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PROXY ACCESS ROUNDTABLE

Lucian A. Bebchuk and Scott Hirst, Editors

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The Harvard Law School Proxy Access Roundtable

Lucian A. Bebchuk* and Scott Hirst, Editors

Abstract

This paper contains the proceedings of the Proxy Access Roundtable that was held by the Harvard Law School Program on Corporate Governance on October 7, 2009. The Roundtable brought together prominent participants in the debate – representing a range of perspectives and experiences – for a day of discussion on the subject. The day’s first two sessions focused on the question of whether the Securities and Exchange Commission should provide an access regime, or whether it should leave the adoption of access arrangements, if any, to private ordering on a company-by-company basis. The third session focused on how a proxy access regime should be designed, assuming the Securities and Exchange Commission were to adopt such an access regime. The final session went beyond proxy access and focused on whether there are any further changes to the arrangements governing corporate elections that should be considered.

Speakers in the roundtable included Joseph Bachelder (The Bachelder Firm), Michal Barzuza (University of Virginia School of Law), Lucian Bebchuk (Harvard Law School), Robert Clark (Harvard Law School), John Coates (Harvard Law School), Isaac Corré (Eton Park Capital Management L.P.), Steven M. Davidoff (University of Connecticut School of Law), Jay Eisenhofer (Grant & Eisenhofer P.A.), Richard Ferlauto (American Federation of State, County and Municipal Employees [AFSCME]), Abe Friedman (Barclays Global Investors), Byron Georgiou (Of Counsel, Coughlin Stoia Geller Rudman & Robbins LLP), Kayla Gillan (U.S. Securities and Exchange Commission), Jeffrey Gordon (Columbia Law School), Edward Greene (Cleary Gottlieb Steen & Hamilton LLP), Joseph Grundfest (Stanford Law School), Howell Jackson (Harvard Law School), Roy Katzovicz (Pershing Square Capital Management, L.P.), Stephen Lamb (Paul, Weiss, Rifkind, Wharton & Garrison LLP), Mark Lebovitch (Bernstein Litowitz Berger & Grossmann LLP), Lance Lindblom (The Nathan Cummings Foundation), Simon Lorne (Millennium Management LLC), Robert Mendelsohn (formerly of Royal and Sun Alliance Insurance Group), Ted Mirvis (Wachtell, Lipton, Rosen & Katz), James Morphy (Sullivan & Cromwell LLP), Toby Myerson (Paul, Weiss, Rifkind, Wharton & Garrison LLP), Annette Nazareth (Davis Polk & Wardwell LLP), John F. Olson (Georgetown University Law Center), Mark Roe (Harvard Law School), Eric Roiter (Boston University School of Law), Leo Strine (Delaware Chancery Court), Daniel Summerfield (Universities Superannuation Scheme), Greg Taxin (formerly of Glass, Lewis & Co.) and John C. Wilcox (Sodali Ltd).

Key words: Proxy access, Securities and Exchange Commission, shareholder voting, corporate elections, corporate governance, directors, boards.

JEL classification: G3, G38, K2, K22.

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Editor's Note:

This edited transcript seeks to make publicly available the proceedings of the Proxy Access Roundtable that was held at Harvard Law School on October 7, 2009. Editing was done by the participants and the editors, with the aim of retaining the spirit of the Roundtable while ensuring that the message of each participant is clearly and accurately conveyed to readers.

The Roundtable was organized by the Harvard Law School Program on Corporate Governance, and we would like to use this occasion to thank the members of the Program's Advisory Board; they are William Ackman, Peter Atkins, Joseph Bachtelder, Isaac Corré, Jay Eisenhofer, John Finley, Byron Georgiou, Robert Mendelsohn, Theodore Mirvis, Robert Monks, James Morphy, Toby Myerson, Eileen Nugent, Paul Rowe, and Rodman Ward, many of whom participated in the Roundtable. We are also grateful to Professor Robert Clark and Howell Jackson for moderating sessions and to Dean Martha Minow for her encouragement and support. Finally, for her help in organizing the Roundtable, we are grateful to Emily Lewis.

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Session I: Should the SEC Provide a Proxy Access Regime?

Moderator: Robert Clark, Harvard Law School

Lucian Bebchuk: Good morning. Welcome to all of you. I'm Lucian Bebchuk, and the Program for Corporate Governance is delighted to have all of you here. One of the things the Program is trying to do is to facilitate a discourse on issues that are important for policy decisions. The proxy access proposal poses such issues, so we thought it would be natural to have an event about the subject.

As all of you know, Bob Clark is the former Dean of Harvard Law School. He is also the permanent Dean of Corporate Law Scholarship, so we are delighted to have him chair this morning's sessions.

Robert Clark: Thank you, Lucian. Welcome, everyone. It's good to see you here at this roundtable discussion on the proxy access proposals² of the [Securities and Exchange Commission (hereinafter, the SEC)]. What a wonderful time to have this discussion!

We are going to have four sessions today, and just to give you the overview, the first two are supposed to be about the subject of whether there should be an access rule emerging from the SEC, or whether it should be left to private ordering. I know it's a very broad framing of a lot of potential thoughts, but that's what I've been instructed by our leader, Professor Lucian Bebchuk, to say about the rules of our game. The third session, after lunch, which Howell Jackson will chair, will be about if we do have an access rule, what should the mechanics be – things like thresholds, or triggers, or holding requirements, aggregation rules, etc. And then a fourth session on what else ought to be done to reform the shareholder voting process, which is a wide-open closing session. Some of you who are of pragmatic and agnostic bents like myself may find it difficult to keep these categories separate, but let's do our best.

Our format in this first session is very open ended. Basically, after one set of opening remarks by Joe Grundfest, it will be free from there. And the idea is to give everyone a chance to say something. Now, with that, let me introduce Joe Grundfest, who doesn't need any introduction. He's a professor at Stanford Law School, runs a wonderful corporate governance program there, and is a former SEC Commissioner. He's going to talk for up to seven minutes, I am told, about his views on this subject. He

² See Facilitating Shareholder Director Nominations, Exchange Act Release No. 60,089, 74 Fed. Reg. 29,024 (proposed June 18, 2009) (to be codified in various parts of 17 C.F.R.); hereinafter, the "Proposed Rule".

has recently done an article for *The Business Lawyer*³ that I think will be in the issue that has one by Lucian and Scott Hirst⁴, which I imagine takes a different viewpoint. But let's hear from Joe, and then we'll open it up.

Joe Grundfest: Thank you very much, Bob, and thanks very much for the invitation to be here. In light of Bob's theological background, I'd like to begin this conversation with a theological perspective. In theology, the position of strong agnosticism very simply is, "I don't know whether God exists, and neither do you." In corporate governance, the strong proxy access agnostic position is, "I don't know whether proxy access is a good idea or a bad idea at every corporation in America. And if it is a good idea, at some, many or every corporation, I don't know how to structure the access rules for every corporation, and neither do you."

I am a strong proxy access agnostic. And you should be too. By that definition, I am a democrat – lowercase D – when it comes to proxy access. Very interestingly and importantly, that position has very different implications than being a Democrat, uppercase D, although I'm a registered Democrat, uppercase D, as well. So just a few observations about the proxy access debate.

First, if you have a look at the proposed rules and the proposing release, they are so riddled with internal contradictions that if the SEC proceeds with the standards that it's proposed, my prediction is that the rules do not withstand review under the Administrative Procedures Act.⁵ The two major contradictions between the proposing release and the rules are as follows.

Number one – the simplest, most obvious one – the release repeatedly states that the Commission is attempting to replicate state law through the proxy process. Help me out. Can anyone in this room point to any state in the United States that has anything like [Rule] 14a-11⁶ or 14a-8? It doesn't exist. So the SEC says with one hand, we're attempting to do one thing. With the other hand, it's obviously not trying to do that at all. If that isn't the easiest way to get a rule overturned as arbitrary and capricious because it's internally contradictory, I don't know what is.

³ Joseph A. Grundfest, *The SEC's Proposed Proxy Access Rules: Politics, Economics, and the Law*, Rock Center for Corporate Governance at Stanford University Working Paper No. 64, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1491670, forthcoming in *The Business Lawyer*.

⁴ Lucian Bebchuk and Scott Hirst, *Private Ordering And The Proxy Access Debate*, Harvard John M. Olin Discussion Paper No. 653 (2009), forthcoming in *The Business Lawyer* [henceforth, *Private Ordering and the Proxy Access Debate*].

⁵ Administrative Procedure Act, 5 U.S.C § 706(2)(A) (2009).

⁶ See the Proposed Rule, at 29,082; to be codified as 17 C.F.R. 240.14a-11; hereinafter, "14a-11".

Second, there is a more fundamental contradiction embedded in this proposal. In order to believe in proxy access, you have to believe that shareholders are responsible enough and intelligent enough to nominate and vote on directors. I think they are. But if you think that the majority is responsible enough and smart enough to nominate and vote on directors, why are they also not responsible enough and smart enough to set the rules by which they vote? How do you believe in one proposition and not the other? Yet, the SEC says nothing in the entire release about why they believe so much in the intelligence of the shareholders that they're going to prevent the shareholders from deciding how to exercise their own intelligence.

These are only two of the examples of the internal contradictions. I generally believe that mature adults intend the consequences of their actions. I think the SEC intends to try to achieve its result under 14a-11, and it's very easy to come up with a political explanation for why 14a-11 and the asymmetric opt-out rule under [Rule] 14a-8⁷ look the way they do. The answer is, rooted in traditional agency capture politics that we all know from Washington, DC. When the Republicans were in charge, they tried to shut down the governance reform process. I think that was a huge mistake. Today, the Democrats seek to satisfy their traditional constituencies through rules that, I believe, are also mistaken, but from a different direction.

The proposed rules are designed to generate what I call “megaphone externalities” and electoral leverage. The value to some constituencies is not in actually getting directors onto the board – the value is in qualifying to get on the ballot so you're able to pick up the megaphone that comes along with the opportunity to run a candidate for the board. These megaphone externalities are tremendously valuable to state pension funds, to unions, and to a wide variety of other groups that might want to be able to run candidates, for reasons that have nothing to do with shareholder value optimization. It's a perfectly rational strategy for the SEC to attempt to generate benefits for political allies, but here, the Commission is attempting to generate those benefits in a manner that has nothing to do with shareholder value maximization.

The difficulty, however, is that given the current record as developed by the Commission, the only option available for the SEC is to adopt an opt-in approach, not to set default rules that rely on opt-outs. In my view, the SEC has already painted itself into that corner. If the SEC proceeds with the current rulemaking proposal and is overturned or, if it builds a very different record for review, you can imagine a situation in which the SEC sets a default rule subject to opt-out. The question then is how do you go about

⁷ See the Propose Rule, at 29,082; hereinafter, “14a-8”.

setting the optimal default rules? By the way, I think from an academic perspective, opt-in on these facts is much better than opt-out.

But if you wind up going to the suboptimal opt-out approach, how do you set the default rule? This is an important and difficult question, and allow me to suggest that the SEC's powers of introspection, mighty as they are, can't discern the optimal default rule for every corporation in America. And the opt-out also clearly has to be symmetric. It can't be this foolish 14a-8 approach, which relies on asymmetric opt-outs.

So, if we're actually going to have a situation in which the SEC has to divine a default rule that is optimal for corporate America, let me make a radical proposal. Instead of relying on the SEC's powers of introspection, why don't we just ask the shareholders for their views as to the optimal, value-maximizing default rule? Why don't we conduct a scientifically designed, stratified, random sample survey, and try to discern the will of the majority?

When you're lost, it's a good idea to ask for directions. And this is an interesting theme that, I think, comes up again and again in the corporate governance debate when we talk about legislators and regulators trying to establish optimal default rules. In many of these situations, no amount of introspection is going to help the regulator reach the result. Why then don't we do something as simple as ask the shareholders? We may learn that for many corporations, the vast majority of shareholders don't want proxy access of any form. We may learn that for other corporations, the vast majority of shareholders want proxy access, but with a 5%, one-year trigger. We may learn that at other corporations, they want access with a 1%, one-year trigger.

Ask the shareholders. What's the matter with that as a democratic approach? I know that back in the old day, when I was an SEC Commissioner, I wasn't smart enough to be able to figure that out for myself. I'm sure the Commissioners today are much smarter than I was then, but I question whether their powers of introspection are strong enough to allow them to determine the optimal result.

And let me close by again emphasizing that setting a default rule with an opt-out is, in my view, and for reasons explained in my paper, clearly inferior to using an opt-in approach that can be very easily implemented under 14a-8. I think it's an easy answer to a difficult problem.

John Olson: Joe, have you discussed your ideas with any members of the Commission, and; if so, have you had a response?

Joe Grundfest: The short answer is, I have not discussed my ideas with any members of the Commission. The reason why I haven't is, if you have a conversation with a member of the Commission, they've got to put a notice into the record, and the whole bit, and –

Kayla Gillan: Do you want to do that?

Joe Grundfest: I'd prefer not.

John Olson: You filed your article as a comment, though, right?

Joe Grundfest: I filed a comment.

John Olson: So all they have to do is meet with Joe to talk about his comment.

Joe Grundfest: That's right. I just assume that they will read the comment, as well as this longer version of the paper that Lucian was kind enough to provoke me to write. I'll also file it as a comment, and I will assume that they'll read that comment as well. For a variety of reasons, I prefer not to have the administrative record show that I called five different commissioners to talk about an academic writing. Maybe I'm wrong. Maybe I should. But I'm just happy to let my comments speak for themselves.

Robert Clark: Would anyone like to comment on Joe's suggestion about doing a scientific survey of investors' beliefs about the importance or not of proxy access, whether they want it, and in what form they want it? Why not do such a survey?

John Coates: Yes. So, I actually like the survey idea. I think the results would actually be unpredictable, and so, for that reason also, I agree with Joe about the deep uncertainty that we all have approaching the general topic. On the other hand, I have to push back a little bit on one point, which is Joe's suggestion that the SEC can't easily set a default rule. They have, and they are, and they will have to. And regardless of whether they do anything under 14a-11, or if there's anything in 14a-8 implicitly, either the default rule is status quo or not. And there's just as much skepticism I'd bring to that to that as I do to any alternative. There are trends towards greater use of shareholder power in this area. So I don't know whether you can infer anything from that, though it at least suggests that the current default is not a good one.

Joe Grundfest: Should I respond? I'm happy not to respond.

Robert Clark: Why not – yes, why don't you have the same skepticism about the current default situation as about these proposed rules?

Joe Grundfest: Of course, it's true that every rule of law has an embedded default, because no matter where you start, that of course becomes the default. But the charm of an opt-in, fully enabled 14a-8 approach is that it avoids all of the complexity of the SEC trying to figure out where to set that initial starting point. I mean, if you look at the literature on dynamic default rules, there is no reason to believe that there's any collective action problem at all, with regard to getting these sorts of proposals onto ballots. You have over 1,000 shareholder proposals being submitted every year. Getting these proposals onto ballots is so easy even law school professors can do it.

(laughter)

And so, if you look at the literature, it's a straight shot. If shareholders at one corporation want a 5%, one-year rule, they can propose that, they can vote on it, and we can have it. That's democracy.

Leo Strine: I think one way, more reliable than a survey, is to free it up. I don't want to say that I've been talking about this for the entire century, because I have. And we in Delaware have wanted, for a long time, the Commission to end its long standing gag rule, which is a federal gag rule, on the use of 14a-8 for its traditional purpose, which is to facilitate stockholder voice.

For over a quarter of a century, I believe, the Commission itself, as a federal rule, has gagged the ability of people to exercise their state law rights under 14a-8 in the area probably most critical to them, which is election reform. Most people believed that under state law, there was a lot of potency for institutional investors to shape the election process, but institutional investors, frankly, they didn't take their methadone – they're on the 14a-8 stuff. And without 14a-8, they don't make proposals.

And because they couldn't make proposals in this area, you couldn't tell what they could do. And the Commission was also keeping off the ballot anything that was arguably invalid under state law, not something that definitively was. So we asked, free our people. We actually passed a statute that allows people to go way beyond the narrow card. Elections are a process. They're not a card.

I understand that many people are for proxy access. But being for a 5% rule, or a 2% rule, or a 1% rule, or a one-year holding period, or a two-year holding period, or colonoscopy-like exposure to make a proposal, is not being for one rule.

One way to get the survey is free up stockholders right now, fix 14a-8, if we need to tweak it specifically for elections, and let the market begin to show what investors want. That would allow the Commission, in a low cost way, to absorb this, if we need a

good federal default. If people are resisting, we can come back to it. You could free that up right now. The experiment could begin in the next proxy season.

Joe Grundfest: I agree entirely with the Vice Chancellor, and the idea of moving to a survey is, in my view a suboptimal resolution. I think it's entirely unnecessary if we have an opt-in approach. But it is an observation with potentially broader implications in other areas of corporate law, where wherever you do think that you actually want a default rule or need a default rule, how do you go about doing it? Again, an opt-in approach renders the survey totally unnecessary here, and I agree that we should free the Delaware 5,000 – if there are 5,000 Delaware corporations listed and regulated by the SEC.

Jay Eisenhofer: Can I just respond briefly? I think that there's one thing missing from the discussion so far, and that is, the fact that this discussion and debate is not taking place 10 years ago, or 15 years ago. It's taking place after 10 or 15 years of efforts to try to get some type of proxy access enacted.

And had 15 years ago, Joe, the response been, OK, let's put in a system where we can go company-by-company and let's see what develops, that would be one thing. But here, we've spent 15 years trying to get some type of proxy access, including through those means, and have been blocked. And as a result, the question now is, after having had all efforts to enact some type of proxy access frustrated for a good 15 year period, are we now going to enter into a process whereby maybe proxy access will become a reality five years from now? Maybe it will become a reality 10 years from now, at a significant number of corporations. And maybe the answer to that question is, well, that's better than the alternative. But you can't have this debate in a vacuum. This isn't the first day where proxy access has been discussed.

Robert Clark: Jay, may I interpret – I hear you saying something to the effect that this reliance on the private ordering theme that's so strong now among critics of the SEC proposals is a kind of opportunistic, last ditch defensive move?

Jay Eisenhofer: Right, because proponents of proxy access know the extent of the resources that will be necessary to do this on a company by company basis will be tremendous, and will exceed the grasp of the proponents of proxy access, such that within a number of years, there will have been some minimal achievement towards the proxy access regime, and hopefully the political climate will change, and something will happen where proxy access won't even be feasible anymore.

Robert Clark: Of course, that all may be true. But it doesn't necessarily mean the private-ordering-is-better claim is a bad argument on the merits. It seems to me we have to separate the political strategy and the actual merits of arguments here.

James Morphy: I just wanted to note that I don't think frustration is a basis for ruling, and I think you still have to return to the basic point, which is, if I were to suggest that 1% of the people in this room could disrupt the proceeding and cause a vote on whether somebody should be removed from it, we'd think that's ridiculous. If 1% of the electorate could cause Congress to revisit the election of a senator or a Congressman, that would be ridiculous.

And so, the idea that for 7,000 public companies, 1% of the shareholders can cause those companies to incur the cost and distraction of going through this process – and by the way, that cost and distraction is borne by the other 99% of the shareholders.

The fact that it has taken a long time to get here is not an argument, and I return to what was said previously: No one can tell me, and no one in this room can be at all confident, that the way this rule has been prescribed is the optimal structure that should apply to 7,000 companies. It's just not fair.

Robert Clark: Could you elaborate on what you see as the cost of the system?

James Morphy: Well, paying lawyers to work through this thing. It's going to cause an election contest. People don't like to be criticized in public – sitting directors are naturally going to want to defend themselves. There's going to be campaign “fight letters” that will go out, and back and forth, with each criticizing and challenging the other. There's going to be news in the press, with big companies. People are going to worry about being embarrassed. And money is going to be spent on all of those interests, and all of those concerns. And forget the money; the distraction that takes place at the board level, and the time that we spent talking about this and figuring out what's the right thing to do. Don't underestimate the cost of that, which as I said, is borne by the other shareholders.

Richard Ferlauto: I just want to concur with Jay. I think history here is particularly important.

There's a supreme irony, I think we see in the room, that those – my friends from Delaware excluded – who are the most vociferous opponents now of 14a-11 were also the opponents of the 14a-8 rule not three years ago. I remember a very similar gathering, this time at Yale, where we had a similar discussion, and a similar array of sides were taken, basically talking about how 14a-8 would be ruinous to internal corporate governance.

So I think that's an important understanding to take away. And if somebody is going to invoke politics here, I think we have to understand the full view of the way both the Commission and political players have been engaged in the process, and I think that's going to continue to happen, because that's just the reality of the way the world works these days.

More specifically about the idea of a stratified survey, I'm not sure how you'd structure a survey. Does Fidelity have the same vote as a 100 share owner in GE? Is this a survey of the whole population, only of investors, of people who are prospective investors and they would invest in the markets except for their fear of the lack of accountability? So I think there are serious obstacles to say we're going to do a survey. That being said, we've actually done scientifically stratified surveys, and we find 91% of the people think that there is a serious lack of accountability on the part of directors, and that 83% would support an across-the-board proxy access right. So I think that if you want to put this up to a plebiscite, I think we can match you, but I think either side would find methodological problems with doing that.

And then finally, before we get into the core of the debate here, a so-called democratic election process is hard to construe, even if there was an open plebiscite, the way Leo suggests, because of the nature of elections itself. You don't have a unified card, you have the power of the treasury and the incumbents to contact, to solicit, to use the apparatus that they have at hand to structure and manipulate, or at least influence, the outcome of elections, so that if we're going to move towards a private ordering solution, I think what you have to do is take a further step back and talk about how you fairly and democratically – if that's your word; I don't like to use that word, actually, I like to talk about accountability – but how do you democratically establish a private ordering regime that would also work for shareholders?

And I think that's the flaw in Joe's argument you can't have private ordering unless you've got an equal playing field to begin with.

Robert Clark: Any counterarguments?

John Olson: A couple of points. The fact that something has been pending for 15 years and hasn't happened certainly is an indication that there were proponents who were frustrated, but may also be an indication from the political process, which during that 15 years has been led by presidents of different parties, and involved Congresses and SEC chairs and members from different parties, and their majorities, is an idea that doesn't make sense. The fact that it's been 15 years, I think, may actually prove that it's not a good idea.

Richard Ferlauto: But 14a-8 wasn't a good idea three years ago, so what's happened, John?

John Olson: No, I'm talking about proxy access. And actually, in terms of three years ago – I wasn't at Yale three years ago – I happened to be one of those people, unlike some of my colleagues, who thought it was a good idea to let the *AFSCME v. AIG*⁸ decision stand, and to have the SEC accommodate private ordering under Rule 14a-8, even though I recognized that without a federal minimum standard, there could be some chaos, because it creates an opportunity for individual corporations and investors in corporations to work out an accommodation under the pressure of a 14a-8 proposal.

One of the problems – there's a very interesting comment that's gotten very little attention, filed on the 14a-11 proposal by former senior staffers at the SEC led by David Martin, the highly respected former head of the Division of Corporation Finance under Arthur Levitt – who argued that by creating a 14a-11 federal mandatory minimum regime, you would put the staff of the SEC and its no-action process right in the bull's-eye for years to come, in the middle of election contests, as the arbiter of who gets to participate, whether the qualifications are met, what the disclosures are, and then subject, of course, to review by the courts. Is that really a good use of not only resources, but is it smart for the Commission politically, to jump into the middle of that, given the issues it's already facing in terms of its charter and its mission, and the challenges that have been laid at its door with respect to past failures?

I think that's a serious issue which people seem to not be focusing on in this debate between, roughly speaking, certain members of the business community on one side, and by the Chamber of Commerce, which thinks having the federal nose in the corporate governance tent is evil no matter how it happens, and folks on your side, who want to get that nose in the tent one way or the other, and damn the consequences.

There is a middle ground of people who are concerned about something that works, and about the damage it can do to the agency, and frankly, too, to Joe's point, to a meaningful exercise in shareholder participation in governance, by putting this rigid thing in place, which will then be administered by the SEC staff.

Robert Clark: OK. Before I call on the next person, I want to introduce a thought, and invite anyone to comment on it. We heard what I thought was a rather easy to grasp and *prima facie* compelling argument about the costs of an access rule. They will be real – that's my perception, as someone who has served on the boards of various public

⁸ See *American Federation of State, County & Municipal Employees v. American International Group, Inc.*, 462 F.3d 121.

companies. Even if most election candidates don't get elected, there will be huge costs borne by all the shareholders.

I'd like somebody to give a compelling, easily accessible argument about the benefits for shareholder value, in the short or the long term. What are the benefits, and what's the rationale for thinking that the proposal might generate them? And if anyone wants to take a stab at these questions, please go beyond mere words like "accountability."

Edward Greene: I administered this rule for two years when I was the Director of the Division of Corporation Finance. And I want to go back to what John Olson said.

The problem is, the SEC regulates proxy solicitation. So the issue that comes up is, what could shareholders have included in the proxy statement? You could take several approaches. One is, anything they want, subject only to state law. That's the open lottery system. But, as someone pointed out, that imposes costs on shareholders. And so there's some need to create some standards, but those standards are very difficult for the staff to administer. For example, it can't be a personal grievance. Well, how do you know whether it's a personal grievance or it's a legitimate issue to be brought before shareholders?

And it was always thought that because of the subsidization and cost aspect, you didn't want to have a hostile board contest conducted in the company's proxy statement. But the problem is the Staff has not been able to administer rule 14a-8 consistently over the years. And now I think I'm more of the view that we ought to basically have a bit more experimentation, widen the rule to see what shareholders want, because the Staff in the middle – honestly, how does it make these judgments? The language will always be broad, we will always be subject to second guessing. If it's going to be appealed, it can take the Commission's time. And I therefore think we might be better off having it a bit more broad, to have more proposals come forth for a short period of time, and then look at a cost/benefit analysis. I just don't think you can put the Staff into the middle of a lot of these issues, as to what should be in the proxy or not, when you've got a mechanism to find out what shareholders want.

John Coates: So two quick points. One, again, I'm going to counter Joe's original statement, and a little bit more about costs.

If the default had a full outcome – so if 14a-11 applies, the Staff will have to figure out exactly what the content is. But any company, in the following year before it takes effect, can put to their shareholders the right to vote on whether to opt-out

completely of that rule. Then, you have a one-time set of costs. If everybody in the room who is against this idea is right, and very few shareholders actually would want another player in there, it's a one-time cost. And we've now settled Joe's basic questions up front, about what people want.

The second point. You suggested that politics is a little different, that it's tangential in some ways, to the policy question. But I'm going to suggest actually that it's not, because the policy choices that can be made by actual people, like the SEC, Congress, boards of directors, shareholders in thinking about whether to sue, etc., they're all going to be playing out in an environment which is political, and in which people can expect that the financial environment, and the general opinion that people in the country, voters, have of business, will affect the way everybody behaves. And this is really to Jay's point earlier, that part of the reason that three years ago, people had one view, and today, they have a different view about 14a-8, has nothing to do with the merits, and has all to do with the fact that the economy has collapsed, and that people perceive – I think, in some ways, wrongly – that corporate governance has something to do with that. And that can be expected to change. You can't then make a policy choice in the abstract, without taking that reality into account.

Robert Clark: That's like some of the oft-repeated placebo-effect arguments for Sarbanes-Oxley, those saying that even if the new law doesn't make sense, it restores investor confidence, It's important because people think it is.

John Coates: Which is true.

Robert Clark: I know. Actually, there is something to that. It's probably the only good argument for some parts of Sarbanes-Oxley.

Mark Lebovitch: I want to make a comment. Jim talked about cost, talk about 1% or 5%, whatever the trigger is. There are a lot of boards of directors that own less than 1%, and they get to impose the cost of an election on 100% of shareholders. And it's, I think, inherent in Jim's position and concern about costs is, it's just better for corporations to not have contested elections. And that's his core position. And I think the place where I would disagree is to say: do we want a set of rules that allow shareholders who want to nominate their own *bona fide* candidates to do so, recognizing that there is a lot of cost to running a proxy fight and that the gains on any particular contest are not easy to calculate in the near term. And clearly we have the board saying proxy fights are expensive.

John Olson: Could I just suggest – we haven't heard from any of the private equity or hedge fund folks here about what they think of this.

Robert Clark: We will, but I'm going to go with the queue.

Joe Grundfest: Sure, very briefly. Let me address some of the political issues, because I think they're extraordinarily important, and have received insufficient attention in the academic arena.

First observation. I think that this area has been bollocksed up for years, but I also believe that a history of error is not a reason to go ahead and make a new, additional mistake. I've always been in favor of a democratic approach – you know, lowercase D. I've been consistent in my view, and so I don't feel like I've changed my position on this at all.

If you understand what's going on politically, I think a reductionist approach works quite well. Certain constituencies believe that they can win more at the Commission table than they can at the corporate ballot box. They can get a default rule, that will be broader and more pro-activist out of the SEC as currently constituted than would be approved by shareholders after actually having votes at the corporate level.

And it's perfectly legitimate within our political system for constituencies to consider that political calculus, and to decide to push for an anti-democratic rule at the SEC level. That's how special interest politics works. That's how corporations worked the system when the Republicans were in charge of the SEC, and there's nothing wrong or surprising about seeing unions and pension funds working it from the other end now that the Democrats are in charge of the SEC. That's the way the world works, and intellectual integrity has very little to do with that.

Last observation. If Rich's data are correct, and if 83% of shareholders would actually support proxy access, then my political advice to him to embrace the will of the majority. Because if you go in that direction, you will gain a degree of legitimacy for shareholder access that will politically far trump anything that results in the event that the SEC imposes its rule from on-high. It would be a brilliant outcome for the labor movement, and the question that I have is, whether, when you shut the doors to shareholder democracy that really is your political calculus .

Last observation. I, too, would like to get to a proxy access rule quickly. If you go the 14a-11 approach, my bet is that the proposed rule gets stayed on appeal by the D.C. Circuit. It then gets reversed, just like the vast majority of SEC rules are reversed before the D.C. Circuit. It then gets remanded back down, and we're here for another conference in two or three years. In contrast, if you go with the 14a-8 fully enabling approach, it's in, it's done, we're there.

Jay Eisenhofer: Can I answer your question that you [Robert Clark] asked? You asked if proponents of proxy access could provide a basis for why we want proxy access?

I'll just give you a brief answer. I think the fundamental premise behind proxy access is that shareholders do not have sufficient influence over composition of boards of directors, and that proxy access is the mechanism that will help provide that influence, and underlying that premise and argument is the idea that Mark alluded to, which is that it will be a good thing for corporate governance and management of these corporations if shareholders have greater influence over composition of boards of directors. That's the fundamental issue that I think you want to debate, versus the cost.

Robert Clark: I understand that. I just don't know – the underlying premise or idea may be true, it may not be.

Jay Eisenhofer: OK, well, it may not be true. But your question was, what's the argument in favor of it. I believe that's the argument in favor of it, that needs to be balanced against the cost issues.

Stephen Lamb: I just want to respond very quickly to something that John Coates said, which is along the lines that this is the perfect time to use politics because of the current market turmoil, and it just strikes me that it's the perfect explanation for why issues of corporate governance should never be politicized. You can't have decisions of this sort being made in the middle of crises where one group or another has gained ascendancy. We're talking about the entities in our nation that generate wealth, and it seems to me that they deserve the sort of stability that comes from not politicizing questions of their corporate governance.

And the default rule – we are all talking about default rules here – the default rule we have existed under, fundamentally, in the last 100 years, is that issues of corporate governance are governed by state law, not the SEC. And I was in a class last night, Lucian's class, where the point was made repeatedly that proxy access has been around as a proposal since 1942. It isn't 15 years, it's more like 67 years. And that doesn't make it a better idea now than it was then. It doesn't mean there's any more reason now than there was in 1942 or whenever. It doesn't mean it's a good idea, just because it's been around a long time.

Jay Eisenhofer: It doesn't mean a thing, except that debate as to whether or not you want to try an intermediate step needs to be evaluated in light of the fact that people have been trying to push this for a long time. That's the only point that I was making, not –

Stephen Lamb: Well, then, the response to that is that frustration isn't an explanation for why something's worth enacting.

Richard Ferlauto: Yes, it's worth \$11 trillion in shareholder value and social wealth that was destroyed, because the corporations are unaccountable. That needs to be said, up front – that there's a real reason we see this now. And that is because we sued, we threatened to sue, Citigroup seven years ago. We sued AIG to get on the ballot, because the boards of directors were an impediment to change that threatened the economic system.

Stephen Lamb: Excuse me. I think I had the floor, and I'll stop speaking in a minute. I have great respect and admiration for what AFSCME has done, as recorded in your comment. I understand your frustration. You should be as frustrated with the SEC for what they do with 14a-8 as anything else. And now that the SEC has put off 14a-11 for another year, to now say “don't do 14a-8 now”, when it would permit you, next year, in the next proxy season, to make proposals of this nature, I think is wrong.

Robert Clark: Let me introduce another thought, to see if anyone wants to bite: Is there any way to introduce a proxy access rule that would really facilitate a carefully designed empirical study of whether it actually leads to increased shareholder wealth? And shouldn't the SEC be thinking about that? Since we're in a realm of everyone making *a priori* arguments one way or the other, I'd like everyone to mull that suggestion.

Jeffrey Gordon: I have trouble with why this issue matters so much, in the age of electronic voting. I've written an article, which was on the website. I say that in seriousness, because the proxy system that the Commission has, maybe it's not ideal, but it can be made better. What are the real costs? So if the cost is not having to file the pink as opposed to the orange card, folks who really claim to focus on these things, that can't be the reason why you need access to the ballot.

If the reason is that a proxy provides a screen from the liability rules that might otherwise attain, well, that, perhaps, is a serious cost that needs to be addressed. Perhaps it's not a cost. Perhaps the liability rules are important when it comes to who's putting the nomination up or not. But that's a cost that ought to be addressed, but it should be addressed in an up-front way. What should be the disclosure required? And if it's for one group of share owners then it ought to be made across the board; they can always try to smuggle it in through the dint of just putting it on a form of disclosure that it now has achieved.

So I see this as a bit of a side issue from the basic question as to what role should the share owners play, and if there are means available by which they could be asserting much greater governance rights, then that seems to be the current play, why has that occurred?

Lucian Bebchuk: My own view is that we should have a federal access regime, but that we should allow opting-out. This view is developed in an article which, together with Joe Grundfest's article, will be published in the February 2010 issue of *The Business Lawyer*, it's an article that's Scott Hirst and I are co-authoring, and it will be on SSRN soon.

Let me just react to a few of the things that I have heard. To begin, I am delighted to see that so many people who speak on behalf of companies and on behalf of corporate law firms now have seen the light about how good it is to have private ordering by shareholders, and to have shareholders set the rules. If nothing else, this is already a good outcome of the debate on proxy access. And what is interesting, and conceptually puzzling, is that people feel so strongly about facilitating opting out of a default that makes it easier to replace directors when in the past they have not been concerned about shareholders being able to opt out of arrangements making it difficult to replace directors.

Second, it is also ironic that people from the corporate side are now interested in eliciting information about shareholder preferences on the subject and expediting the change in rules that would allow shareholders to place access proposals on the ballot. The reason why shareholders do not have this ability now is not that the SEC has not gotten around to the subject. Rather, in 2007 the SEC adopted – at the urging of companies and corporate law firms – a rule that allows companies to exclude shareholder access proposals.

In the course of writing our paper, Scott Hirst and I went over the SEC file carefully. There are many commentators who now argue that (1) any SEC intervention should be preceded by a period in which shareholders express their preferences on access proposals, and (2) that shareholders should be able to opt out of any SEC-adopted arrangement; but in 2007, when the default was no-access, these commentators opposed facilitating shareholder access proposals and shareholder opting-out into an access arrangement.⁹

Let me turn to the substance of the private ordering question and make three points. First, Joe argued for a scientific poll before an access regime is adopted even as a default. Why is the scientific poll threshold raised only in connection with the consideration of an arrangement that would make it easier to replace directors? We have

various default arrangements in place that make it difficult for shareholders to replace directors, and I have not seen Joe or anyone else questioning these defaults as not having been validated by a poll of shareholder preferences.

Take, for example, the fact that plurality voting remains the default under state law, and shareholders of some companies need to press boards to get majority voting. Why is Joe not bothered by the fact that plurality voting remains the default without a scientific poll establishing that it reflects shareholder preferences? Indeed, with respect to majority voting, there is evidence that there is a widespread consensus among investors that majority voting is superior to plurality voting. I hope that concerns now expressed about having defaults that reflect shareholder preferences would – as they should – lead to reconsideration of the retention of some default arrangements that make it difficult to replace directors and that differ from shareholders’ preferences as expressed in votes on shareholder proposals.

Second, Bob was asking for evidence that access arrangements would likely produce benefits. There is a solid body of empirical evidence in financial economics that “entrenching” arrangements making it difficult to replace directors are associated with lower firm value and worse firm performance. Scott Hirst and I review this evidence in our paper.¹⁰ This body of empirical evidence provides support for moving in the direction of making directors easier to be replaced by –and thus more accountable to – shareholders.

Robert Clark: I think that's the best argument I've heard for doing something: generalizing from the evidence on other mechanisms of entrenchment.

Lucian Bebchuk: The last point I would like to make briefly – and it is also developed in our paper – relates to the choice of defaults. Joe discussed the choice between an opt-in approach under which shareholders can opt into an access arrangement from a no-access default and an opt-out approach under which shareholder can opt out of a default access regime. As I just mentioned, the empirical evidence suggests that an access arrangement would be more likely to serve shareholders than a no-access arrangement in most public companies.¹¹ However, in addition to examining which arrangement would be more likely to serve shareholder interests, public officials should give substantial weight to another consideration – which default would be easier to reverse when it does not serve shareholder interests. The reality in the marketplace is that it's more difficult for shareholders to opt out to another arrangement when the switch is disfavored by directors

⁹ See *Private Ordering and the Proxy Access Debate*, 5.

¹⁰ See *Private Ordering and the Proxy Access Debate*, 7-10.

¹¹ *Id.*

than when it is favored by them. Our paper provides empirical evidence for this asymmetry and explains the reason for it.¹² This asymmetry in reversibility weighs against retaining no-access as the default.

Robert Clark: Good comments, although I thought that last point was supposed to be for session three. Shows you how they all got mixed together.

Abe Friedman: I want to answer the question that you [Robert Clark] originally asked about the benefits. And in so doing, perhaps challenge Joe on his idea that we should all be agnostic about this. Frankly, some of the political discussion I think is just uninteresting - we could spend the whole day talking about politics, but I don't think that's really the point. It seems to me – that the real issue is that shareholders are faced with a situation where they don't currently have much voice in the director nomination process. And that structure is actually OK, from my perspective, speaking as a shareholder and on behalf of shareholders, because in the corporate setting, you don't have the same transparency we do in a public setting, and we can see what's happening inside the boardroom. We don't really see what's missing in that boardroom very easily, and we don't really know what the process looks like in the boardroom. And you give that right up when you invest in a company, in part, because you don't want one competitor to know what another competitor's board is up to, and vice versa. They're not public bodies.

But at the same time, we do know that boards fail. Boards sometimes make really bad decisions, they do things that are counter to shareholder interest, and in certain instances, we actually also know very clearly that boards fail and entrench themselves. Occasionally they refuse to acknowledge their failures, and they refuse to correct those failures. And the result is shareholders having to suffer: Either they have to sell their shares, often at a loss if you have to sell after a failure and you can't correct the situation, or you hold on and are somewhat powerless to deal with it. And so, because boards fail, despite the fact that we, generally speaking, give up this opportunity, this right to nominate directors, in situations of board failure, we should not be agnostic. We should actually want a right to say, "Wait a minute, we need to insert some voices into this boardroom, to actually look out for shareholder interests."

And so, while I think that the 14a-8 option is a good option, and probably at least a good start, the reason that we ought to think about crafting a rule that goes slightly beyond that is because we know of other failures. And there are other triggering mechanisms available to identify those failures. So for example, if shareholders come

¹² See *Private Ordering and the Proxy Access Debate*, 18-23.

together in a particular year and vote overwhelmingly against one or more members of the board, then that, I think, is a signal from shareholders saying that they think that board isn't getting the job done on their behalf. It happens very, very rarely, so we're not talking about this being some kind of massive transformation of the corporate landscape. But when it does happen, it usually happens for a good reason.

And so to develop some kind of a rule that says, where there is a board failure, and we have some trigger that clearly identifies that, we don't have to wait a year for shareholders to come together, create an access regime at that company, and then come back another year later, but we can actually go in and nominate somebody now, or tomorrow, for the next board meeting, is actually a meaningful thing.

Speaking from the shareholder perspective, I don't think we should be agnostic about this, and I also don't think that it's impossible, or it's too difficult, to craft a rule. There are certain things that we can do. Frankly, if you want to go back to politics, which I think is not all that interesting – I'd rather focus on substance – but if you want us to talk about politics, I think we all missed the boat back in 2003, when the SEC came up with triggers. And it was complicated, and everyone thought “oh, this going to be too complicated,” but it wasn't that complicated.

Basically, if shareholders came together, with a Rule 14-a8 kind of solution, and said “we want access next year,” they could have access. Or if shareholders voted substantially against a particular director in one year, then they could have access the next year. And it's just not that complicated, (a), and (b), it's actually the right kind of thinking for when access is relevant.

Joe Grundfest: So back to a simplified version of the 2003 proposal, which we had a great roundtable discussion about then. Thank you, Abe. I take all your points, I think they're all very good. But I also want to reinforce my underlying profound agnosticism by suggesting that even activist hedge funds fail, and shareholders fail. Or, to put it another way, who's the better judge of how to run the company, or who should be in charge? It is, ultimately, an empirical question.

Abe Friedman: But I'm not talking about activist hedge funds, or any particular investors at all. I'm saying it is exceptionally rare for the community of shareholders in a company to come together.

Robert Clark: To perceive failure, and that perception, you think, would often be right? Maybe so. Maybe not.

Abe Friedman: But they're the owners, so at the end of the day, they take the risk if they're wrong.

Byron Georgiou: I'm struck by the vitriol with which this proxy access notion is opposed. The proposed rule only permits shareowners to submit the name for consideration, and that person is only seated on the board if and when the majority of shares are voted in favor of that proposed director. It is simply not that revolutionary an idea.

It appears to me that the opposition comes largely from the regime that we've seen established and dominant for so many years in the corporate world, which is a management-centered regime. Several people have already suggested today that the existence of the financial crisis ought not to be a motivation for any particular action regarding proxy access.

Having just been appointed to the Financial Crisis Inquiry Commission, which will be looking into the causes of the financial crisis over the next 15 months and report to the President and Congress, I have a particular professional interest in this area. What we've seen is a dramatic diminution in value in all institutional investor portfolios. I'm not suggesting that a direct cause and effect relationship can be proven between the disempowerment of shareowners and the management excesses which have contributed to the financial crisis, because I don't profess to be a scholar in this area.

But our retirement savings at the public, private, and employee levels have been diminished. The percentage of earnings of American corporations devoted to management compensation has risen, at the expense of the many other things those earnings could be used for, including dividends to shareholders, purchase of shares on the open market, reserves against the unfortunate circumstances that we sometimes face when these companies have to collapse or be infused by enormous amounts of taxpayer money to keep them alive

A move in the direction of giving shareowners a larger voice in the governance of corporations than they currently have, with a corresponding diminution in the influence of current management, is an experiment well worth trying. There's really very little risk. I spent the weekend reading all the materials that everybody here has submitted in advance of this roundtable, and I was struck by the fact that a relatively short proxy access rule precipitated a response from some of the top legal minds all over the world of 65 pages in a letter that picks at every nit. The letter includes some very sound arguments that the rule should be changed, or ought not to be adopted in that particular form. And clearly, if you have that many excellent private sector lawyers go after almost

anything that's developed by out-gunned public sector lawyers working at the Securities and Exchange Commission doing their best to propose a rule in the public interest, it is no surprise that some deficiencies in the proposed rule will be identified..

I just don't understand why everybody appears to be so fearful of a regime that includes access to the proxy by shareowners, suggesting to me that we very much need to move in that direction, in order to give shareowners, a little more room and time to establish their *bona fides*, to prove that they ought to have a greater say. After all, they provide the capital to America's corporations. People are fearful of institutional investors, but they provide the capital that enables corporations to invest, and their purpose in doing so is to get a return on their investment. These are not crazy people – these are the owners of the corporation. They're not going to put somebody on the board who isn't interested in advancing the interests of the corporation to make money, which is, after all, why we create corporations and why people invest in them.

I have some experience with regard to proxy access in the context of securities litigation, where my firm, over the last five or six years, has had half-a-dozen securities class action settlements with companies which have resulted in proxy access to propose directors by those lead plaintiff shareowners.

I can assure you that in each and every instance, there's a safety valve of some sort, where the nominating committee gets to vet the people that are submitted, or a handful of names are submitted from which the nominating committee chooses. And the reality is that in each instance, the boards of directors have been dramatically improved by the presence of the new shareowner nominated directors, and have embraced those new directors. And I believe, in every single instance, the nominating committees have retained the new directors and put them on the slate to be reelected in subsequent years. So I just don't see why everyone is so fearful of giving a say to the actual owners of the corporation

Robert Clark: Byron, I can't resist saying -- So you don't object to this rule even though it's going to eliminate a very good proxy access give-up that facilitates settlements benefiting your firm? Oh, well. There will be other things.

(laughter)

John Wilcox: I approach this issue from a variety of perspectives, having worked for corporations as a service provider, having worked at TIAA-CREF as the Head of Corporate Governance, and now, working at a company which deals primarily with issuers outside of the U.S. In this country, I'm still an advocate for governance reforms.

Outside of this country, primarily continental Europe and Latin America, I am working on behalf of corporations.

I agree with what Byron just said. I think there's an overreaction to this proposal. When I look at the array of remedies that are available to shareholders, access is not all that aggressive. Shareholders have the right to wage proxy contests for control, which are quite expensive and obviously very aggressive. They can wage short slate campaigns – those are also more aggressive and more expensive. They can have “Just Vote No” campaigns – something that Joe advocated many, many years ago that wasn't really used very much, and is now used much more aggressively. I would put this access rule at a level just below the “Just Vote No” campaigns in terms of aggression, and a little bit higher than Rule 14a-8 shareholder proposals.

In our class yesterday, [Toby Myerson] mentioned that at a recent meeting of shareholders in hedge funds, the question was asked, how many in that room would use access? Not a single hedge fund raised his or her hand. This is not a tool that is of major use to activists. It is, in my view, like so many other governance changes, primarily aimed at changing the behavior of directors in the boardroom. I'll use my favorite quote from Nell Minow, which I used yesterday. She said, “Directors are like subatomic particles; they behave differently when they are being observed.”

This rule is a form of observation. We can have a debate over whether the Commission has drafted an access rule that is right in every detail. This is not the sky falling. This is not something that is going to fundamentally shift the power of the company from management or the board to shareholders. It's not even close to that.

But access is about boards of directors being aware that there is another check that they've got to think about – another way that they can be held accountable for looking after shareholder interests. I think what would actually happen if the rule were in place and a shareholder group initiated the access process: it would lead to dialogue and a compromise candidate would be found who would satisfy both the company and the shareholders. It would probably be done without any kind of confrontation at the meeting, and perhaps not even having a “shareholder designated” nominee on the proxy.

That is the kind of engagement process that we ought to encourage. We ought to be trying to get shareholders and boards of directors of companies to develop more ways to communicate without fighting. The U.S. system is structured around adversarial relations between shareholders and companies. It goes way back to the 1930s, when you needed to be adversarial, because the shareholders were small and powerless, and the companies were huge and economically powerful, and did all kinds of bad things.

Times have changed. The shareholders are now as large as – or larger than – the corporations. They're also agents, they are fiduciaries. The real issue that deserves our attention is the fiduciary responsibilities and the governance of the shareholders themselves. Leo Strine should chime in on this issue. But I really think that institutional shareholders ought to have to look more closely at their governance, at their structure and how they as fiduciaries are looking after the assets that have been entrusted to them by our retirees. We all share blame for what happened in the recent crisis. All these dollars eventually go back to individuals like us, and we all chase performance. We all chase higher and higher rates of return. And that, then, gets reflected at all levels – and ultimately ends up influencing the behavior of the corporation.

How to break this cycle? I recommend the Aspen Institute's recent statement on this, on which even people as diverse as Marty Lipton and I can agree. It looks at the governance of shareholders.

I think we shouldn't be so over reactive on this issue of access. We ought to put it into proper context, and think about the real issue of whether or not it will favorably influence the behavior of directors in the boardroom as a practical matter.

Robert Clark: Spoken very much like a long-serving member of the TIAA-CREF community on this board.

(laughter)

That's the long standing theory of soft activism: Don't worry about these rules, all they do is facilitate dialogue, that's where the real action is, and when there's dialogue mutual understanding and improvement occurs. I've heard it so often that I'm almost beginning to believe it.

(laughter)

Daniel Summerfield: My experience of the UK market leads me to reinforce what John and Byron said, that there's actually nothing to fear from access to the proxy. It never ceases to amaze me whenever I participate in these debates, how polarized, politicized and overly complex the issue has become, where for many of us, it is a non-contentious and rarely-utilized tool. By way of introduction, I work for USS, which is the UK equivalent of TIAA-CREF. and we have global portfolio of companies in many markets.

And I don't think we need further scientific studies. I think the evidence can be drawn from experiences in different markets. If you look at how many times – this goes to Byron and John's point – this tool is actually utilized in, for example, the UK –it is not

evident that it would be as disruptive as the critics claim. Would anyone like to hazard a guess as to how many times access to proxy has been utilized in the last five years?

(Participant): Three?

(Participant): One?

Daniel Summerfield: Six times. It's been used six times in the last five years. And this shareholder right has been in place since 1856.

(laughter)

And how many times do you think a director has been voted off a UK board in the last 5 years? Any ideas?

(Participant): One.

Daniel Summerfield: Once. And, we don't necessarily see this increasing, because –

James Morphy: It's a 10% rule, isn't it?

Daniel Summerfield: For an annual general meeting, you need to have 5% of the issued share capital to file a resolution, and that has to be passed by a majority of shareholders. But in the UK you can also call an extra-ordinary general meeting with 10% of the issued share cap..

But again, you rarely see this come into play, because it goes to John's point. It focuses the mind. If you have that nuclear deterrent of being able to eject a director, or to put forward your own slate of directors, what happens is that companies want to avoid that happening at all costs, and some will, reach out to their shareholders at an early stage to address the issue.

And that has happened recently, in a recent case involving a FTSE 100 company. This company was going to put forward a director who was also a former director of a UK bank. It was quite clear as the AGM was approaching that shareholders would vote against this particular director, because of what happened at the bank. Many shareholders spoke to the company and voiced our concerns. There was no Regulation FD insider dealing or acting in concert issues because directors were in listening mode, and it became clear to the company that there was danger of him being voted off the board.

And what happened was that the board decided that it would be in everyone's interest if he stood down before the AGM. No fuss, no fanfare, no access to the proxy, no shareholder resolutions, no shareholder litigation. It happened because of this nuclear deterrent

So I think the concerns that are being put forward by the critics of access to the proxy are somewhat exaggerated . It's a tool which encourages a real sense of accountability, and which works well in different markets.

(Participant): You're advocating a 5 to 10% threshold?

Daniel Summerfield: Well, I think it's fine at 5%. I think if you look at the shareholder registers in most U.S. companies, it is apparent that the shareholder base has become quite diversified. In the UK, we now have 30% of an average UK FTSE 100 company that is owned by overseas investors. And I think the same is becoming increasingly true of U.S. corporations, where a large proportion of U.S. company shareholders are based overseas.

Robert Clark: Very good observations, although some of you might want to comment on whether the apparent implications are transferable to the U.S., or whether the situation here is importantly different -- because Brits are more polite, the investor composition is different, or the legal culture is different. Who knows? But Daniel offered a very strong opening argument.

Isaac Corré: John Olson asked for someone from the hedge fund community, so I guess I'll say something.

I guess I really come in to the kind of agnostic camp here, and it doesn't strike me that this is going to cause a lot of shareholder proposals, because so much of the costs of doing that have nothing to do with the actual proxy. It's the reputational issues, it's the loss of access to management. There are all sorts of things that happen when you go through this process that I think, are the real costs of it, and the actual kind of mailing, or e-mailing, is just not really a driver of why people don't do it.

So I don't think I can necessarily agree with the parade of horrors that we hear might happen. On the other hand, I don't see the passion for advocating it, either. I do think that directors do entrench themselves, and that's something that ought to be addressed, and shareholders do own the business, and we're shareholders, and we feel that we own these businesses.

But this isn't the barrier to shareholder participation. I think if we were to look abroad for a model that might make more sense, it's actually, I believe in Norway, where if you're a 5% shareholder, the company consults with you on the appointment of directors. Or, at least that's happened to us, so I'm assuming that's the case all the time. And we're told it was part of a formal process.

So you could create a system that gets shareholders involved in that dialogue, or sets that default in a way that maybe makes it easier for shareholders to have the governance conversation. There are folks here from the shareholders meeting who were advocating this very passionately, but I'm skeptical that we're going to see a rash of slates.

So I think there may be ways to sort of skim this problem in a way that is much, much more collaborative, and ultimately gets to a better result.

Mark Roe: Fear and uncertainty sometimes exclude a middle, and the principal “middle” that’s come up in the discussion thus far focuses on 14a-8. I'd like to put other middles on the board. Some should be good places to start, enabling us to get more information about how access should work.

One middle is semi-political. We have three large groups involved – institutional financial investors, management/directors, and the people Joe Grundfest referred to earlier as people looking for a megaphone. Some of the debate has opponents of the rule looking to institutional financial investors, and saying, “Go with us, we don't want a rule because the megaphone investors are going to get that megaphone and that result isn't going to do any good for the corporation and its managers.” And the megaphone investors are the cutting edge of shareholder authority inside the firm.

The debate has the effect of splitting financial investors, asking them to decide which way they're going to go. “Are you going to with the board and the status quo, or are you going to go with the megaphone investors for a new rule for shareholder access?”

Another middle road, or a middle way of to deal with uncertainty, is to start-up with an access rule, but start out with an access *number* that's noticeably higher than what we might think is ideal. An advantage of starting out high is that, if the SEC sets up a bad access structure, if we're wrong, there won't be that many access proposals, we'd get only a few, because the access rule is a hurdle.

And then we get feedback. We find out what goes wrong with the first few access efforts, and if we had a non-political process – maybe we can't do this in the political

world we really live in – we get feedback from what goes wrong, what can work better, and we amend the rule.

Consider the Bankruptcy Code, which I'm holding in my hand because I have to go off soon to teach bankruptcy. We had a massive reconstruction of the Bankruptcy Code in 1978. It was very well done – yet, still, lots of things went wrong. But fortunately not every company in the United States had to go through bankruptcy in 1979 and 1980. So by 1984, we could amend the Bankruptcy Code, fix up the things that we saw going wrong in 1979 to 1983.

So, let's start higher than what the consensus is as to what access should look like. Get feedback, and then see if the rule needs to be altered three years later.

Eric Roiter: I'm at Boston University Law School now, but I was general counsel of Fidelity's mutual fund business for ten years. Picking up on Joe Grundfest's opening remarks, I find myself to be an agnostic, but a reluctant one. I would like to believe, and I think that there are some points in the middle that occur to me that I want to put out there.

One is a sunset provision – I know we're going to talk about ways to implement later today. Put a sunset provision on the rule, say, three years, let's see what happens. Then you have the empirical data. Maybe it's too short a period of time. But that might allow people to reflect on actual experience and draw some empirical findings.

A survey is intriguing, but I think if you did a survey – if you took Fidelity, for example, and said, OK, fund managers, vote on this, they would net each other out, and it would be zero. I mean, there's no unanimity of thought among them. And by the way, I think if you do a survey, it should be equity assets under management.

Another point that I'm not clear on here is whether it might be an alternative to access to management's proxy statement for the SEC to come up with a streamlined, online proxy statement for those who want to put forward, consistent with Delaware law, nominations of directors. In other words, the SEC can say, "We'll come up with a streamlined, single-issue proxy statement for shareholders that you can "distribute" online.

Access to management's proxy statement involves an issue of appropriating corporate assets by one or a few shareholders to put forth a nomination of their own. That issue has been overtaken, or could be overtaken, it seems to me, by technological advances allowing us simply to skip over this question of getting onto the management proxy statement. What's the magic about getting on management's proxy statement? I

acknowledge that there can be real costs that are completely disconnected to the mechanics of getting a proxy statement, but if the issue is, can you use corporate assets, well, I think, you get around that by saying, “OK, come up with your own proxy statement. We'll make it easy for you, we'll adopt a narrow, one-issue online proxy statement that you can do. And of course, you'd be subject to liability rules to the extent you made materially misleading statements or omissions in your proxy statement.”

I have to say, from my exposure to fund managers and senior management over ten years at Fidelity – it might be different at private equity firms and hedge funds – but in the mutual fund world if you get behind the lip-service – fund managers don't really think of their funds as owners of companies. They think of their funds as having a claim on corporate earnings. Running a diversified portfolio held by a mutual fund is akin to being a parent and having 300 children. How much would you really care about each of your 300 children?

(laughter)

You might miss a few weddings. So I suppose these fund managers, if you say they are “owners,” they might pound the table, Rich, really, like you. But when it comes to follow-up, they are likely to say, “I'm too busy.” Part of my job at Fidelity was trying to get them to think about issues like proxy access, or majority voting for directors. And they were often too busy.

So I think when you get past the words, and you look at deeds and actions, I think those actions actually tell you how mutual fund managers view their role as institutional managers of other people's money.

I'm not saying – and I actually don't think – that this reflects a breach of fiduciary duty. Fund managers are running a diversified portfolio. I am sitting next to [Mark Roe] who explained why that is the case in the mutual fund world. The Investment Company Act was adopted so that mutual funds would not exert much influence over, and certainly not dominate, corporate affairs.

So, I know there are different kinds of shareholders, but there's a huge portion of our equity markets that is hardly ever represented in discussions like this – funds that are the non-labor union, non-pension plan, non-state-and-local investment funds. I'm here to report to you that managers of those funds really view their role as different. They view their role, generally, to outperform a benchmark index by overweighting and underweighting the equities that they are allowed to invest in. And that's how they approach their job.

Session II: Should the SEC Provide a Proxy Access Regime? (Continued)

Moderator: Robert Clark, Harvard Law School

Robert Clark: I am very happy now, before we resume our session, to welcome the new Dean of Harvard Law School, Martha Minow. I'll say a few words about her. She's entering her deanship at an interesting time. I thought I had it rough when I became Dean in 1989. HLS was called Beirut-on-the-Charles then, with faculty fighting and so on. There were certain issues that had to be worked out over a few years. But Martha, now, she's in a very different kind of a situation – the financial crisis – which has affected even the Harvard endowment. She's had to pull back. And I must say, my gut instinct, my true reaction is, wow, she's the perfect person for this particular time. I'm sure that sentiment doesn't make her job any easier. But I think we're very fortunate to have her.

She is a graduate of some other law school, I think in New Haven. But she did go to the Education School here, and she clerked for Judge Bazelon on the D.C. Circuit and Thurgood Marshall on the Supreme Court, and then came here in '81. I was on the Appointments Committee, and I thought. "This is someone we really ought to hire!" Why? Well, because as experience has shown, she was actually willing to teach Civil Procedure, an unusual thing.

(laughter)

And unlike other people who do standard things – I teach Corporate Law all the time – she was interested in lots of other exciting stuff. She had her degree in education, she cared about education law, she cared about family law, she cared about non-profit organizations. And she's worked in all of those areas.

And to give you a sense of her multifaceted nature, which is why I think she's great for this law school at this time, I suggest you look at her list of publications. She's a co-editor/author of a casebook on civil procedure; very good, important. But she's also the author of a very interesting book called *Beyond Vengeance and Forgiveness* about dealing with the situation of countries after genocide and other similar traumas. So she's a person who does the work-a-day stuff, but also is very interdisciplinary, which is what we need. Anyway, I'll turn it over to her.

Martha Minow: Thank you. And thank you, Bob. You're the one who convinced me to come here, so I guess I can blame you.

It's just a tremendous pleasure to be here. Some of you know this, and just to take any suspense out of it, yes, Nell Minow is my sister. And if that makes you a friend, I'm delighted. If that makes you now wary of me, I apologize, but I don't agree with her on everything.

This Program, though, is something that I've always believed in. Having a sister, a father, friends and former students who let me know the importance of corporate governance before it hit the pages of *The Wall Street Journal* and *The New York Times*. And I'm just absolutely thrilled that the Program has grown and thrived the way that it has, that the Forum has the presence that it does in the world.

I'm very grateful to all of you for being here for this event. It is a model of what this Program does. It brings together people who are at the cutting edge of practice, the cutting edge of academia, and the cutting edge of policy making. And the question that you're here to address is timely and intriguing. Proxy access reform absolutely is going to happen in one way or another. You all have the opportunity to help shape the discourse. I don't think it's going to happen tomorrow. I think that the transcript of your remarks here can have an absolutely real impact on how people understand the issues, what they think that the challenges are, and what the options are.

I want to take this opportunity to thank the Program's Advisory Board, all terrific people. We're absolutely honored by your time and your participation in the Program. Your participation at this event is an example of the way in which a university can bridge theory and practice, and a law school can bridge theory and practice. Before the current financial crisis that sounded like nice language. At the moment, I think everybody understands that we need to have places in this society where you can stand back from the crush of daily business, and ask, "Are we doing things the right way?"

And at the same time, from the academic point of view, I know that we need to be talking with people constantly about, "does that make any sense?" Sure it's going to work in practice, but is it going to work in theory, is the old joke about the way we operate there. That's not true of the Program on Corporate Governance. This is a Program that models what I think is the best of the academy and, the best of the Harvard Law School because it's the flow of back and forth that I think is very productive. I can't wait to hear what you're going to come up with. I promise I won't tell my sister unless you tell me I can. And again, welcome, and thank you all very much for being here.

I just want to say one thing. I wish I could stay, and I'm going to stay for a minute, but I actually have my own governance problem. I have to go see the President of the University.

Robert Clark: Well let's begin with where we left off.

Joseph Bachtelder: I'm becoming comfortable with the idea of a modified 14a-8. I'm still very uncomfortable with the ideas of 14a-11 and a mandated minimum standard of proxy access.

Following is a statement of where I come from on this. The object of good corporate governance is the profitable operation, short term and long term, of a business enterprise with appropriate attention to the obligations and responsibilities of the enterprise to its constituencies and to the communities of which it is part. The object of corporate governance is not to create a paradigm for democracy.

To the extent proxy access would help that object of corporate governance, as I just stated, fine. But whether to elect to have it as part of a corporate governance program of an individual company should be voluntary as to that company, and its shareholders and not, as we see, in some cases, in response to difficulties that exist due to particular circumstances at the board level and the management level.

From a corporate governance standpoint, I think we can assume that most of the 7,000 companies that would be involved in proxy access are doing OK -- even in their more difficult moments. We are looking at those cases where there is a real problem. And perhaps 14a-8, as modified, gives the opportunity to shareholders in such cases to establish a way of rectifying it. But it should not be a broad-based, and certainly not a mandated corporate governance tool.

In this regard, I ask "what about the board of directors and their voices?" I don't hear them. I know that some, such as Bob Clark and others here, have served on boards of directors. I don't hear the voices of those in the clamor that's going on with regard to proxy access. We should hear from them as well.

Harvard Business School published a working paper in September dealing with interviews with 45 directors of major public corporations, and some of the directors said more government regulations and more imposed processes are not the solution. Some of the observations are summarized in the following paragraph. I quote from the report, not from individual interviews:

"Each board must develop structures, processes and practices that fit the needs of the company and its business. The notion that one size fits all is viewed with extreme skepticism. In essence, there was a strong consensus that the key to successful governance rests in the hands of each board. Specifically, it resides in how directors work together, and with

management, to oversee the company and make decisions. In directors' view, these are matters that cannot be regulated by government."¹³

Boards of directors already face too many interventions – some very complex, and they are from many sources, and they impact extraordinarily on the time of directors in seeking to manage, as supervisors, the corporations that they are directors of.

I would just note one unintended consequence of this could be a disruption of the processes that are involved in the management of a corporation, whether from the standpoint of strategy, compensation, compliance or otherwise. As one who has acted in the field of negotiating executive compensation, I observe the management process a lot - - from the standpoint of one party or the other. In my particular case I have found that over the years when the process is intervened on, whether it is Federal pay controls in the '70s or new tax rules such as parachute taxes or, more recently, the 409A rules on deferred compensation, there can be significant adverse consequences. The more distant the decider of the standard the less likely the standard is going to succeed in the highly complex and sensitive arena of determination of executive compensation.

Once again, among these 7,000 corporations, my experience is that the vast bulk of them are doing a good job. It is not a case that calls for either government intervention, or shareholder intervention, to improve the governance process. And with that, I would conclude by noting, again, after reading the papers and hearing discussion today, I feel much more comfortable with the concepts of a modified 14a-8. But, as also noted, I have problems with 14a-11.

Annette Nazareth: I've traveled this road before. I guess I'm the only person in the room who actually got to vote on this at one point, and I lost. So I would say that I would not count myself in the agnostic category. That would not be appropriate.

I took somewhat seriously the statement displayed in the SEC lobby - 'We are the investors advocate', and I believe that part of being the investor's advocate is working to ensure that shareholders have some say in the companies in which they invest. And my own view is that while there may have been historic reasons, the Commission's continued interpretation of 14a-8 as a means to deny access to proxy by adopting the interpretation that shareholders could not make proposals that related to the election of directors was actually contrary to the SEC's mission. And that Commission view was in fact,

¹³ See Jay W. Lorsch, Joseph L. Bower, Clayton S. Rose, and Suraj Srinivasan, Perspectives from the Boardroom - 2009, Harvard Business School Working Paper (Sept. 2009), available online at <http://www.people.hbs.edu/jlorsch/BoardroomIssues.pdf>, at 2.

influenced by, as was referred to before, not a 15 year, but a multi-decade fight by corporate interests to maintain the status quo. That's basically what happened.

It was particularly indefensible when we saw that the states, as Mr. Strine said, were clarifying that this was permissible under state law. So now you actually had the federal government standing in the way of the exercise of state rights. That's how I viewed the situation.

So I thought it was appropriate to fix the 14a-8 issue. Unfortunately, I think, what's happened now is — because we missed the opportunity in 2007 to act at that time —the advocates of proxy access are now even more impatient and are looking for something that is more hard-coded, frankly than was suggested at that time. And now, the politics have shifted. And there's no question that what we have in 14a-11 is highly prescriptive and in, some cases, difficult to defend, in terms of the applicable thresholds and the significant complexity around how some of it would be applied. Indeed the interpretative work will keep people on this side of the table employed for some time. So that's quite unfortunate.

I also think that as it's currently constituted and given the legal precedent, there will be issues of whether the Commission is exceeding its authority on 14a-11. I worry about people like Joe Grundfest busily studying these issues. Perhaps part of this delay on the Commission's part will also give them time to get Senator Schumer or somebody else in Congress to introduce a bill that will clarify that the SEC has authority to do this, because I don't think there's any question that there will be legal challenges.

I want to comment on another point that was made that I think is going to be critical. Proxy access is really one means by which shareholders are going to be able to let their voices be heard. And I don't think this will necessarily result in chaos in the board room. Proxy access is the shotgun behind the door, the ability to say look, if things are not going well with this company, we are going to be able to exercise our franchise.

But the other thing that's going to help, I believe, is electronic communications in general. I think we have far too little of that, and given all of the advances in electronic communication it is really quite remarkable that the Commission hasn't done more to encourage communications between shareholders and companies and boards. And I think you would have less frustration if there were easier means of communication. I think that's another area where they could really make significant progress.

Toby Myerson: I would just make a couple of rather short observations. In my view the tectonic plates on voting are already shifting. And some of those who are impatient may

have some interesting things to observe in the next proxy season or two – specifically the NYSE’s decision to eliminate discretionary voting by brokers starting with January 2010. It may well produce some interesting results. Well worth the people on our side of the table, Jim [Morphy], and maybe some interesting results on the other side.

Specifically, one of the large proxy solicitor firms with whom we talked recently did a study of the information in their database about the results of the last couple of proxy seasons. And they tried to factor out votes cast as discretionary broker votes and combined that with RiskMetrics’ withhold votes. And the statistics they come up with are quite surprising, both on the large increase in withhold votes, but also finding that their statistic was of the companies they surveyed, votes for directors in that context. Remember, no broker votes and RiskMetrics recommendation against, actually produced 49.3% in favor. The point being, less than a majority.

So the combination of the change in the NYSE rule, and majority voting bylaws, I think, is going to produce some very interesting results for the next season. So for Jay [Eisenhofer], who I know is very impatient, you may not have very long to wait before you see some interesting developments.

The other thing I would just underscore, John Wilcox was referring to a conversation we had on the panel yesterday. This same proxy solicitation firm was chairing a very recent activist investor meeting. And the general counsel of the firm asked for a show of hands in the room among the activist investors – “raise your hand if you or your firm could use 14-a11.” Not a single hand was raised.

The point of the observation really is just to say, 14a-11, I think, has utility for some investors. And let’s not lose sight of the fact that when we talk about investors who are interested in shareholder value, probably no single community is more interested in shareholder value than the hedge fund community. And they would not find this rule to be useful in communicating with the boards of directors and enhancing shareholder value.

So I think, to me, Joe Grundfest’s comments about the big megaphone resonate. I think this is an opportunity to give people a big megaphone in a particular type of constituency, and it seems to be not the right approach at this point.

Robert Clark: I can verify that the issue of the combination of proxy access and discretionary voting is a topic of frequent stories and newsletters sent to boards of directors by the various firms that are trying to get us to hire them. I’m not sure what to

conclude. But it certainly is on a lot of people's minds as they get ready for the next proxy season.

Robert Mendelsohn: I'm one of those people that Joe Bachelder was referring to who actually has been on boards in a number of countries, and also been a chief executive of a FTSE 100 company and also been a president of a publicly traded company here in the States. So I've seen this issue wearing a lot of different hats – including, by the way, a major institutional investor, which insurance companies in the U.K. tend to be.

What Dan [Summerfield] said about the regime in the United Kingdom is correct. Consultation is a way of life. Now the nuclear option isn't quite as nuclear as you make it out to be, because the shareholders would bear quite a bit of costs in some of those contests. But the fact of the matter is that we do have regular ongoing consultations between major shareholders and the company. No company that I know of can even think about adopting an executive compensation plan with stock options, without sitting down and consulting the shareholders.

Now it's easier to do in the U.K. It doesn't translate exactly here in the U.S. In the U.K. the shareholders are used to acting collaboratively. So there will be a single view from the insurance company and pension fund community being presented to management about the plans they're proposing. Here in the U.S. where we're much more concerned about collective action and getting together in groups, I think you're not going to have the same sort of unanimity, so management may have various discussions that they have to go through instead of the kind of calm, orderly British ones that we're used to in the U.K.

Having said that, and having had discussions with major shareholders, those discussions tend to only focus on three issues, in my experience. Number one, executive compensation, specifically share option plans. That's what attracts most institutional investor attention, and that's what we talk about more than anything else. Second, capital. They want more dividends. They don't want us to raise capital that would require them to dip into their pockets. That's another big area of discussion between boards and institutional investors.

James Morphy: That's a UK issue, isn't it?

Robert Mendelsohn: Well, the pre-emptive rights offering system makes the UK shareholder more sensitive than they would be here.

And the third is what I call the activist agenda. That is, "sell this division and give us the money." Those are the three areas, and they're in that exact order.

Never in my six and a half years of running a UK public company did a shareholder come and approach us and talk about the creation of long term value. Never did they approach us to talk about risk management, which I felt was particularly amusing, because we were an insurance company, and AIG's largest commercial competitor. I would have thought that risk management would be something shareholders cared about. They didn't.

Now, is our experience in the U.S. going to be the same? I don't know. The legal system here is so different, with restraints on what management can say, and what the shareholders as a group can do, are so different that I think we are doomed to the kind of polarization that we seem to be having today. Sad but true.

The other thing I might comment on is "Who are these shareholders that we're talking to when we're in our directors' and executives' hats?" And they're all very different and have very different motivations. I agree with Eric's characterization of the mutual fund. The fund managers that we talked to, their personal compensation is tied to beating a particular index in a particular one year period. That's it. That's their focus. Yes, they're fiduciaries for the people who gave them the money, but I think that we all know that in the institutional world, they're in the business of gathering assets.

I told the story yesterday at the panel in Lucian's class, that I had a discussion with a mutual fund manager who was a pessimist on our shares. If we constituted about 1% of the FTSE index, he was a real pessimist so he owned 0.75% instead of 1%. And his main competitor, one of whom was Company X, was a bull, and they owned 1.25%, which is a wildly bullish. But all of them are compensated against that index, so they're all afraid of going too far from the index.

This guy was very candid. He said "I'm rooting against you, I hope your shares go down." I said that's not good for your shareholders. And he said, "well, I'm in the business of competing for assets under management with Company X. And if your shares go down, it's going to hurt Company X a lot more than it's going to hurt me. And that helps my business." Very honest. Now is that actually the kind of behavior we want from the people we give our pension money to? That's a different question, and I think those who have suggested that looking at the governance of the institutional investors, and how they steward the money that's been given to them by their fiduciaries, will be as interesting a topic for discussion as that which we are talking about today.

So I could go on and on about the differences between the two systems, but I just wanted to share the observations of someone who's been in the UK.

Robert Clark: I appreciate those points . And you do flag an enormous other topic for conversation – the many types of investors and their particular motivations and agency cost problems. But that’s a topic for another big conference.

Simon Lorne: It seems to me we’ve got a lot of different streams, or rivers, of thought going through here, and it may be useful to try to separate some of them out, because we’re getting some strange bedfellows in the politics of the situation.

It seems to me we start with some different concepts of what the corporation’s all about. Are shareowners owners, or are they investors? And what does that mean? And are directors agents of the owners? Or are they trustees of a trust for beneficiaries who ought to be listened to, but not necessarily obeyed. A fair question. There are different thoughts and they generate different reactions.

A separate area of distinction is “state versus federal”. Leo [Strine]’s the only person so far to hold the flag up for states in this context, but do we want to go down the road of federalization of corporate law this much further? Or do we not? And that generates some different sorts of analyses that may or may not be aligned with concepts of the company.

The third area – and I congratulate you for bringing it together—is that we are a very diverse group. We come from different perspectives for philosophical or practical representational reasons. We tend to align with the established board concept, or we tend to align with the insurgent sort of concept – not quite as starkly, perhaps. But we tend to be on one side or another of that divide which may or may not match up with where we are in the state-versus-federal issue or the concept of the company.

And then fourth, to my mind, we are also talking about both the abstract question of access and the specific 14a-11 proposal for access. And as John and Bob both mentioned regarding the panel yesterday, there are likely no activists raising their hands to use 14a-11. 14a-11 is premised on not wanting to influence control of the company, and activists are, by and large, all about influencing control. (Footnote: I don’t understand what the SEC is thinking of when it says it wants directors who don’t want to influence control. I thought that’s what directors pretty much did, was control the company.) But that’s there.

And it’s very hard to tease out the influence of all the different factors to figure out where we are, which is why I think a lot of us end up saying we’re agnostic, not meaning really that we don’t have a view. But really meaning we’ve got so many different views we can’t sort them out.

I might, as another footnote, come back also to Leo [Strine]'s earlier comment about the SEC and the gag order of 14a-8, and recognize the SEC is by and large in the business of abridging freedom of speech. That's what it does. And what it does in 14a-8 is that it influences, or affects, the ability of shareholders to communicate. And it then layers [Regulation] FD on top of that to make it difficult for companies to allow directors to target shareholders.

So maybe somebody ought to rethink the role of the SEC in that context. This is a small part of that debate, but it's a different debate.

Lance Lindblom: I'd like to just take a step back and get out of the weeds for a second. First of all, we bring resolutions. In order to bring a resolution, we have to have partners, which means that we have to convince partners that we have a real concern or perceive a problem. Then we contact the company to try to have a conversation. Many times the company just stonewalls us. There are some that do open up and discussion happens and concerns are met, and they're in a listening mode. It's only to get their attention, the management's attention on these issues. Or the directors.

If we get stonewalled, then we go and we file the resolution. Many times it's a scorched earth campaign on the part of managements of the corporations to knock you off that proxy, and when it could have been, in many cases, solved by a conversation and exchange of concerns.

We then – if we survive that, and we do – we then go and we make a case to the proxy services. That case is a business case. And we have to make that case, and they have to – and if they support us, they do it on the basis of those business concerns. We have a record – except for this year, we've been disappointed once - but over the past two years, except for that one time, we're almost at 100% supported from RiskMetrics and others, because we're good at putting the business case. It also may meet our mission interest too. But it has to meet that business case. So there is a process that we go through that does encompass costs on our side.

Now what are the kinds of concern that we've had? Well, we've gone through on compensation issues. What is the countervailing power in the system to an incestuous board, and an incestuous nominating committee? And if you don't think they're incestuous, look at this table and the diversity around this table. They are incestuous in many cases, not all.

So there are lots of concerns that can be expressed in these things. And this is the only alternative that we have to bring them. We'd much rather have that discussion with

the companies. And we do, we do have partnerships and managements respond positively.

Now I hear this discussion about politics, which is what the stockholders allegedly practice, while the managements practice intellectual integrity. This is ridiculous. The managements and the directors are neck deep in politics. They're neck deep in politics. And given the current Supreme Court decision, no matter how that's decided, they're going to be directly, overtly, and explicitly involved in politics. Just walk in Washington corridors and see the lobbyists and tell me that managements and corporations aren't involved in politics. They're setting the context.

So again, where is the countervailing power to keep managements from being entrenched, if it's not for this type of proxy access, where we can bring up these concerns?

And the last issue dealing with this, and I can give you hard cases, if you have a discussion with a corporation, you've come to an agreement, in some cases on environmental issues, or a whole series of other issues. They even incorporate that in the business plan, and yet they're giving money to an association, the National Association of Manufacturers, or the Business Roundtable or somebody, who is using their dues, their contributions, to do exactly the opposite of what they've committed in their lobbying efforts.

So this is a check. All it is a check, and it's a countervailing power within the system. We have, as stockholders, the ultimate well-being of the corporation in our sights. That's why we're there. Attributing intellectual integrity just to the managements doesn't add to the conversation. I actually was thinking people looking for that access have a lot of intellectual integrity. They're actually trying to make the system work. And they're trying to make the system work after that system has destroyed \$11 trillion worth of value. And maybe this isn't the right way to do it. But the inertia, and the fighting and the obstacles that are put in place, to me, are ridiculous.

Which leads me to the last point, and I hate to disagree with you on this, Lucian. I don't think there should be an opt-out. I think my own experience over the years is that unless the corporations are forced to the table, unless there's that option, then several, not all, but several will not come to the table. And to have an opt-out provision where at a given particular time, a majority might opt-out after a huge campaign, and then forevermore is opted-out of the system, I think, is a big mistake. Because it's a dynamic situation, as concerns change. Just like freedom of speech, in the sense when you have a

minority, and there may be a majority that is against what that minority is saying, but that minority may turn into the majority if it's really heard.

So that's why I would be against the opt-out.

John Olson: Isn't this useful to have a clear statement of where all the issues reside?

Ted Mirvis: I was going to suggest there was a consensus in the room.

(laughter)

Let me put it in the form of a question. I think we're all aware that the SEC recently decided to delay action on 14a-8 and 14a-11, and to do nothing for the 2010 season. The question I have is this: couldn't we all agree that it would have made good sense to amend 14a-8 now, to allow Delaware's new [Section] 112 to work for at least a season to see what shareholders and boards did in response, to get that information and take it into account in the further consideration of 14a-11. Can we all agree that would have made sense? Then why didn't it happen?

John Coates: Politics.

Ted Mirvis: Politics? Is there any other answer?

Richard Ferlauto: No, there's actually a very good answer, that if you're going to have a 14-a11 rule, and a change to 14a-8 i8, they need to be compatible in some way. And it doesn't make sense to move forward to changes to 14a-8, in terms of the i8 exclusion – and have it incompatible with a structure that would be set up across the board to a mandated minimum standard through a11. It would not make sense for shareholders to move forward under a new 14-a8 set of rules, to establish proxy access procedures if they don't understand what the 14 a-11 framework would be.

John Olson: The fact is a number of Commissioners have floated that very idea and were told that it's unacceptable to the pension funds, because they were afraid that the half-loaf would never become a whole loaf. That's a political answer. That's perfectly legitimate.

Robert Clark: The timing is right for getting 14a-11 through, I think is the answer. And if you believe in it, why not? We could debate this – this is a very good question. But maybe we should save it for lunch.

Kayla Gillan: I've been taking copious notes. I am not here to speak on behalf of the Commission or its staff, but to listen and observe. But the statement that the Commission

decided to delay a decision is false. And I know it was reported in the press, but you can't believe everything you read in the press.

The Commission had never decided when it was going to consider final rules in this area. The Chairman had indicated she would like to have it done by the 2010 proxy season. And that was at the time of making the proposal. By the time the comment period closed, there were over 500 incredibly complex, thorough, thoughtful and long comment letters that the Commission staff and the Commissioners have an obligation, under the Administrative Procedures Act, to conscientiously and thoroughly review and consider. And that will take some time.

And so in case people don't know, any major rule by the SEC, unless it's an emergency rule, does not become effective for 60 days anyway. And when you start adding that all on, there really wasn't time for this proxy season anyway.

So that's just the facts of it. We are hoping to have something in early 2010 for the Commissioners to consider in final. But I want to address that delay issue. The option of taking 14a-8 separate from 14a-11 was considered from a timing perspective, but even that had that 60-day before implementation issue. And most of the due dates for shareholder proposals for the proxy season are in before Christmas. So we weren't going to make it anyway.

Leo Strine: Well, here's the thing. One thing we have to keep in mind here is in 2007, as the Commission will remember, I wouldn't have brought the letters to Chairman Cox, but I care very much about this law school, and I didn't want the building to catch on fire. But at that time, he received flame thrower for not keeping the election, essentially the victory, the AFSCME rule in effect. And that came from also members of the Senate Banking Committee.

And so my proposal for you all to consider, is 14a-8, big, huge, huge, humongous E. Which would be – with the desire of those folks who want something more than simply 14a-8, and given the importance of the election rules, and the spirit of Mark Roe of looking for not simplistic binary solutions, that we shape a rule designed to deal with the serious subject of election reform. That we give stockholders more words. Because something real, as opposed to something imaginary, ought to be perhaps explained more. Perhaps you could hyperlink to the text of the bylaw.

For those concerned that management might amend, repeal or otherwise thwart the shareholder rule, perhaps use the disclosure reform, such that in the next 10-Q or 10-

K, to the extent that management amended, repeal, or otherwise altered the proposal adopted under 14a-8(e), it had to explain the reasons why.

To the extent that folks are concerned with the separate issue, which frankly 14a-11 will not cure, of frivolous corporate issue or litigation against proxy proponents, perhaps Section 13D ought to be amended to provide for fee shifting if an issuer does not prevail against proxy proponent.

And there may be others. But one way to do this would be go to private ordering, acknowledge within the room, those of you who are for 14a-11, that you have different views of what it should say. Acknowledge that you shouldn't be surprised to get lengthy comment letters, because Kayla, I respect Kayla very much, and the view that the Commissions need to consider the comments. Remember how many questions the Commission asked, 500. Five hundred questions. That was not about 14a-8. With all due respect, I believe the Commission could fix – go back to the pre-AFSCME way thing, get it into effect. They could do it in an emergency basis, if it's a crisis, right?

But I would say for the afternoon discussion, think about solving some of these issues, but in a way that really does let majority rule go forward. And that would be simply a tweaking of 14a-8. It would be something real.

Greg Taxis: I have, as always, just a little bit, if any, value to add here. But I most recently have been running an activist fund, and I agree with Isaac [Corre] that this rule will not enable an activist fund to run a campaign they otherwise would not run. And actually I don't think we could really use this rule.

The costs associated with running a proxy contest are largely in the identification of the company, researching its issues, understanding the board, recruiting new board members, convincing them that they should be willing to stand against their corporate brethren, promoting that slate, getting a proxy soliciting firm to work on its behalf, going out and talking to shareholders, flying down to Maryland to talk to RiskMetrics and so forth. The costs associated here are much bigger than the mere cost of spilling ink on a piece of paper. That's actually the tail of the dog.

If you weren't prepared to do all those other things, no credible director, or director candidate, would sign up with you. One cannot go to director candidates and say, "We're going to do the poor man's version of a proxy contest, and we we're not going to spend any money, and we're not going to defend you against what a corporation might say about you or your record, we're just going to put you on their proxy and hope for the best." Nobody credible is going to sign up for that.

So you've got to be willing to spend what is really 90% of what you're going to spend anyway, or 95% of what you're going to spend anyway to identify the directors, identify the issues and back them and make a good case to your fellow shareholders.

And so I don't actually think this [proposed reform] goes very far to help the responsible activist investors who have done their work and research and are willing to put forward a good slate of qualified candidates. Maybe nothing will come of it, like in the UK, Daniel, and no one would actually use it. But to the extent anybody uses it, it's going to be somebody that presumably can't afford to do all those other things, or isn't likely to do all those other things. And I fear that it does become basically 500 words for you to say whatever you want to say about the company, germane or not germane, to the directors or the election or anything else. You have your free moment to say 500 words at the expense of the company or the shareholders.

And one of the issues there, for whatever it's worth, is you're in some cases a 1% holder, a 2% holder, a 5% holder, whatever you are, you're a small holder. You have no fiduciary responsibility to your fellow shareholders. Yet, you can essentially use the company's assets and you can undoubtedly force the company to respond by using your fellow shareholders' money. And you have no obligation to your fellow shareholders to be doing something that's productive.

And I think to Daniel's point, activist shareholders, and shareholders in general, already have a bunch nuclear options, as I think is demonstrated almost every week in this country. We have an ability to do proxy fights, we increasingly have majority voting standards. With the broker vote going away, you certainly have boards paying very careful attention to any credible investor that threatens a proxy fight, or threatens a "vote no" campaign.

At my activist fund, as Lucian knows well, we threatened a proxy contest at a company where we owned 32 basis points of the stock. We put together a slate, we went to the company and its directors had a bad record. They were convinced they were going to lose. And so they sat down and negotiated with us. We didn't need 14a-11. We didn't even, frankly, have much desire to run a full proxy contest, but we convinced them that was the intention. And they knew they had a bad case.

So it seems to me there's lots of answers today that amount to the nuclear option, at least in the minds of corporate America. And that gives the investor negotiating leverage.

I think most importantly, this is all going to be anachronistic, or is anachronistic, or going to be more so, in five years. What we're talking about, just step back a minute – we've assembled all these high powered people in Cambridge to talk about who gets to put ink on someone else's paper. And in a world where two 23 year olds, with \$10 in their pocket went out and did some videotaping, stuck it on YouTube, and did some serious damage to ACORN, I just don't know that it's actually all that relevant. We're going to get to a world where everybody has access to lots of printing and distribution, or be able to say their peace online and promote it; where it gets printed, and at whose pays for the ink and for mailing it through the U.S. Postal Service, seems like something that's going to be only marginally relevant in five years, or ten years.

Robert Clark: Interesting idea – although I can't refrain from mentioning the recent survey data that shows electronic voting has not been widely used by retail voters. Perhaps because of the way it's designed, but perhaps because of the demographic gap. We may have to wait for all of those old non-digital shareholders to pass away, and for the younger generation to take their place.

Greg Taxis: But I'll just say a quick thing, and then I promise to turn over the floor. And that is, I think the SEC could much more productively spend its time figuring out that problem.

Robert Clark: Trying to solve it, yes. Well, actually that's a good topic for the final session today. I think electronic voting is a wonderful thing. Why hasn't it worked better so far?

But your main point, your main argument sounds very – it resonates as a realistic account of the activist hedge fund mentality that I've come in contact with.

Richard Ferlauto: A couple of comments. Some of it might be reserved for later, but I wanted to respond to Leo about the changes in 14a-8 in particular, and what a reconstructed 14a-8 might authorize.

One of the problems with private ordering, is the 500 word limitation that we have now, and that's something which we commented on in our SEC letter. Private ordering doesn't mean a lot if we really don't have the capacity within the proxy language itself, to do appropriate bylaw construction. AFSCME is somewhat expert in trying to figure out how to do that but it is a very significant limitation that is problematic. We would prefer, however as the rules come together, that that 500 word limit gets increased and that's something to focus on as a fix whatever else the final rule contains.

But there was also an important distinction that was being made that needs to be recognized on the panel. And that is between beneficial asset owners and the asset managers. And that's why you see the public funds and the labor funds, in particular, asset owners focused on the issue of capital accumulation and market efficiency, because it affects us most directly as owners. Of course, we're interested in meeting the benchmark ultimately, but we have a different view in terms of the creation of long term economic wealth. And I think some of the hedge funds folks – and Robert you actually touched on that – is whether we use the language of long term shareholder value, capital stewards, or something that I've been talking about more recently, patient capitalists.

There's a fundamental discussion in the economy now about long-termism in the markets, long-termism in investing, and how we're creating real economic value rather than ephemeral value through market transactions. It's something that we take very seriously and we think proxy access actually gets to a fundamental of how to deal with short-termism in the markets.

And let me talk very concretely about sort of the dilemma that we face as large institutional investors when we've got a failed board, or a board that isn't functioning as efficiently as it could. Take the example of the failed board example most specifically were the asset owners many times are confronted with a problem. We've got a hedge fund there that wants to extract value out of that company. And it may be value that may be more specifically beneficial to them than all the other shareholders, because it's a short term play on the balance sheet, as opposed to real operational change that may create value in two, three or five years for us.

But when there's an entrenched board, what do we do? We have very few tools, absent proxy access, to effect that change. So that many times the choice is to join up with the hedge funds, who've got different economic interests than those interests that we have as share owners. We're not interested in control for value extraction. We're interested in more fundamental management changes, that focus more on the company operationally. Such as how can the function of the board, and therefore the function of the firm, be more conducive towards a long term strategic planning? But because we don't have these tools, we often have no other choice than to be in with the hedge funds.

So of course, and by design, the kind of proxy access that we're looking for is not structured to be used by the hedge funds, but is structured to be used by the long term, patient capitalists, if you will, who've got a different view of the market, and who lack those tools because of collective action and agency problems that we haven't been able to get over.

Michael Barzuza: So if we adopt an opt-in rule, probably what's going to happen is what we've seen with other corporate governance terms, that some of the corporations are going to opt-in and some will not. And I think what we're trying to learn from this, as an experimentation for the future, one of the things that we should be thoughtful about is the differences between the corporations that opt-in and don't.

So one possible way to view it is to say well, one size doesn't fit all, and corporations that opt-in are the corporations that really need that and this is a good solution. But it's also possible that the corporations that opt-in are those that already have a stronger shareholder base, stronger shareholders. And they may actually need it less on the margin than the corporations that are not willing to opt-in.

So this is something that we need to take into account when we're trying to learn from the implementation of such a rule.

Robert Clark: Well, it sounds like a very interesting proposal. It actually squares very much with attitudes I've observed in certain boardrooms. One company I'm on the board of could care less about all this. It's because the market loves them. I will not comment about other companies, though.

James Morphy: I just want to comment on a couple of things that were said. One, Lucian noted with some sense of glee, the irony that there were those who opposes proxy access in 2003 and today are in favor of private ordering. I want to speak on behalf of that group.

(laughter)

I've participated in the ABA letter then and now, and participated in the firm's letter then and now, and participated in a letter sent by seven law firms, most recently with respect to this proposal. And I want to go back at least in terms of the purpose behind proxy access.

The way proxy access is discussed today --and one of the first things that comes up as to why it's necessary now is accountability and the financial crisis we've just been through. And I would defer to the Chair, but I would love to have a vote of hands of the people in this room that believe that if proxy access-- in whatever form you want to imagine-- was passed in 2003, that the financial crisis would have been averted. And if you don't believe that, then all of this stuff about proxy access and financial crisis and corporate governance gets stripped away and it starts to work its way down to advancing certain interests.

But having said all that, Lucian, we saw the election. We know which way the political winds are blowing. And if you asked me if I'd rather be hit by a train, or injured in a smaller way, I'll take the smaller injury.

And so it's not that I necessarily believe – it's not that I necessarily believe that proxy access is a good thing. I think it will create costs. I'm not sure, having heard even from people in this room who spend their days investing, that it makes much difference to them. It does lead me to question who does really care about it the most and why?

But if we have to – the reality is that there is going to be some form of proxy access. And so give some credit to those on the corporate side for being realists. And by the way, I'll point out that there were – there might have been 50, 100, you pick the number of companies – that failed. There were 6,900 who dealt with this crisis in ways, and managed their corporations through this crisis in a very admirable way. But somehow others wants to translate that into a generalized failure of corporate governance.

And at the end of the day, people who have written the letters now, at least that I represent, basically have come to the view that if there's going to be access, it should be responsibly done. That no one has – no one in this room has yet explained why 1% is the correct number for every company. Why a one-year holding period is the correct number for every company, and why 25% is the correct percentage. There is no one in the room that can actually make that statement. And in the UK it's 5%.

So from my perspective there's no vitriol here. We're not opposed to people – I'm speaking for myself, we're not opposed to proxy access. We're not clamoring that it shouldn't happen. It's that we would like it to be done in the marketplace, we'll live and die by the marketplace. If the shareholders decide that they want 100 shares after being held for 15 minutes, and that should be the bylaw, then that should be the way it works. But we will put our faith in the marketplace to say that there has to be a rational middle ground, where this could be used, and the marketplace will decide where that makes sense. And what we're objecting to, at the end of the day, is five people sitting in a room and dictating that result.

Isaac Corré: Could we limit the amount of money that corporations will spend on the contest over the proxy access bylaw so that they can't spend any more than the shareholders were proposing in the bylaw? It's not going to be a fair fight.

James Morphy: Put it on your bylaw and send it into to the marketplace. We'll see what happens.

Robert Clark: It's been a wonderful discussion. There are so many ideas that have been opened up for further debate and inquiry.

Session III: The Optimal Design of a SEC Access Regime

Moderator: Howell Jackson, Harvard Law School

Howell Jackson: The topic of this first session this afternoon is the optimal design of an SEC access regime. And from our discussions this morning, it's pretty clear that there are somewhat different ideas about what might be optimal. So let me frame the way that we're going to address the question of how a 14a-11 regime should be structured.

So, assuming that the SEC is going to go forward with more or less the approach that its proposal suggested, as was mentioned this morning, there were plenty of open issues – 500, or so, I think was the count. And there are lots of them that we could talk about. We will eventually get to how an opt-out might be designed around this.

So one of the questions for their regime is how you actually might opt-out. But I want to focus on the 14a-11 issue as opposed to thinking about designing an opt-in system that was discussed this morning – Leo's 14a-8(e) – which would be another optimal approach in some people's minds. So that's what the topic is. I think we should think of ourselves as trying to help the commission do this correctly. We're going to have a transcript that will be forwarded along, and so we're all going to put our minds to helping the SEC in this task.

There's a number of different issues we can look at. I looked over the rule and some of the comment letters and have organized some topics to talk about. I think the one to begin with is the "eligible proponent" question – who should be an eligible proponent for one of these proposals. And I think a good place to start is the ownership levels – what kind of ownership levels should there be – there was some discussion about that this morning and how Daniel [Summerfield] was telling us the British rules are a little bit different.

The SEC proposal makes distinctions based from size, levels of ownership. There are a bunch of issues that are around the ownership levels including the question of accumulation of interest of different shareholders and holding periods for shareholders. But let's just talk about eligible proponents. The floor is open for either endorsement of the SEC proposal or friendly amendments to improve its optimality.

Richard Ferlauto: I think that the SEC has generally got it right, but I don't think you can separate out the ownership threshold questions from the holding period questions. If you're going to organize a group – first of all because of the dispersment of ownership,

getting to beyond a 1% ownership threshold as the length of holding period extends out gets to be very difficult, for organizational and administrative purposes in terms of proving ownership levels over time.

So that a 1% threshold higher than 1 % with a holding period than one year, -- which we recommend be extended out over some length of time-- would make the rule inoperable in terms of the mechanics of putting together a group that would qualify according to the rules as they're established.

Howell Jackson: So they need to be thought of together?

Richard Ferlauto: They need to be thought of together.

Howell Jackson: And your intuition is you could go over 1%.

Richard Ferlauto: And the way we would structure it is with a smaller ownership requirement with a longer holding period.

John Wilcox: I was just going to mention that in Italy, there is an access rule that mandates that every listed company leave seats open for minority shareholders. And they define minority shareholders – this is a term that we don't use in this country very much, but because so many companies outside the U.S. – in continental Europe, Latin America, etc., are controlled either by families who still have a large ownership position or by the government or by shareholder groups that have been created.

The way it works in Italy is that the control group – which is referred to as the majority – presents a slate. But it is not a slate for the whole – for all seats. They are then required to leave some seats open for minority slates. And then there's a rather cumbersome process by which shareholders can form groups and nominate candidates and have competing slates.

So when this happens, basically every annual meeting is a contest in a sense, except that it isn't a contest because there is politics prevailing in this process that ensures that the majority is going to get all or most of its directors elected and some of the minority will also get on.

The reason why I raise this at this point is that they have an eligibility requirement – shareholders can sponsor slates if they meet certain ownership requirements. And they have a sliding scale where the ownership requirements get higher as the company's capital size gets smaller. So it goes from one-half a percent for the largest companies to I

think 4.5% – we can check on this – for small companies. And so I just throw that out as being an alternative that might be worth looking at.

Howell Jackson: So a floating scale?

John Wilcox: Yes, a sliding scale based on the size of the company so that small companies aren't victimized at a 1% level more than huge companies would be.

Richard Ferlauto: Well, that's in the current rule. That's the SEC proposal, too.

John Wilcox: That's the proposal.

Richard Ferlauto: It has that structure?

John Wilcox: Yes.

Howell Jackson: There are a number of different suggestions that have been made about these requirements. The holding period – the one-year holding period. There's been some question about whether it should be lengthened to two years, and also some suggestion that the holding period should be lengthened beyond the shareholder meeting into the future for some period of time – not totally clear how long it would go on for, but you'd have a eating-your-own-cooking kind of holding period.

John Coates: That's OK. So a letter that a number of us at Harvard Law School and Business School put together – Bob signed it – did we drag you into it, Howell?

Howell Jackson: No, but it was well done.

John Coates: It basically endorsed the position that Mark Roe made before lunch. I just want to get it back on tape, and restate the way he framed the question, which is starting higher is a good idea because it won't permit any from occurring. It will allow for more than if you stick to just private ordering. But it will also mean that you don't have a flood – a giant rush – there's no risk of that if the threshold's high. And personally, I thought 10% would be a good starting point, and then you have it built in to scale down, unless the SEC were to step back. And others thought 5% was the right starting point since even the law firms endorse only a 5% threshold. And so I think there's a lot to be said for that approach.

One point that Mark made that I also agree with – and I wrestled with – is to go back to politics, and regardless of whether it should or shouldn't part of the conversation. The Vice Chancellor earlier suggested it shouldn't be; it is, and there's no escaping that. If you believe – as I think Lucian does – that political dynamics will erode, over time, the

support for the general proposition, then the kind of approach that we suggested – starting high, and scaling back over time, might be a bad political move.

And so again, to go back to the earlier conversation this morning, I don't see how you escape thinking, unfortunately, both on the level of policy and the level of politics and having some gut instinct about where we're going to be in five years or three years on this issue – not just as a matter of policy but also as a matter of the political environment – that has to be part of what the SEC takes into consideration.

Howell Jackson: So John, mentioning that letter, which is an interesting one, I think there was some reference to 13D – this notion of using levels that are familiar and that had law around them as opposed to creating yet another piece. I mean, 10% also has some law around it, so you could pick your level, but is that an important issue to think about.

John Coates: Well, at a margin, I think most of institutional shareholders currently monitor ownership levels at those thresholds, so there's a little bit of cost saving if you peg it to the same threshold. If you create a new threshold, it means they're just going to have to have a little bit of change to their internal policies. I'm not sure that that's the biggest issue in the world, but that's, I guess, a marginal cost.

Robert Clark: Also, the 5 and 10% levels seem politically stable – that's another reason to give them priority consideration.

Jesse Fried: I just wanted to comment on the ownership threshold. My intuition coming into this conference, which has been confirmed by what I've heard this morning, is that most institutional investors and activist investors are just not going to use this proxy access provision. So who's going to use it? It's going to be pension funds and unions – people like Rich [Ferlauto].

So if you think that giving state pension funds and unions access to the proxy this way is desirable – which is what I believe – you would not want to have a threshold of 5 or 10% because that's going to make it extremely difficult for them to form a coalition to use the mechanism. So if you think that the rule is likely to have positive effects, but may not, it would make sense to have a very low threshold and then give shareholders the ability to opt-out of the rule so that after several years of experimentation, if people don't like the proposals that Rich is putting forward, they can shut down this form of access to the proxy.

Lucian Bebchuk: We need to think about ownership requirements not in the abstract but rather based on existing ownership patterns. In the abstract, 1% might sound a low

threshold. However, the empirical reality of ownership patterns suggests that this threshold would be quite demanding in many cases.

The SEC's release suggests that 1% is reasonably low because the lion's share of companies have one or more shareholders with more than 1%. However, when you look at the data, you find that many of the 1% shareholders are either index funds or ETFs or large mutual fund families such as Fidelity, and no one is expecting the index funds or the large mutual fund families to use proxy access arrangements to nominate directors. When you look at institutional investors that might be more willing to be active, you find that even the largest such as CalPERS do not commonly hold more than 1% of the shares of a given public company..

Richard Ferlauto: The number is 0.4 to 0.45 % which is their traditional index holding.

Lucian Bebchuk: Right, and this is similarly the case with respect to TIAA-CREF. A second point I would like to make is about aggregation. While it sounds straightforward in theory, the reality – and we have to take it as given – is that institutional investors, for whatever reason, are somewhat reluctant to act together.

Lastly, requiring shareholders nominating directors to continue to hold shares in the future would impose a significant liquidity cost on shareholders considering the use of proxy access. Suppose a shareholder believes that nominating a director would increase expected shareholder value by one percent. If making a nomination were to preclude the shareholder from selling its shares for several months in the future, the liquidity cost to the shareholder might exceed the one-percent benefit from having the director on the ballot. So a holding requirement would pose a substantial deterrent to the use of proxy access.

Greg Taxin: Well, on the latter point, I totally agree with you and that's one of reasons I think this rule's never going to be used, because you can run a proxy contest and you only have to hold –

Lucian Bebchuk: If you have a requirement to hold?

Greg Taxin: Yes, if there's a requirement to hold, no one's ever going to use this rule, but you're better off on a cost basis –

Howell Jackson: On the old system.

Greg Taxin: – spending the money on the ink and the paper and mailing rather than the illiquidity. I don't know that this was in your taxonomy, Professor Jackson. One of the

things I find particularly arbitrary and somewhat curious about this rule is that only one shareholder – and it seems to be a race to the courthouse kind of situation we’re setting up – only one shareholder gets the benefit of this rule at any given company.

Maybe Rich [Ferlauto], you can explain to us – if this is such an important right for shareholders at companies where there are big problems, why should we base this right on the shareholder who files first? He or she is the only shareholder who’s enabled here. And by the way, sometimes that can be the 1% holder. There may be an 8% holder that cares even more, has more economic incentive, but they’re a day behind.

Howell Jackson: Right. Let’s come back to that in a second, but I first want to wrap on the amount question and the eligible –

Abe Friedman: Can I just ask a real quick question – on your point, Greg and Lucian, on the holding period, were you talking about holding past the meeting date, or were you talking about any holding period at all for even filing a proposal?

Lucian Bebchuk: Well, the economic argument is the same. As to the meeting date, one could reasonably require a nominator to state an intention to continue holding the shares through the meeting, as well as to require a nominator to disclose if it has to sell its shares prior to the meeting – a disclosure that could affect shareholders’ voting decisions. However, going beyond such requirements and mandating that the institutional investor continue to hold shares – even, say, if its beneficial investors withdraw significant funds in the interim – would impose significant liquidity cost on nominators and discourage nominations.

James Morphy: As some of you might suspect, I would be in favor of a higher threshold and certainly as a way to pick these off. As an experiment, there’s a lot of wisdom in that. I also find it fascinating that a weakness has been turned into an argument in favor, in that 99% of the stockholders can’t get agitated to do this and so there must be a rule so that a minute segment of the investing population has access? I mean, the fact that you can’t generate enough interest to put together some meaningful percentage – I mean, 1%? And yet you want to take corporate mechanisms and put everybody through this process when 99% of the investors don’t care is amazing to me.

Howell Jackson: So Jim, you were saying that if you could get 5% to come along, even you would persuaded that –

James Morphy: I’m saying 5% is a reasonable place to say, you’ve got 5% who are that dissatisfied they want to act, then who am I to stand in your way.

Robert Mendelsohn: Because the purpose of proxy access is not to give Rich a megaphone. He's loud enough. The purpose of access is, in a situation in which shareholders – I emphasize “shareholders,” are dissatisfied with the performance of management and feel that there is a need to get a new voice on the board, then to give them some sort of mechanism for doing so – but that's for “shareholders.” And I agree with Jim on this. I mean, I'm a moderate on the whole thing –

James Morphy: So am I.

(laughter)

Robert Mendelsohn: I guess that makes me a liberal. Seriously, this is not about giving the union its 500 words or its 1,000 words. This is about addressing a corporate need. And I happen to agree with Rich, I think it requires a holding period. This is supposed to be for shareholders who are trying to affect value creation over the long term in their corporation. If he's not prepared to be a long-term holder, why are we giving that particular shareholder access to the proxy? It makes no sense to me. I think there should be a substantial holding period, both before and after, because that is consistent with what we're trying to do here, which is to help a company that's not performing well. Now, if you're going to put somebody on there, get him elected and then you're not going to stay to reap the rewards or the pains of having that director on the board, then that seems to me inconsistent with what we're trying to do with access.

I also think yes, there should be a substantial percentage requirement– and I agree with the point Jim made in the beginning, which I hadn't heard in these terms. Do you want one guy in this room to be able to vote out somebody else because they don't like them if everybody else in the room is perfectly content with the person? I think we need more than 1% and I would say 5% is generous but...

John Olson: And in fairness, is can one person make the motion, not can one person carry the vote?

Lance Lindblom: One thing I think we ought to all admit, is that it's not just the unions. I don't represent a union. I represent an endowment, and we're concerned with these issues too. So it's not just unions. The second thing is a real concern about the race to the door, which is an important issue that must be dealt with.

The third issue is the percentage question. I just see – and I don't mean to put in motivations– it's salami tactics – we'll keep trying to put in obstacles and higher threshold points, etc. The fact is that to bring a proxy resolution, the transaction costs to get to the 1% are fairly high. You have to get people to agree on what the concern is and

bring it. And remember, the proof is in the pudding. It depends upon the vote that they're going to get. You're just putting it on the agenda.

I don't understand why you take a default position of being very worried that we're going to have a race and a bevy of crazy stockholders bringing resolutions to having a lower threshold and see what happens. I don't think you're going to get a bevy of crazy stockholders. I think you're going to have more like the English situation. The efficacy and the importance I see of having a low threshold point is to encourage – and it seems to me that to get attention of some boards, that takes government pressure to sit down and talk about these issues. The resolution of the proxy access is only a last resort by stockholders.

Byron Georgiou: I have a question and an observation. Lucian, I don't know if you're the right person to ask, but is there empirical evidence establishing, if you ignore the index funds, how many investors would be required in most significant capitalization companies to get to 1%? Do we know?

Lucian Bebchuk: We do not have good evidence on this question. What we know is that, in most public companies, there is no single public pension fund that owns more than 1%.

Byron Georgiou: No single-shareholders. From personal experience, I know CalPERS fairly well. They hold about four-tenths-of-a-percent, I believe, of all S&P companies in their internally managed index fund. CalPERS is the largest institutional investor in America, so it seems to me that even if you had a very low threshold, what people regard as a very low threshold, 1% – you'd still have to have a fairly significant number of individual institutional investors collectively agreeing that there's a problem, the nature of the problem,, who the director is that they collectively agree could add value in a way that would be fundamental to the company, then put that director on the ballot and get 50% plus one of the shareholders to vote to seat that director.

That isn't easy to do. I hearken back to the same point I made in my earlier remarks, don't assume that there's going to be a floodgate of proxy access attempts from this proposed rule. This is simply not something to be overly concerned about. If somebody goes to all of the effort to avail themselves of this process and fails, they're simply not likely to repeatedly make the futile effort. So it's only going to be attempted and accomplished in the serious case. And even at a 1% threshold, it's going to be hard for people to meet the threshold collectively. And under what circumstances do you permit them to communicate with one another to reach that threshold – is that a problem with current law?

Howell Jackson: Well, the communication issue is also one of the issues. There's a lot of different related topics here, but I think since so many people are referring to it, the question of who is the representative proponent if you have more than one – the multiple proponent situation. Now, those of you who think it will rarely be done, you would predict few. But the SEC clearly has been worried about this. Their proposal was a first-to-file approach.

Other suggestions have been the largest holder would get to choose. There have been some concerns about the largest holder getting to choose that companies might find friendly groups that would become the largest holder, so you might have to police that. And of course, we had some experience with these kinds of test under the Private Securities Litigation Reform Act.

Byron Georgiou: I don't want to add too much credence to the validity of the Private Securities Litigation Reform Act.

(laughter)

It's worked fairly well. The provision that identifies the largest holder, the party that suffered the greatest financial loss, to be the presumptive lead plaintiff has actually worked reasonably well in practice over the last 15 years.

Howell Jackson: So you would think that that would be the way to go here?

Byron Georgiou: It could be a way to go so long as you don't have collusive efforts where, once there's some rumbling going on, the company itself puts in a straw person shareholder that takes over the process and effectively undermines the integrity of the proposal of a new director. I don't know how exactly we'd police that.

Howell Jackson: Presumably the SEC would be making the call about in contested cases. Ed talked a little before about the SEC's capacity to play these roles, that will be a new role, I think.

Edward Greene: It would be a new role, but it requires judgment and you're going to hear from both sides of the fence as to what's going on. And that's the trouble – by putting the SEC in the middle, you're going to basically have to make decisions which inherently will be a question of who you believe. I think that's a tough role. And we haven't debated it, we've assumed that the SEC should stay in the middle as the intermediary between shareholders and companies. Once you put them in the middle, they're going to have to make these choices – is it legitimate, is it collusion, does everybody own the position that they have – so they're going to have to do a lot of

homework to give it legitimacy and that's going to be a challenge for creditability going forward, plus a disproportionate amount of staff time, I think.

Roy Katzovicz: Just to focus on some of these, I believe, more technical issues – I suppose the theoretical issues about the approach, and just to wrap up a few points that people have made. First to Jim [Morphy]'s point – “Why allow owners who only have 1% of a company's stock impose costs on 99% of the people who really don't want this? Why should we impose cost on the system?”.

There are probably two types of shareholders generally that we should imagine – two buckets in to which we could split things up neatly – one being sorts of indexed funds, large mutual fund complexes and so on. The reason why indexed and similar funds are interested in having a seat at the table at the 1% level is a function of their perception of logistics and how hard it is to get there since their portfolios are spread far and thin. It doesn't mean that 99% of the other people don't want them there. I think to suggest that that's the case is wrong – it's counterfactual. It might not be that 99% of people want them there. It may be only 10% or 20% and, if so, when they nominate directors they will not win.

But to simply say well, if you can only get to 1% support to post a nomination *prima facie* you must fail doesn't take into account those large index funds who feel that they've had a positive impact on corporate governance and value creation over the long term and across the economy.. Now, under the proposed shareholder proxy access regime the fear is that they might be interested in targeting specific companies because these shareholders have a particular issue or political axe to grind. But the efforts of these types of funds in corporate governance historically – Rich [Ferlauto], for example – has been to serve as the tip of the spear of reform. Their focus has been very broad-based and I'm a happy free-rider on a lot of their work as a consequence. Even though I'm a hedge fund and he's a union pension fund, right? Funny bedfellows, but works out OK.

In terms of holding periods, I think we need to be very careful about holding periods after a nominating shareholder has successfully elected a nominee – I'm less offended by holding periods for shareholder proponents before an election contest. But to Bob [Mendelsohn]'s point – most boards have ownership rules for their directors. Rather than focus on the holdings of a nominating shareholder, at the end of the day, the focus should be on the holding period of the director – whoever's appointed – take aside whether it's an affiliate of the proponents or not. They're going to have skin in the game as a director. And in that regard, I just don't think the fact that the shareholder proponents may have sold out after the election really has any impact whatsoever. What

you care about is the individual in the role fulfilling their fiduciary duty and abiding by the corporation's own requirements as to ownership.

Candidly, when we thought about this issue – and we think about it a lot, and we had the benefit of knowing it was coming up on the radar screen during a proxy fight this past spring. We were able to talk to quite a few of the largest institutional shareholders in the country and asked them about their views. And, privately, they were all very, very apprehensive particularly about organized labor's influence. That's the perspective that we received from a variety of the firms that often represent top-10 shareholders in the Fortune 1000. That's really what they were worried about.

And they thought that the right way to address that potential issue was to raise the qualifying threshold to a 5% threshold. Now, candidly, since our firm is a very concentrated investor, we get to 5% pretty easily, it doesn't make a difference for our business. The question is systemically, what's the right answer? And, we're torn. And, we do think that we should have implementation, experimentation and then change, potentially, but we wouldn't go from high down, we'd go from low up.

Let's see if, in fact, the feared "nuisance proxy fights", if you will, occur. If they don't occur, if there's no prevalence of waste, if we're like the UK, it won't make a difference whether we're at 1% or 5%.

As to the "first to file" elements of the SEC's proposal, that's just a terrible, horrible rule. It creates incentives on the part of people engaged in contests to enter into confrontation sooner rather than later. People here, I know, have had lots of experience with engagements with relational investors and boards and otherwise. Having a long runway in front of you in the face of a shareholder contest where you can talk and speak collaboratively is a good thing, and forcing people to run to the courthouse or nominating ballot is a bad thing.

One additional thing I'll bring up – it's one of my pet peeves – and a meaningfully worse difference between the SEC's 2003 proposal and today's proposal – is Section 16 relief for groups that do in fact form. As we all know, Section 16 is intended to address specific, *per se*, insider problems. If you have disparate holders who are acting in concert together for the sole purpose of making a nomination, that really isn't an issue. And, to not provide relief in this proposal seems actually counterproductive. If the goal is to increase the activity by large and semi-large holders in governance, in the affairs of a firm, to then create a disincentive from collective action by imposing short swing profit disgorgement really just works in the opposite direction.

One last little issue in here, and a question that was posed by the SEC and maybe is interesting for us to talk about, is whether or not proponents should or should not be affiliated with the people they actually put up on the board. Our own view is that requiring them to be either affiliated or unaffiliated makes no sense. It's a question for the election contest and should be up for discussion among all the shareholder groups. The problem of requiring that all nominees be unaffiliated with their shareholder proponents is that it will impose an even greater separation of ownership and control with a "stand-in straw man" as the director, and that seems like a bad idea.

Toby Myerson: Lucian, I'd ask you the question, since, in your theory, you don't need to own shares at the time of the meeting, would you have to own an economic interest at all or to exercise this right, can you exercise a vote and no economic interest. And if the answer is no to the second question, how do you distinguish?

Lucian Bebchuk: I do think that it is important to have shares at the time of making the nomination as well as to state an intention to hold shares through the annual meeting. We could conceivably even disqualify a nominee if the nominator is forced to sell prior to the meeting some of the shares establishing its eligibility. However, requiring a nominator to hold its shares through the meeting "no matter what" would impose a significant liquidity cost as the price of using proxy access and deter its use.

Eric Roiter: This is not theoretical because for a foreign holder, a lot of jurisdictions have these "share blocking" rules, for as narrow a window as five days or seven days, wrapping around the date of the shareholder meeting. And at Fidelity, fund managers were almost always unwilling to run even a five or seven day liquidity risk. Their thinking was "If we have to choose between preserving our ability to choose when to sell or vote, we'll preserve our ability to sell whenever we want to."

James Morphy: Well, just to be clear, nobody's saying you can't sell – that's not the issue.

Toby Myerson: Lucian, I guess the observation I'm leading through this – so I can conclude from your remarks that in your view, at some point, the investor has to own a net long position which equals or exceeds the threshold, so I take that to be your point.

Lucian Bebchuk: The investor has to pass the ownership test at the time of the nomination, state an intention to hold the qualifying shares through the meeting, and disclose if circumstances force it to change course.

Toby Myerson: But you're saying that that net long position can exist for a moment in time, which is –

John Olson: – Overnight? –

Toby Myerson: – the record date, and so on the record date you acquire a strong position, you declare your intention and you can then put up the director and sell the next day. And the observation I wanted to make is it seems to me that on that, theory and practice drastically diverge because the theory is you want to improve shareholder value by improving the governance of the company and putting a director on the board, which I think we would all agree, is not an instantaneous change, service on the board and making change is going to take a period of time.

That theory diverges with a practice which you say cost of capital gets in the way of. And so to me, where that leads is that a premise is flawed as opposed to let's eliminate this unattractive cost of capital problem we've inherited.

Abe Friedman: I just want to comment – and I just want to preface my comment with a statement that I'm not a new converted supporter of this because of any shift in policies. I supported the 2003 proposal. I think BGI has sent maybe three letters to the SEC encouraging proxy access. I don't write letters to the SEC almost ever, so we are strong supporters of access. But I think that having a threshold – à la the 5% kind of threshold that others were espousing for different reasons is really important because you want to have a sufficient number of investors having to come together to suggest that there's – just to put forward a nominee before the nominee actually reaches the company.

And the reason for that – and I speak from an investor perspective – is there is absolutely, unquestionably a level of distraction that a company goes through and a ton of cost borne in the system. And here, I've got to say – Eric [Roiter], the picture that you paint of Fidelity is very different from the picture that I would say, for example, Barclays Global Investors and the way we think about this. But when it comes to share blocking, we have an unblocking process, so that if an investor wants to trade, they can by pulling back a vote. We don't not vote because of share blocking. And similarly, we don't have a process where we sort of say well – Anyway, we have a very different approach, I think.

And I think, frankly, the picture that you painted, Eric, is a little bit outdated in terms of what I think of as – from most of my peers, almost every one of the major fund complexes in the country. And so there are lots of investors who care about this, but I think that we come from a perspective of saying there has to be sufficient support for this in order to make it work.

The other thing I just want to say is on the holding period issue, I actually – I don't know if I totally understand you, Lucian, which is why I asked the question and I still don't know if I totally understand. But I don't disagree with you that there is probably too much cost to require your shareholder to hold going forward. But I don't think that there's – I actually think it's critical that you require shareholders to have been holders for a long enough period.

I think one year is probably a sufficient timeframe to suggest that there's a commitment to the stock when people aren't going to invest the cost involved in doing this unless there is commitment. But I think you have to have at least a year holding requirement to know that this is an investor that's focused on the long-term and it's there for the long-term because otherwise, again, you get back to the distraction factor and there's a lot of costs that go into this. And you want – when a candidate gets proposed ultimately, you want them to have a sufficiently reasonable chance of success that it's not a waste of everyone's time to have gone through the process.

And now, I just want to make one other comment, and Roy, I was hoping you would say more about this, and maybe you're planning to later, but I actually don't think – I disagree strongly with Greg and a few of the other assertions that the proposed mechanism, if adopted, isn't going to get used. If it happens, it is going to get used. It's going to get used by all sorts of folks in the process, including, by the way, hedge funds who want to have their candidate show up on the same ballot and on a separate ballot as they would in another context. And that's another reason why it's really important to design the rule in a way that's sufficiently restrictive so that candidates who are representative of the voice of a substantial minority and also who are likely to actually have some success are the ones that get put forth and not – it doesn't become this fight for the opportunity to make a comment on the company, because that's – it's not a free opportunity. There is a lot of cost that goes into defending against a contest and distraction to the management team. And it's not – that's a problem.

James Morphy: Abe said he supports 5% for different reasons. And I assume – I think I know what he's suggesting. My reasons for supporting 5% are 100% aligned with what he just said.

Abe Friedman: My point there was simply that I haven't come recently to this idea that this is the lesser of all evils. This is actually really important. Shareholders need a right to access because boards do fail.

James Morphy: I am aligned 100% with your remarks on why 5% is an appropriate threshold.

Abe Friedman: I'll think about whether I want you to be aligned with me.

(laughter)

Lucian Bebchuk: You're completely right that the liquidity points applies only going forward.

Abe Friedman: That's why I asked the question before.

Lucian Bebchuk: Right. It applies just going forward.

Howell Jackson: I just want to throw out a topic area because it's related to a number of things that have already been said, and I think about this as the communication component. Now, one area of communication is communication amongst the proponent groups – especially if we're going to a 5% threshold, I think one has to assume that this is going to be an aggregation, and maybe even for 1%. But there is that – the question of what the SEC should think about there.

There's another communication which is sort of outbound communication from the companies – the vision of proxy access working this morning entailed dialogue often being what happens rather than actual proxy access. It's like Regulation FD – the company can have dialogue as long as it doesn't say anything – it can listen. Is it important here to have some sort of adjustment around Regulation FD to make this work informally? And then, as Roy said, one might think about how the liability rules interact – do we need to do something about Section 16 liability and exemption. There was a mention this morning about 13D litigation – do we need to have a cost-shifting rule to prevent disruption of group-forming. And one might more generally think about just liability anti-fraud rules in this context – would we relax the somewhat in order to have the communication?

So as we go through, I think we should start thinking a little bit more about the communication questions and what the optimal way to structure rule on those issues are.

Simon Lorne: I guess I think a couple of things, and one is that the long-term strikes me as important, although that's a declaration against my institutional interest since our fund holds almost nothing long-term. But I think we need to consider whether a proponent will hold for the long-term after the vote is taken – it's as important as having held for long-term before the vote, probably more important. I don't know how you put teeth in that, but I think it's important to think about. I've still got a file full of letters from 37 years ago about “change in circumstances” and we can perhaps pull all those out again and use them from the pre-Rule 144 days.

The other thing I think that is important, I think with Abe – the dangers, the risks that we have here are more on the abuse side than on the non-abuse side. That is likely to be important seldom, but very important then. But the abuse could be quite disconcerting. And I think I'm less troubled by the cost of distraction than I am by the threat to the process. I am a corporate director, and I have also participated in proxy fights – not as a director but as a lawyer – and I'll tell you, I wouldn't want to participate in one as a director. I don't like the political mudslinging and everything else. And if that were abused, I think there would be a significant additional penalty for the position of director that would discourage people from wanting to get into that mix. And all that causes me to think that there's real value in starting with a high threshold – with a view to moving it down--starting with a high threshold simply because the risk of abuse is worse on that side than on the other side. After all, we've lived with the system other way for the last 100 or so years and it came close to collapsing a year ago, but not for these reasons. And we could live further.

So I would tend to start with a high threshold. Having said that, if you eliminate some group of shareholders from the mix, presumably you want to eliminate them from the denominator when you figure out the percentage, as well. It ought to be that percentage of long-term holders, however you figure that out. Not that percentage of holders that include the people that you wouldn't let participate.

Joe Grundfest: A couple of observations. First, reiterating the entirely predictable perspective of the representative of the devout strong agnostic church. Again, these are both great questions. Why don't we just ask the shareholders? They could tell us where they want to put the different levels. They could also resolve the question of well, what if you've got a hedged position, do you have to make any commitments in terms of long-term holding and what have you? Every question that we're talking about here has a very nice, simple, strong agnostic solution.

Second observation: As I'm listening to this discussion, it becomes clear to me that many of us are talking past each other because we really have three different decision criteria that we're considering in terms of articulating the rules for getting onto the ballot. One conversation is about the ease of getting onto the ballot. Byron and Lucian, for example, focus on this question, and there the challenge is to make sure that it's easy to qualify. At the next level, which is I call the Abe Friedman test, you stop and say "wait a minute, we want to make sure that the level of support that you have when you get on the ballot indicates that there's a credible chance that you might actually prevail when you get to the point of the election." That's a very different standard than how easy is it to get onto the ballot. Then there's a third articulation that we can pull out of the earlier comments of Dan Summerfield and Greg Taxin: What level of support do shareholders

need in order to be able to create a credible threat to the incumbent board so that you can negotiate a resolution independent of the question of whether they can prevail.” This threshold is arguably set at a lower level than Abe’s “prevailing” test.

I believe in Freudian slips, and by articulating our views in this manner some of us may be displaying our true underlying motives in this policy debate. Byron and Richard have inadvertently told us that what’s really important to them. “I’ve got to get on the ballot.” It’s not about winning – it’s about exerting pressure. I’ve got to get on the ballot. We can then speculate as to why getting on the ballot is so important. I have my views. But it’s clear that Byron and Richard have articulated it’s getting on the ballot that’s key. Abe has very intelligently said, “now, wait a minute, I’m a responsible long-term shareholder, I really want to have a test that means if I can put somebody on the ballot, then I’ve got a chance of actually changing the board and *a fortiori* also exerting some leverage in negotiations if it gets there.”

Greg and Dan say, “now, wait a minute, hold off. I want a level that, if satisfied, allows me to go knock on the CEO’s door and the CEO isn’t going to say who are you? Why should we talk?” Now, these are three very different, extraordinarily intelligent ways to approach the proxy access problem, but they’re all really, really different. It says a lot about why people are getting exercised about these different trigger levels.

Richard Ferlauto: What matters to us is to change the complexion of boards of failed companies. It’s got little to do with getting on the ballot but being able to ensure that the nominating committee does its job, either through negotiation or through the force of a contest, ultimately. And we’re now creating a pool of directors who could credibly stand for election and win and provide value added to board. So to assert that we’ve got some other motivation is just wrong – a good debating point, but really doesn’t deal with the facts.

Joe Grundfest: I’ll just take the good debating point as a compliment.

Richard Ferlauto: I won’t go there – I’ll tell you later over a bottle of wine. We’ve run the numbers, and provided them to the SEC roundtable a number of years ago. It takes three of the top five public fund holders to get to 1%. It takes six of the top seven public fund holders acting in concert to get to 2%. It takes over 20 of the top 25 holders of public funds to get to 5%. And if you add into that mix 13D filing requirements, the aggregation of a group that’s functional is almost impossible, so that the thresholds that we’re talking about – if the goal – and I assert that that’s what our goal is – is to qualify long-term shareholders to give them some voice in this election of directors. So the current thresholds are appropriate.

And I want to remind everybody that the funds that I represent and the public funds that our members are invested in – have a fiduciary duty to produce retirement benefits with 20 or 30-year time horizons. So if there's a criticism of the motivations of why these groups may be engaged, I could and would welcome a discussion about fiduciary duty and about what fiduciary duty means regarding long-term investment strategy. Public funds have got a fiduciary duty to be activist owners and to engage in this type of reform. But if there is some criticism, I would invite you to review state fiduciary duty statutes, or even ERISA statutes to make clear what the motivations are.

Abe Friedman: Can I just say one quick thing, which is – and it's sort of on this last point – on what Joe was saying. And Rich, I don't know how you feel about this, but there was actually a recent example where there was a consent solicitation. So shareholders at this particular company – I actually don't remember the name of the company off the top of my head – shareholders of a particular company had the right to call a special meeting by 10% – 10% meaning there's a 10% threshold. So they did a consent solicitation and they sent out a consent and they got enough shareholders to get together to call the special meeting. And in that instance, for example, we voted at BGI to support the consent solicitation because we thought that shareholders should, in this instance, be exercising their right to call a special meeting.

Couldn't we just use the same model to address the very issue that you raise? It shouldn't be a problem. My point is, it's not bad to have 20 investors required to do this. You should have – to me it's actually very akin to calling a special meeting. You don't want to call a special meeting of the company and have them issue a proxy to every shareholder, without there being some legitimate thing where people really get together.

Richard Ferlauto: But it's not any 20 shareholders here. You need the top – you literally need to go from one through 20 in order to aggregate enough to meet that level of threshold. **Jeffrey Gordon:** Two points. First, hearing the debate between the 1% and 5% and 10% and the different motives, potentially – three of them that could form the one box more or less, it does make you aware that it's very hard in an *a priori* way to say not only what might be good for any single firm but what might be good when we're thinking about, from a system-wide point of view, the externality that rule may create in the governance of firms generally.

And it makes me think again as a design point that perhaps the way the SEC might reframe the test is by coming up with a menu of like a 1% or 5% – holding period is different, but a discrete group of choices. And require each public firm to have a vote on the menu as prescribed by the SEC within the next period.

And so you could genuinely think that this is a hard issue – (a) that a change needs to be done, (b) it won't happen if you leave it state law, (c) the SEC is in a good position to frame the choices, which the shareholders might then be required to vote on. So you get input onto which firms prefer which kind of voting system.

Howell Jackson: So a mandatory opt-in or a mandatory vote.

Jeffrey Gordon: No, no – it might be opt out – none of the above, except what I'm saying is that the choice ought not be – if it's a mandatory – I mean, if it's an opt-in – no, not between this and not – in a sense. I mean, the SEC could well have a menu among which firms could choose.

Joe Grundfest: Professor Gordon is a reform agnostic.

(laughter)

Joe Grundfest: Not an orthodox agnostic – he's a reform agnostic.

Jeffrey Gordon: Conservative agnostic, maybe – I don't know which way to go with that.

But anyway, this second point – and this is really in response to what Rich said – and I have enormous respect for the work that AFSCME has done in pushing the government stuff for many years. But the claim that he makes, in effect, is we will provide an externality – a public good for the economy as a whole, if you empower us to do so. And one might start to think hey, that's really a pretty good thing that some group will act beyond its economic interest to try provide a public good.

But then I have – all right, so I start off thinking, that's very fine. But then I can't but remember the comment he made this morning which is to say the corporate governance failures accounted for an \$11 trillion loss in market value, which I think is – I don't agree with it, I think, in a very profound way, which then makes me rethink – wait a minute, is there a cost to empowering somebody to create a public good, which – the public good is in a formal sense, right? It's sort of like it's an externality, except whether it is a public good in the sense of wealth increasing, then – without thinking that you guys are doing any bad thing, you then raise the question of whether we should empower any group in a way to create public goods, which is to say it's a systemic effect in how U.S. firms are run.

And then you get to the question of is – if in fact the 1% threshold would so empower you, is that a good thing or a bad thing, just because we don't know exactly a

particular model you'll have in your head. And we do take a systemic risk if we empower you to put forth that economic model in a way that you might want to do.

Richard Ferlauto: Just a quick retort there – and we could talk about what the effects were, and obviously there were multiple effects and various influences on what led to the economic collapse – lot of different pieces in motion there that all came together in this unique period of time. But our initial focus on access was because we didn't trust Citi's books.

And it was their SIV structure that we believed was unmanageable in terms of risk – and that if we had been able to achieve victory through proxy access at that company in 2003 when we began to focus on Citigroup, in theory, it would have helped unravel, early on, the risks that were being carried by all those financial companies in terms of the way they manage risk.

John Olson: Which nominees were you going to put on the board at Citigroup that were going to solve this problem?

Edward Greene: I think we ought to switch a little bit to what you highlighted, because it's not just the percentage, it's not just totally directed communication, because the higher the percentage, the more you want to be able to allow people to communicate. And then you would have to take a fairly critical view as to what the role of the SEC's going to be.

One way is to say, this is the rule, company shareholders go back and forth and we're not going to regulate it. You will be subject to maybe a fraud prohibition – but we at the SEC are not going to get in the middle. This is what the rule has done. That is something that would be difficult for the Commission to do, because it's been involved much more. But that's where the problem is, because then you would have to deal with issues of proof, you're going to have to deal with issues of clearance, you're going to have to deal with issues with who gets to see the communication going forward.

I think – and your agnostic doesn't deal with that, because even your agnostic proposal – let companies decide – that's not going to deal with the communication issue, because the shareholder resolution's not going to affect what the rules are going to be. So you can't do this in isolation. I would move – because of the experience the staff has had on this, I would basically free it up and take some risk, especially if the threshold were higher. Then we could have people who do have common interests getting together. We wouldn't make them worry so much about litigation, about fraud. But we'd allow

them to put proposals before a company. If you couple that with a holding period, it seems to me you might get more of a robust dialogue and debate than you have today.

But you can't keep the current system in place with disclosures and the same threats that are there if you're going to have this work with a high threshold unless it can be –

Howell Jackson: So Ed, specifically what do you – what's the safe harbor – what are the boundaries?

Edward Greene: Well, I think it would be to say that, just remind people that any communications are subject to the anti-fraud rules. We do that with respect to a lot of our communications to the market. And any company that issues to the market is told, oh, by the way, you're subject 10b-5. So we limit it, we put out statements to the market all the time.

Howell Jackson: So a FD carve out?

Edward Greene: FD – I'd carve – I'm not – there, I think the question would be, if there were sensitive non-public information disclosed, I think there would have to be some expectation of confidentiality because others would not be comfortable if that information were made available and then going forward was traded on. I think that would – you have to be sensitive. But the real question is, what level of oversight do you want the staff to have in monitoring communications if you expect those communications to increase because of these threshold levels.

John Olson: Oh, well, communication point, I agree with that. Deregulate communication outside of the company's proxy – the company's proxy, obviously, because of the company's paper, company's ink and so forth – introducing limits on number of words – 500 may be too few for proposing a bylaw. Now, that might be plenty for proposing nominees, but I would free up communication outside the limits of Rule 14a-8 but subject to Rule 14a-9 and other anti-fraud rules, and stop worrying about it.

I mean, it's happening anyway. I don't think it's an FD issue, because very little information about this process is going to have anything to do with a company's internal projections or confidential business information that's market moving, factors that might be market moving.

I wanted to make another observation. I was struck how this conversation – the last hour here – relates to some of the conversation this morning. I heard from Byron this

morning, from Dan Summerfield and from Isaac, who's not with us, a theme which I thought was quite appealing, which is that in another regime – in the UK, where they've had this around for a long time, as a matter of statute, not a matter of rule, and in Byron's experience in negotiating corporate governance-type settlements of securities class actions, and derivative actions, and then Dan's experience as an investor, is that what is good is when it leads to dialogue. And I think Byron specifically said in their settlements, they involve the nomination and governance committee of the board in the process of vetting prospective candidates – that's worked well.

And what strikes me about this federal regime is none of that is in it. There is no safety-valve, there is no formal way of involving the nominating and governance committee. I don't know that that's easy to do, but it strikes me that that's missing.

Then with respect to the holding period, whatever the holding period is, if in fact the purpose of this proposal is to empower shareholders to exercise their state law franchise right, then you have to observe, I think, the state law requirements for making nominations and presenting proposals, which, at a minimum include being a shareholder – not a borrower of shares or somebody with a derivative interest but no economic interest at the time you make the nomination and at the time that the nomination is considered in the meeting.

And there's going to be a minimum period there of some number of months – it may not be a year, but it's probably going to be five months. So the person who says I have got to have complete liquidity and I'm not going to put myself in a position where I can't sell it at a moment's notice, at least as to the qualifying percentage, he's going to have to set that aside or not be a participant. Otherwise, you're doing violence to state law and the whole fundamentals of what is the franchise about, to whom is the franchise available, who is a shareholder? I don't think any of us would say it's available to somebody that borrows shares overnight and doesn't plan to be at the meeting. So there's going to be some limitation on liquidity for those people who meet the threshold and participate in the process.

And what I hear Abe and Rich saying is, that's fine with us, because the funds that we represent are largely indexed, they're long-term investors, they're not in-and-outers. And we can, with some effort – and we can argue about how much effort – put together a group that is going to be in the position of meeting a reasonable holding period.

Daniel Summerfield: Just a couple of comments I think John mentioned the communication issue. And if access to the proxy does come about – if you do have the

right to put forward a slate of directors , that would indicate that the communication channels have broken down – this tool would be utilized as the last resort.

So essentially, you want to avoid this actually happening in the first place. So you could threaten to do it, as Greg has mentioned –

Greg Taxis: But to do it credibly, we'd need to be prepared with a slate.

Daniel Summerfield: Right, OK. But that would happen, and presumably at some stage, you could withdraw that slate if you felt that the directors were putting forwards candidates that met your expectations. So essentially, what we're trying to do is change the dynamics – change the way in which companies disclose the rationale behind the selection of the current slate of directors for a particular company.

And what we find in all markets in which we operate is that we get very little information from companies in this regard. In the UK, you get a paragraph on the work of the nominations committee, and 50 pages on the remuneration committee. Now, as a follower of Jim Collin's school of thought, I believe governance starts with getting the right people on the board in the first place

And how do you actually improve this process? In a sense, as shareholders, we don't actually want to do this ourselves. I would argue that it takes a huge amount of time and resource to do this job properly and to identify the right candidates that are appropriate for a particular board. You want the boards to come up with the right candidates rather than having to do this ourselves. We've got – thousands of companies now in our portfolio. It's really not something that we would want to deal with on a regular basis.

Now, one company which I've identified here – as exhibit A – is I think a great example of a company that does this well. For each candidate that is up for election or re-election , it gives the reason why this person is standing from the perspective of the board and it also gives a statement from the nominee as to the reasons why he thinks he's the right candidate for the job.

This isn't a company which is in a market that is renowned for having good governance. It's actually a Japanese company called Eisai which is a pharmaceutical company. And I think we could encourage companies to replicate this approach.

Greg Taxis: I just wanted to respond on one point because, as you said, it's becomes a – this is a last resort. I actually don't think that's the way it will be treated. This is going to be a fire-first sort of scenario. I think shareholders will – anybody who meets the

threshold will nominate themselves, their sister, their uncle and that will get them into a conversation of management. And unfortunately, that filing process under this rule is public, and so they're going to file a 14N, there's going to be a news story that there's a shareholder that's angry.

They're then going to get themselves in the dialogue. Under the current system, what we have is shareholders who want to meaningfully engage with company management aren't under the pressure of a timeline to file first. They can go in, have, as Roy said, a long dialogue, they can say we're prepared to file a proxy contest and we will do so under the company's bylaws. But, by the way, even that filing is private and confidential, so you can show your nuclear weapon without getting yourself into armed conflict that everybody in the world will witness. Once the world is watching, egos can get in the way of reasonable dialogue.

Maybe the minute this rule passes, some index fund that owns a lot of shares in every company will just file their uncle and their cousin at every company they own so they can be first filed. And they'll be the guys first up in 2011 in every company. And then they can get themselves into the discussion.

So I'm a little a worried under this rule that it is going to be a race to the courthouse, investors will file, perhaps because they want the notoriety; you'll get a bunch of press stories that will not actually be conducive to engagement with companies in a private negotiation or discussion because you're going to have this very public fight.

Daniel Summerfield: Since Professor Grundfest put us in the same category, I'm going to distance myself from Greg. I think this will happen, perhaps, in the first couple of years, but what boards have got to try and do is rebuild trust with their investors. I think there's been a fundamental breakdown of trust between investors and companies.

And if companies can explain to their investors exactly what's going on, what are the value drivers in the company and to provide more information on the directors etc and start from that position, then we will be less reliant on utilizing these tools when engaging with companies.

Byron Georgiou: I want to agree with some of the people who historically might have seen me to be on a different side of this debate. I agree that this first-to-file notion is ridiculous. Eventually, I think the largest-to-file is going to control, subject to anti-collusion problems. The SEC is fully capable of investigating fraud and prosecuting people for fraud; certainly they can make the determination on the facts of these cases. You ought to have been a previous holder – you shouldn't have to hold your shares until

the vote. I would definitely concur with John on those issues. You want long-term holders. I would argue for a lower percentage because I think the higher thresholds prevent meaningful participation.

It really doesn't advance the debate to diminish the perception of the motivations of people who advocate for proxy access. The reality is that institutional investors are motivated by their fundamental responsibility as fiduciaries for the hundreds of thousands, sometimes millions of public and private sector employees who have worked a lifetime in reliance on an expectation – a contractual expectation – that they're going to have retirement benefits in the future.

What we have seen is that these beneficiaries and the fiduciaries upon whom they rely, genuinely believe that they haven't had an adequate opportunity to influence the companies to create greater shareholder value. Our system of corporate governance will be better served if these fiduciaries can go back and say to their beneficiaries that they've undertaken their full fiduciary duty to try to earn as much money within their funds – and sufficient money within their funds – to honor the obligations that they've made to their retirees and their prospective retirees.

And that is a fundamental notion which has a general societal value, but more importantly a company-specific, pension fund-specific value. The institutional investor needs to make money from the companies so that the pension fund stays actuarially solvent. The reality is that under-funded pension funds in the public and private sector impact society extraordinarily because governments at the federal, state and local levels have no money to infuse additional capital into these funds.

Similarly, private sector company retirement plan sponsors don't have sufficient capital to infuse into their funds, and unions certainly don't. So the institutional investors that are advocating proxy access are looking to the private sector, looking to the corporations they invest in to provide them those kind of returns. And they believe proxy access this can have an impact on those returns. And without trying it, we can never answer that question. We would have a lot more satisfied shareholders of American corporations if this proxy access opportunity were provided to them.

A lot of the rancor that has existed would be ameliorated by the safety valve of proxy access. We can debate what the particular criteria ought to be, but the general principle is one that's sound and at the end of the day is in the interest of the corporate world as well, to promote a degree of comity and collegiality with their ownership base, which increasingly has become public, private and union, pension funds.

John Olson: There's zero evidence that CalPERS has been under-funded because of bad governance of its equity investments in public companies. It's under-funded because, all by its little lonesome, it invested billions of dollars in things like real estate inventory and alternative investments which went south.

Byron Georgiou: Well, John, they certainly made some bad real estate investments.

John Olson: That's a CalPERS governance problem, that's not a corporate governance problem.

Byron Georgiou: Perhaps, but it's also the case that they're invested widely in the public market place.

John Olson: So am I.

Byron Georgiou: Well, so are a lot of people.

John Olson: But I don't really believe that my portfolio would have done better if the corporations had had better boards. I think we have our losses for lots of reasons.

Byron Georgiou: Well, you may not think so, but –

John Olson: I think maybe Alan Greenspan had a little more to do with it –

Byron Georgiou: Well, I think Alan Greenspan had plenty to do with it. Let me just respond to that one point. You may not think so, but a lot of people do believe that if shareowners could have proposed directors, they might have elected directors with a broader perspective and ability to guide the investment policies the operations of corporations in a better way. Now, as a shareowner, you can disagree with the election of a particular director and simply vote no if you think that the new director would not be appropriate.

John Olson: I'm all in favor of good directors, and I wish it were true.

Howell Jackson: Well, I think we can all agree on good directors.

(laughter)

John Olson: I wish it were true that that made as big a difference as you think.

Howell Jackson: So I want to make sure that we circle back to where Joe started with us this morning – at the temple of agnosticism. We've had a lot of conversations about opting-in and opting-out, and one of the debates this morning was whether it's better to

have an opt-in or an opt-out. One of the things that the SEC will have to take up if it moves forward with something like 14a-11 is whether or not it should include an opt-out aspect to it – so is it mandatory for all time or mandatory with opt-out.

Now, Joe is not going to be happy with the rule, but I assume he would like an opt-out included. And we need to think about how that would be designed, what the temporal timing. Do we make an opt-out decision before we get experience, do we have experience and then have opt-out? And then of course the question of, once you opt-out how do you get back in? How should those things interact, if at all?

John Wilcox: I was going to suggest that the SEC should look back at the question of raising thresholds on shareholder proposals about 10 years ago. Steve Wallman actually championed this. And it was unfortunately turned down by the shareholders who, in a sort of rainbow coalition, were rallying behind social issues and those kinds of proposals. But there was a quid pro quo for higher thresholds that could serve as a very valuable precedent for the issue of whether or not we should raise thresholds on this proposal. There has to be a quid pro quo if they are set high. One requirement might be to take a look at the suggestion that was in the WorldCom Report, “Restoring Trust,” prepared by Richard Breeden which required – and I don’t know if this actually ever happened – that the company should create a website that could be used by shareholders to assemble shareholder support for initiatives. It would have been paid for by the company, but it would be a facility that the shareholders could use amongst themselves. That kind of facility could be useful if you’re going to set a higher threshold and make it easier for the shareholders to do so. I also agree with Ed Greene’s point that you need – and John Olson’s – that you need to deregulate communications amongst shareholders in this area if you’re going to set higher thresholds.

Finally, the article that I wrote suggesting a model bylaw for access had a requirement in it that the corporation would be required to meet with the shareholder proponent within 60 days after the filing of an access slate. The board nominating committee would have to meet with the proponent. The objective of that meeting would be to do what we’ve all been discussing here, which is to find a suitable candidate acceptable to both the company and shareholders.

I agree with what Daniel Summerfield said, which is that institutions are not in the business of director search. They don’t have specific candidates. They want the company to choose effective directors and they recognize that the company knows what’s needed on the board – what qualifications, what particular skills are needed, to achieve their business strategy

An enforced meeting between the nominating committee and the sponsor would lead to a better understanding on the part of the shareholders of what the company is doing and a better understanding on the part of the nominating committee as to what the concerns of the shareholder are that have led to this initiative. And they should –

John Olson: John, let me – just to clarify, what you were talking about would be a requirement before the proponent could put forward a nominee?

John Wilcox: The proponent would file an access proposal and, the company would receive this filing. It might not have the name of a candidate, actually, on it at that point.

John Olson: But before you could make the nomination, you'd have to have the meeting in the company –

John Wilcox: Yes. Comparable meetings were held in the case of Lockheed Corporation. They were going to lose proxy fight back in the 1980s and reached agreement with shareholders on a new board member.

There are two situations I can recall where we have a model for collaboration on director selection (and I know there are other, more recent examples) One was Lockheed and its proxy fight where the company was expected to lose. It sat down with several of its largest institutions, including CalPERS, and together they made up a list of board candidates who would be acceptable to both sides. And Lockheed then chose a candidate from that list, CalPERS and the others voted in favor of that slate, and Lockheed won the proxy contest.

The other situation was Texaco, when they did their bankruptcy filing. There was an agreement between the company and the equity committee to prepare a list of eligible candidates that both groups could agree would serve their interest. My recollection is that John Brademas was the candidate they selected from the list.

Now, how to make this happen, I think, should be an objective of this type of –

John Olson: It happened many years ago at Phillips Petroleum when Melvin Laird and Frank Wheat went on the board in a settlement of a proxy contest.

John Wilcox: I think shareholders are not that interested in nominating directors or being directly represented on boards, except in special cases, like Greg Taxin might submit a slate because to achieve a particular strategic objective. But in general, though, certainly TIAA-CREF and the largest institutions do not want to say, Mr. X or Ms. X is our candidate, we think this is best person to serve on your board. We don't know

enough to micromanage board selection. The shareholders want the nominating committee to do its job well. At best shareholders can supplement the efforts of the nominating committee, not take over their job.

Mark Lebovitch: I'll touch on the thresholds and on the opt-out. On the thresholds, there's a concern that I think we all share of abuse of the proxy access. I just wonder whether this isn't based on anecdote or maybe speculation. I don't know what evidence there is of any abuse of proxy access. We've heard a lot of people say, it may not be used at all.

There's not empirical data showing abuse. We have some empirical data, very limited, of free proxy access with very few restrictions, and that was in the window, I think, after the AIG opinion. I don't think there's examples of abuse in that period.

Getting to the thresholds, if you start at 10%, we may never know why people aren't running proxy fights, because the standard may be so high. I mean, you have no abuse, and we'll be stuck in a largely unused rule.

If we start off at a lower level, the same people who like the status quo today will continue, you know, to lobby in Washington, will continue to make intelligent arguments against the rule. And if there's an instance of abuse – if we have a CSX-type situation where people are gaming the system – we'll hear about it. And the rules can be changed. Just like now there's a fight for them to change the status quo, we could change back and we could go up to 5%.

I think 10% would prevent those who would like proxy access from continuing the argument to approve proxy access. I think some of the fear is not over proxy access itself but maybe a slippery slope – if we allow proxy access and give this little inch that shareholders in the room say may not really mean much, I think there might be a, well, what's next. And that's really the source of the resistance.

And on the opt-out, I couldn't imagine that you would have an opt-out rule, if that just is based on plurality, I mean, I've worked with proxy solicitors. It's very clear that there's some percentage of every shareholder electorate that just does what management says unless management are clearly looters. So it can't be a plurality standard. If you're going to have an opt-out, it should be a majority, like a majority of the outstanding has to support the opt-out. Otherwise companies will go back to Jim's concern, will use a lot of money to basically convince the first time around the shareholders to opt-out. And who's going to oppose it? Who's going to be spending money in opposition?

Session IV: Corporate Elections Beyond Proxy Access

Moderator: Lucian Bebchuk, Harvard Law School

Byron Georgiou: This is the hardcore, Lucian.

Lucian Bebchuk: So now is the time for the grand finale. This session aims at looking beyond the particular proposal of shareholder access and examining corporate elections in general. Are there any additional changes that people would want to consider to the arrangements governing elections? I've talked with people during the breaks, and some of the issues that have come up are empty voting, annual elections, majority voting, reimbursement of expenses, and new technologies for corporate elections. So I would like to invite participants to explain what changes they would like to see, if any, and why.

Roy Katzovicz: Lucian, if you'll allow me, I'll integrate a little bit of the shareholder proxy access discussion into this. On a number of occasions today, some people in the room have offered an opinion that their hedge funds or other hedge funds may not actually take advantage of this, and I think that's really wrong. I think, if no one else will take advantage of it, maybe I will.

But there are a number of elements that are embedded in the shareholder proxy proposal that can be teased out that have enormous value to a relational investor, in particular as far as highly concentrated fund - we manage funds that currently have roughly \$5 billion in assets. We invest in eight to 10 or 12 companies at a time, so this is a very concentrated investment strategy. The cost associated with activism, i.e., some of the out-of-pocket cost associated with engaging in a contest, are immaterial to us. However, we engage in such contests very infrequently, because we prefer to have discussions with management. Typically that's very successful as a strategy.

But when we do enter the fray, the mechanics of voting systems become incredibly important. And, although a universal ballot concept was not adopted by the SEC for all contests in the context of making the shareholder proxy access proposal, that by itself - just the universal ballot, by itself - is probably the single most important element in a shareholder proxy access proposal from this hedge fund's point of view. The reason is very simple, and part of it's practical, and part of it's very cultural.

First, as a practical matter, right now, whether it's because of the proxy advisory firms' habits, or perhaps because of Broadridge's history, right now, as most of you understand, most contests are on a slate by slate basis. Typically, and I think somewhat unfortunately, the standards for change, whether change is merited, is something that is

looked on as a whole – against the incumbent board and an insurgent slate, and then matched against each other, not so much for the individuals and directors themselves.

I think that when we go to a universal ballot, which will have basic elements that include, on every ballot, all candidates' names, as a practical matter, we no longer have to deal with thinking about proxy contests as a slate versus slate. Oftentimes we've been involved in situations where large holders would prefer to take one or two of our nominees, and the balance of incumbent board members, and that's simply practically not possible today. That fix is going to be very helpful to us.

As a cultural matter, there are two sub-points. First and foremost, having the decision of choosing two people, one next to the other, invites, we think, a more intelligent analysis on the part of shareholders generally. In particular, we think that if the basis for election for a nominee is their merit as an individual, a fund or an investor of any type that can identify the deadweight on the board, and in place of that deadweight find ideal candidates from a skills perspective to round out the board, they're going to have an easier time getting shareholder support for their nominee. Their ability to vote among all the nominees and from all proponents, I think, facilitates that kind of person-by-person analysis, versus slate-by-slate analysis.

Then, all of a sudden, the cultural shift in the boardroom happens. Every director is out there by himself or herself. Every director understands that he or she is at risk, and could be at risk because of their own personal qualifications and/or decisions. In other words, a chair of a compensation committee may be a specific target because of some bad decisions by his committee, and he'll be accountable for that. It's not abstract apple pie accountability, but this is, to a person, allowing people to choose by comparing each candidate side by side. I think that is incredibly important development as it relates to shareholder proxy access. Because shareholder proxy access is not upon us, certainly we will be advocating for adoption of the universal ballot across all contested proxies, and we think that that would have a huge impact.

Lucian Bebchuk: Can you please describe how it would work?

Roy Katzovicz: Well, taking aside the issues of rendering in terms of presentation, let's assume just for the moment, because it's easy, that you'd have a list of people who are proponents – who are nominees of the company on a ballot, and next to them the insurgent proponents. And, of course, there's only a limited number of seats that are up for election –

Jeffrey Gordon: What do you mean next to them?

Roy Katzovicz: Side by side.

Jeffrey Gordon: X is running and would management put forth X, and then the insurgent has Y and directly – a pairwise comparison?

Roy Katzovicz: I mean, ideally, from my perspective, we would – the insurgent would be able to match up on a person-by-person perspective. That said, I'm not sure if that's going to be practical, or ultimately something that gets negotiated. I don't really care. In other words, I think that shareholders are intelligent enough to be able to take from a pool of names, so long as the names are identified as incumbent versus alternative director, whether or not it's person by person or that gets replicated in the decision process, if not on a piece of paper. And because I do think it will be replicated in the decision process, not on a piece of paper, assume you have a total of 13 candidates, nine incumbents, four insurgents, on a nine-person board, the shareholders will be asked to choose among the 13 only their top nine. And they can do the correlations between who they prefer – this one versus the other one on their own. It needn't be force-fed to them necessarily in the manner of presentation.

So now, there may be, in the paper world, some difficulties here. Undoubtedly there'll be the case that people vote for 10 instead of nine, and that may create confusion. But with electronic voting in particular, and other developments, I don't think that's going to be a major problem.

Lucian Bebchuk: Any reactions?

Robert Mendelsohn: Just a thought, Lucian, and one of the things that sometimes gets lost in the matching up of qualifications of insurgents against those nominated by management really is the whole question of boardroom dynamics, and the role of the nominating committee. We did a very interesting study – our company wrote a tremendous amount of directors and officers liability insurance around the world. So we were in a position to look at what went wrong. Companies – when companies failed, litigation ensued, and we took a look back at the qualifications of the board. And in many, many cases, probably the vast majority of cases, there was no correlation between the paper qualifications of the directors and the failure of the company. Our classic example is Enron. Enron, on paper, had a board that ticked every corporate governance box you could imagine. What you could not do is determine whether those people, as a collective group, when you put them in a room together, or put them on a teleconference together, actually could get the job done.

And we really are looking today as if this is a – corporate governance is a panacea, and we can diversify the boardroom, we can solve the world’s problems in avoiding the next financial crisis. You have to be very careful. The mechanics of whether a company works or not has an awful lot to do both with the paper qualifications as you match those people side by side, but an awful lot is matching the right skills in the boardroom. And in my experience, really, there’s no substitute for a thoughtful nominating committee that really does its job. And we ought not get too carried away with the ability to put up two extra people. And a lot of it really gets back to whether, as Dan was saying earlier, you can have a meaningful consultative process between the nominating committee and the shareholder activists, and come up with a slate that will meet the company’s needs, because otherwise you may end up with too many marketing people in a financial company if you were to add two more marketing people to the board. By far, if you work out a system where consultation occurs, then most companies, I think, will be willing to do that.

Roy Katzovicz: Look, I totally agree with you’re saying, but remember, we’re talking about the special case where shareholders have decided that there’s been a failure of governance. So while, of course, strong nominating committees and processes are the preference – we all prefer, I think, to avoid direct conflict if possible – we’re talking about the special cases where shareholders who are promoting change think there’s been a failure.

But from our own experience, the question of whether or not the board is going to work is the first question that every shareholder who we solicit support from asks, and if we don’t, in the first five seconds of the interaction, prove to them why it is the case that either the qualifications of the people that we brought to bear are appropriate and/or their demeanor is appropriate, I think these are all – then it’s over. So of course you’re right. But that’s part of the contest. Proving that out is what the solicitation’s all about.

If I can go to one other big issue that also touches on the shareholder proxy access proposal, but also the next wave of kind of big issues, if you will, in this space, in the shareholder proxy access proposal as drafted, there was a phenomenal, from at least this person’s point of view, conforming change that was made to Schedule 13G and related rules. Take aside the issue of whether a person can view themselves as passive if they seek to elect directors who then have “control” which was mentioned earlier, which is a very important issue. In the proposed rules there’s an idea that you can design to elect a small minority of directors and continue to be a passive holder, The idea is that you continue to report as a passive holder and nonetheless harbor the desire to elect up to 25% of the board, which is a very, very different regime than we have today. That is excellent. And it’s excellent in a world where each of the items (a) through (j) of Item 4

of Schedule 13D – which has historically encompassed the universe of “activist” plans – should be reviewed as to the merit of their applicability. I think you can probably carve out a few of those items, that aren’t directly implicating “control” over corporations . So long as shareholders have the requisite intent , a regime that gives shareholders the ability to be relational investors and put people on the board, whether they’re affiliated with the investor or not, is a phenomenal opportunity.

Now, unfortunately, it’s not only likely that the SEC’s – obviously – delayed or not, postponed, if you will – implementation of shareholder proxy access has clearly happened and passed us. But it’s also the case that very recent – and I say as recent as just a few days ago – proposals in Congress, both in the Agriculture Committee and the House Financial Services Committee, have new rules where the SEC’s asked for complete discretion and power to completely change 13D, G, and F reporting regimes, including, as you can imagine, from the folks on the inside of the SEC who now populate the SEC who used to be in the academy, also to the issues like empty voting and so on are going to be addressed very directly.

And what it appears to be is, rather than allowing for regime as a shareholder proxy access proposal would allow for relational holders to also have board seats, and nonetheless, not have to be subject to 13D reporting requirements, it’s likely that the opposite is going to happen. It’s likely that 13D is going to become more restrictive, and there’ll be much more disclosure in service to unknown ends, necessarily. In other words, the aims of these required disclosures have not yet been articulated. These include, among other things, shortening the time window once a person crosses 5% from 10 days to two days, as well as aggregating economic ownership and beneficial ownership as the exact same thing. This is a battle that’s only beginning now, but it’s going to heat up very quickly over the next six months, because legislation is being put on the floor as we speak.

John Olson: That’s true. Be worth having another day on that, maybe having Henry Hu here and maybe having Kayla or somebody else come back, because it is a – something’s going on within the Commission in Congress. People are working opposite directions, even though some of the same people are working in those opposite directions.

Richard Ferlauto: Although – I mean, Henry’s literally in rulemaking are preparing to, so I’m not sure what he’d be able to say, other than sit in the corner, but –

Lucian Bebchuk: Any suggestions how to deal with empty voting?

John Olson: I think that one could actually get to voting – the way to deal with empty voting and with voting without an economic interest is – empty voting or vote buying is to require full disclosure, which some advance notice bylaws now purport to do, of your full range of interests, economic, derivative, whether settled with cash or settled with delivery, as part of your qualification to present a proposal. The harder question is – when you’re not trying to present a proposal, and you’re simply filing a 13D – do you have to disclose all these things? When do you have to disclose them? And the impact of some of these interests which are not now reached by the beneficial ownership rules when you decide whether or not you go over the threshold.

And then, of course, there’s the question of, should there be a threshold when short positions are reported, which they now have in the UK and Germany, and other countries. I think it’s 3% in UK, and in a short position you’ve got to make a report that becomes publicly available. That would be a big change for our markets, has lots of consequences –

Simon Lorne: Isn’t that why we’ve got Henry [Hu] at the SEC?

John Olson: That’s why they’ve got Henry [Hu] at the SEC to look at those issues. That doesn’t mean that a majority of the Commission is going to agree to do any of these things.

John Wilcox: That obviously probably requires some sort of rules as to where the vote is found when you have these split interests. I asked Annette Nazareth about this question at lunch, and she said that actually Brian Breheny has been assigned the enviable task of trying to figure out where the voting rights should be deemed to be lodged in situations where they are arguably in more than one place. If you look at share lending, a lender is supposedly not entitled to voting rights, but if the lender is someone in a margin account, that individual is getting voting rights because the broker gives them voting rights. When the shares are lent out, the vote is supposed to follow the shares, so the shares then go to a third party, etc., etc. through multiple trades. We don’t have a mechanism now in the voting area that enables us to find out where those voting rights are at a given moment. We’re very good at determining who’s entitled to get a dividend. And if we can do it for a dividend, we can certainly do it for votes. But there is a failure of will within the broker community –

Simon Lorne: Well, actually, that’s not true. A dividend you can always make up with cash. You can make it up after the fact, etc., and you do. You can’t do that with votes.

John Wilcox: Well, the other suggestion that was made, which I think is probably equally fruitless, is that you look at some of the rules that determine whether a taxable event has taken place in terms of giving up a sufficient amount of ownership, and try to see whether voting rights could in some way be linked with ownership for tax purposes. But apparently those rules –

John Olson: This is basically a matter of state law. Now state law's based on record ownership. I don't know why a state legislature couldn't, if it wished, say that it's got to be based on beneficial ownership, and write its own beneficial ownership rules. And some states may do that.

Greg Taxis: Well, I was just going to add to John's more practical point. At the theoretical level, there's lots of empty voting going on. If you look at investment strategies, as simple as what Eric talked about earlier today, where people are underweighting a security in an index, that's equivalent to being short the company from the investment manager's perspective. It's a bet against the company.

Abe Friedman: No, no, no, no.

Greg Taxis: Absolutely. It's a bet against the company, to be underweighted relative to an index benchmark. And if you get to vote that security, you're essentially voting at a company that you are hoping doesn't perform. And there's a whole range of – that's just one example, but there's a range of derivative instruments, bets on peers, shorting peers, that I think creates all manner of complicated situations that our very simple notions of ownership that are in state law, and in the federal proxy rules, don't really take account of. I think investors have far outpaced the sophistication of state law on proxy voting and federal securities laws, and so too with our information technology systems. And I think, John, our failure to be able to track the real beneficial owner, the universal ballot issue, which I think is a key issue, really all boils down to Broadridge, and the fact that we've turned over all of our voting mechanics to a single company that has a monopoly, has no interest in keeping that system current or able to handle the sophisticated transactions that occur in our capital markets today. They run our proxy voting system, and they run it on circa-1985 technology, and the reason we don't have a universal ballot is because they can't figure out how to code it in COBOL.

Roy Katzovicz: I offered to pay for that, by the way.

(laughter)

Seriously.

John Olson: And they make a ton of money doing so, by a government-sanctioned monopoly.

Greg Taxis: They make a ton of money. The dropped digit on the Yahoo! vote should be an embarrassment in this country. And what we need, it seems to me – and I don't have the answer to this – but clearly what we need is to modernize that whole infrastructure and system. And that would make, I think, a world of difference –

John Wilcox: The SEC has said that they're going to undertake a review. But there's been plenty written about how the system could be redesigned relatively easily. If you're going to do it in a really correct way, then you have to really universally dematerialize stock certificates. You have to get rid of stock certificates, instead of immobilizing them as we now have, so that we can catch up with the rest of the world. But absent that, which requires the states to cooperate, you can still open up the old proxy system, get rid of the no vote/low vote rules, create ways for companies to communicate with beneficial owners, allow beneficial owners to have privacy through dedicated nominee accounts, and get the brokers and the banks out of the voting process, just as DTC is now out of the voting process. So it's not hard to do. So add that to your list - change the proxy system.

Abe Friedman: So I wasn't going to make this point before but I need to make it right now, that I completely and totally disagree with what Greg just said. To take an index and say, I'm going to realign the index slightly because I want to try and out perform it does not make you against some companies. You want to outperform the index. If some company – if any company in your portfolio is doing well, you're doing well. So there's no incentive to not have a company do well just because you only own 80% of what you otherwise might have chosen to own originally.

My second point is – and I vote stocks and portfolio like that all the time and we vote them exclusively in the long-term best economic interest of shareholders, not from an empty voting perspective. And secondly, this business about empty voting, frankly, is – I was just trying to make a quick comment, which is, I think it's great for the SEC or anybody else to figure out how to deal with it. I actually don't think – and I think even Henry would tell you, if you had him in the room, that empty voting is really happening particularly in the U.S. It's happening, I think, around the world, largely outside of the country. It's already not legal to borrow shares for purposes of voting in the U.S., and frankly, whatever we can do to get it off the table so we can focus on things that actually are happening would be a much better outcome for shareholders. Because, really, this is used by some in the corporate community, frankly, as a tool for beating up on why shareholders – why they shouldn't grant rights to shareholders, why shareholders shouldn't have the opportunity to have proxy access, why shareholders don't deserve

majority voting, and other things. And I think it's a red herring. And even the best research that is out there on the question suggests that in the U.S., empty voting is really not particularly – at least it's not a particularly identifiable problem. And I just think we should move to things that actually are problems, and not get caught up in red herrings and the idea that granting shareholder rights is dangerous because shareholders are empty voting

Joe Grundfest: As John Olson has already suggested, one approach to the empty voting problem is to let shareholders define the rules for ownership for voting on their own. Again, this goes to the notion of right of the franchise, and it's entirely consistent, dare I repeat the phrase, with a strong agnostic position in this area as well. Although I must admit that it raises a very interesting philosophical point of contention, because does that then mean that we're going to have empty voting on empty voting? Now –

(laughter)

Joe Grundfest: You see my point. But if Abe is right, and if as a practical matter empty voting isn't really a fundamental problem in the United States, and it tends to arise more in foreign jurisdictions, then again, looking to this fully enabled opt-in agnostic approach – if it's not the perfect solution, it's better than any other solution we're likely to be able to come up with in this room or in any other.

Also, there's no reason why you couldn't provide for proxy reimbursement and several other aspects of reform that activists would like to see, again, through a fully enabling, opt-in, strong agnostic approach. And because I'd like to think I'm logically consistent about this, and I have no objection to having shareholders say, all right, we're going to have proxy access, it's going to be at a 5% threshold, and anybody who runs is going to get compensated for a percentage of their expenses equal to the percentage of the vote that they get. So if you get 30% of the vote, you get 30% of your expenses compensated, subject, of course, to the board's determination of reasonableness. You need that fiduciary out. That is an intellectually consistent and legitimate way to go at these issues, and at many others.

Simon Lorne: So directors only get 40% of their compensation if they only get 40% of the vote?

Joe Grundfest: If the shareholders decide that that's what they want to do, then – the trouble is, there's no corner that you're going to box me into on this, except for the empty voting on the empty voting. At that point the logic does fall apart, I'll concede that.

Lucian Bebchuk: What then is your view on staggered boards?

Joe Grundfest: I'm glad you asked that question. Again, I would, of course, allow shareholders to vote. But if you have a look at just vote no campaigns, in at least two recent situations, where directors either had a majority of the vote against them or close to a majority – and I think Dollar General is one example –, you had the directors offer their resignations, but the board said, wait a minute. The shareholder disaffection really wasn't personal. The shareholders were sending us a very strong message that they don't like the staggered board. So the board agreed to de-stagger. Think about what that means: you don't have to go through the mechanism of getting the board to propose a change to the charter, giving the board the total veto authority in order to de-stagger the board. The evidence is now that you can bypass the board's agenda control through the cheap and easy mechanism of just vote no, and you can actually cause de-staggering without a formal charter amendment.

This, in my view, is huge. It's entirely consistent with what Greg's been saying, it's entirely consistent with what Dan's been saying, and it's very close to what Abe's been saying. And again, it also suggests that some of the stuff that's written about dynamic default rules may be based on an empirical assumption that's not entirely correct.

Lucian Bebchuk: I think the evidence on staggered boards might actually be suggestive of the opposite view. Most staggered boards are charter-based, and many of the charter provisions establishing staggered boards were adopted before the powerful antitakeover consequences of staggered boards became clear. For the last two decades shareholders have been unwilling to vote for new staggered boards, and shareholder proposals to dismantle existing staggered boards have been receiving large majorities. Some public companies have responded by eliminating staggered boards. As Scott Hirst and I discuss in our paper, however, the shareholders of roughly half of public companies are still “stuck” with a staggered boards.¹⁴

Joe Grundfest: Institutional investors should care about getting rid of staggered boards, but they have not been following the right strategy. With all humility in the world, they should have been following the strategy I wrote about in 1992. They should just vote no. We now have evidence that it works. At Pulte Homes and at Dollar Tree, you vote against the individual directors. You make it personal. You're going to have a majority withheld. Why? It's not that I don't like how you look. I don't like the staggered board. You change the staggered board, and then I won't object to you. To my knowledge, we have a sample size of two, and in both cases, Dollar Tree and Pulte Homes, they're going to de-stagger. You follow that alternative strategy, I believe that works.

¹⁴ See *Private Ordering and the Proxy Access Debate*, 18.

Greg Taxin: There is another issue with staggered boards. I think that strategy's not going to work any more because of the proxy access rule, because of majority voting, and because of the broker vote going away. The boards that I've talked to have said, you can't go to annual elections if there's going to be a majority voting standard, no broker vote, and, heaven forbid, proxy access. So we have to stay staggered so that we have continuity. And we may – Professor Bebchuk, if you're right, as undoubtedly you are, always – that staggered boards are the most highly correlated governance structure to underperformance, I fear what we're trading here is the chance to de-stagger boards across the capital markets for a reform that actually doesn't get us quite as much, namely, proxy access, majority vote –

Joe Grundfest: I would wind up agreeing with Greg, but with a different mechanism of action. I just think, as a simple matter, just vote no campaigns are so easy to do, they require no government intervention, and they can achieve everything that you need to achieve in the vast majority of circumstances. All this additional sturm-und-drang about getting on the proxy – it just may not be worth it. Rich, you would be better off running a series of aggressive and intelligent “just vote no” campaigns.

John Olson: Just say no is another SEC proposal which is pending, which would allow people who want to conduct a just say no campaign to distribute the company's proxy with a recommendation to vote no selectively on those proxies and send them to the company, as long as they don't solicit proxies for themselves. So it makes it very cheap and easy to do a just say no campaign, and that's likely to be adopted, I think, next month.

Daniel Summerfield: I'm going to join the agnostic camp on the classified board debate. I think that, certainly from the UK experience – we do have staggered boards where most directors are appointed on a triennial basis. And there's a debate going on at the moment as to whether or not to move to a system of having annual re-elections for all directors. A number of government-sponsored reviews are currently underway, which is the usual way the UK responds to a crisis.

Abe Friedman: One commission? There's like 10.

Daniel Summerfield: One of the debates going on at the moment under the aegis of the Walker Commission is whether boards should now become annually reelected. And there's a big divide actually, in the institutional community in the UK as to whether or not to retain the current triennial election process, or to move to an annual election process. And USS has publicly supported retaining the current format. –. And the reason is that, if we are trying to engender a longer-term outlook on the part of the boards, then

surely having an annual reelection process could encourage a short-term outlook on the part of directors.

The second reason is that if you've got the tools available, whether it's access to proxy, or real majority voting, then the annual reelection isn't going to be necessary as shareholders will have the means to remove and appoint directors when necessary.

Lucian Bebchuk: Although most UK directors are elected for three years, shareholders have an inalienable right to remove them at each year's meeting as well as in a special meeting called for this purpose.

Daniel Summerfield: That's right.

Lucian Bebchuk: In contrast, in the U.S., when you have a staggered board, shareholders are practically precluded from removing the director until the end of the director's three-year term.

Daniel Summerfield: But if you had access to the proxy – and presumably you could put forward a candidate or slate of directors to replace –

Lucian Bebchuk: Not with a staggered board. With a staggered board, if you have a director that is elected for a three-year term, you cannot remove this person until the end of those three years. That's how proxy access would work in a company with a staggered board in the U.S.

Jeffrey Gordon: I was just going to say that, that a staggered board system, where you permit removal without cause, which is the UK system, may be different than in the U.S., where you can't remove, except with cause. I mean, it goes to show, in a way, it's a nice point about how these changes, it seems A or B actually have pretty important effects, which makes the design issue all the harder, because small details seem to matter a fair amount.

Eric Roiter: A couple of points, and I'd like to clarify the record. When I hear staggered board, I kind of think them the same way I think of independent chairman. I mean, you tell me the company, and I'll tell you whether I like the staggered board, I'll tell you whether I like an independent chairman. You take all the data, Lucian, and do all the analysis and then say, on average, the companies that have staggered boards underperform those that have annual elections. But then, within that universe of companies with staggered boards, you have, presumably, some companies that do quite well with staggered boards, and by the same token you have companies that do quite well with a CEO who also is chairman of the board. So I think, pragmatically, investors would say

”Tell me the company - is it responsive to investors, is it performing well? Then I’ll accept a staggered board, I’ll accept a CEO who is also the Chairman of the Board, but once it starts underperforming, maybe that’s a different matter.”

But the clarification I’d like to make is that institutional investors can have different opinions. I was only trying to report a fact. You might say “that fact sounds unreal to me.” All I can tell you is, give me your e-mail address, and I will forward to you any number of shareholder reports that come out of Fidelity for individual equity funds, and you will see how they explain fund performance. The template for disclosure for a fund that outperformed its index is along the following lines: “The fund outperformed its benchmark index because we made some good picks in over-weighting certain stocks, and we also found sectors of the economy that we don’t particularly like, and we picked some companies that we thought would under-perform. We underweighted those stocks compared to their weighting in the benchmark index. It turns out that we were right for some of those underweighted stocks and that helped the fund outperform its index.” I’m reminded of a story Peter Lynch once told me. An analyst went up to him and said, “Peter, what do you think about Company X?” And Peter said, “I love Company X, I keep telling the trading desk, keep buying more and more stock of Company X. I love it. I can’t get enough.” And then the analyst says, “but Peter, you’ve under-weighted Company X.” And he says “I have?” So some fund managers are indifferent to where their holdings are against the benchmark index. You can have some funds where the manager loves every stock he or she has, maybe loves some more than others, so some stocks wind up being underweighted. All I can tell you is that has not been the universal experience from where I sat, and I saw it, and it’s reflected in the shareholder reports that explain fund performance.

Here is another example: One fund manager manages a 130/30 fund, which means he sells short 30% of the portfolio. I asked him, , “Does that mean you’re not going to under-weight stocks in your fund because the investment policies of your fund allow you to sell short? So, if you don’t like a stock you’ll simply sell it short rather than under-weighting it?” He said, “no, this is just a continuum. It depends on how strong my conviction is. If I have a mild conviction that this stock is not going to perform well, I’ll under-weight it. If my conviction is stronger, I might keep going on the continuum and short sell it.”

Abe Friedman: Just to clarify, according to Greg’s comment, somehow because you underweight a stock, you are “empty voting” when you vote that stock.

Eric Roiter: Oh, OK.

Abe Friedman: My point is simply this. When you're short a stock, you make money if the stock price goes down. When you are long a stock, you lose money if the stock price goes down. There is no incentive to – I understand how enhanced indexing strategies work, and I understand that if that stock price goes down, if you're right, if your bet is right and that stock price does fall, and you've underweighted it, you're going to beat the index. But you're confusing that for the incentive for the investor to actually drive the stock price down, to use your vote to do something negative at the company, when actually that will just bring down your total performance overall. And what you care about at the end of the day more than anything is making a return.

Lucian Bebchuk: Would anyone like to talk about either confidential voting or majority voting?

Steven Davidoff: There is something I would like to talk about, which is, it strikes me that part of what we're talking about is rewarding long-termism. And if that's the case, perhaps one thing to look at – I don't know if there's any empirical studies, if there's a fellow looking for one – is in France. If you hold shares for longer term, you gain extra votes on your shares. And so one thing that we may want to think about in terms of enhancing proxy access is looking for rewards – because it's not proxy access, but enhancing long-termism, is looking at ways to reward shareholders, and I don't know how the French system works –

James Morphy: Well, there was phased voting in the U.S. - 19c-4 took it out.

Steven Davidoff: Right. I'm not saying – I'm saying this is a goal, not a practicality right now.

James Morphy: There used to be phased voting systems. The longer you held the stock, the greater votes, which is exactly what's being described. And they were all wiped out by 19c-4, which said you have to have one vote per share.

John Wilcox: How was that administered? Did they use LIFO or FIFO to account for shares in a portfolio that keeps turning over??

(laughter)

Steven Davidoff: Jim, 19c-4 was struck down.

James Morphy: Yes, I know, all I was saying is that there were examples of this type of voting in a handful of public companies in this country. And after 19c-4 they basically disappeared, and I don't know of anyone who's suggested putting it back.

Steven Davidoff: There are systems that do have this, particularly the French system I'm thinking of. And so I think that as one thing that people might want to think about. Thank you, Jim for pointing that out.

John Olson: I think that Lynn Stout at UCLA is doing some research on that very subject. If you want to get in touch with her, she may have some –

Steven Davidoff: No, I'm asking the fellows actually to look at it. It's a project to look at.

I think secondarily, just with that in mind, I think it's very important – a lot of us have talked about the English system. I just said the French system. I practiced in England from 2000-2005. I think it's very – maybe I'm restating the obvious, but there's big cultural differences there, and so when we talk about the need for dialogue, the English system pushes for dialogue. A lot of that is the culture. I remember the takeover panel, for example, for a long time, didn't have the power to make monetary fines. They just censured people. And that worked very well in England. And England also has a much – has prohibitions on takeover defenses, as we also know, which may affect the way the proxy systems work.

I think, finally, just – because I'm not sure if I'll speak again, but just the universal ballot that Roy mentioned. So I write a column for the *New York Times*, and part of the joy is, every proxy battle that happens, the proxy solicitors call me, so I get both sides.

But I think the universal ballot, which I know you pushed in Target, I think is viable. I think you're going to see more of it, particularly by the hedge funds running short slates, because that's a back-door way to get their short slates nominated. And I think there are, with all due respect, I think there's real issues with those types of universal ballots and sort of breaking up the board in a back-door way. But I do think it's something to watch for the next proxy season that has the big event.

Roy Katzovicz: Steven, why is it back door as opposed to front door?

Steven Davidoff: Well, I think it's – so essentially, the conventional wisdom was that – and up until this year with Target, and there was one other – Amalyn –

Steven Davidoff: Was that from hedge fund put up a short slate, the ratings – the proxy advisory services would push it forward, and as Rob Kindler says, any idiot can elect a short slate. He was saying that at CSX constantly.

Roy Katzovicz: Oops.

Steven Davidoff: No, no, no, you seem quite smart.

Roy Katzovicz: That's OK, it didn't work.

Steven Davidoff: Economically, I think that it seems that there's – as the low hanging fruit is taken down and the proxy contest – and the hedge fund activists become more competitive, and nominating short slates becomes a more competitive process, universal – you know, just not being through the front door on your short slate, you're looking for every vote you can. And it's very easy if you have a universal ballot. And I know that you were pushing this in Target to just say, not only just vote for one if you're not going to vote for the other, but it's also on the ballot, so you can pick and choose. So I mean, please rebut that, but that was the impression I got.

James Morphy: The Amylin situation involved two short slates that were not treated as a group, did not have to file a 13D, and were allowed to use overlapping ballots, so both short slates could proceed with each other's nominees, and a selection of the board's nominees.

Jeffrey Gordon: This is on a different issue, and what it relates to, to the discussion about what the overall effect of voting reforms is going to be. And so one question that I had is to what extent is majority voting locked in, in a way such that change in the broker discretionary voting system won't lead firms basically to go back? Because it seems to me that if it's that majority voting is simply by a change to the bylaws, I can easily imagine a case where one large firm had a failed election or a bad outcome, that would lead many other firms to decide, well, it's time to rethink the change we made here. And I wonder if anybody has given thought to whether that might occur.

Roy Katzovicz: It's typically not locked in. It's a board policy, and sometimes a bylaw. Where it's a bylaw, typically it's a bylaw that can be amended unilaterally. So there's no such thing as locked in, in this case. There are some people who have it in charters, but it's very much the exception.

Lucian Bebchuk: Both Roy and Jeff are focusing on the companies that now have majority voting. But a substantial fraction of the Russell 3000 firms do not have majority voting. If those companies don't have majority voting yet, you obviously can't use majority voting to press them to get majority voting. Now that we have ample evidence that investors prefer majority voting, should we change the default from plurality voting to majority voting and have companies subject to majority voting unless shareholders approve otherwise?

John Wilcox: A state law change?

Lucian Bebchuk: Yes.

John Wilcox: Well, people have tried that.

Lucian Bebchuk: Is this a good idea?

James Morphy: I think majority voting is such a non-issue now, at least at the level of the companies I deal with. I mean, basically, it's *fait accompli*, it's done, it's over.

Lucian Bebchuk: You deal with the largest companies.

James Morphy: But Lucian, when you use your statistics you refer to 3000 companies, I have a feeling that the statistics, as you go down into companies 250 through 3000 aren't the companies that Richard and others are talking about changing.

Abe Friedman: No, no, that's not true.

James Morphy: OK. Alright.

Abe Friedman: Majority voting is categorically, without question, the most important shareholder right that we don't –

James Morphy: No, I'm not saying that it isn't important to investors.

Abe Friedman: And the issues tend to come up more in the smaller companies than the larger –

James Morphy: OK, I accept that, but from my view of the corporate world, specifically large public companies, with respect to majority voting, it's a done deal. It's over.

Greg Taxin: It's easy to have a list of all the things you'd like to have and say, that would be good, that'd be good, that'd be good, that'd be good. But there's actually interplay between them that I don't think we should lose sight of. I don't think shareholders will be successful in getting majority voting, access, de-staggering, and getting rid of the broker vote. At some point corporate boards say, now we're vulnerable in a way that threatens continuity of the board. And so I guess my humble advice to my fellow shareholders is, we ought to pick our battles, because I think to the extent you try to get the whole menu, you may be jeopardizing the more important elements of that menu.

I happen to think de-staggering is pretty important, but to the extent you get majority voting and no broker vote, people don't want to destagger. And I think in some sense majority voting has hurt the effort to de-stagger boards.

Daniel Summerfield: So what would you be your order of priority? What would you say is on top of your list

Greg Taxis: I don't know. De-staggering is pretty high on my list, maybe at the top of my list, because a vote this year focuses the mind. Directors –

James Morphy: Just one observation, we have discussed many aspects of proxy access, and a thought that just I haven't heard much discussion of is, to the extent there's going to be proxy access, which does raise legitimate concerns about disruption, etc and board dynamics. ,a possible way to bridge some of the differences is the idea that access, if it takes place in year one,– that there isn't another access opportunity at that company, for another three years.

And the reason I say that is because part of the problem with access – and it goes to what Sy [Lorne] said earlier about board dynamics. After year one, if there's going to be access for another 25% in year two, you actually want the board to take – let's say my board of 12 and I add three – you actually want that board to absorb those three into the board, and you want them to be re-nominated, I think, the next year. And you're adding tension to that process, if the board knows that by bringing those three on and renominating them, they open it up again next year to three more, etc. And so from my perspective, it would be – the shareholders who want to make their point about governance, etc. and put three people on the board shouldn't need to do it again the following year. And I think by this mechanism you would encourage board collaboration and cohesion at the end of the day among all the directors. I simply throw it out for consideration.

John Wilcox: Jim, is that issue effective if the three directors who make up the 25% – are they permanently labeled as directors representing – as shareholder nominated directors?

James Morphy: Under what I just said, no, not permanently. In effect they would be shareholder nominees for three years.

John Wilcox: Right, well, I think that's a question.

James Morphy: Yes, it is a question.

John Wilcox: Because if that were the case, then once you reach that 25%, you're done. You can't have any more the next year. How long does that go on?

James Morphy: As the rules are drafted, that's not the case but, in my example, it would last for three years.

John Olson: That's not what the rules say.

Simon Lorne: I would argue on the other side of it, if you put up the three, you can't put up three more, because then you are getting control of the board.

Lucian Bebchuk: We are going to end the official part of the session. I would like to thank Scott Hirst and Emily Lewis for their work on organizing this event and to thank the participants for their contributions to the discussion. Thanks to all of you.