HEADWATERS INCORPORATED

Adding Value to Energy™

4 October 2010

Honorable Mary L. Schapiro, Chairman
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Concept Release on the US Proxy System
SEC File No. S7-14-10

Dear Chairman Schapiro:

I am writing on behalf of the board of directors of Headwaters Incorporated. We are providing comment on proxy advisory firms in response to SEC's request for comment in section V.A.4 of the Concept Release. Headwaters is a public company, whose stock is traded on the New York Stock Exchange and predominantly held by institutional stockholders. Proxy advisory firms make annual recommendations on company proxy matters and in many cases vote proxies on behalf of institutional stockholders. We believe that the relatively recent phenomenon of highly influential institutional proxy advisors causes significant problems for public companies and concerns for the market as a whole.

First, there is undue power in the hands of too few. It is well known that a single proxy advisory firm predominates in its market, and at best, there are two or three influential proxy advisors in the field. In our experience, the majority of the quorum at our annual meetings is controlled by the recommendations or voting of a single proxy advisory firm. Of course, this places extraordinary power and influence in the hands of a few analysts at a single firm that investigate, recommend, and vote on company proxy matters.

We do not believe that it is good governance for a public corporation's course to be charted by a single perspective. A strength of stockholder voting in public companies is that a majority of a broad base of stockholders is likely to make good stockholder decisions in most cases. There is no such safety where power is isolated in the analysts of a single, or even a few, proxy advisory firms. There is strong logic for decisions that pass the test of executive, board, and stockholders, with increasing diversity of voice at each point of governance.

Second, it is our experience that proxy advisors often base their analysis on poor comparisons of different companies. This comparative process is used because analysts cannot possibly understand the individual merits of each company they attempt to assess. There are simply too many companies to analyze. Largely as a substitute for individualized understanding, purported peer groups are created and company proposals and metrics are compared to the perceived norm. In our experience, inapt peer groups and comparisons are regularly made by proxy advisors, establishing inapt standards for measurement. Companies are forced to conform to practices that may not fit their particular business and circumstances. This one-size-fits-all approach to stockholder decision-making stifles innovation, experimentation, diversity, and progress in company thinking.

Of course, this concern is magnified as stockholders are required to vote on more and more proposals and have increased proxy access. As the pendulum swings away from board of director-based governance and towards stockholder-based governance, stockholder understanding of the uniqueness of each company, rather than broad unhelpful comparisons, becomes increasingly crucial to sound stockholder decisions.

Third, the proxy advisory firm recommendation process lacks transparency, access to decision makers, and meaningful communication between a company that does not pay for access and the advisory firms. When, as is the practice, proxy advisor reports are issued only days before an annual meeting, there is no meaningful opportunity for dialogue between analysts and the company that could lead to an exchange of information and ideas and improved understanding and decision-making. Given the opaqueness of proxy advisor analysis and the timing of their reports, in our experience, it is very difficult, if not impossible, to persuade proxy advisors to change their eleventh hour recommendations, whether premised on faulty data or just ill-advised.

There is also an enormous disclosure void as to the extent of actual proxy voting being undertaken by proxy advisory firms. In practice, such firms are voting their own recommendations, even if done on behalf of their institutional investor clients. It is troubling that substantial share positions, often large enough to sway the outcome on important proxy matters, are voted without any public disclosure of the pervasive proxy advisor influence. For the most part, proxy advisory firms operate behind closed doors. We would submit that agency relationship voting positions of this size should be subject to public disclosure, with adequate notice and response time, consistent with other institutional investor disclosure obligations.

Fourth, the proxy advisory system suffers from conflicts of interest. The original business model of the stockholder proxy advisory firms was to recommend how stockholders should vote on proxy proposals. More recently, these proxy advisors solicit consulting work directly from companies. For a fee, a group of the proxy advisory firm will consult regarding a company's annual meeting proposals. While on the one hand the proxy advisors are advising stockholders how to vote regarding proxy matters, on the other hand they are consulting with management on how to structure these same proposals. Allegiance or even clarity of purpose is difficult to determine. Regardless, understanding that their annual meeting proposals will be assessed and perhaps controlled by proxy advisors, companies have little choice but to cede to the consulting engagements, further enriching the proxy advisory firms to attempt to secure their positive recommendations.

We believe that the growth and direction of the institutional proxy advisory system raises significant concerns. Stockholder control has been consolidated or delegated into one or at most a few decision makers who too often take a one-size-fits-all approach to corporate governance. Analysis is too often based on sweeping comparisons rather than the facts and circumstances of an individual company well understood by experienced directors and stockholders. Management is provided with no real avenue to influence proxy advisor analysis except by consulting engagements which leave firms in the position of evaluating proposals they have helped to create.

Very truly yours,

Headwaters Incorporated

Harlan M. Hatfield
Vice President, Secretary,
& General Counsel