Social Investment Forum

SIF Response to Business Groups' Proxy Access Challenge

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In a petition for review filed in the U.S. Court of Appeals for the District of Columbia Circuit on Sept. 29, the U.S. Chamber of Commerce and Business Roundtable charge that the recently enacted proxy access rule "is arbitrary and capricious, violates the Administrative Procedure Act, and that the SEC failed to properly assess the rule's effects on 'efficiency, competition and capital formation' as required by law." Eugene Scalia and Amy Goodman of Gibson, Dunn, and Crutcher LLP will be counsel to the Chamber and Business Roundtable on this litigation.

The Chamber and the Roundtable argue that in adopting the rule, the U.S. Securities and Exchange Commission (SEC):

> Erred in appraising the costs that proxy access would impose on American corporations, shareholders, and workers at a time our economy can least afford it. For example, the Commission essentially disregarded numerous commenters who explained that the rule will be misused by special interest investors such as labor union pension funds and state pension funds.

SIF response: The proxy access rule the SEC adopted requires companies to include nominees from shareholders proving at least 3 percent ownership for three years, and excluding small-cap companies with less than $75 million in market capitalization. The rule ensures only shareholders with the long-term interests of the company in mind have access. In addition, the rule delays implementation for small-cap companies for the next three years to study whether the rule would prove too onerous for small-cap companies. To comply, larger issuers will need to present qualifying director candidates presented by shareholders along their own slate on the proxy card and allow the candidate to explain her qualifications. This amounts to a few pages at best in proxy statements that often exceed 100 pages and are largely disseminated electronically, making the costs negligible for companies of the size falling under the new rule.

The Chamber and Roundtable also ignore the benefits access will bring, namely greater accountability and oversight. The trade associations paint a bleak picture of special-interest groups purchasing a few shares and whimsically nominating poorly qualified candidates in the name of gaining leverage over companies for aims out of step with the majority of shareholders' interests. This could not be further from the truth. Even the largest public pension funds in the United States hold less than a half of a percent of the shares in any given publicly traded company. It will take several of them to band together to nominate a director, and even then, they can only nominate a number of directors not to exceed 25 percent of the board. To succeed, the nominating groups will have to offer compelling arguments to the majority of shareholders to succeed. Given these tough parameters, proxy access will only be used in circumstances where boards have failed to provide shareholders with the leadership and oversight needed to ensure managements execute strategies in the best interests of all shareholders, not a few disgruntled shareowners.

The recent financial crisis has offered ample evidence that outside perspectives injecting fresh ideas and challenging management are needed on the boards of America's corporations. While having a nominating committee composed entirely of independent directors is a good

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governance practice to ensure a company has a board slate of qualified candidates, this system sometimes fails. Managements at times stack boards with unqualified or overextended board directors that simply rubberstamp management's wishes. Proxy access aims to end this practice. As purported champions of good governance practices, we would hope that the Chamber and Roundtable would, therefore, endorse proxy access and drop their suit.

> Ignored evidence and studies highlighting the adverse consequences of proxy access, including that activist shareholders would use the rule as leverage to further their special interest agendas;

SIF response: Proxy access, as the Chamber and Roundtable point out, has been debated for decades. The SEC and its staff underwent a very thorough survey of research and opinions of the pros and cons of implementing proxy access before acting. The final rule reflects extensive SEC research on ownership norms in the United States and other critical issues related to proxy access, including three public roundtables on the topic since 2003. The SEC published a draft rule on proxy access on June 10, 2009, which received more than 600 public comments, including from SIF and many of its members. For the many studies the Chamber and Roundtable offered pointing to negative consequences for implementing proxy access, there were many more that pointed to benefits. Furthermore, the SEC consulted extensively with other financial markets regulatory bodies around the world that have a long history of overseeing similar proxy access rules with great success.

> Claimed to be empowering shareholders, but actually restricted shareholders' ability to prevent special interest shareholders from triggering costly election contests; and

SIF response: Again, proxy access means access for all types of investors and giving shareowners of all stripes more choices when it comes to board elections. The Chamber and the Roundtable often espouse the merits of free competition, so we would hope that they would welcome a little competition in board elections too.

> Claimed to be effectuating state law rights, but gave short shrift to existing state laws regarding access to the proxy and related principles, including the law in Delaware and the Model Business Corporation Act, and created significant ambiguities regarding the application of federal and state law to the nomination and election process.

SIF response: The SEC rule intends to set a minimum bar for proxy access, and states are still free to experiment with different rules that exceed these minimum requirements. It is difficult for states to offer alternatives in this area, as corporations race to register in the jurisdiction with the fewest requirements. That is one of the reasons today why most U.S. companies continue to register themselves in Delaware.

> The rules would impose unnecessary costs and allow special interest groups to disrupt corporations' focus on long-term sustainable growth at a time when America's economy is unstable. They would force retail shareholders to support special interest campaigns by union and state pension funds, and would divert the energies of directors and managers from other business of the corporation.

SIF response: By requiring a 3 percent threshold and ownership for at least three years, the proxy access rule promulgated by the SEC focuses on the interests of long-term shareholders and sustainable growth. It does not force any retail or other investor to vote in any particular way. In fact, there are more resources than ever for retail investors to leverage to learn about the proxy voting process and to vote their own shares according to their own interests and beliefs. Our community supports the efforts of engaging retail investors and those that represent them further to encourage them to vote their proxies in a thoughtful, independent manner.

The Chamber and the Roundtable label the SEC's proxy access rule as "arbitrary and capricious." This opinion holds no validity. The proxy access rule enacted by the SEC in August is the result of extensive consultations and research by the SEC staff and its commissioners. It also sets a high bar, higher than many investors wanted, to nominate a director, and it proceeds very cautiously in expanding requirements for small issuers.

We believe the case filed by the Chamber and the Roundtable is without merit and unproductive in achieving what is in the best interests of America's companies, shareholders and economy—promoting vibrant capital markets with the right amount of oversight and accountability for corporate executives.