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**VIA FEDERAL EXPRESS**

Mr. Jonathan G. Katz  
Secretary  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549-0609

Re: Comments to "Proposed Rule: Security Holder Director Nominations"  
File No. S7-19-03.

Dear Mr. Katz:

The following is submitted to you on behalf of Waddell & Reed Financial, Inc. On October 14, 2003, the Commission requested comments on its "Proposed Rule: Security Holder Director Nominations" (the "Proposed Rules") described in Release No. 34-48626 (the "Release"). As one of America's leading publicly held mutual fund and financial planning firms, we believe that Waddell & Reed can provide the Commission with a valuable perspective on the advisability of adopting the Proposed Rules.

For the reasons set forth below, we firmly believe that the adoption of the Proposed Rules will not benefit the shareholder community at large and will serve only to generate substantial risks and adverse unintended consequences that will have pervasive and disastrous effects on all levels of corporate direction and management. Reforms in corporate governance resulting from the enactment of the Sarbanes-Oxley Act of 2002 and the recent adoption by the Commission of substantially enhanced nominating process disclosures and board communication procedures will have a significant impact toward the Commission's goal of enhancing shareholder participation in the proxy process. These extensive governance reforms are the appropriate manner in which to redress the deficiencies in corporate accountability revealed by the recent high-profile corporate wrongdoing and to provide shareholders with additional methods to provide input to corporate boards. The implementation of further significant changes in the proxy rules on the heels of these important enactments is simply unnecessary. Furthermore, we foresee that the adoption of unprecedented changes in the rules governing election contests will upset the delicate balance that has been established in the market for corporate control. Such changes risk tilting the playing field unfairly in favor of a minority of the shareholder community that has only its own special interests in mind and at heart, resulting in adverse consequences that could undermine the efficient operation of our capital markets.

I. There is not a problem that needs to be solved.

The early years of the Twenty-First Century have been plagued by corporate scandal, misconduct and malfeasance. Congress, the Bush Administration, the Commission and self-regulating organizations have all taken significant steps to implement new standards, new procedures and new requirements for publicly-traded companies to prevent future wrongdoing and restore public confidence in American capital markets. The centerpiece of these initiatives was the Sarbanes-Oxley Act of 2002. In connection with the Sarbanes-Oxley Act, the Commission, the New York Stock Exchange and The Nasdaq National Market adopted regulations and listing standards that, among other things, require publicly-traded companies in the United States to reform the manner in which they nominate directors for election and enhance related disclosure in connection with the solicitation of proxies. For example, a company's slate of director nominees must be chosen or recommended to the full board by an independent nomination committee (or the independent directors generally) that is charged with identifying and recruiting qualified candidates to stand for election by the shareholders. The Commission also recently adopted substantially enhanced disclosure requirements relating to nominating procedures and the methods by which shareholders may communicate with boards of directors. Without a doubt, these requirements will have far reaching effects on not only corporate governance reform, but also will significantly increase "meaningful" shareholder participation in the nomination process. Once these initiatives have been fully implemented, public shareholders will clearly have the structure, procedure and disclosure necessary to ensure that their input regarding director nominees is heard. At a minimum, we urge restraint while the investing public and the public companies burdened with compliance implement and assess the effect of the new rules. The new reforms expressly impact shareholder input and are responsive to the initiatives undertaken. In our view, it is imprudent at the very least to implement a second, deep layer of regulation before anyone has had a chance to implement or assess the effects of the first massive stratum of reform. The adoption of the Proposed Rules is a premature and reactionary response, particularly when the new reforms have not been allowed sufficient time to prove themselves.

In the Release, the Commission stated that "the presence of nominating committees has not eliminated the concerns among some security holders with regard to the barriers to meaningful participation in the proxy process in connection with the nomination and election of directors." This is not surprising for two reasons.

First, to some activist security holders, "meaningful participation" means that they are given the keys to the boardroom. However, the proper role for security holder participation is to communicate with the nomination committee (or the independent directors charged with making nominations), not to supplant it. While assuring meaningful participation in the nominating process is an important goal, it should not require that investors dictate the outcome of the process. A decision by a board of directors not to act on a shareholder communication does not in and of itself preclude "meaningful participation" by the shareholder. In order for the process to be meaningful, investors ought to have meaningful input. The board of directors should, however, retain the power to consider shareholder sentiment, to weigh it, to evaluate how it effects the company in a broad perspective, and ultimately accept or reject the shareholders' suggestions.

Second, the new regime guiding the operation of nominating procedures was finalized only within the past two months. Any lingering shareholder concern regarding perceived “barriers to meaningful participation” continues to persist at this time because the new reforms simply have not been given the time necessary to prove their success. We suspect that most public companies, like us, have recently adopted or amended their nomination committee charters and are no doubt currently examining the Commission’s new regulations for enhanced disclosure of the nomination process and board communication procedures, and evaluating how to implement and improve their own disclosure on these important subjects. It is without question that it is critically important to provide a reasonable period of time for these new initiatives to be assimilated and implemented by companies before passing judgment and concluding that nominating committees have failed to accommodate concerns that security holders may have.

The Commission also observed in the Release that the proposed changes in listing standards by the NYSE and Nasdaq “do not address the role of security holders in the nomination procedure.” We strongly disagree. The changes in the listing standards do address the role of security holders in the nomination procedure – the proper role – which is first and foremost to provide input to the board of directors. State corporate law imposes upon the board of directors, not the shareholders, the duty and responsibility to manage the business and affairs of the company. One of the most important responsibilities of the board is to identify, recruit and nominate persons of good character and exceptional skills to stand for election to the board as the company’s slate of candidates. This responsibility is framed by fiduciary duties of care, loyalty and good faith that are owed to the company and all of its shareholders – large and small, short-term and long-term, and all shareholders in between. For publicly-traded companies, this responsibility is now conferred on an independent nomination committee or the independent members of the board, and the challenge to create an effective slate has only been heightened by stringent requirements that the board contain sufficient numbers of independent directors, including directors having requisite financial expertise. The appropriate role for shareholders in this process is to provide input to the nomination process – to bring talented individuals to the board’s attention, to suggest to the board the skills and experience that nominees should possess and to express the shareholder’s view of the company’s strategic direction and how it may be shaped by specific nominees. The board must be open to shareholder communications, but must also be conscious of the fact that no shareholder is unbiased and no shareholder is required by state law and fiduciary duty, as the board is, to take into account the best interests of the company as a whole or other shareholders. In fact, many investors are bound by their own fiduciary obligations to act only in their narrow self-interest. With this in mind, it is clear that the new listing standards recently adopted by the NYSE and Nasdaq, together with the new disclosure requirements of the Commission, do, in both theory and practice, address this proper role of security holders in the nomination process. The balance of power has been shifted to the independent directors in the nomination process, the procedures for shareholder communication with the board have been established and the appropriate disclosure to inform shareholders of these procedures will be made.

The Commission has also expressed a concern about the ability of shareholders to finance an election contest and the fairness of using company funds to solicit support for the company’s slate of director candidates. We take serious exception to these equitable justifications. To begin, it is our firm belief that proxy contests are, almost uniformly, negative for the companies involved. Thus, it is not clear why the Commission should make any effort to facilitate such

exercises. The existing proxy rules reflect a finely-balanced tension between the need to provide an avenue for direct shareholder solicitation of proxies, in cases where such action is warranted, and the need to ensure that such contests are not undertaken lightly and do not become ubiquitous (not to mention the need to provide fair and complete disclosure to solicited shareholders). Moreover, fairness does not dictate that the company underwrite the expenses associated with shareholder nominations and solicitations of proxies simply because company funds are used to solicit proxies for the slate fashioned by the board. There is a critical difference between the competing slates. Candidates on the company slate have been chosen by independent directors, in accordance with their fiduciary duties, to further the best interests of the company as a whole. The benefits of their election are benefits to be enjoyed by all shareholders generally and in proportion to each shareholder's ownership interest in the company. It is completely appropriate that company funds be expended to solicit votes for their election. By contrast, director candidates advanced by one or more shareholders outside of the nominating process are chosen by such shareholders for reasons known only to such shareholders. Such shareholders are not bound to discharge fiduciary duties to the company or to their fellow shareholders, nor would human nature lead us to expect that they would be guided by anything other than their particular, private self-interest. The expense of soliciting proxies for the election of these nominees should properly be borne by only the shareholders for whose benefit the nomination has been made – that is, the shareholders seeking the proxies and not the shareholders generally by way of company funds. Nothing, in fact, could be more inequitable than tapping the company treasury and otherwise draining company resources to subsidize the crusades of minority shareholders pursuing their private agendas. As investors ourselves, we have no desire to see our financial interests used to fund election contests in the first place, particularly contests promoting the nomination of director candidates of shareholders who might be even remotely interested in furthering their own self-interests as opposed to interests of the company as a whole.

We have carefully considered the reasons advanced by the Commission for issuing the Proposed Rules. We acknowledge that, historically, there has too frequently been inadequate processes for shareholders to share their perspectives with the board in choosing the individuals to be nominated as directors of public companies. However, the recent initiatives by the Commission and the self-regulating organizations have successfully addressed the legitimate concerns of both security holders and the Commission. There is no need for, nor wisdom in, expanding the ability of individual shareholders to hijack a company's proxy process for the purpose of advancing their own private agendas at the company's expense. Such an unprecedented action will skew the proxy process towards endemic election contests and result in shareholders as a whole bearing the costs of the privately-motivated efforts of a select few. For the foregoing reasons, we believe that the adoption of the Proposed Rules by the Commission is unnecessary and rash.

## II. There will be unintended, adverse consequences of adopting the Proposed Rules.

Commentators, both in the press and in comments previously submitted to the Commission, have expounded on the numerous distinct disadvantages that will result from the adoption of the Proposed Rules. We do not intend to repeat all of those observations and arguments here. Rather, we believe that our views as both a publicly held company and institutional investor will assist the Commission in assessing the Proposed Rules and provide the Commission with the

unique perspective of a party that would frequently be the nominal beneficiary of the rights conferred by the Proposed Rules.

We firmly believe that the availability of the company proxy to shareholders desiring to nominate director candidates outside of the nominating process currently provided for will result in a significant increase in contested elections, and that, as a general rule, contested elections will harm the businesses of affected companies. The frequency of contests for corporate board seats can be understood in terms of market forces operating within the governing regime of the proxy rules. Any change in such market forces, or the governing regime, can be expected to upset the equilibrium existing within the system. Institutional shareholders such as ourselves perform a largely economic calculus when determining whether or not to initiate a proxy solicitation: what are the expected benefits, what are the expected costs, is the former greater than the latter. The adoption of the Proposed Rules will clearly reduce the expected costs that would be incurred by any shareholder contemplating a proxy solicitation. We see no evidence in the Proposing Release that the Commission has considered to any significant extent the degree to which the Proposed Rules will upset the subtle balance that the current system embodies. As a consequence, there will be a larger number of instances in which the perceived benefits will outweigh the reduced costs, undoubtedly resulting in a dramatic increase in the number of contested elections. No one can realistically speculate as to the magnitude of this increase, but the fact that it will occur is an undeniable certainty. As an institutional investor whose financial interests will be affected by both the increase in, and destructive nature of, such election contests, our concern is that the study by the Commission and other interested parties on the practical effects of the Proposed Rules has so far been, at a minimum, inadequate and overlooked.

There is no doubt that a contested election is bad for business, regardless of whether viewed from the perspective of management or shareholders. Such elections drain the time and attention of corporate officers and directors that could be devoted to the operation and economic success of the business of the company. Additional resources of the company will have to be dedicated to the election contest, and particularly with respect to shareholders' nominees if the Proposed Rules are adopted. Additionally, there are numerous indirect, negative effects of such elections. A contested election invariably introduces uncertainty into the governance and future strategic direction of the business (because the insurgents may win), and institutional investors such as ourselves do not like uncertainty. Moreover, a contested election can be an indication that the company may have fundamental problems that are not readily apparent. These factors will negatively affect the decisions of investors and potential investors in the company, and perhaps even key customers and vendors of the business. As an institutional investor, we view contested elections as a value deflator in our assessment of a prospective investment, particularly if the contests appear to be a recurring phenomenon with the company. While this may be a healthy result under a regime where election contests are rare and waged only when good cause exists, it can be economically inefficient when election contests become cheap and easy to wage for less significant or even trivial reasons. Investors may not be willing to take the time to separate the wheat from the chaff. As a consequence, good companies that are unfairly subject to an increase in contested elections (perhaps because they have a shareholder with a bent towards electioneering) could lose value in the capital markets without any economic justification, and their shareholders will unfairly suffer.

We would also note that an increase in the frequency of election contests may be at odds with the general philosophy that underlies the Sarbanes-Oxley Act. Pervasive throughout the new regulatory structure under the Sarbanes-Oxley Act is the premise that the board of directors, and specified committees of independent directors, are to serve as the first line of defense against corporate fraud and scandal. The board is viewed as an ally of the shareholders, the Commission and other parties interested in avoiding repeats of the recent spate of scandal. To best perform its watchdog role under the Sarbanes-Oxley Act, a board should be strong, stable and free of unnecessary distractions, which becomes increasingly more difficult for boards that are repeatedly beset by election contests. Such boards are distracted by the need to respond to and participate in elections. Qualified individuals may decline to be named as candidates to avoid the personal inconvenience and vilification frequently associated with an election contest, adding to the existing difficulty in cultivating qualified candidates who are put off by the currently charged environment of public company directorships. If one or more shareholder nominees are in fact elected, they may have attitudes and priorities that differ substantially from the remaining board members, resulting in divisiveness, ineffectiveness and weakness of the board. These are not characteristics that will further the proper functioning of the board of directors as a bulwark against corruption and other corporate misconduct.

The Commission should also consider which shareholders are most likely to take advantage of the benefits conferred by the Proposed Rules, and why they would do so. As a financial investor, we have absolutely no interest in initiating or becoming involved in election contests within our portfolio companies. We are in the business of making smart investments in well-managed companies. We do not have the expertise to weigh in on the operation of our portfolio companies and we do not view ourselves as better qualified to assess the experience and skills that will be most beneficial to the boards of these companies than the independent directors who serve them. Our primary interest as a shareholder is the financial success of these companies and, as noted above, we firmly believe that such success will be jeopardized by dissident shareholders who overestimate their proper role in the nomination process. Any concerns we have regarding the management of a portfolio company (including those companies with too many election contests), are addressed by our ability to exit the position and seek better-managed investments elsewhere. Shareholders with a strong desire to directly influence the management and operation of a company would better serve the entire investment community by devoting their efforts to funding, developing and operating their own businesses instead of interfering with the operation of others. We suspect that many other financial investors have similar sentiments.

The institutional investors that we view as most likely to employ the company proxy to nominate their own director candidates are those formed for the purpose of advancing a political or social goal (e.g., environmentally-friendly mutual funds) or organizations with a history of political activism (e.g., labor unions and pension funds). We have serious concerns that such investors will base their decision-making and their choice of director nominees on factors unrelated to the business or financial performance of the company, and will not take into account the best interests of the company or its shareholders generally, both of which will have dramatic, tangible effects on the subject company, and more importantly, our underlying financial investment. Such goals may be socially laudable, but are often contrary to the best interests of the company and shareholders. Furthermore, the Commission cannot ignore the fact that the Proposed Rules will provide an avenue for shareholders with malicious motives to disrupt operations and injure the company, the very issues that the Commission seeks to avoid through new reforms and

regulations with respect to actions of the board of directors. It is entirely possible that litigants or others with potential claims against a company, meritorious or not, could leverage a relatively small investment into a large bully pulpit for entirely nefarious reasons.

This concern is magnified under the Proposed Rules because of the possibility that the solicited shareholders may become confused over the source of various nominations. Under the current rules, it is clearly evident which slate of nominees is proposed by the company and which slate has been nominated by a shareholder. Once a company is required to include shareholder-nominees in the company proxy statement and voting card, there exists a danger that some solicited shareholders may mistakenly believe that the company has endorsed the shareholder-nominee and that such nominee has been named following the independent directors' review based on the best interests of the company and guided by their fiduciary duties.

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We understand that transparency of disclosure, corporate governance and corporate democracy are sensitive issues at this time in our nation's history. We understand the pressures that are brought to bear in such times to act quickly to fix the problems, both real and perceived. We believe that the governmental and self-regulating organizations responsible for these issues, as well as corporate America itself, have responded promptly and appropriately to the erosion of public confidence that has undermined our capital markets. We hope that the Commission will not allow the pendulum to swing too far in the opposite direction, because the results of overreacting can sometimes be more harmful than taking no action at all. We urge the Commission to follow its own lead – in 1942, 1977 and 1992 – and decline to adopt rules that would allow shareholders direct access to the company proxy for the purpose of making director nominations.

Please feel free to contact me if I can be of any further assistance in this or any other matter.

Best regards,



Wendy J. Hills  
Secretary and Associate General Counsel

cc: Hon. William H. Donaldson – Chairman, U.S. Securities and Exchange Commission  
Hon. Paul Atkins – Commissioner  
Hon. Roel Campos – Commissioner  
Hon. Cynthia A. Glassman – Commissioner  
Hon. Harvey Goldschmid – Commissioner  
Alan L. Beller – Director, Division of Corporation Finance