

# GIBSON, DUNN & CRUTCHER LLP

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June 28, 2005

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VIA E-MAIL

Mr. Jonathan G. Katz  
Secretary  
Securities and Exchange Commission  
100 Fifth Street, N.E.  
Washington, DC 20549

Re: *Investment Company Governance Rule;*  
*File No. S7-03-04*

Dear Mr. Katz:

I am enclosing the following materials for inclusion in the rulemaking record in advance of the June 29 Open Meeting concerning the above-titled proceeding:

- A June 21, 2005 article from Bloomberg.com, titled "SEC Must Reconsider Fund Governance Rule, Court Says";
- An email from C. Meyrick Payne of Management Practice Inc.;
- A June 23, 2005 article from the Wall Street Journal, titled "Donaldson's Last Stand";
- A June 23, 2005 article from CBS MarketWatch, titled "Business group urges SEC to hold off fund vote";
- A letter from the Honorable Harvey L. Pitt to the Commission;
- A June 24, 2005 article from Dow Jones Newswire, titled "Republican Senators Urge SEC to Defer Action on Fund Rule";

- A June 24, 2005 article from the Washington Post, titled “National Briefing: Regulation”;
- A June 24, 2005 article from Bloomberg.com;
- A June 25 New York Times article, titled “Ex-Officials Urge S.E.C. to Postpone a Vote”;
- A June 28, 2005 New York Times article, titled “S.E.C. Chief Defends Timing of Fund Vote”;
- A June 28, 2005 Wall Street Journal article, titled “Donaldson's Finale Draws Uproar”; and
- A PDF of a letter from eight United States Senators to the Commission.

Very truly yours,

Cory J. Skolnick

Enclosures

cc: Hon. William H. Donaldson, Chairman, SEC (via hand delivery w/ enclosures)  
Hon. Paul S. Atkins, Commissioner  
Hon. Roel C. Campos, Commissioner  
Hon. Cynthia A. Glassman, Commissioner  
Hon. Harvey J. Goldschmid, Commissioner  
Mr. Giovanni Prezioso, General Counsel  
Mr. John W. Avery, Special Counsel

Bloomberg.com

SEC Must Reconsider Fund Governance Rule, Court Says (Update4)

June 21 (Bloomberg) -- A federal appeals court ordered the U.S. Securities and Exchange Commission to reconsider a rule requiring mutual funds to be overseen by independent chairmen, a victory for Fidelity Investments and Vanguard Group, which spent more than a year fighting the provision.

The decision by a three-judge panel of the U.S. Court of Appeals for the D.C. Circuit in Washington said the SEC failed to properly consider the costs of the governance rule passed last June. About 80 percent of fund companies, including Fidelity and Vanguard, the two biggest, have boards run by insiders.

The SEC has a legal obligation to determine as best it can the economic implications of the rule it has proposed," Chief Judge Douglas Ginsburg wrote in the unanimous decision.

Today's ruling in a suit filed by the U.S. Chamber of Commerce is a setback for departing SEC Chairman William Donaldson, who heralded the requirement as central to the agency's efforts to curb trading and sales abuses in the \$7.9 trillion industry. Donaldson is leaving at the end of this month, and it is unclear if the SEC will respond to the court's concerns before he goes.

Republican Representative Christopher Cox of California has been named by President George W. Bush to replace Donaldson. His views on the case could be decisive since the rule passed on a 3-2 vote with Donaldson siding with the two Democratic commissioners, Harvey Goldschmid and Roel Campos. Cox spokesman Paul Wilkinson declined to comment.

#### Rule's Future

While the decision calls for the SEC to reevaluate the measure, it doesn't necessarily mean the rule will be scrapped. SEC spokesman John Nester said the agency is reviewing the decision and considering how to proceed.

There is a good chance that the whole decision on whether to try to resuscitate this rule is going to be deferred," said Kathryn McGrath, a partner at Crowell & Moring LLP in Washington and former head of the SEC's mutual fund division. "I seriously doubt that it's going to go into effect" as scheduled in January.

Ginsburg, along with Judges Judith Rogers and David Tatel, sided with the SEC on one major part of the case, finding that the agency had the legal authority to craft the requirement. The rule also ordered fund boards to have 75 percent independent directors.

The SEC adopted the rule last year after the industry was engulfed by a scandal in which funds allowed favored clients to make trades that harmed the returns of long-term

investors. The agency argued that fund boards, which are supposed to represent shareholder interests, would be strengthened by having fewer ties to the companies that run the mutual funds.

#### Cost Contention

While most fund companies opposed the measure as burdensome and expensive, the SEC said complying with the rule would entail "minimal" costs. The agency didn't estimate how much. The two Republican commissioners, who voted against the rule, said the costs would be "substantial."

In today's ruling, the court said the SEC should have done a better job determining the costs. The judges also said the agency should have considered an alternative, less onerous regulation. The SEC's actions, the court said, violated the Administrative Procedure Act, which gives federal agencies such as the SEC the power to write regulations.

#### Lacking Focus

Former SEC Chairman Harvey Pitt, who supported the rule, said the decision "points up some of the serious weaknesses" at the SEC.

"The SEC is a marvelous agency and it has a great staff, but it lacks a real economic focus and, in particular, its ability to weigh costs and benefits has been sorely lacking," he said in an interview.

The chamber, which filed its suit in September, warned the SEC to carefully reconsider the policy.

"Courts don't remand rules like this just so an agency can rubber stamp them and say, 'OK, these costs aren't excessive,'" said Stephen Bokart, executive vice president of the chamber's legal department. "They've got to give real consideration, legitimate consideration, or the court will slap them down again."

Commissioner Paul Atkins, who voted against the rule along with Republican colleague Cynthia Glassman, said he was "pleased" by the ruling.

"We should undertake a thorough, public reconsideration of alternatives and costs in accordance with the court's decision," he said. "It's disappointing that we had to be forced to take this step."

#### 'Easy to Remedy'

Goldschmid, who, like Donaldson, is leaving the SEC in the next few months, said the court's blessing of the agency's legal authority will ensure that the rule remains intact.

“The procedural deficiencies cited should be easy to remedy,” he said. “This is better than a total defeat for the Chamber of Commerce, but they should not be feeling good.”

Bokat responded, “If they want to snatch victory from the jaws of defeat, let them.”

Vincent Loporchio, a spokesman at Boston-based Fidelity, declined to comment on the decision. The company's funds are overseen by Edward Johnson III, who is also Fidelity's chairman and chief executive officer.

“We believe the rule limits substantially the discretion of the board of directors, particularly the disinterested directors, to exercise their informed business judgment to appoint any individual of their choosing to serve as the board chairman,” Loporchio said.

ICI, T. Rowe

Both Fidelity and Vanguard, run by John Brennan, opposed the independent chairman rule. John Demming, a spokesman at Valley Forge, Pennsylvania-based Vanguard, said the company “will wait to see what the commission does.”

Demming said the fund company hasn't actively opposed the rule and noted that Vanguard has said it would comply with the independent chairman requirement since it was adopted.

Paul Schott Stevens, president of the Investment Company Institute, the Washington-based mutual fund trade group, said the decision emphasizes that “the SEC must give due consideration to cost-benefit issues and to reasonable alternative approaches.” The ICI opposed the rule.

“We feel that the court's decision certainly reflects many of our thoughts and concerns over the action taken,” said Henry Hopkins, chief legal counsel for T. Rowe Price Group Inc. in Baltimore. T. Rowe Price manages about \$236 billion.

Fidelity Study

Fidelity sponsored a study in March 2004, cited by the Chamber in its court case, that said funds with company-employed chairmen have better performance than those led by outsiders. Johnson also published a column in the Wall Street Journal before the SEC vote, saying independent chairmen would have less “expertise and hands-on ‘feel’” than company-employed chairmen.

Vanguard runs 129 funds in the U.S. and manages a total of \$850 billion, while Fidelity has 361 funds and \$947.4 billion in mutual fund assets.

The case is Chamber of Commerce of the United States of America v. U.S. Securities and Exchange Commission, 04-1300, U.S. Court of Appeals for the District of Columbia Circuit.

To contact the reporter on this story:  
Robert Schmidt in Washington at [rschmidt5@bloomberg.net](mailto:rschmidt5@bloomberg.net)  
Last Updated: June 21, 2005 17:35 EDT

From: C. Meyrick Payne [<mailto:MPayne@MPIweb.com>]

Sent: Sunday, June 26, 2005 4:48 PM

To: Al DePrince; Alan Richards; Allan Mostoff; Ann Torre Grant; Arne Carlson; Bryant Stooks; Charles Ladner; Charles Porter; Clayton Yeuter; David S. Ruder; Dawn Marie Driscoll; Donald E. Nickelson; Ed Smeds; Faith Colish; Fergus Reid; Jock Patton; John Carter; John Hill; John Winthrop; Kenneth Froewiss; Leigh Wilson; Bateman, Marguerite; Meg Graham; Michael Scofield; Peter Drotch; Richard Armstrong; Richard Redeker; Ted Coburn; Tony Pusturino; William Cunningham

Subject: SEC's Wednesday Hearing about Independent Chairman

I am sure you know that Bill Donaldson has called an SEC meeting to consider the costs and alternatives to the independent chairman rule as required by the US Court of Appeals. He leaves office almost immediately afterwards.

MPI has been conducting "Role of the Chairman" workshops around the country for the past six months. Generally we have found favorable reaction to the independent chairman concept.

Based on these workshops and our 2005 Directors Compensation and Governance Practices Survey, we have summarized some facts about the costs and alternatives.

If you, or your board, feel that an independent chair is an appropriate response to the recent mutual fund scandals you might like to write to SEC or your favorite newspaper on Monday or Tuesday so that your opinion can be influential.

In my experience the best newspaper contacts are Gretchen Morgenson at the New York Times and Riva Atlas or Jenny Anderson at the Wall Street Journal (regrettably I don't have email addresses available), but please use your own contacts. Mike Eisenberg is the acting director of the Division of Investment Management at the SEC ( [EisenbergM@SEC.gov](mailto:EisenbergM@SEC.gov) ).

C. Meyrick Payne

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Wall Street Journal  
REVIEW & OUTLOOK

Donaldson's Last Stand  
June 23, 2005; Page A12

The Securities and Exchange Commission was once considered Washington's premier regulatory agency, staffed with professionals committed to rule-making based on facts. That reputation has taken a drubbing during the tenure of Chairman Bill Donaldson, who is up to more mischief in his last week on the job.

The latest embarrassment came Tuesday in a unanimous rejection by a D.C. Circuit Court panel of the SEC's new rule demanding more independent directors on mutual fund boards. The 3-0 rebuke was all the more remarkable because the court said the agency simply hadn't done its homework before promulgating the new, and potentially costly, regulation.

The rule requires that 75% of all mutual fund board directors be "independent," including the chairman. This was a sweeping change, given that, of the hundreds of funds managing \$7.5 trillion in assets, some 80% have chairmen from management, while about half fail the 75% "independent" standard. There is also no evidence that funds with "interested" directors have been any more prone to scandal than those with "independents" in charge. But the SEC staff wanted the rule, and Mr. Donaldson forced it through the Commission on a 3-2 vote.

Notably, the SEC had itself admitted that it had "no reliable basis" for estimating costs of the new rule. But the appeals court panel said there was no excuse for the agency failing even to try. The court also rebuked the SEC for failing to consider alternatives to imposing independent chairmen. One lower-cost option would require funds to disclose whether they had independent chairmen or not, thereby allowing investors to judge for themselves how important this is.

This legal setback is an opportunity for the SEC to review its earlier rush to regulate and look more deliberately at the alternatives and their costs and benefits. Yet even as he's cleaning out his desk, Mr. Donaldson is proposing a mere one-week review of the court's questions. He has tentatively scheduled another Commission vote on the issue for next Wednesday -- the day before he leaves office. Having argued in court that it was all but impossible to estimate the rule's costs, the SEC now proposes to do precisely that in a regulatory land speed record.

No doubt Mr. Donaldson realizes that once he leaves the SEC the mutual fund regulation might not survive. President Bush's nominee to replace him as Chairman, Congressman Christopher Cox, will want to make his own review of the measure. And given this week's legal decision, he is almost obliged to do so. A public hearing would also be in order. Let's hope someone higher up in the Bush Administration asks Mr. Donaldson to

leave gracefully and allow the SEC to repair its reputation, rather than redoubling its errors.

CBS MarketWatch

June 23, 2005 Thursday

**SECTION:** NEWS & COMMENTARY; MARKETS

**HEADLINE:** Business group urges SEC to hold off fund vote

**BYLINE:** Robert Schroeder, MarketWatch; <mailto:rschroeder@marketwatch.com>;  
Robert Schroeder is a reporter for MarketWatch in Washington.

**BODY:**

WASHINGTON (MarketWatch) -- The U.S. Chamber of Commerce is urging the Securities and Exchange Commission to hold off on a scheduled vote about mutual fund governance, shortly after a U.S. court asked the SEC to review a fund rule.

In a letter to the agency's general counsel, attorney Eugene Scalia said the SEC is proceeding "in a hasty manner" to reconsider the rule, which was handed back to the agency by a U.S. appeals court Tuesday.

The chamber challenged the rule, which states that 75% of mutual fund directors, including the chair, be independent of management.

The SEC has scheduled a vote on the matter for June 29, one day before Chairman William Donaldson retires.

"Proceeding in such a hasty manner would constitute a profound departure from the requirements of the administrative process," Scalia wrote to SEC General Counsel Giovanni Prezioso.

Scalia requested 60 days of public comment period for the SEC to collect information about the rule and said further legal action against the SEC could arise if the agency acts quickly.

"For the agency to rush to judgment a day before the departure of the chairman would cause the public, and the Court of Appeals, to conclude that the commission's decision was pre-ordained," Scalia wrote.

"Such a course would subject the commission to yet further legal proceedings in which it is unlikely to prevail," he wrote.

Scalia's letter comes one day after eight Republican senators wrote to Donaldson urging him to forego the June 29 vote.

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From: Harvey Pitt  
Sent: Thursday, June 23, 2005 10:40 PM  
To: 'donaldsonw@sec.gov'; 'Glassman, Cynthia'; 'goldschmidh@sec.gov'; 'Campos, Roel'; 'Atkins, Paul'  
Subject: Revisitation of the Commission's Mutual Fund Rules

Dear Chairman Donaldson and Commissioners Glassman, Goldschmid, Campos and Atkins:

On Tuesday, the District of Columbia Circuit Court embraced the SEC's authority to impose a controversial rule requiring that mutual fund board chairs be independent. But, to use the Commission's own current jargon, the Court criticized and rejected the agency's transparency, governance and thoroughness in considering the costs its proposed rule might impose, and any less invasive alternatives that were available. Confronted with that stark reminder of the importance of adhering to the rule of law, and following appropriate processes, I assumed the Commission would take a fair amount of time to consider the Court's opinion, and develop a record on which to reconsider its prior actions.

That, however, doesn't appear to be what's about to happen. With the Chairman retiring the very next day, and two supporting Commissioners whose terms have both expired already, the Commission has announced its plan to use next week's final open meeting of Chairman Donaldson's tenure to readopt the exact same rule, again presumably by a three-to-two vote, with only the three commissioners whose terms are ending embracing either the process or the result. That has never before been the course followed by an independent regulatory agency, and certainly never before has it been the methodology at the SEC.

When the Commission's rule was up for consideration, I along with the six other living former SEC Chairmen, supported the rule, despite my concern that the rule was more cosmetic than substantive. After all, abuses in the fund industry cried out for action and, in the absence of the fund industry taking the lead itself, the government was virtually forced to weigh in.

But, as a society, we long ago rejected Machiavelli's notion that any end thought to be worth pursuing can justify any means of getting to that result, even means that are legally suspect and immoral. If the Commission proceeds with its reconsideration of these rules, the Commission is proposing to do precisely that.

The rules in question took a considerable period of time to gestate through the system. The decision of the Court of Appeals is not even two days old, yet. What's the rush? It surely can't be substantive. It also surely can't reflect a desire to implement the teachings of the Court's decision promptly. No, the only plausible explanation for what the Commission is proposing to do must be that the three whose terms have ended or are ending don't want to leave the issue in the hands of Chairman Donaldson's successor and their two remaining colleagues. That makes a mockery of the rule of law. Worse, it breeds and encourages disrespect for the agency's actions - not just this action, but all of them. How could any court decide that other rules enacted by the same three-to-two votes (or even controversial rules adopted by five-to-zero votes) weren't also the product of suspect motivations?

The SEC is far too important, and far too vital to allow suspect motivations to take over in the waning days of Chairman Donaldson's tenure. If the SEC were evaluating this behavior by the Chairman and two directors of a publicly-held corporation intent on trampling the rule of law and the rights of the minority as lame ducks and expiring terms, – its Enforcement Staff would be all over the perpetrators of such conduct, as it should be, and the agency would be expressing appropriate pieties about transparency, governance, and protecting the rights of public investors.

The agency tasked with promoting the public interest can't act this way if it expects others to take it seriously. If the SEC can't be trusted to practice what it preaches, can anyone really have much faith in or respect for what it's preaching to others? Rather than demeaning the agency's credibility and impugning its morality, the SEC should immediately remove this issue from its last public meeting before Chairman Donaldson's resignation becomes effective, and stick to important, but properly-motivated, objectives.

Sincerely,

Harvey L. Pitt



Republican Senators  
Urge SEC to Defer  
Action on Fund Rule

DOW JONES NEWSWIRES

*June 24, 2005; Page C13*

WASHINGTON -- Eight Senate Republicans and several business groups urged William Donaldson, the departing chairman of Securities and Exchange Commission, to defer action on a disputed proposal requiring mutual funds to have an independent chairman.

The mounting pressure shows how Mr. Donaldson's decision to rush the rule through in his final days is creating a lot of consternation both inside and outside the SEC.

The U.S. Chamber of Commerce had sued the SEC over the rule, and on Tuesday, the U.S. Court of Appeals for the D.C. Circuit sent the rule back to the SEC, saying the agency had the authority to adopt it, but failed to adequately estimate the rule's costs or to consider alternatives.

The court ordered a review of the rule, and the SEC surprised mutual-fund industry executives and politicians by saying it will address the court's concerns at its Wednesday meeting, suggesting that Mr. Donaldson would use the support of the two Democrats on the five-member commission to push through a revised rule despite the opposition of his two fellow Republicans on the commission.

The proposed rule, set to take effect early next year, requires that 75% of a fund's directors, including the chairman, be independent of the fund company's management.

Washington Post  
**June 24, 2005** Friday  
Final Edition

**SECTION:** Financial; D02

**HEADLINE:** NATIONAL BRIEFING

**BODY:**

## REGULATION

Eight Republican senators urged the chairman of the Securities and Exchange Commission to postpone a vote on a controversial mutual fund rule.

A federal appeals court told the agency on Tuesday to reconsider the costs of and alternatives to the rule, which forbids mutual fund chairmen from having ties to management. SEC Chairman William H. Donaldson, who is leaving his post next Thursday, quickly scheduled a vote on the issue for his final public meeting. The initial rule passed on a 3 to 2 vote last year.

Sen. Michael D. Crapo (R-Idaho) and seven other senators sent a letter to Donaldson calling the swift move "inappropriate."

The U.S. Chamber of Commerce, which sued the SEC over the original rule, also sent a letter saying the vote "would constitute a profound departure from the requirements of the administrative process." An SEC spokesman declined to comment.

**LOAD-DATE:** June 24, 2005

By Robert Schmidt

June 24 (Bloomberg) -- The U.S. Securities and Exchange Commission is harming its credibility by scheduling a vote on a mutual-fund rule the day before Chairman William Donaldson leaves his job, a former commission member said.

Joseph Grundfest, a Democratic appointee who was on the commission from 1985 to 1990, said in a letter yesterday to Donaldson and the other four SEC commissioners that the vote also puts the agency at "substantial legal risk." The U.S. Court of Appeals for the D.C. Circuit sent the rule back to the SEC earlier this week for a further review of its costs.

"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," wrote Grundfest, who is now a professor at Stanford Law School in California.

Eight Republicans on the Senate Banking Committee yesterday urged Donaldson not to proceed with a vote on the rule, which requires that mutual-fund boards be comprised of 75 percent independent directors, including the chairman. The SEC adopted the requirement last year on a 3-2 vote, prompting a lawsuit by the U.S. Chamber of Commerce.

After the court's ruling on June 21, Donaldson put the matter on the agenda for consideration at his final public meeting, June 29. The move makes it appear that the chairman is trying to ensure that the rule passes again before the three-vote majority changes, Grundfest wrote.

### 'Looks So Bad'

Matt Well, Donaldson's spokesman, declined to comment. Grundfest didn't return a call for comment.

Another former SEC commissioner, Edward Fleischman, who served with Grundfest, said in an interview that he was "somewhat appalled" at the situation.

"It just looks so bad for an agency that tries to stand so righteously to treat a judicial decision, an appeals court decision, in this very rapid and inappropriate way," said Fleischman, a Republican appointee who is now an attorney at Linklaters in New York.

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**New York Times**  
**June 25, 2005**

### **EX-OFFICIALS URGE S.E.C. TO POSTPONE A VOTE**

**By RIVA D. ATLAS**

Several former Securities and Exchange Commission officials have sent letters to the commission's members urging the agency to put off a vote scheduled for Wednesday on a rule covering mutual fund directors.

The rule, which requires mutual funds to have independent chairmen, was the subject of a federal appeals court ruling on Tuesday that the S.E.C. must assess the costs of the rule and demonstrate that it had considered alternative proposals. The rule on mutual fund boards was adopted in June 2004 by a 3-to-2 vote, with the commission chairman, William H. Donaldson, voting with the two Democratic commissioners.

The ruling, by the United States Court of Appeals for the District of Columbia Circuit on a lawsuit filed by the Chamber of Commerce, is significant because it comes as Mr. Donaldson is set to resign. President Bush has named Representative Christopher Cox, a Republican from California, to be Mr. Donaldson's successor. Some industry analysts say they worry that Mr. Cox, who has been perceived as friendly to business interests, will not support the rule.

The commission has said that it will review the court decision at a previously scheduled meeting on Wednesday, the day before Mr. Donaldson is scheduled to leave office.

Officials at the agency said yesterday that the rule was likely to come up for a vote despite the letters.

Several former S.E.C. officials, including a former chairman, Harvey L. Pitt, argue that an attempt to push through the rule in the eleventh hour would set a bad precedent and damage the agency's reputation for objectivity.

"The S.E.C. is far too important, and far too vital to allow suspect motivations to take over in the waning days of Chairman Donaldson's tenure," said Mr. Pitt, in his letter to Mr. Donaldson and the four other commissioners. "As a society, we long ago rejected Machiavelli's notion that any end thought to be worth pursuing can justify any means of getting to that result, even means that are legally suspect and immoral."

Mr. Pitt, who is now chief executive of Kalorama Partners, a Washington consulting firm, noted in his letter that he had supported the original rule.

In another letter, a former S.E.C. commissioner and Stanford law professor, Joseph A. Grundfest, said the attempt to rush through the rule "threatens the commission's long-term credibility with the public, the Congress and with the courts." He added that even if the rule was adopted on Wednesday, the commission could decide after Mr.

Donaldson left to delay the rule from taking effect, pending the fact-finding requested by the court.

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## NEW YORK TIMES

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### S.E.C. CHIEF DEFENDS TIMING OF FUND VOTE

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Published: June 28, 2005

William H. Donaldson yesterday defended his decision to put a proposed rule regarding the independence of mutual fund boards up for a vote the day before he steps down as chairman of the Securities and Exchange Commission.

He said the commission had spent a year debating the merits of the rule, which would require greater independence among the directors of mutual funds. He expressed trepidation that the newly constituted commission could kill the measure.

"There are those who have thwarted this from the beginning who are saying I am trying to ram something through," Mr. Donaldson said in an interview. "There's nothing further from the truth. We've spent a year on this and we have the principled responsibility to act in the interest of investors."

His call for a new vote has drawn opposition from Congress, former commissioners, industry groups and some fellow commissioners, who have asserted that he should not force a vote in his last week.

Last summer, the S.E.C. voted 3 to 2 to require 75 percent of a mutual fund's directors, including the chairman, to be independent of the fund company's management. Mr. Donaldson and the two Democrats on the commission voted for the rule.

The United States Chamber of Commerce sued the commission, saying it did not have the authority to impose such a rule. The chamber also accused the S.E.C. of violating administrative procedures in not considering an alternative, a disclosure requirement, and not adequately contemplating the costs of putting the rule into effect.

Last week, the Federal Court of Appeals for the District of Columbia Circuit ruled that the commission had acted within its authority.

But the court agreed with the chamber that the S.E.C. had failed to adequately consider the costs of putting such a rule into effect and that it had failed to consider an alternative proposal to simply require a fund to disclose whether at least three-quarters of its directors and its chairman were independent.

In response, Mr. Donaldson scheduled a vote for the commission's meeting tomorrow, the day before he is expected to leave the commission. Representative Christopher Cox, Republican of California, has been nominated to succeed Mr. Donaldson but not confirmed.

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Mr. Donaldson expressed concern about leaving the question to a future commission.

"The inefficiency and delay of throwing this to a total new group carries with it undue risks to investors," he said. "There are 90 million people who own mutual funds who are entitled to have the confidence that the directors who represent them and the chairman are independent people."

Mr. Donaldson's opponents have accused him of ignoring the court's order to analyze the costs and benefits of the requirements.

His supporters have said the court's request can be easily addressed using the research and comment gathered before the original vote.

The debate almost ensures that Mr. Donaldson's final meeting will include a heated debate, an appropriate conclusion to a tenure in which Mr. Donaldson, a Republican, was frequently at odds with the other Republican commissioners.

Opposition to a vote tomorrow by the S.E.C. has been widespread. Eight senators, all Republicans, wrote a letter to the S.E.C. last Wednesday, the day after the court ruling. They urged the commission to "defer final action on this controversial and complex matter until the commission's new chairman is in office and the full commission can make a deliberate decision."

The Chamber of Commerce has threatened further legal action.

"If the commission forges ahead and promulgates a rule on Wednesday, we will be back in court," said Stephen Bokart of the National Chamber Litigation Center, the legal arm of the Chamber of Commerce. "We will challenge the failure of the commission to adequately respond to the court's remand."

Since the court's decision last week, the S.E.C. staff has given the commissioners a 28-page response on the issues of cost and disclosure. The report details the cost of requiring an independent chairman; various ways to achieve a board that is three-quarters independent (the cost of letting two insiders go or adding three directors, for example); and further consideration of the disclosure option rather than the rule, said one person who had seen the study.

# Donaldson's Finale Draws Uproar

**Departing SEC Head Sets**

**Vote for Mutual-Fund Rule**

**On the Day Before His Exit**

**By DEBORAH SOLOMON**

**Staff Reporter of THE WALL STREET JOURNAL**

*June 28, 2005*

As he prepared to leave office this week, Securities and Exchange Commission Chairman William Donaldson defended a last-minute decision to push through a controversial mutual-fund governance rule, saying that delaying action could have a "severe, detrimental effect" on investors.

The rule, which requires more independence at mutual-fund boards, was adopted by a 3-2 vote last year by Mr. Donaldson and the SEC's two Democrats but was challenged in court by the U.S. Chamber of Commerce. A federal appeals court said last week that the agency had the authority to adopt the rule, but hadn't adequately considered its costs or alternatives.

Mr. Donaldson, who is stepping down on Thursday, stunned many people when he quickly scheduled a vote for tomorrow to readopt the rule.

The move has prompted a swift backlash from business groups, lawmakers and current and former SEC officials, who say the rush undermines the SEC's credibility and is an attempt to circumvent coming changes at the commission. President Bush has nominated Rep. Chris Cox (R., Calif.) to succeed Mr. Donaldson, and the terms of the SEC's two Democratic commissioners are expiring.

But Mr. Donaldson said the agency needs to act quickly on a key reform that's integral to stemming abuses in the mutual-fund industry. The rule requires mutual funds to have an independent chairman and to increase to at least 75% the number of independent directors -- outsiders without ties to the management company that oversees the fund's portfolio -- on the board.

"My responsibility is to call them as I see them, and this is an extremely important juncture here for work that's gone on for a long period of time," Mr. Donaldson said. "I would be derelict in my duties if I just responded to political pressure out there."

Mr. Donaldson said the court's decision focused on some "narrow" deficiencies in the rulemaking process that the agency is able to address quickly.

"The most important thing, I think, is that we believe that this independent-chair and independent-board issue is critical to the implementation of the range of mutual-fund regulatory rules we've put in place. This is the capstone to the whole program," he said. But in a tacit acknowledgment that the agency will likely be sued again if it readopts the rule, Mr. Donaldson said "ultimately, of course, it will be the court that decides whether they are satisfied with our answers."

Mr. Donaldson's decision to schedule a vote so quickly has prompted cries from both supporters and opponents of the rule, who say he is trying to do an end-run around Mr. Cox and push through a controversial rule without a thorough re-examination.

Eight Republican senators have urged Mr. Donaldson to delay action on the rule, as have several former SEC commissioners. Yesterday, the Securities Industry Association, a major trade group, cautioned Mr. Donaldson, saying "if it acts in a hasty manner, the SEC

undermines its authority and reputation." The Financial Services Roundtable, a group representing large integrated financial-services companies, asked the SEC to make "an informed and fair decision."

"The prudent thing to do would be to go back out for comment on these issues out of respect to the court and to investors," said Commissioner Cynthia Glassman, a Republican who voted against the rule last year, along with Commissioner Paul Atkins. The rule is expected to pass along the same 3-2 lines tomorrow, with the support of Mr. Donaldson and the SEC's two Democrats. But SEC observers say that will merely toss the issue back to the court -- and into the hands of Mr. Cox and a new commission.

"The court of appeals effectively gave the next chairman the opportunity to consider anew some of the concerns that have been raised," said Harvey Pitt, a former SEC chairman who initially supported the rule, but who opposes Mr. Donaldson's decision to push it through now. Mr. Pitt said the court's ruling offers the commission "a real opportunity" to look at the costs and benefits of the rule, and that Mr. Cox will likely want to re-examine the issues raised by the court.

While the rule may be in the best interest of investors, Mr. Pitt said, the regulation "will have even more validity if it got passed after a reconsideration."

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