EQUAL ACCESS - WHAT IS IT?

Equal access refers to shareholders' ability to place issues in management's proxy statement or on the proxy card. Most of the following discussion narrowly focuses on shareholders' ability to nominate candidates for directors on management's proxy card.

PROS AND CONS

Equal access has been touted as a low-cost way for shareholders to run alternate candidates for board seats. Currently the only way investors can run their own candidates is to lead an expensive (minimum cost estimated at $250,000) proxy contest. Some say the current system stacks the deck against shareholders, for the following reasons:

- Though many board nominating committees say they will consider candidates suggested by shareholders, most investors view the director-nomination process as management-dominated, with the company putting its nominees on the proxy card.
- Management has full access to company coffers to run its own candidates and oppose shareholder initiatives and candidates.
- The cost of running a proxy contest is considerable, and management can increase the cost by commencing expensive litigation, running expensive print ads and initiating multiple mailings.
- Shareholder resolutions are limited to 500 words, but management's opposing statements have no limit.

But opponents express concern that equal access might result in cluttered ballots with too many investors suggesting alternate candidates and might be abused by dissidents to mount a no-premium corporate takeover disguised as a boardroom coup. As the American Society of Corporate Secretaries noted in 1990 in response to an equal access rulemaking petition at the SEC. equal access would result in a "costly, massive, unfocused multiparty referendum that would jeopardize the integrity and functionality of the proxy process."

CURRENT RULES - SHAREHOLDER ACCESS

Today the only way shareholders can access management's proxy card is by filing a shareholder resolution. The shareholder proposal rule, which has been in place since 1942, sets eligibility requirements ($2,000 in stock or 1 percent of stock held continuously for at least a year), limits the length of resolutions (500 words, including supporting statement), restricts subject matter (13 grounds for omission) and stipulates resubmission requirements (minimum 3 percent vote in year one, 6 percent in year two and 10 percent in year three).

Shareholders may not use the shareholder proposal rule to nominate directors. Under Rule 14a-8(i)(8), companies may omit any proposal relating to an election for membership on the company's board of directors or analogous governing body. The only way shareholders can run candidates for the board is to launch a proxy contest, an expensive and difficult proposition.

CURRENT ACTIVITY

The debate over shareholder access to management proxy cards to nominate directors and raise other issues has been re-energized with a rulemaking petition submitted Aug. 1 to the Securities and Exchange Commission by the Committee of Concerned Shareholders and James McRitchie. The group wants the SEC to amend Rule 14a-8 of the Securities Exchange Act of 1934, the rule governing shareholder resolutions, so that companies could no longer exclude proposals relating to the election of directors.

The committee, a group of individual shareholders who met on the Internet and ran a grass roots proxy contest to replace directors at Luby's, and McRitchie, editor of CorpGov.net, said "entrenched managers and directors will only improve corporate governance when they can be held personally accountable, e.g. voted out of office and replaced."

Their petition, file #4-461 at the SEC, would enable any shareholder eligible to submit a resolution—those continuously owning at least $2,000 worth of stock for at least a year—to nominate director candidates satisfying certain requirements. As proposed, shareholders would have to provide a letter of nomination containing a statement that the candidate would serve as director and include additional key information, including the candidate's name, age, business address, relationships with the company and work experience. The petition also calls on the SEC to prohibit broker votes (votes cast by brokers without the written instructions of the beneficial owners) on the election of directors.

eRaider, an Internet confederation of investors, also recently petitioned the SEC on the issue, asking it to mandate that public companies must place the names of all legitimate director candidates on ballots distributed to shareholders. The group also urged the SEC to disallow broker votes for any candidate, to ban the use of corporate funds for campaigning for any candidate and to strike down unreasonable qualification tests for director candidates. Its petition doesn't set any requirements for director candidates, though it said it has no objection to some qualifications, such as age and stock ownership.

The Social Investment Forum, a trade association for financial practitioners promoting the growth, concept and practice of socially responsible investing, recently submitted a letter to the SEC asking it to consider requiring two candidates for each open board seat and to develop a way for companies to include shareholder nominations.

BACKGROUND OF THE ISSUE

The shareholder access issue has been around for decades. The issue was first considered in 1942, when the SEC proposed giving shareholders access to management proxy materials to nominate director candidates. The Commission dropped the idea in response to unfavorable public comments and strong congressional opposition. (Proxy Contests for Corporate Control, Randall S. Thomas and Catherine T. Dixon)

But the idea has persisted. According to the Investor Responsibility Research Center, in 1976—the same year the SEC took a comprehensive look at the shareholder proposal rule—a University of California professor recommended that shareholders with more than 5 percent of the stock should be allowed to nominate directors using management's proxy card.

In August 1977 the Business Roundtable spoke out on the issue, when its corporate organization committee responded to the SEC' s request for written comments on governance issues. At that time, the SEC, responding to a series of corporate scandals and several highly publicized corporate bankruptcies, was holding public hearings concerning shareholder communications, shareholder participation in the corporate electoral process and corporate governance.

Surprisingly, the BRT memo, submitted by Coca-Cola chairman J. Paul Austin, was supportive of the equal access concept, recommending that "the SEC should adopt, if necessary, amendments to

Rule 14a-8 that would permit shareholders to propose amendments to corporate bylaws which would provide for shareholder nominations of candidates for election to boards of directors." But the group was opposed to allowing shareholders to use management's proxy card to exchange views on different issues.

Noting that shareholders have the exclusive right to elect directors at annual meetings, the memo said "to permit shareholders to propose charter or bylaw amendments to provide access to the nomination process by way of management's proxy materials would do no more than allow the establishment of machinery to enable shareholders to exercise rights acknowledged to exist under state law."

The memo didn't advocate universal shareholder access. Instead, it supported giving shareholders the right to propose, on a company-specific basis and through the shareholder proposal process, whether and to what extent management's proxy materials should be available for shareholders to nominate director candidates.

The memo said the following limitations were appropriate in all situations:

- Support of a minimum number of shareholders (number of shares or percentage) should be required before a candidate would be eligible for inclusion on management's proxy card.
- A limit should be placed on the total number of non-management nominees to be included, and a method should be established to pare down the number of nominees, if necessary.
- A procedure should be devised to omit repeat nominees who did not receive a certain percentage of votes in prior elections.
- Limits should be placed on the number of nominees that may be proposed by a single investor or group of investors to guard against a takeover under the guise of better shareholder access. The group said this aspect of shareholder access was complex and warranted careful analysis. It said, "the objective of such access is to create a greater opportunity for shareholder input, not to create a new takeover technique…Persons attempting to take over management should not have access to the corporation's proxy soliciting material."
- Nominating shareholders should be required to obtain the written consent of their nominee to serve if nominated and elected.

Regarding disclosures, the BRT said shareholders making director nominations should be subject to the same disclosure requirements as management, and they should have to disclose the qualifications of their nominees.

We're still searching for details on the SEC's public hearings and its final proposals. But clearly nothing was done on the equal access issue. Adopted reforms included congressional passage of the Foreign Corrupt Practices Act of 1977 and the stock exchanges' adoption of rules requiring a corporate board to have an "independent" audit committee.

In 1990, corporate attorney Martin Lipton argued for a number of changes to the elections of corporate directors. To counterbalance his proposal that the annual meeting be replaced with quinquennial meetings to be held every five years, Lipton said that eligible shareholders or groups of shareholders should have access to management's proxy card to nominate directors. To be eligible, a shareholder or group would have to hold 5 percent of the firm's shares or stock worth $5 million. Lipton said his proposal was intended to focus on longer-term issues and eliminate short-term performance pressures.

In 1996 SEC Commissioner Steve Wallman suggested overhauling the shareholder proposal process by eliminating the, “ordinary business” exemption and requiring any proposals addressing “core” issues or proposed by shareholders owning more than 3 percent of the outstanding shares to be included on management’s card. Other non-frivolous resolutions would be drawn under a lottery, with the number of resolutions selected varying from three to six, depending on the number of company shareholders. Core and 3 percent proposals would be counted against the limit but would not be limited by the cap. His proposal didn’t get very far; the SEC ended up making only a few modest changes to the shareholder proposal.

SHAREHOLDER EFFORTS

According to the Investor Responsibility Research Center, in the 1980s individual investor Kurt Wulff sponsored a number of resolutions calling on companies to give shareholders equal access to the proxy. He argued that access is a more peaceful means for change that could eliminate the necessity of disruptive corporate takeovers. But his resolutions didn’t get significant levels of support,, and Wulff told IRRC his resolutions “may be ahead of their time.”

In 1990 the United Shareholders Association submitted a rulemaking petition to the SEC that included a number of reforms, including equal access. Under its proposal, qualifying shareholders would have equal access to management proxy materials to nominate directors, respond to management proposals and answer management’s opposition to shareholder proposals. Its intent was to give qualifying shareholders equal opportunity to communicate with other shareholders through all of the management’s written communications, not just the original proxy statement. A shareholder or group of shareholders owning the lesser of at least 3 percent of the outstanding shares or $1 million worth of stock would qualify.

USA said the qualification thresholds would limit frivolous or nuisance challenges. To ensure fair treatment of shareholders, USA said any rule should require companies to give equal space, coverage and treatment to shareholder-nominated candidates for directors. It also requested that:

- the limit on shareholder proposals and supporting statements be increased to 1,000 words.
- management be required to file a pre-distribution disclosure notice of the issues, proposals and board nominees to be presented for shareholder votes.
- expenses of qualifying shareholders running alternate candidates be reimbursed regardless of their success.
- comparable funding be provided to qualifying shareholders when management engaged in extraordinary communication efforts such as employee-manned phone banks.

The AFL-CIO echoed USA’s request in May 1991, when it sent a rulemaking petition to the SEC asking for revisions to the proxy rules. One of its proposed reforms addressed increased shareholder access to company proxy materials. The union suggested that shareholders be allowed to use the company’s proxy material to address issues on the proxy card. “Absent a counter solicitation effort by a nonmanagement shareholder, the shareholders do not receive any information that opposes or simply raises questions about the contemplated shareholder action,” the union said. It suggested setting a “fair threshold level” for eligibility.

In the early 1990s, former New York State Comptroller Edward V. Regan, sole trustee of the New York State Common Retirement Fund, focused on the concept as a way for shareholders to communicate with other shareholders about a company's performance. He asked the SEC to reform the proxy rules to give shareholders access to management proxy cards for the purpose of commenting on the company's long-term performance.

In 1993 the New York fund sponsored a bylaw resolution asking A&P to allow shareholders or groups of shareholders owning at least 0.5 percent of the outstanding shares for three years to insert a statement of up to 300 words describing how they intended to vote on the election of directors and their opinion of the board's and management's ability to achieve long-term corporate growth and shareholder gain. The proposal also would have required the company's outside directors to insert a similar statement. Regan's resolution set a limit of three statements per proxy statement; if more were submitted, a company could determine by lot which ones to include. The proposal was supported by only 8 percent of the votes cast for and against.

Since then a few resolutions on the issue have come to votes, but for the most part the resolutipns received fairly low votes. In recent years, the Council has tracked several resolutions calling on companies to nominate two candidates for each open board seat; this resolution doesn't address shareholder access, although its intent is to provide shareholders with some choices for director.

SEC ACTIONS

Rulemaking petitions filed by investors addressing equal access haven't made any inroads at the SEC. But calls for less stringent communications rules for shareholders were heard, since in 1992 the SEC finished up a two-year review by amending the proxy rules to free up shareholder communications, authorize so-called "exempt solicitations" and allow investors to run short slates of directors.

Before the rule change, discussions among 10 or more investors—even if simply involving opinions or views on management performance or initiatives—could have been alleged to constitute a solicitation warranting disclosures, filings and mailings. The new rules allow shareholders to freely communicate if they aren't seeking proxy authority from other shareholders or if they don't have a substantial interest in the subject matter beyond their interests as shareholders.

While the rules changes didn't give shareholders equal access to the proxy, they were powerful reforms that enhanced shareholders' ability to communicate with each other.

LEGISLATIVE ACTION

Members of Congress have periodically been interested in the issue. Most recently, Sen. Carl Levin (D-Mich.) introduced on May 6, 2002, Senate Bill 2460, the Shareholder Bill of Rights Act, which would direct the SEC not to prohibit shareholder proposals permitted under state law to remove or nominate a director, among other things. Levin's bill sets tougher eligibility requirements than Rule 14a-8. Under his bill and similar to USA's proposal, a shareholder or group of shareholders would have to own at least $1 million worth of stock or at least 3 percent of the outstanding shares to be eligible to propose removing a director or adding a candidate to management's proxy card.

McRitchie and the Committee of Concerned Shareholders oppose Levin's tougher standards, calling them "paternalism by the wealthy." "Why the focus upon the wealth of the nominator as opposed to the ability of the director-nominee to benefit all shareholders with his/her election to the board of directors?" they asked.

Rep. Edward J. Markey (D-Mass.) introduced corporate governance reform legislation in 1994 that would have allowed shareholders to nominate candidates for the board, but his bill wasn't adopted.

Various legislative bills proposed in 1987 would have given shareholders equal access management's proxy card. One proposed House bill set eligibility limits of 5 percent or more of a company's stock (or market value of more than $5 million). Another set eligibility thresholds of the greater of 3 percent of the stock or $500,000 in stock. A Senate bill would have given equal access to any shareholders owning more than 10 percent of the outstanding shares.

ISSUES

- Eligibility requirements for access?
- 13D issues related to eligibility requirements?
- Limits on the number of shareholder-nominated candidates? If so, what should be done if more candidates are proposed than permitted?
- Limits on number of nominees proposed by a single investor or group of investors?
- Company resources—would an access rule open the floodgates and overwhelm companies?
- How should timing issues for filings be handled?
- Would equal access result in special interest representation that could be harmful to shareholders in the long term?
- Resubmission thresholds?