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June 23, 2005

Hon. William H. Donaldson, Chairman
Hon. Paul S. Atkins, Commissioner
Hon. Roel C. Campos, Commissioner
Hon. Cynthia A. Glassman, Commissioner
Hon. Harvey J. Goldschmid, Commissioner
Securities and Exchange Commission
100 F. Street, N.E.
Washington, DC 20549

Re: Investment Company Governance; 69 Fed. Reg. 46,378 (Aug. 2, 2004); File No. S7-03-04

Dear Chairman and Commissioners:

As a former Commissioner of the United States Securities and Exchange Commission, I write to express substantial concern over reports of an intended action that, in my view, threatens the Commission's long-term credibility with the public, with Congress, and with the courts.

The United States Court of Appeals for the District of Columbia Circuit in Chamber of Commerce of the United States of America v. Securities and Exchange Commission, No.04-1300 (June 21, 2005), held that the Commission "violated its obligation under 15 U.S.C. § 80a-2(c), and therefore the [Administrative Procedures Act]," slip op. at 17, "by failing adequately to consider the costs that mutual funds would incur in order to comply with the [75% independent director and independent chairman] conditions and by failing to consider a proposed alternative to the independent chairman condition." slip op. at 1. The court remanded the matter to the Commission to address these deficiencies.

I express no view as to the merits of the proposed rule. I express no view as to the merits of the court's decision. My concern relates exclusively to a matter of process.

The Commission has noticed a public meeting for Wednesday June 29, 2005, to consider "matters remanded to the Commission by the U.S. Court of Appeals for the District of Columbia Circuit on June 21, in its decision in Chamber of Commerce v. SEC..." Sunshine Act Notice dated June 22, 2005. Unless this meeting is designed simply to direct the Staff to prepare a new notice of proposed rulemaking, the decision to move so rapidly to reconsider the mutual fund rules raises no fewer than nine distinct concerns.

First, if it is the plan of the agency to gather additional data to address the concerns raised by the courts, it is far from clear that the necessary data can be collected and analyzed in a professional and unbiased manner in less than one week. Indeed, I am unaware of any situation in the agency's history where a comparable analysis has been performed in accordance with the provisions of the Administrative Procedure Act in a comparably short period of time. This fact alone will place at risk any rule adopted or re-adopted by the agency in the event of the inevitable legal challenge.

Second, if it is the plan of the agency to gather additional data, then it seems that the time allotted to conduct the proposed study has not been determined by objective reference to the professional factors that would usually be considered in such deliberations. The time allotted to conduct the study is instead determined by the Commission's decision to schedule the matter for public discussion on June 29. Put another way, the decision to schedule the matter for a hearing as of a particular date has determined the nature of the inquiry that will be conducted by the agency without regard to the adequacy of the underlying process. This fact again places the Commission's proceedings at substantial legal risk.

Third, if it is the plan of the Commission to rely on the record already developed in this matter, then the Commission's rulemaking will be subject to the criticism that it has not considered the actual cost data reflecting the experience of mutual funds that have already initiated efforts to comply with the Commission's proposed rules. These data cannot be part of the record because they were generated after the record in this matter was closed. This omission could well be fatal to the Commission's analysis because, as the Commission itself observed and as the Court of Appeals noted, the Commission was "without a reliable basis for determining how funds would choose to satisfy the [75% condition] and therefore it [was] difficult to determine the costs associated with electing independent directors." Slip op. at 15 quoting 69 Fed. Reg. at 46,387. Precisely the same observations apply to the independent chairman provision of the proposed rules. See slip op at 16 – 17. Now that a reliable basis for the estimation of such costs exists, it would be difficult for the agency to proceed with adoption of the rule absent serious, thorough and public consideration of those clearly ascertainable cost data.

Fourth, if it is the plan of the Commission to re-examine the record and to discern within it information sufficient to respond to the concerns expressed by the Court, then it will have no choice but to contradict its previously stated view that it was "without a reliable basis" for reaching certain cost determination. Slip op. at 15. The Commission will then have no choice but to contradict itself in a situation in which it has also determined not to seek additional, clearly relevant and knowable data.

Fifth, in reaching its determination, the Court of Appeals cites Section 80a-2 (c) of the Investment Company Act which provides that when the Commission "engage[s] in rulemaking and is required to consider or determine whether an action is consistent with the public interest [it] shall ... consider ... whether the action will promote efficiency, competition, and capital formation." Slip op. at 12 – 13. In proceeding on the rapid track evidently currently contemplated by the Commission, the agency would not only have to identify or collect relevant cost data, but would also have to collect or identify data relevant to the rule's effect on "efficiency, competition, and capital formation." Again, the record suggests that no such data were presented to the court. Further, the record cannot contain currently ascertainable information relevant to "efficiency, competition, and capital formation" and it is inconceivable that the agency would be able to build a record adequate to address these matters on such short notice. Further, it may be helpful to point out that Chief Judge Ginsburg, the author of the decision causing the remand, was formerly Director of the Office of Information and Regulatory Analysis in the Office of Management and Budget and is exceptionally well informed regarding techniques and methodologies associated with competent assessments of a rule's effects on "efficiency, competition, and capital formation." Forwarding to this Court a record that is deficient in this regard will not lead to a result comfortable to the agency either under the Investment Company Act or under other provisions of the securities laws that contain comparable requirements.

Sixth, it is public information that the Chairman intends to resign from the Commission as of the end of the month. It is also public information that the Commission approved the rules at issue by a vote of three to two with the Chairman voting with the majority. The inescapable implication is that the matter has been scheduled in order to retain a majority in favor of the rules' approval. The inescapable concern is that this sequence of events supports the inference that the matter has been prejudged and that any additional consideration of the record is being conducted more as a procedural fig leaf than as a professional and good faith inquiry.

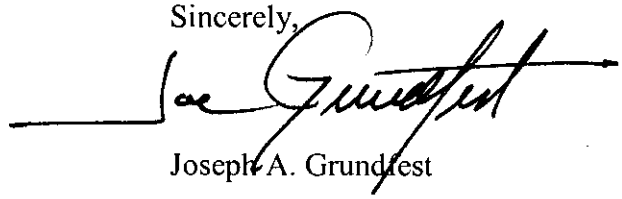
Seventh, this course of action cannot be conducive to a sense of collegiality at the Commission. I have had the experience of voting in the minority and have had occasion to express concern over the wisdom of the views held by a majority. I have, however, in the overwhelming majority of circumstances remained confident in the good faith and objective professionalism of my colleagues on the Commission and of the work of the Commission's excellent staff. The scheduling of the matter at issue, however, raises the possibility that decisions are to be made on purely political grounds and for purely political reasons, in the narrowest sense of the term. The long run implications of such conduct can only be corrosive and unfortunate within an agency that has in the past prided itself on the ability to integrate divergent policy perspectives in a constructive manner.

Eighth, and by far of greatest significance, the Commission's decision to schedule the matter as it has will likely promote public skepticism over the integrity of the Commission's process, erode support for the agency on Capitol Hill, and expose all Commission rulemaking procedures to more searching scrutiny by appellate courts that will - - because of the agency's conduct in this matter - - be less inclined to defer to the agency's judgment on other matters. The Commission's decision also opens the Commission to the very significant risk of a further loss on appeal in this matter with language that will not be flattering to the Commission or to its process, which language can have adverse precedential implications for the agency's agenda for a long period of time.

Finally, if the reality of the matter is not apparent to all members of the Commission, it would be well within the authority of the Commission, as it is likely to be constituted at some time in the not too distant future, to consider many of the observations shared in this letter as part of a reconsideration of the rule. Such reconsideration would, in my view, be advisable without regard to the merits of the underlying rule proposal if only to avoid an appeal that is likely to do serious harm to the agency's reputation. It is therefore unclear how the Commission, as currently constituted, expects to further the interests of the agency in the long term by pursuing the remarkably rapid reconsideration of the mutual fund rules currently under contemplation.

I share these observations with the greatest concern for the long run success of the agency in its critical mission to maintain confidence in the integrity of the United States' capital markets and am grateful for your attention to this difficult and controversial matter.

Sincerely,



Joseph A. Grundfest

cc: Jonathan G. Katz, Secretary