy.

4 This is not really the full effort of the
5 Commission, because the Commission's efforts in this field
6 have been substantially constrained over the years by the
7 Federal courts.

8 Let's talk first about this area of shareholder
9 proposals, where as I think we have heard, state law is
10 relatively silent. There is nothing detailed or prescriptive
11 about shareholder proposals.

12 I agree that Auer vs. Dressel says there can be a
13 vote. It doesn't say that the company has to send out all
14 these notes at its cost to everyone out there.

15 To exclude a proposal, the Commission has always
16 tried very hard to winnow, to ration, screening devices to
17 withdraw some kinds of proposals that were unlikely to have
18 any significant shareholder support.

19 Over the years, the courts have just about negated
20 that effort. I am speaking here about the Medical Committee
21 decision and the Lovenheim decision, which said even a
22 proposal asking the company not to buy pate foie gras from
23 France producers and put it on American delicatessen shelves
24 was too important to social policy to be excluded.

25 Once the courts say that, the Commission was

1 significantly constrained and it couldn't do much. That left
2 the Commission only with one means, which was its
3 interpretation of its ordinary business exclusion.

4 Frankly, over 50 years, and other commentators have
5 said this, and no one to my knowledge has said anything
6 different, the ordinary business exclusion has been
7 interpreted in an inconsistent haphazard and fairly sort of
8 trendy way. It becomes popular and it moves from being
9 ordinary to being extraordinary and suddenly, shareholder
10 proposals go in.

11 This is functionally similar to what Professor
12 Bainbridge said to the provision in many western states that
13 give shareholders a power of initiative. There is one very
14 significant difference.

15 The significant difference is before you get a
16 shareholder proposal on the ballot, even the State of
17 California, you probably have to get a very significant
18 number of shareholder nominations. It takes some time and
19 effort and at least you find out that somebody out there,
20 maybe a minority, but a minority that cares intensively,
21 wants this proposal on the ballot.

22 We have nothing similar to that under the Federal
23 proxy proposal rules, and as a result, we are subject to the
24 tyranny of the 100 share shareholder with a deep ideological
25 commitment to a particular issue.

1 I understand people do. We all have deep
2 ideological commitments. That doesn't mean we should have
3 full access to the corporate treasury.

4 I would submit to you this is the area where we
5 have too much democracy and it goes far beyond what state law
6 permits in a functionally similar field.

7 The way to even the playing field here might be to
8 require for at least many forms of shareholder proposals,
9 perhaps those that don't have an immediate and obvious
10 business significance, that there be a substantial showing of
11 shareholder interest, perhaps a test such as either one
12 percent of the shares or one million shares, whichever is
13 smaller, and I don't mean to be specific about the actual
14 specific quantum here, but something like an one percent test
15 or a million vote nomination process is feasible today, and
16 to make it feasible, the attempt to obtain those votes should
17 be exempt from the proxy solicitation mechanism.

18 There is very low prospect of fraud here if you are
19 seeking to propose rules about pate foie gras, and if you can
20 get one percent of the shareholders to support it, that
21 doesn't sound like ordinary business exclusion any more.

22 That would be a way of saving costs and I think
23 focusing proposals on matters that in the most part are
24 economically significant to shareholders. That is an area
25 where I think you give too much democracy.

1 Now, with respect to too little democracy, we have
2 just heard also that the shareholder nomination process is
3 not much addressed by state law.

4 It just says the shareholders may nominate
5 directors. This is not an area where there is a significant
6 conflict between state law and Federal law. State law is
7 pretty skeletal, pretty simple in terms of nominating
8 shareholders.

9 It is Federal law and Federal law for 50 years that
10 says you cannot use the proxy statement to nominate
11 directors, as 14a-8(c)(8). You may think that is a good rule
12 or a bad rule. It is, however, not a rule that is motivated
13 to any extent by difference to state law.

14 I do not know any reason why a shareholder by-law
15 amendment adopted pursuant to 109b of the Delaware law saying
16 that the shareholders shall have the ability to add to the
17 corporate proxy two names that are adopted by a shareholder
18 vote of X percent would not be a valid shareholder by-law.

19 I admit there could be an intense debate, and I
20 expect later today, there will be an intense debate, over
21 whether shareholder nominations of directors pursuant to the
22 proxy statement is a good idea or a bad idea, but it is not
23 an idea that is in any respect barred by state law.

24 State law says the company has power -- the Board
25 of Directors has power over the business and affairs. 109

1 talks about business and affairs, and then goes on to talk
2 about the rights and powers of the directors and the
3 shareholders.

4 I think it is part of the rights and powers of the
5 shareholders to make a nomination.

6 Debate the issue of shareholder nominations
7 pursuant to the proxy statement as a matter of what is good
8 policy or bad policy, it is not an area where state law
9 significantly confines you.

10 Thus, I am suggesting in some areas, we have a
11 little too much democracy, and in some areas, Federal law
12 right now gives us no ability to have shareholders attempt to
13 engage in greater democracy through by-law amendments.

14 On that note, I will turn the floor back to you,
15 John.

16 MR. DUNN: I will take one thing very quickly. I
17 think I owe it to everybody on the staff who does shareholder
18 proposals to say that under (i)(7), we do our best not to be
19 haphazard in our interpretation of it. We work extremely
20 hard to be consistent on that.

21 I do agree with you that there is a creeping
22 significant social policy issue under (i)(7).

23 I really like your notion of allowing folks to get
24 together to meet a certain threshold. I wanted to get
25 everybody else's opinion on the current thresholds under

1 14a-8 and whether they match any notion of under state law
2 how things would actually work, whether they work counter to
3 what we are supposed to be doing here.

4 The last time it was changed, when it was first
5 adopted, then 50 years later the Commission made the bold
6 move of making it 2,000 in 1998. It hasn't moved since then.

7 I will turn to Leo to start this off. I want
8 everybody's views. Is there some notion that the small
9 threshold there is allowing a little bit of -- I don't want
10 to say a tyranny of minority -- a notion of smaller
11 shareholders having a larger say than people think they
12 should or shouldn't?

13 VICE CHANCELLOR STRINE: I actually think the
14 thresholds probably do not matter as much. The thing is foie
15 gras, I love foie gras, so I'm conflicted on it. Most
16 Americans eat like force fed geese anyway. I don't know why
17 we are complaining on their behalf.

18 I think the issue is a balance question. I think
19 Jack is right about what is the threshold cost. I think
20 there is an elegant -- one of the elegant ways out that would
21 deal with what Jack is talking about is stockholders actually
22 have the ability to shape a lot of these electoral systems
23 themselves, and they are increasingly vocal through precatory
24 proposals about ideas about that.

25 I think what we are sort of saying is if the proxy

1 proposals facilitated the presentation of by-laws that were
2 company specific, then the stockholders could propose a
3 reimbursement scheme if they liked. They could propose a
4 proxy access thing.

5 The SEC would be facilitating the presentation of
6 that without having to design a system.

7 You do question, and here is where I would get in a
8 little bit on the precatory proposals, if stockholders are
9 increasingly exercising voice and power over real things, is
10 there potentially an argument to cut back on the imaginary
11 things.

12 Which is if 25 years ago really real things never
13 got done by stockholders, and you needed this sort of outlet
14 to express things to managers so they would at least hear
15 something, if now stockholders are acting in ways that are
16 binding, perhaps the room for them to just exercise pure
17 voice about other things should be reduced a little bit, and
18 where the thresholds that Jack and Steve are talking about
19 would come in, they could not restrict it altogether, but
20 make sure that it is someone with a real economic stake.

21 By the way, this is something for the Commission to
22 watch, how long have they held the stake potentially, which
23 is how long have they been around. Have they just bought in
24 to make this proposal? How long are they committing to

25 it? Are they actually long the company, which is

1 another thing I hope we will get into through the day, which
2 is do they actually have an interest that is aligned with the
3 best interests of the company itself or are they short the
4 company, which is something we often don't know.

5 PROFESSOR ROMANO: I would like to take a shot at
6 this, too. I think in some sense, the view of this by
7 corporations as democracy is inept, because in democracy, we
8 think of things as one person/one vote, and it is people's
9 visions of the good.

10 Whereas, corporations are not really a polity, and
11 they are there to serve as engines of efficiency in terms of
12 the allocation of resources and the production of goods and
13 services, and the concept of that is one share/one vote and
14 not one person/one vote, because we think the more financial
15 interest you have in the firm, the more likely your voting
16 will be for increasing the value of the firm and with the
17 other investors.

18 The thresholds of 14a-8 is really like an one
19 person/one vote, because you can have a trivial investment
20 and you have the same equal access to using everyone else's
21 resources in the proxy statement as those who have a large
22 block.

23 One could do this in two ways. One could do sort
24 of what Jack was saying, something like a percentage of a
25 threshold. I would sort of prefer to think about this more

1 as making people have to invest their resources in it.

2 If it is a high enough threshold, I guess they
3 would have to invest resources to get other people to be in a
4 block with them, but the other way would be to try to figure
5 out what the expense is to firms of doing this.

6 Obviously, one could say the expense is very low
7 because the marginal cost of adding a paragraph or a page to
8 a proxy statement is minimal, but there is a lot of other
9 expense that goes in. They have to spend time and effort in
10 responding to this. You have to have staff doing this.

11 Maybe if the Commission could get a sense of what
12 the cost is or what firms think the cost is of having these
13 kinds of proposals, one could say this is the kind of cost
14 that we are going to impose someone to pay, sort of like a
15 bond, but if you succeed, we would follow the state law
16 approach that says, well, people who succeed in a proxy fight
17 get reimbursed.

18 So we would have people have to put up some up
19 front costs, which I think would also make them more serious
20 in devoting their resources of what makes sense to put up,
21 and then if they succeed in getting enough votes, one could
22 say a majority of 50 percent, but one could have some
23 substantial amount of votes that showed support, 40 percent
24 or some other sort of measure, I'm not sure what the right
25 one would be, and then we would reimburse them. If not, they

1 would bear that risk. That is another way to think of this
2 and get it more to be like the one share/one vote as opposed
3 to the one person/one vote, and thinking more about sort of
4 what we think corporations are.

5 They are not really supposed to be political
6 systems. They are not intended to be democracies. If they
7 were, that would not really be serving why we have these
8 business enterprises.

9 MR. JOHN WHITE: Professor Coffee?

10 PROFESSOR COFFEE: I think the Vice Chancellor's
11 idea is a worthy one. You could well have a system that
12 tries to integrate a Commission default rule with the
13 possibility of override by shareholder action with either a
14 higher or lower standard.

15 The advantage of the Commission additional default
16 rule is if nothing is done, there is going to be a fair
17 amount of corporate waste going on because of what I keep
18 calling the tyranny of the 100 share shareholder.

19 The real cost here, and this is sort of a response
20 to Professor Romano, it is not just the costs incurred by the
21 company. It is the costs incurred by shareholders reading
22 proxy statements.

23 If it is too easy and you get 100 proposals on the
24 proxy statement, it will look like the Peking Wall in 1962.
25 There will be so many different social issues that none will

1 get attention.

2 You do need a mechanism that prioritizes and one of
3 the things might be to put the top ten proposals in terms of
4 shareholder support or the top five. I do not think you can
5 evaluate the costs just in looking at what it costs the
6 corporation.

7 Shareholder attention is a precious commodity and
8 it is not going to get spread very far, and thus, minimizing
9 these proposals actually gives more weight to the more
10 serious proposals.

11 MR. JOHN WHITE: I would like to take us back to
12 where you were a few minutes ago, Professor Coffee.

13 If I understood your description of where the
14 Federal role is, the Federal role is both, I guess I would
15 say, over inclusive and under inclusive, if that is a way to
16 describe it.

17 We have been talking about the precatory side a
18 fair amount. If we could come back for a moment to what I
19 will call the under inclusive side.

20 If I understood your description, you think the
21 Federal rules really do interfere with shareholders
22 exercising some of their core rights under state law.

23 I guess my question is -- I think you were pretty
24 clear on that. I guess I would like to pose that question to
25 the rest of the panel to see whether others agree with your

1 view that the Federal rules are getting in the way.

2 Professor Bainbridge?

3 PROFESSOR BAINBRIDGE: This is an issue that I
4 hoped we would have a chance to address. I would like to
5 begin to get at it by agreeing with Roberta that notions of
6 corporate democracy and Leo's phrase "republic," really
7 obscure what we are about.

8 It is important to recognize that what we are
9 dealing with in the corporation is an unique entity, a legal
10 fiction that represents the line the law has drawn around a
11 set of complex implicit and explicit contracts between
12 multiple constituencies.

13 There is no "their" there. There is no book that
14 you can own and say this is the corporation and I own it.
15 You do not own legal fictions. You have contractual rights
16 that relate to this fiction. We have to get away from the
17 notion of shareholders as owners.

18 This goes to the answer to your question, that I
19 wrote an article that was published in the UCLA Law Review
20 called "The Case for Limited Shareholder Rights."

21 I would just like to take a minute to lay out that
22 argument. If we think of the directors as being the central
23 body that exercises fiat with respect to this complex set of
24 contracts, the directors are not the agents of the
25 shareholders.

1 The shareholders come to the corporation and make a
2 deal. The deal basically is we are going to give you our
3 money, in return for which, we are going to receive a liquid
4 investment that represents the claim on the residual,
5 whatever is left over after all other corporate claims have
6 been satisfied.

7 The rights that we get with that are certain rights
8 of liquidity and we get a limited right to participate in
9 corporate governance to hold you accountable for how you run
10 the company on our behalf.

11 The problem, of course, is that authority and
12 accountability are in constant tension.

13 When I teach this issue in class, I say to the
14 class imagine that the Dean is sitting in the back row with a
15 stack of money representing my monthly salary. The Dean
16 initially says Steve, go teach business associations however
17 you want.

18 But he's sitting in the back row. Every time I do
19 something he doesn't like, he takes some of my monthly
20 paycheck back. I can see him doing that.

21 Pretty soon, I am going to be teaching the class to
22 keep him from reaching to the stack.

23 The power to review is in some sense the power to
24 decide. That is the basic problem of corporate governance,
25 that to the extent that we empower shareholders to review

1 what boards do, we are necessarily limiting the scope of the
2 board's authority. That means that we have to be very
3 careful when we talk about shareholder rights to remember
4 that those rights potentially impinge on what makes the
5 corporation work.

6 Roberta Romano has written, of course, a wonderful
7 book, "The Genius of American Corporate Law," which makes the
8 case that competitive federalism is the genius.

9 I would make the case that it is the separation of
10 ownership and control that is the genius of American
11 corporate law.

12 This is really what I wanted to have a chance to
13 say to the Commission today, which is it seems to me that the
14 Commission was founded on the Burley and Means premise that
15 the separation of ownership and control is a problem seeking
16 a solution.

17 Whereas, I would put it to you that the separation
18 of ownership and control is the fundamental source of the
19 success of American corporate governance.

20 We have a system of governance in American
21 corporations that I have called "director primacy." In order
22 to make director primacy work, we have to remember that
23 holding directors accountable inevitably undermines their
24 authority.

25 I think that there is a very useful way of sorting

1 out the state and Federal roles in this area, and that is the
2 decision that was issued back in the 1980s when the
3 Commission adopted Rule 19c-4, and the D.C. Circuit in
4 Business Roundtable vs. SEC, said okay, what are the purposes
5 of Section 14a? Nothing in the 1934 Act was intended to let
6 the Commission regulate the substance of corporate
7 governance.

8 Section 14a is not an exception to that. Your
9 powers under Section 14a are limited to disclosure and
10 process.

11 Substance of corporate voting rights was left to
12 the states. That is significant because it is the
13 substantive ability to constrain directors that poses the
14 real threat to their authority.

15 It is substantive empowerment of shareholders that
16 creates the risk that the power to review becomes the power
17 to decide.

18 Where Federal law has, I think, to a certain extent
19 gone beyond the Business Roundtable area, has been through
20 the use of what we might call "therapeutic disclosure," where
21 you are adopting what purport to be disclosure rules that
22 really seem to most observers to be intended to impact the
23 substance of how corporations behave.

24 Of course, there are long-standing examples like
25 the requirement for fairness opinions and going private

1 transactions. A lot of people might say that the executive
2 compensation rules are examples of these.

3 I think that the Commission has to be sort of aware
4 of the Business Roundtable line and ensuring that as you
5 adopt disclosure rules and process rules, that you are really
6 not stepping over the Business Roundtable line and getting
7 into the substance of corporate governance, the substantive
8 allocation of shareholder rights which to my mind is
9 appropriately left to state corporate law.

10 MR. JOHN WHITE: Before I ask our panelists to give
11 us their closing thoughts, looking at my watch and seeing the
12 time here, are there any questions from any of the
13 Commissioners?

14 COMMISSIONER NAZARETH: I have one reaction that I
15 feel compelled to make in response to the last statements by
16 Professor Bainbridge, which I guess is that again, I would
17 analogize what the shareholders are doing with respect to the
18 Board of Directors as more like the faculty people who are
19 deciding on tenure, sitting in the back of the room and
20 checking occasionally to ensure that the people getting
21 tenure are meeting certain quality standards and not
22 necessarily going to the specifics of every action and every
23 class that the professor is teaching.

24 I understood the analogy, but I thought if I were
25 making an analogy, it would a bit different.

1 I would be happy in your responding to that
2 comment.

3 MR. JOHN WHITE: Professor Romano?

4 PROFESSOR ROMANO: I do think that is really the
5 issue, is the nomination substantive or procedural. I think
6 the line is it is not obvious where that is because this is
7 sort of like substantive due process and the procedure
8 teachers who do that because sometimes having that really
9 becomes the substantive right. I think that really is a
10 question on this.

11 I would feel more comfortable in a process that
12 sort of blurred that issue, if we thought that the people
13 doing this had financial responsibility, and the way the
14 structure is, even if we sort of get rid of all the precatory
15 proposals and we used the materiality test, but we still said
16 set up by-laws.

17 And I agree, I think shareholders have the right
18 and should be able to put up by-laws, but if we do that and
19 keeping in the current structure, you have whatever the
20 people have.

21 You don't have people who can put these nominations
22 up who have the resources available or devoted to a staff
23 person who could find a nominee or can finance a nominee to
24 do the research or a hedge fund or private equity funds, who
25 have substantial pools.

1 When they put someone on a board or running people,
2 they can also give them the support to making informed
3 decisions.

4 Mutual funds, pension funds, they are not managers
5 of real assets. That is not what their skills are. It is
6 not clear how they can actually use this in a productive way.

7 I think you want to sort of -- if you are going to
8 move in this way, you really have to re-think what that
9 threshold or the reason or how you allow people to be able to
10 put these things up. I think that is really what the heart
11 is of the issue with the whole sort of the 14a process.

12 It is state law when people can put these up at
13 meetings, they have to sort of be present and if they want to
14 get the support before, they have to use their own resources.

15 It's sort of that point about the financial
16 incentives. I agree with you. Tenure procedures are very
17 substantive of who we are putting on that faculty, and they
18 stay there forever. We don't have mandatory retirement now.
19 It has expensive ramifications when we do that.

20 MR. JOHN WHITE: Commissioner Campos?

21 COMMISSIONER CAMPOS: First of all, I have
22 appreciated the discussion. It seems to me the last comments
23 by Professor Bainbridge sort of bring up some of the most
24 fundamental issues regarding corporate law, and that is who
25 is the owner and who is subject to accountability or not.

1 I don't know. It is an interesting discussion. I
2 have had academics and others say to me, well, you know, the
3 true value proposition is management. After all, they are
4 the ones who know how to turn assets into value and so forth.
5 Forget about shareholders. Forget about directors. All of
6 them are just there essentially as enablers.

7 Professor Bainbridge is sort of saying, well, wait
8 a minute. Directors shouldn't be accountable at all.
9 Essentially, directors, if you are going to hold them
10 accountable, then you are reducing their power. That is
11 rather -- I don't know if "shocking" is the right word -- it
12 does not seem to me to comport to all of the basic corporate
13 law that I remember studying in my days. Maybe it is out of
14 date. Maybe it is not popular any more.

15 I always thought that shareholders were owners and
16 they were principal agents essentially, and you held
17 directors accountable.

18 To throw away that proposition, to me, is very much
19 getting us into exactly the basis of corporate law, which is
20 substantive, at the state level.

21 I find that interesting. I am not sure if that
22 goes way too far. I do not think the Commission has a
23 mandate to change substantive American Anglo-Saxon corporate
24 law from that perspective.

25 MR. JOHN WHITE: This is interesting. I can see

1 everyone on the panel wants to respond to this. Maybe we are
2 lucky enough that we are also at the point where we would
3 like to ask each of the panelists to give us their closing
4 thoughts and suggestions for the Commission.

5 Perhaps at the same time that you give us your
6 closing thoughts, you can respond to Commissioner Campos'
7 remarks, if that works.

8 We will start with Professor Bainbridge.

9 PROFESSOR BAINBRIDGE: Commissioner Campos, I was
10 obviously not suggesting that directors should never be held
11 accountable. What I was trying to suggest is there is a
12 tension between authority and accountability, that holding
13 people to account necessarily infringes on their authority.

14 Clearly, there are times that you want to do that,
15 despite the fact that telling directors you can't steal from
16 the corporate treasury is a limitation on their authority, it
17 is a limitation we would all support.

18 My point simply is that one must recognize that
19 there is always a tension between authority and
20 accountability. One has to try to resolve that tension in
21 ways that are appropriate given the nature of the problem at
22 hand.

23 For example, where we deal with a simple claim that
24 the directors were negligent, the business judgment rule, of
25 course, makes it very difficult to hold directors accountable

1 for decisions that are merely negligent.

2 Where we talk about directors engaging in self
3 dealing, the duty of loyalty comes into full play, and with
4 potentially very severe consequences.

5 My point is not that directors should be
6 unaccountable. My point simply is that we have to remember
7 there is this core tension. That core tension traditionally
8 has been resolved at the state corporate law level.

9 My point is whatever the SEC does, they should
10 recognize that they have very limited authority under 14a-8
11 to change the balances that have been struck by state
12 corporate law in this area.

13 It is always a matter of balance. It is also a
14 question of who gets to set the balance.

15 MR. JOHN WHITE: Mr. Balotti?

16 MR. BALOTTI: I, like Steve, believe that directors
17 should be accountable. It is the system by which they should
18 be accountable that I think is important.

19 Certainly, they should be accountable through the
20 court system. Certainly, they should be accountable in the
21 sense that if the stockholders don't like the job they are
22 doing, they don't elect them again.

23 Should the stockholders have a vote on whether we
24 are going to build the next plant in Washington, D.C. or
25 Delaware? No, I don't think so. Accountability in that

1 sense, I think, is a mistake.

2 Let me comment very briefly on Jack's thought of
3 under inclusiveness. I think the balance, save one area, is
4 just about right. I am not one who favors discriminating
5 among shareholders by reason of size.

6 I do not think we need to make it easier for the
7 large shareholders who can afford to use the existing proxy
8 system to shift that burden to the corporation and the other
9 shareholders.

10 I like Steve's idea of a materiality test, that
11 only those proposals which affect the wherewithal, the
12 business of the company, should go forward. I would draw the
13 line there, not on the size of ownership.

14 The area that I said maybe is one that can be
15 relaxed a little bit is the ten shareholder rule.
16 Shareholders can only talk to fewer than ten shareholders
17 before they have to have a proxy on file. I do not
18 understand the rationale of 10 versus 12 or 13 or any other
19 number.

20 As far as I'm concerned, I'd let sophisticated
21 shareholders talk to sophisticated shareholders. Maybe that
22 is one area where I would discriminate among shareholders. I
23 truly do not care if hedge funds lie to hedge funds. That is
24 not something that bothers me. Let them straighten out in
25 their own world if there is fraud between them.

1 I think I would let them talk to each other and if
2 they want to make changes in the way the corporation is run,
3 I think the by-law area is wide open. Let them enact by-laws
4 that relate to the power of directors and stockholders and
5 the methodology by which the corporation is run, and then the
6 stockholders will have spoken for a different regime at that
7 corporation. Let it go forward at that basis.

8 MR. JOHN WHITE: Professor Coffee?

9 PROFESSOR COFFEE: I think it is mandatory that I
10 start by responding to Stephen Bainbridge who made an
11 interesting and provocative suggestion.

12 I would tell the Commission first of all that
13 frankly, the separation of ownership and control, which is
14 where he started, is now declining, with the rise of
15 institutional investors, we don't have the same separation in
16 the past, and inevitably, whether we like it or not, the
17 allocation of power between the board and the shareholders is
18 going to change, in an era where institutional investors are
19 large and concentrated ownership is quite possible with the
20 minimum of effort between them.

21 That means the world is changing and I think SEC
22 rules have to recognize that.

23 What I would suggest that you recognize, and here I
24 am going to sound like the classic spokesman of Delaware, I
25 think you should recognize that corporate law is enabling.

1 By "enabling," it means the shareholders have some power to
2 design the rules of the game.

3 I do not mean that there should be by-law
4 amendments telling you where to build a plant or what color
5 to make the plant. That is classic ordinary business.

6 I do think, however, the shareholders have great
7 power to adopt by-laws addressing the shareholder nomination
8 process, which is much more clearly governed by 109 than by
9 141a, and there could be any number of by-laws in that area,
10 and maybe they can even get into expense reimbursement,
11 although that gets to be a closer question.

12 Where there is some tension is by-law amendments
13 addressed at issues such as the "poison pill." Is that 141
14 or is that 109?

15 If Delaware adopts a procedure by which the courts
16 will tell us, I think it is perfectly appropriate in a system
17 of federalism to try to give the courts some role in doing
18 that, but I do think when we are dealing with the basic issue
19 of the nomination process and the voting process, that
20 shareholder power to establish the rules of the game is part
21 of an enabling system of corporate law.

22 To say the board has all the authority, that is,
23 and I love to use this phrase, because it has been used
24 against me many a time, that is an "one size fits all" model.
25 It says the board has all the power, no one else can do

1 anything.

2 There can be all kinds of modifications.
3 Intelligent sophisticated shareholders and institutional
4 investors often own 70 percent or more of our largest
5 companies, and they are not going to deliberately injure
6 themselves, and they are probably making prudent thoughtful
7 decisions.

8 In that kind of world, dealing with the rights and
9 powers of shareholders, which is the nomination and voting
10 process, I would think an enabling system should recognize
11 that shareholders can redesign the balance of power at least
12 marginally, and I am not going to disagree with Frank that
13 you cannot tell the board where to locate the plants or what
14 color to paint them.

15 By the way, for a brief shining moment, I even
16 agreed with my friend, Franklin, here. I think the ten
17 shareholder rule probably is out of date. It means less than
18 1993 when the Commission did de-regulate communications among
19 institutional investors, so long as they were not seeking
20 proxy authority.

21 I do think you could have greater communication and
22 even proxy authority for purposes of things like shareholder
23 proposals.

24 The assumption here that when you say we have to
25 have an one percent or one million vote test, we are just

1 giving all power to large shareholders, it isn't really true.

2 The true small shareholder told that he can
3 communicate with others and using a web site could very
4 quickly, using the web site, if it was de-regulated, get one
5 million votes for an issue that really was important to all
6 the shareholders, even though it might strike us as a moral
7 or ethical issue that wasn't meeting a materiality test.

8 I would not tell you to go solely down the
9 materiality road. I would say if shareholders really care
10 about a moral issue, you get one or two percent, whatever
11 your threshold is, to band together, and you permit them to
12 do this without any serious regulation, then they will use
13 web sites and you will find 100 shareholders aggregating
14 together and being able to satisfy that kind of test.

15 I think if you give shareholders more voice, they
16 will like it and it will help the system in the long run.

17 Today, however, we do have the tyranny of the 100
18 share shareholder, and that person is often an ideological
19 partisan rather than a person who has a true interest in the
20 interest of the corporation.

21 I would also tell you that the current system of
22 the ordinary business exclusion under 14a is not working. I
23 am not saying the Commission does not work hard. There is no
24 real standard for what is "ordinary" versus "extraordinary."
25 It shifts with the time.

1 I think it would be better to use a more democratic
2 solution that looked to an expression of shareholder
3 interest.

4 The hot issue is by-law amendments. Later panels
5 will deal with that. I do think there is a line drawing
6 issue here, and the line drawing has to be what is corporate
7 governance and what is ordinary specific business decision
8 making, and I think you can draw that line.

9 MR. JOHN WHITE: Professor Romano?

10 PROFESSOR ROMANO: I want to say one response to
11 Commissioner Campos and to something Jack said, and then I
12 want to take a slight diversion and say something about the
13 interesting idea of a proxy forum.

14 To Commissioner Campos, I want to say I agree
15 completely. My whole view is that shareholders own the firm.
16 The directors and the managers are their agents. We have to
17 understand corporate law and securities regulations as means
18 to reduce agency problems.

19 I do think the separation of ownership and control
20 is not what people have emphasized. In fact, I think the
21 whole point of 14a-8 is based on a premise of separation of
22 ownership and control and you have to subsidize them because
23 there are collective action problems where you have little
24 investors, and that is not what we have today.

25 Not only do we have hedge funds who have large

1 blocks, but the institutional investors who I think are
2 small, I think CalPERS and the unions who look big compared
3 to the individual, they are not big investors. They do not
4 have a lot of resources and informed people, but these people
5 have collective groups. You have the CII. You have ISS.
6 There are other sort of means that deal with the old
7 collective action problem.

8 In that sense, 14a-8 is an outmoded approach, but
9 that is what you have.

10 To pick up on the "one size fits all," and the
11 enabling view, the real thing that I think would
12 be -- although it is beyond what you are thinking about -- is
13 to let firms opt into your system or opt out of their system.

14 If firms want to have precatory proposals, they
15 should be able to put them up, if that's what their
16 shareholders want. If they don't want to have any of these
17 proposals, I really think that what you really want to sort
18 of think about is whether it is a super majority vote or
19 whatever, have the shareholders vote to say do we want to be
20 in this system as it is.

21 Do we want to modify it, and we are going to have
22 the \$1 million shareholder or we will put in some of our own
23 sort of limits on who can put these things up and who can't,
24 and I think that would be one way sort of if you are really
25 talking about the voice of the shareholders and thinking of a

1 system, one might want to think of this as authority of
2 enabling firms to modify somewhat their system.

3 CHAIRMAN COX: I do not want to interrupt closing
4 statements, but just a quick question. Is your thought that
5 you have just expressed that the shareholders would
6 essentially have a referendum on whether to opt in or opt out
7 of a --

8 PROFESSOR ROMANO: That is right. The firms put up
9 to their shareholders they could vote to say do we want to be
10 in this regime. They could say we want to be partially in
11 this regime or to modify whatever, sort of in your regime,
12 but we will modify piece A of it.

13 Say we want to have a three percent requirement or
14 we don't want any requirement, anyone can put it up. I would
15 say to think about this, here's my regime, but you have the
16 choice to sort of not follow this if you can get a sufficient
17 number of shareholders to agree with you on that.

18 I really think that is in the full spirit of this.
19 You would not have to worry. If shareholders want to do
20 precatory and that is what they approved, if they don't, they
21 just want mandatory by-laws, that would be their system. I
22 do not really think -- I would sort of take it that way.

23 I did want to say something about proxy forums,
24 which I thought was a very interesting idea. When you think
25 about this in terms of you wonder about unintended

1 consequences about something like this.

2 My thought is we think about sort of managers of
3 firms. They have a hard time as it is just doing what their
4 job is, which is to try to run the firms efficiently and make
5 profits. There are these market constraints.

6 There is a study by Steve Kaplan that just came out
7 to show the CEO turnover has dramatically increased. They
8 are like in office for maybe five or six years on average.
9 They have hedge funds and the like.

10 There are concerns here about nominations and these
11 other proposals that disrupts management, distracts them, the
12 media harasses them. How do we get them to focus their
13 attention?

14 It does have sort of this nice idea that you get
15 these things off the proxy process so shareholders can be in
16 these deliberations, sort of chat rooms, but then you think
17 what does that mean?

18 The management is going to have to have staff that
19 monitor this all the time because they have to be responsive.
20 Will it be a breach of their fiduciary duty if they don't
21 participate? Then they will have to have staffs full time
22 looking at what is going on, what are people saying. I had
23 not thought of it as the tyranny of the 100 shareholders, but
24 if anybody can put things up, that is where all of these
25 things are going to go, but it won't really avoid some of the

1 problem.

2 Under the Investment Company Act, this is not a
3 fiduciary obligation to sort of participate in this.

4 I think it is a really interesting idea, but I
5 don't know how that will affect whether or not it is just
6 something they are going to have to do even more than what's
7 done in the proxy process.

8 CHAIRMAN COX: I think we will get into that more
9 in subsequent panels. I would just observe shareholders get
10 a chance to blog on the Internet, whether you like it or not.
11 Maybe somebody ought to pay attention anyway.

12 PROFESSOR ROMANO: I agree they should. I agree
13 with you completely on that. They do have to do that.
14 Should the Federal Government then sort of make it
15 into -- the question would be does that impose more
16 obligations on all the other investors to participate as
17 well.

18 I do think it is sort of related also to just the
19 whole general shareholder proposal process. That is why I
20 think the issue of the nominations has caught so much
21 attention, because managers are worried that you have someone
22 who is not fully interested in the firm who could use this
23 process.

24 I would go back to emphasizing the cost of the
25 process and maybe Jack is right. Maybe I am too narrow to

1 look at the firm, and in thinking about what the cost is, you
2 have to add other costs.

3 You could get information about how much it costs
4 to do a proxy fight, which I think has gone down over time,
5 given sort of the greater ability to coordinate with other
6 investors. That might give a better handle on how to craft
7 what you want and getting them to also have financial
8 responsibility.

9 MR. JOHN WHITE: Vice Chancellor Strine?

10 VICE CHANCELLOR STRINE: Roberta's mention of this
11 sort of referendum idea actually is a great intro into sort
12 of my biggest picture point, which goes to Commissioner
13 Campos' comments.

14 The separation of ownership and control we continue
15 to obsess over is this idea that the people who manage
16 entities that deliver services and make products are going to
17 exploit everyone else.

18 I guess we have this assumption that people who
19 manage money for a living are people of higher ethical
20 caliber than people who manage companies that deliver
21 products and services.

22 It is not the most intuitive assumption about human
23 nature I have ever heard, but it is the one that we continue
24 to make. What do I mean by that?

25 There has to be accountability on the part of

1 directors and managers, but to whom. I am an ordinary
2 American. That means I now have to save for my retirement.
3 I have to put money in the market every month. I also know
4 something about corporate finance. I have been taught by
5 good professors up here that I am not likely and no one else
6 is likely to engage in an act of trading strategy that over
7 time beats the market.

8 I invest through index funds. I don't read these
9 proxies. Someone else reads them for me. I am investing
10 primarily for college and for retirement, like most
11 Americans.

12 The money managers who often manage my money, they
13 are not incentivized in terms of their compensation on a time
14 horizon that is consistent with that of their investors.
15 Many of them brag that they have set up proxy voting units
16 that are separate from the people who make investment
17 decisions, and they brag about the fact that the people who
18 invest your securities are totally different from the people
19 who vote them. Think about that. Think about who you are
20 giving power to.

21 What I call it is separation of ownership from
22 ownership. The people in the middle are influencing
23 corporations and they are now proposing very specific
24 strategies, business strategies, most of which involve
25 increased leverage, increased pay outs of short term cash.

1 These are often proposed by very short term investors who
2 will not be around to eat their own cooking. When it goes
3 bankrupt, when the strategy fails, they will be around buying
4 the distressed debt. The index investors will still be in.

5 The thing about the precatory proposals, who will
6 advise the 1940 Act companies on how to vote on whether to
7 opt out of precatory proposals? Institutions which make
8 their money because they get paid to advise on these votes.

9 These firms that advise, you allow them to
10 represent both management and stockholders, and they market
11 themselves as knowing more about the electorate and how it
12 will vote than anyone else. Why not? They get paid to make
13 advisory decisions to stockholders.

14 There is a basic question about who you are
15 empowering. Are you empowering the general electorate or the
16 primary electorate, and how are you aligning the incentives
17 of people in the middle?

18 I think it is a very big picture issue to think
19 about. Some more specifics, and I just want to finish on
20 that. When you are an old passive stockholder and you vote,
21 and you left it to the managers, if the managers made
22 mistakes, they were accountable. They could be sued. If you
23 are now a stockholder and you influence a board to change
24 these policies and then you are gone, are you a fiduciary?
25 What responsibilities do you have?

1 We are seeing compromises right and left. The rise
2 of the independent director affects this in a big way. A lot
3 of the independent directors now make their living as
4 independent directors. They don't want to oppose anything at
5 a particular company which will get them in trouble with the
6 advisory institutions.

7 They are more than willing to compromise. They
8 look like elected officials, but not the most courageous
9 ones. They look like the ones who want to stay in office.

10 A lot of what they are doing is making
11 accommodations. In the political process, we know globally,
12 compromise is vital. If you talk to each other, if you paper
13 over a difference and don't blow each other up, thank the
14 Lord for that. That is a blessing.

15 In the business world, that is not as clear. It is
16 not clear that we want every public company's business
17 strategy to be compromised a little by people who want to
18 stay in office.

19 I think part of what Steve is saying is managers
20 would make mistakes but to a diversified investor, allowing
21 different management teams to pursue the long term profit
22 overall works out really well for the United States. We have
23 to be careful about balancing it.

24 A couple of specific solutions. One way in which
25 you are actually in the way is we have annual meetings in

1 Delaware. Vice Chancellor Lamb will probably talk a little
2 bit more about this. Both he and I face situations where
3 there are corporate catastrophes, no regular filings, and the
4 company can't solicit proxies.

5 What do they do? They don't hold annual meetings.
6 You need to have a rule that deals with this up front. It
7 should not be that you come to us as the school marms and we
8 have to order them.

9 Stockholders need annual meetings more than ever in
10 these corporate catastrophes. There has to be a way so that
11 the incumbents don't go in totally naked without proxies.
12 There should be some accountability measures. That may be
13 where proxy access would actually be a facilitator, to put a
14 penalty on a management where you can't file financials, but
15 to open up the access.

16 Here's what happens. In Health South, I have a
17 completely written opinion in the drawer on this. Vice
18 Chancellor Lamb issued a very good decision.

19 The stockholders of Health South didn't pick the
20 new board. The lead plaintiffs picked the new board. There
21 was a compromise.

22 A lot of these things are getting worked out that
23 way, and it is almost back to a form of cumulative voting,
24 where the most active institutions come in and get some
25 representatives in the board room, and so this annual meeting

1 thing could be a fix.

2 The other basic point that I think everyone on the
3 panel will agree with is if you let binding by-law proposals
4 go on the ballot that relate to the election process, not
5 that Strine is a jerk, you know, if I'm running for office, I
6 would think that is what you are relating to the election,
7 you can't have let's have a precatory proposal that Strine is
8 a jerk, maybe inarguable, but it's not really proper.

9 If it relates to the actual system of elections,
10 let the state courts determine that. That will allow
11 stockholders to have innovation and actually elegantly gets
12 you out of the middle of this, which is you are facilitating
13 change of the electoral process, responsiveness to
14 stockholders, without a single solution to myriad
15 circumstances.

16 You are giving life to the state law right. I
17 actually do not think you need to go to the Delaware Supreme
18 Court every single time. If it is uncertain, you put it on
19 the ballot. You let it come out. If there is a fight about
20 whether it is valid, frankly, a lot of times the boards go
21 along with it voluntarily once there is a stockholder vote.

22 That is my thoughts. I appreciate the opportunity
23 to be here with you all.

24 MR. JOHN WHITE: I would like to thank all the
25 panelists for being here. We will take about a ten minute

1 break and convene with the next panel.

2 CHAIRMAN COX: I just want to join in on behalf of
3 the Commission. That was just an absolutely superb
4 discussion. Thank you very much. I think you really helped
5 us a lot.

6 (A brief recess was taken.)

7 PANEL TWO

8 THE PURPOSE AND EFFECT OF THE FEDERAL PROXY RULES

9 MR. JOHN WHITE: Thank you. We will get started
10 with our second panel, the purpose and effect of the Federal
11 proxy rules.

12 I will begin by introducing our five panelists,
13 starting on the left, Jill Fisch, Professor of Business Law
14 at Fordham University School of Law, and currently visiting
15 at the University of Pennsylvania Law School.

16 Second, Steve Lamb, Vice Chancellor, Court of
17 Chancery, State of Delaware. Third, Don Langevoort,
18 Professor of Law at Georgetown University School of Law.
19 Next to him, Ted White, strategic advisor to Knight Vinke
20 Asset Management and also a consultant to the Council of
21 Institutional Investors, and fifth, John Wilcox, head of
22 Corporate Governance at TIAA-CREF.

23 As you can see, this panel is somewhat tilted, not
24 quite as much as last time, towards academics and the
25 judiciary, as we continue our discussion.

1 The topic for this panel is the purpose and effect
2 of the Federal proxy rules. I don't know that I was
3 particularly successful the last time through with breaking
4 it up into topics, but I am at least going to say that I am
5 going to try to break it up into topics. Who knows where my
6 success will end up.

7 I had thought we would try to do this in three
8 parts. The first being the effect of the Federal proxy rules
9 generally on shareholders' exercise of their state law
10 rights, and then to look specifically at the impact on
11 binding shareholder proposals and how the Federal rules, I
12 guess, to use Professor Coffee's comments, are limiting or
13 under inclusive in that area, and then third, move to the
14 impact on non-binding or precatory proposals and how our
15 rules may be over inclusive or too expansive there.

16 If I can, I will start with Vice Chancellor Lamb,
17 and then go to Professor Langevoort, on the general question
18 of do the Federal proxy rules -- what is the impact of the
19 Federal proxy rules on the exercise of state law rights.

20 I guess I should actually ask us to look
21 particularly with respect to proposing matters to be voted on
22 at annual meetings.

23 Vice Chancellor?

24 VICE CHANCELLOR LAMB: Thank you, John. It is a
25 pleasure to be here.

1 There is, I think, an anomaly in asking a state
2 court judge to be the first one to answer the question about
3 the impact of Federal proxy rules.

4 MR. JOHN WHITE: You mean on state laws. Got it
5 wrong already?

6 VICE CHANCELLOR LAMB: I am willing to give it a
7 try. I am especially happy for me to be here since I served
8 on the staff of the Commission from 1978 to 1980, and I have
9 only the greatest respect for the work of the Commission and
10 the people who both serve as commissioners and who devote
11 themselves to the work of the staff.

12 Having said that, I am now a state court judge, or
13 I sit on the state court. My view of these things is mostly
14 shaped from that direction. Although from time to time, I
15 get matters before me that require me to sort of put my SEC
16 staff guy hat back on to examine the SEC rules, and to see
17 how to make them work with state law.

18 John has tried now to limit my opening comments to
19 one issue, and I will address that issue, but I think I will
20 mention another one as well.

21 The first is really an observation that it is to my
22 mind anyway somewhat anomalous that at the time the
23 Commission was examining the whole question of whether or not
24 to adopt a very complex system of proxy access that the
25 interpretation the staff took of one of the sub-rules of

1 14a-8 precluded from inclusion in company proxy material
2 proposals to adopt by-law amendments at the corporate level,
3 company by company.

4 That would have included, for example, proposals to
5 establish a different system of election at the corporation.

6 The prior panel talked about the state law issues
7 raised by that, and I think at the end, there seemed to be an
8 agreement, even Frank Balotti seemed to be agreeing, that a
9 by-law that was simply process oriented probably would stand
10 up under the conflict between 109 and 141a.

11 Maybe more question about ones that had financial
12 implications, but those are all questions that can be and
13 some day I guess will be addressed and answered by state
14 courts, and in particular, maybe first and maybe not, by our
15 court and by the Delaware Supreme Court.

16 The rule that the Commission has keeps those
17 matters off the ballot. At the same time, the Commission is
18 thinking about adopting or had been thinking about adopting
19 this very complex "one size fits all" system.

20 It just seemed in great tension with the normal
21 state laboratory sense of allowing corporation law and state
22 corporation law to work those problems out.

23 I think the Commission really would do well to
24 examine that rule or the staff's interpretation of that rule,
25 and if the rule needs to be amended, to do so.

1 I will just also mention something that Vice
2 Chancellor Strine said at the end of his remarks about
3 whether or not there is a tension or conflict between state
4 law requirement that companies hold annual meetings and
5 interpretation of Rule 14c that prevents companies that are
6 delinquent in their public filings from soliciting proxies.

7 I know that is not why 14c was adopted. Section
8 14c was adopted to prevent companies from having meetings
9 without soliciting proxies. If you go back and look, that is
10 what it was all about. It is being used by the staff,
11 because of the way it is written and interpreted by the
12 staff, to prevent issuers from soliciting proxies when they
13 don't have certified financial statements.

14 A problem I suppose a few years ago might have been
15 less rampant, but at the moment, given the option of back
16 dating problems, it is a problem that is widespread, and
17 really, I think, does call for some attention by the staff
18 and the Commission to work out a system in which companies'
19 managements will be able to have meetings and issue proxy
20 material and even solicit proxies with the proper
21 disclosures.

22 Maybe as Vice Chancellor Strine suggested, some
23 penalty against what management can do, and perhaps also to
24 have some other benefit to the shareholders who wish to have
25 a meeting and wish to be able to elect a new board of

1 directors, at a time when one might perhaps -- in the worse
2 of these cases, when it is the most important time for the
3 shareholders to be meeting for that purpose.

4 One observation. I had a case a few months ago or
5 six months ago in which a company which did not have
6 certified financials, it was a very small company that owned
7 a cell phone company in the Republic of Georgia, not the
8 State of Georgia, the Republic of Georgia.

9 They wanted to sell their cell phone business. It
10 was their principal asset. They were advised that you can't
11 have a meeting to do this. What we are going to do, even
12 though you are not insolvent, we are going to put you in
13 bankruptcy so that you can hold a meeting under the
14 supervision of the Bankruptcy Court.

15 The effect of that was to give the preferred
16 shareholders rights in connection with that decision which
17 they did not have under the company's charter or under state
18 law.

19 It really had a very deleterious effect on the
20 rights of the common shareholders. I told them to come back
21 to the Commission and try to get an exemption. I ordered
22 them to do that. In the end, the deal went away and the
23 issue wasn't resolved.

24 It is something that I think needs to be addressed
25 by the Commission.

1 MR. JOHN WHITE: Before I turn it over to Professor
2 Langevoort, just to comment. What you are suggesting is that
3 we allow the solicitation of proxies when the financial
4 statements that are out there cannot be relied on and the
5 company is in the middle of a restatement and there are no
6 available financial statements?

7 That obviously presents an issue and there is not a
8 clear answer.

9 VICE CHANCELLOR LAMB: It is a situation which can
10 persist for years; yes.

11 MR. DUNN: I would say before we move on, the
12 interaction between 211 and 14c and 14a-3 is truly a rock and
13 a hard place situation for us, as I think you appreciate.

14 You said they don't necessarily conflict, but you
15 can see from our side, it is put in a tough spot. What we
16 generally try to do with folks is we have not had a situation
17 yet that I am aware of where absolutely push came to shove.

18 In the situations we have, they have settled or
19 they have agreed to do something and then they didn't meet
20 the situation they had, and at the same time, when we have
21 done it and we have recently had discussions with a few folks
22 on this, and you are exactly right. It can't have the effect
23 that it would have if read literally, you are dead right.

24 We have actually had some conversations with folks
25 where we think push it going to come to shove and we need to

1 come up with something. I could not agree with you more that
2 we need to find a flexible way to apply it.

3 VICE CHANCELLOR LAMB: Marty, I would urge you,
4 allowing the company to solicit proxies may be the farthest
5 out thing you could do. I am told by people who come before
6 me that you will not allow them to call a meeting. The
7 meeting is supposed to be called by the management. You will
8 not permit them to have a meeting.

9 MR. DUNN: No. I think that is what they tell you
10 we tell them. We can't tell them whether or not they can
11 have a meeting. We can tell them if you call a meeting and
12 solicit proxies, and don't satisfy the proxy rules, you have
13 a problem, which is what we do, and then they take that to
14 mean that they can't call a meeting.

15 CHAIRMAN COX: Let me offer a suggestion as
16 Chairman of the meeting.

17 MR. DUNN: Thank you.

18 CHAIRMAN COX: That we note that this 14c problem
19 having been raised repetitively is a serious one and a real
20 one that we need to deal with. We will by all means do so.
21 It is at least germane to what we are talking about here
22 because we are talking about the importance of the annual
23 meeting of shareholders. Let's move on.

24 VICE CHANCELLOR LAMB: I am all for that.

25 MR. JOHN WHITE: Professor Langevoort.

1 PROFESSOR LANGEVOORT: Maybe the best way to start
2 this is to pick up on some things that were said in the first
3 panel and build.

4 If you start with the analogy that the Commission
5 has used, at least since the 1940s, that what we are trying
6 to do in 14a is create as much parity between the person
7 attending the meeting and the people who are forced to vote
8 by proxy, cannot attend the meeting, what you are dealing
9 with is solving two problems.

10 When we teach shareholder voting, I think we all
11 focus on these two problems rather considerably. One is
12 informational, and that, the Commission does very well at
13 resolving. The other is the collective action problem, that
14 it is costly and there are free rider problems, there are a
15 whole bunch of things that stand in the way of shareholders,
16 when you are talking about 10,000 or 100,000 of them, acting
17 differently from the way a small group of people sitting in a
18 meeting would.

19 I have always thought the Commission's authority,
20 Section 14a, is a legal matter, and can very nicely be
21 summarized as the Commission has been given the power by
22 Congress to help shareholders solve the informational and
23 collective action problems associated with exercising their
24 rights.

25 You posed the question what has been the effect in

1 the last 50 to 60 years of the particular rules that the
2 Commission has put forward.

3 There are two sets of events. Again, I think both
4 were raised at least obliquely if not directly in the first
5 session. Effect number one, there are two provisions, 14a-7
6 and 14a-8, access to shareholder lists and access to the
7 ballot, that are subsidies.

8 They provide a mechanism by which the cost of
9 communicating and the cost of putting an issue forward is
10 much lower than it would be without those rules.

11 With respect to those, simple economics teaches
12 that the effect is going to be very predictable. Behavior
13 will seek out the lowest cost mechanism of pursuing what you
14 want to pursue.

15 If you have a cheap access to the ballot, as
16 opposed to other mechanisms for putting an issue on and
17 trying to rally shareholders, you are going to pursue it.

18 For example, Leo Strine mentioned that to this day,
19 we still do not have a square ruling by the Delaware Courts
20 on the appropriate relationship between by-laws and
21 shareholder rights, the tension we have been talking about.

22 Yet, because the Commission has drawn that line in
23 exception number one that shareholders can't exceed their
24 powers in state law, there has been immense attention by the
25 legal community, academic community, this is an obsessive

1 issue, the by-laws issue. That is just an example of the
2 Commission having drawn that attention to that by the way it
3 has written the rules, because that is where the subsidy is.
4 Therefore, attention has moved in that direction.

5 With respect to the subsidy issue, of course,
6 behavior has followed it. It has avoided those places where
7 the expenses remain heavy.

8 The other kind of issue that we need to talk about
9 and it only came up briefly in the first session today, is
10 the opposite effect. The Commission's proxy rules also have
11 costs imposed on those who would exercise shareholder rights.

12 The costs associated with preparing a proxy
13 statement when a proxy statement is necessary. The fear
14 associated with 14a-9 when opening your mouth may expose you
15 to the risk of liability. The group issues under 13d as well
16 as the proxy rules on when you have become a force that
17 triggers the laws.

18 Those are costs that weigh on the process. I often
19 believe that one of the justifications for fairly strong SEC
20 subsidies, ala my first group, in helping out the process of
21 shareholder exercise of rights, is the fact that the
22 Commission has also imposed costs.

23 If we are going to get a reasonable degree of
24 shareholder democracy and an active shareholder voice in the
25 public corporation, we have to be very sensitive to that

1 whole group of costs.

2 My bottom line answer, and maybe this tees it up
3 nicely, is when you think about the proxy rules in terms of
4 their dollar impact, the fact that behavior follows those
5 incentives should surprise nobody.

6 MR. JOHN WHITE: Let's see if we can focus first on
7 the impact on binding proposals and put off precatory
8 proposals and non-binding proposals for a moment, just to try
9 to separate the two.

10 Professor Fisch, can we start with you on the
11 binding proposal side and impact?

12 PROFESSOR FISCH: Thank you. I am not sure I can
13 strictly adhere to that separation, but I will try.

14 Your first question was on the effect of the
15 Federal proxy rules overall, and I think the comments that we
16 have heard so far, they make it pretty clear that the
17 Commission has largely taken over regulation, not just
18 technically of proxy solicitation but of shareholder voting.

19 This had a couple of effects. I think it has
20 pushed us in the direction of certain kinds of shareholder
21 voting, substantive issues, that shareholders vote on
22 precatory resolutions, that we favor precatory resolutions,
23 the social policy exception to the ordinary business
24 exclusion pushes us toward more social policy proposals and
25 for a long time, pushed us away from arguably corporate

1 governance proposals dealing with things like the voting
2 process, executive compensation, independence of directors
3 and so forth.

4 At the same time, we take certain things off the
5 table, as Vice Chancellor Lamb said. We don't get the
6 opportunity for courts, Delaware Courts in particular, but
7 courts and legislatures to determine the appropriate balance
8 of power, the extent to which shareholders should have voice
9 on a lot of binding -- as Leo said -- things that count.

10 When I heard some of the discussion in the first
11 panel, it struck me that we were aiming a little bit too low
12 in the effort to solve this.

13 We talk about the fact that we don't want
14 shareholders to micro-manage the company. I think we also
15 don't want the Commission to try to micro-manage the voting
16 process. Why don't we want that? Because it is a delicate
17 balance between how much power shareholders should have
18 vis-a-vis directors and management.

19 It is a balance that may change in response to the
20 rise of different groups, different types of institutional
21 investors, the effect they have on the process, the effect
22 which the power of certain groups either reduces the agency
23 costs that we are worried about, or creates other agency
24 costs, agency costs between shareholders and so forth.

25 The courts and the state legislatures are really in

1 an ideal position to weigh that balance. The Delaware Courts
2 have traditionally done this in a very incremental way.

3 If you think about the takeover era, the Commission
4 considered and Congress considered trying to find the right
5 answer, solving the policy problem.

6 What the Delaware Courts did is they took a little
7 step in this direction, they looked to see what is the effect
8 on the market. They took a little step, some might argue, in
9 a different direction, but they tried to do it through this
10 sort of step-wise approach, rather than coming up with the
11 absolute right answer.

12 We have the state law system and the company
13 specific system. It gives us a real opportunity to do that.

14 In terms of getting in the way, one of the places
15 that we are getting in the way is with binding proposals, to
16 the extent that we have a rule that prohibits a company from
17 prohibiting policy oriented proposals or establishing a
18 higher minimum threshold for shareholders to introduce
19 proposals, we are getting in the way of the ability of
20 companies to experiment and then the ability of the Delaware
21 Courts and the legislature to evaluate that experiment and
22 see does it make sense. Is it consistent with the agency
23 issues that the Delaware Courts have addressed in the Blasius
24 case. Are they getting it right or are they going too far?

25 I will stop there.

1 MR. JOHN WHITE: Mr. White, do you want to give us
2 your views on this?

3 MR. TED WHITE: Yes. Let me just add my thanks for
4 the invitation. It has been a very thought provoking
5 conversation, and hopefully we will keep up that effort on
6 this panel.

7 First, to your overall question, as a practitioner
8 and somebody who has been in the position of using proposals
9 and part of engagements with companies, responsibilities for
10 voting a very significant number of proposals, I have sort of
11 seen all sides of it.

12 I certainly understand where some of the
13 frustrations in the system come from, and it is not perfect.
14 There is no doubt about that.

15 I could not emphasize strongly enough the value,
16 the long term value to the market that the SEC has provided
17 in a level of consistency and a role as an arbiter and in
18 setting some of the standards for the proposal process.

19 I think you are right to make a distinction between
20 binding and non-binding and look at the two, and clearly the
21 Federal rules have facilitated more non-binding, but I have
22 to admit I sort of bristled a little bit at the first panel
23 in that I had the distinct impression that non-binding
24 proposals are second class citizens at best and have no
25 value.

1 I think that is wrong. They are distinctly
2 different. I would not argue with that, and certainly,
3 binding proposals are more direct to very significant
4 governance issues than probably more short term, intermediate
5 term performance issues.

6 Non-binding proposals, I think, have served an
7 unique purpose in our market in which they have been this
8 almost incubation tank for what have turned out to be over
9 the course of a decade best practices.

10 Some of the things that shareholder proposals a
11 decade ago were putting in were considered somewhat of a
12 joke, frankly, and yet they have matured to the point through
13 a form of public debate and precatory proposals to the point
14 where they have become accepted.

15 I think you see that even with some of the
16 proposals right now, as they quickly mature and they focus on
17 the things that the market will tend to accept.

18 One of the other things that I sort of took notice
19 of out of the first session is we still have tended to have a
20 focus in the last couple of years on the regulatory and legal
21 process as a governance, sort of the primary governance tool,
22 and even the debate today is very focused on the legal
23 issues.

24 There is a whole other element to the market's
25 oversight, and that is the active manager, the role of the

1 owner.

2 I loved the exchange there. I would certainly
3 associate myself more with Commissioner Campos' comments on
4 sort of the role of the owner. I view it as extremely
5 valuable.

6 Again, the governance of systems and institutions,
7 I think Vice Chancellor Strine was correct, you have to look
8 at that. There are a lot of moving currents in that. It is
9 also an effective tool. It is separate and distinct from the
10 proposal process.

11 I think we make judgments about the proposal
12 process and its value based solely on the type of proposals
13 or the numbers that come out in the public that we are
14 missing a big part of what goes on in the marketplace.

15 From my personal experience, I probably left, I am
16 going to guess, less than ten percent of the proposals I ever
17 put into companies on ballot that anybody would have ever
18 seen. If you have judged my actions based on the number of
19 proposals, even the type that have come, you are missing most
20 of the picture.

21 I think from the academic standpoint, they have
22 been terribly frustrated with really understanding the
23 interaction between owners and companies, and they are making
24 judgments upon proxies in some cases that are weak proxies
25 for how that actually happens and how we influence each

1 other, frankly.

2 I think the markets and active owners are
3 unfortunately a somewhat under utilized tool for effecting
4 long term behavior. I do not like the characterization that
5 hedge funds are something you can identify as all types of
6 investors, lump them in a pool and consider them all to be
7 short term. That is simply not true.

8 Some of them are short term. Some of them are long
9 term. Some of them are intermediate term. That is the way
10 markets work.

11 John, I am afraid I am probably very guilty of
12 drifting from your question. Just to reiterate, I think that
13 your influence in this has been extremely powerful. I have a
14 lot of respect for what you have done at the staff.

15 I realize that Marty and the folks that work on
16 that probably age in dog years in the few months they have to
17 go through these, and it is not a pretty job. It has helped.

18 I think even from an issuer standpoint, having some
19 level of consistency has helped.

20 The comments in the last panel that your
21 interpretations have evolved, how could they not have
22 evolved? You have to evolve with the markets and you have to
23 do it in a responsible manner. I think largely you have done
24 that.

25 MR. JOHN WHITE: Staying, if we can, on again the

1 binding side, Mr. Wilcox, as a large investor can you give
2 us your perspective of where the federal proxy process is
3 affecting again binding proposals?

4 MR. WILCOX: Yes. Let me start first by just
5 talking a little bit about how TIAA-CREF views the rules in
6 the federal proxy process. It is a very, very important tool
7 for us. Vice Chancellor Strike said earlier that he's
8 unhappy with the way that some institutional investors brag
9 about the fact that they have separate voting and investment
10 decision-making.

11 That's the way TIAA-CREF works. We don't use -- we
12 don't look at government issues when we make our investment
13 choices. We are largely indexed, so we own everything. We
14 have over 6,000 securities in our portfolios.

15 But as soon as we become an owner, we view our
16 responsibilities as owners very seriously. And the group
17 that I head at TIAA-CREF is responsible for looking at
18 governance issues and for voting our shares in all of these
19 companies.

20 When economic issues are first and foremost, we go
21 and speak to our analysts and our portfolio managers. It's
22 not as if the economic issues are completely separate. When
23 our governance -- when we're looking at governance issues or
24 issues of shareholder rights, we are always looking at the
25 economic impact of those issues.

1 I have set down here electronically a copy of our
2 policy statement on corporate governance, which has just
3 recently been revised. And it reflects the thinking of our
4 trustees. And you have to recognize that large institutional
5 investors have trustees behind them, and these individuals
6 view their responsibilities with a great degree of
7 seriousness. They are fiduciaries.

8 And so when we look at our voting responsibilities
9 as owners, we take them very seriously. And we have made a
10 very strong effort to integrate our concerns about
11 shareholder rights, our proxy voting powers, and the ultimate
12 economic objective that we are trying to achieve for the
13 3.2 million individuals whose retirement assets we have.

14 Now, often it is said to us, well, gee, TIAA-CREF
15 is very special, and isn't it a shame that more institutional
16 investors aren't like TIAA-CREF. I don't really believe that
17 that's an appropriate comment at all. I work with a lot of
18 other institutions, and sometimes there's a little bit of
19 good cop/bad cop going on.

20 We take advantage of the more aggressive tactics of
21 some of the activist investors to seem more reasonable, and
22 that enables us to get in the door a little bit more easily
23 and have a substantive discussion with the board and managers
24 of a corporation rather than getting instantly into an
25 adversarial relationship with them.

1 It works very well. But there's a lot of
2 collaboration that goes on amongst different types of
3 institutional investors, and even special interest groups.
4 We work very closely with some groups who are advocating
5 issues such as human rights, Darfur, the environment.

6 So in general, we find the proxy rules to be a
7 very, very important part of the way that we fulfill our
8 fiduciary duty to those individuals who have entrusted their
9 assets to us. It is a major part of our job, not just
10 picking the stocks, but monitoring the behavior of the
11 companies and making sure that they are well-governed, and
12 taking action when there is a problem.

13 With respect to binding versus non-binding
14 proposals, we rarely have to end up submitting a shareholder
15 resolution. We use them. For example, this fall we
16 submitted a majority vote resolution, non-binding, at ten
17 companies. And they were all companies in which we held
18 large amounts of stock. They were all Delaware companies.
19 They were all companies that had not taken voluntary action
20 with respect to a majority vote in director elections.

21 In the end, we had meetings with every one of them,
22 and they all adopted bylaw amendments. It didn't matter
23 whether we had submitted a binding or non-binding resolution
24 to them. What was important was a process of discussion that
25 ensued, and one that ultimately led to a change by the

1 company.

2 This is a very important part of the process, and I
3 urge the Commission to recognize that it's important to look
4 at the overall impact of this process and not to dwell too
5 heavily -- although it's obviously part of your job to do
6 so -- on the distinctions between federal and state law.
7 Those distinctions don't matter as much to us, as a practical
8 matter, as they do to judges and lawyers, and I guess to
9 regulators as well.

10 We prefer non-binding resolutions. When we are
11 looking at resolutions that have been submitted by other
12 shareholders and we are trying to decide how to vote on those
13 issues, we prefer them to be non-binding because it is very
14 important for us to not micro-manage the internal
15 decision-making of the company and to focus primarily on the
16 board of directors as our elected representatives.

17 So we look to the directors as the group whom we
18 want to hold primarily responsible for the preservation of
19 our rights and for looking after our interests. We don't
20 want to go down into the next layer of influencing the
21 behavior of management. We want the directors to do that.
22 And we also do not want to interfere with the flexibility of
23 companies to organize themselves in ways that they think are
24 appropriate for their own business situation.

25 We are extremely happy with the new disclosure

1 rules with respect to executive comp, but what we are happy
2 with in those rules is the opportunity that they create for
3 corporations to tell their own story, to write a narrative in
4 which they explain to us how their plan works, how it's
5 performance-based, how it is responsive to the particular
6 business needs of the company at that time, how it is
7 customized to the particular requirements of their business,
8 and how it is ultimately going to drive long-term value
9 creation.

10 Now, we're not finding that narrative this year. I
11 don't think we've found -- we're looking for them right at
12 the moment. But I think what's happened is that most
13 corporations have focused on getting the numbers in the right
14 boxes and organizing themselves -- and the outside counsel
15 have been writing a lot of these things -- have found that
16 companies do not have a compensation philosophy, but they
17 will have one in a year or two.

18 So we're very optimistic. This is the way we think
19 that the proxy process ought to operate, in that it allows
20 the managers and directors of the company to communicate to
21 shareholders, and it gives the shareholders an opportunity to
22 respond in response to what management has done, to tell them
23 if they think they've done a decent job or not, and to engage
24 in a discussion that is going to ultimately improve the
25 long-term performance of the company.

1 MR. JOHN WHITE: I'm going to avoid discussing the
2 new executive comp rules.

3 Commissioner Atkins, you had a question?

4 COMMISSIONER ATKINS: Yes. I guess just in
5 response to what John and Ted were talking about, the SEC is
6 a disclosure agency and, for example, we want to try to have
7 things done in the open. And part of our rule regarding
8 nomination of directors requires a company to disclose
9 shareholder groups that have approached the nominating
10 committee with respect to putting forward certain nominees.

11 And here you're talking about basically large
12 institutional investors, who have no duty to other
13 shareholders, pushing behind the scenes particular measures
14 that we've seen at company after company, when these are
15 actually put up for a vote, they fail.

16 But you're saying that because of your
17 behind-the-scenes maneuvering, you've been able to actually
18 have the company adopt those or take steps. So I'm just
19 curious how that jibes with our disclosure regime, and isn't
20 that something that perhaps we need to have some more focus
21 on through our proxy disclosure system.

22 MR. WILCOX: Do you mean disclosure by us, or
23 disclosure --

24 COMMISSIONER ATKINS: No. By the company, or how
25 these things came into effect, or what the behind-the-scenes

1 maneuvering may be because other shareholders obviously are
2 not clued in to that.

3 MR. WILCOX: If those ten companies had not agreed
4 to adopt bylaws, bylaw amendments -- which were authorized
5 also under Delaware law; there had been some changes, and
6 there had been a fair amount of public discussion about this
7 issue, as I think you know -- if we had reached an impasse
8 with the company, we would have left our resolution in the
9 proxy and it would have been fully disclosed, and there would
10 have been a shareholder vote on the resolution, and the
11 outcome of that vote would have then influenced how the
12 company -- what the company chose to do.

13 So I think that also on that particular issue of
14 the majority vote in director elections, the case had already
15 been made -- and I think it was an easy case for us to make;
16 there was very little resistance to the adoption of the
17 majority vote, at least as set forth by us -- but I don't
18 think there was any sacrifice of disclosure there or any lack
19 of transparency because our style is to meet privately with
20 companies.

21 Because it's easier for them, and we don't want to
22 shame them. We don't want to create a public discussion as a
23 way of pressuring companies through publicity. But we will
24 do that if our discussions do not then achieve a negotiated
25 result.

1 COMMISSIONER ATKINS: Well, but it still is sort of
2 like arm-twisting because in other companies, these sorts of
3 things have failed. And so you are using your particular
4 influence, the threat of shame or whatever it is, to try to
5 get the company to acquiesce to your position. That
6 essentially is what it's come down to.

7 MR. TED WHITE: If you don't mind, I'd actually
8 love to respond to that because you raise a point that I kind
9 of wanted to discuss. And that is, on a macro sense, how do
10 you judge the legitimacy of proposals? You kind of touched
11 on that, that there seemed to be a sense that precatory
12 proposals are illegitimate because they deal with sort of
13 silly policy issues.

14 But first to your very specific question. To show
15 you -- to demonstrate to you what I see as the typical
16 pattern of respect for the barriers between the things that
17 shareholders should and could be involved in and what
18 management should and could be involved in, and how we would
19 tend to escalate pressure, if you want, during a
20 relationship.

21 Every one of my engagements with a company that
22 dealt with something that would be disclosed, like the
23 recommendation of a director, we started with the types of
24 qualities that we want to see in a director. So our
25 discussion and recommendation to them would start, number

1 one, around tell me how you evaluate the performance of your
2 board and the individuals, and tell me how, over time, you
3 assess the needs and bring in the type of skill sets that you
4 need to have.

5 Surprisingly, a lot of companies fail that
6 question, or have historically over the course of the last
7 decade. And one of the things that we bring is, let me tell
8 you as an independent observer of the company, okay -- I
9 don't hold any -- there's no way they hold a sway over it; I
10 can tell them what I really think -- let me tell you what I
11 see.

12 And you can tell me that, well, it's just the
13 disclosures are wrong, and you don't really understand it,
14 and we'll do a much better job of telling you what the skill
15 sets are. Or in some cases it's been, you know what? You're
16 right. We have a hole. We have an existing hole or we have
17 something that we can't deal with in the future. And that's
18 been companies that have grand-scale plans to expand
19 internationally and have absolutely not international
20 experience. It's been things as simple as that. Okay?

21 And so that's where our involvement has been. And
22 I think that you would recognize that that is a responsible
23 role for a shareholder to sit and push those questions on
24 them and let them deal with them. It has not been
25 prescriptive to say, I want Mr. Langevoort on your board and

1 I'm going to pressure you until you do it. Now, there are
2 strategies that get that far, and that's sort of a very
3 different environment than what we've been talking about.

4 COMMISSIONER ATKINS: Although that has been your
5 experience, and I'm sure there are lots of other examples of
6 behind-the-scenes pressuring that might not be so salutary as
7 what you're talking about. But enough said.

8 MR. WILCOX: I think the arm-twisting is actually
9 not in the behind-the-scenes talking, but is in the actual
10 proposal. It's something that we want to have happen. We
11 want dialogue between companies and shareholders. And when
12 we go and knock on the door, half the time what we find is
13 that we haven't properly understood the issue.

14 In the case of these ten companies on the majority
15 vote resolution, some of them had started a process of a
16 voluntary arrangement that fell short of what we recommended
17 in our own policy and which we actually had adopted
18 ourselves. But we still agreed in those cases that that
19 would be satisfactory for the moment.

20 So there was a fair amount -- I mean, I would not
21 characterize it as a smoke-filled room, this discussion. I
22 would characterize it as kind of throwing a softball rather
23 than a hardball at a company first as a first stage of what
24 ultimately we all agree is a public process that shareholders
25 are certainly entitled to use.

1 COMMISSIONER ATKINS: I just want to leave it -- I
2 mean, to me it's just sort of a tyranny of the minority,
3 frankly. And a lot of these things probably -- maybe not the
4 one that you mentioned, Ted, but some of these others, when
5 they are actually put up to a vote, they fail at other
6 companies.

7 But yet because of this behind-the-scenes
8 maneuvering, you have been able to achieve something through
9 which -- I mean, you would not be able to achieve in a more
10 public type of process. But anyway, enough said. Thanks.

11 MR. JOHN WHITE: I guess I'd like to, if we could,
12 maybe on this topic, while we're still -- before we move over
13 to the non-binding side, any comments from the judicial and
14 academic end of the table before we -- Vice Chancellor Lamb?

15 VICE CHANCELLOR LAMB: Certainly a couple things
16 that come into my mind. And one is -- and again, I'll have
17 to say, John, I'm not sure that it exactly fits into what you
18 just asked me --

19 MR. JOHN WHITE: You mean that you're at the
20 judicial and academic end of the table, or something
21 different?

22 VICE CHANCELLOR LAMB: I guess I'm just not used to
23 being asked questions.

24 VICE CHANCELLOR LAMB: But I just wanted to put on
25 the table a couple of problems that do seem, at least from

1 our point of view, to be creeping in. And one of them is
2 that there's some evidence that really because of the way the
3 CD or the depository trust process operates and the
4 broker -- what is that, the ADP brokerage counting votes
5 thing operates, and I think it's subject to SEC
6 regulation -- it appears that shares of stock are voted two
7 times and even three times in the same election.

8 And it's not something that state law can do
9 anything -- we really have any way to do anything about. But
10 I would urge the Commission to think about it and see what
11 can be done from your point of view. Because I do think you
12 can do something about it.

13 For example, shares that are held at Merrill Lynch
14 from my account may be loaned by Merrill Lynch to somebody
15 else, who votes them or who sells them, who may vote them and
16 then sell them. And the person who buys them might vote them
17 again. And so long as the total number of votes that are
18 being added up inside all these positions don't exceed the
19 number of shares in the position, the votes count or can be
20 counted.

21 I mean, I think that's a real problem. Someone can
22 actually go out and borrow 10 million shares and vote
23 them -- never own them, but vote them. And the votes -- so
24 long as there isn't an over-vote, the votes can be counted.
25 And I do think that is something that could be dealt with.

1 I wanted to ask, with all the new majority voting
2 bylaws that are coming into operation, is the Commission
3 requiring those companies to put "vote for" and "vote
4 against" on the proxy?

5 MR. JOHN WHITE: Wait a minute. I thought I got to
6 ask the questions.

7 VICE CHANCELLOR LAMB: Marty, are you making people
8 say "vote against" or "no"?

9 MR. DUNN: I don't make anybody. The rules do.
10 The way the rule works, if it's with holds versus majority,
11 then you do the abstain and it counts against it. But if
12 it's a true majority vote where you're voting for or against,
13 then it says "against." 14a-4 contemplates both, and it
14 depends on how it works.

15 VICE CHANCELLOR LAMB: But are you making them
16 actually print their proxy cards that way, "vote against"?
17 Because I remember I had a case a couple years ago where the
18 company, for some reason, had a bylaw that required a
19 majority vote to elect.

20 MR. DUNN: Well, if the vote is truly for or
21 against, then that's what it has to say. If it's not truly
22 for or against, then it doesn't. That's the way the rule
23 works.

24 Steve, while I have you, can I ask one question?
25 It strikes me on the majority vote -- and I know you're not

1 used to this, and you'll say something else anyhow -- but is
2 part of the -- and John keeps talking about majority vote and
3 the effect it's having.

4 Is part of it -- and anybody else can answer
5 this -- Delaware changed Section 216 to say that if
6 shareholders adopt a majority vote, then only shareholders
7 can do away with it. That was mentioned on the last panel.

8 Is one of the reasons why there's a particularly
9 leveraged effect this year the fact that boards want to get
10 ahead of that and adopt their own, and so they're more
11 willing on this topic than on others?

12 VICE CHANCELLOR LAMB: Well, you're not really
13 asking me. I have no idea.

14 MR. DUNN: Okay. I'll ask anybody else, then.

15 MR. WILCOX: Well, you mean are they companies
16 trying to do it in such a way that the shareholders don't
17 have the --

18 MR. DUNN: They'd much rather cave into pressure
19 and adopt their own.

20 MR. WILCOX: If they cave into pressure -- and I'm
21 not saying that that's the right term -- but if they adopt
22 their own, then they get the flexibility to amend it. So
23 isn't there a little more leverage you have when you bring it
24 to the table?

25 MR. DUNN: I don't think so. I'm not that cynical.

1 I think this is an issue in which the substantive arguments
2 in favor of a majority vote won out, and the technical
3 concerns were pretty minimal. It's what's done in almost
4 every other country of the world, and we require a majority
5 vote on every other item presented for shareholder approval.
6 I just think people realized it really was not worth fighting
7 over.

8 PROFESSOR FISCH: If I could, I wanted to follow up
9 on some of what Vice Chancellor Lamb said about disclosure
10 because I think it kind of nicely highlights the distinction
11 between the disclosure and the sort of market development
12 area where the Commission has real expertise, and some of the
13 stuff we've been struggling with about, well, gee, how much
14 voting authority should shareholders exercise?

15 I think the whole growth of intermediaries, both
16 intermediaries on the ownership side, the institutional
17 investors, and intermediaries in terms of who's voting the
18 stock, who's passing on the information, who's dealing with
19 the mechanics of the voting process, who's dealing with the
20 tabulation of the votes -- I think that's something the
21 Commission really has to look at more carefully.

22 As I understand it, the contractual provisions and
23 the regulatory system and the role of the SROs really makes
24 this something of a mess and creates a whole layer of agency
25 problems about who's going to make sure that the process is

1 working properly.

2 And if we have majority voting, if we have -- and
3 see, I can tie this to binding resolutions because if we have
4 binding resolutions so the shareholder vote really matters, I
5 think we care a lot more about getting the shareholder vote
6 right.

7 And I think these days it's very hard to be
8 confident that we're doing that. It's hard for institutional
9 investors to monitor the process and even be sure that their
10 vote has been reflected accurately. And then you've got
11 issues with loaned stock and empty voting and multiple voting
12 and so forth.

13 So I think that's a real issue, and I think really
14 that's within the heart of the Commission's expertise.

15 MR. JOHN WHITE: Yes. The reason I'm not taking
16 the bait to ask more questions on this is that as Chairman
17 Cox mentioned in his introductory remarks, the next of our
18 three roundtables is going to be focused particularly on this
19 issue. So I was not playing it out as each of you have
20 commented on it.

21 I guess before I move to non-binding proposals, to
22 the extent we haven't already discussed them, any questions
23 from the Commission before we move to the other -- to the
24 next topic?

25 Well, Professor --

1 CHAIRMAN COX: Yes. Actually, I think I have one
2 sort of overarching question because these have all been
3 useful comments. And I wonder if we could just ask the
4 participants to tie them back to the thematic question, which
5 is: How much of what you've described is a function of the
6 proxy rules as you find them?

7 We've described a little bit what's going on. One
8 of the topics we really want to dive into is how much of that
9 is a function of the proxy rules having an influence on the
10 process. And I think, Mr. Langevoort, you mentioned to us
11 that to the extent there's a subsidy involved, obviously that
12 drives behavior.

13 Anything else about the proxy rules that you think
14 is responsible for things being the way that they are?

15 PROFESSOR LANGEVOORT: It's a focal point. I guess
16 the game to play is imagine you repealed all of the proxy
17 rules. What kind of -- in today's institutional
18 environment --

19 CHAIRMAN COX: That's actually an excellent
20 question. I mean, if we didn't have them, what would happen?

21 PROFESSOR LANGEVOORT: Yes. Where would behavior
22 be different from what we -- first of all, I suspect that
23 behavior would be less different than we might think because
24 of alternative technologies and methods of communication and
25 the growth of alternative ways of exercising influence. I

1 suspect they'd be pretty much in the same direction.

2 I do think, and I agree with what Ted and John have
3 said, that the ability to put a precatory vote up creates a
4 salience to the issue. It attracts media attention. It's a
5 nice way of framing the issue. And if you didn't have the
6 subsidy, you'd have investors, I think, looking in different
7 directions for ways to accomplish the same thing.

8 But again, salience, subsidy, that's really the
9 economic effect of the rules we have.

10 CHAIRMAN COX: Professor Fisch?

11 PROFESSOR FISCH: Yes. If I can just add to that.
12 There's one more thing, and that one more thing is
13 legitimacy. By having rules that say, this is a shareholder
14 power, this is a shareholder right, in essence the Commission
15 is saying, we want shareholders to act this way.

16 And I think that's a big issue with shareholder
17 access to the proxy and shareholder nomination of directors.
18 I think there are classes of shareholders -- and it's not
19 true and this doesn't apply to hedge funds -- but I think
20 there are classes of investors who look at the Commission's
21 continuing to revisit this issue and not passing a rule. And
22 they say, okay, this is a message. We're not supposed to be
23 doing this.

24 And I'm thinking in particular -- because I've done
25 some empirical research in this area -- I'm thinking in

1 particular of public pension funds. There's a dramatic
2 difference between public pension funds, activity,
3 participating in the shareholder nomination process -- and
4 I'm not talking about a formal nomination; I'm talking about
5 any role, informally suggesting people, meeting with
6 management, running by names, whatever, versus serving as
7 lead plaintiff.

8 They think about it completely differently. Why?
9 Well, there are a lot of possible explanations. But at least
10 one possibility is Congress said in the PSLRA, we want public
11 pension funds to serve as lead plaintiff. We're legitimizing
12 this, and public pension funds are the kinds of institutions
13 that respond to that message.

14 I think the Commission, at least thus far, has sent
15 the opposite message with respect to shareholder nomination.
16 And I think it's something that you all should be conscious
17 of when you think about how to structure the rules.

18 MR. WILCOX: With respect to the choice between
19 acting as a lead plaintiff or acting through the proxy
20 process, we much prefer to try to address issues before the
21 war has been lost and all there are are some crumbs to pick
22 up.

23 We don't act as lead plaintiff. We have a lot of
24 discussions about it internally, and we look at the cost to
25 us and so forth. But we prefer to act earlier. And the

1 proxy rules are a very important route for us. And I think
2 our trustees would emphasize that their duties as they see
3 them in terms of the proper management of the assets
4 entrusted to us and the focus on long-term performance of the
5 companies whose stocks we own is enhanced by our ability to
6 operate through the proxy rules and to influence the behavior
7 of companies.

8 So it's a very important issue for us. There is
9 obviously some tweaking. Sometimes Rule 14a-8, particularly
10 the ordinary business issue, will require that a resolution
11 has to be drafted one way rather than another. And I think
12 we've seen some this year dealing with the shareholder
13 advisory vote have been drafted in a way that's slightly more
14 awkward than we would like to see them simply because the
15 proponents were advised that they would have an ordinary
16 business resolution if they did it in a simpler form.

17 So those kinds of tweaks I think are of only minor
18 importance, but they are ones that you could address,
19 certainly.

20 MR. JOHN WHITE: Mr. White?

21 MR. TED WHITE: I would agree with some of the
22 comments that the rules facilitate in particular the use of
23 precatory proposals. But I think there's a number of other
24 reasons why they have been more prominent. And as John kind
25 of articulated, one is that, frankly, they're considered less

1 intrusive. And so it's kind of -- it's one reflection of a
2 responsible way to have some influence before you need to
3 bring out the bigger guns. So that is part of the equation.

4 And I think the other thing, to get back to
5 Commission Atkins' question earlier, that's an interesting
6 topic here is: Who is the right to judge of what is
7 legitimate? For us to propose and to re-propose, obviously
8 the thresholds are relatively low. And so it's easy.

9 But I for one don't think that that's a real great
10 role for the Commission to be in, the business of saying
11 which proposals are the best ones for the market to submit.
12 I think that's actually better done by the market. And I
13 think what Commissioner Atkins was getting at is proposals
14 that come in and lose, should they continue to be able to
15 propose those?

16 And I think the market is the perfect place for
17 that to be judged. And bad proposals lose. You're right.
18 Things that -- that's the right audience to judge the
19 economic impact of proposals. And I don't know where the
20 right thresholds are. I know it's not 45 percent to resubmit
21 and I know it's not 1 percent to resubmit, but somewhere in
22 there.

23 But the market, I think, is the good place for
24 that. I think it's a very difficult place for you guys to be
25 in to make those judgments.

1 MR. JOHN WHITE: Mr. Casey?

2 COMMISSIONER CASEY: Yes. If I could just follow
3 up with a question on that.

4 Recognizing that the view is that the market would
5 be the most effective means of testing that legitimacy, how
6 concerned should the Commission be, though, if there are
7 those circumstances where you've identified as strategies
8 where it's -- this is our guy, and you're -- and again,
9 appreciating the value that comes from the kind of dialogue
10 that you believe the proxy rules provides in resolving issues
11 earlier or without having to put forward a proposal in the
12 proxy, how concerned should we be about the disclosure aspect
13 that doesn't allow that kind of testing in the marketplace?

14 MR. TED WHITE: I'll take the first crack at it,
15 and if John wants a chance, too. But the first panel, I
16 think, was very clear in that -- while maybe not to Professor
17 Bainbridge's liking as far as it would go.

18 But the current model is already a director
19 supremacy. And as much as the newspapers would make you
20 think that me as the big mighty investor can make these
21 companies do whatever I want, it is not true.

22 And they have a responsibility to say no, and they
23 say no a lot. And it can lead to a public debate, and it can
24 lead to a proposal. And I think that's the right mechanism.
25 It's a great thing for the public markets to do. I will win

1 if my arguments are right and I will lose if my arguments are
2 wrong.

3 And I like that test of legitimacy rather than,
4 well, I'm a million shareholder and Don's a hundred
5 shareholder; therefore, I'm much smarter than him. That's
6 wrong, and I think those things that are set upon size are
7 the wrong element. And I think that most of the active
8 managers in this strategy, if you look at them, are very
9 focused on the quality of their arguments and they tend to do
10 better. And that's right.

11 Now, as far as disclosure, I would have no problem
12 of companies willingly or even were required by the
13 Commission to disclose that, hey, we had a conversation with
14 a major shareholder and we debated about this topic. I think
15 that would be perfectly healthy and I would have absolutely
16 no problem participating in that disclosure.

17 Hopefully I answered your question.

18 MR. JOHN WHITE: Okay. So having learned -- oh,
19 I'm sorry.

20 MR. WILCOX: I was just going to say, if you're
21 talking about access now, we're talking about getting a
22 shareholder-sponsored candidate onto the management proxy. I
23 think we're at a very, very early stage of thinking as to how
24 that ought to work or even if it should work.

25 Shareholders, I think, want the right in concept.

1 But I know I've talked to our trustees, and I don't get any
2 sense on the part of our trustees that we want to be in the
3 director search business or that we would even feel
4 comfortable being involved in that process separate from the
5 company and its nominating committee.

6 We certainly do not want to have our own
7 representative sitting on the board because that would
8 interfere with our ability to buy and sell securities, and it
9 would create all kinds of issues for us. So clearly, we
10 don't want to do that.

11 I think access needs a tremendous amount of careful
12 thought. And as I suggested in a letter that I sent to the
13 Commission after the *AIG v. AFSCME* ruling, I think that the
14 shareholder proposal process is a useful way to test
15 different approaches as to how that might work. But I don't
16 think we're even close yet on an idea of how it should work.

17 MR. JOHN WHITE: Okay. So having learned my lesson
18 the last time, we're going to start the closing part earlier
19 this time. According to my watch, it's about three minutes
20 each. And if you don't have enough to fill up your three
21 minutes, tell us what you think the federal rule ought to be.

22 But we'll start with you, Professor Fisch.

23 PROFESSOR FISCH: Just briefly, I think the federal
24 rule really should focus less on figuring out what at this
25 particular time in this particular climate is the right level

1 of shareholder power and more on enabling a mechanism in
2 which the market, the courts, the shareholder proposals, can
3 sort that out.

4 I think the Commission will be much better
5 positioned to evaluate questions like, well, gee, are there
6 going to be too many shareholder proposals, are shareholders
7 going to nominate unqualified candidates, will special
8 interest groups take over, if we allow some experimentation
9 and we don't try to judge at the outset and predict what's
10 likely to happen. Because even between the time that we're
11 sitting here today and the time that any rule or rule change
12 takes effect, market developments could cause our production
13 to be inaccurate.

14 And I think there are a lot of safety valves.
15 We've talked about the safety valve of other shareholders
16 having to go along, right, if it's going to be a binding
17 bylaw. And then the shareholders have to approve it. But
18 there's safety valves in addition to that. The market is one
19 check. Another is the courts.

20 Another is the state legislatures. Right? The
21 state legislatures might decide, gee, binding resolutions
22 aren't the answer, or majority voting isn't the answer -- I
23 mean, Delaware has decided the opposite way on that -- but so
24 that it's not all something that has to be solved at the
25 outset before we have that kind of information. And I think

1 the Commission really is very powerful in the statement that
2 it sends about the kinds of experimentation and the kinds of
3 innovation that are appropriate.

4 MR. JOHN WHITE: Vice Chancellor Lamb.

5 VICE CHANCELLOR LAMB: I completely agree with
6 everything Jill just said, and I join in her remarks.

7 Going back, if I could, just for a moment to the
8 question that the Chairman asked, I thought that the things I
9 was talking about were all things that reflect how the
10 federal rule works, are working now with state law. And I
11 wanted to add one other thought, and I'll use this by way of
12 summary, I guess.

13 When you focus just on how the proxy rules are
14 affecting, say, contact between large shareholders and
15 management, there's another set of rules that you have, the
16 13(d) rules that are also implicated in that process and are
17 important. And I think it's important to take a look at how
18 large shareholders -- and I'm thinking even in terms of
19 people who own in excess of 10 percent of the stock -- from
20 time to time file a 13(g) disclosure form rather than a (d),
21 and perhaps are masking an intent to influence management.

22 So I would suggest you look at the (d) and (g)
23 triggering points, and look at particular instances in which
24 people have switched from a (g) to a (d) and at the same time
25 proposed a slate of directors. One way of thinking about it

1 is, is more disclosure required of a (g) filer, for example,
2 contacts with management or contracts and arrangements that
3 have been entered into by a (g) filer for the purpose of or
4 at least laying the groundwork for making a charge at a
5 company because sometimes when the (d) finally gets filed,
6 it's filed too late.

7 And if I could just -- one other thought on that
8 is -- and maybe this is for your next panel -- I have seen
9 situations where people who are actively engaged in a proxy
10 solicitation with respect, say, to a merger don't have a (d)
11 on file and don't disclose -- or do have a (d) on file and
12 don't disclose short positions they hold in related
13 securities.

14 And I think that's a weakness in your disclosure,
15 and the case I'm thinking of, I guess, is well-known. But I
16 even had letters written to me by counsel for this one
17 stockholder who was urging me to do something because people
18 who were long in a particular security might have some
19 interest in conflict with other shareholders, at the same
20 moment this stockholder was short in the security in a very
21 significant way and didn't disclose that fact to me or
22 publicly.

23 PROFESSOR LANGEVOORT: Quickly, a couple of
24 thoughts. First of all, checks and balances probably is the
25 best way of thinking about whether we need to expand the role

1 of institutional voice through any of the tweaking to the
2 proxy roles we can imagine.

3 It does strike me that, although I appreciate
4 Commissioner Atkins' concerns and agree with him with respect
5 to many companies, there's a great diversity of companies.
6 And there are many where the private benefits of control are
7 still being extracted fairly aggressively. And if you don't
8 empower some check or balance, then I think our only choices
9 are through greater institutional voice.

10 Then the balance is going to get out of whack.
11 Yes, it is balance. But we have to remember, the collective
12 action problems associated with shareholder democracy are
13 severe, and they haven't been solved yet. And the thumb on
14 the scale I think still needs to be in favor of weighing
15 shareholder voice a little bit more than it has been.

16 The other point I would make is I hope the
17 Commission is not shy about its statutory authority to
18 address these kinds of issues. As I said before, the
19 solution to both the informational and collective action
20 problem seems a fair way of describing what Congress wanted
21 to give you. And it does strike me that as we think about
22 the costs and the fact that the Commission is subsidizing in
23 so many ways, it's already walking down the path of saying,
24 where is the right balance?

25 We've talked a lot at Delaware. And I have a lot

1 of respect for Leo and Steve and the Delaware judiciary. But
2 Delaware isn't everything, and I don't think the
3 conversations we're having today that do occur in Delaware
4 are occurring in every state around the country. I think the
5 Commission is a place where some of the best thinking is
6 going on on these subjects. And I think it's a fair reading
7 of Section 14a and the right thing to do for the Commission
8 to take a fairly bold leadership role in carrying out these
9 responsibilities.

10 MR. TED WHITE: I agree with a lot of comments that
11 have been made in summary here to date, and in particular,
12 one of the concerns that I would have with the state, with
13 relying too much on the state laws, is that it's an uneven
14 playing field for us as investors because there's obviously a
15 number of states with very different approaches to the
16 proposal process, and we're forced with very different
17 dynamics in different companies.

18 And the federal level proxy process and the ability
19 to put in precatory proposals and its consistency has been, I
20 think, a net benefit. And I know have an issuer later, and
21 that would be a good question to ask Cary. But I'd even
22 think while they have some frustrations with the proposal
23 process, they would agree that the consistency has been
24 valuable, and hopefully they learn from shareholder opinions
25 over time on that. And I'll just close with that.

1 MR. WILCOX: Well, I approached this with the
2 thought of putting together a wish list for the Commission.
3 And when I thought about it, and I had a big laundry list of
4 things, I realized that they all really could come under one
5 wish, which is one easily granted by you but may be hard to
6 implement, and that is transparency.

7 The process, as you will discover in the subsequent
8 roundtables, has lots and lots of hidden elements in it.
9 It's a black box. It's complicated. It's expensive.
10 There's no audit trail. There's no end-to-end vote
11 confirmation. There are all kinds of issues like that.

12 I would like the process to be transparent. And I
13 think that is the way to make it achieve the highest level of
14 integrity and fairness and one in which it will operate most
15 smoothly.

16 The wish for transparency also extends to what Vice
17 Chancellor Lamb was discussing, and that is information about
18 the ownership of institutions such as TIAA-CREF. I think
19 there needs to be more information, particularly as of record
20 date, about the ownership positions and what's hedged, what's
21 out on loan, and where these shares actually are. This is
22 part of a wish for transparency in the communications
23 process.

24 And as Commissioner Atkins suggested, we don't want
25 to have back room deals going on. We would be very happy to

1 be completely transparent in our discussions with companies.
2 I think that's a healthy thing, and there isn't, obviously,
3 on the part TIAA-CREF, anything that's hidden.

4 But transparency is one of the fundamental
5 principles of the federal securities laws. And I think it
6 really holds the key to making this process one that we can
7 all have greater trust in.

8 MR. JOHN WHITE: Okay. I would like to thank all
9 of the panelists. We very much appreciate your being here.
10 And we will now take a break, and resume again at 1:30.

11 Chairman Cox, do you want to --

12 CHAIRMAN COX: On behalf of the Commission, thank
13 you to every one of our panelists. This was outstanding.
14 And this is a good opportunity to say thanks as well to John
15 and Marty for being excellent moderators.

16 (Whereupon, at 12:23 p.m., a luncheon recess was
17 taken.)

18 A F T E R N O O N S E S S I O N

19 1:36 p.m.

20 P A N E L T H R E E

21 N O N - B I N D I N G P R O P O S A L S U N D E R T H E P R O X Y R U L E S

22 MR. JOHN WHITE: Good afternoon and welcome back.

23 This afternoon we have two panels which will be
24 taking a more in-depth look at non-binding and binding
25 shareholder proposals. Marty Dunn will be taking the lead in

1 moderating the discussions this afternoon. I introduced him
2 this morning, but I'll do it again.

3 Marty is the deputy director of the Division of
4 Corporation Finance. He also has led the Division's efforts
5 to respond to no-action letter requests in the 14a-8 world
6 for many, many years, about 400 of them this year. I don't
7 know how many in prior years, Marty, but I know it's a
8 massive project every year.

9 So he's quite an expert on this topic. So Marty,
10 I'll let you introduce the panel.

11 MR. DUNN: I will. Do you want to say anything?
12 Are we good?

13 CHAIRMAN COX: Well, I want to welcome this panel
14 formally. We're looking very much forward to learning from
15 you. I want to thank our moderators once again. And I think
16 the other commissioners will join us in due course, but we
17 want to be punctual and respect your time as well. So let's
18 get on.

19 MR. DUNN: As John said this morning, we talked a
20 good bit about where federal and state law intersect and,
21 more importantly, I think, for today's discussion, where they
22 should intersect. And hopefully we'll get to that a little
23 bit as we go along today.

24 But what I want to try to do in our panels this
25 afternoon is really get a little bit more detailed on how

1 they intersect in practicality, and what we learn from them,
2 and how they work, and some alternative ways we can go about
3 possibly doing this.

4 So without wasting more time, I'd like to introduce
5 our five. I'll start at the end. Rich Daly is the chief
6 executive officer of BroadRidge Financial Solutions. I'm
7 still getting used to say that. Welcome, Rich. Amy Goodman
8 is with Gibson Dunn & Crutcher. Did I get it right, Rich?
9 You looked at me like I was wrong. No? Okay.

10 Stan Keller is at Edwards Angell Palmer & Dodge.
11 Cary Klafter, who is vice president, legal and corporate
12 affairs, and corporate secretary at Intel. And Paul
13 Neuhauser, who's a professor emeritus at the University of
14 Iowa College of Law. Thank you all very, very much for your
15 time. We've come across each other many, many times on these
16 topics so that hopefully this will go well today.

17 What we're going to focus on first this afternoon
18 is non-binding proposals. And I'd like to start off by just
19 discussing the practical -- how people see them playing out
20 in reality. And then I want to talk about how much they're a
21 creature of 14a-8 or not.

22 So I think a good way to start is with Professor
23 Neuhauser, which is: Your area of expertise, the area we see
24 you come across our desks most often, is more with socially
25 responsible investors. And my question for you is: Their

1 proposals go more towards behavior and ethics and less
2 towards governance, as a norm. I'm sure there are exceptions
3 to that.

4 I was just wondering: Your clients, what do they
5 see as their motives and what do they see as the role of
6 these proposals in corporate governance? I think that's a
7 good place to start.

8 PROFESSOR NEUHAUSER: Well, I guess I'd answer that
9 by saying that their primary objective is to make capitalism
10 work better. If you think of the big economic machine, and
11 there may be some areas where, as a societal matter, there's
12 a clear clashing of gears -- that is to say, they're not
13 meshing properly -- how about applying a little grease to try
14 and make them work a little better?

15 The underlying idea would be that while they're all
16 investing for a return -- I mean, you're talking about such
17 things as the retirement plan of the Sisters of Whatever, or
18 of the Methodist Church, or of socially responsible advisors
19 whose clients are not going to stay if they're not going to
20 get a market return.

21 But they believe that in addition to the return,
22 that if some aspect off a given corporation's business is
23 ethically questionable, morally repugnant, or something along
24 those lines, the corporation may need some prodding to try
25 and get more in line with broader society's needs and

1 understandings. South Africa would have been a classical
2 example of that.

3 Secondly, the corporation sometimes may need some
4 prodding to better recognize some long-term risks of
5 operating in certain matters. The most classical example of
6 that would be environmental stuff. Charitable proposals on
7 environmental issues go back at least to 1973, long before we
8 had the Clean Air Act, the Clean Water Act, and various other
9 things.

10 You can think of it in some ways as sort of them
11 acting as the canary in the mine, with some bringing to the
12 attention of corporations some issues that are maybe
13 long-term risks for that industry, that company, or the
14 society, and asking them to take some actions, usually to
15 change a policy or to report on what they're doing about a
16 given perceived problem.

17 In my experience, SRI shareholders have frequently
18 been ahead of the curve on that -- I mean, the environmental
19 thing is one example of that -- and raised issues before they
20 were generally recognized by the corporations. That doesn't
21 mean that they're always right.

22 Just like anybody else, they may be raising an
23 issue, and it may turn out to be a real issue, or it may turn
24 out in the long run that they were wrong about that. There's
25 no guarantee that because it's put in by a socially

1 responsibly investing group, that they're right on that given
2 issue.

3 But the other thing I'd say on that is also that I
4 would agree with what John Wilcox said earlier, that
5 basically most of these things should be resolved in
6 discussion. My view is that if the proposal goes on for
7 ballot, it goes onto the proxy statement, there's been a
8 failure either on the part of the company, or the
9 shareholder, or both, because most of these things are things
10 that should be able to be resolvable without going to the
11 mat, i.e. going to a shareholder vote.

12 MR. DUNN: I want to follow this up with Cary in a
13 second, but there's one thing. And you mentioned the canary
14 in the coal mine part of this.

15 And that is: Both John and you have both said, we
16 put these precatory, non-binding proposals in with the goal
17 of getting a discussion, not so much going into the proxy.
18 Is that the right role of the proxy process, or should there
19 be something else necessitating those discussions other than
20 the costly precatory proposal and everything that comes up
21 out of it?

22 PROFESSOR NEUHAUSER: Yes. That's hard to say. I
23 mean, what the 14a-8 does is allow for a threat, if you want
24 to call it, that there will be some consequences if you don't
25 talk.

1 Now, companies today -- and I was talking with Amy
2 about this at lunch -- companies today are much more willing
3 to talk to their shareholders. But maybe that's because of
4 14a-8, or at least in part because of 14a-8. And I was
5 telling Amy about an experience in the mid-'90s, not
6 representing an SRI group but representing an institutional
7 investor, that had 9.9 percent of a company.

8 And the company simply wouldn't meet with them. So
9 they got a shareholder proposal from them on the issue. And
10 it was a corporate governance issue, not an SRI issue. And
11 without the backstop of the ability to say, yes, we will ask
12 the other shareholders to give their view on this matter, my
13 guess is that there would be a lot less dialogue.

14 MR. DUNN: Cary? That obviously opens up to you.
15 And we get a lot of non-binding proposals. We see them in
16 letters from companies. And according to the things I read,
17 there are about 1100 proposals this year alone, and I'd have
18 to imagine two-thirds or three-quarters of them are
19 nonbinding. You deal with their proponents all the time.

20 My question to you is: What's the company
21 experience with it? What do you find thereafter, and
22 how -- at the company level, when you get a proposal, what's
23 the thought process? What do you go through in deciding
24 whether or not to include it, whether or not to try to
25 exclude it, whether to meet, how you go about it?

1 MR. KLAFTER: So we get all the possible scenarios
2 that you can think of. You have people who come in and they
3 talk with you. They want to talk with you. And we talk with
4 everybody. That's our policy.

5 And what we find in a fair amount of circumstances
6 is that if you talk with people and you educate them, you can
7 come to some sort of a position which may involve no change
8 at all in your behavior, and it won't involve any kind of new
9 policy, but they will know more about you. Because
10 oftentimes, as you might imagine, these proposals are coming
11 in to hundreds of companies. And you're nothing special, and
12 they don't know anything about you or your policies. So
13 there's that.

14 You have people who submit proposals, and they
15 won't talk to you at all. And this is oftentimes individual
16 proponents as opposed to institutional proponents. You call
17 the person up. You want to negotiate. You want to find out
18 what's really behind all of this. And there's just no give
19 and take whatsoever.

20 And at that point, you're basically thrown to
21 either adopting the policy, or coming to you guys and asking
22 for a no-action letter with respect to the proposal, or just
23 putting it into the proxy statement. So the opportunity to
24 negotiate doesn't exist.

25 And then we have circumstances where you get a

1 proposal before anybody has spoken with you. It's definitely
2 an aspect of leverage. They drop the dime on you, and at
3 that point you have to pick up the telephone and start
4 talking. We would have talked earlier, but that's the first
5 gambit.

6 And so sometimes maybe we'll adopt the proposal.
7 Maybe we'll come to some negotiated middle ground. Or maybe
8 we'll agree to disagree, and then once again we'll come and
9 visit you, or we'll put it in the proxy statement, depending
10 upon what it is.

11 So when you're thinking about the proxy rules and
12 you're thinking about the behavior that's occasioned by the
13 regulations, you have you have to understand that it's all
14 different kinds of behaviors. You have people who are going
15 through the step-by-step process. We'll talk, then we'll
16 propose. But you have a lot of people who are just going to
17 propose and not talk.

18 And you have a number of people -- apropos of the
19 commissioner's comment in the earlier panel -- there's lots
20 of dialogue with folks that does not involve any kind of
21 formal proposals. And it oftentimes does not get up to the
22 CEO level. It does not get up to the board level. It
23 involves people coming in and saying, well, you have this
24 environmental issue, and we want you to do this and we want
25 you to do that. And maybe it's implicit or explicit that a

1 proposal will follow if you don't do something.

2 But very oftentimes, it's resolvable at a staff
3 level. The people come in. You talk to them. You either
4 don't change your behavior but they're satisfied, or you
5 change your behavior and they're satisfied, and that's the
6 end of the matter. And so it doesn't rise to the level of a
7 proposal.

8 MR. DUNN: Amy or Stan, I'd ask you guys to follow
9 up on that, maybe. When you have your corporate clients, how
10 do you advise them when they get that kind of a proposal?
11 Turn on your microphone there, Amy.

12 MS. GOODMAN: As Cary indicated, I think most
13 companies would much prefer, if a shareholder has a concern,
14 to come and talk with them. I think we're in a very
15 different place than we were in the mid-'90s. I think there
16 are a number of reasons that companies are communicating much
17 more with their shareholders.

18 There's New York Stock Exchange listing standards
19 that require companies have a means to communicate with their
20 shareholders. There's SEC rules that require companies to
21 disclose whether or not they have a means of communicating
22 with their shareholders. There's the Internet. There's
23 additional press attention to governance and related issues.
24 So for a variety of reasons, companies want to talk to their
25 shareholders.

1 So we are seeing a lot more dialogue taking place.
2 For an example, there was a popular proposal this past season
3 dealing with the disclosure of political contributions. And
4 while you may have gotten a few requests from companies
5 seeking to exclude it, most companies resolved the proposal
6 by having discussions with proponents and coming to a
7 compromise agreement over disclosing certain information on
8 their web sites about their political contributions.

9 So I think in general, the bias today by companies
10 is to try to have this kind of dialogue with proponents,
11 irrespective -- or with shareholders, irrespective of whether
12 they're proponents or not.

13 MR. KELLER: Let me jump in on that. I think it's
14 important to do some differentiating. I agree with what Amy
15 said and what Cary said. But, one, you have to ask who are
16 the shareholders, and the approach may differ depending upon
17 the nature of the shareholders and what you think their
18 motivation is and what you think their past track record is
19 as to how you approach it.

20 I think the other differentiator that we have to
21 keep in mind is what is the nature of the non-binding
22 proposal. And they really do come in different stripes. I
23 mean, the social responsibility types of proposals are at one
24 level, and I guess there the question is, do you really do
25 think it's socially responsible? Do you think it's

1 tangential? Does it go to the core? Is it something of
2 interest?

3 Then there are the governance types of non-binding
4 proposals. And in many cases those come in, even though they
5 could be binding proposals, because it's a way of
6 circumventing the difficulties that may be encountered
7 dealing with the state law issue of whether or not it's
8 permissible. You can get to the same result by, if you will,
9 going the easy route with a non-binding proposal.

10 And then there are those proposals, and the ones
11 that I think, as we have seen the increase in shareholder
12 activism and aggressive activism by the new breed of
13 investors, what I'll call tactical, which are really the
14 proposals may be made for other motives. It may be to
15 embarrass the corporation; indeed, it may be to put the
16 corporation in play.

17 So I think this is kind of multi-dimensional and
18 you do have to realize that there are differentiating
19 factors.

20 MS. GOODMAN: Marty, I just wanted to add that
21 while we keep talking about non-binding proposals, these
22 non-binding proposals can have legal significance. For
23 example, ISS will recommend a withhold or against vote
24 against a director if a company has received a majority vote
25 on a shareholder proposal for one or two years, depending

1 upon whether it's a majority of outstanding or votes cast.

2 But if a company has gotten a majority vote on a
3 shareholder proposal and has chosen not to implement it, or
4 the board has chosen to implement it in a different way than
5 the proposal was phrased, ISS will recommend an against vote
6 against the directors.

7 And with many companies having switched to a
8 majority vote standard, as we discussed early today, you can
9 start to see, and I think we will start to see, the potential
10 for directors actually not receiving a majority vote because
11 the company board, in the exercise of its fiduciary duty,
12 decided not to implement the shareholder proposal.

13 MR. DUNN: That actually leads me to my next
14 question, which we hadn't planned on but I think it follows
15 from that, and that is: If you look at non-binding
16 proposals, the votes they get, you have a category of them
17 that get about 10 percent or so. You have a category that
18 caps out 25, 30. And then you get some that always get more
19 than a majority vote.

20 When the vote comes in and you look at what's
21 there -- and this is for any of you all to answer -- how do
22 you advise the board or how do you advise the proponent as to
23 what next steps to take, depending upon that vote? I realize
24 if it's a majority vote, they're going to be faced with a bit
25 of trouble the next year.

1 But what if it gets 30 percent? What if it's a
2 non-binding proposal that shows some true interest, but not
3 enough that it's going to hurt you later on? How do you
4 advise the client?

5 MS. GOODMAN: Well, I think usually at that point
6 it's initially handled, depending upon the proposal, by a
7 board committee, often the governance committee. And
8 depending upon the type of proposal -- for example, I'll give
9 you one like classified boards -- they are getting higher
10 votes.

11 A client a couple of weeks ago got a significant
12 vote. It was under 50 percent, but they got a significant
13 vote on a classified proposal. They're setting up a meeting
14 for -- they're inviting in a variety of academics and other
15 people, the governance committee, to come and talk to them
16 about the pros and cons of classified boards to help them
17 reach their decisions.

18 So I think once the proposals start to get a
19 significant vote, there's no question that companies take
20 them seriously. They just may decide, for a variety of
21 reasons, either to implement them differently or not to
22 implement them. And that's where the rub comes in.

23 MR. DUNN: I wanted everybody to kind of get a feel
24 for what we see on non-binding proposals. And you just
25 mentioned, and Stanley mentioned just a minute ago, you see a

1 lot of non-binding proposals on subject matters that they
2 could be binding proposals.

3 You just said classified board. Well, you could
4 submit a bylaw change that would do away with or implement a
5 classified board. And yet they come in as non-binding
6 proposals.

7 And a question I wanted to ask Stan is: Has 14a-8
8 shaped the fact that these are non-binding proposals because
9 people know that they can get a certain effect? Or would
10 they have been binding but for 14a-8? I'm trying to get the
11 interplay between those two.

12 MR. KELLER: Well, one, I think there's no
13 question, as we heard from this morning's panels, that 14a-8
14 in and of itself I think has created the non-binding
15 proposal. I think as a matter of state law it really didn't
16 exist outside of 14a-8. And just permitting it as a
17 practical matter -- and in some states, like mine, I can't
18 tell you whether it's permissible in Massachusetts or not,
19 for example, for any shareholder to just toss anything out
20 there. So the fact that 14a-8 permits it indeed encourages
21 the proposals and may encourage the courts in deference to
22 the federal rules to allow them to come through.

23 I think the ability to exclude binding proposals as
24 not being consistent with state law certainly has moved, and
25 let me say the ease of probably getting opinions in many

1 cases that it is inconsistent with state law has moved the
2 playing field to taking advantage of the non-binding
3 proposal.

4 But I think there's another dynamic which is in the
5 vote itself. If you were advising proponents, I think you'd
6 say, look. You're likely to get a higher favorable vote if
7 it's non-binding because there's less at stake with the
8 non-binding proposal. You're probably not going to get as
9 much active opposition from the company. Shareholders are
10 going to be more willing to vote for something that sounds
11 good than if there are consequences, legal consequences, that
12 flow from a binding proposal.

13 PROFESSOR NEUHAUSER: Yes. I agree, at least with
14 part of what Stan says. One is concerned about whether the
15 vote would be less if it's a binding proposal. What I would
16 disagree with is that the bifurcation between binding and
17 non-binding is one being created by 14a-8 and not the other.
18 They're both created by 14a-8.

19 You don't have bylaw proposals coming in without a
20 proxy fight without 14a-8, whether it's binding or
21 non-binding. 14a-8 provides the vehicle that allows for,
22 depending upon your view, either to solve the collective
23 action problem or a free ride. It depends upon whether you
24 think it's a good idea or a bad idea.

25 But that's true whether it's binding or

1 non-binding. The non-binding are in there, I think, because
2 not only the possibility of a lesser vote on a binding, but
3 also, if you go back to what the vice chancellor said this
4 morning, intrusions are not desirable. People basically
5 don't want to command the company to do X. They'd much
6 rather say, hey, I suggest strongly that you ought to do X.

7 You could think of it in terms of the corporation's
8 doing something, whether it's SRI corporate governance or
9 whatever. You could think of it as, what do you want to use
10 to try and prod them? Do you want an elephant gun, i.e.
11 let's have a proxy fight and kick out the board. Do you want
12 a spear and throw a spear at them, i.e. a binding proposal?
13 Or do you want to use a fly swatter and try and get their
14 attention?

15 And I think that's the function of the non-binding
16 proposal, is to get their attention without being intrusive
17 and without going after them with an elephant gun.

18 CHAIRMAN COX: Marty, I think that that last
19 explanation that Mr. Neuhauser made is a very useful one in
20 helping us with the discussion we've been having about
21 binding and non-binding.

22 Within the universe of non-binding proposals, I
23 think we've had it laid out fairly clearly here. There are
24 those that could be made binding and those that couldn't.
25 One of the questions that I hope this panel can tackle is

1 whether or not with respect to the latter, the federal proxy
2 rules -- not necessarily the ones we have, but the ones we
3 ought to have -- should, as a normative rather than a
4 descriptive matter, should facilitate shareholder proposals
5 on subjects where shareholders can't direct management or the
6 board of directors under state law.

7 MS. GOODMAN: I was going to say I think that's
8 what the ordinary business exclusion in 14a-8 was intended to
9 do. But with the addition of the significant social policy
10 exclusion from the ordinary business exclusion, we've gotten
11 away from that. But at least it seems to me that the genesis
12 of the ordinary business exclusion was to not permit
13 non-binding proposals on things that shareholders couldn't
14 deal with under state law.

15 PROFESSOR NEUHAUSER: Well, that, I think
16 overstates it a little, Amy. Of course, you could always
17 have knocked out a proposal on the grounds that state law
18 didn't allow it long before the exception. The exception
19 goes back at least 35 years, and maybe more.

20 MS. GOODMAN: But isn't state law -- state law is
21 ambiguous, as I think we heard this morning, as to where the
22 appropriate line is with respect to ordinary business matters
23 being the subject of a proposal. I think that's part of the
24 problem here.

25 PROFESSOR NEUHAUSER: Well, I think if you're

1 talking about a non-binding proposal, Matter of Auer v.
2 Dressel, which was referred to this morning, is the classic
3 case -- maybe the only case, but certainly the classic
4 case -- which says that you can have a precatory proposal on
5 anything.

6 In that case, it was endorsing the administration
7 of the former president, put in by the former president who
8 happened to have 52 percent of the vote and was sure to get
9 it passed. But that went to the Court of Appeals, the
10 highest court in New York, and the highest court said, yes.
11 That's perfectly fine.

12 So that as a matter of state law, you could put
13 in -- and I think most people assume -- Stan, you said you
14 weren't sure what Massachusetts would say. It simply doesn't
15 get raised. But people assume that Auer v. Dressel is the
16 common law rule that, going back what the Chairman said at
17 the opening this morning, what do you have?

18 You have this meeting where shareholders could come
19 in and raise whatever they wanted to raise, and you're trying
20 to replicate that under the proxy rules. And if they can
21 raise whatever they want without it -- as long as it wasn't
22 non-binding, then 14a-8 makes perfect sense.

23 What you've got to avoid is people using 14a-8 in
24 such an outlandish way that it has nothing to do with the
25 company. You need some kind of rules to exclude. We have,

1 what, 13 now that we have as substantive exclusions. You
2 need some of those things because you don't want someone to
3 have a proposal that -- and this goes back to one of the
4 reasons why we have one of those rules.

5 A shareholder proposal was presented back in the
6 '40s to -- I can't remember whether it was to endorse the
7 antitrust laws or ask the antitrust laws to be repealed, one
8 or the other. Inappropriate. Has nothing to do with the
9 company.

10 So you need some kind of exclusions. You can't
11 simply -- it's the equivalent of the Chairman's analogy to
12 the town meeting kind of thing. When you had a small
13 corporation when all the shareholders were local back in the
14 19th century, everyone could show up. I guess the chair
15 could rule out of order something as saying it's not relevant
16 to this meeting, and the chair ruling it out.

17 That's the function as I see it, of the exclusions,
18 the substantive exclusions, under 14a-8, is to rule out some
19 things as saying, this is not germane to what's going on at
20 this company. Therefore, it's not appropriate to raise it
21 here at this meeting.

22 MR. JOHN WHITE: I'm sure I know what your answer
23 to this is, Professor Neuhauser. But I just wonder if I
24 could get the rest of the panel.

25 If we take this category of non-binding proposals

1 that couldn't be binding, if that's, I think, the category
2 we're talking about, are they really -- I mean, why is it
3 that we have 14a-8 addressing those at all, and where does
4 that fit in the process? Is that part of the role of the
5 federal proxy process? I guess I'll put that to the other
6 panelists. I can guess where you are.

7 MR. KELLER: Well, that is a fair question. One
8 way to approach the question is to say, should there be a
9 mechanism for communication from the shareholders to the
10 company to let their views be known? I suppose if you take
11 the meeting model as the paradigm, people can come to the
12 meeting and they can say whatever they want until they were
13 ruled out of order.

14 The problem is -- and they could say what they want
15 if given the floor. But for any action to be taken, there's
16 the state law concept of notice of the meeting so all
17 shareholders can come and express their own view. So it's
18 informal communications.

19 And one could ask, as you do, why in fact are there
20 non-binding proposals if it is just making a point of view
21 known? And if there's going to be a communication system,
22 isn't that better dealt with outside of the formal proxy rule
23 structure and, if you will, the annual meeting framework
24 governed by 14a-8.

25 MR. JOHN WHITE: I'm also asking the question: Is

1 that what Congress had in mind back in 1934?

2 MS. GOODMAN: And we're also
3 talking -- historically, we're talking now in a time where
4 there are so many more avenues of communication possible. I
5 think what Congress was concerned about with 14a was that
6 there were things that were going on at meetings where
7 shareholders didn't have appropriate notice and opportunity
8 to vote.

9 And I think that was more of a concern, while today
10 there are so many different communication mechanisms
11 available, we're in a very different place.

12 MR. KLAFTER: I think you also have to look at this
13 in terms of the physical document that you're creating. The
14 second we start coming out with our CD&As, we start hearing a
15 lot of commentary out of Washington about, holy Toledo, look
16 how long they are, and they're not in an active voice, and
17 all of this other good stuff.

18 The fact of the matter is, when you have a set of
19 regulations which require lots of disclosure, you're going to
20 get lots of disclosure. If you want to open up the proxy
21 statement to every possible topic, you will have 300-page
22 proxy statements year in and year out.

23 No one will read them. They'll be impossible to
24 figure out. But that's what the document is going to be. So
25 if you guide people and force people to that particular kind

1 of behavior, that's exactly what's going to come out at the
2 end.

3 MR. KELLER: But we have a system where there has
4 been precatory proposals and there have been this opportunity
5 for shareholders to communicate. And I frankly don't see us
6 wiping that off the table. And to me, the challenge is to
7 find let's call it a streamlined way that permits that
8 communication process to take place, if you will, to explore
9 whether there's a workable alternative to the existing 14a-8
10 system, which kind of is something of a mismatch and in some
11 ways undermines those proposals or those aspects of the
12 annual meeting that are important.

13 MR. KLAFTER: But this is a really big-picture sort
14 of a point, i.e. what are we talking about here? What is
15 supposed to happen at the annual meeting? What could happen
16 at the annual meeting? What do you want to put in the
17 documentation which memorializes the annual meeting to come?
18 Or do you want to shift and start looking toward some other
19 kind of mandated or other form of shareholder communication
20 system intended to bleed off a number of these topic areas
21 from the annual meeting?

22 You could very well say that the annual meeting is,
23 to a fair degree, an obsolescent concept. It used to be 14
24 guys sitting in a room and wondering whether the ship was
25 going to come back from Singapore in the 16th century. But

1 now it's theoretically 3 million people, in my case, sitting
2 in a room and voting on assorted topics as to which, for a
3 fair number of them, they really have very little knowledge
4 and very little interest.

5 Some have a lot of knowledge. Some have a lot of
6 interest. Some of them have been stockholders for a day and
7 a half, and some of them have been stockholders for 20 years,
8 an amazingly disparate sort of group. So query: What are
9 the topic areas that you're going to raise within that
10 context?

11 I was reading in the paper that Warren Buffett had
12 a six-hour Q&A at his annual meeting recently. That's a fair
13 amount of discussion to be had, presumably not involving
14 stockholder proposals at all, and perhaps technically not
15 even part of the annual meeting. They adjourn and then they
16 have their six hours' worth of Q&A. That's another format to
17 consider.

18 I think under German law you have to keep the
19 annual meeting going until the last question is asked and the
20 last answer is given, a really debilitating sort of a
21 concept, as you might imagine.

22 MR. JOHN WHITE: But German.

23 MR. KLAFTER: But German, yes.

24 MR. DUNN: As I've already said, we're going to cut
25 off at 4:45 today. But Stan, I want to get back to the

1 broader notion of the under-inclusiveness or
2 over-inclusiveness of non-binding proposals. But since Stan
3 brought it up, I think this is a good time to divert away.

4 Stan, you and I talked way too many years ago for
5 me to recall about the potential for some kind of
6 alternative. If there was some kind of an alternative -- and
7 I want to turn to Rich after you answer to give us details
8 about what's possible -- but if that was some kind of
9 alternative, what should it try to accomplish? How do you
10 think it should go?

11 MR. KELLER: Well, it seems to me the question is
12 whether you can take the non-binding proposal out of the
13 annual meeting framework governed by 14a-8 and create an
14 alternative method of communication using modern technology
15 as that means of communication. One could think of the chat
16 room as a starting point, and I know this is something
17 Richard can address, and certainly the technical feasibility.

18 I think if it's going to be a sufficient equivalent
19 or substitute for the 14a-8 non-binding proposal approach,
20 you really have to get beyond what I'll call kissing your
21 sister, the chat room type, and think more of the American
22 Idol model, where people are in a position to, if you will,
23 vote, express a viewpoint so you could get to a conclusion.

24 Okay, what was the sense of the relevant
25 constituency? How you define that is another issue. And you

1 can certainly set up a mechanism which permitted shareholders
2 meeting an eligibility level -- and you can define an
3 eligibility level; either it defined now or you could raise
4 the bar somewhat -- to submit proposals and to ask that that
5 be subjected to the kind of electronic voting regime, with
6 shareholders having PIN numbers or whatever -- I won't get
7 into the mechanics of it -- which the company could then
8 monitor, control, and, if you will, facilitate.

9 And have a defined period in which people could
10 record their view on it, and then the company has a sense of
11 what the view is. I think you'd accompany it with the
12 company disclosing the results.

13 And to me, you would then ask the question, are
14 there any consequences that should follow from that vote?
15 And I think, as we've seen using the disinfectant of full
16 disclosure, at some point after the process the board
17 indicating what action they took in response to the
18 proposals, and if they didn't take action, the reasons for
19 not taking the action. So you've got both a dialogue taking
20 place and an opportunity for the company to communicate and
21 for the board to demonstrate that, indeed, they fulfilled
22 their fiduciary duty.

23 And to me, the benefit of that, taking it out of
24 the 14a-8 system, is, one, you probably improve that system.
25 You make it easier for the staff to deal with this whole

1 area, and you improve the communication process between
2 companies and their management. And you take it out of this
3 realm where it really has this dramatic focus.

4 Just to test it, I said, now, how do I distinguish
5 this from something I do not favor, which is the legislation
6 making its way through Congress to have mandated
7 non-binding -- interesting oxymoron -- mandated non-binding
8 votes on whether you like the company's compensation policies
9 or not. And that's a proposal in my own mind is misguided
10 because you don't know what the vote means, and it could be
11 misused and create mischief.

12 And to me, the distinction is if you have one out
13 of the 14a-8 system as a more routine matter, it's important
14 but it doesn't have the same significance and focus.
15 Certainly it doesn't have that significance if it were
16 mandated by Congress, where everybody has to assume it has
17 important meaning if there's an adverse vote.

18 MS. GOODMAN: What would you do in terms of, for
19 example, ISS, which has such significance today, and how they
20 would view this kind of vote, and what importance they would
21 give to it?

22 MR. KELLER: One, I think you have that problem
23 already. Two, it really gives management, the board, the
24 opportunity to state its own position, both in the front end
25 and in the back end, as to how it has reacted to the vote

1 that it received.

2 MR. DUNN: If I could jump in, every letter we get
3 from Rich always says, I don't say anything about policy. I
4 can tell you what's technically available. So before we get
5 into some policy and some discussion on that, if I can turn
6 it over to you. This concept of finding some way to better
7 have shareholders speak to themselves and to management, you
8 know better than any of us up here what's possible.

9 MR. DALY: Sure. Well, first of all, thank you for
10 the opportunity to be here.

11 We had been asked by the Commission a little over a
12 year ago would it be feasible to create a secure chat room.
13 And very quickly, we were able to come back by looking at the
14 existing system and saying, yes, it can be expanded to create
15 an environment that would have an alternative to the proxy.
16 Let me quickly describe the existing system and then what
17 that alternative would be.

18 We currently act as agent for 850 custodians.
19 These are both brokers and banks. And these are the largest
20 custodians in the country. And behind them, there are about
21 90 million shareholder accounts. We link those 90 million
22 shareholder accounts to the 13,000 corporations that have
23 annual meetings in North America.

24 It's about 350 million ballots. Each of those
25 ballots, whether it's electronic or on paper, has a unique

1 PIN number. All right? And we worked this out with the SEC
2 when we rolled out electronic voting and telephone voting
3 that there's a 1 in 3 million chance of guessing a live PIN
4 number. And if you come in three times, we block you from
5 going back out. So it's a very secure environment.

6 Half of those ballots right now are without paper.
7 Sixty percent of the shares are electronic. And all in all,
8 in today's process, on the records we receive, we have a Big
9 Four firm come in on a quarterly basis and they verify that
10 the voting results on the records we receive are 99.9-plus
11 percent accurate.

12 Now, taking that infrastructure that could be
13 expanded if those who decide policy, the policy-makers,
14 believe it would be in the best interest to have an
15 alternative to a proxy, what could be done is as follows.

16 Now, this could be as of the record of for the
17 annual meeting. It could be as of any other record date
18 desired. Okay? Because all that simply matters is in that
19 plumbing I described, every day we have a level 4 data
20 center -- actually, it's two level 4 data centers that back
21 each other up -- that connection with each of those 850
22 institutions and draw down all the long positions for the
23 company whose record is of that date. We're not limited to a
24 specific date a year, and it could be multiple times a year,
25 for example. So there aren't constraints of that nature out

1 there.

2 Through that PIN number process, though, that would
3 be the get-in card, the entitlement to get into a discussion
4 room. So you would be in there only with other shareholders
5 through that PIN number.

6 Now, you have the ability to comment. If it was so
7 desired, those comments could be recorded in terms of that
8 not that your identity would have to be disclosed, but once
9 you decide to comment versus just observe, we could
10 sequentially number you so that you could never come back and
11 misrepresent who you are.

12 So if you were the 1,010th participant to comment,
13 you would always be 1,010, 100 shares. You couldn't come
14 back a day later and say that you were 1,000 shares, 5,000
15 shares. You would always be controlled to your actual number
16 of shares -- again, if this was so desired.

17 Things could be proposed there. Now, I think it
18 would be a little different than American Idol in that we
19 would know exactly who was doing what, and that we would not
20 have an identity of who was coming in. And there would also
21 be the ability to track people to be accountable for their
22 comments. So if somebody slandered a CEO or a director, we
23 would be able to unwind that position ultimately to go back
24 to know who that was.

25 Now, going this route, there are significant

1 consequences, as in all of these activities, when
2 policy-makers decide that it's appropriate to make a change.
3 Marty, as you pointed out, we're not here to say what the
4 right policy would be. We think we're experts, though, on
5 processing, and we certainly are confident that we could lay
6 out on a very, very accurate basis what these consequences
7 would be, and that the devil is really in the details. Let
8 me give you a couple of quick examples.

9 If you were to just put a proposal out there in a
10 non-proxy, pure poll environment, unless someone put effort
11 into getting people to go to the web site and look at the
12 proposal, I would suspect that the activity would be very,
13 very limited. All right?

14 If this was tied to a notice and access process
15 where somebody said, well, I have a proposal out there and I
16 want to send a notice out, but I'm not willing to spend money
17 for mailing; I'm only willing to notify those who have
18 electronic links right now to handle this, in a large cap
19 you'd cover 60 percent of the shares.

20 If somebody wanted to go and then say, I want
21 everyone to be aware of this, they could do a full notice to
22 all holders or they could turn it into the traditional
23 process of today. So there's lots of different avenues
24 available.

25 This goes to some of the dialogues that we talked

1 about earlier in terms of who is paying the freight to get
2 this done, the free riders, so to speak. And all of these
3 are policy decisions that give you options. But I would
4 argue that the technology can go well beyond where we are
5 today. The devil's in the details, and the consequences need
6 to be thought out.

7 MR. DUNN: I want to turn this over to everybody
8 else, but I want to ask you one last question before I do.

9 Within such a structure, would it be able -- you
10 know, everybody loves to be able to go online, and you vote
11 and it shows your results right away on ESPN Nation or
12 whatever about whether Tiger Woods or Michael Jordan are
13 great, or something like that.

14 Would that kind of capacity be in there? Would it
15 be any realistic capacity, or would it just be -- would it be
16 the American Idol, if it was a vote?

17 MR. DALY: I think the capacity for very, very
18 timely results are indeed in the street process. So, for
19 example, Motorola is having their meeting today. Within a
20 half hour of that meeting closing, we'll issue a final
21 certified, never-to-be-changed vote. There's probably 40- to
22 50,000 man-hours of audit that went into that vote already.
23 And as you know, on the registered side it's likely going to
24 be several weeks before less than 10 percent of the vote
25 ultimately gets sorted out in terms of what the final results

1 are.

2 So we have a technology advantage in that for every
3 meeting, for every investor in every meeting, we're using the
4 same process. It's very heavily system-driven. For those of
5 you who aren't familiar with a level 4 data center
6 environment, there aren't that many in the country. It's a
7 massive environment. And I can't guarantee it would be real
8 time, but it would be near real-time results.

9 MR. DUNN: Anybody want to -- go ahead, Stan.

10 MR. KELLER: Let me -- just so the distinction
11 isn't lost, I was trying to draw a distinction between what
12 I'd call the chat room, which one could call idle chat, or
13 basically you get views tossed up by whoever is interested in
14 tossing up their views; and one that really replicated to
15 some extent the proxy system, where you got a meaningful
16 expression of views, which was accompanied by advocacy
17 explaining the views, so that what you ended up with was, in
18 fact, what one could consider a meaningful expression.

19 Let me also add that if the Commission were to go
20 down that route, I would certainly clearly do it, at least at
21 the outset, on an opt-in basis. So, for example, if you
22 opted into this kind of system, which -- and again, keep in
23 mind it's not just limited to the annual meeting, but it
24 would be during the entire year, effectively -- that if you
25 opted in, then non-binding proposals would not be subject to

1 the 14a-8 regime, so that there was a carrot that was
2 offered.

3 And to me the interesting question is whether, one,
4 from the company's perspective, there would be any appeal to
5 this, assuming it was workable and manageable; and two, from
6 the investor perspective, whether they think this would
7 accomplish their objectives, or would they lose something.

8 MR. JOHN WHITE: Just one other mechanical
9 question. We had some comments earlier today that shares can
10 be voted once or twice or three times as they're borrowed and
11 lent and so on. Does that issue -- how does that work out
12 here?

13 MR. DALY: Sure. I specifically made the comment
14 of the records we receive. We have a very rich securities
15 market, where we have more individual participation than any
16 other market out there. So, for example, on the most simple
17 transaction, if I buy 100 shares, and I buy it on 50 percent
18 margin, and those shares are ultimately lent out -- I'm
19 sorry, short sold and then resold, and the next person buys
20 50 shares, there are pre- and post-reconciliation dialogues
21 that go actively in place right now in the brokerage
22 community.

23 For someone who uses a post-reconciliation -- I'm
24 sorry, pre-reconciliation; excuse me -- the margin holder
25 would be netted down to 50 shares, the other 50 shares would

1 be out there, and the 100 shares is all that would be voted.

2 For someone who uses a post-reconciliation process,
3 my 100 shares that I brought, I'd still be give a proxy to
4 vote or a ballot to vote 100 shares, and those other 50
5 shares would be out there. And in the very rare exception in
6 a retail environment where that firm who treats those
7 positions as being fungible -- they don't track individual
8 100-share buy and sells; it's all continuous net settlement
9 through DTCC.

10 And in that situation, if there was a very rare
11 case where my 100 shares couldn't be voted, now with this new
12 over-voting reporting service we have, we would notify the
13 broker and he would net those shares down.

14 And I gave you a very simplistic example of
15 why -- and firms have different views on, should the owner of
16 those 100 shares, who still has the economic gains and losses
17 tied to 100 shares, be able to vote those 100 shares, if the
18 shares are available to vote or not. Then when you get into
19 fails and other activities, it becomes more complex.

20 Now, in additional dialogues with the Commission,
21 if everyone went to a pre-reconciliation, you still wouldn't
22 be addressing the reality that I could be long 2 million
23 shares in Firm A and short a million shares in Firm B, and
24 still have the right to vote the 2 million shares.

25 My suggestion here is as follows. Technology can

1 enable us to go forward and provide additional
2 reconciliations. And at times, although it may not sound
3 like that, I completely agree with John Wilcox in terms of
4 the transparency. But it's a matter of taking technology and
5 reconciliations forward, and recognizing what technological
6 capabilities that exist today are versus at the time it was
7 necessary to write the rules.

8 MR. DUNN: Cary and Amy, I'd like to ask you guys.
9 Cary, you advise at least one board, and Amy, you advise a
10 bunch. If something like this came along, if there was some
11 alternative for some portion of 14a-8, or just in general to
12 14a-8, that was out there to provide shareholders a better
13 means to interact with each other and with your board, how
14 would you advise the board? And if it was purely voluntary.
15 How would you advise them? Do you think it would be
16 something they would want to do or should do?

17 MS. GOODMAN: Well, I think it would depend upon
18 the facts, I mean, how the system is sorted out and what the
19 benefits were. Because as I mentioned earlier, there are
20 already informal communication means, and I think people
21 would prefer to err and rely on the informal communication
22 means, especially if we're going to all of a sudden have
23 year-round voting on these matters. Because they do take a
24 lot of time.

25 I think people are looking for alternatives to

1 putting all these precatory proposals in their proxy
2 statements. So I think they would look favorably upon the
3 idea, but question whether we need something so mechanistic
4 to do it.

5 I mean, it seems with the proxy rules, that could
6 almost -- any shareholder who really has something
7 significant they want to share with other shareholders will
8 have a way of doing that. So I think it's very much an open
9 question.

10 MR. DUNN: Cary?

11 MR. KLAFTER: It all depends on the detail. Right?
12 If what you're actually creating is a kind of proxy proposal
13 light system, or if it's something else, that's really going
14 to be determinate as far as companies are concerned.

15 My expectation is that a fair amount of the overlay
16 that you currently have in the proxy system would follow this
17 new system. What does that mean? That means ISS is going to
18 look at these proposals and is going to advise with respect
19 to them. And there will be pressure brought to bear in
20 connection with the voting.

21 Some of the issues will become -- let's say that
22 you have no bar any more with regard to the kind of proposals
23 that can go in. So for a number of the proposals, the
24 companies won't care, a lot of the holders won't care, and
25 you'll get a very low vote.

1 But for a number of the issues, because they will
2 have now been pushed to this new system, pushed by new
3 regulation, people are going to care quite a bit. And so
4 you're going to have the same potential for a proxy contest,
5 so to speak, as you have under the current system.

6 The current view of a lot of issuers is that we are
7 entering the era where every vote is a potential proxy
8 contest, with majority vote, as far as directors are
9 concerned; with ISS, as Amy explains, really putting it to
10 you if you don't follow a majority vote with respect to even
11 a precatory proposal.

12 As you suggest, in the olden days you worried about
13 this 3 percent vote threshold under the rules, whether
14 someone can resubmit or not. But 3 percent is old news.
15 Only the most marginal of proposals are getting 3 percent or
16 even less. You have all of these proposals getting 20, 30,
17 40 percent.

18 You remember when it was giant news that a
19 stockholder proposal would get 10 or 15 percent. But that's
20 nothing these days. So everything becomes very, very
21 important. And all of the detail with regard to this kind of
22 proposal becomes very, very important.

23 And let me just say one further thing. I'll leap
24 forward to your next roundtable. And I won't get into the
25 detail, but you're going to hear a lot at the next roundtable

1 about how the current plumbing operates and how it's
2 relatively limited in terms of who can play what particular
3 role in this process.

4 And I would caution you very greatly with respect
5 to thinking about creating an entirely new process that only
6 involves a very small number of potential players in the
7 system. I mean, if as Stan says this is starting to look
8 somewhat in the nature of a chat room with voting, there are
9 a lot of people who can do chat rooms with voting if they
10 have proper access to the stockholder lists. And you should
11 encourage that sort of thing.

12 MR. DUNN: You're next, and then I'll go to
13 Commissioner Atkins. And can I interrupt before you start?
14 To the extent that shareholders would or would not view this
15 to be an attractive alternative, if you don't think they
16 would, what would need to be in it for them to do so?

17 PROFESSOR NEUHAUSER: I'm sorry?

18 MR. DUNN: If you were going to say that from the
19 shareholder viewpoint this would not be an attractive
20 alternative, I'd like to know what would need to be in there
21 to change that.

22 PROFESSOR NEUHAUSER: I don't know. I mean, the
23 mechanics, as explained, obviously solve some problems on it.

24 CHAIRMAN COX: Marty, I wonder if we can simplify
25 the question a little bit because I think part of the

1 difficulty in answering the question is that we've said it's
2 an alternative.

3 So let us suggest that it's not an alternative, and
4 that you're simply evaluating it on its own merits, so that
5 you don't have to count it as a cost that you'll no longer
6 have access to precatory proposals under 14a-8. Leave that
7 to one side for purposes of analysis, and just address the
8 desirability of this as an additional option. Then maybe we
9 can focus on it on its own merits.

10 PROFESSOR NEUHAUSER: Thank you. That's well done.
11 I think that it doesn't add a lot right now. Shareholders
12 can communicate without impinging on the proxy rules. They
13 can communicate even in favor of things that are going to
14 show upon the proxy statement as a result of the 1993
15 amendments. They can always get together around common
16 interests. And indeed, there are chat rooms that they can go
17 into.

18 To the extent it looks like a chat room, it seems
19 to me it is totally useless. I went on Saturday --

20 CHAIRMAN COX: I think Rich maybe went through some
21 of this stuff quickly. But I'm having trouble squaring what
22 he said and what you just said because there are so many
23 dramatic differences between what's available now and what he
24 just described, starting with anonymity; second, knowing that
25 the only people that you're talking to are also shareholders

1 in the company; third, knowing in real time what percentage
2 of shares are represented in that discussion.

3 And fourth, the ability to do this 24/7 year-round
4 instead of once during the annual meeting; fifth, the
5 opportunity of management to be notified at all times of what
6 is the content of this discussion; and lastly, but certainly
7 most significantly, the opportunity to conduct -- somebody
8 put it here; was it you, Stan -- an American Idol -- who came
9 up with the American Idol idea?

10 MR. KELLER: I'll take the blame.

11 CHAIRMAN COX: But there really isn't any useful
12 mechanism for doing that with real shareholders right now.

13 PROFESSOR NEUHAUSER: Well, all those, I think, are
14 very good points. Here are a couple things that I think need
15 to be considered.

16 To the extent that you don't have someone chairing
17 the meeting to rule things out of order, what are you going
18 to get? I went on the Internet on Saturday evening -- I had
19 nothing better to do -- and went to General Electric, which I
20 picked out of the hat on Finance.Yahoo for the message board.
21 And if you'll bear with me for a couple of minutes, I will
22 read to you the topic headings of the 20 things, the first 20
23 that were listed out of 200,014.

24 Friday: "Six GIs, 71 Iraqis killed, 89 wounded."

25 The second one: "Enemy surging in Iraq."

1 Third one: The "fatal flaw in Zionism's defeat."

2 Fourth one: "Bush getting his chimpanzee-loving
3 ass kicked."

4 Fifth one: "Islamo morons stone innocent girl to
5 death."

6 Seventh one -- this is way out of line: "Market
7 intelligence." Both words seem to me somewhat out of place
8 on this web site.

9 Next one: "Low risk, high return."

10 Next one: "Sold GE, bought PLXS." Well, yes. I'm
11 trying to get you to buy it, too, so my stock will go up.

12 "XSNX, the new solar Microsoft."

13 "10 percent down side this week globally."

14 Appropriately using the moniker, "Buystocktank."

15 Next one: "Let me ask you neo clowns with indoor
16 plumbing." I don't know what that one's about.

17 And so on. If you don't have someone to rule some
18 things out of order on this chat room or whatever we want to
19 call it, what are you going to get? And it seems to me that
20 what you're going to get is however nicely one may have set
21 up the idea that, hey, we could get a vote on X that would be
22 useful, it's going to get lost, and no serious shareholder is
23 going to pay attention to it. And management will pay no
24 attention to it.

25 If you say it should be regulated in some way, then

1 who's going to regulate it? You're back to the SEC
2 regulating it? Is the company going to regulate it? Will
3 the shareholders say, hey, we think it's a fair chat room
4 because the company is regulating it?

5 I think there are some serious problems as to
6 whether or not what the product would be would be meaningful
7 to shareholders and to management. And if the shareholders
8 don't think it's going to be a meaningful product, they're
9 not going to participate, and all you get are people like
10 that.

11 CHAIRMAN COX: Paul, I think you've done a
12 conclusive presentation on why what we have today is not
13 workable. I take it that there was no requirement in order
14 to post in that chat room that you be a financial stakeholder
15 in that enterprise.

16 PROFESSOR NEUHAUSER: Well, yes. It may be that
17 all these GE people are -- these are GE shareholders, for
18 all -- I mean, we don't know the answer to that. But yes,
19 maybe people spend their Saturday nights going on
20 Finance.Yahoo as non-GE shareholders to put up silly
21 messages. But I would assume that the majority of people who
22 go to a chat room about a specific stock are in fact
23 shareholders.

24 I have occasionally looked at things on stock I
25 own. And I say occasionally because it's useless. I mean, I

1 don't have GE so I don't have these things. I have obscure
2 stocks where there's usually nothing posted for weeks. But
3 when they are posted, they're like this thing. Someone has
4 bought or sold short and is trying to influence what's going
5 on.

6 MR. KELLER: That's why I distinguish between chat
7 room and a focused, workable expression of views on proper
8 subject matter. So yes, some of the current trappings of the
9 proxy system -- who's eligible to get it in, what subject
10 matter can go into this expression of view -- would still be
11 a necessary part of it, although hopefully the stakes become
12 less important. It becomes more routine that you don't have
13 to be as concerned about some of it.

14 So, for example, ordinary business matters may be
15 acceptable, may be tied to their having a material economic
16 impact on the company. And I would see it as the company
17 monitoring it to make sure that there's proper material. And
18 yes, you need some kind of dispute resolution. And not to
19 get into a particular subject that's particularly sensitive
20 now, there may be some arbitration system to deal with that.

21 MR. DUNN: If I could ask one last question on
22 this. And I haven't forgotten about you, Commissioner
23 Atkins. I'll get around.

24 That's why I wanted to go back to Rich, is the
25 reason I wanted you to talk about the technology that's there

1 is I wanted to get a feel for whether it's possible for it
2 not to be the Wild West that Paul's talking about. Is there
3 a means to have it be a useful piece?

4 MR. DALY: I'd said earlier that the devil is in
5 the details. So, for example, there could be, depending on
6 the policy decisions, that these are the topics; that you
7 could respond within a limited range of your views that could
8 be predetermined up front. You could also have somebody have
9 the able to -- for example, each time you go in, you're going
10 to be the same sequential chatter.

11 So hypothetically, let's say you are a true
12 shareholder and you happen to not be a fan of the company
13 that you're a true shareholder in. The viewer could be given
14 options to eliminate comments of a certain chatter number,
15 just so they don't have to be bothered by it, if they wanted
16 to get a sense of what was going on.

17 The company's management, of course, would have
18 access; or based on a policy, I assume, the company's
19 management would have access to view all this activity as
20 well. Let's assume the board had access to view this
21 activity as well. They could go in there, and if they wanted
22 to get a sense but there was clearly someone who was every
23 other comment and they didn't want to waste their time having
24 to page through these comments, just eliminate them by
25 number.

1 So there can be word searches done to eliminate
2 activity. There can be far more disciplines put in here. I
3 think the most significant thing, though, is that it would be
4 for shareholders only through that PIN identification with a
5 very high difficulty to get into any meeting. And then it
6 gets compounded to get into a specific meeting by guessing
7 a PIN.

8 So I believe, from a technology point of view, the
9 amount of controls that could be put in place there could be
10 loose to excessive, depending on the design.

11 MS. GOODMAN: Right. But you'd still have an
12 arbiter, and the question is who the arbiter would be,
13 whether it would be the Commission staff or the company, or
14 exactly who would perform that role.

15 MR. DUNN: I don't know that you have to
16 necessitate that because, as the Chairman said, if you view
17 it purely as alternative -- I mean, 14a-8 stays as it is and
18 this is purely additional so it's purely a benny -- I don't
19 know that you have as much of that.

20 Commissioner Atkins, did we cut you off or did -- I
21 apologize for that.

22 COMMISSIONER ATKINS: No. This line of discussion
23 was very good. This is sort of a corollary to this because
24 of course the SEC in particular, the staff, is caught in the
25 unenviable position of being the arbiter of these various

1 proposals that come up.

2 And before I got here and before John got here, the
3 staff apparently decided six or so years ago that they would
4 only look at the four corners of the company's submission as
5 to whether or not -- as to decide whether or not it was in
6 bounds or out of bounds.

7 And Mr. Klafter, unfortunately you're the
8 only -- in our four panels today, you're the only corporate
9 participant. But I was just curious. From my perspective
10 here, especially recently, some of the staff determinations
11 have not been consistent.

12 And I was curious what your perception is. And
13 perhaps the lawyers on the panel have something to say as
14 well. But does that help you when you are looking at these
15 things as to whether or not to go along with them or to
16 submit a no-action letter? How does that -- if you've
17 considered that, how does that affect your determination?

18 MR. KLAFTER: Well, there's a definite impact. And
19 you're absolutely right. When you look at the universe of
20 no-action letters, it is very oftentimes an imperfect
21 pattern. Here's letter No. 1; it seems to say this. Here's
22 letter No. 7; it seems to say something else, but you're not
23 quite sure.

24 So ultimately you operate on the basis of
25 resignation, that what comes is going to come. You put your

1 best foot forward in terms of all the arguments that you're
2 going to be making with respect to the particular topic.

3 Sometimes you have clear precedent that's not in
4 issue. Other times, as people have discussed, you have this
5 looming specter of the substantial social policy interest,
6 which seems to trump two of the three major exceptions that
7 companies will tend to use.

8 They will look at ordinary business practice and
9 they will look at relevance, and they will say, here's a
10 stockholder proposal dealing with hardly anything that
11 relates to what we actually do for a living, and therefore
12 here are these two exceptions and we should take advantage of
13 them. But lo and behold, we can't do that because this topic
14 has been designated as having some super status, and there's
15 nothing to be particularly done about that.

16 And then the third exception that we oftentimes
17 look to is "substantially implemented." And "substantially
18 implemented," both with the staff and with ISS, as a
19 practical matter, is also oftentimes a kind of black hole
20 because you think you're pretty much within the zone. You
21 have people who say, yes, you've basically gotten there. But
22 it turns out not to be the case.

23 So you put your best foot forward with the
24 arguments. I think issuers would generally say, it is better
25 to load it onto the staff than to fight with people in

1 lawsuits over the particular topic. So all other things
2 being equal, it's probably the better way to go.

3 But it can be frustrating, particularly if you have
4 a board and they're saying, well, what's the deal here? I
5 mean, surely this is an ordinary business practice we're
6 talking about. Surely this is completely irrelevant to our
7 business because it represents virtually nothing in terms of
8 revenues or profits. And there you are.

9 MS. GOODMAN: And I think it puts the Commission in
10 a bad light in the sense that the staff is trying to provide
11 guidance, but there are so many letters that have to be
12 answered in a very short period of time that they generally
13 indicate whether some exclusion applies or not without giving
14 a reason.

15 A board, usually the governance committee, will be
16 considering how the company should respond to this
17 shareholder proposal, and you can't give them real guidance
18 as to how the Commission is going to act. So the Commission
19 looks arbitrary and capricious to them. Then when it comes
20 time to the mechanics of handling the process, you may not be
21 able to get an answer faxed back to you or e-mailed back from
22 the staff because the proponent hasn't given a fax or e-mail
23 address.

24 So the overall process becomes very confrontational
25 and makes everybody look in a bad light. And so I think,

1 depending as you go forward, there are a number of things
2 that I think could be done if the process is going to stay in
3 place to improve it.

4 COMMISSIONER ATKINS: Well, the whole socially
5 important thing has grown up. I mean, that doesn't really
6 have necessarily any basis. If it got crafted or onto the
7 rules over the years, should that be looked at?

8 MS. GOODMAN: Certainly.

9 MR. KLAFTER: Yes, absolutely. And maybe you even
10 wind up building it into your rules when you take a fresh
11 look at everything. But at the moment, it's just one of a
12 number of real wild cards as far as the regulations are
13 concerned, and so gives you a lack of predictability.

14 One of the things that Amy briefly noted is that
15 when you get responses back from the staff, it's just the
16 response. Yes, no, we agree with you on this point, not on
17 this other point, but without a lot of reasoning. Now, that
18 would add an additional load to the staff. But it would also
19 require that there be the creation of something in the nature
20 of a miniature opinion so that you could understand the
21 reasoning and so all sides would have better guidance as to
22 which way to go in the future in terms of how is some
23 particular regulation being interpreted.

24 MR. DUNN: And then every time I issued one of
25 those, the opinion would be challenged as I was adopting a

1 new rule. So I couldn't go forward.

2 Professor Neuhauser?

3 PROFESSOR NEUHAUSER: Yes. One always wants more
4 certainty rather than less certainty. To the extent that one
5 could get it, that's terrific. We have it on those occasions
6 when I help draft things, which is not very often. But it's
7 very useful to be able to know what we mean by "risk" or
8 other things. But I'm not sure, as a practical matter,
9 writing opinions is going to be within the realm of reality.

10 I'd make one comment, though, on the ordinary
11 business exception. It technically isn't in the rule, but
12 it's in all the releases, and the courts have said the
13 releases are part of the rule. So it's pretty clear.

14 The economic one is in the rule, the economic
15 exception, when it says new to economic unless it is -- I
16 don't remember the exact phraseology, but it's the same kind
17 of phraseology of an important matter. That's in the rule.
18 It doesn't help much that it's in the rule.

19 MR. DUNN: Well, before we turn around to you all's
20 closing remarks, I was going to ask the Commission if they
21 had any other questions. But I don't think Paul is allowed
22 to ask any more. So anybody -- he's not even listening to
23 me. I'm giving him a hard time and he's not even listening
24 to me.

25 The last 15 minutes, I think -- I'd like you all to

1 give your closing remarks here. But if I could give
2 something I'd like to hear from you, which is: I want
3 reading an article recently about the fact of junk news, and
4 things become news just because people put it out. You
5 suddenly see everybody finding an image of Engelbert
6 Humperdinck in their grilled cheese because CNN.com will put
7 that online. And so suddenly more and more people find
8 images in their grilled cheese or in a potato or something.

9 And is that similar to what we have here? Is
10 because of 14a-8, because of the press 14a-8 brings, because
11 of the interest it brings, is that why we have non-binding
12 proposals? I mean, as Leo mentioned this morning, they don't
13 create these things. They don't negate them, either. But
14 they really are not something that state law encourages or
15 begs for. And yet it has become this thing.

16 And my question to you is: Is this thing there
17 because of 14a-8, and is that right or wrong? Now, Rich, you
18 never express a view on policy, but I'll start with you and
19 you can feel to pass and then we'll just come down the table.

20 MR. DALY: I'm certainly going to pass.

21 MS. GOODMAN: Well, I think there's no question
22 that the fact that 14a-8 is out there that creates this. For
23 example, there are groups that come up with the idea of a
24 particular proposal in a given years, whether it's majority
25 voting or splitting the chairman -- let's take splitting the

1 chairman and CEO.

2 And people would tend to think that at some
3 companies it's a good idea and at some companies it may not
4 be. But you have proponents who submit that same proposal to
5 a hundred companies without consideration beforehand of
6 whether or not that proposal makes sense for an individual
7 company.

8 And in that Credit Suisse, I would say that it's
9 the non-binding proposal of 14a-8 that creates the mechanism
10 that makes people want to do something like that.

11 MR. DUNN: Any other views on shareholder --

12 MS. GOODMAN: Okay. This is my last -- then I'll
13 keep going. I'll keep going. And I don't think I thanked
14 you for the opportunity for being here today, and I do want
15 to thank you.

16 I'd like to make two points. The first relates to
17 what you're going to be discussing at your next panel. And I
18 know I'm a broken record on the issue of shareholder
19 communications and the whole process, but I think it's very
20 important, as was discussed earlier this morning, that some
21 of these mechanical issues relating to over-voting, empty
22 voting, be addressed.

23 And along with that, the Commission's shareholder
24 communication rules that deal with communication with street
25 name holders, the NOBO-OBO rules that go back to the 1980s,

1 we have a whole lot more technology available to us today to
2 deal with these issues.

3 I think much as the Commission is looking overseas
4 to answer some of these questions, there are systems in place
5 in the U.K. and Australia whereby issuers know who all their
6 shareholders are, including those in street name. And as we
7 move towards a time and a process where communicating with
8 shareholders is so much more important, I think this is a
9 great opportunity for the Commission to look at those rules.

10 Finally, as a segue to the next panel, I want to
11 suggest that whatever approach the Commission takes to
12 dealing with precatory proposals, it not just move along of
13 these precatory proposals into non-binding proposals.

14 We do have a means out there for shareholders to
15 communicate with one another, and on a lot of these issues I
16 don't know that we want to get so confrontational that
17 everything that today is a non-binding proposal becomes a
18 binding bylaw since, as the earlier panels indicated, it's
19 still not clear under state law what is an appropriate
20 subject for a shareholder bylaw.

21 MR. KELLER: I think, as I said, I think it is
22 clear that non-binding proposals or precatory proposals are a
23 creature of 14a-8, and really, by and large, don't exist as a
24 practical matter, and in some cases, a legal matter
25 independently as a matter of state law.

1 Having said that, I think they're here. And given
2 the communication and the desire to increase communication,
3 certainly informal communication, but where necessary and for
4 those shareholders who in fact do not have access to the
5 corporation, I think it would be moving backwards to just
6 say, well, we created it and now we can eliminate it.

7 But rather, to me the challenge is to think through
8 whether there are alternatives that would, one, dial down
9 somewhat the significance of the non-binding proposal. And I
10 think by taking it out of the annual meeting frame and to do
11 it on a basis that in fact improve the communication, allow
12 14a-8 to operate where it should operate with those
13 proposals, that -- I'll say in quotes -- "really means
14 something."

15 That's not to suggest non-binding proposals don't.
16 But for those binding proposals which should be the subject
17 matter of shareholder action at the annual meeting, and to,
18 as I said, just think hard whether there is an alternative
19 system, chat rooms are one approach. Controlled chat rooms
20 are certainly better than open chat rooms. But there also
21 may be ways to keep score so that you get a meaningful
22 response.

23 And then to think about the overlay of the
24 disclosure regime so you've got management communicating back
25 to shareholders how they are reacting to, responding to, the

1 proposals and how they are fulfilling their fiduciary duty,
2 which is where the ball should stop.

3 MR. DUNN: Thank you. Cary?

4 MR. KLAFTER: There's no doubt that there's an
5 industry that's built around 14a-8 with regard to non-binding
6 proposals. And any kind of change that you make, whether you
7 take advantage of Rich's proposal or you do anything else,
8 it's going to move everybody in the system.

9 And so what I strongly recommend, what I think
10 you'll hear from most issuers, is that you need to take a
11 bigger picture look at topics rather than a narrower look.
12 And that includes both the substantive public policy
13 determinations as to what it is that you think ought to be
14 within the purview of the proxy statement, and secondly, the
15 whole topic, directly related, of shareholder communication
16 and voting integrity.

17 As I mentioned before, all votes are potentially
18 becoming contests. Are votes are becoming more and more
19 important than they were in the '50s and the '60s and the
20 '70s.

21 We've said in letters that we think the process
22 itself is in a pre-scandal stage; that is to say, nothing big
23 and horrible has happened as yet, but it seems inevitable, a
24 statistical probability, that somebody big and horrible will
25 occur when it comes to a really close vote. And there will

1 be so many more really close votes in the future that you
2 need take into account all of the plumbing and whether it's
3 in good shape or not in good shape.

4 And as Amy says, think out of the box. Think about
5 all sorts of radical changes with regard to revamping the
6 system in its entirety to do better as far as voting
7 integrity is concerned.

8 MR. DUNN: Thanks. Paul, you get to go last.

9 PROFESSOR NEUHAUSER: I guess first I'd reiterate
10 that while 14a-8 may have created the precatory proposal, it
11 also creates the binding proposal. That is to say, can you
12 think of proxy fights that were waged outside of 14a-8 to
13 amend the bylaws, or are they done under 14a-8? They're
14 done under 14a-8. It isn't that 14a-8 created precatory
15 proposals. It created a mechanism for any kind of proposal.

16 The second thing would be that the concern, I
17 think, that many proponents would have is that moving it off
18 the proxy statement will mean it will literally be lost. The
19 number of people who may participate in whatever system is
20 set up is likely to be very slight. It will be even slighter
21 if there is no control about what's said.

22 If there is control, you've got free speech
23 problems. You've got SEC authority problems. If the company
24 is running it, you'll have no trust in it. There are all
25 those kinds of things. And as I commented earlier, it seems

1 to me that the availability of a fly swatter rather than an
2 elephant gun is good for the system.

3 The final thing I would comment on is something
4 that went on this morning when we were talking about do you
5 need a million dollars' worth or a million shares or
6 1 percent or anything of the sort like that. Whether \$2,000
7 makes sense or not, the 3 isn't important.

8 But the idea that the smaller shareholder should be
9 able to participate is important. That's certainly our
10 tradition. If you compare that with -- and I've been retired
11 for a couple of years. I haven't talked comparative
12 corporation law for a couple years; maybe things have
13 changed -- but anyway, in France, you need a much higher
14 percentage than the United States. I can't remember offhand
15 what it is. And it is graduated depending on the size of the
16 company. But once you reach that, there are no controls.
17 Anything you want goes in.

18 Even more extreme, in Holland -- and I was involved
19 in this back in the apartheid days with Royal Dutch
20 Shell -- in Holland, 10 percent of the shareholders not only
21 can put in a proposal, they call the meeting. They chair the
22 meeting.

23 It seems to me that when you say, look at our
24 system which says, we're going to protect the smaller
25 shareholder and not give everything to the larger

1 shareholder, is a lot better system than having no controls
2 if you've got \$10 million worth of stock, or no controls if
3 you've got 10 percent and you can replace the chairman with
4 your own chairman to chair that meeting.

5 So it seems to me that one doesn't want to go very
6 far down that road of restricting access to smaller
7 shareholders and putting everything on the larger
8 shareholders.

9 MR. DUNN: On the next panel, actually, we are
10 going to be discussing some U.K. things on that.

11 With about three minutes to go here, I'd like to
12 thank all you all. I've been doing 14a-8s for a long time,
13 and over this long period all of you have been incredibly
14 generous with your time with the staff and incredibly helpful
15 to all of us as we've gone along. And I can't thank you
16 enough. I really appreciate it.

17 With that, I will turn it over to the Chairman to
18 close us out for this one and take our break.

19 CHAIRMAN COX: I thank you very much. I think
20 you've not only done a good job of talking about the
21 non-binding proposals with us, but also bridging to where
22 we're going to be not only in the next panel but the next
23 roundtable, raising a lot of interesting issues.

24 But at least within the four corners of the
25 precatory proposals and non-binding proposals that we've been

1 talking about, you've made it abundantly clear to us that if
2 we're going to rely upon the mechanisms of Rule 14a-8, then
3 we have to first solve the problems of broker voting,
4 over-voting, under-voting, OBOs, and NOBOs. And if we're
5 going to use the power of the Internet to improve shareholder
6 communications, then we have to solve the problem of spam.

7 So we'll take your advice very seriously and see if
8 we can't solve all of these problems. Thanks very much.

9 (A brief recess was taken.)

10 PANEL FOUR

11 BINDING PROPOSALS UNDER THE PROXY RULES

12 MR. DUNN: Okay. At the risk of losing my job for
13 starting without the chairman, we'll give this a go.

14 We're on to our final panel of the day and, for a
15 complete change of pace, we thought we'd talk about
16 shareholder proposals. And I'd like to introduce the
17 panelists to start.

18 Starting from the end, we have Joe Grundfest from
19 Stanford Law School, Jim Hanks, from Venable, who is also an
20 adjunct professor at Cornell and Northwestern, Larry
21 Ribstein, from the University of Illinois College of Law,
22 Bill Underhill, who gets the award from flying all the way
23 here from London today and flying back tonight -- thank you
24 very much for that -- he's with Slaughter and May, and Ann
25 Yerger, who is the executive director of the Council of

1 Institutional Investors. Thank you all very, very much for
2 your time.

3 Our goal here is to be done by 4:45. There's a
4 chance we may wind up a few minutes early as everybody is
5 running out of gas and interest but, to the extent we're
6 still rolling, we'll push through until 4:45.

7 As an introductory matter, it's important to
8 remember under 14a-8 that there are procedural guidelines,
9 you know, who can propose, when you can propose, how long it
10 can be, one proposal, blah, blah, blah. There's also 13
11 subject matter bases upon which a company can say, no, we
12 don't have to include the proposal. The first two of those
13 go to is it legal under state law or appropriate under state
14 law. There is, of course, ordinary business. There is does
15 it relate directly to a dividend. You know, there's a full
16 range of things in there.

17 And so the obvious question is that even those
18 cases where you get past that first hurdle and it would be
19 permitted under state law, if it hits one of the subject
20 matter bases there it still doesn't go in even if you're an
21 eligible shareholder.

22 And so I'd like to start off with Jim and follow up
23 with Ann a little bit, but the first question is, okay, so
24 with that outline as to how 14a-8 works, is there any
25 examples of rights that 14a-8 provides shareholders that they

1 wouldn't have under -- of a right that they wouldn't have
2 under state law absent the existence of 14a-8?

3 MR. HANKS: Are there any proposals --

4 MR. DUNN: Turn your mike on, Jimmy.

5 MR. HANKS: Are there any proposals that 14a-8
6 deals with or permits that would not be available under state
7 law? My answer to that is no. The reason -- but you have to
8 focus on the word available. And I think of shareholder
9 access or the availability of being able to make various
10 proposals in several different ways.

11 First of all, to me, shareholder access means the
12 right to come to the meeting and observe it, say your piece.
13 A second form of shareholder access is coming to the meeting,
14 listening and then deciding how you want to vote. Third is
15 shareholder access in the sense of getting something before
16 the meeting, shareholder access to what happens at the
17 meeting and the advance notice by-laws that virtually every
18 public company that I know of has addressed that subject in
19 detail and, finally, shareholder access in the sense
20 of -- that we've been talking about it a lot here
21 today -- shareholder access to the proxy statement.

22 But just because there may be various clusters of
23 things that a stockholder might want to propose that for one
24 reason or another -- and, you know, we can debate and have
25 been debating the wisdom, policy, logistics, process and

1 otherwise of getting these matters into the proxy statement
2 -- doesn't mean that shareholders aren't able to bring those
3 matters before the stockholders at the annual meeting.

4 And, of course, as Amy and others mentioned
5 earlier, there are lots of ways -- additional ways for
6 stockholders to communicate with each other and with other
7 interested parties.

8 I want to loop back just for a moment in connection
9 with -- referring to advance notice by-laws, which have not
10 been mentioned yet here today, to this question that was
11 debated this morning or at least put out for discussion about
12 whether state law authorizes precatory proposals.

13 I don't think that Maryland is much different from
14 Delaware and other states in this regard, or Massachusetts,
15 as Stan Keller mentioned. I think the answer is,
16 surprisingly, it's unclear. You can look at the relevant
17 statutes, as I have, and in fact they're not just unclear in
18 a way -- and I'm not going to parse them and go through them
19 here. I'd be happy to, upon request, later. They're not
20 only unclear but, in a way, circular.

21 Putting that aside, I think that's largely moot.
22 Why? Because of the advance notice by-law provisions. I
23 think if you look at the typical advance notice by-law
24 provision for stockholder proposals of new business, the
25 companies themselves, in their by-laws, have ceded away that

1 question because the typical language is that a matter may be
2 brought before the annual meeting in only one of three ways
3 and one of them is following the advance notice procedures
4 that then follow in the by-laws.

5 Now, whether companies are going to begin to
6 reexamine that and try to draft to preserve some real or
7 imagined right, I don't know. But I think that question that
8 we were discussing this morning is largely moot because of
9 the advance notice by-laws.

10 MR. DUNN: Now, to turn to the flip side of the
11 question, as I said before, the 13 subject matter
12 exemptions -- one of -- the first one is, is it appropriate
13 under state law. And even if you get past that, there are a
14 number of subject matter exemptions that, if a binding
15 proposal fits within them, the company can choose to exclude
16 it.

17 Given that, I'd like to turn to Ann
18 and -- does -- do your members bump up against that a lot?
19 Is there a true right under state law that -- and we know
20 that, in theory, at least, there is a right under state law
21 they can't practice. Does it really come into play that
22 often?

23 MS. YERGER: Well, let me step back for a second
24 and explain that most Council members do not file shareholder
25 proposals. The minority who do, however, file a great number

1 of them. In fact, by our calculation, they file on average
2 about 45 percent of all corporate governance proposals. So,
3 Marty, you and your staff know my members who are filing
4 these proposals very well.

5 I think -- I called a number of them before I came
6 here, surveyed them on precisely this question and their
7 feeling was by and large that they're really comfortable with
8 the 13 exclusions. They understand what they are and, for
9 the most part, it's not a barricade to them submitting issues
10 that are of keen importance to them.

11 Now, certainly over the years there have been, I
12 think, heated disagreements with how the staff has
13 interpreted the exclusions and I think there have been
14 frustrations about whether certain topics really should not
15 be excludable under any of the 13 items outlined in the
16 federal laws.

17 And certainly, most recently the topic was raised
18 in the AFCSME proposal at AIG and ultimately that was
19 litigated, something that happens, I think, very, very
20 rarely. We, on balance, are very pleased with the outcome of
21 that and where the SEC is on that. I think we agree with
22 where Vice Chancellor Lamb and Vice Chancellor Strine were
23 this morning about, I think, permitting -- having more of an
24 enabling approach on some issues that are of keen importance.

25 I think there is no topic more important to our

1 members than the issue of the process for nominating and
2 electing directors and we feel that's definitely an area that
3 should be permissible under the shareholder proposal rules.

4 MR. DUNN: One follow-up on that before -- I was
5 going to ask the professors a question, but following up on
6 what the panel we just finished was talking about was
7 significant social policy issues and its impact on ordinary
8 business and how that relates to binding proposals and
9 non-binding proposals, for that matter.

10 Any of you who wish to join in here -- does that
11 leave us with the situation under 14a-8 that seems to be a
12 little bit flipped on its head where you wind up with
13 proposals that are very much social issue proposals, you
14 know, sustainability reports, things like that that don't
15 affect the daily operation of the company and those proposals
16 go in and yet the vast majority of shareholders would
17 indicate that they care more about the daily operation of the
18 company and those proposals don't go in.

19 Does that create an odd situation -- I don't know,
20 Jim, you're nodding your head, if you want to jump in.

21 MR. HANKS: Yes, I think it does create an odd
22 situation and I think that your social responsibility
23 exception is ill-conceived and I would urge you to reconsider
24 it if you want to preserve the ordinary business exception.

25 MR. GRUNDFEST: Yeah. I mean, it is yet another

1 paradox in the remarkable panoply of regulations we have at
2 the SEC and at other agencies where there's clearly a
3 situation where if you were to show up on the floor of the
4 shareholder meeting and abide by all of the requirements with
5 regard to notice, you would be able to make a proposal that
6 would go to the heart of the governance mechanism that would
7 otherwise be precluded by the Commission's current
8 interpretation, the staff's current interpretation under
9 14a-8.

10 We also know from the data that generally you get
11 higher turnouts, higher support for governance-related
12 measures and there's also some indication that -- from your
13 research -- that governance-related measures actually make
14 more of a difference, even though they are precatory, with
15 regard to the operation of the corporation than social
16 policy-related initiatives.

17 So if one thinks that the goal of the proxy process
18 is to replicate the mechanism as it exists under state law
19 and simultaneously to assure that shareholders actually have
20 the ability to make the kinds of proposals that the empirical
21 evidence suggests is most important, we have it exactly
22 backwards.

23 MR. DUNN: Okay. Then my job is done here. Larry,
24 I'll go to you next. In our exactly backwards system, in the
25 binding proposal area, how backward is it, i.e., is it doing

1 its job if you read 14a to say that the goal of federal proxy
2 regulations should be fair corporate suffrage and should be
3 to replicate the meeting? Is it succeeding or failing when
4 it comes to binding proposals?

5 MR. RIBSTEIN: Well, I mean, I think you're putting
6 the question correctly. What I want to do is kind of step
7 back a little bit and take my usual professorial kind of
8 50,000-foot perspective. But, you know, the question as to
9 why -- I think it's clear from all the sessions so far
10 today -- and we're sort of cleaning up here -- that the
11 Commission has been making these distinctions based on its
12 view of shareholder power and it's not clear that this view
13 is actually supported by state law. Shareholders seem to
14 have a lot more power to bring these kinds of proposals than
15 would be indicated by the ways 14a-8 has been applied. So
16 there doesn't seem to be this basis in state law for the way
17 the rule has been applied.

18 Then the question is, you know, what is exactly
19 state law on this. It was kind of interesting, last night I
20 was looking at an old chestnut of an article that I
21 used -- that I read many years ago and hadn't read again
22 until last night, the Schwartz & Weiss Georgetown Law Review
23 article from 1977 about shareholder proposals. And they
24 asked the same question; what is state law? They didn't know
25 then and we don't know now. It would be nice if we had a

1 mechanism for getting these things clarified better, I think.

2 Vice Chancellor Strine mentioned this morning why
3 not just let them all through? Why even -- I think he
4 implied why even have the state law -- the exclusion one
5 apply? We just don't make a judgment at all about whether
6 these things would fly under state law. Let them go through
7 and get the state's determination.

8 Then the question is are you going to get some
9 other kind of -- what kind of other screen are you going to
10 have because, obviously, you would need some sort of a
11 screen. And that, I think, depends on what the function of
12 the rule is or should be.

13 We heard a lot of this morning about what the right
14 amount of shareholder power is versus director power. I
15 don't sign on to a particular theory of whether there's a
16 right amount of shareholder power or director power. I think
17 we've got a very dynamic, fluid, evolving kind of corporate
18 structure and we don't want to lock in a particular view of
19 what that structure ought to be.

20 We've also got a way of dealing with these
21 questions which is state law on an evolving dynamic basis and
22 I think that whatever the Commission does, it should maximize
23 the ability of state law to evolve in response to changing
24 circumstances.

25 Now, I notice -- as I was sitting in the audience

1 this morning, I was looking at the eagle behind me and the
2 MCMXXX was -- IV on the date. I noticed that that's a long
3 time ago, you know.

4 We're talking about MMVII today and when you think
5 about what's happened since then, it's an awful lot. And
6 we've heard about a lot of that today. We've heard about
7 shareholder coordination, ISS didn't exist and MCMXXX -- it's
8 late in the day and I don't remember the Latin -- but the ISS
9 didn't exist. We have many social responsibility mechanisms
10 that didn't exist in those days. We've got the Internet,
11 we've got private equity hedge funds and so forth.

12 I guess one -- somebody asked this morning what
13 would we do today about adopting the -- or should we get rid
14 of the proxy rules today. I think one way to sort of ask
15 that question is what if we didn't have the shareholder
16 proposal rule today or what if we didn't have the proxy
17 rules? Would anybody be proposing that we need some
18 mechanism of shareholder coordination given ISS, given mutual
19 funds, all kinds of institutional investors? Would anybody
20 be thinking that shareholders are so weak today that we would
21 need this kind of coordination mechanism? I'm not sure. I
22 don't think it would be high on the agenda.

23 Now, I'm not actually sitting here proposing that
24 we get rid of it. What I'm saying is, given that we have a
25 very dynamic situation, given that we've got a mechanism for

1 dealing with the dynamic evolution of state -- of corporate
2 law, which is state law, I think the SEC should take as
3 modest an approach as possible and that would include, I
4 think, shying away from any kind of merit -- what I would
5 call merit regulation; that is, making substantive judgments
6 about the kinds of proposals that ought to be brought. We've
7 seen some of the problems with applying those 13 exclusions
8 today. And, again, I think there should be some greater
9 mechanism for deferring to state law.

10 MR. HANKS: If I may, one response to Larry's
11 question about where would we be or what would we be doing
12 today if we didn't have the -- if we hadn't had the proxy
13 rules all these years. And my answer is we really don't know
14 because if we hadn't had the proxy rules, we don't know what
15 the state legislators might have done in the interim.

16 I think that there's at least a good plausible
17 argument that if we hadn't had the proxy rules, that state
18 law would have developed more fully insofar as legislating on
19 proxies, forms of proxy, proxy solicitation process, contents
20 of the proxy statement and so forth than it has now.

21 It's really touched only little pieces of that
22 process. You know, there's some stuff about the term of the
23 proxy and some states now legislate that -- on what an
24 interest coupled with the proxy is and there are a couple of
25 other things. You know, we did a few things -- and Delaware

1 has, too -- in Maryland a few years back on authorizing your
2 proxy through the telephone and Internet.

3 But I think that if we hadn't had the proxy rules,
4 this would have been a much more fully developed area of
5 state law. Now, I'm not suggesting going back; I'm simply
6 responding to Larry's question.

7 MR. DUNN: Okay. Ann and Joe both want to go and
8 since I'm going to go out on a limb Ann will be quicker, why
9 don't you go and then Joe will go after.

10 MR. GRUNDFEST: That was safe. That was a short
11 limb.

12 MR. DUNN: It was meant as a compliment, Joe.

13 MS. YERGER: And an insult to me?

14 I guess let me just comment that -- just add some
15 facts here.

16 I mean, I think even if the laws -- even if things
17 change and somehow there is a more permissive environment for
18 binding proposals, I just don't think you'd be getting many
19 of them. I mean, the fact is that 97 percent of the
20 corporate governance resolutions over the past couple of
21 years are filed in a non-binding way and that's because the
22 proponents I think are deliberately in many cases crafting
23 them that way.

24 They use them as a way of dialoguing with
25 companies. It's a way of communicating. It's a market-based

1 tool to get feedback from the market at large and communicate
2 with management. In some cases it's been used to push very
3 broad reform such as accounting for stock options, majority
4 voting for directors, I mean, even auditor independence.
5 This is where proponents or a group of proponents would file
6 hundreds of resolutions on certain topics.

7 I mean, I think that what's happened through
8 precatory proposals has been very profound over the years,
9 has not only changed behavior behind boardroom doors,
10 corporate governance practices at companies but also rules
11 and regulations whether it's at the state level or at the
12 federal level.

13 So, I mean, I know no one here is proposing that we
14 sort of revert to a binding-only sort of regime or somehow go
15 back -- somehow think about what would happen if the states
16 were in charge. I think that the reality is that the
17 proponent community is very relieved that the SEC sits and
18 has the uncomfortable position of being the judge and juror
19 on these resolutions but the fact that you are involved
20 ensures that there is some consistency and uniformity and I
21 think that's very important for investors who are
22 diversified, they've got companies who are incorporated in
23 states all around the country.

24 MR. DUNN: I might be wrong but go ahead, Joe.

25 MR. GRUNDFEST: I'll try to be as brief as I can.

1 With regard to Professor Ribstein's question in
2 terms of where would we be without 14a-8, look at how much
3 power shareholders have today and do they really need a lot
4 more, it's an interesting kind of factual question to ponder
5 because shareholders wouldn't be where they are but for where
6 14a-8 has let them be and we have data to support that.

7 So, in particular, we now have majority vote
8 provisions at more than 50 percent of the S&P 500, whether
9 they're done through Pfizer-type policies or whether they're
10 done through by-law provisions. The situation is
11 extraordinarily unstable, it's rapidly evolving. Directors
12 at these corporations are discovering that they have to
13 become much more responsive to their shareholders once they
14 have these provisions in because the last thing that a
15 director wants is to be targeted with a just vote no campaign
16 aimed directly at that director which brings their level of
17 notoriety in a socially non-positive way very much to the
18 fore. So this is also acting very powerfully behind the
19 scenes to increase shareholder influence.

20 A very recent paper by Randall Thomas and James
21 Cotter, a January 2007 publication, looks at the data with
22 regard to 14a-8 proposals over the last two years and
23 demonstrates that the experience post-2001 -- actually, the
24 last 3 or 4 years -- is extraordinarily different than the
25 experience 2001 and before, extensive data analysis basically

1 showing that there's a greater focus on governance issues now
2 than ever before, there's a significant increase in the
3 percentage of proposal receiving majority support,
4 significant increases in turnouts on a wide number of these
5 governance measures, unions are concentrating their efforts
6 on compensation-related proposals but those proposals are
7 getting, to date, less shareholder support than many of the
8 external governance proposals, and that if you look at the
9 total universe of the 333 proposals they looked at, 33
10 percent of the full sample that received 50 percent of the
11 shareholder vote were fully implemented by the board.

12 But there's a powerful time trend here. In '02,
13 that percentage was 15.4 percent. In '04, it's 50.4 percent.
14 So the probability that a proposal that gets majority
15 approval in the 14a-8 process will actually be adopted by the
16 board, notwithstanding the fact that it's precatory, is
17 triple what it is today than it was in 2002.

18 MR. DUNN: Anybody else want to follow -- Larry,
19 you can follow-up on your own question.

20 MR. RIBSTEIN: Well, actually, I wanted to follow
21 up on something that Ann said and that is I want to make sure
22 to point out that I'm not actually recommending a distinction
23 between binding and non-binding. My point -- one of my
24 points that didn't really come through clearly enough in my
25 initial remarks is that whatever the Commission does is going

1 to -- and I think this is certainly consistent with what Joe
2 just said -- is going to have an effect in channeling
3 proposals, in channeling corporate governance activity.

4 And it's going to have that effect, again, in a
5 very dynamic environment, which is why -- which really is why
6 I suggested that the Commission proceed very carefully and
7 make as few merit kind of based distinctions as possible,
8 because of that channeling effect that whatever the
9 Commission does in a very rapidly-changing dynamic
10 environment.

11 MR. DUNN: The next thing we want to do is -- well,
12 first off, I'm going to apply lessons learned from 20 years
13 of being married and just say to Ann, I'm sorry if I
14 offended.

15 But I'd like to turn it over to Bill next because,
16 believe it or not, the U.S. proxy rules don't cover all
17 jurisdictions in the world and I think Bill has great
18 background with the Company Act and how it goes there and I'd
19 like to turn it over to you for a few minutes to compare
20 first off what the rights are of shareholders under the
21 Company Act and, secondly, give us a little bit of a
22 discussion about how you view the two systems comparably.

23 MR. UNDERHILL: Thanks. Well, if I may, I'm going
24 to take those questions in the reverse order because I think
25 it's important to start with the environment and then get

1 onto the rules. We have rules in this area which are
2 generally much more open than yours. When I say we have
3 rules, we have procedures for shareholders to have access.
4 We don't have nearly so many rules as you seem to. You seem
5 to have a lot of rules governing this area.

6 How is the environment different? First of all, I
7 think, for U.K. corporates, there is a real and actual
8 shareholder democracy in the sense that there is significant
9 power in the hands of a relatively smaller number of
10 institutional shareholders than perhaps you've got over here.
11 So typically for even a large listed company, it may be
12 possible to get to a 50 percent majority of votes with 20 to
13 30 institutions. And so the number of active conversations
14 that management need to have in order to have security on
15 where the voting power really resides is maybe many fewer
16 than over here.

17 And that is against a background, however, that the
18 directors' grip on office is perhaps more tenuous for U.K.
19 companies than it is here. Directors in any company can be
20 removed by a simple ordinary resolution, which is a simple
21 majority of votes cast at the meeting, disregarding votes
22 withheld. That's only votes for and against. You count them
23 up and, if there's a majority, that director will be removed.

24 That, I think, goes hand-in-hand with the same
25 phenomenon that we see in the context of the change of

1 control rules, which I think you have to see as part of the
2 background against which these rules all operate. What
3 drives the way directors relate to shareholders in part
4 depends on what shareholders can do to the directors.

5 Change of control in the U.K., there are no poison
6 pills, there are no defensive measures permitted. The simple
7 50 percent test on a tender offer will get control and there
8 are relatively few restrictions on purchases of shares. So
9 directors live in an environment in the U.K. where they have
10 to keep on board, then, their shareholders. Fortunately, as
11 I've said, it's relatively fewer.

12 It's also worth noting, I think, that there are
13 many more things that U.K. companies have to go to
14 shareholders for, anyway, than U.S. companies do. So, for
15 example -- and I put together a list and I'll be as brief as
16 I can -- changes to the by-laws, the articles, as we call it,
17 but also authorizing directors to allot shares, authorizing
18 directors to allot shares for cash on a non-preemptive basis;
19 authorizing buy-back of shares; major acquisitions and
20 disposals, and that's at a 25 percent level; transactions
21 with directors or substantial shareholders will require
22 shareholder approval; approval of share plans, long-term
23 incentive plans need shareholder approval. Political
24 contributions, as mentioned in the earlier panel, that also
25 anyway requires shareholder approval for U.K. companies.

1 So there's a whole menu of things that shareholders
2 get to vote on in any event. And maybe last but not least,
3 executive compensation. We have this phenomenon of the
4 remuneration report which is a detailed report describing the
5 remuneration policies and remuneration of the executives that
6 has to be put to shareholders at the annual meeting. It's
7 voted on with a merely advisory vote but that's one that
8 shareholders take seriously and management takes seriously
9 and that's been the source of many upsets, in fact, where
10 public companies have found they've had to rework their
11 compensation plans and their bonus schemes in order to meet
12 shareholder pressure.

13 So that's, if you like, most of the background.
14 Perhaps two other things worth mentioning. One is there is
15 also a broad consensus on corporate governance standards for
16 public companies. We have what we called the combined code
17 that dictates certain things such as splitting the chairman
18 and chief executive, requires companies to comply or explain
19 and that generally pushes companies to do what the code says.

20 So, again, the scope for shareholders to need to
21 use these rights is less.

22 And then the final point though, to note, which
23 is -- all of this is against a background where shareholders'
24 access to the courts in order to enforce proper governance
25 and proper standards by their directors is very much less,

1 perhaps, than it is here, that the prospect of class actions
2 is very much diminished, that the ability to bring a
3 derivative action, while that's changing, is still not going
4 to be an open door.

5 So the courts aren't really an answer. All
6 shareholders have is access to general meetings and that's
7 why these rules are particularly important.

8 So if we look at what the rules are, in a U.K.
9 company, any shareholder or shareholders who have 10 percent
10 of the votes can require a general meeting to be held to
11 consider the business that they propose to carry out at that
12 meeting so they can propose resolutions to be put to
13 shareholders at a general meeting. And the board is required
14 to hold that meeting within a relatively short time of being
15 required to do it.

16 Shareholders can also add resolutions to the annual
17 meeting of shareholders, which must be held in each year and
18 to do that, they need to have 5 percent of the votes or to
19 have a hundred shareholders holding a hundred ten thousand
20 pounds nominal capital of shares. What does that translate
21 into these days? Probably 40 to 100,000 shares between the
22 hundred shareholders in order to require a resolution to be
23 put to the annual meeting. So that's a higher threshold, I
24 think, than you have, but it's one that people -- that the
25 institutions find easily manageable.

1 And the final right is to have a statement
2 circulated, either before an annual meeting or a general
3 meeting, that shareholders, again with 5 percent of the votes
4 or the hundred shareholders with 10,000 pounds nominal of
5 capital, can require a resolution.

6 In the case of the right to require a resolution to
7 be put and to have a statement circulated, the Companies Act
8 says that the shareholders can be made to pay the costs but
9 in practice -- recommended practice and most companies don't
10 require additional costs to be paid by the shareholders,
11 particularly not if the requests are received before they
12 have completed the printing and mailing of their notices. So
13 a late request probably would incur a cost but if it gets in
14 on time, it wouldn't.

15 I think the only other thing I would
16 mention -- well, two other things, maybe, to mention at this
17 point. First of all, there is no equivalent of the SEC
18 process in reviewing and controlling this process of what
19 shareholders can do. The board of a company has limited
20 rights to go to court. Currently the law says they can go to
21 court to ask for an order that they don't have to circulate
22 something which they think is giving needless publicity to
23 defamatory material.

24 That right is going to be changed as our laws
25 change later this year but even then it will be necessary to

1 go to court and show abuse of the process. But the
2 courts -- and these go back over a hundred years -- have said
3 that directors don't have to convene meetings or put
4 resolutions if there would be no purpose. So if the
5 resolution would be ineffective, contrary to the by-laws or
6 serve no purpose, then the directors can ignore that request.
7 If the directors ignore it, then the shareholder is put to
8 the expense of going to court to try to enforce those rights.

9 What does all of that mean in practice? I think
10 what it means in practice is that companies and shareholders
11 rub along pretty well together. There has been an increase
12 in the kind of social responsibility precatory resolution is
13 being put not least by U.S. institutions who are trying to
14 use the practice they have over here in the U.K.

15 Those are dealt with relatively easily by
16 companies; there aren't very many of them. They tend to get
17 put. Companies don't look for technicalities to rule them
18 out because that only attracts more adverse publicity and
19 it's generally better to put the resolutions.

20 Examples in the last year for 1st Group and Shell
21 suggest no votes against these kinds of resolutions of the 93
22 percent order, meaning that management are not particularly
23 worried about that kind of resolution being put and
24 shareholders don't tend to go to the bother of putting them.

25 One of the points that Cary made on the other panel

1 is that if there was no control, you'd have 300-page proxy
2 statements. Certainly in the U.K. there is no control but we
3 don't have that and I've been trying to answer the question
4 as to why that might be. And I think it's a combination of
5 all these things. It's the more direct access to the
6 shareholders that control the vote. It's the -- maybe it's a
7 U.K. reticence about institutional shareholders putting their
8 heads above the periphery. But I suspect that institutional
9 shareholders feel they don't need these rules; they have a
10 good enough dialogue with directors that they will get their
11 own way.

12 MR. DUNN: If I could follow up with a couple of
13 things, just drive them home, because you mentioned them.

14 On the cost side -- Don Langevoort referred to it
15 this morning as costs and subsidies of the system. Is the
16 battle over costs ever large? To the extent a shareholder
17 has -- because in our system here, if a company thinks it can
18 exclude -- it has the obligation to -- it has the burden to
19 show that it can exclude, you indicated there that if the
20 company thinks it would be ineffective or invalid if passed,
21 that they can take that position and the mechanism for
22 effecting it is for shareholders to go to court.

23 Has that ever been an issue? Is that something
24 that's pressed or do you think the cost/subsidies thing is
25 not a problem because of the largeness of the shareholders?

1 MR. UNDERHILL: I think directors for U.K.
2 companies are very reluctant -- would be very reluctant to
3 take those steps. Failure to propose a resolution or issue a
4 statement is a criminal offense -- sanctionable by a fine,
5 but it's still a criminal offense, so that concentrates the
6 directors' minds. If they fail to requisition a meeting
7 properly, then the meeting can be convened by the
8 shareholders and then the costs recovered directly from the
9 directors out of their remuneration. That also focuses the
10 directors' minds.

11 So when it comes to taking a fine judgment on a
12 legal point as to whether the resolution is valid and can be
13 put, directors would usually decide to spend the company's
14 money and put the resolution, convene the meeting or
15 circulate the statement rather than take risks themselves.

16 MR. DUNN: The other thing -- and I just -- just to
17 confirm, in a lot of the examples we've seen that you shipped
18 along -- the nature of the shareholder that was forcing an
19 action was, in U.S. terms, very -- I mean, huge. It was 13
20 percent, 18 percent, 22 percent. Is that the more common
21 situation, that you don't have to gather shareholders
22 together to reach that limit?

23 MR. UNDERHILL: I would say so. And these divide
24 the kinds of resolutions that we see and these rules being
25 used in two ways. They can be used by truly activist

1 shareholders who are trying to change the policy of the
2 company or who are trying to change the board. In that case,
3 you would expect to see one, two, maybe three institutions
4 gather together with sufficient voting power to make it into
5 a real issue. They would have had dialogue with the company
6 and failed to get their way and then they would be prepared
7 to, having threatened to require a meeting to be convened or
8 have resolutions put.

9 Then you have the corporate social
10 responsibility-type precatory resolutions where there's
11 enough shareholding power gathered in the ethical funds that
12 can -- they can usually trip the 5 percent limit and they can
13 require those resolutions to be put.

14 MR. DUNN: The last question I want to ask you is
15 in a number of the readings we had that are in -- some of the
16 materials, the readings from the professors today, there's a
17 notion of concern regarding when one or two shareholders are
18 able to force company action or force a vote on something,
19 that there's a concern about a lack of fiduciary duties in
20 that shareholder and the notion of a smaller shareholder
21 effecting its will on others when it doesn't necessarily have
22 a fiduciary duty to do as the board would.

23 If you have an individual shareholder with that
24 kind of potential rights under the U.K. system, do you deal
25 with that situation at all or does custom deal with it or how

1 does that work?

2 MR. UNDERHILL: I think the answer to that is that
3 U.K. shareholders will rally around the board to protect it
4 from a predatory shareholder largely on the basis that that
5 -- they would say to themselves that shareholder wants to
6 have that kind of influence over the conduct and management
7 of the company, ought to be making a takeover offer, ought to
8 be paying a premium, ought to be paying for control and they
9 wouldn't want to see control ceded in that way.

10 I think the other technical element that needs to
11 be borne in mind is that while we would accept mandatory
12 resolutions, the idea that shareholders can dictate what the
13 board will do, that would have to be at the level of a
14 special resolution; that is to say, a three-quarters majority
15 of shareholders voting, the theory being that it's the
16 articles, the by-laws that create the delegation by
17 shareholders to the board, more than the by-laws, and that a
18 special resolution is capable of changing the by-laws,
19 therefore that can change the nature of that delegation.

20 But an ordinary resolution -- and there is decisive
21 authority on this point -- an ordinary resolution will not be
22 sufficient. So a shareholder seeking to influence the policy
23 of the company has got a higher threshold in order to get a
24 change to the articles than he does in order actually to
25 acquire control.

1 MR. DUNN: I can turn it over to anybody else here
2 who wants to answer this. And Joe, you run the litigation
3 database out there at Stanford so maybe you know some of
4 this. How do you think such a -- if -- and this is purely
5 theoretical so I apologize for that but what are the limits
6 we have here in the U.S. that would keep something like that
7 from succeeding or are there any?

8 MR. GRUNDFEST: Oh, my God. To summarize that
9 wonderful summary of British law, as I understand it, there
10 are fewer formal rules and much more shareholder access and
11 interaction. So in other words, you're getting the result
12 that many people in the United States want with a far simpler
13 legal and regulatory mechanism.

14 And I think that there are cultural reasons for
15 that and there are also legal reasons for that. Cultural
16 reasons, you know, my goodness; where would you start? But
17 basically I think there's a level of civility in British
18 society that has been driven out of ours for a wide variety
19 of reasons and on the legal front, you know, litigation is a
20 little bit like the great American pastime.

21 I think it's, you know, ahead of baseball in many
22 ways even though, as a practical matter, you have a look at
23 the data that we keep, the volume of class action securities
24 fraud litigation is down very significantly beginning as of
25 the middle of 2005. So it's a separate debate about why

1 there's less class action securities fraud litigation but
2 it's clear that anybody involved in this kind of an
3 influencing process in the United States opens themselves up
4 to potentially greater litigation risk than is the case in
5 Britain.

6 MR. RIBSTEIN: I just have a very brief kind of
7 reaction to that extensive summary, which is to emphasize the
8 polycentricity -- what I call the polycentricity of the
9 nature of the decision that you have to make -- that the
10 Commission has to make about revising these rules. You can't
11 just adopt a rule from the U.K. and expect that it will work
12 in an extremely different environment.

13 And I think the same kind of polycentricity idea
14 applies to the other -- the rest of the background for
15 whatever you do in terms of broker voting and all kinds of
16 shareholder voting rules, empty voting. That's just the
17 voting rules, the litigation background and so forth,
18 Sarbanes-Oxley. So it's very difficult to determine the
19 effect of a given rule which I think supports -- or is
20 another piece of support for what I was saying before, the
21 need to act carefully and conservatively.

22 MR. HANKS: I think it's worth remembering, too,
23 that as we talk about the rights of shareholders, which we've
24 been doing a lot today -- it's worth remembering that -- and
25 this is not a one-to-one relationship but to a certain

1 extent, as we empower shareholders more and more, there may
2 be, often will be, a diminution or restriction of the board's
3 power. And I think that ought to be recognized and it can be
4 accepted or not.

5 But I think it's important to remember that
6 shareholders do and legally can act in their best interests,
7 in their own personal interests. Save the majority
8 shareholder fiduciary duty concept, shareholders are
9 perfectly free to act in whatever they perceive to be their
10 self-interest. The board is not. Directors are under a duty
11 to act in the best interests of the company.

12 I know my friend Steve Bainbridge disagrees with me
13 about that; he thinks they must act in the best interest of
14 the stockholders. You know, I think the law and opinion has
15 moved beyond that. I think that it's well accepted now in
16 Delaware, in Maryland by statute, which is second to Delaware
17 in a number of New York Stock Exchange companies. We've got
18 it in our statute, the board must act with a reasonable
19 belief that what they're doing is in the best interest of the
20 stockholders.

21 So as we view --

22 CHAIRMAN COX: I'm sorry. To the stockholders or
23 the company? I thought you just made the point that it was
24 the company.

25 MR. HANKS: I'm sorry?

1 CHAIRMAN COX: You said you've got it in Maryland
2 statute --

3 MR. HANKS: Yes.

4 CHAIRMAN COX: -- the board must act in the best
5 interest of?

6 MR. HANKS: Each director must act with a
7 reasonable belief that what he or she is doing is in the best
8 interest of the corporation.

9 CHAIRMAN COX: Of the corporation. Right.

10 MR. HANKS: Right. And, by the way, that duty is
11 an individual duty that applies on a director by director
12 basis, not a collective duty for the board.

13 And so recognizing that -- and, by the way, that's
14 a standard that was taken from the Model Act as well, so all
15 the Model Act states, which is about half the American
16 states, have that.

17 So I think that we need to bear that in mind as we
18 look at and legislate or regulate or allocate power between
19 the shareholders and the directors, that the shareholders are
20 acting for themselves, the directors should be acting for the
21 company.

22 Now, I think a corollary -- I will cheerfully
23 concede that a corollary of that is that if the
24 directors -- given that responsibility of the directors,
25 that's focused on what's in the best interest of the company

1 and when it comes to the director selection process, however,
2 I don't think that that should be necessarily confused with
3 what's in the best interest of the company. And I think the
4 Delaware courts have shown that they understand that with
5 cases like Blasius, et al.

6 CHAIRMAN COX: While we are on the topic, since I
7 think we got a good summary from Mr. Underhill of some of the
8 distinctions between Delaware, Maryland, other U.S. law on
9 the one hand and the U.K. law on the other and the Companies
10 Act, he mentioned that by a simple resolution of the
11 shareholders in the U.K., shareholders can remove a director.
12 Want to describe Maryland law for the removal of a director?
13 It's a pretty elaborate procedure, isn't it?

14 MR. HANKS: I'm sorry, Chairman. I didn't hear
15 your --

16 CHAIRMAN COX: If shareholders want to remove a
17 director --

18 MR. HANKS: Yeah. Right.

19 CHAIRMAN COX: -- how does that work under Maryland
20 law?

21 MR. HANKS: In Maryland? In Maryland, the statute
22 is that directors can remove a director -- shareholders can
23 remove a director at any time with or without cause by the
24 affirmative vote of a majority of the shares entitled to vote
25 generally in the election of directors unless the charter

1 provides otherwise.

2 And the --

3 CHAIRMAN COX: So can they simply propose at an
4 annual meeting to do that by simple resolution and get a
5 majority vote and address --

6 MR. HANKS: Subject to the advance notice by-laws,
7 yes.

8 CHAIRMAN COX: Uh-huh. So actually that is the
9 same, then, as the U.K.

10 MR. HANKS: That would be the same except -- your
11 ordinary resolution -- is that a majority of shares entitled
12 to be cast or majority of shares actually cast?

13 MR. UNDERHILL: It's a majority of shares actually
14 cast.

15 MR. HANKS: So it would be a little bit different,
16 then.

17 MR. GRUNDFEST: And you'll correct me, Mr.
18 Underhill, but I believe that there's no requirement that you
19 wait for the annual meeting; if you had 10 percent of the
20 shareholders you could cause the removal at any time?

21 MR. UNDERHILL: That's correct. You would then use
22 the requisition to require a meeting to be held. That's the
23 10 percent of votes test that you can require --

24 MR. GRUNDFEST: And a further very important
25 difference between the British system and ours -- and again

1 I'm going to defer to Mr. Underhill on matters of British
2 law -- I don't want to be accused of practicing without a
3 license -- the takeover process in Britain is far simpler
4 than it is here. No poison pills, all right, none of this
5 mumbo jumbo. Bottom line, you got a bid, you put it on the
6 table, you make it; it either passes or it fails, all right?

7 So much of the complexity that we have in our
8 system, if you look at the history of the process, really
9 evolves from decisions in the early 1980s where the
10 regulatory process got in the way of the hostile takeover
11 mechanism, where the poison pill was allowed to be adopted
12 without shareholder approval, where the shareholders in
13 effect revolted against that kind of a mechanism and we had a
14 lot of this push and pull.

15 In contrast, Britain never went down that path.
16 British corporations and their directors therefore knew that
17 they had to make peace and work with their shareholders,
18 otherwise they could be ousted fairly easily through the
19 hostile takeover mechanism.

20 We are in this political mess in large part because
21 it's the knock-on effect of us having stifled the hostile
22 takeover market in the early 1980s whereas the British
23 allowed it to evolve in a more civilized manner.

24 MR. UNDERHILL: Can I just say that I'm an observer
25 at this point, I'm not recommending any particular system,

1 before I lose all my friends at the American Bar.

2 MS. YERGER: Well, if I could just note very
3 quickly that I think it's been the power of the precatory
4 proposals that a lot of these impediments have been removed
5 over the past two decades, so I think it's important to note
6 that.

7 MR. HANKS: I think that's historically accurate.
8 I think it's also historically accurate to say that in
9 regards to one of the forms of shareholder access that I
10 referred to at the beginning of the session, that is, the
11 right to come to a meeting, the right to get up and speak, 20
12 years ago, even as recently as 10, 15 years ago, we were
13 talking about various people as corporate gadflies. Well, it
14 turns out that a lot of things that they were beating the
15 drums for in those days are now mainstream.

16 So that form of access I think is an important
17 right that shareholders have and should not be overlooked.

18 MR. DUNN: Commissioner Campos.

19 COMMISSIONER CAMPOS: I just want to explore a
20 little bit, without a big academic lecture -- but I
21 understand the concept of the corporate entity and then
22 directors owing a responsibility to the corporate entity and
23 of course it's obvious to think about other stakeholders like
24 creditors and in particular in a bankruptcy situation where,
25 you know, those stakes are very different than shareholders.

1 But short of a bankruptcy and short of creditor
2 rights, okay, how far removed is that duty from the interest
3 of shareholders in terms of the directors to the corporation
4 to shareholders?

5 MR. HANKS: Well, I think it depends. It depends
6 on what your stockholder base is and what you know about it.
7 If you've got a corporation where there's one shareholder and
8 you're not that shareholder but you're a director, it's kind
9 of easy to figure out --

10 COMMISSIONER CAMPOS: Let's stay with big.

11 MR. HANKS: Okay. I was getting there. I think
12 one reason why the law is, as I believe it to be, that a
13 director has a duty to act in the best interest of the
14 corporation is that with a big corporation, it's impossible
15 to figure out what the interests of the shareholders are.

16 Some may be young shareholders who don't care about
17 income but care about growth that are investing for the long
18 term. Others may be widowers and widows who are elderly and
19 very much income-oriented and don't want to spend a lot of
20 money on research and development.

21 COMMISSIONER CAMPOS: When wouldn't long-term
22 returns be the predominant interest of shareholders?

23 MR. HANKS: Well, the example I just gave. With
24 elderly shareholders whose life span is not that great, who
25 are more income oriented and short term oriented, they might

1 like to see a lot of things like R&D and other things not
2 done to maximize their dividends.

3 And it's not just a contest between shareholders
4 with different interest. Even the --

5 COMMISSIONER CAMPOS: Well, how does the -- then
6 tell me how you break -- how you make that analysis, okay?
7 If you can't figure out what shareholders want, how can you
8 figure out what the corporation wants?

9 MR. HANKS: That's where the board comes in. And
10 the Delaware courts in Time Warner have said it's the duty of
11 the board, the right and power and duty of the board to
12 determine what the investment horizon over which the
13 corporation is going to be operated should be.

14 So that's up to them to work that out. And they
15 may look --

16 COMMISSIONER CAMPOS: And then if 50 percent of the
17 shareholders disagree with the board?

18 MR. HANKS: They vote out that board or they turn
19 down whatever charter amendment or merger --

20 COMMISSIONER CAMPOS: It seems to be converging to
21 me but I'm trying to find the distinctions that you're
22 making.

23 MR. HANKS: Well, at some level it should converge
24 but only I think in an abstract sort of way assuming you had
25 all the information that you could possibly get, which you

1 can never get, about all the shareholders and all of their
2 interests and, by the way, even if you could get that, those
3 shareholders are changing. The shareholders of Microsoft at
4 the close of the market today are a different group than at
5 the opening of the market today.

6 COMMISSIONER CAMPOS: But they can vote.

7 MR. HANKS: But they can vote. That's right.

8 MR. DUNN: Larry, do you want to jump in here?

9 MR. RIBSTEIN: Yeah. I know Commissioner Campos
10 doesn't want a long professorial lecture so I'll give a
11 really -- two really short responses because I've actually
12 done a fair amount of research on that issue.

13 It's basically -- the provision that Jim is
14 referring to is basically a statement of the business
15 judgment rule which is that we're going to leave it up to the
16 directors' judgment. I think the question is very
17 appropriate in the current context because -- and I've been
18 talking about the polycentricity of the rules that you're
19 considering and fiduciary duties are part of the context.

20 And we do leave a lot of judgment up to the boards,
21 which suggests that we need other kinds of constraints and I
22 think it really all boils down to what is the best set of
23 devices for constraining agency costs for constraining the
24 directors.

25 MR. DUNN: One thing I was reading in a piece that

1 Don Langevoort wrote is -- and it ties into what we're doing
2 here -- a lot of what we're talking about here is the primacy
3 of state law and Steve Lamb referred to it as the state law
4 laboratory this morning and whether that was functioning.

5 In Don's piece he referred to that as a theory but
6 he viewed it not as a true laboratory because Delaware had
7 one and that he viewed it as a monopoly instead of
8 competition for corporate charters.

9 Any of you all up here -- how -- would you agree or
10 disagree with Don?

11 MR. RIBSTEIN: I guess I would disagree. I mean, I
12 think there's a lot of different ways to characterize the
13 competition. It's been characterized by several commentators
14 as a national competition with one dominant player, which is
15 Delaware, and then 49 individual competitions where states, a
16 lot of them adopting the Model Business Corporation Act, are
17 competing to keep their corporations at home. So Delaware
18 does not have -- it has a large chunk of the national market
19 but it doesn't have that large a chunk of the state market.

20 And as Roberta Romano has asked in several
21 articles, we don't know what an optimal competitive market
22 would look like, so -- and we would need to know to decide
23 whether what we have is sub-optimal. Unless we know that, we
24 can look at general theory and the idea that competition is
25 often better than no competition.

1 MR. DUNN: Let me go Joe and then Jim.

2 MR. GRUNDFEST: Marty, it's not at all clear to me
3 that the state is the appropriate level of analysis if we're
4 going to be looking at the question of experimentation. It
5 may well be that the more vibrant level is really at the
6 corporate level itself.

7 If you really believe in corporate democracy, then
8 doesn't it inevitably follow that we can look to the
9 shareholders of the corporation and the corporation itself to
10 set the rules by which it wants to govern access to the
11 corporations own proxy?

12 And even if you have two corporations, both of
13 which are chartered in Delaware, their individual
14 circumstances can differ in very, very dramatic ways and it
15 could well be the case that the optimal rules of proxy access
16 for one corporation are very different than the optimal rules
17 of proxy for another and clearly different than a national
18 standard set by the Securities and Exchange Commission which
19 also as a practical matter requires content regulation by the
20 staff under 14a-8 and also compels speech on matters that are
21 very close to political, which is not necessarily the
22 healthiest business for our government to be in.

23 So if you combine all of these different vectors, I
24 wonder if the time isn't ripe for the Commission seriously to
25 consider some form of devolution of authority, not

1 necessarily to the states but to the individual corporations
2 which would then operate under appropriate state law and
3 which would allow a much more interesting and vibrant form of
4 tailoring of governance mechanisms to individual situations.

5 MR. HANKS: I think that characteristically for Joe
6 that's a very interesting and provocative idea. And to get
7 back, Marty, to your question, I think that the competition
8 for state law legislation, state to state to state, is still
9 very much alive and well. I agree with what Larry said and
10 we need to look no further than just a few weeks ago when the
11 North Dakota legislature passed something called the North
12 Dakota Publicly Traded Corporations Act, which -- and I
13 haven't really studied it but if I understand it correctly,
14 after having just gone through it a couple of times, it's
15 basically a public company supplement to the North Dakota
16 General Corporation law.

17 Now, that's a very interesting idea. You have to
18 be a North Dakota corporation to opt into this public company
19 Act, which is a separate Act. But, as I say, I think it
20 functions basically as a public company supplement to their
21 law. Now, whether there are going to be institutional
22 shareholders who start beating the drums for corporations to
23 re-form -- reincorporate to North Dakota or not, we'll see.

24 I think there are a couple of big problems with the
25 statute. One is, again, if I read it correctly, it's an all

1 or nothing proposition. You're either all the way in it or
2 all the way out of it, with a couple of exceptions. So that
3 means you can't have a class of five board, you can basically
4 not have any significant advance notice provisions, all these
5 various things, and I think that's a weakness.

6 And the other is -- and I'm a little bit surprised
7 that they didn't do this -- the other is they make no
8 provision for any attempt to replicate the Delaware Chancery
9 Court. So, you know, it's a wonderful statute if you look at
10 things from that perspective but it's missing the Delaware
11 Chancery Court or the equivalent of a really excellent state
12 business court.

13 MR. DUNN: If I could ask one last question before
14 we get to closing statements here.

15 When the shareholder proposal rule was first
16 adopted in 1942, I guess, it merely said any proposal that
17 was -- I'm sorry, Paul. I'll get to you. I'm sorry. I
18 didn't see that before I started.

19 Any proposal that was appropriate for shareholder
20 vote was -- shareholder action was the standard. And then,
21 as always happens, everybody is like, well, put more meat on
22 that bone, give us more certainty, give us more certainty.
23 And so you wind up with the rule we have now which has
24 basically the first test which is, is it appropriate under
25 state law and then is it ordinary business, which would seem

1 to be the parameters of what was intended in 1942, and then
2 you've got 11 other things that have added on as we've gotten
3 smarter over the years.

4 The question I have for you all very quickly is is
5 that an improvement? Would it be better to go back to the
6 basic test and say if it's legal under state law it's fine or
7 have we gotten the better of it as we've gone along?

8 We'll start with Larry.

9 MR. RIBSTEIN: Well, as I said earlier, I'd even go
10 further back and have some sort of economic test -- and I'm
11 not sure what that would be, possibly a shareholding test,
12 possibly something like what Roberta Romano has suggested in
13 terms of looking at revealed preferences of shareholders in
14 their votes on previous proposals, but I'm not sure I would
15 retain any kind of merit standard which includes a Commission
16 judgment on whether it's consistent with state law. So I'd
17 even take out or consider taking out even that criteria.

18 MR. DUNN: Similar to what Leo was speaking about
19 this morning. Ann?

20 MS. YERGER: Well, I will comment. Certainly, my
21 members would say open the doors, we're happy to have the
22 rules as loose as possible. But I do think they're
23 comfortable, by and large, with those 13 exclusions. They
24 weren't comfortable with where the SEC was on access
25 proposals and they were very pleased with that change.

1 COMMISSIONER ATKINS: Yeah. I wanted to -- you
2 referred to Professor Langevoort. I wanted to also alert to
3 him as well when earlier he was talking about a large part of
4 14a-8 being a subsidization of, you know, some views versus
5 others. So, in effect, I guess the many pay for the views of
6 the few being put to the shareholders.

7 So I was just curious when Ann and others are
8 talking about how the whole precatory proposal aspect helps
9 to incubate some of these corporate governance changes,
10 that's only one aspect of the precatory proposal that we've
11 seen, I'd say probably a minor aspect of it. We have all
12 sorts of other -- under the social important issue exception
13 we have lots of other things coming in.

14 So I was just interested in exploring if we would
15 change things because a lot of these corporate governance
16 things could be done through by-law proposals and whatnot and
17 how that might change if we started focusing on the precatory
18 proposal aspect to either restrict it in some way or change
19 the parameters.

20 MS. YERGER: Well, I'm not certain if what you're
21 asking is, you know, if there'd be a shift more to a
22 binding-only kind of regime, so why don't I try to tackle
23 that question? I'm not going to comment on social -- I mean,
24 the Council really focuses on corporate governance issues so
25 I just don't have much experience in the socially oriented

1 resolutions. That would be a question more for Paul
2 Neuhauser.

3 But I do think that our members would have a great
4 deal of concern if there was a movement strictly to a
5 binding-only kind of regime for shareowner proposals and I
6 think that -- a few of the reasons I mentioned earlier. The
7 first is that, you know, these are used for dialogue and I
8 think there's a perception that a binding proposal is more of
9 a stick and it doesn't help communication.

10 I think also, by their very nature, binding by-laws
11 are prescriptive and in many cases our members don't want to
12 be overly prescriptive. And certainly I think majority
13 voting for directors is one area where, even though Delaware
14 now explicitly allows owners to be filing by-laws, that most
15 of those proposals are not filed in a binding capacity.

16 I also think there's some practical issues to
17 consider and that is that the 500-word limit, quite frankly,
18 is very challenging for proponents to craft a by-law with all
19 its nuances and really work through those issues and then to
20 file a meaningful supporting statement. I think that needs
21 to be considered also.

22 And I think, finally, a big hurdle, to a certain
23 extent, is that many companies have super majority voting
24 requirements to amend the by-laws so that we're not even
25 talking about a majority of outstanding votes. Even as

1 opposed to a majority of votes cast, we're talking about
2 companies with, you know, over 75 percent outstanding shares
3 to amend the by-laws. And I think that's such an extreme
4 hurdle that it would really harm, I think, what the whole
5 intent of the proposal process is.

6 MR. DUNN: Larry, did you want to follow-up?

7 MR. RIBSTEIN: Well, I definitely agree with
8 Langevoort's point that any time you have a subsidy it's
9 going to channel things into the subsidized category.
10 So -- and that's one reason why I think that having these
11 merit-based categories is a bad idea.

12 On the other hand, there may be a concern if we
13 move to something like what I'm suggesting of having a
14 substantial shareholding or reveal preference kind of
15 approach, are we going to be slighting the social proposals
16 that used to be filed as non-binding when we had the -- under
17 the current system and I think that's something very
18 important. I'm not sure it was even addressed in the last
19 panel but I do think that the function of the corporation is
20 what's going to be relevant to that.

21 And I think that the function of the corporation is
22 as an economic entity and that concern really is not
23 something that we should be too worried about but that's
24 probably a subject for another panel on another day.

25 MR. DUNN: Joe and then Bill and then we'll wrap

1 up.

2 MR. GRUNDFEST: Can we all recognize that we're
3 really not all that smart? I don't think that we are wise
4 enough to be able to figure out what the right threshold is,
5 how to implement review preference, how to do all of these
6 different things in a way that would be right for every
7 publicly traded corporation in the United States. We're
8 bound by -- whenever we would try to set any one of these
9 rules, especially at the federal level, we're going to make
10 big mistakes. We're going to be over-inclusive, we're going
11 to be under-inclusive, we're going to set the level too high,
12 we're going to set the level too low. We're doomed to
13 failure.

14 My general advice is if you look down a path and
15 you realize that you're doomed to failure, don't go there,
16 okay? The better way to go, it seems to me, is to recognize,
17 again, that if we really do believe that shareholders will
18 intelligently act in their own best interest, why do we not
19 believe that they'll intelligently act in their own best
20 interest with regard to framing a rule for access, whether
21 it's over precatory or non-precatory mechanisms, in a way
22 that best serves that individual corporation?

23 CHAIRMAN COX: I wonder on that point -- I know
24 we're trying to wrap up here. I don't know how much time
25 exactly we do have since it's the last panel but just to tie

1 a few loose ends together with all the assembled expertise
2 that we have here, three things.

3 First, under the U.K. Companies Act, a proposal to
4 nominate directors automatically goes on the company's proxy.
5 Is that right?

6 MR. UNDERHILL: That's correct.

7 CHAIRMAN COX: And likewise with a proposal to
8 remove a director.

9 MR. UNDERHILL: That's correct. If the thresholds
10 are met in each case, that would go on the proxy.

11 CHAIRMAN COX: All right. And at least under
12 Maryland law -- because we have that expertise represented
13 here -- we can do this at an annual meeting through a normal
14 resolution of shareholders and if we meet the advance notice
15 requirements, that could be done certainly in person if
16 present at an annual meeting.

17 What about through the 14a-8 process?

18 MR. HANKS: No, I don't believe that that could be
19 done through the 14a-8 process.

20 CHAIRMAN COX: I mean, it's clearly legal under
21 state law. What is the -- what kicks it out of 14a-8?

22 MR. JOHN WHITE: -- directors --

23 MR. HANKS: -- the election of directors --

24 MR. JOHN WHITE: -- because it relates to the
25 election --

1 MR. HANKS: Yes. Correct. Yes.

2 CHAIRMAN COX: Or, in this case, the removal of a
3 director. And the second question: can companies in the U.K.
4 customize the procedures for precatory proposals or, if you
5 will, proposals to nominate a director or is the Companies
6 Act one size fits all in this respect?

7 MR. UNDERHILL: There is scope for some
8 customization to the extent that for nomination of directors
9 these days a public company's Articles would stipulate a
10 minimum period of notice and information that needs to be
11 provided before that person can be nominated. That doesn't
12 apply to the removal. The removal of directors is a
13 straightforward inviolable statutory right that shareholders
14 casting an ordinary resolution can remove a director.

15 MR. JOHN WHITE: Just to clarify, when you said if
16 you meet the threshold, there is a 5 percent ownership
17 threshold?

18 MR. UNDERHILL: That's the 5 percent or hundred
19 shareholders with 10,000 pounds of nominal capital.

20 CHAIRMAN COX: All right. And third and last, you
21 mentioned that there is a super majority required to amend
22 the by-laws in some if not all cases. How do those
23 boundaries get established?

24 MR. UNDERHILL: That's established by the Companies
25 Act. Again, that is part of the Act and can't be effectively

1 changed.

2 CHAIRMAN COX: So if I want to amend the by-law
3 concerning the election of directors or the procedure for
4 nominating directors, do I need a super majority for that
5 by-law amendment?

6 MR. UNDERHILL: You need the three-quarters
7 majority of shares voting at the meeting to do that. Just in
8 that context, just picking up on one thing that Ann said, we
9 do see what are effectively precatory resolutions put as
10 mandatory resolutions, i.e., with a special resolution. The
11 shareholders putting them don't expect them to be passed
12 because they don't expect to get to the 75 percent level and
13 yet they can lawfully and properly propose a resolution just
14 in case it might.

15 So they can get the resolution on the table even
16 though it's unlikely to be passed. It becomes effectively
17 precatory because if they get a significant vote in favor, it
18 has the same influence as if it were just put as a precatory
19 resolution.

20 CHAIRMAN COX: And then you answered the question
21 about whether you can customize proposal -- customize the
22 procedure for nominating directors. What about customizing
23 the procedure for precatory proposals?

24 MR. UNDERHILL: I guess that you could do that,
25 that you could impose special limits within the Articles of

1 the company. It's not a question I've been asked before and
2 I would suspect it's not a question that has crossed people's
3 minds to --

4 CHAIRMAN COX: Because the practice is people can
5 take them and do them --

6 MR. UNDERHILL: -- simply because everybody is
7 living with the current system.

8 CHAIRMAN COX: But as far as the Companies Act is
9 concerned, that would also fall into the realm of a
10 three-quarters majority of those present voting, right?

11 MR. UNDERHILL: If you were changing the by-laws to
12 do that, you would need a three-quarters majority.

13 MR. DUNN: Okay. We have about 5 or 10 minutes to
14 go so I think we'll start with Joe at that end and everybody
15 give anything you want to leave us with and Ann will get the
16 last word.

17 MR. GRUNDFEST: I think I've basically spoken my
18 piece. I -- what I'd like to do is liberate the staff of the
19 Division of Corporation Finance so you don't have to go
20 through the seasonal process of reviewing these 14a-8
21 proposals. I would hope that all of you would have better
22 things to do with your time than that.

23 I'd like to see greater experimentation. I'd like
24 to see greater individualization and if there really is a
25 belief in the power of the shareholder voice, then let's

1 belly up to the bar and really accept what we believe and let
2 the shareholders and the corporation also decide the rules
3 for access for themselves.

4 MR. HANKS: Well, my closing remarks would be to
5 congratulate the Chairman and the Commissioners and the staff
6 on putting on this conference. I think over the years there
7 may not have been enough cooperation between the Commission
8 and people who are involved with state law, whether it's
9 legislators or state corporate lawyers or state bar
10 associations that are involved with corporate law, and I
11 think this has been a wonderful opportunity to establish or
12 at least enhance that kind of relationship and I hope that
13 will continue.

14 I do have a couple of recommendations for your
15 consideration. First, I think that some thought needs to be
16 given to the issue of record dates, who's entitled to vote
17 at -- not only on stockholder proposals but everything else,
18 but since we've been talking a lot about stockholder
19 proposals, I think that there needs to be some more careful
20 thought about how record dates work, particularly in light of
21 some of the voting issues that have been referred to earlier,
22 empty voting and multiple voting and that sort of thing.

23 And I would also make the comment that the idea of
24 the record date is a pretty old concept, you know, freeze
25 the -- before the record date, you stop transfer and defer

1 the transfer books until you could vote. With modern
2 technology, maybe we don't need record dates so far in
3 advance of the shareholders meeting. Maybe they should be
4 closer to the meeting so that the people who are voting at
5 the meeting are -- more accurately reflect the current group
6 of shareholders.

7 Second, I think that there's a lot of confusion
8 among the corporate bar, among state corporate lawyers, on
9 your view of voting for adjournments of meetings. You've got
10 some unwritten policies that some people know about and some
11 people don't know about and, you know, if you go to the right
12 program and listen to, you know, the right staff members,
13 you'll hear one view or another.

14 Adjournments are becoming an increasingly important
15 thing in governance. Adjournments to win, adjournments for
16 other purposes. If you've got a policy on adjournments or on
17 the use of proxies to vote for adjournment, I think it would
18 be helpful for that to be published in the usual way. And
19 again, I think that's another area, like record dates, where
20 we could work together with state corporate lawyers and
21 develop a best -- if not best practice, a model provision.

22 Third, I would urge you to consider expanding the
23 required disclosure for director nominees and particularly
24 for proponents of director nominees and director proposals.
25 In response to Commissioner Atkins' question, I'm fine on

1 expanding the substantive range of proposals that
2 shareholders can take to the annual meeting and eliminating a
3 number of the exclusions.

4 I would have some de minimus requirements just so
5 we don't get the 300-page proxy statement but at the same
6 time I think that more ought to be known to the shareholders
7 about who the shareholders are who are proposing these things
8 because they may have very, very different interests than
9 other shareholders.

10 Next to finally, I think as was alluded to in
11 earlier panels, there's a lot of work that's got to be done.
12 Again, this is an area where I think federal and state law
13 come together, overlap, should mesh on vote counting and
14 getting it right. It's just amazing to me the things that I
15 read and the things that I hear from the proxy solicitors and
16 others about how this still isn't sorted out in any accurate
17 or reliable way.

18 And finally, again, another issue of federal and
19 state law and that's the availability of shareholder lists.
20 I think a lot more work needs to be done in that area as
21 well. I think there's some confusion. I think some of the
22 state courts are confused, so I would urge you to take a look
23 at that. And that's not an exhaustive list but thank you
24 very much.

25 MR. DUNN: Thanks, Jim. Larry?

1 MR. RIBSTEIN: Well, just very briefly, I'm very
2 much in sync with Joe's comments. I'm not sure that the
3 Commission is ready to repeal 14a-8 so I guess my general
4 perspective is what is the least intrusive way that the
5 Commission can respond to what I think is possibly still a
6 perceived need to provide a subsidy to the shareholders to
7 effectuate shareholder coordination.

8 And, as I've said repeatedly, I don't think that
9 merit-based or actually signing off on the substance of
10 proposals is the way to go. It so happens -- and Steve
11 Bainbridge alluded to this earlier -- I also think there's a
12 First Amendment problem, which I won't get into, but in
13 recognizing the difficulties of where the cutoff is going to
14 be, what kinds of tests ought to be applied, I think that
15 some kind of numerical test reflecting the economic stake or
16 support that the shareholder has is possibly the least
17 intrusive way to go although, frankly, if I ruled the world I
18 might be willing to get rid of the rule.

19 MR .DUNN: Bill?

20 MR. UNDERHILL: Thanks. I think just a couple of
21 things. One, the point already made but I think worth
22 emphasizing that corporate governance systems are complex and
23 plucking one rule from one system and plugging it in another
24 could give rise to any kind of error or something you didn't
25 want. So it's difficult to pick from other systems.

1 The other is a rather more specific response -- and
2 maybe the answer isn't very brief -- but you discussed in the
3 previous panel the idea of this sort of chatroom opportunity
4 for shareholders to exchange views and maybe have votes. In
5 the fear that we may become infected by any such proposal,
6 which is always possible, I think the management that I know
7 at companies who like to think that they have open dialogue
8 with shareholders would find it a huge burden. I think
9 institutional shareholders would find it a huge burden to
10 know on a 24/7, 365 days a year which proposals on these web
11 sites they had to respond to to avoid the vocal minority who
12 are keen to use the web making their views known and having
13 achieving a sort of apparent consensus for things for which
14 there is no support.

15 I would go to the kinds of precatory resolutions
16 that we've seen where we've seen massive institutional voting
17 against them. Whether institutions would be sophisticated
18 enough to pick up those proposals as they emerged through
19 this rather less choate system is questionable. Plus I
20 wonder whether the management time devoted to monitoring them
21 would be worth spending in light of the alternative, which is
22 a 300-page proxy statement with shareholders voting on a
23 complete set of information, everything in one package. It
24 may be not a question you wanted to ask me but I've answered
25 it.

1 MR. DUNN: Ann, bring us home.

2 MS. YERGER: Well, today has reminded me that 14a-8
3 is the rule that everybody loves to hate. But I think that,
4 from our members' perspective, this rule really has worked by
5 and large to date and I think that the outcome of shareholder
6 proposals have been profound changes to corporate governance
7 practices and rules and regulations.

8 I think that our members take comfort in the fact
9 that the SEC staff is playing a role in terms of overseeing
10 these proposals. Of course we would be happy with a much
11 more open-ended rule in terms of allowing more types of
12 proposals. I think very clearly our members feel that
13 resolutions addressing processes for electing directors
14 should be permitted and the SEC rule should not stop that.

15 I think there were interesting ideas today
16 including maybe revisiting Steve's concept of an override
17 where perhaps a group of investors of some total amount of
18 stock could override an SEC decision, perhaps on ordinary
19 business.

20 I think that, finally, the integrity of the process
21 is very important to everyone involved, companies and owners,
22 and I think we're really supportive of the SEC tackling the
23 thorny issues of empty voting, over voting, and we're very
24 eager to see broker voting go away.

25 MR. DUNN: Okay. Well, I'm going to turn it over

1 to John in a second but, before I do, I wanted to thank
2 everyone. I wanted to thank the Chairman of the Commission
3 for letting me be here today and learn all that I learned.
4 I'd like to thank all 20 of our panelists who were here and
5 particularly I'd like to thank you 5. I appreciate it very,
6 very much. Thank you for your time. I know how much effort
7 it was. Thank you.

8 MR. JOHN WHITE: A couple of things. First, I
9 certainly echo all of Marty's thanks. I also wanted to
10 particularly thank three lawyers in corporation finance that
11 have helped Marty and me put today's roundtable together and
12 have it run so smoothly. They're all actually sitting over
13 there on the corner to the Chairman's right.

14 Lily Brown, Tamara Brightwell and Ted Yew. We are
15 certainly very appreciative for all of their help. I should
16 also mention that Tamara and Ted actually led the 14a-8 team
17 this year and got 400 no action letter responses out on time
18 and Marty and I are very appreciative of that as well.

19 Final thing, I hope we'll see all of you on May 24
20 for the next roundtable when we will take up the topic that
21 we've heard mentioned a number of times today in terms of
22 mechanics.

23 With that, Chairman Cox, I'll turn it back to you.

24 CHAIRMAN COX: Thank you, John, very much. Once
25 again, thank you to John White and Marty Dunn for being

1 excellent moderators for all of our four panels today. I
2 want to thank our last panel particularly for helping us if
3 not tie a bow around this then certainly to conclude the
4 discussion today in very, very elegant fashion. I think we
5 had a nice, truly global discussion of all of these issues.
6 In particular, I want to thank Mr. Underhill for traveling on
7 what I understand is an overnight in order to be here for
8 this presentation, gives us a good opportunity to do some
9 comparative law and some comparative policy analysis.

10 This, as John said, is the first of three
11 roundtables so we'll be back at it very, very soon. We'll do
12 this three times this month. The purpose of all three of
13 these roundtables is to elicit comment and ideas just as
14 we've seen today to help us as we fashion rule making that we
15 expect to have ready by early summer in proposed form.

16 It's an important rule making because it involves
17 such fundamental questions about what shareholders get to do
18 and how they get to do it. We're starting, as we did today,
19 with the legal framework. The next roundtable I know is
20 going to be very popular with, if no one else, all of our
21 panelists because everyone wanted to talk about a lot of the
22 proxy mechanics issues. They're vitally important. We
23 recognize that they're very closely connected to what we're
24 talking about here.

25 And in the third roundtable we're going to listen

1 to the stakeholders about what works now and what can be made
2 to work better. So we truly have a broad scale and we're now
3 a third of the way into the first part. We have a lot more
4 to do but you've gotten us off to a really, really excellent
5 beginning.

6 So thank you very much and particularly to all the
7 Commissions. As you've seen, we've had either all five or
8 four of the five commissioners here with us all day long.
9 This is obviously of enormous importance to the Commission as
10 a whole and we hope and expect that our eventual work product
11 will be very much the better for your contribution, so thank
12 you very much.

13 Our meeting is adjourned.

14 (Whereupon, at 4:52 p.m., the meeting was
15 adjourned.)

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