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Administrative Office  
c/o Professor George Kaufman  
Loyola University Chicago  
820 North Michigan Avenue  
Chicago, Illinois 60611  
Tel: (312) 915-7075  
Fax: (312) 915-8508  
E-mail: gkaufma@luc.edu

Statement No. 297

Marshall Blume  
215.898.7633

Kenneth E. Scott  
650.723.3070

Chester S. Spatt  
412.268.8834

Statement of the Shadow Financial Regulatory Committee on

**Proxy Access and the Market for Corporate Control**

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The problem of proxy access to the corporation's ballot has been one that the Securities and Exchange Commission (SEC) has struggled with for a long time. Using specific authority under the Dodd-Frank Wall Street Reform and Consumer Protection Act, the SEC moved quickly to expand the scope of when shareholders could obtain access to a corporation's proxy ballot by its adopting Rule 14a-11. Under this rule, the SEC will now allow groups of shareholders who own at least three percent of the equity for three years to place candidates on the corporate proxy ballot for up to one-fourth of the number of board seats.

While the proxy ballot is an important mechanism to resolve potential agency problems between shareholders and a firm's management, the parameters of the SEC's rule raise questions about the underlying rationale for this rule. Conceptually, the proxy process should be a way to discipline management and resolve agency concerns. Certainly, a legitimate argument for limiting proxy access is that shareholders as a whole should not be required to pay for contests that do not, a priori, possess a modest level of possible shareholder

support. That does suggest a principled basis for requiring support from a minimum percentage of shareholders. However, some commentators have suggested that the specific choice of the percentage level was selected to facilitate the eligibility of union and social activist shareholders motivated by private benefits or societal causes.

Though it is difficult to judge whether that was the specific rationale for this standard, other aspects of the rule leave little doubt that the rule's parameters were motivated in part by non-economic considerations. For example, the basis for the three-year holding period requirement is not clear. Neither the organization of capital markets nor economic theory suggests a rationale for regulators to discriminate against newer shareholders and offer special privileges to longer-standing shareholders. Rules for securities markets should be designed to facilitate access by activist investors who are motivated to increase the value of a firm by reducing its inefficiency rather than designing the rules solely to help union and pension shareholders to promote their own causes. It is unlikely that economic activist shareholders would have purchased many of their shares within the past three years. It's also worth noting that such investors would not be able to gain control of the board by obtaining 25 percent of the board seats. In contrast, for the institutional union or pension investors who may be more anxious only to confront management or promote a social cause, these constraints are much less problematic.

One of the most important failings of the American system of corporate governance is the current absence of a serious market for corporate control. Of course, much of the blame for this rests with the positive treatment of poison pills by Delaware. However, the damage from this would be mitigated if it were feasible for an activist group to obtain control of the board and thereby allow redemption of the poison put.

Furthermore, the traditional attitude of the SEC about the proxy voting process has resulted in a legal morass characterized by restrictions on mounting proxy contests and communication among shareholders. The renewed interest and attention to investor protection would suggest that proxy rules should be designed to help open the market for corporate control and encourage increasing the value of the firm, rather than protecting entrenched management or promoting the non-economic objectives of particular shareholders at the expense of others. In order to facilitate market discipline, such a proxy-access rule would require higher percentage ownership, include recent share purchases and permit more than 25 percent of the board seats to be contested on the corporate proxy ballot.