# NEWS RELEASE

## Committee on Energy and Commerce Democrats

Congressman John D. Dingell, Ranking Member

For Immediate Release | Contact: Jodi Seth
June 28, 2004 | 202-225-3641

**DINGELL, FRANK, OTHER KEY LAWMAKERS URGE SEC TO ADOPT PENDING RULE TO LET SHAREHOLDERS NOMINATE DIRECTORS AT BAD COMPANIES**

Rep. John D. Dingell (D-Mich), Ranking Member of the House Committee on Energy and Commerce, today released a two-page letter dated June 24, 2004 to SEC Chairman Donaldson, urging his agency to adopt the pending rule that would provide shareholders the ability to nominate directors to corporate boards. Citing the huge frauds at Enron, WorldCom, HealthSouth and other companies, the lawmakers said that granting shareholders limited access to corporate proxies, would "increase accountability and transparency in the boardroom." Five other lawmakers also signed the letter: Barney Frank (D-Mass), Ranking Member of the Committee on Financial Services; Carolyn B. Maloney, Ranking Member of the Financial Services Subcommittee on Domestic and International Monetary Policy, Trade, and Technology; Edward J. Markey (D-Mass), Ranking Member of the Energy and Commerce Subcommittee on Telecommunications and the Internet; and Diana DeGette (D-Colo) and Tom Allen (D-Maine), lead Democrats on the Energy and Commerce Subcommittee on Oversight and Investigations hearings on corporate corruption and accounting fraud.

Dingell previously wrote to Donaldson on this matter in the context of a letter releasing a GAO report on corporate governance and also lambasting business and Bush administration efforts to water down the proxy-access rules. (See May 12, 2004 letter, bottom page 3 and top page 4, also enclosed). Donaldson wrote to Dingell on June 15, 2004. That two-page letter, also enclosed, addressed: (1) providing investors with early and ongoing notice that a listed company is not in compliance with its market's continued listing standards; (2) ongoing efforts to improve corporate governance; (3) the SEC's pending proposal concerning shareholder nominees for director; and (4) the SEC's use of SRO internal audit reports during inspections of SROs.

Congress of the United States
House of Representatives
Washington, DC 20515

June 24, 2004

The Honorable William H. Donaldson
Chairman
United States Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549

Dear Chairman Donaldson:

We are writing to strongly encourage the Commission to adopt the pending rule that would provide shareholders the ability to nominate directors to corporate boards. We think that granting shareholders, under certain circumstances, access to the corporate proxy would not only give them a long overdue voice in the companies they own, but would also increase accountability and transparency in the boardroom.

As you are aware, Congress has been instrumental in exposing and investigating the corporate fraud that allegedly took place at Enron, WorldCom, HealthSouth and other companies. While we were shocked by the systemic nature of the fraud that purportedly occurred at these companies, we were equally disturbed by the lack of accountability that seemed to exist on the part of the boards of directors. Instead of looking out for the welfare of shareholders, many directors at these companies abdicated their fiduciary duty to protect shareholders' interests and functioned as rubber stamps for management – sometimes out of negligence, often to satisfy their own self-interests.

While the reforms, such as the Sarbanes-Oxley legislation, following these publicized scandals have been a good first step in increasing responsibility at the management level, such reforms have nevertheless failed to address the lack of accountability to and isolation from shareholders on the part of some corporate directors. In fact, shareholders remain effectively powerless when wanting to oust ineffective directors, their only option being to wage a costly and usually unsuccessful proxy contest. Consequently, shareholders are oftentimes left to tolerate ineffective and irresponsible directors with little recourse.

We therefore commend the Commission for considering the important and, in our view, long overdue reform that would provide shareholders with some ability to nominate directors. We believe this rule would be instrumental in ensuring that directors and management are responsive to and have interests aligned with those who they are intended to protect – the shareholders. We think that the adoption of this rule would prove to be a powerful tool in preventing corporate fraud as well as restoring beleaguered investor confidence.

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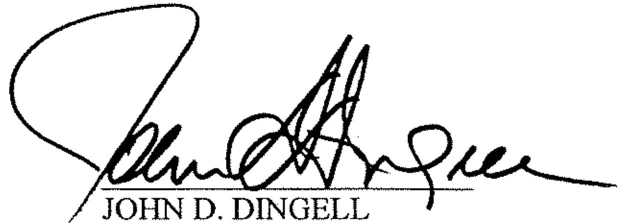
While we acknowledge the concerns of those who are opposed to this rule, we believe that the rule includes sufficient safeguards to assure that shareholders are only able to nominate directors in cases that involve widespread shareholder dissatisfaction. We believe that the triggering events stipulated in the proposed rule are substantial enough hurdles to prevent access to the proxy from being unfettered or overrun by special interest groups. We believe the rule – as it was proposed – is balanced, providing a mechanism to bring democracy to the boardroom while enabling companies to operate efficiently. We encourage the Commission to continue the course it intended to pursue at the outset of the rule-making process and provide shareholders with access to the corporate ballot without including additional provisions that may compromise the effectiveness of the rule.

For over sixty years, the Commission has considered proposals allowing shareholders the right to include nominees on the corporate ballot. In light of the recent corporate scandals, we believe that there is no better time for the Commission to finally adopt this well-crafted rule. While providing access to the corporate proxy is not a revolutionary idea, the adoption of the rule would be a powerful indicator of the Commission's commitment to good corporate governance in our country.

We applaud the Commission for devising a balanced rule, urge the Commission's adoption of the proposed rule, and support the continued efforts of the Commission to improve corporate governance in America.

Sincerely,

DIANA DEGETTE
Member of Congress



JOHN D. DINGELL
Member of Congress

EDWARD MARKEY
Member of Congress

BARNEY FRANK
Member of Congress

THOMAS ALLEN
Member of Congress

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Member of Congress

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BUD ALBRIGHT, STAFF DIRECTOR

ONE HUNDRED EIGHTH CONGRESS

U.S. House of Representatives
Committee on Energy and Commerce
Washington, DC 20515–6115

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May 12, 2004

The Honorable William H. Donaldson
Chairman
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Dear Chairman Donaldson:

I am writing with respect to the April 8, 2004 report, Securities Markets: Opportunities Exist to Enhance Investor Confidence and Improve Listing Program Oversight, GAO-04-75, which was prepared by the U.S. General Accounting Office (GAO) at my request and that of Reps. Barney Frank and Paul E. Kanjorski. The initial request predated the 2001 terrorist attacks but was expanded to respond to the critical investor-protection issues raised in the wake of that terrible event as well as the collapse of several major U.S. corporations as a result of accounting debacles and major corporate governance failures.

The resulting 117-page GAO report that was released yesterday provides updated information on (1) the actions of the three largest U.S. securities markets -- the American Stock Exchange (Amex), the Nasdaq Stock Market, Inc. (NASDAQ), and the New York Stock Exchange (NYSE) -- to address recommendations from the Securities and Exchange Commission (SEC) Office of Compliance Inspections and Examinations (OCIE) for improving their market's equity listing programs, (2) the extent to which OCIE uses self-regulatory organization SRO internal review reports in its inspection process, (3) SEC's oversight of NASDAQ's moratorium on the enforcement of certain of its listing standards, and (4) actions the SROs have taken to strengthen corporate governance for their issuers and themselves. The report includes 12 recommendations, with which the SEC expressed general agreement (SEC comment letter, pp. 101-103), while the SROs expressed concerns, and in some cases opposition, to those relating to notifying the public of noncompliance with listing standards and to enhancing board independence by requiring a super majority of independent directors and separating the positions of chief executive officer and board chairman (SRO comment letters, pp. 104-117).

Ranking Member Frank of the Committee on Financial Services and Ranking Member Kanjorski of its Capital Markets Subcommittee, which now have jurisdiction over these issues, have indicated that they will follow up on selected portions of the report in the near future. My comments on the report are as follows:

1. GAO notes at page 66 that: "Investors need timely and ongoing information on the listing status of issuers for use in making investment decisions. In the absence of such information, they might logically assume that all issuers comply with the listing standards of their markets." I wholeheartedly agree. GAO has determined that: "In the absence of voluntary action by the SROs, further SEC action is warranted to ensure that the public receives early and ongoing notice of an issuer's noncompliance with its market's listing standards." (p.67) I agree and believe that the SEC should commit to a firm time frame for such action.

2. GAO found that "SEC acted within its authority and followed its applicable regulations" with respect to the enforcement moratorium on NASDAQ's continued listing standards for bid-price and market value of publicly-held shares as well as subsequent changes, and that the rules "met their objective of allowing noncompliant issuers more time to trade." (p. 67) At page 40, GAO reports, however: "In its approval order, SEC said that the length of the extended compliance periods under the new rule raises investor protection concerns. According to SEC, if a listing standard is suspended for too long, the standard is not transparent and the investor protection principles underlying the premise of listing standards would be compromised." I am troubled by the implication of these observations and believe that this area deserves careful attention. In that regard, GAO issues this warning on page 67: "2 years is a long time to allow a noncompliant issuer to continue trading in the absence of a means of providing the public early and ongoing notification of the issuer's listing status." I agree with this observation and urge continued efforts to reach a viable solution whether through implementation of modifiers, indicators, or another solution. The recently adopted amendments requiring issuers to file a Form 8-K within 4 days of being notified by the SRO of their noncompliance with either a quantitative or qualitative listing standard is a huge step in the right direction.

3. GAO found that OCIE does not routinely use SROs' internal review reports in planning and conducting inspections and that this is inconsistent with the standards of organizations with functions similar to OCIE (p. 28). The Government Auditing Standards, also called the Yellow Book, recommend the use of internal review reports in conducting performance and other types of review (pp. 29-30). Both the SEC (p. 102) and NYSE (pp. 115-116) comment letters argue, among other things, that the routine use of these reports would have a "chilling effect" on the flow of information between SRO internal review staff and other SRO employees. I disagree. These reports, if well done, are a useful source of "red flags." I strongly agree with GAO's observation that: "these reports could aid OCIE in determining the

objectives and scope of inspections designed to assess the SROs' effectiveness in fulfilling their oversight responsibilities." (p. 67) This is particularly true if both the SEC and the SROs are missing the seeds of the same debacles.

4. The GAO report discusses in some detail the Congressional, SEC, and SRO efforts over the past three years to strengthen corporate governance, and I commend the SEC and SROs for completed and ongoing actions in that regard. One area of concern remains the ability of directors to provide active and independent oversight of management. This will remain an ongoing and difficult balancing act. But the SEC's primary mandate is and must remain the protection of investors. More remains to be done.

First, GAO recommends that the SEC work with the SROs to further enhance board independence by giving serious consideration to requiring issuers, through listing standards, to establish a super majority of independent directors and to separate the positions of CEO and chairman. The GAO report states at page 74:

> As SEC has noted, and we agree, with a super majority of independent directors and an independent board chairman, independent directors will set the board agenda as well as have the power to control the outcome of board votes. Although the SEC and we recognize that such actions do not guarantee effective management, we both agree that greater board independence could promote board decision making that is aligned with shareholders' interests, thereby enhancing board accountability.

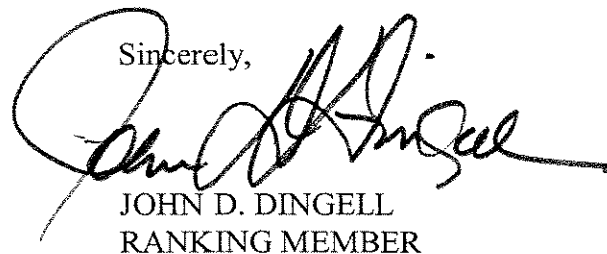
GAO acknowledges that "some issuers would not be in a position to immediately implement these best practices" (p. 74) and NASDAQ notes that it might prove "unduly burdensome" for smaller issuers (p. 110). I encourage the SEC and SROs to continue a dialogue with corporate America and shareholders as to how to achieve the best possible model of corporate accountability, along with a requirement that issuer's disclose annually any deviations from that model and the reasons therefore.

Second, GAO notes that "[f]or at least 60 years, shareholders have sought greater access to the issuer's proxy as a means of replacing ineffective or unresponsive directors and improving board accountability," and discusses the SEC's proposed rulemaking in this area (pp. 58-59). The proposed rule includes triggers that, when activated, require disclosure in an issuer's proxy materials of director nominees made by long-term shareholders or groups of long-term share-holders, with significant holdings. I commend the SEC for this courageous and appropriate action. It is long overdue. However, recent press reports, e.g., "SEC Feels Pressure To Weaken Some Rules," New York Times, Monday, May 10, 2004, at C1, indicate that your agency "has come under intense pressure from business and some members of the Bush administration to water down proposed rules." If true, this is wrong. They should be working with you and inves-tors, not against you. I strongly agree with the views of the Council of Institutional Investors whose comment letter states:"We agree that the rule should be carefully crafted to protect against

excesses and abuses. However, we urge the SEC to ensure that refinements to the proposal don't narrow the rule so significantly as to render it essentially meaningless or useless." I urge prompt adoption of the rule consistent with this touchstone.

I remain, and have been throughout my public career, a tireless advocate for investor protection, including the critical need for strong and vigilant SEC and SROs. While the Committee on Energy and Commerce no longer has a direct legislative role in these matters, I have a continuing interest in these issues and stand ready to support your endeavors. Thank you for your attention to my views and requests.

Sincerely,



JOHN D. DINGELL
RANKING MEMBER

Enclosure

cc: The Honorable David M. Walker, Comptroller General
U.S. General Accounting Office

The Honorable Barney Frank, Ranking Member
Committee on Financial Services

The Honorable Paul E. Kanjorski, Ranking Member
Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises
Committee on Financial Services

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Previous GAO Reports on Listing Issues Requested by Rep. Dingell:

American Stock Exchange: More Changes Needed in Screening Emerging Companies for the Marketplace, GAO/GGD-94-72 (May 25, 1994).

Securities Regulation: Oversight of SROs' Listing Procedures Could Be Improved, GAO/GGD-98-45 (February 6, 1998).

Securities Regulation: Actions Taken to Improve Nasdaq Listing Procedures, GAO/GGD-99-53 (April 26, 1999).

THE CHAIRMAN

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

June 15, 2004

The Honorable John D. Dingell
Ranking Member
U.S. House of Representatives
Committee on Energy and Commerce
2322 Rayburn House Office Building
Washington, DC 20515

Dear Congressman Dingell:

Thank you for your letter dated May 12, 2004, commenting on the U.S. General Accounting Office's report entitled Securities Markets: Opportunities Exist to Enhance Investor Confidence and Improve Listing Program Oversight, GAO–04-75. In your letter, you discuss several issues raised in the GAO's report, including: 1) providing investors with early and ongoing notice that a listed company is not in compliance with its market's continued listing standards; 2) continued efforts to strengthen corporate governance; and 3) the SEC's use of SRO internal audit reports during inspections of SROs.

With regard to noncompliant listed companies, I wholeheartedly agree that investors need timely and ongoing notice when a company listed on a particular market does not meet that market's continued listing standards. Investors need this information to make fully informed investment decisions. As you note in your letter, the Commission recently amended the Form 8-K filing requirements to require a company that has received notice from a market that the company does not satisfy continued listing rules or standards to file a Form 8-K disclosing that fact. Noncompliant companies will be required to file the Form 8-K within four days of receiving notice. The rules become effective in August 2004. This Form 8-K filing requirement will provide investors with enhanced disclosure of the listing status of noncompliant companies. In addition to the new Form 8-K requirement, some form of ongoing disclosure to investors is necessary. As you mention in your letter, in some cases noncompliant companies may remain listed on a market for a significant period of time and investors deserve clear ongoing disclosure of this information. The SEC will continue to work with the SROs to provide ongoing disclosure of the listing status of noncompliant companies, whether this goal is achieved by indicators, modifiers or some other appropriate solution.

I appreciate your remarks regarding our ongoing efforts to strengthen corporate governance. The Commission's recent rule changes, combined with the revised listing standards of the SROs, will have a lasting beneficial impact on the way public companies are managed. Given the diverse size and structure of corporate America, these standards have not, where possible, applied a "one-size-fits-all" approach. Consistent with your view, the SEC will continue a dialogue among all interested persons as to the means to best achieve corporate accountability, governance, and transparency.

The volume of public commentary evidences the significance of the Commission's pending proposal concerning shareholder nominees for director. The SEC's work in this area is very much consistent with the statements in your letter; we are assessing all of the public comments and working to achieve a middle ground that both protects against abuses and is not so narrowly crafted as to be ineffective.

You also comment on the GAO's recommendation that the SEC's Office of Compliance Inspections and Examinations routinely review SRO internal audit reports when planning and conducting inspections of SROs. As noted in our letter to the GAO, the inspection staff requests and reviews SRO internal audit reports when the staff believes it is appropriate to follow-up on a particular problem or issue in an SRO program area. While SRO internal audit reports are one source of information regarding an SRO's performance and compliance, the value of SRO internal audit reports depends on the quality and content of the reports. SEC oversight inspections of SROs are generally more comprehensive than a review conducted by an SRO internal audit department.

Thank you for your comments and your continued interest in the work of the Commission.

Sincerely,

William H. Donaldson
Chairman

The Washington Post

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TUESDAY, JUNE 29, 2004

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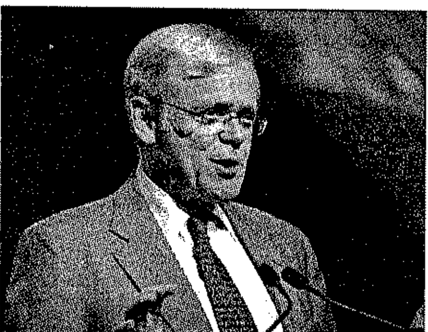

BY BRENDAN SMIALOWSKI—BLOOMBERG NEWS

**SEC Chairman William H. Donaldson is under pressure to advance a rule making it easier for unhappy investors to nominate directors.**

# Democrats Urge SEC Chief to Adopt Ballot Access Rule

*By* CARRIE JOHNSON
*Washington Post Staff Writer*

Key Democratic lawmakers are urging the Securities and Exchange Commission to adopt a controversial rule that would help dissatisfied investors more easily nominate board members at public companies.

Citing financial scandals at Enron Corp., WorldCom Inc. and HealthSouth Corp., the legislators recently told SEC Chairman William H. Donaldson there is "no better time" to "bring democracy to the boardroom." Their letter was dated June 24 but it was not released publicly until yesterday.

The issue of shareholders' access to the ballot is the most intensely fought item on the SEC's agenda this year. The Business Roundtable and the U.S. Chamber of Commerce oppose changes to the way board members are selected, arguing that special interests could "hijack" the process. But shareholder rights groups, including labor-backed pension funds, are pushing for an alternative to the expensive and often futile proxy battles that investors currently must mount to bring change to corporate boardrooms.

The last time the SEC considered altering board election rules, in 1977, lobbyists scuttled the proposal. In a recent speech, Donaldson decried the increasingly "shrill" election-year rhetoric and said he would not rush ahead under an "artificial" timeline.

Still, Donaldson is laboring under heightened pressure from both sides to broker a compromise to the original plan,

*See* **PROXY**, *E2, Col. 1*

**PROXY**, *From E1*

which would permit shareholders to nominate board candidates the following year if shareholders withhold 35 percent of votes from a sitting director or a group of directors.

Instead, Donaldson is now looking at a plan that would give current board members the right to choose alternative candidates if investors withheld 50 percent of their votes from one or more candidates. The two Democrats on the SEC oppose such a compromise, reasoning that it will do little to ensure that shareholder interests are represented in boardrooms.

Lawmakers led by Rep. John D. Dingell (D-Mich.), the ranking minority member of the House Energy and Commerce Committee, and Rep. Barney Frank (D-Mass.), the ranking minority member on the House Financial Services Committee, late last week asked Donaldson to continue with the process "without including additional provisions that may compromise the effectiveness of the rule."

SEC spokesman Matthew C. Well said the agency "will carefully consider the views put forth in submissions and letters such as this one from members of Congress."

The Washington Post

AN INDEPENDENT NEWSPAPER

# Mr. Donaldson's Next Move

THE SECURITIES and Exchange Commission did the right thing when it voted Wednesday to make the boards of mutual funds more independent. These boards theoretically represent the individuals who put money in the funds: They are supposed to negotiate what fees to pay investment managers, and to police the potential rip-offs that loom when unsuspecting folk entrust the care and nurture of their cash to a handful of complete strangers. Until now, the mutual fund board members have been mainly people who work for the investment firm that manages the money; Fidelity Investments (to take one well-known example) has been negotiating with itself about what fees might be reasonable. Thanks to the SEC's new rule, Fidelity's money managers will now negotiate with a mutual fund board that's headed by a non-Fidelity chairman and that draws three-quarters of its members from outside the firm. This won't prevent all abuses of mutual funds, but it is a step in the right direction.

It is also a good precedent. For the past several months, William H. Donaldson, the SEC chairman, has been weighing another tough question: How much opportunity should shareholders of corporations get to put their own candidates up for election to boards of directors? Just as has been the case with mutual fund governance, the SEC has been divided 2 to 2, with the Democratic commissioners favoring stronger rights for investors and shareholders, while Republican commissioners have resisted. This gives Mr. Donaldson the swing vote—a power that he rightly used to back mutual fund reform. But he has been leery of doing the same on the rules governing the boards of public companies. He must now summon up his courage.

At the start of this debate on corporate governance, the SEC proposed a modest but sound rule: If 35 percent of shareholders withhold their support for a board-selected candidate to serve as a director, then shareholders get the right to put their own candidate up for election the following year. This would not usher hyper-democracy into the boardroom: At nearly all companies, boards (and the chief executives that tend to dominate them) would continue to have a monopoly on nominating candidates for directorships. In the small number of companies that are sufficiently poorly managed to trigger a revolt among 35 percent of the shareholders, a non-CEO-backed candidate could stand for election, though he or she would have no guarantee of winning. The chief result of this new rule would be that large institutional shareholders—especially the nation's corporate-governance-minded public retirement funds—would gain a new tool to pressure managers. Companies that pay top executives lavishly despite mediocre performance would be the prime targets.

It seems hard to imagine that an objective observer could oppose this proposal. Shareholders are the owners of public companies, after all. But the SEC has been lobbied noisily by a powerful group of observers who are not objective. The nation's CEOs resent even modest challenges to their authority in the board room. Mr. Donaldson understandably would rather avoid casting a deciding third vote that angers this constituency. But before the chief executives lobbied him, he was clear in his support for this measure, and in a recent speech he repeated that managers exploit the current system to ignore shareholder protests when they mishandle their companies. Mr. Donaldson's original proposal is modest. He should avoid diluting it, and he should vote his principles.