

American Federation of Labor and Congress of Industrial Organizations



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May 15, 2003

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: File No. S7-10-03

Dear Mr. Katz:

On behalf of the American Federation of Labor and Congress of Industrial Organizations (the "AFL-CIO"), I am writing to petition the Securities and Exchange Commission (the "Commission") to adopt comprehensive new rules under Section 14 of the Securities and Exchange Act of 1934 to permit shareholder-nominated director candidates to appear in the corporate proxy statement and proxy card.

Granting institutional shareholders the ability to economically run independent candidates for boards of directors is a key response to both the broader corporate crisis and the specific longstanding problem of corporate boards ignoring investor concerns. Although state law permits shareholders to run director candidates, this fundamental shareholder right remains effectively unavailable so long as shareholders' nominees are denied equal access to the corporate proxy. As a result, incumbent directors can freely spend the corporate treasury to get re-elected while shareholders are forced to mount costly proxy contests that are difficult for particular investors to justify absent a battle for corporate control.

We welcome the Commission's recent decision to review the proxy rules and regulations regarding procedures for the nomination and election of corporate directors, and urge the Commission to use this process to provide shareholders with equal access to the corporate proxy. In particular, we believe the formulation recommended in this petition will enable long-term shareholders to exercise our existing rights more effectively under state law and thereby restore democratic corporate elections, enhance board of director performance and accountability, and lessen investors' dependence on regulatory oversight.

I. Background

The AFL-CIO is the federation of America's labor unions, representing 65 national and international unions and their membership of more than 13 million working women and men. Union members participate in the capital markets as individual investors and through a variety of benefit plans with over \$5 trillion in assets. Union-sponsored pension plans account for \$400 billion of that amount.

The AFL-CIO, its member unions and their affiliated pension funds have had the opportunity to discuss shareholder access to the proxy for director nominees with the Commissioners and staff on several occasions, most recently in the context of a shareholder proposal at Citigroup sponsored by the American Federation of State, City and Municipal Employees' Pension Plan (AFSCME). As you know, the Commission ruled that existing Rule 14a-8 did not require Citigroup to include this proposal on the nomination of director candidates in its proxy materials.

While we disagree with the Commission's ruling on the Citigroup proposal, we welcome its concurrent directive to the Division of Corporation Finance to formulate possible changes in the proxy rules and regulations regarding procedures for the nomination and election of corporate directors. We recognize that this review may extend beyond director nominations and elections to encompass a broader examination of Rule 14a-8, including those aspects that now involve significant Commission resources, and look forward to discussing our ideas and concerns on these issues with the Commission as part of its review.

We are particularly interested, however, in focusing the Commission's review on the critical issue of shareholder access to the proxy for director nominees. We believe this is essential to repair what is now a badly compromised corporate election process. In our view, any resulting rule changes that merely allow shareholders to vote on proposals such as the one sponsored by AFSCME at Citigroup would not be sufficient.

We urge the Commission to use this opportunity to adopt comprehensive new rules that will give shareholders equal access to the proxy for their director nominees. We believe the new rules *should* be a practical tool to enhance the ability of long-term shareholders to nominate and elect directors to represent their interests. They *should not* provide a tool that can be used to facilitate low-cost hostile takeovers by short-term investors. We believe the specific criteria proposed in this petition would enable the Commission to formulate new rules that achieve these objectives.

II. Recent Commission Reforms Address Director Conflicts, Not Accountability

Recent Commission reforms have sought to address structural flaws in our corporate governance system laid bare by the collapse of Enron in 2001 and the wave of corporate scandals that followed. These scandals revealed how unregulated conflicts of interest can compromise the independence of the very people entrusted to protect investors, including

boards of directors and the auditors they retain. In response to these governance failures and the Sarbanes-Oxley Act of 2002, the Commission adopted a broad set of reforms, including new rules to enhance the independence of audit committees and outside audit firms, and is expected to approve new exchange listing standards to strengthen the independence of the board and its key committees.

The AFL-CIO believes these Commission reforms are essential to rein in the conflicts of interest that can compromise directors' loyalty to the corporation and its shareholders. In fact, we filed rulemaking petitions on director and auditor independence in December 2001 (SEC File nos. 4-448 and 4-449), and we will continue to advocate for additional reforms to protect shareholders. But these and other possible regulatory reforms, however essential, cannot ensure that directors act independently, are responsive to shareholder concerns and contribute to building the long-term value of the corporations they serve.

As recent scandals demonstrate, corporate boards, including those comprised mainly of independent directors, too often fail to live up to this fundamental standard. At Enron, for example, a board ostensibly composed of a majority of independent directors failed in its oversight duties, with devastating consequences for shareholders and employees. According to a report by a special committee of Enron's own board, the board's audit and compliance committee performed required reviews "only in a cursory way", and the entire board "did not fully appreciate the significance of some of the specific information that came before it."¹

It may take an extraordinary collapse into bankruptcy like that of Enron to expose outright board failure, but examples of corporate directors who are unresponsive to shareholder concerns are common. Perhaps the starkest examples are those corporate boards that ignore majority votes on shareholder proposals. In 2002, companies reported receiving majority votes on 98 shareholder resolutions yet, according to the Council of Institutional Investors, only 14 have been adopted. In some cases, corporate boards have failed to act on resolutions that have received majority votes for several consecutive years. Kroger, for example, has yet to declassify its board despite receiving a majority vote for four consecutive years on a proposal sponsored by the International Brotherhood of Teamsters asking the company to do just that.

Investors expect more from the directors we ostensibly elect to represent our interests. We expect directors to be open and responsive to shareholder input on issues facing the company, willing to challenge management with tough questions and goals, and prepared to take action when needed to maximize the long-term value of the corporation. Unfortunately, given the current incumbent-dominated director election process, shareholders have surprisingly little ability to hold directors accountable for failing to meet these fundamental standards.

¹ Report of Investigation by the Special Investigative Committee of the Board of Directors of Enron Corp, February 1, 2002.

Shareholders need a way to hold boards of directors accountable, both for their actions and their failure to act. This problem is especially serious for long-term shareholders, including the many worker pension funds that place the majority of their equities in index funds to both minimize fees and address the difficulty large funds have outperforming the market as a whole. Unlike actively managed funds, indexed funds are unable to sell their stock in a company with an ineffective or unresponsive board. For these shareholders, director accountability is paramount.

Some shareholders have urged the Commission to address the specific problem of companies failing to implement majority vote shareholder proposals by making these proposals binding. This approach, however, is beyond the Commission's jurisdiction and raises a series of state law and other problems. Moreover, corporate directors argue that it is their prerogative, not shareholders', whether or not to implement a shareholder proposal.

We believe the Commission can address this problem, and the more general problem of unresponsive boards, in a less draconian and more flexible manner by providing shareholders with equal access to the proxy for their director nominees. Most importantly, this would address the underlying obstacle to real director accountability, which is the current incumbent-controlled corporate election process.

Finally, we believe that absent real accountability to long-term investors, directors will never be really independent from management. No matter what bright line rules are adopted, the politics and information flows in a boardroom without real ties of accountability, leading to directors' inevitable psychological dependence on management.

III. Directors, Not Shareholders, Currently Control Director Elections

Under the current director election process, shareholders vote only on candidates nominated by the directors themselves. Although state law permits shareholders to run their own candidates, in reality this only occurs at public companies in the rare event of a hostile takeover given the tremendous cost of proxy fights. These costs are prohibitive even for the largest institutional investors given their diverse portfolios. With no meaningful ability to cost effectively run directors, or to even vote against incumbent directors², shareholders can do little more than rubberstamp a company's nominees. For shareholders, this inevitably results in an inability to hold directors accountable for their performance and an extreme reliance on government regulation and oversight.

We share the Conference Board's view that "Shareowners, particularly long-term shareowners, should act more like responsible owners of the corporation. They should have not only the motivation, but also the ability to participate in the corporation's election process through involvement both in the nomination of directors and in proposals in the

² In corporate elections, shareholders can "withhold" their votes for one or more directors, but are not able to vote "against" a director. This amounts to little more than a protest vote. In fact, it is conceivable that, absent a requirement to the contrary in state law or a company's bylaws, the number of "withhold" votes could outnumber the number of votes "for" a given nominee, who would nonetheless be elected.

company's proxy statement about business issues and shareholder concerns regarding governance of the corporation."³

In the wake of recent accounting scandals, institutional shareholders increasingly recognize that active ownership to promote good corporate governance can preserve and enhance shareholder value. Worker funds, for example, have sponsored roughly 380 shareholder proposals in the 2003 proxy season, over 40 percent of all shareholder resolutions filed at public companies. Even more telling is the fact that these proposals, most of which focus on executive pay, are drawing record support from shareholders. Proposals calling on PPG, Weyerhaeuser, and US Bancorp to expense stock options and to require shareholder approval for golden parachutes at Alcoa, Hewlett Packard, Raytheon, Sprint and Tyco are among those that have already received majority shareholder votes this year.

Unfortunately, even motivated shareholders do not currently enjoy the ability to participate in the nomination of directors without running a proxy contest, a cost-prohibitive exercise absent a battle for corporate control. As a result, corporate boards currently control director nominations and thus, in effect, the entire election process. The purpose of the new rules that we propose would be to correct this unjustifiable imbalance by making meaningful the rights that shareholders already ostensibly enjoy under state law. Moreover, by empowering shareholders, we believe these rules will lessen investors' reliance on regulatory action and oversight.

IV. New Rules Should Empower Shareholders, Not Facilitate Low-Cost Takeovers

As described above, we believe the new rules *should* be a practical tool to enhance the ability of long-term shareholders to nominate and elect directors to represent their interests. They *should not* provide a tool that can be used to facilitate hostile takeovers by short-term investors, nor should they impractically crowd the company's proxy materials. To achieve these objectives, we believe the new rules should include criteria governing qualifying shareholders and the number and rights of shareholder-nominated director candidates. Specifically, we recommend that the Commission consider the following criteria:

- *Minimum Ownership Threshold:* Nominating shareholder group should own a substantial block of shares (e.g. 3% minimum).
- *Minimum Holding Period:* A majority of the shares held by the nominating shareholders must have been held for a minimum holding period in excess of one year.
- *Exemption from Regulation 13-D:* Communication among shareholders together holding more than 5% should be exempted from burdensome requirements under Regulation 13-D so long as that communication is limited to efforts to nominate director candidates.

³ Conference Board Commission on Public Trust and Private Enterprise, Findings and Recommendations Part 2, January 9, 2003.

- *Maximum Permissible Slate:* Qualifying shareholders should have the right to nominate a maximum number of directors at each shareholder meeting (e.g. equal to the greater of (a) two directors or (b) one-third of the number of company nominees standing for election at a particular meeting, but in no case a majority of the entire board). This represents the maximum number of shareholder nominees that would be allowed in the company's proxy, regardless of the number of competing shareholder groups seeking to nominate candidates.
- *Competing Shareholder Groups:* Unlike the pressures present at many large cap companies regarding shareholder proposals under Rule 14a-8, we think it is relatively unlikely that multiple shareholder groups at a particular company will compete for access to the proxy for their director nominees given the high ownership threshold required. Thus, we believe a simple decision rule (e.g. the largest shareholder block) will be sufficient to address the possibility of competing shareholder groups collectively exceeding the maximum permissible slate size.
- *Director Statement:* Each shareholder-nominated director candidate should have the opportunity to include a background statement (e.g. 500 word maximum) in the proxy statement in support of his or her candidacy. In contested situations, management-nominated candidates should be afforded the same opportunity.
- *Provisions to Prevent Management from Gaming the System:* The new rules should contain appropriate provisions to prevent management or the incumbent board from seeking to pre-empt an independent shareholder effort to nominate directors by, for example, colluding with a friendly shareholder group to nominate directors who are in effect their own nominees. In addition to strong language prohibiting such collusive activity, the rules could include a provision whereby the only incumbent directors eligible to be nominated by shareholders would be those who (a) were originally elected as a shareholder nominee or (b) are being ousted by the incumbent board without adequate justification to shareholders.

We believe the above criteria would create a fair process to allow long-term, institutional investors access to the proxy for their director nominees. We believe that the creation of this process will encourage incumbent directors to be more responsive to shareholder concerns and more likely to consult with shareholders when putting together their director slates.

Moreover, the potential for shareholders to use the proposed mechanism to replace incumbent directors will likely be limited since companies generally have the ability to increase the size of their boards to accommodate additional nominees. Therefore, we envision this primarily as a tool to promote positive director accountability. We believe that this proposal would have significant benefits for investors even if rarely used, and the costs, even to those companies where shareholders ran candidates, would be small even in proportion to the cost of the proxy itself.


Jonathon G. Katz, Secretary
May 15, 2003, p. 7

V. Summary

We commend the Commission for recent reforms to enhance the independence of corporate directors. We believe the time has now come to restore democracy to corporate elections and genuine accountability to the boardroom by giving institutional shareholders the ability to economically run independent director candidates. We therefore urge the Commission to use its current review of the proxy rules on director nominations and elections to adopt comprehensive rules granting shareholders access to the corporate proxy for their director nominees.

Finally, I understand that the Commission has asked the Division of Corporation Finance to consult with interested parties as part of its proxy rule review process. We would welcome the opportunity to discuss these rules in general, and this rulemaking petition in particular, with Commission staff. Please do not hesitate to contact William Patterson or Damon Silvers of my staff at (202) 637-3900. Thank you.

Sincerely,

A handwritten signature in black ink, appearing to read "Richard L. Trumka". The signature is fluid and cursive, with a long horizontal stroke at the end.

Richard L. Trumka
Secretary -Treasurer

cc William H. Donaldson, Chairman
Paul S. Atkins, Commissioner
Roel C. Campos, Commissioner
Cynthia A. Glassman, Commissioner
Harvey J. Goldschmid, Commissioner
Alan L. Beller, Director of Corporation Finance