

# **Shareholder Access to the Proxy: Increasing Democracy & Accountability in Corporate Governance**

**The American Federation of State, County  
and Municipal Employees (AFSCME), AFL-CIO**

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## Executive Summary

Investor confidence in the market has fallen to Depression-Era lows as a result of the scandals at WorldCom, Enron, Tyco and HealthSouth. Corporate governance reform is the best way to begin to restore investor confidence. Current flaws in governance ranging from non-performance-based executive compensation to audit committee failures to director conflicts of interest are mere symptoms of the fundamental problem: incumbent directors exercise de facto control over the entire board nomination process.

Last year, the AFSCME Employees Pension Plan submitted shareholder proposals at Citigroup and five other companies seeking access to the proxy for the purpose of director nominations. On April 14, 2003, the Securities and Exchange Commission (the “Commission”) allowed the companies to exclude the proposal.

On the same date, the Commission announced that it had directed its Division of Corporation Finance to examine “current proxy regulations and develop possible changes to those regulations to improve corporate democracy.” This announcement and its accompanying request for input from the affected community is the latest effort by the Commission to review the system governing proxy rules, shareholder proposals and the election of corporate directors.

Many parties, including the Commission itself, have been trying to remedy the shortcomings of the current system since the implementation of the Exchange Act over 35 years ago. In response, several reforms, including the strengthening of audit committees and the enhancement of penalties for violations, have been undertaken. A proposal to give shareholders increased participation at the corporate board level, namely direct proxy access, however, has not yet been instituted.

The Commission should propose new rules providing substantial, long-term shareholders with access to the corporate proxy statement for the purpose of nominating director candidates. Other mechanisms which shareholders and the Commission

had hoped would lead to increased shareholder participation in the nomination process have failed to achieve this aim.

Direct proxy access would enable groups of shareholders to nominate candidates to stand for election to the corporate board by using the company's proxy materials under specific guidelines. Allowing shareholder-nominated, non-incumbent candidates to run for election would introduce a fresh perspective to the board and encourage increased responsiveness and accountability to shareholders. By providing a cost-effective and efficient means for shareholders to nominate candidates and communicate with one another regarding director elections, a shareholder right of access to the company's proxy statement would help restore accountability to our system of corporate governance.

## Background

*“[F]undamental and far-reaching issues have been raised concerning the adequacy and effectiveness of shareholder participation in corporate governance.... [N]umerous recent examples of an apparent breakdown in corporate accountability have led informed commentators to question the efficacy of existing methods of corporate governance.”*

It would be natural to conclude that these concerns were expressed in the context of the corporate meltdowns that began in 2001 with the collapse of Enron and that continue to the present day, most recently with allegations of massive accounting fraud at HealthSouth. This series of failures, punctuated by the two largest bankruptcy filings of all time at Enron and WorldCom, has provoked both soul searching and finger pointing by companies, shareholders, boards of directors, regulators and the media.

But the statement above dates from 1977, not 2003.<sup>1</sup> Like today, in the 1970s, shareholders and the public reacted to revelations of corporate misbehavior, includ-

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<sup>1</sup> The language appears in Exchange Act Release No. 13901, 1977 WL 173489, at \*2 (Aug. 29, 1977).

ing bribery, kickbacks, illegal political contributions and accounting malfeasance, by questioning the system of corporate accountability.<sup>2</sup>

In response, the Commission sought comment regarding how to increase shareholder participation in corporate governance.<sup>3</sup> The Commission explained, “In recent years there has been a considerable amount of thoughtful criticism concerning the ability of shareholders to participate meaningfully in the governance of their corporations.”<sup>4</sup> Among the questions posed by the Commission was, “Should shareholders have access to management’s proxy soliciting materials for the purpose of nominating persons of their choice to serve on the board of directors?”<sup>5</sup> A few months later, comment was resolicited on this question in anticipation of public hearings.<sup>6</sup>

In the end, the Commission decided not to provide shareholders with access to management’s proxy statement for the purpose of nominating director candidates. Instead, the Commission embarked on what it characterized as a three-stage process: the first stage entailed requiring additional disclosure regarding a number of matters, including the independence of the members of the nominating committee, if a company has one; whether the committee will consider candidates recommended by shareholders; and the procedures to be followed by shareholders in making such suggestions.<sup>7</sup> However, the Commission made clear that it intended to consider further the issue of shareholder participation in the director election process, explaining that “the institution of nominating committees can represent a significant step in increasing shareholder participation in the corporate electoral process, a subject which the Commission will consider further in connection with its continuing proxy rule reexamination.”<sup>8</sup>

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<sup>2</sup> See Exchange Act Release No. 13482, 1977 WL 173444, at \*2 n.1 (Apr. 28, 1977)

<sup>3</sup> See generally *id.*

<sup>4</sup> See *id.* at \*3.

<sup>5</sup> *Id.*

<sup>6</sup> See in Exchange Act Release No. 13901, at \*4.

<sup>7</sup> Exchange Act Release No. 14970, 1978 WL 19391, at \*7-8 (July 18, 1978).

<sup>8</sup> *Id.* at \*8.

Three years later, the SEC Staff Report on Corporate Accountability emphasized that it was abandoning direct shareholder access only temporarily in order to allow other approaches an opportunity to work, stating that “we do not want to discourage the voluntary initiatives currently under way toward establishment of nominating committees. We therefore recommend examining the 1980 proxy data with a view toward determining the extent to which companies are establishing nominating committees, and the extent to which these committees are considering shareholder nominations.” If “sufficient progress” was not seen, the report asserted, “the staff recommends that the Commission authorize it to develop a rule which would require issuers to establish ... procedures for shareholder access to issuer proxy material for the purpose of making shareholder nominations....”<sup>9</sup> It does not appear that the contemplated review of 1980’s proxy materials was ever completed.

Events that have transpired since the 1977-78 rulemaking and 1980 Staff Report demonstrate that reliance on disclosure and nominating committees — whose members, while independent, are also incumbents — has not remedied the passivity common to corporate boards. It has become clear that the presence on a board or committee of formally independent directors does not ensure a subjective attitude of independence, nor does it guarantee independent action. Put simply, formal independence, defined as the absence of certain kinds of relationships with the company, does not alone ensure that a director will adequately safeguard shareholder interests.

The perils of putting too much faith in formal independence is evident from the numerous spectacular failures — often amid allegations of self-dealing and accounting fraud — of companies with formally independent boards. A majority of directors at Enron, Tyco and WorldCom were considered “independent,” yet they failed utterly in their duty to monitor management and respond appropriately to red flags indicating fraudulent practices. Less dramatic but equally important are the across-the-board upward spiral of executive compensation, the explosion in earnings restatements and an unresponsiveness to shareholder concerns evident in recent

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<sup>9</sup> Senate Committee on Banking, Housing and Urban Affairs, 96<sup>th</sup> Cong., 2<sup>nd</sup> Sess., SEC Staff Report on Corporate Accountability 125-26 (Comm. Print. 1980) (quoted in Jayne W. Barnard, “Shareholder Access to the Proxy Revisited,” 40 *Cath. U. L. Rev.* 37, 65 (1990)).

years, all signs of a system in which accountability is lacking. The way in which directors are elected contributes significantly to these problems.

### Shortcomings of the Current System

Under the current system, boards of directors are self-perpetuating; that is, incumbent members select nominees to fill vacancies and decide whether to renominate themselves. The candidates selected by the incumbent board — and no others — are then included in the proxy materials and on the proxy cards sent to shareholders in connection with the annual meeting. It is easy to forget, given how entrenched the practice of exclusive incumbent access is, that in other electoral settings candidates bear their own costs of campaigning and all those who run for office appear on the ballot. In nearly all director elections there is no meaningful choice among candidates, and shareholders' actions can be more fairly characterized as ratification.<sup>10</sup> Indeed, one author has noted that director elections at U.S. corporations resemble nothing so much as “the elections held by the Communist Party of North Korea....”<sup>11</sup>

It is well-established under state law that shareholders, as well as the incumbent board, have the right to nominate candidates for election to the board.<sup>12</sup> To promote an alternative board candidate, though, a shareholder must undertake an independent solicitation; specifically, a shareholder must circulate a separate proxy statement promoting its nominee, solicit shareholders' support and ask shareholders to execute a separate proxy card, and have the votes on those proxy cards tabulated. The legal, mailing, solicitation and other costs associated with mounting an independent solicitation in support of a director candidate has been estimated at several hundred thou-

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<sup>10</sup> Some companies do provide procedures in their bylaws for shareholders to suggest potential candidates to the board or nominating committee. However, the advance notice requirements for raising matters other than nominations and the burdensome amount of information required regarding candidates lead us to conclude that the primary purpose for such bylaws is to deter hostile takeovers. See Barnard, *supra* note 9, at 51. In any event, we have seen no evidence that candidates suggested through this avenue are seriously considered by nominating committees, nor is there any mechanism for shareholders to monitor the steps taken in response to these nonbinding suggestions.

<sup>11</sup> Edward Jay Epstein, *Who Owns the Corporation* 13 (1986).

<sup>12</sup> See Melvin A. Eisenberg, “Access to the Corporate Proxy Machinery,” 83 Harv. L. Rev. 1489, 1505 (1970).

sand to over a million dollars. Moreover, filing requirements under Rule 13d-1 — and the litigation arising thereunder — deter some institutional investors from undertaking election contests.

It is thus unsurprising that election contests are exceedingly rare. According to Institutional Shareholder Services, it voted on 45 proxy contests between January 1, 2002 and May 15, 2003, out of a coverage universe of approximately 10,000 U.S. public companies.<sup>13</sup> On average, then, during that period, there were about 33 contests per year. That figure does not represent a significant increase over 1988 — when 30 contests took place<sup>14</sup> — despite the intervening 1992 proxy rule revisions designed to facilitate the running of “short slates” by shareholders. As two Delaware judges recently noted, “The aberrational cases in which shareholder activists have actually mounted proxy contests tend to prove the incumbent bias of the system, rather than cast doubt on it.”<sup>15</sup>

#### Benefits of Direct Proxy Access

Many of the reforms undertaken in response to the current crisis of confidence in corporate governance, including strengthened audit committee standards, restrictions on accounting practice and enhanced penalties for wrongdoing, will prove useful in shaping corporate behavior. However, a key piece of the puzzle is still missing. Shareholders should be able to protect their investments by intervening and effecting real change where it matters most — at the board level — rather than watching helplessly as a company fails.

Distinguished commentators agree that increased participation by shareholders in the director selection process is critical to restoring the corporate governance balance. The Commission on Public Trust and Private Enterprise established by The Conference Board<sup>16</sup> to investigate the causes of, and suggest remedies for, the cur-

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<sup>13</sup> E-mail from Robert Kellogg, Institutional Shareholder Services, May 15, 2003.

<sup>14</sup> See Barnard, *supra* note 9, at 39 n.11.

<sup>15</sup> William B. Chandler III & Leo E. Strine, Jr., “The New Federalism of the American Corporate Governance System: Preliminary Reflections of Two Residents of One Small State,” at 66 (Feb. 26, 2002) (available on [www.ssrn.com](http://www.ssrn.com)).

rent investor malaise, opined, “Shareowners, particularly long-term shareowners, should act more like responsible owners of the corporation. They should have not only the motivation, but also the ability to participate in the corporation’s election process through involvement both in the nomination of directors and in proposals in the company’s proxy statement about business issues and shareowner concerns regarding governance of the corporation.”<sup>17</sup>

Chancellor William B. Chandler and Vice-chancellor Leo Strine, Jr., of Delaware’s court of chancery — the nation’s premier corporate law court — go even further. In a recent paper, they urge consideration of a shareholder access regime, asserting, “The reality that thoughtful deliberation on this front is warranted cannot obscure an equally apparent reality: the rhetorical analogy of our system of corporate governance to republican democracy will ring hollow so long as the corporate election process is so tilted towards the self-perpetuation of incumbent directors.”<sup>18</sup>

Shareholder-nominated directors could improve the functioning of corporate boards in several ways. Most scholars and observers of boards agree that boards carry out three broad sets of tasks: servicing, which involves advising the CEO and senior management on strategy, business development and other similar matters; obtaining the company’s share of external resources; and monitoring, including assessing the performance of senior management, determining the CEO’s compensation, and overseeing the audit and compliance processes. Although board members generally work collaboratively with each other and with senior managers, especially in connection with the servicing function, they must bring to bear even on these tasks a healthy skepticism. In extreme cases, and in the monitoring context, board members must be capable of assuming an adversarial posture with management.

Like other small groups, boards display biases that can interfere with their ability to carry out their functions effectively. Boards exhibit a natural tendency toward cohe-

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<sup>16</sup> The Commission’s members include former chairman of the Federal Reserve Paul Volcker, ex-SEC chairman Arthur Levitt and former U.S. Senator Warren Rudman.

<sup>17</sup> The Conference Board Commission on Public Trust and Private Enterprise: Findings and Recommendations, parts 2 and 3, at 15 (January 9, 2003).

<sup>18</sup> Chandler & Strine, *supra* note 15, at 67.

siveness because, as discussed above, they self-select and because a strong norm of reciprocity prevails. Such cohesiveness can lead board members to trust one another and can help foster effective decisionmaking. However, it can also lead boards to overcommit to past decisions.<sup>19</sup> For example, a board that approved a merger may be reluctant to conclude that the transaction should be unwound even if that action is in the company's best interest. Similarly, a board that hired a CEO may refuse to recognize that her performance is not meeting expectations and that her employment should be terminated. Overcommitment thus can impair a board's discharge of its monitoring and servicing functions.

Cohesive small groups that value civility and cooperation may also suffer from "groupthink." Groupthink leads groups to neglect or devalue alternative viewpoints and to discount information that is not consistent with the group's preferred point of view. In other words, boards afflicted with groupthink "value consensus more than they do a realistic appraisal of alternatives."<sup>20</sup> Groupthink can prevent board members from effectively exploring all options open to a company and from challenging approaches that have the group's imprimatur.

Directors nominated by shareholders can break the cycle of self-perpetuation and introduce a fresh perspective, thus combating those biases. Although the injection of one or more outsiders can indeed disrupt the cohesiveness of a board, as some have warned in arguing against shareholder access, such disruption will almost certainly be more helpful than harmful when a board is paralyzed or severely dysfunctional. The new insights provided by a shareholder-nominated director would improve the

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<sup>19</sup> See "Emerging Trends in Corporate Governance," *Corporate Board Member*, 2002 Special Supplement (available on [www.kornferry.com](http://www.kornferry.com)) (comments by Harvard's Jay Lorsch that boards have "a problem of understanding and recognizing the failure of the decision [in] which they participated").

<sup>20</sup> Stephen M. Bainbridge, "Why a Board? Group Decisionmaking in Corporate Governance," 55 *Vand. L. Rev.* 1, 32 (2002).

board's performance of both its monitoring and servicing functions under such circumstances, since both call for directors to make critical evaluations.<sup>21</sup>

Further, the availability of shareholder access would encourage boards to be more responsive to shareholders and other key constituencies. Chancellor Chandler and Vice-chancellor Strine emphasized this effect: “The very fact that an open process is created would influence independent directors to be more responsive on an ongoing basis and to consult with key stockholder constituencies in shaping the management slate. Put differently, by facilitating fair contests, the new rules of the game will cut down on the need for them.”<sup>22</sup>

Finally, the existence of a shareholder access safety valve may reduce the reliance of shareholders on an unfettered market for corporate control to discipline managers. Managements and boards of directors have long complained that shareholders place too much faith in an active takeover market, which they argue is too blunt an instrument for dealing with both subpar corporate performance and conflicts of interest.<sup>23</sup> However, with few means at their disposal for influencing corporate behavior — short of a control contest — such dependence is unsurprising.

A shareholder right of access to the company proxy statement would not change the state-law allocation of power between the board and shareholders, as some opponents have argued. Shareholders already have the ability to nominate director candidates, and nothing in a shareholder access regime would deprive the incumbent board of the power to nominate a slate of candidates and recommend that shareholders vote to elect it. Similarly, nothing in a shareholder access right (or any of

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<sup>21</sup> It is puzzling that opponents of shareholder access claim that such a regime will result in the election of “special interest” or “constituency” directors. Regardless of whether a candidate is nominated by the incumbent board or through a shareholder access procedure, he must receive the support of a plurality of shares voted in order to be elected. This fact distinguishes a shareholder access regime from one employing cumulative voting, in which a minority of shareholders can ensure the election of a particular candidate, who might as a result feel that he in some way represents only those shareholders.

<sup>22</sup> Chandler & Strine, *supra* note 15, at 67.

<sup>23</sup> See, e.g., Martin Lipton & Steven A. Rosenblum, “A New System of Corporate Governance: The Quinquennial Election of Directors,” 58 U. Chi. L. Rev. 187, 197-202 (1991) (criticizing market for corporate control as a disciplining device).

the Commission's other proxy rules, for that matter) would alter the state-law rules regarding the granting of proxies and shareholder voting.

A right of access would, however, further the objective of full disclosure to shareholders embodied in section 14(a) of the Exchange Act by facilitating and defraying the cost of shareholder communication regarding director nominations. For that reason, a Commission-created shareholder access right is easily distinguishable from the one-share/one-vote rule struck down by the court in *The Business Roundtable v. SEC*.<sup>24</sup>

In the *Business Roundtable* case, the Commission imposed a one-share/one-vote rule on the New York Stock Exchange in reliance on section 19(c) of the Exchange Act, which allowed the Commission to amend exchange rules as it deemed necessary “otherwise in furtherance of the purposes of [the Exchange Act].”<sup>25</sup> The Commission invoked several different sections of the Exchange Act and cited broad considerations of public interest and equal regulation, but did not claim that the rule could be justified as implementing the guarantees of full disclosure contained in section 14(a). The court ruled that the provisions cited by the Commission did not support its intrusion into the state-law distribution of powers among the corporate governance constituencies. (Indeed, the Commission's rule required a one-share/one-vote regime even if a company's shareholders approved some other arrangement.)

Unlike the one-share/one-vote rule, a right of shareholder access would improve shareholder communication and disclosure. The *Business Roundtable* court opined that “[t]he goal of federal proxy regulation was to improve those communications [with shareholders] and thereby to enable proxy voters to control the corporation as effectively as they might have by attending a shareholder meeting.”<sup>26</sup> A shareholder access regime would do just that, recognizing that the proxy solicitation process has almost completely supplanted the annual meeting, and that disclosure in the com-

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<sup>24</sup> 905 F.2d 406 (D.C. Cir. 1990).

<sup>25</sup> *Id.* at 408-09.

<sup>26</sup> *Id.* at 410.

pany proxy statement regarding shareholder-nominated candidates would enhance shareholders' control over their own elected representatives and by extension the corporation.

A ready analogue can be found in the shareholder proposal rule, Rule 14a-8. Rule 14a-8 requires companies, under defined circumstances, to include shareholder proposals on matters other than director election in the company proxy statement. Shareholders already have the right under state law to move proposals at a meeting of shareholders. What Rule 14a-8 does is enable shareholders to exercise that right in a particular venue, the company proxy statement. In exchange, shareholders accept certain procedural requirements and limitations on the subject matter they may discuss which are not found in state law. Similarly, a right of access to advance director nominations would allow shareholders to exercise that state-law right in the company's proxy statement.

A direct shareholder access right would also allow shareholders to decide when their intervention is warranted, rather than leaving that decision solely in the hands of nominating committees. Members of such committees, despite their formal independence from the company, are simply too conflicted on the question of their own continuation in office and the continuation of their fellow board members to be given sole discretion over reviewing candidates suggested by shareholders and deciding whether their inclusion in the slate is appropriate. This is especially true when the board has become too insulated and clannish to be effective, exactly the time when the presence of a shareholder-nominated director would be most beneficial.

Three factors would constrain large shareholders' exercise of a proxy access right and ensure that it is used responsibly. First, in many cases, institutional investors hold shares in a fiduciary capacity and thus are legally required to ensure that their actions, including corporate governance activism, are in the best interests of their beneficiaries. Second, more practically, any shareholder seeking to elect a director using the proxy access right would need to mount a campaign in support of the candidate; although such a campaign would not be as costly as a proxy contest is now, it would involve legal and solicitation expenses. Accordingly, it would only be undertaken if the shareholder or group was willing to bear those costs. Third, particularly

in light of the increased attention to governance activities, investors that manage money for others or that manage mutual funds would suffer reputational harm from engaging in initiatives that lack merit.

The shareholder access right itself can also be designed to maximize the likelihood that it will be invoked when the benefits of any disruption occasioned by its use outweigh the disadvantages. The contours of such a right are described below.

### Specific Contours of the Access Right

The Staff should recommend a right of access that would empower substantial shareholders to promote director candidates in a cost-effective manner. To that end, we propose seven specific restrictions on access.

First, shareholders seeking access through this process must hold 3 percent (alone or aggregated together with the holdings of other shareholders seeking to sponsor the same candidate(s)) of a company's outstanding shares. (For convenience, a shareholder or group of shareholders meeting this requirement is referred to as a "Nominating Shareholder.") Although other participants in the dialogue regarding shareholder access have proposed higher thresholds, a 3 percent threshold is sufficient to deter frivolous challenges.

This point is best illustrated by an example. Delta Air Lines is a company whose common stock is widely held and is included in the Standard & Poors 500 index of large capitalization companies. The most recent list of beneficial ownership produced by the Vickers service indicates that 123,354,000 shares of common stock are outstanding. Only five institutions — Primecap, Vanguard, Fidelity, Wellington and Lord Abbett — report ownership of more than 3 percent of outstanding shares. None of these conservative and well-respected institutions is likely to sponsor a candidate using a shareholder access right, absent compelling circumstances. Mutual

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<sup>27</sup> See Robert A.G. Monks & Nell Minow, *Corporate Governance* 112 (2001); Exchange Act Release No. 47304, "Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies," at n.14 and accompanying text (Jan. 31, 2003).

funds and investment managers engage in shareholder activism extremely infrequently.<sup>27</sup>

The largest ownership by a public pension fund, arguably the most activist category of institutional investor,<sup>28</sup> is the 733,531 shares, or .6 percent, reportedly held by the Ohio State Teachers' Retirement System. The next-largest public fund holding belongs to the California Public Employee Retirement System, with 523,814 shares or just .4 percent. Thus, the two public pension funds with the largest holdings would together hold just 1 percent of Delta's outstanding shares, necessitating an alliance with one or more other significant holders.

The 3 percent threshold we propose stands in stark contrast to the \$2,000 ownership requirement for submitting a shareholder proposal imposed under Rule 14a-8. Because the use of the company's proxy statement to advance a director candidacy has much more serious implications than the distribution of a nearly always non-binding shareholder proposal, the higher 3 percent threshold is appropriate. Unlike shareholder proposals, which are submitted by individuals with small numbers of shares as well as by large institutional investors, shareholders of any size can begin the process of forming a 3 percent group, but placement of their nominee on the company's proxy statement would be limited to those who had gained sufficiently broad based support to justify the cost of exercising these rights.

Second, to reduce the possibility that a raider could use a shareholder access right to effect a takeover of a company, a Nominating Shareholder should be required to hold the requisite 3 percent of outstanding shares for a period of one year before it may nominate any candidates. A hostile bidder is unlikely to hold target company shares for this period of time without obtaining some assurance that a transaction will be consummated.<sup>29</sup>

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<sup>28</sup> *Id.* at 123-24.

<sup>29</sup> See Lucian Arye Bebchuk et al., "The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence & Policy," 53 *Stanford L. Rev.* 101 (2002) (analyzing why staggered boards, which require hostile bidders to maintain bid over a period longer than a year and to mount two successive election challenges, are extremely effective at preventing hostile takeovers).

Third, in any given year, Nominating Shareholders should not be permitted to capture control of a majority of the board using the access right. For example, if a board is composed of 12 directors, the maximum number of candidates that could be nominated using the shareholder access right would be five. (If the company had a classified board, and four of the 12 directors were standing for reelection, the Nominating Shareholder could nominate candidates for all four slots.) There should be a specific prohibition on management abusing this constraint by organizing or coordinating the efforts of management-friendly shareholders to nominate candidates.

Fourth, if in the rare circumstance of different Nominating Shareholders presenting competing slates that in the aggregate exceeded the third restriction above, the Nominating Shareholder(s) representing the greatest level of initial support should have access to the proxy.

Fifth, a shareholder access right should ensure that the same amount and type of information is provided about shareholder-nominated candidates as candidates nominated by the incumbent board. Shareholder access to the proxy is not intended to serve as an end run around the disclosure requirements imposed by the Commission's proxy rules on sponsors of director candidates. Accordingly, a Nominating Shareholder should be required to furnish the company with the information called for by Schedule 14A, including biographical and other background data on all nominees, as well as information about the Nominating Shareholder and other participants in any solicitation undertaken on behalf of a nominee.

Sixth, the company's proxy material should include a statement of reasonable length supporting each nominee's candidacy<sup>30</sup> and procedures to resolve disputes over whether such statements, or the Schedule 14A information discussed above, contain false or misleading statements in violation of the Commission's Rule 14a-9 or violate

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<sup>30</sup> If a Nominating Shareholder or nominee wished to use soliciting material other than the company proxy statement (including a separate proxy card), the shareholder access right could provide that compliance with all of the Commission's proxy rules, including Rule 14a-12 (which now governs election contests), would be required.

other applicable rules. It is crucial to the smooth administration of a shareholder access right that disputes over the content of disclosures be resolved expeditiously.

Seventh, the Commission should provide a safe harbor from its filing requirement under Rule 13d-1 to facilitate use of the shareholder access right. Shareholders should be required to file reports on Schedule 13d only when they seek to influence or change the control of the company. Currently, there is uncertainty among institutional investors over the extent to which “short slate” contests and other activities that conceivably are related to the control of a company, such as urging redemption of a “poison pill,” are included in the activities requiring a 13d filing. A safe harbor should clarify that joining with other shareholders that collectively hold more than five percent of a company’s stock to nominate candidates pursuant to a shareholder right of access — which by definition cannot result in a change of control of the company — does not constitute the formation of a group within the meaning of Section 13(d)(3) of the Securities Exchange Act.