United States Senate

COMMITTEE ON
HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

WASHINGTON, DC 20510–6250

September 27, 2007

The Honorable Christopher Cox
Chairman
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: **Shareholder Proposals Relating to the Election of Directors**
File Nos. S7-16-07 and S7-17-07

Dear Mr. Chairman:

On July 27, 2007, the Securities and Exchange Commission (SEC) issued two releases on the subject of shareholder proposals relating to the election of directors. The first, Release No. 34-56160, proposed establishing a new procedure to enable qualified shareholders to include in company proxy materials their proposals for bylaw amendments regarding the procedures for nominating candidates to the board of directors. The second, Release No. 34-56161, would codify an interpretation of Rule 14a-8(i)(8) that the obligation of companies to include shareholder proposals in company proxies does not extend to shareholder nominations for directors or to shareholder proposals seeking to modify the nomination process.

The purpose of this letter is to express support for the first proposal, which would enable shareholders to propose bylaw amendments to facilitate shareholder nominations of directors, and opposition to the second proposal, which would impede the exercise of fundamental shareholder rights by barring from the proxy process shareholder nominations of directors and shareholder bylaw proposals to nominate directors.

Proposal to Increase Proxy Access

Release No. 34-56160, the proposal to give shareholders access to company proxy materials for their bylaw proposals on procedures for nominating candidates to the board of directors, while it could be further improved, is an important step forward in addressing a serious problem at too many publicly traded companies in this country: inattentive and compliant boards of directors that fail to protect shareholder interests and too often place the interests of corporate management ahead of the interests of the corporation's owners.

The events of recent years have made it abundantly clear that U.S. corporate boardrooms today place too high a premium on comity. Directors who speak out, ask hard questions, or

exercise detailed oversight are too often seen as intrusive, troublesome, or counterproductive. It is no surprise that many corporate executives prefer to operate with minimal oversight and do not willingly nominate directors who challenge management. But our capitalist system cannot operate efficiently without meaningful board review of management actions. The SEC is correct about the need to change current boardroom dynamics and create conditions that will revitalize the independence and watchfulness of corporate board members as the guardians of shareholder interests.

The past few years have exposed the investing public to one disturbing example after another of corporate misconduct taking place either with the apparent knowledge and consent of the company's board of directors or with the board's apparent ignorance or indifference. The facts cry out for corrective action.

One early example involves the Enron Corporation, which was the subject of a year-long investigation by the U.S. Senate Permanent Subcommittee on Investigations, which I chair. After interviewing thirteen Enron board members and holding a 2002 hearing on the role of the Enron board of directors in the company's collapse, the Subcommittee issued a bipartisan report that concluded the following:

> "The Enron Board of Directors failed to safeguard Enron shareholders and contributed to the collapse of the company by allowing Enron to engage in high risk accounting, inappropriate conflict of interest transactions, extensive undisclosed off-the-books activities, and excessive executive compensation. The board witnessed numerous indications of questionable practices by Enron management over several years, but chose to ignore them to the detriment of Enron shareholders, employees and business associates."

A report exposing the failures of the WorldCom board of directors provides another disturbing example. This 2003 report was issued by the WorldCom bankruptcy examiner, Richard Thornburgh, former U.S. Attorney General, after months of investigative work. It identifies a host of deficiencies in WorldCom's corporate acquisitions, strategic planning, debt management, internal controls, executive pay and loans, and other activities, characterizing these deficiencies as marked by "egregiousness, arrogance and brazenness." The report states: "These deficiencies reflect a virtual complete breakdown of proper corporate governance principles, making WorldCom the poster child for corporate governance failures." It found that the company had been dominated by its top executives "with virtually no checks or restraints placed on their actions by the Board of Directors," despite "misgivings" and "under circumstances that suggested corporate actions were at best imprudent, and at worst inappropriate and fraudulent." Examples of poor board oversight included the following:

> "Several multibillion dollar acquisitions were approved by the Board of Directors following discussions that lasted for 30 minutes or less and without the Directors receiving a single piece of paper regarding the terms or implications of the transactions. ... [The Board's Compensation Committee] agreed to provide enormous loans [of more than

> $400 million] and a [bank] guaranty for [Worldcom's Chief Executive Officer] without initially informing the full Board or taking appropriate steps to protect the Company."

The report concluded that "WorldCom's conferral of practically unlimited discretion" upon its top executives, "combined with passive acceptance of Management's proposals by the Board of Directors, and a culture that diminished the importance of internal checks, forward-looking planning and meaningful debate or analysis formed the basis for the Company's descent into bankruptcy."

Enron, and WorldCom each provide evidence of a breakdown in boardroom oversight and corporate governance. Other corporate scandals suggest they are not isolated examples. Corporations such as Tyco, HealthSouth, and Adelphia continue to demoralize investors with examples of inattentive and compliant boards of directors. The intractable problem of excessive executive pay unrelated to corporate performance – pay which is the sole responsibility of boards of directors to establish and review – provides still more proof of the need to create new incentives for meaningful boardroom oversight of management actions.

The report issued by the Permanent Subcommittee on Investigations on the Enron Board of Directors identified numerous failures by the Enron Board to exercise reasonable oversight in the area of excessive executive pay:

> The Enron Board, through its Compensation Committee, was not only informed of the company's lavish executive compensation plans, it apparently approved them with little debate or restraint. ... The evidence suggests that keeping up with competitor pay, rather than overseeing existing compensation plans, was the central objective of the Enron Compensation Committee. ... Board members indicated that they had been unaware that the company had paid out almost $750 million in cash bonuses for a year [2000] in which the company's entire net income was $975 million. Apparently, no one on the Compensation Committee had ever added up the numbers. The Compensation Committee appeared to have ... deferr[ed] to the compensation plans suggested by management and the company's compensation consultants.

Excessive executive pay at dozens of other major U.S. companies shows Enron's Board is not alone in its oversight failures. Shareholders have for years been protesting inappropriate executive compensation at some of the companies they own, with limited effect on the excessive bonuses, equity awards, severance pay, and retirement benefits that have too often been lavished on CEOs and other senior officers by compliant corporate boards.

The problem of inadequate board supervision of executive compensation issues has most recently manifested itself in the scandal involving backdating of executive stock options. Corporation after corporation has been forced to restate earnings after the disclosure of improper practices involving the granting and exercise of executive stock options. It goes without saying that strong, independent boards of directors would have made it much more difficult for corporate management to engage in these abusive practices.

Shareholders have long pressed for a greater role in nominating directors, reasoning that a director nominated by investors would analyze issues with investor concerns in mind, would represent those concerns in boardroom discussions, and would help remind other board members that their paramount duty is to company shareholders, not management. Without proxy access, the only way shareholders can nominate a board candidate is through distribution of a separate ballot to shareholders. As experience has shown, the difficulty and expense of such a distribution has effectively deprived shareholders of a voice in the nomination process, leaving company management in effective control of director nominations. The result has been boards of directors that, in too many cases, have functioned as captives of management rather than protectors of shareholder and investor interests. Giving shareholders a bigger say in the companies they own, including providing shareholders with a reasonable opportunity to nominate directors, could help revitalize the independence and watchfulness of corporate boards and help restore investor confidence in U.S. corporate governance systems.

In 2003, the SEC announced a proxy access proposal that specified a process for including shareholder nominees in proxy solicitations whenever certain triggering events took place. This proposal met with controversy in part because, as you put it, the proposal would have effectively "imposed a national bylaw on every public corporation in America." To address that concern, unlike the 2003 proxy access proposal, the current proposal allows qualifying shareholders to put specific director nomination procedures to a vote at their company, as long as those procedures comply with state law and the company's charter and bylaws. In order to get such a proposal on the proxy, the proposing shareholders must beneficially own more than 5 percent of the company's stock for at least one year, must be eligible to file a Schedule 13G in that they do not hold their securities for the purpose of effecting change or influencing control of the company, and must meet the procedural requirements of Rule 14a-8.

Although I preferred the 2003 proposal because it moved directly to address the problem of lack of shareholder proxy access, the present proposal is also acceptable. If adding the extra step of a shareholder vote on a director nomination bylaw assuages concerns that the 2003 proposal improperly intruded on the province of state law, then it is an acceptable compromise to move the process a step closer to ending the effective monopoly that corporate management currently exercises over director nominations.

The principal weakness of the current proposed rule is that it limits the right to propose a proxy access bylaw to shareholders who have controlled over 5 percent of the company's stock for a year or more. This threshold is excessively high. Legislation which I introduced in 1991 (S.1198) and 2002 (S. 2460) to facilitate shareholder nominations to corporate boards would have set the threshold at 3 percent. In today's market, a 3 percent threshold means that qualifying shareholders would have to have a collective investment of more than $500 million in an average S&P 500 company. Surely a $500 million investment is significant enough for shareholders to be able to nominate at least one member of their company's board of directors.

In addition, requiring that a shareholder hold shares for a full year before being eligible to propose a proxy access bylaw is unduly restrictive. The proposal already requires that shareholders proposing such a bylaw certify that they did not acquire or hold the stock for the purpose of effecting change or influencing control of the company. This certification eliminates the need to discriminate among shareholders based purely on the length of time they have held their shares.

A second part of Release No. 34-56160 seeks to facilitate greater use of electronic shareholder forums by exempting from the rules governing proxy solicitations "any solicitations in electronic shareowner forums by, or on behalf of, any person who does not seek directly or indirectly, either on its own or on another's behalf, the power to act as proxy . . . ." I support this proposal to increase the ability of shareholders to communicate with one another, provided that the proposal is not used to curtail existing procedures allowing the submission of advisory shareholder resolutions. Advisory shareholder resolutions serve a useful function by focusing management's attention on an array of issues posing risks to corporate interests, on matters ranging from corporate governance to economic risks involving social and environmental issues. An electronic message board or other forum would not be an acceptable substitute for such shareholder resolutions, because the offering of such resolutions, involving as it does both the proxy process and shareholder meetings, compels real management focus on the issues in a way that an electronic forum would not. For this reason, I would support the use of electronic forums as an adjunct to, but not a substitute for, shareholder resolutions. This proposal could be further strengthened by explicitly exempting from the proxy rules any use of an electronic forum to form a group of shareholders sufficiently large to meet the threshold for proposing a shareholder access bylaw under the first part of the current proposal.

Proposal to Restrict Proxy Access

Release No. 34-56161, the proposal to codify the Rule 14a-8(i)(8) interpretation struck down by the Second Circuit, seeks to allow company management to exclude from company proxies any shareholder proposals relating to the nomination or election of directors or to a procedure for such nomination or election. As noted above, this proposal would force interested shareholders to the expense of distributing their own proxies, and so would impede the exercise of their state law rights to meaningful participation in the election process. The stated goal of this proposal is to nullify the Second Circuit ruling in American Federation of State,County & Municipal Employees Pension Plan v. American International Group, Inc., 462 F.3d 121 (2d Cir. 2006), which the SEC has stated it will not follow in other circuits. While the proposal undoubtedly would resolve the uncertainty as to how shareholder proposals will be treated in other circuits, the new certainty the proposal would bring is the certainty that shareholders would be denied the meaningful participation in the electoral process that the Commission has stated it wishes to foster. It would also eliminate a promising shareholder-based means for revitalizing boardroom oversight and activism.

Moreover, as you noted in your opening remarks at the July 25, 2007 open meeting of the Commission, the Committee on Capital Markets has concluded that this proposal would accord shareholders of U.S. companies fewer rights to participate in the selection of directors than shareholders of their foreign competitors, "creat[ing] an important potential competitive problem for U.S. companies." The better way to create parity between the shareholders of U.S. companies and their foreign competitors is to adopt the first proposal enhancing shareholder rights and to abandon the second proposal that would perpetuate the present competitive problem noted by the Committee on Capital Markets.

The SEC is to be commended for focusing public attention on this important issue. I urge it to act in the public interest to increase shareholder electoral participation in the companies they own by adopting the first proposal to increase proxy access and by rejecting the second proposal to curtail proxy access.

Thank you for this opportunity to comment on the proposed rules.

Sincerely,

Carl Levin, Chairman
Permanent Subcommittee on Investigations

CL:ejb

cc: SEC Commissioner Paul S. Atkins
SEC Commissioner Kathleen L. Casey
SEC Commissioner Annettee L. Nazareth