THE WALL STREET JOURNAL.
WSJ.com

OPINION MAY 27, 2009

# The SEC’s Proxy Access Proposal

By LUCIAN BEBCHUK

The Securities and Exchange Commission voted last week to ask the public to comment on a proposal to let shareholders place director candidates on the corporate ballot. The adoption of such a rule would be a useful step toward the necessary reform of corporate elections.

As my research has shown, it's hard for shareholders to replace directors, and electoral challenges to incumbent directors are infrequent. One main impediment to such challenges is incumbents' control of the company's proxy card – the corporate ballot sent by the company at its expense to all shareholders. While board-nominated candidates appear on the ballot, challengers must bear the costs of sending (and getting back) their own proxy card to shareholders.

The SEC's proposal would provide shareholders in certain limited circumstances with "proxy access" – the right to place director candidates they nominate on the company's proxy card. To be allowed to place candidates on the corporate ballot, a shareholder (or a group of shareholders) will need to hold 1%-5% of the shares (depending on the company's size) for more than one year. These requirements mean that only long-term shareholders with a significant stake will be able to propose their own directors.

Opponents of the SEC's proposal argue that the SEC shouldn't impose a blanket rule about proxy access, but rather should leave the provision of proxy access arrangement to company-by-company choices. One size does not fit all, the argument goes, and the SEC's proposal would prevent variation and experimentation.

It is ironic that opponents of proxy access now raise the banner of company-by-company choices. In 2007, the SEC examined whether to let shareholders propose bylaw amendments that would establish proxy access for shareholders seeking to nominate directors. At that time, opponents of proxy access persuaded the SEC to prohibit the inclusion of such proposals on the ballot. This prohibition made it rather difficult for shareholders to adopt proxy access arrangements on a company-by-company basis. For many opponents of proxy access, then, uniformity seems to be quite acceptable when it doesn't involve shareholder access but becomes unacceptable when it does.

In fact, the proposed SEC rule would allow some meaningful variation. The proposal would establish some mandatory requirements as to shareholders nominations that would have to be included, but would allow companies to adopt arrangements providing shareholders with more expansive access to the company's proxy.

Opponents also argue that establishing any minimum requirements for inclusion of director candidates on the company's proxy card departs from the SEC's traditional role into an area best left for state corporate law. However, the SEC's proxy rules already mandate the inclusion of some information, including certain shareholder proposals, on the corporate ballot and accompanying proxy materials. The SEC's proposal would merely expand the current mandatory requirements, and wouldn't enter any new territory.

The objections to the SEC proposal are weak. Indeed, the proposed proxy access should be supplemented with additional reforms of corporate elections.

First, proxy access wouldn't eliminate the cost advantage of incumbent directors, whose campaign expenses are fully financed by the company. To reduce this cost advantage, firms should reimburse the campaign expenses of successful challengers.

Second, firms should dismantle staggered boards. All directors should stand up for election at each annual shareholder meeting.

Furthermore, the arrangements governing corporate elections should be set by shareholders, not by the very directors whose election is regulated by these arrangements. To this end, as the SEC's release suggests, shareholders' ability to adopt election bylaws should be facilitated. In addition, boards shouldn't be permitted to adopt bylaws making their own removal more difficult or to repeal any shareholder-adopted election bylaws.

The case for comprehensive reform of corporate elections is supported by a significant body of empirical evidence. Arrangements that insulate directors from removal are associated with lower firm value and worse performance.

The proxy rules have been intended by Congress, the courts have stated, "to give true vitality to the concept of corporate democracy." Adopting the SEC proposal, and the additional reforms I discussed, would advance this important goal.

*Lucian Bebchuk, professor of law, economics, and finance and director of the program on corporate governance at Harvard Law School, is author of "The Case for Shareholder Access to the Ballot," "The Myth of the Shareholder Franchise" and "The Case for Increasing Shareholder Power."*

Copyright 2009 Dow Jones & Company, Inc. All Rights Reserved