

**WASHINGTON LEGAL FOUNDATION**  
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May 7, 2004

Mr. Jonathan G. Katz  
Secretary  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549-0609

Re: Proposed Rules Relating to Security Holder Director  
Nominations (File No. S7-19-03)

Dear Mr. Katz:

The Washington Legal Foundation (WLF) hereby submits these comments in response to Exchange Act Release No. 34-48626 and IC-26206 proposing a rule that would require in certain circumstances the inclusion in company proxy materials of shareholder nominees for election as a director of a publicly-held corporation. While the official period to comment on this proposed rule has passed, we understand that the Commission is still considering comments from the public on this proposal.

***Interests of WLF***

WLF is a nonprofit, public interest law and policy center based in Washington, D.C., with supporters nationwide. Since its founding 27 years ago, WLF has advocated free-enterprise principles, responsible government, property rights, a strong national security and defense, and a balanced civil and criminal justice system, all through WLF's Litigation Department, Legal Studies Division, and Civic Communications Program.

Last year, WLF instituted its new INVESTOR PROTECTION PROGRAM. The goals of WLF's INVESTOR Protection Program are comprehensive: to protect the stock markets from manipulation; to protect employees, consumers, pensioners, and investors from stock losses caused by abusive litigation practices;

to encourage congressional and regulatory oversight of the conduct of the plaintiffs' bar with the securities industry; and to restore investor confidence in the financial markets through regulatory and judicial reform measures. In that regard, WLF has pending before the Commission two complaints requesting formal investigations of two class action lawsuits, and the relationship between the plaintiffs' attorneys and certain short-sellers of the stock of the companies that were sued. More information about these complaints and WLF's INVESTOR PROTECTION PROGRAM are available on WLF's website at [www.wlf.org](http://www.wlf.org).

### ***Comments of WLF***

WLF shares the Commission's belief that corporate boards and management must hold themselves to high standards of corporate governance. However, we submit the proposed changes as currently written should not be adopted. First, the proposed rule exceeds the Commission's authority under Section 14 of the Securities Exchange Act of 1934. Secondly, recent revisions to the nominating committee and corporate governance requirements eliminate the need for the proposed rules. In that regard, WLF agrees with comments submitted earlier to the SEC by the Business Roundtable and the Chamber of Commerce of the United States.

#### ***A. Proposed Rules Exceed SEC Authority***

The proposed rules would result in direct regulation of the relationship and balance of power between corporations and their shareholders, exceeding the Commission's authority. These proposed rules would provide certain large shareholders with a new federal substantive right that does not exist under state law. The practical effect of the rules would fundamentally change the director election process, a matter which lies at the heart of corporate governance. The Congressional intent of the proxy rules is to ensure an informed and orderly vote on matters coming before shareholders. The proposed rules would radically alter this purpose by forcing companies to solicit proxies for nominees opposed to the company's own choices.

The Supreme Court has noted that “except where federal law expressly requires...state law will govern the internal affairs of the corporations.” *Sante Fe Industries v. Green*, 430 U.S. 462 (1977). The proposed rules, if implemented, would supplant current state law and impose federal standards many states have not chosen to implement.

Although the proposed rules are limited to states where shareholder nominees are permitted, they still would exceed the Commission’s authority. Even in states where shareholders are allowed to recommend nominees, the proposed rules would expand these rights and create a new right; namely, *requiring* corporations to include the shareholders’ nominee in company proxy statements at the company’s expense. Thus, in the vast majority of states that currently allow shareholders to recommend nominees, the proposed rules would create a new substantive right above and beyond the Commission’s rulemaking power.

***B. The Proposed Rules are Unnecessary***

New standards established by the New York Stock Exchange (NYSE), the NASDAQ Stock Market, and other major stock exchanges require independent directors to have much greater involvement in the director nomination process. In addition, the Sarbanes-Oxley Act of 2002 mandates several additional corporate governance changes that will result in enhancing the accountability, integrity, and transparency of the listed companies. In addition, the Commission has recently adopted rules requiring company proxy statements to include disclosure of the nominating committee process and actions.

WLF submits that taken together, these changes render the proposed rules by the Commission unnecessary. The recent changes made by the exchanges, the Commission and Congress are likely to have a major impact on the director nomination process. These changes were heavily debated and carefully considered, and these reforms should be allowed an opportunity to work before implementing any new rules that would mandate direct shareholder access to the issuer proxy.

The recent changes by the exchanges and the Commission regarding disclosure rules emphasize

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more involvement of independent directors and the transparency of the nominating process. These changes will protect all shareholders, while the proposed rules currently being proposed by the Commission would unduly favor large shareholders, giving them a too large a voice in the nominating process. Company directors have a fiduciary duty to *all* shareholders, and independent directors are in the best position to take advice from all sources – including management, shareholders, and other sources – and make recommendations to the full board regarding which nominees should be included in the proxy.

The proposed rules would give large shareholders an ability to force the company to advance the nomination of these shareholders' nominees. This would be the case even when independent directors have carefully studied the situation and determined that these nominees should not be placed on the proxy ballots. Large shareholders do not owe a fiduciary duty to the corporation, and there is no guarantee that they will act in the best interest of small shareholders or the corporation in this nomination process. Independent directors should be the main source of director nominations, as they will take into account the interests of *all* shareholders, and will act in the best interest of the corporation.

### ***Conclusion***

WLF generally supports the Commission's determined efforts in making corporate governance more transparent. The proposed rules of the Commission, however, exceed the Commission's authority. In addition, the proposed rules are unnecessary at this time, due to the sweeping changes in corporate governance recently instituted within the past year.

Respectfully submitted,

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Chairman and General Counsel

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Paul D. Kamenar  
Senior Executive Counsel