TESTIMONY OF

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SHAREHOLDER RIGHTS: THE ROLE OF THE FEDERAL PROXY REGULATORY SYSTEM

BEFORE THE SUBCOMMITTEE ON SECURITIES
OF THE COMMITTEE ON BANKING,
HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

October 17, 1991

Chairman Dodd and Members of the Subcommittee:

I am pleased to have the opportunity today to respond to the Subcommittee's invitation to discuss the vital topic of shareholder rights. This subject is controversial, for it raises issues going to the heart of the balance of interests among shareholders, directors, and management of America's more than 12,000 public corporations. It also necessarily raises questions as to the proper balancing of the roles of federal and state law. In my view, these issues should be considered carefully and calmly, with the understanding that there is probably not any "right" or "wrong" position on how to balance all the concerns that must be accommodated.

I. The Central Role of the Capital Markets

The starting point for analysis lies in the fundamental importance of America's national capital market in meeting the financing needs of businesses across the country. Indeed, during the first three quarters of 1991, the aggregate total of public and private offerings of securities of all types has exceeded $510 billion. That amount exceeds the highest previous annual total of financings by about 6%. If current trends continue for the balance of the year, total securities market financings for 1991 should exceed $670 billion, a growth of more than 50% over financings in 1990.

Although the United States has the lowest savings rate of any major industrial nation, it also has by far the highest participation in its securities markets. While the aggregate ownership of U.S. public corporations by individuals has fallen in recent years, the number and percentage of individuals participating in the U.S. stock market has shown a generally steady increase. Indeed, the level of ownership of corporate equities in the United States is nearly double that of the next largest country.

As the aggregate market value of shareholders' equity in U.S. corporations has grown, the shareholder base of many large publicly-traded companies has expanded dramatically. Du Pont, reported to have had 9,970 shareholders in 1928, has more than 195,000 shareholders today. The Coca-Cola Company had 498 shareholders in 1927 but has more than 95,000 today. The number of shareholders in IBM has grown from 2,880 in 1928 to more than 815,000 at present. Indeed, the list shown below exemplifies the enormous growth in the number of shareholders in many of the largest corporations listed on the New York Stock Exchange ("NYSE"):

Company	Shareholders of Record 1/	
	1990	1927-32
Abbott Laboratories	45,361	150 (1928)
American Telephone & Telegraph	2,552,104	567,694 (1930)
Coca Cola Co.	95,952	498 (1927)
du Pont de Nemours (E.I.)	195,593	9,970 (1928)
Eastman Kodak	171,954	27,180 (1928)
Exxon Corp.	785,000	52,921 (1927)*
General Electric	515,000	51,882 (1928)
General Motors	1,457,843	71,185 (1928)
International Business Machines	815,580	2,880 (1928)
Minnesota Mining & Manufacturing	112,672	800 (1928)
Mobil Corporation	226,267	53,127 (1928)*
Pacific Gas & Electric	287,000	61,931 (1930)
Procter & Gamble	102,516	7,997 (1928)
Texaco Inc.	180,151	39,319 (1927)*
Westinghouse Electric	106,770	35,502 (1927)

* Predecessor entity

This spectacular growth in the level of participation in America's capital markets has financed massive economic growth. U.S. gross national product ("GNP") has risen from $709.6 billion in 1929 to more than $4.1 trillion today (in constant 1982 dollars). In per capita terms, the U.S. GNP rose from $5,828 per person in 1929 to $16,531 per person in 1990 (in constant 1982 dollars). 2/

In recent years, the growth in the number of individual investors has been eclipsed by the growth in the value of stock holdings by institutional investors. In 1955, institutional investors held approximately 23% of U.S. equities, worth approximately $73

1/ Walker's Corporate Directory 1991; Share Ownership in the United States (Brookings 1952); Moody's Industrials (1929).

2/ Economic Report of the President (Feb. 1991) (Tables B-2, B-31).

billion. In 1990, the aggregate equity holdings of all institutional investors had a value of more than $1.8 trillion, representing 53.5% of all market capitalization.

Thus, the backdrop to any consideration of shareholder rights, and the balancing of interests among shareholders, directors and managers, must be the size, breadth and dispersion of the U.S. national capital market and the critical role of capital market liquidity in providing funds for the U.S. economy. Changes or trends that would undercut the incentives to participate in the U.S. securities market could have severely adverse economic effects. To the degree to which those who bear the ultimate residual economic risk in any corporation -- the common stockholders -- perceive that they are not assured of certain basic protections against, for example, self-dealing, fraudulent financial reporting, use of inside information, coercive offerings or inadequate or misleading disclosure, the result could be a serious erosion in the level of investment needed for economic growth.

While it is important to achieve (whether through state or federal law) certain objectives vital to the protection of the interests of shareholders, the most important objective of all for investors is good long-term economic performance. From the perspective of investors, there is no substitute for growth in the value of a company.

Achieving sustained economic growth in an intensely competitive national and international economy depends on many factors. Prominent among these are having top-quality management and the ability to pursue long-term strategic objectives ranging from fundamental research and development to patient expansion of market share and geographic scope of operations. To be successful in running a company, management must have the time and ability to focus on the fundamentals of the business. It is in the interests of <u>all</u> shareholders that management should have the flexibility to run the company's operations over both the short and long term under systems of oversight and accountability that are both workable and hopefully, reasonably efficient.

Although it is in the interests of shareholders to allow good managers to run the company without undue interference, it is not in the interests of shareholders (or the overall economy) to allow dishonest or ineffective management to continue at the helm of a company until it has been driven into bankruptcy court. It is also not in the interests of shareholders to allow insiders to misappropriate for their personal benefit corporate assets or opportunities, or to engage in other unlawful activities for personal benefit. Thus, there must be some method of holding management accountable for both economic performance and ethical practices. In our system, that accountability comes in the first instance from oversight by the board of directors. This oversight is most likely to be effective where the board includes qualified and independent-minded members who take their responsibilities seriously. Indeed, it is a hallmark of our system of corporate governance that oversight of the corporation's activities proceeds generally through the board. Ours is a system of representative, rather than Athenian, democracy.

In addition to the board of directors, the courts have traditionally played a strong role in providing accountability of the management and directors to the shareholders. State law fiduciary duties of care and loyalty have been vital to the protection of shareholder interests.

Probably the most fundamental of all protections of shareholders, however, is the right to vote to elect directors and to approve or disapprove extraordinary transactions and charter amendments that will affect the fundamental nature of their investment or the value of the corporation. While proxy contests to remove a board of directors have been limited in number (and rarely successful), the ability of shareholders to seek to remove directors who do not discharge their responsibilities to shareholders is a vital part of the American framework of corporate governance. Annual elections and the related proxy reporting to shareholders provides perhaps the most tangible demonstration of the fact that directors are intended to represent the equity holders of the corporation.

The ability of shareholders to decide whether or not to approve certain fundamental transactions also avoids relying exclusively on litigation, with its enormous costs. Litigation is certainly the most expensive, and quite possibly the least satisfactory, means for shareholders and the marketplace to monitor the process for approving or disapproving corporate transactions. By contrast, shareholder ratification or disapproval through an informed vote is the most certain means for legitimizing the most important transactions.

Prior to 1933, all matters pertaining to the interplay among shareholders, directors and managers were governed by state law or the rules of the securities exchanges. Disclosure standards, voting rights and procedures, conduct of contests for corporate control and all other corporate matters were either regulated by the states or self-regulatory organizations ("SROs"), or not regulated at all.

The use of state laws to control corporate governance had enormous benefits. The states served then, and serve now, as laboratories for experimentation. The decentralization of decisionmaking among the various states allowed for differences in approach, and prevented any improvident standard from causing widespread economic damage.

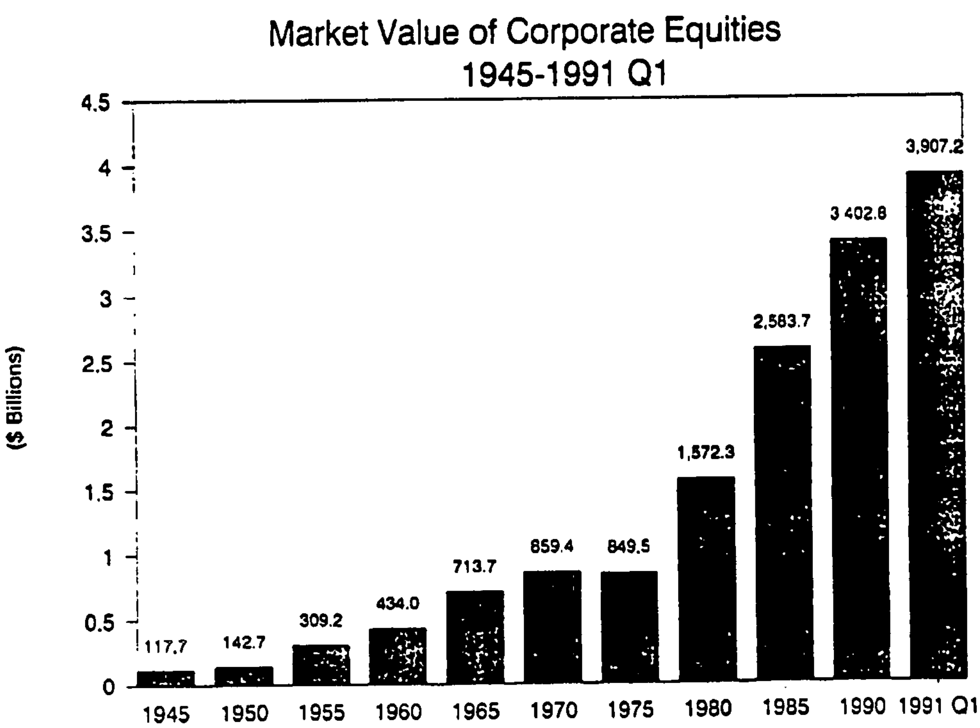
On the other hand, exclusive state oversight had certain limitations. Institutionally, the state legislatures were not accountable to many of those shareholders whose rights could be profoundly affected by state law. Even today, for example, the State of Delaware has only about .3 of 1% of all U.S. shareholders, though its laws govern the operation of a large number of U.S. corporations, including approximately 300 of the Fortune 500 companies. Thus, 99.7% of the shareholders of Delaware corporations do not have an ability to express their views on Delaware's laws through the ballot box. In addition, the interests of maximum liquidity in a national capital market might not be served best by a system in which there could be 50 different sets of rules regarding issues such as financial reporting and disclosure.

Beginning with the Securities Act of 1933 and the Securities Exchange Act of 1934, and continuing through the Williams Act in 1968 and the Market Reform Act of 1990, Congress has created a body of federal law that provides national uniformity on certain matters relating to the activities of those state-chartered corporations that choose to participate in the national capital market. Federal law thus coexists with state law in governing the activities of corporations.

In some areas, such as disclosure, the concurrent roles of state and federal law are clear. In other areas, including takeover procedures and exercise of shareholder voting rights, the allocation of responsibility between federal and state law is less clear-cut. Overall, it is important to maintain a healthy and well-considered balance between the objectives and important contributions of both sets of laws. As a fundamental part of this balance, there should not be any question that the Commission opposes the establishment of a federal law of corporations.

II. Market Developments and Trends

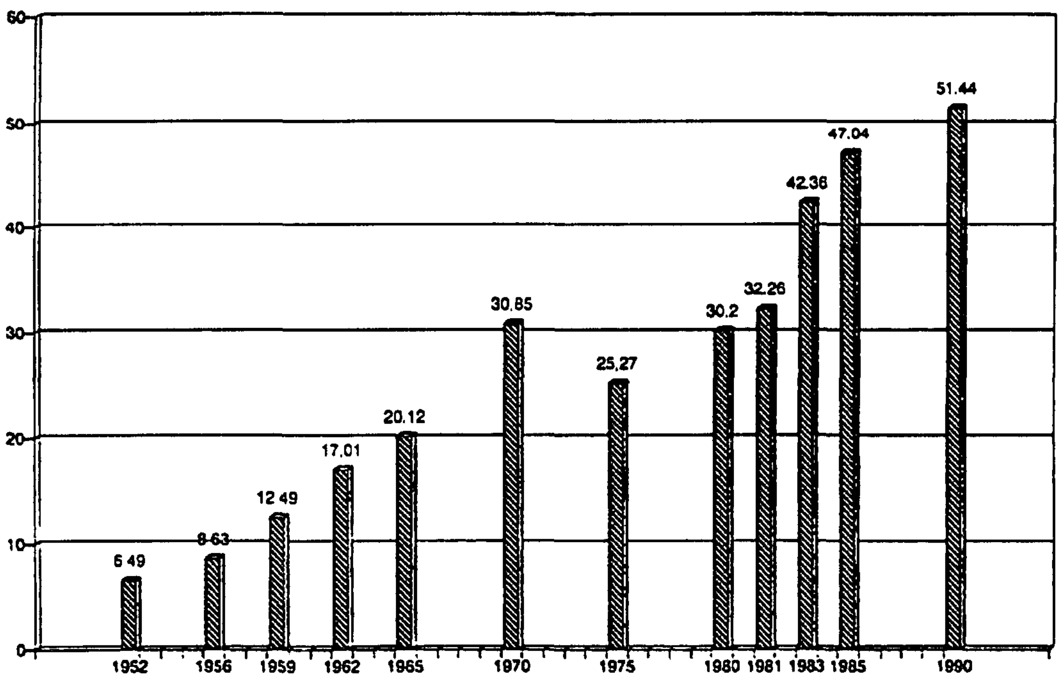
In examining whether current corporate governance concepts are adequate to meet the needs of the nation in fostering a vibrant and growing equity capital market and strong levels of long-term investment, recent trends and developments in that market and in takeover activity should be examined. Of significant importance is growth in the size of the equity markets. Notwithstanding the significant number of going private transactions and buyouts, capitalization of the U.S. equity market increased nearly three-fold in the last 10 years alone.



Source: Board of Governors of the Federal Reserve System

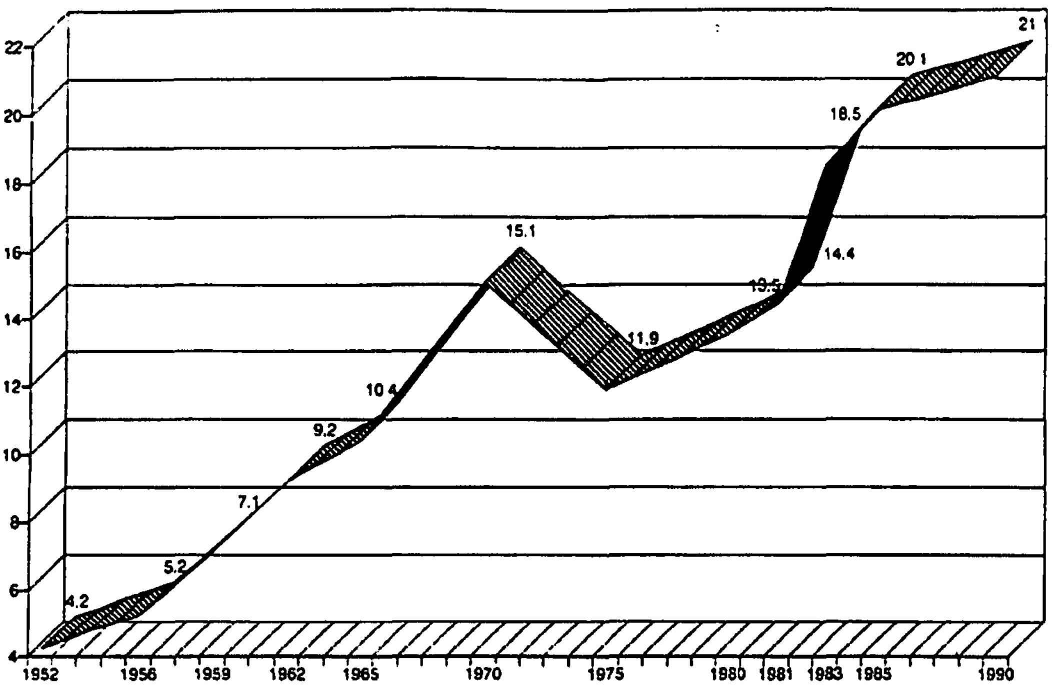
At the same time, the number of direct and indirect shareholders of U.S. corporations also increased in dramatic fashion. According to NYSE surveys, in 1952 roughly 6-1/2 million individuals (or 4.2% of the population) owned shares in public corporations, either directly or indirectly through mutual funds. By mid-1990, that total had grown to more than 51 million individuals, representing over 21% of the U.S. population.

Millions of Shareholders



Source: NYSE Shareownership Survey 1990

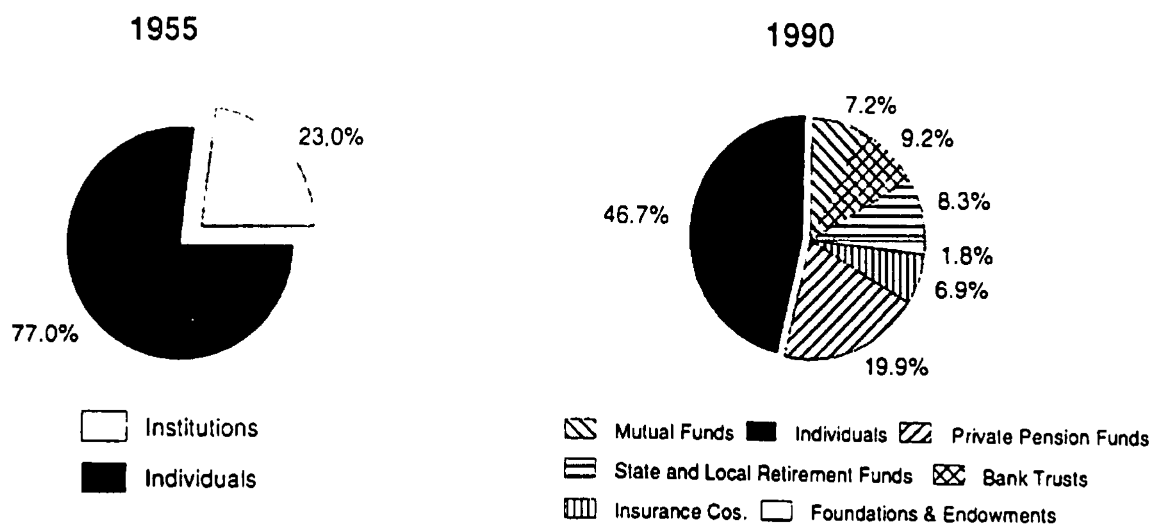
Shareholders as a Percent of Population



Source: NYSE Shareownership Survey 1990

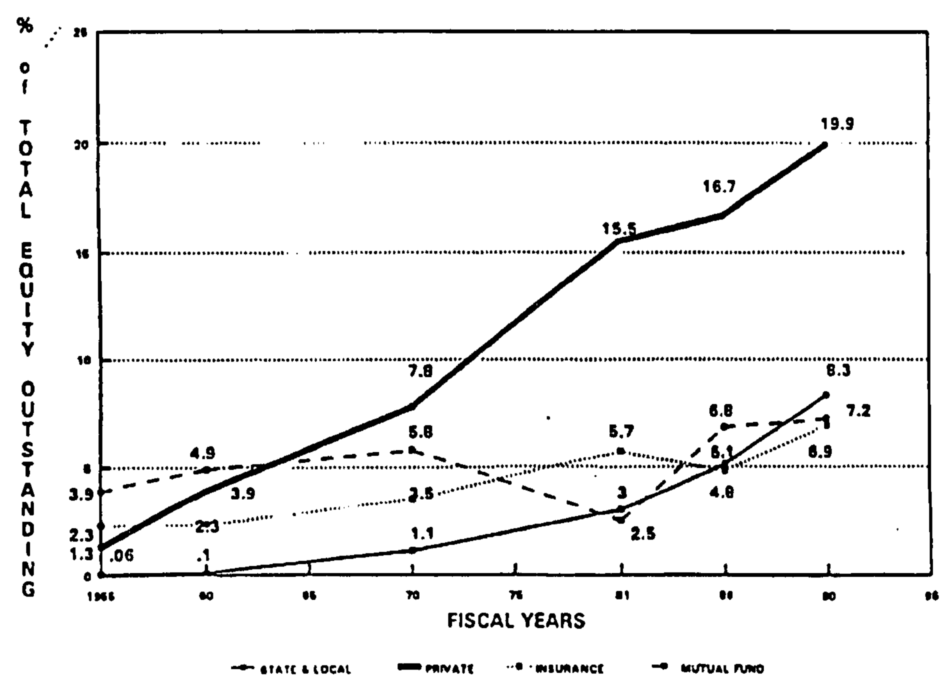
While the number of individual shareholders has shown strong growth, their share of total equity ownership has fallen substantially in the last two generations. The aggregate holdings of institutional investors have increased from 23% of the value of all U.S. equities in 1955 to 53.3% in 1990. Within the broad definition of "institutional" investors, the holdings of public and private pension funds have grown explosively. Indeed, the total assets of pension plans have risen from $17.5 billion in 1950 to nearly $2.5 trillion in 1990. Equity holdings of pension plans during that period have grown by roughly 96,000%.

Distribution of Corporate Equity Ownership, 1955 and 1990



Source: Columbia Institutional Investor Project (Brancato 1991)

COMPOSITION OF INSTITUTIONAL OWNERSHIP



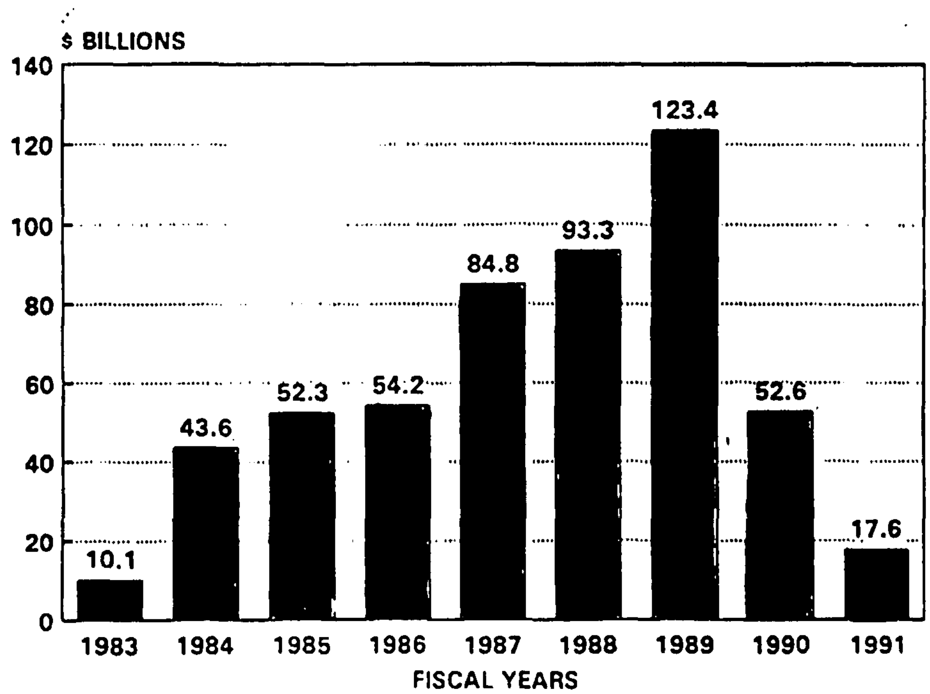
SOURCE: COLUMBIA INSTITUTIONAL INVESTOR PROJECT(BRANCATO 91)

The key market development affecting shareholders' rights over the last decade was the tremendous volume in tender offers and going private transactions. The dollar volume of tender offers filed with the Commission increased from $10.1 billion in FY1983 to a peak of $123.4 billion just six years later in FY1989.

For the last half of the decade, these transactions were financed in large part by the extraordinary growth in high yield securities markets. From $4.6 billion in 1982, the new issue market for high yield securities reached $50.7 billion by 1986 and peaked at $68.3 billion in 1988. At its height, the high yield market reached an aggregate value of $300-$350 billion.

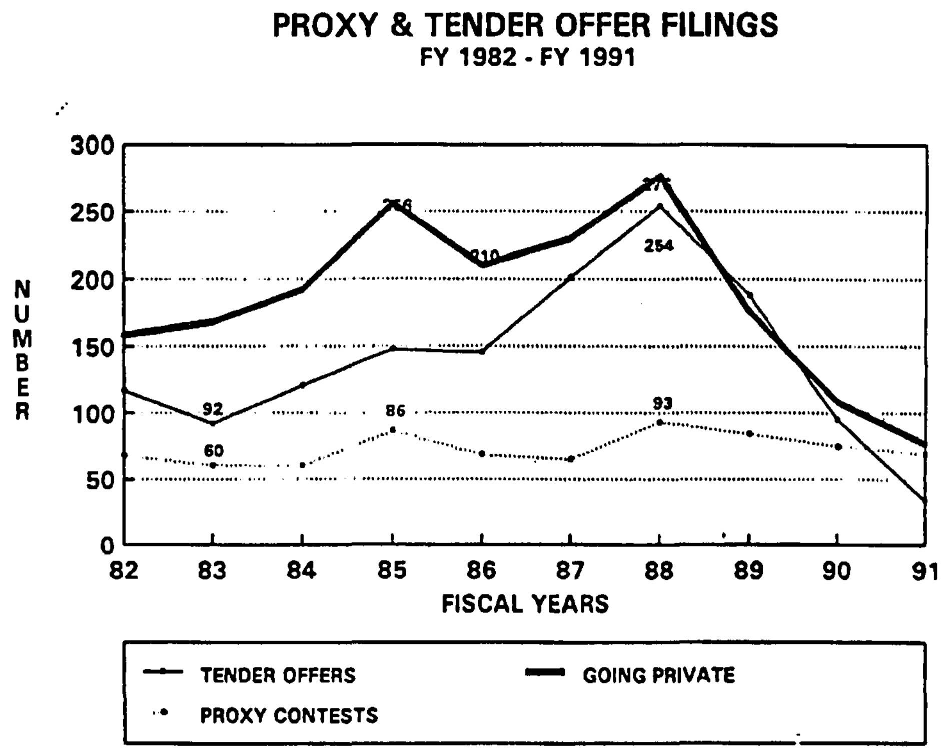
The level of takeover and going private activity has fallen equally dramatically in the last two years.

DOLLAR VALUE OF TENDER OFFERS
FILED ON SCHEDULES 14D-1



A large amount of the current tender offer activity stems from corporate repurchases of outstanding debt securities as issuers seek to restructure the burdensome debt loads taken on in leveraged acquisitions and restructurings. Approximately 54 high-yield debt issuers were subject to cash tender offers or exchange offers relating to a principal amount of $16 billion in securities in 1990. 3/

During this 10-year period, the level of proxy contests filed with the Commission has remained relatively constant, notwithstanding predictions in the last two years that election contests would rise in the absence of takeover bids.



3/ Salomon Brothers, High Yield Restructurings - 1990 Summary (January 28, 1991).

In response to the increase in takeover activity, corporations developed a number of defensive strategies. Perhaps the most popular of these strategies was the so-called "poison pill," first adopted in 1984 by the Crown Zellerbach Corporation, and sanctioned by the Delaware Supreme Court in 1985. By 1990, over 1300 companies (including 50% of the Fortune 500) had issued a poison pill.

Unlike takeover activity, shareholder activism has not decreased in recent years. In fact, the number of shareholder proposals relating to corporate governance has increased by over 400 percent in the last five years.

Corporate Governance
Shareholder Resolutions
1986 - 1990 *

	1986	1987	1988	1989	1990
Independent Nominating Comm.	0	2	2	1	1
Limit Director Tenure	0	0	8	5	7
Equal Access to Proxy	0	0	6	3	0
Advisory Comm	0	0	0	1	1
Minimum Stock Ownership	1	0	11	17	24
Cumulative Voting	0	1	32	40	50
Repeal Classified Board	25	22	38	50	47
Redeem or Vote on Poison Pill	0	32	19	20	41
Antigreenmail	1	2	5	4	2
Confidential Voting	2	4	9	40	51
Amend Super Majority Provision	7	4	4	6	4
Restore Preemptive Rights	0	0	1	9	8
Golden Parachutes	0	1	0	1	12
Disclosure Compensation	0	0	0	2	13
District Compensation	2	9	7	4	1
Opinion of State Antitakeover Law	0	0	0	4	6
Counting Shareholder Votes	0	0	0	0	1
Improve Post Meeting Reports	0	0	6	2	2
Annual Meeting Location	0	0	4	10	2
Approve Auditors	0	1	1	3	2
Other	17	21	33	32	19
Total	55	99	186	254	294

* IRRC Shareholders Voting Almanac 1991 Edition.

III. The Commission's Proxy Rules

At common law, voting rights attaching to a share of corporate stock were deemed personal to the holder and could not be transferred. Shareholders therefore had no right to cast a vote by proxy at corporate meetings -- that is, by executing a power of attorney authorizing another to attend the shareholders' meeting and vote on the shareholder's behalf -- absent special provisions in the company's charter or by-laws. Such provisions were inserted in the governing instruments of English corporations at least as early as the beginning of the 18th century and, in the United States, in the late 1700s and the early 1800s. Stockholders in early American corporations also resorted to by-law revisions to secure proxy voting rights, with mixed success when such action was challenged in the courts. By the beginning of the 19th century, however, many states had enacted legislation permitting voting by proxy in recognition of the impracticability of shareholders' attendance at meetings due to increases in the size of corporations and their shareholder bodies.

The power to vote by proxy, however, did not always result in a meaningful role for the public shareholder. Abuses of the proxy voting mechanism were considered by a Subcommittee of the House Committee on Banking and Currency, known as the Pujo Commission, 4/ when it commenced its 1912 "Money Trust Investigation," which continued until 1922.

By 1932, when a widely respected treatise announced that corporate equity holdings had become so widespread and geographically dispersed as effectively to

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4/ See Report of the Committee Pursuant to House Resolutions 429 and 504 to Investigate the Concentration of Control of Money and Credit, H.R. Rep. No. 1593, 62d Cong., 3d Sess. (1913).

separate the ownership and management of this nation's major companies, 5/ most shareholders cast their votes by proxy. With state law that has been described as "a virtual void with respect to disclosure in the solicitation of proxies," 6/ and no applicable federal regulation, shareholders were the hapless victims of a variety of abusive solicitation practices.

Congressional hearings held before the enactment of the Securities Exchange Act in 1934 documented significant misuse of the proxy process and lax enforcement by the states. During hearings held in 1934 by the Senate Banking Committee, legislators learned of such practices as the solicitation of blanket shareholder ratification for all management decisions and the failure to furnish any prior notice to shareholders as to what matters might be presented for a vote at a meeting.

Seeking to prevent a recurrence of these abusive practices, members of both houses of Congress introduced bills that would establish federal safeguards against perceived abuses in both the procedures and disclosure attendant to the solicitation of shareholder proxies. This legislation sought to empower the Commission to regulate all solicitations, whether by management or outsiders, reflecting Congress' recognition of the potential for abuse inherent in both. 7/

With the enactment of Section 14(a) of the Exchange Act in 1934, Congress expressed its conviction that "fair corporate suffrage is an important right that should

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5/ See A. Berle & G. Means, The Modern Corporation and Private Property (1932).

6/ II L. Loss, Securities Regulation 866 (2d ed. 1961).

7/ For a comprehensive discussion of these bills, see Ryan, Rule 14a-8, Institutional Shareholder Proposals, and Corporate Democracy, 23 Ga. L. Rev. 97 (1988).

attach to every equity security" traded on a national exchange. 8/ Section 14(a) vested broad authority in the Commission to regulate the solicitation of shareholder proxies in the public interest and for the protection of investors. Since the proxy voting system was then, as it remains today, the principal mechanism for exercising the franchise in publicly held corporations, Congress authorized the Commission to promulgate rules that not only would mandate full and fair disclosure, but also would "control the conditions under which proxies may be solicited with a view to preventing the recurrence of abuses which have frustrated the free exercise of voting rights of stockholders." 9/

The Commission first exercised its proxy rulemaking authority in 1935, when it established the basic framework of the proxy system. First, the rules called for a brief description of the matters to be considered, including any shareholder proposals expected to be introduced at the meeting, along with the action proposed to be taken by the holder of the proxy. Second, the company was required as a condition of its own solicitation to mail to shareholders the proxy material of any securityholder upon his or her request and at his or her expense. Third, a general antifraud rule prohibiting the making of any materially false or misleading statement was adopted.

Based on experience gained during three proxy seasons, the Commission determined that the new proxy rules should be expanded. Accordingly, the Commission

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8/ H.R. Rep. No. 1383, 73d Cong., 2d Sess. 13 (1934). See S. Rep. 1455, 73d Cong., 2d Sess. 77 (1934); see also J.I. Case v. Borak, 377 U.S. 426 (1964). The New York Stock Exchange then required voting rights for listed shares. See Stock Exchange Practices: Hearing before the Senate Comm. on Banking and Currency, 73d Cong., 1st Sess. 6677 (1934) (Testimony of Frank Altschul, Chairman, NYSE Committee on Stock List).

9/ H.R. Rep. 1383, 73d Cong., 2d Sess. 13-14 (1934). See L. Loss, Fundamentals of Securities Regulation 1936 & n.36 (1991).

~~in 1938 revised~~ the rules to require that a proxy statement be delivered to each person solicited, and that the opportunity be given to each shareholder to vote "yes" or "no" on each matter to be considered. In addition, the amendments prescribed additional disclosures for specified proposals such as executive bonus plans, authorizations of additional securities, and mergers.

The second major revision of the Commission's proxy rules occurred in 1942, 10/ in light of a perceived need for enhanced disclosure. These amendments mandated that a copy of the annual report to shareholders -- what we know today as the glossy annual report -- accompany or precede the proxy statement, and required more extensive information on director qualifications and management's compensation and dealings with ~~the issuer.~~ A new exemption for non-issuer solicitations of no more than 10 persons was adopted for "stockholders desiring merely to represent [solicit proxies from] a few friends, relatives or business associates." 11/ The Commission also adopted a new rule requiring companies to include in their proxy statements a 100-word statement in

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10/ In 1940, rule amendments codified the Commission's position that management soliciting materials must notify shareholders of any shareholder proposal that would be raised at the meeting and on which management would vote the proxy, and afford shareholders a means of specifying whether the vote should be affirmative or negative.

11/ See Unpublished Summary of Proposed Revision of Proxy Rules, reprinted in Hearings on H.R. 1493, H.R. 1821 and H.R. 2019, before the House Comm. on Interstate and Foreign Comm., 78th Cong., 1st Sess. 35 (June 9, 10, 11, 1943) (Testimony of Ganson Purcell, Chairman, Securities and Exchange Commission). These amendments triggered a firestorm of critical response from Congress and the public, for the most part because they were adopted after Congress had recessed. Although several Congressional hearings were held and bills introduced seeking to suspend the Commission's Section 14(a) rulemaking authority during the war emergency, none of these bills progressed beyond the hearing phase. See id.

support of any shareholder proposal that was "a proper subject" for shareholder action. 12/

No significant changes were made in the proxy rules until 1956, after Congressional and Commission inquiries into the solicitation of shareholder proxies in connection with contested elections. 13/ At that time there was considerable controversy as to whether certain preliminary communications by both sides in a contest were governed by the federal proxy rules. Then, as now, the first communication sent to stockholders by an opposition group, known as a "fight letter," often was in the form of an attack on specific management policies accompanied by a request that any stockholder who agreed sign and return an attached post card. Generally no mention would be made of a future intent to solicit proxies to unseat the incumbent board. In response to the fight letter, management frequently would mail its own letter to stockholders that likewise would be silent as to the possibility of an impending proxy solicitation. Concerns about the undisclosed agenda of potential dissidents and the

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12/ Until 1948, however, Commission rules did not specify circumstances in which management properly could omit a shareholder proposal. Exclusion of proposals for the purpose of enforcing a personal claim or redressing a grievance to achieve ends not necessarily in the common interest of all shareholders was authorized in that year, and, in 1952, management was permitted to exclude proposals submitted "primarily for the purpose of promoting general economic, political, racial, religious, social or similar concerns." Two years later, the Commission again amended the rule to codify prior interpretation and adopt a new ground for exclusion covering shareholder requests or recommendations relating to the conduct of the company's "ordinary business operations."

13/ Rel. No. 34-5253 (1955) (public Commission hearing); Stock Market Study (Corporate Proxy Contests), Hearings before Senate Subcomm. of Senate Comm. on Banking and Currency, 84th Cong., 1st Sess. (1955-56). See Emerson, Congressional Investigation of Proxy Regulation: A Case Study of Committee Exploratory Methods and Techniques, 2 Vill. L. Rev. 75 (1956).

affiliations of third persons speaking on their behalf, coupled with the excessive, often misleading rhetoric disseminated by incumbents and challengers alike, prompted calls for more stringent disclosure requirements and Commission oversight.

In response, the proxy rules were amended to make clear that fight letters and other pre-proxy statement communications constitute "solicitations" subject to the Commission's proxy regulatory jurisdiction if "reasonably calculated to result in the procurement, withholding or revocation of a proxy." 14/ Additionally, the amendments required extensive disclosure regarding the identity, intentions and associations of dissidents presenting a competing slate of directors. The Commission's adoption of these 1956 amendments completed the basic framework of the proxy regulatory structure as it exists today.

In 1964, companies with at least $1 million in total assets and equity securities held by at least 500 persons were required to be registered under the Exchange Act and made subject to periodic reporting, proxy and insider reporting requirements. Previously, Exchange Act registration requirements applied only to exchange-listed securities, leaving approximately one-half of the country's larger corporations outside the ambit of these statutory provisions. Impetus for the amendment was provided in part by

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14/ This expansion of the definition of solicitation was premised on a principle enunciated 13 years earlier by Judge Learned Hand, who held in SEC v. Okin, 132 F.2d 784 (2d Cir. 1943), that the Commission's Section 14(a) jurisdiction extended to any writings that were part of a continuous plan that ended in a solicitation and prepared the way for its success. Otherwise, the court found, the purpose of Section 14(a) would be defeated because shareholders could receive false or misleading information prior to the actual solicitation of their proxies.

the results of Commission studies of the proxy soliciting practices of a number of unregulated issuers. 15/

Reflecting the social and political ferment of the era, shareholders by the late 1960s increasingly attempted to introduce resolutions concerning "economic, political, racial, religious, social or similar causes" using the shareholder proposal process. In response to serious judicial concerns regarding the validity of the exclusion in Rule 14a-8 for proposals submitted "primarily for the purpose of promoting general economic, political, racial, religious, social or similar concerns," 16/ the Commission in 1972 modified the "social causes" provision to establish as the single test for public policy proposals the existence of a significant relationship of such a proposal to the business of the issuer. An immediate, dramatic upsurge in shareholder proposals on social issues resulted and led to major revisions to the rule, in 1976.

One year later, against the background of questionable foreign payments, fraudulent financial reporting and other corporate activities raising public questions as to

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15/ In an early study, the Commission found that, in 84% (160 of 191) of a sample of solicitations pursuant to which proxies were sought in connection with the election of directors, the names of nominees were not disclosed to shareholders. See A Proposal to Safeguard Investors in Unregistered Securities 12 (1946, updated in 1950).

At the same time, Congress amended Section 14 to give the Commission authority to regulate broker-dealer proxies, and to require issuers that choose not to solicit proxies to furnish equivalent information to shareholders. Sections 14(b) and 14(c) of the Exchange Act.

16/ Medical Committee for Human Rights v. SEC, 432 F.2d 659 (D.C. Cir. 1970), vacated for mootness, 404 U.S. 403 (1971) (holding that the Commission's staff should not have concurred in an issuer's exclusion of a proposal relating to Dow Chemical's continued production and sale of napalm on the ground that it involved the "ordinary business" of the issuer or, alternatively, promoted a general political/social concern").

the adequacy of existing corporate accountability mechanisms, the Commission initiated a comprehensive re-examination of its rules governing shareholder communications and participation in the corporate electoral process. A series of rulemaking initiatives resulted from this broad review.

After extensive public comment on the need for proxy reform, including expanded shareholder access to issuer proxy statements to nominate directors, the Commission in 1978 adopted new proxy disclosure standards regarding the qualifications and independence of board members and executive compensation. In 1979, in the next round of proxy rulemaking, the Commission amended its rules to require that the proxy permit shareholders to vote for individual directors and to abstain on various matters. To facilitate shareholder access to expert voting advice, the Commission also created a limited exemption from proxy filing and disclosure rules for the furnishing of such advice by a financial advisor to any person with whom the advisor has an ongoing business relationship, provided the advisor does not receive a fee or commission from anyone other than the recipient-client.

Final results of the Commission's three-year review of the proxy voting system were published in a staff report provided to the Senate Banking Committee in 1980. 17/ Three principal proxy initiatives stemming from the 1980 report were the appointment of an Advisory Committee on issuer communications with beneficial holders, further

17/ SEC, Staff Report on Corporate Accountability: A Re-examination of Rules Relating to Shareholder Communications, Shareholder Participation in the Corporate Electoral Process and Corporate Governance Generally, Senate Comm. on Banking, Hous. & Urban Affairs, 96th Cong., 2d Sess. (1980).

revisions of the rules governing executive and director compensation, 18/ and a reconsideration of the entire shareholder proposal process that produced modest changes. 19/

Since 1983, Commission efforts to protect shareholder suffrage have focused on the accelerating trend toward elimination or limitation of voting rights. Under increased pressure of hostile tender offers, and with competition among the National Association of Securities Dealers ("NASD") and the exchanges on voting standards, listed companies urged the NYSE to abandon its one share/one vote listing standard. In 1986, the NYSE filed for Commission approval amendments to its listing standards to rescind the

18/ Current compensation disclosure requirements were adopted in 1983, after a seven-year effort to update and improve those rules that had evolved over approximately 30 years.

19/ In 1982, the Commission solicited public comments on the appropriateness of the shareholder proposal process, questioning whether the federal proxy rules should continue to provide for the inclusion of shareholder proposals in issuer proxy statements, or whether the entire area should be governed by state law. Comment also was sought on three alternative approaches to continued Commission regulation of the shareholder proposal process: (1) the rule as it then existed with some refinement; (2) a rule that permitted companies to opt out of the federal requirements with shareholder approval; and (3) a rule requiring inclusion of all proposals, subject only to a numerical limit. More than 400 comment letters were received from legislators, issuers, shareholders and other members of the public, overwhelmingly endorsing retention of the existing structure. Accordingly, 1983 revisions to the rule refined the various grounds for exclusion, imposed modest eligibility criteria for proponents, and limited a proponent to inclusion of one proposal in the proxy statement.

In 1987, in response to increased shareholder reliance on Rule 14a-8 to voice concerns over poison pills, greenmail, golden parachutes and other corporate governance matters, the Commission amended the Rule to rescind the pre-existing bar to its use by proponents who engaged in an independent solicitation in support of a proposal.

exchange's then 60-year old standard, arguing that it would lose listings to other markets that did not protect voting rights to the same extent.

As a result of what it perceived as a fundamental threat to shareholder voting rights that was inconsistent with the protection of shareholders and the purposes of

one share - one vote

Section 14(a) of the Exchange Act, the Commission in 1988 mandated in Rule 19c-4 that all SROs adopt minimum standards to protect shareholders from disenfranchisement. Adopted after two years of public comment and hearings, Rule 19c-4 required all national exchanges and the NASD to prohibit listing or quotation of securities of companies that issue securities or take other corporate action with the effect of nullifying, restricting or disparately reducing the per-share voting rights of equity securities.

In adopting Rule 19c-4, the Commission acted to further Congress' intent in enacting Section 14(a) to ensure fair corporate suffrage. 20/ The use of disparate voting

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20/ See H.R. Rep. No. 1383, 73d Cong., 2d Sess. 13-14 (1934). In recognition of the role of the SROs in safeguarding the fundamental integrity of the franchise, Congress emphasized that,

> [i]nasmuch as only the exchanges make it possible for securities to be widely distributed among the investing public, it follows as a corollary that the use of the exchanges should involve a corresponding duty of according shareholders fair suffrage.

Id. at 14.

rights plans to disenfranchise shareholders, 21/ a practice that existed in 1934, was precluded by the NYSE's one share/one vote rule then in effect. 22/

Nonetheless, in a suit brought by the Business Roundtable challenging the Commission's adoption of Rule 19c-4, the U.S. Court of Appeals for the District of Columbia invalidated the rule, finding that the Commission had exceeded its authority under Section 19(c) of the Exchange Act to change the rules of the SROs as necessary or appropriate in furtherance of the purposes of the Exchange Act. 23/ Happily, since that time both the NYSE and the NASD have continued to enforce their respective anti-disenfranchisement standards.

By failing to recognize the Congressional expectation for an inter-relationship of SRO voting standards for nationally traded companies and the efficacy of Section 14(a) to assure "fair corporate suffrage," the Court may have fundamentally altered the federal-state balance in assuring the protection of shareholders in nationally traded public companies. Indeed, since 1934, the Commission has had the unquestioned responsibility for approving or disapproving SRO listing standards.

While state law may have permitted a company incorporated in Delaware to issue non-voting common stock, or take other action, that issuer did not have any legal right,

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21/ During the 1934 Stock Exchange Practices Hearings, Ferdinand Pecora, the Senate Counsel, twice referred to the then-disfavored practice of issuing non-voting common stock as an "evil." See Stock Exchange Practices: Hearings before the Senate Comm. on Banking and Currency, 73d Cong., 1st Sess. 6677 (1934).

22/ See A. Berle and G. Means, The Modern Corporation and Private Property 76 (1932).

23/ Business Roundtable v. SEC, 905 F.2d 406 (D.C. Cir. 1990).

by virtue of its Delaware incorporation alone, to have its securities listed on the NYSE or traded on a national securities exchange. Where a Delaware company seeks a listing on a national securities exchange or trading market, it has to agree to meet specific requirements limiting the corporation's exercise of its powers under Delaware law. For example, Delaware law might permit a corporation to skip an annual meeting or to have a board composed 100% of company management. However, in order to be traded on the NYSE (or another major exchange or the National Association of Securities Dealers Automated Quotation System), the company has to agree to have at least two outside directors and to hold an annual meeting. Among other things, the NYSE listing standards:

1. require an independent audit committee;
2. require at least two outside directors;
3. require that an annual meeting be held each year;
4. prohibit a board consisting of more than three classes;
5. require that shareholders vote on certain related party transactions, including acquisition of a business or property from any director or officer;
6. require that shareholders vote on the issuance of securities that will result in a change of control of the company; and
7. require solicitation of proxies for all meetings of shareholders.

These policies and requirements of the NYSE, reflecting the Exchange's "long-standing commitment to encourage high standards of corporate democracy," are aimed at "maintaining appropriate standards of corporate responsibility, integrity and accountability to shareholders."24/

IV. Shareholder Interests

The relationships among the shareholders, directors and management of a public company are governed by numerous specific provisions of both state and federal law. State laws affecting these issues vary considerably, and a wide range of choice is typically available on many issues for determination by the company in its articles of incorporation and bylaws. Consequently, one of the great strengths of the overall system has been its flexibility, which has allowed evolution in legal principles to keep pace with the changing character and role of corporations over a period of centuries.

Though the specifics of the protections for shareholders may vary from state to state, and even from company to company within a state, it is possible to identify certain fundamental interests of shareholders in every public company arising out of the position of common shareholders as the holders of the residual economic interest in the enterprise. These interests would include:

1. Full and fair disclosure concerning material information relating to the company;
2. Undivided fiduciary duties to the shareholders by the directors;
3. Meaningful board of directors oversight of management; and
4. An unabridged right to vote on matters including the election of directors and the approval of extraordinary transactions.

24/ NYSE Listed Company Manual paragraph 301.00.

The precise manner in which these interests are defined and protected depends on differences in applicable state laws, which continue to govern many issues such as fiduciary duties of directors, the structure of corporate management, the conduct of shareholder meetings and a range of similar matters concerning corporate governance.

While our system is predicated on variation in the specific roles of these groups in the operation of a given company, erosion or impairment of any of these interests could, beyond some point, impair the broader national interest in liquid and efficient securities markets capable of providing financing to businesses throughout the country. Where fundamental national interests are jeopardized, it may then become necessary to consider federal legislation. This is of course what occurred with the enactment of the Exchange Act in 1934 to mandate standards for financial reporting and disclosure, proxy solicitation, insider trading and market manipulation, oversight of national trading markets and other matters. A similar conclusion as to the desirability of federal legislation prompted the enactment of the Williams Act in 1968 to govern procedural and disclosure matters relating to tender offers and similar transactions.

The most critical problem area at present relating to shareholder voting is the need to restore the ability of the Commission to oversee the standards and practices of the self-regulatory organizations -- responsibility given to the Commission as part of the Exchange Act. In ~~this~~ area, the effect of the recent decision of the D.C. Circuit Court nullifying the Commission's rule on listing standards in national trading markets has created undue risks to a vital part of the checks and balances that protect investors in national markets. Until the late 1980s, it had not proven necessary for the Commission to exercise the capacity to limit the listing standards of SROs applicable to voting rights in nationally traded companies that had existed since passage of the Exchange Act in 1934. At that time the pressures of competition among the SROs and the intensity of concerns regarding takeovers among listed companies threatened an outbreak of a "race to the bottom" in listing standards that had protected voting rights of shareholders for generations.

call for legislation

Given the judicial infringement of the Commission's capacity (whether or not exercised) to prevent undue impairment of shareholder voting rights, it would be appropriate for Congress to restore explicitly the Commission's longstanding authority with respect to any and all rules of SROs under its oversight. By restoring this part of the checks and balances that govern our system, Congress would ensure the availability of a safety valve to protect the fundamental voting rights of shareholders from undue abridgment without undercutting the role of the states in establishing the overall framework for corporate governance.

V. Commission's Proxy Rules

The Commission's proxy rules govern the solicitation of proxies with respect to securities registered under the Exchange Act or issued by a registered investment company. 25/ As prescribed by Commission rule and the courts, the term "solicitation"

25/ State law, and an issuer's charter or by-laws, or contract, govern, among other things,

- the power to vote the issuer's security;
- the power to vote by proxy or act by consent;
- matters subject to shareholder vote; and
- the calling, conduct, and adjournment of shareholder meetings.

(continued...)

includes not only a request that a shareholder execute, withhold or revoke a proxy either of the solicitor or another person, but also any "communication to securityholders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy." Thus, the proxy rules may apply to a person regardless of whether the person owns securities of the issuer or is seeking authority from that issuer's securityholders to act as a proxy.

Given the breadth and subjective nature of the definition, communications that many people would view as no more than the exercise of free speech responsive to another's initiatives can be, and have been, asserted to be proxy solicitations subject to

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25/(...continued)
Pursuant to Section 14(a), the Commission and the states have concurrent authority with respect to, among other matters:

- the duration and form of the proxy;
- the extent of proxy authority;
- the disclosure required in connection with a solicitation of a proxy;
- reports to shareholders; and
- access to shareholder lists for solicitations.

The rules of the stock exchanges and NASD have overlapping application in certain of these areas, including

- matters on which shareholder approval must be sought and proxies must be solicited;
- obligation of nominee brokers to beneficial holders; and
- issuer reports to shareholders.

If no proxies are solicited for a shareholders' meeting, the rules do not apply. (Issuers, however, are subject to information statement requirements under Section 14(c) of the Exchange Act.) The Commission's proxy rules do not require shareholder votes. Nor do the rules require the solicitation of proxies; indeed, neither do most state laws. In fact, it is the SROs -- the NYSE, the American Stock Exchange and the NASD -- that generally mandate through their listing standards that issuers solicit proxies, and that the solicitation be extended to all shareholders.

the full compliance costs of the federal securities laws, including prior government review and delivery of a proxy statement. Examples include:

- Employee of company engulfed in a proxy fight wearing a button that bears the company logo and states "I voted blue," the color of management's proxy card;
- Shareholder mailing to other shareholders objecting to a proposed merger viewed as containing unfavorable terms;
- Shareholder mailing opposing adoption of antitakeover charter amendments proposed by management;
- Banner strung outside corporate headquarters building predicting a management victory in an election contest and takeover battle;
- One-page flyer distributed by limited partner objecting to a proposed partnership roll-up transaction;
- Communications with members of a voting trust by the trustee seeking advice on how to vote the securities subject to the trust;
- One-page letter by a union urging stockholders to support shareholder proposals relating to an employee/director committee and the elimination of golden parachutes and poison pills; and
- Shareholder opposition to stock split proposed by management.

These communications stand in marked contrast to the popular understanding of a proxy solicitation as a shareholder committee asking for authority to vote shareholders' securities to defeat management's director nominees and elect the committee's slate, or a solicitation by management of authorizations to approve a merger or management buyout. Yet responsive communications, simply commenting on another's initiative or solicitation, are subject to the same basic requirements and costs as those attempting to change control of the management.

Under the current rules, if a communication -- whether oral or written -- constitutes a solicitation, the person making the statements is required to deliver a proxy statement in compliance with mandated disclosure requirements to every person solicited. 26/ The more public and widespread the communication, the greater the cost of delivery of the proxy statement. Thus, a shareholder, for example, who did no more than publish a newspaper advertisement urging other shareholders to vote against a going-private transaction would have to mail a proxy statement to all shareholders. Moreover, any written materials, 27/ including the advertisement, proxy statement and proxy, are required to be filed and reviewed by the Commission before they are made public.

A. The Commission's Proxy Review

The Commission commenced its latest review of its proxy rules in response to questions raised by individual and institutional shareholders, and other members of the public concerning the effectiveness of the current proxy solicitation process. The Commission has been examining whether proxy regulation continues to further Congress' intent to assure fair and effective corporate voting rights.

In undertaking its review of the proxy rules and the voting process, the Commission sought to determine whether the Commission's rules

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26/ A non-issuer solicitation directed to no more than 10 persons is exempt from proxy statement and filing requirements. The exemption, adopted in 1942, permits organizing activity.

27/ Press releases, speeches and scripts do not have to be filed in preliminary form. Since 1987, company proxy statements involving no more than uncontested elections, ratification of auditors and shareholder proposals have been excepted from preliminary filing requirements. This change decreased proxy statements filed in preliminary form from approximately 9,000 in 1987, to 2,534 in 1991.

- unnecessarily restrict or interfere with the ability of securityholders to communicate among themselves, or with management;
- impose unnecessary costs on registrants or other soliciting persons; and
- adequately address and protect securityholders' interests.

Prior to its June 1991 rule proposals, the Commission had received approximately 400 individual shareholder letters urging general proxy reform and more than 50 letters suggesting specific reforms or commenting on such proposals. Proposals for change in the current proxy regulatory scheme, submitted to the Commission by the California Public Employees Retirement System, the United Shareholders Association, and other shareholder organizations, manifest a strong concern that the Commission's proxy filing and disclosure requirements unduly restrict securityholder communications not only with one another, but also with the issuer's management, board of directors and third-party sources of proxy voting information unaffiliated with any person participating in a particular solicitation. Expressions of need for some revision to the Commission's proxy process, although widely differing in substance, have been voiced by such diverse entities or persons as the American Bar Association's Subcommittee on Proxy Solicitations and Tender Offers, the United Mineworkers of America, and the American Corporate Counsel Association.

Conversely, organizations such as the Business Roundtable, the American Society of Corporate Secretaries and the Business Council of New York oppose these calls for change, arguing that the recent success of securityholders in achieving their corporate governance goals through the proxy system attests to the adequacy of the federal proxy rules in protecting securityholder voting rights. These organizations have urged that the Commission focus its attention more on the implications of the increasing institutionalization of shareownership. Some have called for further restrictions on inter-shareholder communications, at least among the institutional investors whose voting power, derived from ownership of the stock of major public companies, has become increasingly concentrated.

B. Commission Proposals

In June, the Commission published for public comment four limited proposed revisions of its proxy rules designed to facilitate certain shareholder and other communications and to reduce the costs of proxy rule compliance. The staff is still reviewing the hundreds of comments on these proposals, and it is too early to anticipate any Commission decision to adopt or modify the proposals.

These four proposals would:

1. enable shareholders and other persons to exchange views or comment on a proxy solicitation undertaken by the company, or any other person, 28/ without having to bear the costs of filing a proxy statement with the Commission and delivering it to shareholders;

2. require only the proxy statement and proxy card to be filed in preliminary form with the Commission before use;

3. make proxy statements and proxy cards filed in preliminary form immediately available to the public upon filing, like all other Commission filings; and

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28/ As proposed, a proponent of a proposal included in the issuer's proxy statement under Rule 14a-8 would be entitled to the exemption. The Release asked for comment as to whether the proponent should be excluded from eligibility.

4. condition management's solicitation of proxies on shareholders being given equal access to stockholder list information for purpose of the shareholder's solicitation.

1. Communications in Response to Another's Solicitation

At present a shareholder seeking to oppose a planned merger or corporate restructuring by writing a letter to other shareholders, or to the editor of the local newspaper, expressing simple opposition to the transaction, is required to file the letter with the Commission for review prior to publication. The shareholder is also required to file with the Commission, and deliver a proxy statement containing mandated disclosure to all shareholders receiving the communication. The proposed rule would eliminate the current requirements of filing prior to use, and prior Commission review and delivery of a proxy statement for such communications. 29/ To be eligible for the exemption, the person could not engage in a solicitation of proxy authority, 30/ and the exemption would not be available to any person with material economic interest in the

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29/ The communication would still be subject to the antifraud prohibitions under Commission Rule 14a-9. The Commission rejected commenters' proposals that it facilitate shareholder communications by narrowing the definition of solicitation. That approach would have removed communications excluded from the definition from the antifraud prohibition of the proxy rules.

30/ A person could not claim the benefits of the exemption, and thereafter seek proxy authority. As stated in the proposing release:

> [A]ny person who purports to engage in an exempt solicitation with respect to a particular meeting or subject matter of security holder action pursuant to proposed Rule 14a-2(b)(1) could not continue to rely on the proposed exemption through the assertion of a change in purpose or intent should he subsequently solicit authority to act on behalf of securityholders concerning the same meeting or subject matter. Because the earlier solicitation would not qualify for the exempt treatment under such circumstances, any failure to comply with the full panoply of the proxy rules as to that solicitation would be deemed a proxy violation.

outcome of the matters subject to a securityholder vote (other than by virtue of ownership of the issuer's securities or rank-and-file employee status). Thus:

- A person seeking to change control of a company, by soliciting proxies to vote for an opposition slate of directors;
- Insurgents seeking authorizations to call a special meeting; or
- A hostile bidder urging shareholders to defeat a negotiated merger put to a shareholder vote by management, even if the bidder did not solicit proxy authorizations,

could not use the exemption.

The proposal would not allow large institutional shareholders to use the exemption to conceal agreements or joint action to combine their voting power to force a company to take particular actions. Disclosure is required when shareholders act in concert with respect to voting power. Indeed, disclosure of such concerted action is a primary purpose of the public filing mandated by Section 13(d) of the Exchange Act. Those who fail to disclose publicly any agreement among shareowners to coordinate voting of shares representing more than five percent of the class -- whether formal or informal, express or implied -- violate the federal securities laws. Despite suggestions to the contrary, large institutional shareholders would not be allowed to form secret groups for collective action.

The Commission explicitly recognized that the proposed exemption raised a number of issues and solicited public comment on these issues. These issues, which have not yet been resolved by the Commission, demonstrate that the SEC has been seeking the most fair and balanced approach to reduce the costs and burdens of current proxy rules.

To this end, the Commission asked: First, should shareholders whose proposals were included in the issuer's proxy statement be eligible for the proposed exemption? Second, should the proposed exemption be available to any person, not seeking proxy authority, and not having a disqualifying economic interest? The Proposing Release requested comment on the appropriateness of the breadth of the exemption:

> Comment is requested on the appropriateness of coverage of each of the above categories, indicating whether and under what circumstances the interest of one member in a solicitation should disqualify the group from relying on the exemption. In particular, comment is requested as to whether the proposed exemption should be available only to securityholders.

Notwithstanding the disclosures mandated by Section 13(d), a key issue raised by the Commission with respect to the proposed exemption was the potential for, and implications of, fewer public communications by significant shareholders. Highlighting this issue, the Proposing Release stated:

> Some have contended that all securityholders, including those not directly solicited, should be aware of and have access to the soliciting statements of any person engaged in a solicitation. Both securityholders and registrants, they argue, would be better served by requiring all soliciting efforts to be disclosed to the public, thereby providing more information to the securityholder body and permitting the substance of the solicitations to be reviewed by and responded to by the other persons involved in the solicitations.
>
> Under the current proxy rules, a person engaged in a solicitation is not required to solicit all securityholders. However, the required public filing of all soliciting materials, together with the mandated proxy statement, makes publicly available extensive information concerning the solicitation. Oral solicitations are permitted, and generally are not subject to any filing requirement, except for the mandated proxy statement.
>
> The Commission requests comment on an alternative to proposed Rule 14a-2(b)(1) that would permit disinterested persons, who by definition would not be seeking a proxy. to engage in a solicitation without having to prepare a proxy statement, provided that all written materials used in the solicitation are filed with or submitted to the Commission, or otherwise

> made publicly available at the time they are first used to solicit. If this approach were followed, should a proxy statement be required to be filed with the Commission for public notice purposes, but not required to be distributed to securityholders? Should a more limited form of notice identifying the person engaged in the solicitation, the size of the solicitation and a brief description of the substance of the solicitation be required? Would such an approach lead to greater reliance on oral rather than written solicitation, and if so, what additional safeguards should be imposed by the rules?

Finally, the Proposing Release requests comment on whether the proposed exemption strikes an appropriate balance between securityholders' interest in gaining access to reliable, truthful information that would facilitate voting decisionmaking, and the countervailing need to ensure that all materials disseminated to securityholders that may influence their vote will be free of fraud. The Release specifically asks:

> What activities that would be exempted by the new rule should be subject to some or all of the Commission's proxy rules, and why? Are there alternative, more appropriate means of facilitating securityholder communications?

2. <u>Preliminary Filing and Staff Review of Proxy Soliciting Materials</u>

To streamline the solicitation process, reduce costs and minimize timing concerns of issuers and other persons soliciting proxies, the Commission has proposed to eliminate the preliminary filing requirements for all soliciting materials except the proxy statement and form of proxy. Soliciting materials include letters, newspaper ads, flyers, campaign buttons, banners, posters, and many other common forms of written communications short of a full proxy statement or proxy card. Under the proposal, these materials would continue to be filed with the Commission in definitive form when distributed to securityholders, but there would not be any prior review by SEC staff.

This proposal would allow both management and soliciting shareholders to publish newspaper ads, "Dear Shareholder" letters and "fight pieces" without first filing and receiving SEC comment. The material as used would continue to be publicly filed with the Commission, and it would be subject to antifraud prohibitions.

Today, management proxy statements and proxy cards relating to uncontested elections and shareholder proposals are already exempt from prior governmental review. The Commission did request comment on whether there are additional classes of proxy statements that should be exempted from pre-use review.

3. Public Access to Preliminary Materials

The proposals would accelerate the public disclosure of a preliminary proxy statement and proxy card. Under the current rules, preliminary proxy material is not available to the public when filed. This differs sharply from Securities Act registration statements, annual and quarterly reports and tender offer documents, all of which are publicly available even while under review at the SEC. The proposal would conform the treatment of a preliminary proxy statement to that of a preliminary prospectus and provide investors with earlier public notice of proposed actions that could affect the value of their securities.

4. Soliciting Shareholder Access to Securityholder Lists

Under the Commission's proposal, shareholders would be given a limited right to obtain a list of shareholders. Today, they have no such right under federal law, in many instances forcing a shareholder to engage in costly and prolonged litigation to obtain a list under state law provisions. However, under the proposal, in those instances where management was soliciting proxies, shareholders would be able to obtain the list in order to communicate their views to their fellow stockholders. The shareholder would be provided the option of having management mail the soliciting materials at the shareholder's expense. In addition, the mandated list would be expanded to include not merely the names and addresses of record holders, but also the names, addresses and securities holdings of <u>both</u> record and non-objecting beneficial holders.

Currently, under the proxy rules, management's solicitation is conditioned on its mailing shareholder soliciting materials <u>or</u> providing the stockholder list. However, this option lies entirely with management. As a result of this management option, as well as the limited information required by the rule, most shareholders use the federal right to mailing or a list as a last resort.

State corporate laws provide general inspection rights, although in some states, such as New York and Maryland, the right to the stockholder list is conditioned on size of holdings or length of holding. Even where the only condition is that the shareholder must have a proper purpose in requesting the lists, there are instances where shareholders seeking to engage in a regulated proxy contest have been forced to litigate to compel production of the list. The added delay and cost typically associated with seeking a state-law judicial remedy under the significant time constraints of a proxy solicitation undermine the ability of the soliciting person to provide securityholders with information bearing on their proxy voting decision.

The proposal would not provide an unfettered right to a securityholder list, and therefore it does not displace state statutory or common-law inspection rights. The list could be used only to solicit securityholders with respect to a subject or meeting for which the issuer itself is already soliciting, or intends to solicit, a proxy.

5. Public Comment

To date, the Commission has received more than 450 letters of comment on these proposals. Commenters include approximately 230 individual and institutional holders of equity securities in corporations and limited partnerships, more than 170 issuers or issuer organizations, legislators at both the state and federal levels, several law and business professors, and lawyers. Comment ranges from enthusiastic endorsement to vehement opposition to the entire package. Many commenters have suggested revisions and refinements.

The Commission is in the process of reviewing and evaluating the substance of the letters. After completion of its review and analysis of the public comment, the Commission will assess whether the proposals will further the interests of informed, effective shareholder voting, and if so, whether revisions are necessary or appropriate to the proposals to better achieve these purposes. In so doing, the Commission will continue to seek the best possible balance of all the important interests that must be taken into account. At this stage, the Commission has not made any decisions.

VIII. Compensation Issues

1. Corporate Pay Responsibility Act

Your letter also requested comments on the "Corporate Pay Responsibility Act," S. 1198, recently introduced by Senator Levin. The Commission is not prepared to support the bill at this time, although the Commission is currently reviewing the adequacy of disclosures relating to executive compensation. Current compensation disclosure requirements are outlined below.

With respect to the other provisions of the bill, the Commission already has proposed to revise its proxy rules to require prompt access to the stockholder list for shareholder solicitations as discussed above. Provisions of the bill that would mandate confidential proxy voting and independent third-party tabulation of securityholder ballots, large securityholder access to issuer proxy statements to nominate director candidates, and inclusion of compensation policy, criteria and method proposals under Rule 14a-8, raise significant policy and implementation questions.

2. **Commission Compensation Disclosure Requirement**

Current compensation disclosure requirements were adopted by the Commission in 1983, after a seven-year effort to update and improve those that had evolved over approximately 30 years. During this seven-year period, the Commission proposed and adopted three different formulations and issued five interpretive releases. This extended process of regulatory development and refinement focused the Commission on the need to strike an appropriate balance between excessively detailed, complex discussion of all compensation packages and overly-simplified disclosure that did not accurately portray the nature of the compensation received.

The Commission's rules require compensation to be disclosed individually for each of the five highest paid executive officers whose compensation exceeds $60,000, and in the aggregate for executive officers as a group. Disclosure of three principal classes of compensation is prescribed by the rules: (1) cash compensation; (2) benefit plan compensation; and (3) other forms of compensation, including non-plan, non-cash payments and reportable personal benefits.

Cash compensation is required to include all cash paid or earned, whether in the form of base salary, bonuses or deferred compensation, for services rendered to the company and its subsidiaries during the fiscal year. This information must be disclosed in a prescribed tabular form.

Plan compensation encompasses stock option and stock appreciation right ("SAR") plans, as well as pension, retirement, long-term incentive and performance plans. In addition to furnishing the prescribed disclosure regarding the material terms of the plan or plans, the company must quantify the amounts paid or distributed (or accrued and unconditionally vested) during the year to the five highest paid executive officers and all executive officers as a group. A specific tabular presentation showing estimated annual benefits payable on retirement is required for defined benefit plans and actuarial plans where the benefits are determined primarily on the basis of final compensation and years of service. Reporting of compensation in the form of stock options and SARs is governed by specific requirements calling for information concerning the amount and terms of grants, along with the value of securities or cash received on exercise during the year.

Other non-cash compensation paid or distributed to the named executives and members of the executive group, including personal benefits, also must be disclosed. An exception is made where the aggregate value of such compensation, calculated in terms of the aggregate incremental cost to the company, does not exceed the lesser of $25,000 or 10% of all cash compensation reported.

Finally, the proxy statement or other filing must describe all compensatory plans or arrangements whereby payments will be made to senior management in the event of a change of control of the issuer or termination of employment. Payments made in these circumstances, commonly known as "golden parachutes," must be disclosed where in excess of $60,000. If shareholders are asked to vote on golden parachute awards or long-term employment contracts, detailed disclosure must be made in the company's proxy materials of the antitakeover effects of these arrangements.

Disclosure of director compensation is made pursuant to more generalized requirements that divide such compensation into two classes. In the first class is all compensation awarded pursuant to standard arrangements. The arrangements must be described, and the amounts payable specified, including the amounts payable for service on board committees or performance of special assignments. The second class includes arrangements with particular directors. In addition to a description of these arrangements, the director involved and the individual amount paid must be disclosed.

In addition to compensation, transactions between the company or any of its subsidiaries and an executive officer, director or director nominee (or member of the immediate family) must be disclosed where the amount involved is greater than $60,000. Similarly, the company must disclose any indebtedness of more than $60,000 owed to it by such person or certain associated entities.

Information also is required with respect to business dealings between the company and any entity with which a director or director nominee has a specified business relationship, where the amount of business exceeds designated thresholds. For example, where a director's law firm provides legal services to the company, disclosure must be made of this business relationship and the value of the services performed if the fees paid constituted more than 5% of the firm's gross revenues for the fiscal year.

Conclusion

The broad issues of shareholder rights, proxy requirements and overall systems for corporate governance have very important implications for the U.S. economy. These matters can significantly affect the value of trillions of dollars in equity investments, as well as the level of future savings and investment. By encouraging or discouraging equity investments, state or federal action in this area could affect significantly the capital resources for our future economic growth.

Corporate management should be accountable to shareholders for the company's long-term economic performance. They should also be accountable for their ethical standards and compliance with law. At the same time, achieving strong corporate performance depends in part on the ability of management to be able to pursue sound long-term policies without excessive harassment or diversion to unproductive issues. Both the states and the federal government have important roles to play in establishing and enforcing standards on various specific issues. Ideally, decisions in this area should be the product of a careful and deliberate balancing of all the relevant interests and recognition of the vital economic stake every American has in the smooth and efficient functioning of both our capital markets and our public corporations.

Thank you.