



Advocacy: the voice of small business in government

October 2, 2007

**Via Electronic Mail**

The Honorable Christopher Cox, Chairman  
U.S. Securities and Exchange Commission  
Attn: Nancy M. Morris, Secretary  
100 F Street, NE  
Washington, DC 20549  
Electronic Address: rule-comments@sec.gov

**Re: Shareholder Proposals Relating to the Election of Directors (SEC File No. S7-17-07); Shareholder Proposals (SEC File No. S7-16-07)**

Dear Chairman Cox:

The Office of Advocacy (Advocacy) of the U.S. Small Business Administration (SBA) respectfully submits this comment letter on the U.S. Securities and Exchange Commission's (SEC) two alternative releases on shareholder proxy access, *Shareholder Proposals Relating to the Election of Directors*<sup>1</sup> ("Short Proposal") and *Shareholder Proposals* ("Long Proposal").<sup>2</sup> Both proposals seek to address the issue of whether companies can exclude shareholder proposals amending future election procedures, such as allowing shareholders access to company proxy statements to nominate their own candidates to the board of directors.

Advocacy has received input from small business representatives, who are concerned that shareholder proxy access shifts the high cost of these proposals from a minority of shareholders to the smaller public companies and the majority of the shareholders. Advocacy supports the Short Proposal because it affirms the SEC's long-held position that shareholder proposals that result in an election contest, such as proxy access, may be excluded from a company's proxy materials. Advocacy does not support the Long Proposal, because it will enable certain shareholders to include proposals on election procedures in the company's proxy statement and may lead to costly proxy contests. Advocacy believes that these costs will be disproportionate for smaller public companies and may discourage small business from availing themselves of American capital markets.

<sup>1</sup> *Shareholder Proposals Relating to the Election of Directors*, 72 Fed. Reg. 43488 (Aug. 3, 2007).

<sup>2</sup> *Shareholder Proposals*, 72 Fed. Reg. 43466 (Aug. 3, 2007).

## **I. The Office of Advocacy**

Congress established the Office of Advocacy in 1976 by Pub. L. No. 94-305 to represent the views and the interests of small business within the federal government. Advocacy is an independent office within SBA, so the views expressed by Advocacy do not necessarily reflect the views of the SBA or the Administration. The Regulatory Flexibility Act (RFA),<sup>3</sup> as amended by the Small Business Regulatory Enforcement Fairness Act (SBREFA),<sup>4</sup> gives small entities a voice in the rulemaking process. For all rules that are expected to have a significant economic impact on a substantial number of small entities, federal agencies are required by the RFA to assess the impact of the proposed rule on small business and to consider less burdensome alternatives.<sup>5</sup>

## **II. Background**

Rule 14a-8 of the Securities and Exchange Act of 1934 (“Exchange Act”) creates procedures for qualified shareholders to present proposals in the company’s proxy materials.<sup>6</sup> A company can exclude a shareholder proposal if it falls within one of the rule’s thirteen substantive categories of exclusions. Rule 14a-8(i)(8) provides that a company can exclude a shareholder proposal that “relates to an election for membership on the company’s board of directors or analogous governing body.”<sup>7</sup> If a shareholder seeks to nominate their own nominees for the board of directors, they must begin a proxy contest and the contesting party must pay the costs of soliciting their own proxy statements.<sup>8</sup>

In 2003, the SEC proposed Rule 14a-11, which would have required companies to provide direct access to the company’s proxy solicitations for shareholder nominations to the board of directors.<sup>9</sup> Advocacy submitted a comment letter stating that the proposed Rule 14a-11 would have disproportionate costs on smaller public companies, and recommended that any requirement be limited to accelerated filers with more than \$75 million in public float.<sup>10</sup> The SEC never finalized this proposal.

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<sup>3</sup> *Regulatory Flexibility Act of 1980*, Pub. L. No. 96-354, 94 Stat. 1164 (1980) (codified as amended at 5 U.S.C. § 601 et seq.).

<sup>4</sup> *Small Business Regulatory Enforcement Fairness Act*, Pub. L. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C. § 601 et seq.).

<sup>5</sup> 5 U.S.C. § 603.

<sup>6</sup> 17 C.F.R. § 240-14a-8. Exchange Act Rule 14a-8(b)(1) provides that a holder of at least \$2,000 in market value, or 1% of the company’s securities entitled to be voted, may submit a shareholder proposal subject to other procedural requirements and substantive bases for exclusion under the rule.

<sup>7</sup> 17 C.F.R. § 240.14a-8(i)(8).

<sup>8</sup> 17 C.F.R. § 240.14a-12.

<sup>9</sup> *Security Holder Director Nominations*, 68 *Fed. Reg.* 60784 (Oct. 23, 2003).

<sup>10</sup> Comment letter from Thomas M. Sullivan, Chief Counsel, and Michael R. See, Assistant Chief Counsel, Office of Advocacy, Small Business Administration to the Securities and Exchange Commission (Dec. 18, 2003)(*Advocacy Comment Letter*).

In the 2006 case of *American Federation of State, County & Municipal Employees v. American International Group, Inc.*, the U.S. Court of Appeals for the Second Circuit called into question whether the election exclusion in Rule 14a-8(i)(8) applied to shareholder proposals amending a corporation's bylaws regarding future election procedures such as allowing shareholder proxy access.<sup>11</sup> The court asked the SEC to clarify its inconsistent interpretation of this election exclusion and "explain its reasons for doing so."<sup>12</sup>

On August 3, 2007, the SEC released two alternative rules regarding shareholder proposals on proxy access. The Short Proposal would reaffirm the SEC's long-held position that shareholder proposals that result in an election contest, such as shareholder proxy access, may be excluded under federal law.<sup>13</sup> The Short Proposal would amend the regulatory text to specify that the election exclusion applies to both a current nomination and election for the board of directors or a procedure for such nomination or election.<sup>14</sup>

The Long Proposal would create a new SEC policy, that shareholder proposals amending election procedures may not be excluded under federal law. Under this proposal, shareholder(s) could submit such a proposal if they meet the following criteria: 1) the shareholder(s) must file a Schedule 13G that includes public disclosures; 2) the proposal is submitted by a shareholder(s) who has continuously beneficially owned more than five percent of the company's securities entitled to be voted on the proposal at the meeting for at least one year; and 3) the proposal otherwise satisfies the requirements of Rule 14a-8.<sup>15</sup>

### **III. Advocacy's Comments on the Alternative Proposals**

#### *The Long Proposal Will Negatively Impact All Companies*

The SEC has received many comments from the business community, stating that the Long Proposal allowing shareholder proposals on proxy access will be costly and disruptive to companies. A comment letter from America's Community Bankers stated that "shareholder-nominated directors can disrupt board proceedings and create adversarial relationships that may prevent the board from acting quickly and responsively on critical issues."<sup>16</sup>

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<sup>11</sup> *American Federation of State, County & Municipal Employees, Employees Pension Plan v. American International Group, Inc.*, 462 F.3d 121 (2d Cir. 2006).

<sup>12</sup> *AFSCME*, 462 F.3d at 130.

<sup>13</sup> 72 *Fed. Reg.* 43488.

<sup>14</sup> 72 *Fed. Reg.* at 43493. The proposed exclusion text would be revised to read: "If the proposal relates to the nomination or an election for membership on the company's board of directors or analogous governing body or a procedure for such nomination or election."

<sup>15</sup> 72 *Fed. Reg.* at 43470.

<sup>16</sup> Comment letter from Sharon Ann Haeger, Regulatory Counsel, America's Community Bankers to the Securities and Exchange Commission (May 25, 2007).

### *The Long Proposal Is Likely to Have a Disproportionate Impact on Smaller Public Companies*

The Regulatory Flexibility Act (RFA) requires agencies to consider the economic impact that a proposed rulemaking will have on small entities, prepare an Initial Regulatory Flexibility Analysis (IRFA) to analyze these costs, and consider regulatory alternatives to minimize these costs.<sup>17</sup> Although the SEC prepared an IRFA for this proposal, the IRFA did not provide an estimation of costs that smaller public companies will incur due to the resulting shareholder proposals and subsequent proxy contests on company proxy statements.

In the costs section of this rule, the SEC does estimate that “the annual additional burden to companies of preparing the required proxy disclosure would be approximately 270 hours of company personnel time and a cost of approximately \$36,000 for the services of outside professionals.”<sup>18</sup> The Long Proposal states that there may be “increased costs relating to the solicitation of proxies in support of the board’s candidates and against the shareholder nominees,” but does not quantify these costs.<sup>19</sup> Advocacy believes that there will also be extra costs for the additional pages of shareholder proposals and proxy contest information in the company proxy report, along with the increased postage involved. Advocacy recommends that the SEC revise their IRFA to provide an estimation of the potential costs of this rulemaking to smaller public companies.

Advocacy believes that the cost of including bylaw proposals and shareholder nominees in company proxy materials is likely to disproportionately affect small public companies. The majority of proxy costs are represented in due diligence and other background work required to include a nominee for election to the board of directors. A small public company would devote a larger percentage of its earnings to proxy costs than large public companies would.

### *Five Percent Requirement Will Impact Many Smaller Public Companies*

The Long Proposal enables shareholders to include in their company proxy materials their proposals for bylaw amendments to election procedures, provided that the proposal is submitted by a shareholder(s) who has continuously beneficially owned more than five percent of the company’s securities entitled to be voted on the proposal at the meeting for at least one year.<sup>20</sup> Advocacy believes that the five percent ownership requirement is not a significant barrier to shareholders making bylaw proposals for shareholder proxy access in smaller public companies, which may result in many expensive proxy contests for these issuers. A five percent stake in a small public company with under \$75 million in public float would require less than a \$3.75 million investment.

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<sup>17</sup> 5 U.S.C. § 603.

<sup>18</sup> 72 *Fed. Reg.* at 43483.

<sup>19</sup> *Id.*

<sup>20</sup> 72 *Fed. Reg.* at 43470.

Paul Schott Stevens, President and CEO of the Investment Company Institute, recommended a higher ownership requirement than five percent for bylaw proposals in his recent testimony.<sup>21</sup> He noted that “it is not uncommon for one institutional investor to hold five percent or more of a company.”<sup>22</sup> Based on ICI’s analysis, they estimate that 87 mutual fund complexes had a total of 1,887 holdings of five percent or more of the U.S. companies in which they invest.<sup>23</sup> Stevens testified that many of these companies are smaller public companies. Since there are so many institutional investors with five percent ownership in smaller public companies, Advocacy believes that this ownership requirement is unlikely to ensure that the shareholders eligible to submit bylaw proposals and director nominations are acting to protect long-term shareholder interests.

#### *Advocacy Recommendations*

In light of small business concerns regarding the Long Proposal, Advocacy recommends that the SEC choose the Short Proposal because it preserves the status quo and adds no additional costs on smaller public companies. Under the Short Proposal, the SEC will clarify its long-standing position that shareholder proposals that could result in an election contest, such as shareholder proxy access, may be excluded under Rule 14a-8(i)(8).

If the SEC decides to adopt the Long Proposal, Advocacy recommends that the SEC proceed cautiously before implementing these dramatic changes to the corporate board system. Advocacy recommends that the SEC perform a revised Initial Regulatory Flexibility Analysis to analyze the potential costs and regulatory alternatives of this proposal, and publish this document for public comment.

One of the most important provisions of the IRFA is the description of any significant alternatives to the proposed rule that accomplish the stated objectives of applicable statutes that minimize the rule’s economic impact on small entities.<sup>24</sup> If the SEC implements the Long Proposal, Advocacy recommends that the SEC limit the applicability of this rule to accelerated filers or public companies with more than \$75 million in public float. Advocacy made this recommendation in 2003, when the SEC proposed similar rulemaking.<sup>25</sup>

#### **IV. Conclusion**

Advocacy urges the SEC to adopt the Short Proposal, which will clarify the SEC’s long-standing position on the election exclusion without fundamentally changing the way corporate boards function, and will add no additional costs to smaller public companies.

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<sup>21</sup> *Full Committee Hearing: SEC Proxy Access Proposals; Implications for Investors, House Committee on Financial Services*, 110<sup>th</sup> Cong (Sept. 27, 2007) (statement of Paul Schott Stevens, President and CEO, Investment Company Institute).

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> 5 U.S.C. § 603(c).

<sup>25</sup> *Advocacy Comment Letter*, at 1.

Advocacy is pleased to forward the comments and concerns of small businesses. Please feel free to contact me or Janis Reyes at (202) 619-0312 (Janis.Reyes@sba.gov) if you have any questions or require additional information.

Sincerely,

//signed//

Thomas M. Sullivan  
Chief Counsel of Advocacy

//signed//

Janis C. Reyes  
Assistant Chief Counsel

cc:

The Honorable Susan E. Dudley, Administrator, Office of Information and Regulatory Affairs  
The Honorable Paul S. Atkins, Commissioner, U.S. Securities and Exchange Commission  
The Honorable Kathleen L. Casey, Commissioner, U.S. Securities and Exchange Commission  
The Honorable Annette L. Nazareth, Commissioner, U.S. Securities and Exchange Commission  
Gerald J. Laporte, Chief, Office of Small Business Policy, U.S. Securities and Exchange Commission