WORLDWIDE PCE

22 December 2003

VIA EMAIL: rule-comments@sec.gov

Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: Request for Comments on Proposed Rule Concerning Security Holder Director Nominations (Release Nos. 34-48626; IC-26206; File No. S7-19-03)

Dear Mr. Katz:

As we parsed through the proposed regulations which are the subject of this comment, we could not help but sense what appeared to be an underlying sense of uncertainty, and perhaps even fear, in their drafting that was not characteristic of other proposed regulations issued by the Commission. Uncharacteristically, advice was requested seeking both alternative suggestions to as well as missing justifications for many of the principal substantive provisions of the proposed regulation. Extensive analysis was focused on justifying how little impact the proposed rule would have on the vast majority of reporting corporations. Private comments to which we were privy from present and former staff of the Commission reflected a deep concern that somehow this rule might cause more problems than it would solve and a nagging, fundamental doubt as to whether it should be issued at all.

We applaud the Commission's efforts both to address longstanding investor concerns as well as its obvious restraint in tinkering with the traditional corporate governance model so that at the very least, as the Hippocratic Oath admonishes, it would "do no harm." Nonetheless, these proposed regulations are unfortunately grounded on faulty premises. It is therefore the purpose of this comment to discuss those fallacious underpinnings of this proposed regulation with the hope that the Commission will delay its implementation until proper methodological analyses may be undertaken.

1. The Fallacy of Circular Reasonsing.

In justifying any proposal, it is a recognized logical fallacy to begin the argument by assuming what ultimately is to be its conclusion. Regrettably, this proposed regulation is subject to that same infirmity.

In the introduction to this proposed regulation, the Commission began by recounting the history of prior action with respect to this subject matter. Prior to this year, all prior Commission action either recommended that no action be taken or recommended that boards increase their disclosure with respect to the director nomination process and with respect to how shareholder input is treated in that process. The new changes set forth in this proposed regulation were taken from and a consequence of, so the introduction says, the conclusions set forth in a July 15, 2003, Staff Report and suggested recommendations of the Division of Corporation Finance on this matter (herein, the "Staff Report"). Therefore, in order to ascertain the justification for these recommendations, one must go back and read the Staff Report.

Regrettably, the Staff Report gives none. As this report states clearly in its own introduction, there has been serious "interest and debate" with respect to increased shareholder participation for about 60 years. However, this report is quite candid in stating in the second paragraph of this introduction that its purpose is to summarize "prior commission action and discuss alternatives for increasing shareholder participation in the proxy process… ." [Emphasis supplied] Putting this summary another way, history is recounted, the various opinions of interested parties are set forth as well as their conclusions. Yet no rationales for such conclusions or for any of the various suggestions are put forth. No discussion is given that serves as a justification for the assumption that increased shareholder participation is warranted. No analysis whatsoever is undertaken as to whether increased shareholder participation itself in the director nomination process would, overall, be more beneficial or harmful to corporations.

It may seem that, in this country in particular, notions of spreading democracy by increasing shareholder input is a premise that need not be analyzed. However if this really is such an obvious notion, then clearly its stature would only be enhanced by subjecting it to a rigorous analysis of reason. Indeed, a failure to do so, it seems to us, would result in a deification of a concept that is of purely human construct and postulation.

Looking at this matter another way, the proposed regulation is an initial precedent that alters in significant fashion the underlying nature and fabric of our corporate governance system. Before doing so, would it

not be appropriate to undertake a methodological analysis of what that system is, where its weaknesses may lie, and what specific problems it is that we are trying to address? It is our view that by doing this first, we would be empowering ourselves to address specific problems with specific solutions, rather than using a blunt instrument which, though politically popular, may have serious deleterious spillover effects on those fundamental operational structures of United States' corporations, which gives them their competitive advantage over the rest of the world. A fanatic has sometimes been described as a person who, having lost sight of his objective, redoubles his efforts. This comment therefore can be seen as a call to the Commission to undertake the currently-missing critical analysis of its objectives, prior to undertaking any action.

This request is in keeping with many other reforms which are commonplace in regulatory actions. For example in environmental matters, prior to undertaking any major construction project, it is required that an Environmental Impact Report be prepared and submitted in detail prior to undertaking any construction. In that report an analysis is undertaken to analyze the benefits of the proposed change, the possible deleterious effects on the existing environment, the way in which mechanisms have been put in place to minimize or eliminate those deleterious effects, and, finally, a balancing of interests in order to ascertain whether or not the change, even in face of such drawbacks is, on balance, a good thing. United States corporations enjoy a preeminent status in the world economy, in large part, we believe, due to the competitive advantage that empowers creative and entrepreneurial executives to act decisively and quickly. Prior, therefore, to changing that existing environment (and with the possibility of attendant collateral damage), a similar thorough study ought to be undertaken.

Look back at the Staff Report again. No such analysis exists. History is recounted, proposals are made, positions are stated, but no analysis is made as to what the problem specifically is, how the alternative "solutions" to this unstated "problem" addresses such problem, or what the possible negative impacts of those "solutions" might be. Thus, one cannot rely on the Staff Report as a logical underpinning for adopting the changes discussed therein.

In closing this section, we wish to point out quite clearly that lack of shareholder access or input is not a <u>problem</u>. Increased shareholder access and input is a <u>solution</u> that may be appropriate to address a specific problem. However, before we prescribed that medicine, is it not incumbent upon us first to determine what the exact disease is and whether this medicine is appropriate for that disease? Those issues will now be discussed in the balance of this comment.

2. The Failure to Establish a Logical Methodology.

The use of methodology to analyze problems and to propose solutions is fundamental to any logical debate. Without such methodology, we have no way of establishing that we have properly defined a problem or chosen the proper solutions, nor do we provide a fair basis by which others looking at the same matter may understand and determine whether our reasoning is sound. Clearly great ideas are arrived at through the process of "thesis, antithesis, synthesis." However absent a methodological basis for the "thesis," the latter two processes cannot take place. With this goal in mind, let us now look at the problem.

A fundamental and essential lesson that is taught to every first year law student is that words must be interpreted purposefully. Unless we understand the purpose for which a word or term is to be used, we cannot determine what rules ought to apply to it. Thus, for example, a certain rule of law, such as statutes of limitation, may be a "substantive issue" or a mere "procedural issue" depending upon whether we are dealing with conflict of law issues between states or whether we are trying to determine what law a Federal court applies when located within a particular state. This principle applies to the present discussion with significant import.

Over the past two years, Congress and the Commission have worked hard to remedy the failures in corporate governance exhibited by the private sector. While the actions taken have been most helpful in addressing some of the problems that were weaknesses in the system, unfortunately there still was no methodological analysis undertaken with respect to the overall problem or how to address it. Thus, while much progress has been made, we now see that this initial lack of an underlying methodology may lead to what we shall shortly establish as actions, such as this proposed regulation, that do not solve any further existing problems, but may materially weaken the strength and competitive advantage enjoyed by United States corporations.

While the methodology and analysis that we have developed and used successfully is too long here to set out at length, we shall state its conclusions, and attach to this comment the Master's Thesis presented by co-author Richard Wise in 2002 while at The Fletcher School of Law and Diplomacy. As set forth in that thesis, the failures of corporate governance relate to a frightening imbalance of power in the corporate governance oversight process. As explicated in further writings published by the undersigned, boards of directors have two functionalities: oversight and operational guidance. The crisis in investor confidence and the debacles evidenced by Enron, WorldCom and too many other corporations, was the

result of breakdowns in and failures of the corporate oversight process. Sarbanes-Oxley and the regulations promulgated thereunder appropriately and forcefully sought to address the failures of the oversight process, albeit incompletely (due to its lack of a methodological approach). However, **there has never been a suggestion, nor is there any evidence, that there has been a failure in the overall functionality of boards' traditional, and primary, role of providing operational guidance.** The proposed regulation effects an important and fundamental change in this second functionality because it is aimed at the board, generally, rather than the oversight functionality, specifically. Thus, one should naturally ask, if the operational guidance functionality is not broken, why are we trying to fix it?

Let us now return, for a moment, to the requirement of looking at words purposefully, as discussed in the beginning of this section. Recognizing that there are two functionalities to boards of directors, is it necessary, or even desirable or appropriate to have the same form of "corporate governance" model for both functionalities? Putting this question another way, must we be limited to imposing one form of corporate governance model for both functionalities or is it better to have differing models depending upon the function that the board is undertaking? While the foregoing question may seem unusual at first blush, it is not when one ventures beyond our shores. German corporations, for example, have long had two boards of directors: one for oversight and one for operational guidance. Directors on one are forbidden by law to be directors of the other. Their functions are different and their procedures are different. Similarly, the form of justice system in the military is different than the justice system for civilians. Thus, to say bluntly that "the law is the law" ignores the flexibility and precision that purposeful definition can afford us, as we have been trying to urge in this section.

In order to keep this comment to a reasonable length, we shall only state the conclusions of our research that the oversight function requires a more democratic, collegial approach based upon principles of respect for and accommodation of the needs and desires of opposing views and perspectives. Operational guidance, on the other hand, requires a more military-like, "command and control" corporate governance system where the preeminent focus is on the team and the ability to act quickly and decisively to address market needs, opportunities and crises. The failure of these proposed regulations to recognize and accommodate the existence of Boards' two functionalities, therefore, results in politicization of the operational function of boards of directors which, as a matter of importance and time commitment, is their primary responsibility. Such politicization of operations would, we feel, drastically hamstring the

competitive advantage and operation superiority that American corporations traditionally have enjoyed, with no benefit to shareholder value.

Putting this another way, by accommodating two functionalities of boards of directors, the traditional American system, when operating properly, effectively empowers CEOs to carry out operational plans as their talents and instincts best dictate (obviously, within the bounds of the law) while disabling them from putting their "thumb on the scale" when the results and effects of those plans are weighed in the marketplace. That is the essence of the crucial difference between operations and oversight.

3. The Failure to Recognize the Real Problem.

So what is the real problem that needs addressing? The problem, as we have stated in the opening part of this comment, is not the lack of meaningful shareholder input. To repeat, that is not a problem but a solution to be implemented to the extent necessary. The real problem is that because of the failure of Sarbanes-Oxley to establish a global and systematic code for good corporate oversight, powerful CEOs and Chairs of corporations may give lip service to compliance with the requirements of the act without adopting the principles that it was hoped it would instill. As an example, on the director front, many corporations still have directors who are "independent" under all the definitions of the Commission and various exchanges but who, in reality, have no independence whatsoever. Further, procedural rules and structuring of committees can be designed still to permit powerful CEOs and Chairs invisibly to effect oversight of the reporting of results through intimidation and stifling of opposing views. Indeed, even an independent thinker like Warren Buffet has commented to Arthur Leavitt that he feels reticent to speak freely on boards where he sits. We recognize that the proposed regulation hopes to break this "good ol' boy" form of corporate governance by allowing dissidents to try to break that entrenched network by designating those whom it hopes would not be so intimated to speak freely. Yet in proposing such a blunt instrument, a frighteningly dangerous precedent is being set that materially and adversely interferes with the operational guidance functionally of boards of directors. A better way, we have suggested, is to strengthen markedly the balance of the power within the oversight functionality of boards of directors so that cronyism is forever abolished from the corporate landscape, while the close, likeminded savvy necessary to provide operational guidance is preserved.

Look at the matter another way. Once the Commission justifies a dissident group as being entitled to have its representative on a board to "represent" (note this political attribute) its views or goals, can one logically

object to the majority or to management acting to further their own underlying interests? And should we do this, do we not abandon directors' objective and fundamental responsibility, as well as their ethical obligation, to act in the best interests of the corporation as a whole so as to enhance shareholder value?

Bear in mind the genesis of the Staff Report. That report was the product of a complaint by a union pension plan because a corporation in which it had invested refused to allow the union to nominate a director who was to be included in the proxy materials. While the commission refused to require the company in question to comply with the union's request, it did ask that Division of Corporation Finance to analyze how such requests could be accommodated in the future. It is common in many European countries to require labor unions, banking institutions, and other stakeholders in a corporate enterprise to be represented on boards of directors, but we cannot believe that Americans by and large would want to require a change to this less efficient and less effective, albeit more "democratic," European model of operational governance. Thus, while we concede that the Commission has endeavored to tailor the proposed regulations to restrain, to the extent possible, any headlong rush in this direction, it is, nonetheless the first step in a progression towards a disastrous goal and, accordingly a precedent which the Commission must not establish.

We recognize that there has been, and continues to be enormous political pressure to adopt the measures that are the subject of the proposed regulations and to respond in a broad punitive fashion towards boards of directors to appease the millions of registered voters who have lost their hard earned savings in the past few years. However, the principal role of the Securities and Exchange Commission is not to change the operational structure of public corporations, but to provide for fair and complete equal access to corporate information and transparency of all procedures and decisions of reporting corporations. Yet as the distinguished trial lawyer Clarence Darrow observed in the early part of the last century, "there may be things more painful than the truth, but I can't think of them."

Yours very truly,

/s/ Richard L. Wise,
General Counsel and
Senior Director

/s/ John J. Whyte,
Managing Director

Attachment-1