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submitted to the

Securities and Exchange Commission

in connection with

"The Application of the Proposal to Companies and Investors" Panel
Roundtable Regarding Proposed Rules Relating to Security Holder Director Nominations
File No. S7-19-03

March 10, 2004

This statement is submitted in connection with a roundtable panel discussion concerning the Securities and Exchange Commission's proposed rules relating to Security Holder Director Nominations, File No. S7-19-03. I currently serve as Co-Chairman of the Business Roundtable, an association of chief executive officers of leading corporations with a combined workforce of more than 10 million employees in the United States and $3.7 trillion in annual revenues. I also am Chairman and CEO of Fannie Mae, the nation's largest source for home mortgage financing, which employs more than 5,000 individuals. I appreciate the opportunity to speak on behalf of the Business Roundtable regarding the proposed rules, which would have significant, far-reaching implications for all companies and shareholders if adopted.

The Business Roundtable has long been—and will continue to be—a strong supporter of good corporate governance. We have advocated corporate governance best practices for more than three decades, beginning in the 1970s with our first statement on corporate governance, and continuing through the 1980s and 1990s with numerous publications addressing corporate governance best practices. We share the Commission's belief that corporate boards and management must hold themselves to the highest standards of corporate governance. In this regard, the Business Roundtable has issued numerous statements regarding corporate governance, including *Principles of Corporate Governance* in May 2002; *Executive Compensation: Principles and Commentary* in November 2003; and, to be issued this week, *The Nominating Process and Corporate Governance: Principles and Commentary* (March 2004). The Business Roundtable strongly supported enactment of the Sarbanes-Oxley Act of 2002, implementation of the Commission's rules related to the Sarbanes-Oxley Act, and revisions to the corporate governance listing standards of the New York Stock Exchange and NASDAQ Stock Market, Inc.

Although the Business Roundtable has supported all these recent reforms, we cannot support the proposed rules for a number of reasons. First, the proposed rules would apply to all public companies, contrary to the Commission's stated goal of targeting a limited number of unresponsive companies. Second, the rules would enable a small number of shareholders with narrow agendas to impose costs on all shareholders. Third, the election contests that would come about under the proposed rules would divert the time and energies of corporate management from the business of running the company. Fourth, the election of directors under the proposal would threaten the cohesion that is indispensable to an effective board of directors. Finally, the proposed rules exceed the Commission's authority and improperly intrude on the role of the states in this area.

As an initial matter, the timing of the proposed rules is unfortunate. There have been more reforms to corporate governance in the last twenty-four months than in the prior twenty-four years. The recent reforms implemented by Congress through the Sarbanes-Oxley Act, the Commission through its rulemaking implementing Sarbanes-Oxley, and the exchanges through their revised corporate governance listing standards must be fully implemented, evaluated, and understood before we can know whether more change is needed, and what form any additional change should take. And yet, many of the revised listing standards do not even go into effect until later this spring. Similarly, the Commission only recently adopted new rules requiring enhanced disclosure about nominating committee processes and shareholder-director communications.

This panel has been asked to address whether the proposed rules apply to the appropriate companies, and whether they properly address the potential costs to companies. The answer to both questions is “no.” In practice, the proposed rules would impact all public companies, because the “triggers” in the rule are easily tripped. Moreover, the rules have the potential to impose tremendous costs on all companies.

The Commission has said that its objective in this rulemaking is to target a relatively small number of companies that have been unresponsive to shareholder concerns as they relate to the proxy process. But in fact, the proposed rules will affect virtually all public companies, regardless of their corporate governance practices or their responsiveness to shareholders. The “1% shareholder trigger,” which would permit any shareholder or group of shareholders with 1% stock ownership to submit a proposal to trigger the proposed rules, makes it highly probable that proposals of this nature would be submitted at a great number of companies. At companies where this trigger proposal passed, a 5% shareholder could then make the company include his or her director nominee in the company’s proxy statement. A 5% shareholder or group of shareholders with a narrow could thereby impose the extensive costs of an election contest on the company and all other shareholders.

The second trigger under the proposed rules, the “withhold vote trigger,” would also be tripped with much greater frequency than the Commission has projected. The Commission bases much of its analysis of this trigger on the supposition that historical voting data from the past two years is a reliable indicator of how frequently withhold votes would be cast if the proposed rules were finalized. However, the Commission's analysis does not account adequately for the powerful new incentives the rules would create for casting withhold votes, and the manner in which those incentives would interact with the voting practices and policy aims of certain institutional investors.

In particular, the likelihood that the proposed triggers would be tripped frequently is increased by the involvement in the proxy voting process of groups such as Institutional Shareholder Services ("ISS"). Many institutional investors adopt voting guidelines or follow those of proxy advisory services such as ISS. Some employee benefit plans even hire proxy advisory services to vote on their behalf. A November 2003 survey conducted by the Business Roundtable demonstrates that, on average, 40% of our member companies' shares are voted by institutional investors that follow ISS proxy voting guidelines. Many of these investors do not deviate from their voting guidelines regardless of an individual company's position, circumstances, or responsiveness to shareholders.

ISS already encourages withhold votes to "send a message" on grounds that go beyond the qualifications of the specific director nominee. This practice would only increase under the proposed rules. Moreover, ISS and institutional investors are likely to support shareholder access proposals at *all* companies, if for no other reason than to ensure that access to company proxy materials is available in the future. Adoption of the proposed rules thus would result in investor voting patterns unrelated to what the Commission is seeking to regulate—the proxy process—and would render the rules a mechanism for pressuring corporate change on matters wholly outside the Commission's mandate.

Notably, several groups already have acknowledged that they would use the proposed rules as leverage to advance special interests that are unrelated to the proxy process. The Commission seeks to address this problem by requiring a degree of independence between nominees and nominating shareholders, but this provision of the proposed rules does not address the fundamental problem. The fact that a nominee has no economic ties to the nominating shareholder does not lessen the concern that, once elected, he or she will pursue a narrow agenda at the expense of a majority of the company's shareholders.

In addition to occurring far more frequently than the Commission has projected, election contests would impose greater costs than the Commission has recognized. A November 2003 survey conducted by the Business Roundtable suggests that each affected company would spend an average of $700,000 per year under the proposed rules. By contrast, the Commission has estimated the rules' total cost at a mere $4,200 per company.

The Commission's estimate of the rules' cost is inaccurate, in part, because it fails to recognize the frequency with which elections effectively would become costly election contests under the proposed rules. Elections would in a sense be treated as "contested" even where no shareholder nominee appeared on the ballot, because companies would have an incentive to ensure not merely that their nominees win, but that they do so with fewer than 35% "withhold" votes. The Commission also does not account for all the direct costs to the company of election contests, including executive and director time and distraction from regular duties, increased legal fees, the use of proxy solicitors, and increased costs of printing and mailing resulting from the inclusion of additional information in company proxy materials and additional shareholder communications.

In addition to the costs that would be incurred in companies' efforts to prevent triggering events, the proposed rules would often cause companies to expend considerable additional resources to assure the election of its nominees rather than the shareholder nominees that are also included in company proxy materials. When a board of directors nominates a slate of director candidates, its fiduciary duty requires it to select candidates in the best interests of the company and all of its shareholders. A board that receives a shareholder nominee under the proposed rules would be required to consider whether the board's own nominee would better oversee the business and affairs of the company and better satisfy applicable standards of expertise. If so, the board's fiduciary duties would require it to act to counter the shareholder nominee. This is likely to result in substantial costs, borne by the company and *all* of its shareholders.

The proposed rules also would impose significant collateral costs on companies and shareholders that are not easily quantifiable. For example, the proposed rules would threaten the cohesiveness of company boards. Directors should function as a team, within a culture of trust and candor. In the past, companies whose shareholders have elected special-interest directors typically have not been well-served by the resulting dissension and lack of trust on the board. This proposal increases the likelihood of the election of directors who will pursue a narrow agenda that is not in the best interests of the company as a whole, causing disruption within the board and interference in the operation of the company itself.

Finally, the proposed rules would exacerbate the problems companies currently face in communicating with their shareholders because the proposal would dramatically increase the need for, and the costs of, such communications. Companies today are severely hampered in their ability to communicate with beneficial owners of shares that are held in "street" name (which represent 70 to 80% of all publicly held shares) by an unnecessarily time-consuming, circuitous and sometimes prohibitively expensive system developed by the Commission in the mid-1980s. This system has become outdated in light of ensuing technological advancements. Accordingly, the Commission should undertake a full review of the system before adopting these rules.

For all the reasons discussed above, the proposed rules would affect far more companies than the Commission projects, and would impose far greater costs on each company than the Commission estimates. The majority of shareholders would be disserved, and corporate governance itself would be harmed. The Business Roundtable accordingly opposes these proposed rules, and urges the Commission not to proceed with this rulemaking. More good can be achieved by focusing on the corporate governance changes already being implemented rather than creating a director election process which is destined to have many unintended consequences.