Proposed SEC rule would boost investors

by Ron Orol

The Securities and Exchange Commission on Wednesday introduced draft rules that promise to increase shareholder leverage over the selection of corporate boards.

"Overwhelming investor responsiveness to proposals tied to corporate governance demonstrates the need for shareholders to have a more meaningful voice in the board election process," said SEC Chairman William Donaldson at an agency meeting to discuss the measure. "That is difficult under current rules."

Under current proxy-voting regulations, shareholders effectively are restricted to voting for company-endorsed board members. The proposed rules, which will be open for public comment for 60 days, would use a two-step process to let investors nominate board members on corporate proxy cards.

A major investor would first introduce a proxy proposal seeking shareholder approval to nominate a candidate on a company's official proxy card. If a majority of voting shareholders approved the initiative, then the following year an investor could nominate a board member on the proxy card.

The change is expected to give shareholders more influence in proxy contests. Currently, investors wishing to challenge company management must resort to costly proxy fights, introducing their own director slates on separate proxy cards.

The draft rules also offer an alternative two-part process to empower shareholders. Investors could nominate a director on the company ballot if the previous year at least 35% of shareholders taking part in the board election withheld their votes for a director. Shareholders can withhold their vote by checking a box on the corporate proxy card.

"Both these approaches provide us with an indication of enough shareholder dissatisfaction with a company's proxy process," said Corporate Finance Division Director Alan Beller.

Only long-term investors with a significant stake in company would benefit under the proposed rules. To make the initial proxy proposal, shareholders must own at least 1% of the company for a minimum of a year. Only shareholders with a 5% stake for two years may nominate directors on the company proxy card.

While many governance experts have long advocated such rights for shareholders, some observers said the SEC has acted hastily in drafting the proxy rules. They also favor waiting to see the impact of the Sarbanes-Oxley Act, which mandates director independence, on corporate governance.

"The whole approach reflects a sort of unseemly regulatory impatience," said Robert Kohl, partner at law firm **Katten Muchin Zavis Rosenman** in New York. "We should wait and see whether these independence rules will have an effect on improving corporate governance before moving forward with these shareholder rules."

But agency commissioner Harvey Goldschmidt said the new rules would encourage directors to better represent the interest of investors. "This is a shifting balance of power from corporate management to all shareholders, not to special-interest shareholders," he said.