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April 7, 2004

United States Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549  
Attention: Jonathan G. Katz, Secretary  
Via e-mail: rule-comments@sec.gov

Re: Security Holder Director Nominations  
(Release No. 34-48626; IC-26206; File Nos. S7-19-03; RIN 3235-AI93)

Ladies and Gentlemen:

This letter is prepared and submitted by Professor Joseph A. Grundfest of Stanford Law School, and joined by the American Society of Corporate Secretaries (ASCS) and Barclays Global Investors, N.A. (BGI). We observe at the outset that the perspective presented in this letter is, to the best of our knowledge, the only perspective that has material support in both the corporate and shareholder communities. We trust that this fact may help persuade the Commission that the alternatives described herein warrant consideration.

The American Society of Corporate Secretaries (ASCS) is a professional association founded in 1946, serving more than 3,000 issuers. Job responsibilities of ASCS members include working with corporate boards of directors and senior management regarding corporate governance; assuring issuer compliance with securities regulations and listing requirements; and coordinating activities with shareholders such as proxy voting for the annual meeting of shareholders and negotiation of shareholder proposals. The majority of ASCS members are attorneys.<sup>1</sup>

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<sup>1</sup> In a letter dated March 30, 2004, the American Society of Corporate Secretaries has expressed a view entirely consistent with that expressed herein.

Barclays Global Investors, N.A. (BGI) is one of the world's largest institutional investment managers, and the world's largest provider of structured investment strategies such as indexing, tactical asset allocation, and quantitative active strategies. As of December 31, 2003, BGI managed over a trillion dollars in assets.

The Director Nomination rules are of landmark importance. The Commission has, much to its credit, carefully considered extensive public comment addressed to the specific mechanics of its proposed Rule 14a-11. The Commission has not, however, evaluated material public comment as to other mechanisms that might more effectively and efficiently promote the same objectives. Given the fact that the issuer and investor communities alike may have to live with the details of whatever rule is adopted for decades to come, prudence suggests that it is advisable for the Commission to consider alternatives that differ from the structure of the rules presently under consideration.

In particular, as the Commission is aware, the mechanisms currently under consideration have been broadly criticized for a wide variety of reasons. Many of these criticisms emanate from dispassionate observers who are expert in the field of governance and who have no particular axe to grind in the debate. For example, Vice Chancellor Strine recently described the pending rules as "unworkable."<sup>2</sup>

We further observe that at least three commentators have suggested that the root cause of the policy challenge that confronts the Commission is grounded in the fact that state law permits the election of a director by a plurality of the votes cast at a shareholder meeting. Therefore, even if a majority of the corporation's shareholders are marked to withhold authority for the election of a director, that director will be re-elected even if the only votes cast for that director are cast by that self-same director.<sup>3</sup>

We therefore believe that the Commission should actively consider a mechanism that has the effect of assuring that directors be elected by a majority (or some other percentage) of the votes cast at a shareholder meeting, and not by a mere plurality in an uncontested race. Such a rule would be simpler than the mechanism currently under consideration. It could also operate in a single election cycle, thereby eliminating the need for an election as to whether to have an election that protracts the contest over a two-year period. Such a rule would eliminate many of the essentially arbitrary triggers and thresholds found in the pending

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<sup>2</sup> Investor Responsibility Research Center, Corporate Governance Highlights, March 26, 2004, at 1.

<sup>3</sup> See, Letter Submitted by the Honorable E. Norman Veasey, Chief Justice of the Supreme Court of Delaware, dated March 11, 2004, at 2; Letter Submitted by Ira M. Millstein, Weil, Gotshal & Manges, LLP, dated March 3, 2004; and Joseph A. Grundfest, "Advice and Consent: An Alternative Mechanism for Shareholder Participation in the Nomination and Election of Corporate Directors," forthcoming in Lucian A. Bebchuk, Shareholder Access to the Corporate Ballot (Harvard Univ. Press, 2004).

proposal. It would also eliminate the need for investors to track their shareholdings over long time periods in order to determine their qualifications pursuant to the proposed rules, and would eliminate the prospect of expensive litigation over these complex holding requirements, as well as over many other provisions of the pending proposal.

Such a majority requirement would create a strong incentive for corporate nominating committees to confer and consult with shareholders about the identity of nominees. Only through a process of cooperative consultation that actively engages shareholders in the nomination and election process could corporations then be able to assure themselves that the nominees they place on the corporate ballot will actually be able to garner the approval of a majority of the shareholder body. The result will, we believe, be a less confrontational mechanism that constructively engages shareholders in the process of nominating and electing directors.<sup>4</sup>

The challenge in drafting such a rule is to craft it in a manner that rests within the Commission's authority and that does not impinge on the well established rights of the individual states to regulate matters internal to the governance of state chartered corporate entities. We believe that it is possible to achieve this objective by exercising the Commission's well-established right to require that publicly traded corporations make certain disclosures in a manner described below. Specific potential rule language is presented in Appendixes A, B, and C.

To summarize these proposals very briefly, the proposed "advice and consent" rules operate in two parts. First, the proposal suggests the adoption of a new Rule 3a7-1 that would define certain directors as being "unratified" for purposes of the federal securities laws. A director is "unratified" if the director is elected pursuant to state law but fails to obtain a majority (or some other percentage) of the votes cast. This categorization would have no effect on the director's election under state law or on the director's ability to serve under state law.

Appendix A describes a relatively straightforward approach to the definition of the term "unratified director." The bracketed materials are obviously subject to discussion and could be modified in a variety of directions. Appendix B is more complex and is responsive to a concern that a large number of a corporation's directors - - or even its entire board - - could be deemed "unratified." If the Commission determines that such a result is undesirable then Appendix B describes a mechanism that borrows certain numerical thresholds from the pending Rule 14a-11 to limit the number of directors who can at any one point in time be deemed "unratified."

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<sup>4</sup> For an explanation of the extent to which this mechanism mirrors the "advice and consent" provision of Article II Section 2 of the United States Constitution and the efficiency rationale in support of such an "advice and consent" mechanism in the corporate context see Grundfest, *supra*, note 2.

The second part of the proposal, presented in Appendix C, suggests that the Commission adopt expansive disclosure requirements on unratified directors and on boards that allow unratified directors to continue to serve. These new disclosure obligations would be incorporated into Form 8-K and would require that the registrant and any unratified director make extensive disclosures regarding the deliberations and decisions reached by the registrant's board and by any committee of the registrant's board on which one or more unratified directors serve. These disclosures are designed to provide shareholders with far more detailed information than they currently obtain about board process and decision-making. These disclosures will facilitate more scrupulous monitoring of the conduct of directors who serve over the objection of a majority (or some other percentage) of the shareholder body.

We recognize that the burdens imposed by these proposed disclosures are likely to be viewed as being of such a magnitude that no rational director would want to be subject to them. We also recognize that no rational board would want to have as a member a director whose presence would cause the entire board to become subject to these disclosure burdens. If this calculation is correct, then the imposition of this disclosure requirement, which is rationally related to the Commission's well-established disclosure authority, would have the collateral effect of *de facto* requiring that every sitting director be elected by a majority (or some other percentage) of the shareholder body, or be nominated by directors who satisfy that condition. As previously suggested, we believe that this requirement will induce significant consultation and collaboration between boards and shareholders in order to avoid the disclosure burdens that would result from the identification of one or more directors as being unratified.

The disclosure requirements described in Appendix C may well be more expansive than necessary in order to achieve the desired effects. They can, of course, be modified in several respects to impose more modest burdens on registrants and on unratified directors while still serving their intended functions.

Given the potential benefits of this alternative approach to shareholder access, we respectfully request that the Commission re-propose the pending rule along with the alternatives described in Appendixes A, B, and C, and variants thereof, in order to obtain public comment as to the preferable approach. Although our current inclination is to prefer a disclosure driven "advice and consent" mechanism, such as described in this letter, we recognize that the comment process could generate perspectives that would cause some or all of us to change our views as to the matter. We also recognize that several commentators have suggested additional alternatives, and we recognize that if the agency is to re-propose, then it

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would be prudent to include many of these alternatives in a new proposing release. We would welcome the airing of views and exchange of ideas that re-proposal would enable, believing that re-proposal is essential to serving the best interests of the director nomination process and all participants in it.

We are unanimous in the view that the agency will be acting precipitously as to a matter of profound significance to the governance of every publicly traded corporation and to the interests of the shareholder community at large if it proceeds with the Director Nomination rule proposals as currently drafted. There may be better strategies for solving the problems identified by the Commission and a re-proposal is a small price to pay for the assurance that the Commission has carefully considered all available alternatives before adopting a set of rules that will have long-lasting and wide-ranging impact.

Sincerely,

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Appendix A

**Proposed Definition of “Unratified Director”**

**Proposed Rule 3a7-1**

(Without numerical limitations on the number of “unratified directors”)

Unratified Director. The term “unratified director” means any director of a corporation or any person performing similar functions with respect to any organization whether incorporated or unincorporated, where:

- (a) If the director is elected to his or her position as the result of a shareholder election in which more than [50] percent of the votes cast, [as calculated in accordance with section (c) below] are marked to withhold authority for the election of that director, then that person shall, beginning as of [90] calendar days after certification of the results of that election, be designated as an unratified director;
- (b) If a director assumes his or her position as a consequence of a procedure that does not require a shareholder vote then that person shall, for purposes of this Act, not be designated as an unratified director until the date of the next election at which shareholders have an opportunity to withhold votes for the election of any director. If the director stands for election at that next available opportunity then that director’s status as an unratified director shall be determined in accordance with section (a) of this definition. If the director fails to stand for election at that next available opportunity then, as of the date of that election, that person shall be designated as an unratified director;
- (c) [For purposes of section (a) of this definition, all percentages shall be calculated as the number of shares represented by ballots marked to withhold authority for that candidate divided by the total number of shares represented by ballots marked either in favor of election of that director or to withhold authority for election of that director, where broker non-votes are excluded from both the numerator and denominator of the calculation.]
- (d) The Commission may, upon an appropriate showing and in the public interest, provide for an exemption from the operation of Subsections (a) or (b), which exemption may be time limited or subject to other terms and conditions as may be determined by the Commission.

Appendix B

**Proposed Definition of “Unratified Director”  
Proposed Rule 3a7-1**

(With numerical limitations on the number of “unratified directors”)

Unratified Director. The term “unratified director” means any director of a corporation or any person performing similar functions with respect to any organization whether incorporated or unincorporated, where:

- (a) If the director is elected to his or her position as the result of a shareholder election in which more than [50] percent of the votes cast, [as calculated in accordance with section (c) below, and subject to the numerical limitations of section (d) below,] are marked to withhold authority for the election of that director, then that person shall, beginning as of [90] calendar days after certification of the results of that election, be designated as an unratified director;
- (b) If a director assumes his or her position as a consequence of a procedure that does not require a shareholder vote then that person shall, for purposes of this Act, not be designated as an unratified director until the date of the next election at which shareholders have an opportunity to withhold votes for the election of any director. If the director stands for election at that next available opportunity then that director’s status as an unratified director shall be determined in accordance with section (a) of this definition. If the director fails to stand for election at that next available opportunity then, as of the date of that election, that person shall be designated as an unratified director;
- (c) [For purposes of section (a) of this definition, all percentages shall be calculated as the number of shares represented by ballots marked to withhold authority for that candidate divided by the total number of shares represented by ballots marked either in favor of election of that director or to withhold authority for election of that director, where broker non-votes are excluded from both the numerator and denominator of the calculation.]
- (d) [The number of directors who shall be deemed “unratified” pursuant to this definition shall not exceed:

- i. One, where the total number of members of the registrant's board of directors is eight or fewer;
- ii. Two, where the total number of members of the registrant's board of directors is greater than eight and less than 20;
- iii. Three, where the total number of members of the registrant's board of directors is twenty or more;
- iv. If the number of directors who would, pursuant to sections (a) and (b), be deemed "unratified" exceeds these numerical limits then directors shall be deemed "unratified" until the next election at which shareholders can withhold authority for the election of directors in the following sequence: first, directors who assumed their positions without there having been a shareholder vote (in the event that there is more than one such director, the directors shall be deemed unratified in the order of their seniority of board service and in the event that two or more directors have equal seniority all directors of equal seniority shall be treated identically for purposes of this rule, notwithstanding the fact that such treatment could cause the number of unratified directors to exceed the numerical limits of this section); followed by directors who would be deemed unratified pursuant to section (a) of this rule, ranked in descending order of the percentage of votes marked to withhold authority for their election.]

(e) The Commission may, upon an appropriate showing and in the public interest, provide for an exemption from the operation of Subsections (a) or (b), which exemption may be time limited or subject to other terms and conditions as may be determined by the Commission.

## Appendix C

### **Proposed New Disclosure Items on Form 8-K**

Item xxx. If any member of the registrant's board of directors satisfies the definition of "unratified director" pursuant to Rule 3a7-1, then:

(a) within four business days of the certification of the relevant election, the registrant shall identify the unratified director, disclose the date as of which the director first satisfied the definition of "unratified director," and detail the computation required pursuant to Rule 3a7-1(c) supporting that determination;

(b) beginning as of the date on which any member of the registrant's board of directors is deemed to be an unratified director, the registrant shall disclose within four business days of the relevant meetings described below:

(1) the agenda for all meetings of the registrant's board of directors together with a narrative discussion of all matters addressed at that meeting;

(2) the agenda for all meetings of committees of the registrant's board of which any unratified director is a member, together with a narrative discussion of all matters addressed at that meeting;

(3) the votes cast by each member of the registrant's board of directors as to any item presented to the board for its approval or ratification;

(4) the votes cast by each member of any committee of registrant's board of directors of which any unratified director is a member as to any item presented to the board for its approval or ratification;

(5) for each vote cast by an unratified director, provide a statement personally prepared by the unratified director who cast the vote explaining the considerations that influenced each of that director's votes, the extent to which the unratified director

specifically considered the effect of his or her vote on shareholder value and on the interests of other constituencies who might be affected by the unratified director's vote; the extent to which the unratified director consulted with or sought advice from other persons knowledgeable with regard to the matter voted upon as well as the nature and extent of the advice or information obtained (other than as relates to communications protected by attorney-client privilege); and factors that the unratified director viewed as supporting or opposing each vote cast by that director.

(c) The registrant shall, within four business days of the certification of the relevant election, provide a statement, personally prepared by the unratified director, describing that director's views as to why shareholders withheld votes for that director's election, measures that the director took to communicate with shareholders regarding votes withheld, measures that the director took or considered taking to respond to the director's perceived concerns regarding the reasons supporting shareholder decisions to withhold authority for the director's election, and an explanation of the director's views regarding the credibility of the director's ability to represent shareholder interest notwithstanding the fact that a majority of shareholders have withheld authority for that director's election.

(d) The Commission shall have authority to exempt registrants from compliance with any of the preceding disclosure requirements upon a showing that such disclosures would cause publication of trade secret or other commercially valuable information, or that publication would violate privacy or other provisions of law, or for other good cause.