Council of Institutional Investors
The Voice of Corporate Governance

VIA EMAIL AND U.S. MAIL

December 1, 2011

A. Gilchrist Sparks III
Chairman
Corporate Laws Committee
Business Law Section
American Bar Association
321 North Clark Street
Chicago, IL 60654

Re: Voting by Shareowners for the Election of Directors

Dear Mr. Sparks:

Thank you for your response to the Council of Institutional Investors' (Council) letter of August 11, 2011, requesting that the Corporate Laws Committee of the Business Law Section of the American Bar Association, that you chair (Committee), consider amending the Model Business Corporation Act (MBCA) to provide for majority voting as the default rule in director elections.[1]

The purpose of this letter is to inform you that (1) the Council is deeply disappointed with the Committee's response that it "does not believe that reopening consideration of Section 7.28(a) of the [MBCA] at this time is warranted,"[2] and (2) we respectfully request that the Committee promptly reconsider its decision.

[1] Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to Mr. A. Gilchrist Sparks III, Morris, Nichols, Arsht & Tunnell LLP (Aug. 11, 2011), http://www.cii.org/UserFiles/file/resource%20center/correspondence/2011/August%2011%202011%20ABA%20Letter%20(final).pdf.

[2] Letter from A. Gilchrist Sparks, III, Chairman, Corporate Laws Committee, to Jeff Mahoney, Esquire, General Counsel, Council of Institutional Investors 1 (Oct. 25, 2011), http://www.cii.org/UserFiles/file/resource%20center/correspondence/2011/10-25-11%20ABA%20Response%20letter.pdf. Of note, Section 7.28(a) of the Model Business Corporation Act, the so-called "default rule," states that "[u]nless otherwise provided in the articles of incorporation, directors are elected by a plurality of the votes cast by the shares entitled to vote in the election at a meeting at which a quorum is present." 2 Jonathan R. Macey, Macey on Corporate Laws § 13.16[A] (Aspen Publishers, Supp. 2011-1).

Founded in 1985, the Council is a nonprofit, nonpartisan association of public, corporate and union employee benefit plans, foundations and endowments with combined assets that exceed $3 trillion. Council members are large, long-term shareowners responsible for safeguarding the retirement savings of millions of American workers.[3]

As you are aware, at most public companies in the United States (U.S.), directors continue to be elected by a plurality of votes cast, rather than by a majority of votes cast.[4] Thus, incredibly, at most U.S. public companies, a director is elected or reelected "so long as she receives *any* votes in her favor, even if ninety percent or more of the shareholders vote against her."[5]

The Council believes strongly that in uncontested elections, directors should be elected by a majority of votes cast.[6] Majority voting ensures that shareowner votes count and makes directors more accountable to shareowners they were elected to represent.[7]

The Committee's decision rejecting the Council's request to consider amending the MBCA default rule appears to be primarily based on two arguments: (1) the Committee considered the default rule of the MBCA in 2006; and (2) the MBCA includes a provision that would permit companies to adopt majority voting.[8] As discussed in more detail below, we find both arguments less than compelling.

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[3] For more information about the Council of Institutional Investors and its members, please visit our website at http://www.cii.org/about.

[4] *See, e.g.,* Letter from Edward J. Durkin, Director, Corporate Affairs Department, United Brotherhood of Carpenters, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission 1-21 (App. I May 20, 2011), http://www.sec.gov/rules/petitions/2011/petn4-630.pdf (listing those publicly traded companies in the United States that have adopted a true majority voting standard); *Cf.* Lisa M. Fairfax, Shareholder Democracy 141 (Carolina Academic Press 2011) (commenting that the United States is relatively unique among developed markets because unlike the U.S., most "developed markets already have a majority vote standard for director elections").

[5] Lisa M. Fairfax at 85.

[6] Council of Institutional Investors, Corporate Governance Policies § 2.2 Director Elections (Sept. 28, 2011), http://www.cii.org/UserFiles/CII%20Corp%20Gov%20Policies%20Full%20and%20Current%2009-28-11%20FINAL(1).pdf ("Directors in uncontested elections should be elected by a majority of the votes cast.").

[7] *See, e.g.,* Investors' Working Group, U.S. Financial Regulatory Reform: The Investors' Perspective 22 (July 2009), http://www.cii.org/UserFiles/file/resource%20center/investment%20issues/Investors%27%20Working%20Group%20Report%20(July%202009).pdf (finding that "[m]ajority voting in uncontested elections ensures that shareowners' votes count and makes directors more accountable to shareowners").

[8] Letter from A. Gilchrist Sparks, III at 2-3.

The financial crisis and broad acceptance of majority voting as a best practice requires reconsideration of the default rule

The Council acknowledges and appreciates that the "Committee considered issues relating to voting by shareholders for the election of directors, including revising Section 7.28(a) [the default rule], beginning in 2005 and ultimately determined to adopt a new Section 10.22 of the MBCA[9] and companion amendments in 2006."[10] The Committee, however, should acknowledge and appreciate that significant events have occurred in the past five years since the Committee considered the default rule—events that, in our view, mandate a reconsideration of Section 7.28(a).

Beginning in the fall of 2008, the U.S. suffered a devastating financial collapse.[11] As described in an April 2011 report of the Majority and Minority Staff of the U.S. Senate Permanent Subcommittee on Investigations:

> Once valuable securities lost most or all of their value, debt markets froze, stock markets plunged, and storied financial firms went under. Millions of Americans lost their jobs; millions of families lost their homes; and good businesses shut down. These events cast the United States into an economic recession so deep that the country has yet to fully recover.[12]

The bi-partisan Financial Crisis Inquiry Commission (FCIC) was created by the U.S. Congress to examine the causes of the financial and economic collapse.[13] Following the review of millions of pages of documents, interviews of more than 700 witnesses, and the holding of 19 days of public hearings, the FCIC concluded that a "key cause" of the financial crisis was "dramatic failures of corporate governance . . . ."[14]

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[9] "Section 10.22 was added to the MBCA in 2006 to allow a corporation to opt into an election system that gives deference to the will of the majority." 2 Jonathan R. Macey § 13.16[B].
[10] Letter from A. Gilchrist Sparks, III at 1.
[11] Staff of S. Permanent Subcomm. on Investigations, 112th Cong., Rep. on Wall Street and the Financial Crisis: Anatomy of a Financial Collapse 1 (Apr. 13, 2011), http://hsgac.senate.gov/public/_files/Financial_Crisis/FinancialCrisisReport.pdf.
[12] *Id.*
[13] Financial Crisis Inquiry Commission, The Financial Crisis Inquiry Report *xi* (PublicAffairs Jan. 2011), http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf.
[14] *Id.* at *xviii.*

The FCIC's conclusion that corporate governance failures was a key cause of the financial crisis was shared by many other parties,[15] including the U.S. Senate Committee on Banking, Housing and Urban Affairs (Banking Committee)—which had the jurisdictional authority to develop legislative reforms in response to the crisis.[16]

The Banking Committee determined that the corporate governance failures that contributed to the crisis could best be addressed, at least in part, by legislation providing shareowners "more voice in corporate governance."[17] A result of that determination was the incorporation of Section 971, "Election of Directors by Majority Vote in Uncontested Elections,"[18] into what later became the base text of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).

Section 971 would have required the "SEC to direct the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer who has on their board members that did not receive a majority vote in uncontested board elections . . . ."[19] The legislative history surrounding the provision includes the following statement:

> The Committee believes that in the uncommon circumstance where a majority of shareholders voting in an uncontested election prefer that a nominee not serve on the board, it is fair and appropriate for their wishes to be honored.[20]

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[15] *See, e.g.,* Investors' Working Group at 2 ("The financial crisis represents a massive breakdown in oversight at many levels, including at corporate boards.").
[16] S. Comm. on Banking, Hous., and Urban Affairs, 112th Cong., Rep. to Accompany S. 3217, The Restoring Am. Fin. Stability Act 30 (Mar. 22, 2010), http://banking.senate.gov/public/_files/RAFSAPostedCommitteeReport.pdf ("During the crisis, it became apparent that investors needed better protection, shareholders needed more voice in corporate governance, the municipal securities markets needed improved regulation, and the SEC needs assistance.").
[17] *Id.*
[18] *Id*. at 117-18.
[19] *Id. at* 118.
[20] *Id.* We note that the "uncommon circumstance where a majority of shareholders voting in an uncontested election prefer that a nominee not serve on the board" is disturbingly far too common. More specifically, per Council staff review of 2011 Form 8-K filings, 48 directors failed to garner majority support from shareowners in uncontested elections. To-date, only four of those directors have stepped down from their respective boards and *one of those directors, Eduardo Elsztain of Hesha Hospitality Trust, was subsequently replaced by his brother*. Also of note, *only one of the 48 directors was subject to a true majority voting standard*.

Unfortunately for investors and the financial markets, Section 971 was ultimately dropped during the latter stages of the House-Senate Conference Committee negotiations before Dodd-Frank was enacted.[21] The strong support, however, for majority voting by the Banking Committee and by many other parties[22] reflects, in our view, broad acceptance by investors and policy makers that majority voting is a best practice and a needed corporate governance reform.

In addition, we note that even prior to the onset of the financial crisis, there was evidence of a significant movement in support of majority voting in the uncontested election of directors as a corporate governance best practice. Perhaps that movement is most evident in the growth of the percentage of S&P 500 companies that have adopted majority voting in recent years.

More specifically, when the MBCA default rule was last considered by the Committee, only *16 percent* of S&P 500 companies had adopted some form of majority voting.[23] Today, in stark contrast to 2006, more than *77 percent* of S&P 500 companies have adopted a true majority voting standard.[24]

In our view, the Committee's failure to-date to reconsider the Section 7.28(a) default rule in light of the financial crisis and the broad acceptance of majority voting by investors, policy makers, and many of the most prominent and most respected corporations in the U.S. sends a strong signal that the Committee is out of touch and unresponsive to the needs and demands of shareowners and the financial markets.

<u>Section 10.22 of the MBCA does not provide a legitimate basis for refusing to amend the Section 7.28(a) default rule</u>

We do not disagree with the Committee that the adoption of Section 10.22 of the MBCA in 2006 "permits boards or shareholders to implement a majority voting regime by amendment of a company's bylaws."[25] We, however, fail to understand why the Committee appears to believe that a provision that enables some corporations to adopt a majority voting standard justifies the retention of plurality voting as the default rule.

[21] *See, e.g.,* Lisa A. Fairfax at 92 (noting that "[l]egislators removed the mandate from the final bill").
[22] *See, e.g.,* Investors Working Group at 22 (recommending that "[i]n uncontested elections, directors should be elected by a majority of votes cast").
[23] Claudia H. Allen, Study of Majority Voting in Director Elections 1 (Nov. 12, 2007), http://www.ngelaw.com/files/Uploads/Documents/majoritystudy111207.pdf.
[24] Letter from Edward J. Durkin at 13 (App. II).
[25] Letter from A. Gilchrist Sparks, III at 2.

As an initial matter, we note that under most corporate statutes the default rule "[w]ith respect to fundamental transactions" *is majority voting*.[26] It is unclear to us why the election of directors should be treated any differently.

We acknowledge that when the Committee last considered possible alternatives to the default rule in 2006, it was perhaps plausible for the Committee to conclude that majority voting did not yet reflect best practices, particularly given that (1) the Council's policy supporting majority voting had only been in existence for one year,[27] and (2) only a small percentage of U.S. companies had adopted a majority voting standard.[28] In our view, however, the Committee can no longer plausibly defend plurality voting as a best practice appropriate for an MBCA default rule for at least three reasons.

First, the Council's membership approved policy supporting majority voting in the election of directors has been a high-profile policy for institutional investors for more than six years.[29] Second, more than 70 percent of S&P 500 companies have now adopted a true majority voting standard consistent with the Council's policy.[30] Finally, we note that the average support for shareowner resolutions to adopt majority voting in 2011 has to-date averaged 59.2 percent,[31] *an all-time high* for such proposals.[32]

[26] Lisa A. Fairfax at 19.
[27] Council of Institutional Investors, Corporate Governance Policies 2 (Spring 2005) (on file with Council) ("companies' charters and by-laws should provide that directors are to be elected by a majority of the votes cast").
[28] Claudia H. Allen at 1.
[29] *See, e.g.,* Majority Voting for Directors, Council of Institutional Investors, http://www.cii.org/MajorityVotingForDirectors (last visited Nov. 22, 2011).
[30] Letter from Edward J. Durkin at 13.
[31] ISS Voting Analytics Database (last visited Nov. 22, 2011) (on file with Council).
[32] *See, e.g.,* Majority Voting for Directors ("In 2010, shareowner proposals urging boards to adopt majority voting in director elections averaged just shy of 58 percent support, the best showing ever for this issue, according to proxy adviser Institutional Shareholder Services.").

For all of the above reasons, the Council respectfully reiterates its August 11, 2011, request that the Committee consider amending Section 7.28(a) of the MBCA to adopt majority voting as the default rule. We again would welcome the opportunity to meet with you or the Committee in person to discuss these issues in more detail. In the meantime, if you have any questions, please feel free to contact me directly at 202.261.7081 or jeff@cii.org.

Sincerely,

Jeff Mahoney

Jeff Mahoney
General Counsel