Written Testimony for the Record

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Protecting Shareholders and Restoring Public Confidence by Improving Corporate Governance

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Introduction

Business Roundtable www.businessroundtable.org is an association of chief executive officers of leading U.S. companies with more than $5 trillion in annual revenues and nearly 10 million employees. Member companies comprise nearly a third of the total value of the U.S. stock markets and pay nearly half of all corporate income taxes paid to the federal government. Annually, they return $133 billion in dividends to shareholders and the economy. Business Roundtable companies give more than $7 billion a year in combined charitable contributions, representing nearly 60% of total corporate giving. They are technology innovation leaders, with $70 billion in annual research and development spending – more than a third of the total private R&D spending in the United States.

We appreciate the opportunity to participate in this hearing on "Protecting Shareholders and Restoring Public Confidence by Improving Corporate Governance." Business Roundtable has long been at the forefront of efforts to improve corporate governance. We have been issuing "best practices" statements in this area for three decades, including Principles of Corporate Governance (November 2005), The Nominating Process and Corporate Governance Committees: Principles and Commentary (April 2004), Guidelines for Shareholder-Director Communications (May 2005), and Executive Compensation: Principles and Commentary (January 2007) (attached as Exhibits I through IV). More recently, Business Roundtable became a signatory to Long-Term Value Creation: Guiding Principles for Corporations and

Investors, also known as The Aspen Principles, a set of principles drafted in response to concerns about the corrosiveness that short-term pressures exert on companies. The signatories to The Aspen Principles are a group of business organizations, institutional investors and labor unions, including the AFL-CIO, Council of Institutional Investors and TIAA-CREF, who are committed to encouraging and implementing best corporate governance practices and long-term management and value-creation strategies. In addition, Business Roundtable recently published its Principles for Responding to the Financial Markets Crisis (2009) (attached as Exhibit V), and many of our suggestions have been reflected in the Administration's proposal to reform the financial regulatory system.

At the outset, we must respectfully take issue with the premise that corporate governance was a significant cause of the current financial crisis.[1] It likely stemmed from a variety of complex financial factors, including major failures of a regulatory system, over-leveraged financial markets and a real estate bubble.[2] But even experts disagree about the crisis's origins.[3] Notably, with the support of Business Roundtable,

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[1] *See* Lawrence Mitchell, *Protect Industry from Predatory Speculators*, FINANCIAL TIMES, July 8, 2009. Professor Mitchell, a George Washington University law professor, argues that it is "hyperbolic" to suggest that inattentive boards had anything significant to do with the current recession.

[2] *See* Robert G. Wilmers, *Where the Crisis Came From*, THE WASHINGTON POST, July 27, 2009.

[3] Ben S. Bernanke, Four Questions About the Financial Crisis (Apr. 14, 2009), *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20090414a.htm

Congress recently established the Financial Crisis Inquiry Commission to investigate the causes of the crisis.[4]

Because the recently established Financial Crisis Inquiry Commission is just starting its work, any attempt to make policy in response to those purported causes would seem premature. In fact, a legitimate concern is that many of the proposals currently being suggested could even exacerbate factors that may have contributed to the crisis. For example, commentators have asserted that the emphasis of certain institutional investors on short-term gains at the expense of long-term, sustainable growth played a role in the crisis.[5] Some of the current corporate governance proposals, including a universal "say on pay" right and the Securities and Exchange Commission's recent proposal for a mandatory process access regime, may actually exacerbate the emphasis on short-term gains. One large institutional investor, the New Jersey State Investment Council, recently expressed this concern, stating that, "we do not want a regime where the primary effect is to empower corporate raiders with a short-term focus."[6] Thus, we must be cautious that in our zeal to address the financial

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(observing that experts disagree about appropriate weight to give to various explanations for the crisis).

[4] Stephen Labton, *A Panel is Named to Examine Causes of the Economic Crisis*, N.Y. TIMES, July 16, 2009, at B3.

[5] *See* Lawrence Mitchell, *Protect Industry from Predatory Speculators*, FINANCIAL TIMES, July 8, 2009.

[6] Letter from Orin S. Kramer, Chair, New Jersey State Investment Council to Mary Schapiro, Chairman, Securities and Exchange Commission re: comments on File S7-10-09 (July 9, 2009).

crisis, we do not jeopardize companies' ability to create the jobs, products, services and benefits that improve the economic well-being of all Americans.

Moreover, the problems giving rise to the financial crisis occurred at a specific group of companies in the financial services industry. Having the federal government impose a universal one-size-fits-all corporate governance regime on all public companies based on the experience at a small subset of companies could undermine the stability of boards of directors and place corporations under even greater pressure for short-term performance.

We also cannot ignore the sweeping transformation in corporate governance practices in the past six years, many of which have been adopted voluntarily by corporations, sometimes in response to shareholder requests. Similarly, state corporate law has been the bedrock upon which the modern business corporation has been created and it remains the appropriate and most effective source for law as it applies to corporate governance. It has been responsive to developments in corporate governance, most recently to majority voting for directors, proxy access and proxy contest reimbursement. Further, the SEC plays an active role in seeing that shareholders receive the information they need to make informed voting decisions, and, in this regard, recently has issued a number of proposals designed to provide shareholders with additional corporate governance information.

Recent Developments in Corporate Governance

The past few years have seen a sea change in corporate governance through a combination of legislation, rulemaking by the SEC and the securities markets and voluntary action by companies. As long-time advocates for improved corporate governance, Business Roundtable has supported and helped effect many of these changes while simultaneously working to ensure that they provide necessary operational flexibility and avoid unintended negative consequences.

Board Independence

In the past several years, public companies have taken a number of steps to enhance board independence. First, there has been a significant increase in the number of independent directors serving on boards. A 2008 Business Roundtable Survey of member companies (attached as Exhibit VI) indicated that at least 90% of our member companies' boards are at least 80% independent. According to the RiskMetrics Group 2009 Board Practices, average board independence at S&P 1,500 companies increased from 69% in 2003 to 78% in 2008. According to the same study, in 2008, 85% of S&P 1,500 companies, and 91% of S&P 500 companies, had boards that were at least two-thirds independent.

Second, directors increasingly meet in regular "executive sessions" outside the presence of management and 75% of our member companies hold executive sessions at every meeting, compared to 55% in 2003. Moreover, the NYSE listing standards require

a non-management director to preside over these executive sessions and require companies to disclose in their proxy materials how interested parties may communicate directly with the presiding director or the non-management directors as a group.

Third, there has been a steady increase in the number of companies that have appointed a separate chairman of the board. According to the RiskMetrics Group 2009 Board Practices survey, from 2003 to 2008, the number of S&P 1,500 companies with separate chairmen of the board increased from 30% to 46%. Moreover, many companies without an independent chair have appointed a lead or presiding director in order to provide for independent board leadership. A 2007 Business Roundtable survey of member companies indicated that 91% of companies have an independent chairman or an independent lead or presiding director, up from 55% in 2003. According to the 2008 Spencer Stuart Board Index, by mid-2008, 95% of S&P 500 companies had a lead or presiding director, up from 36% in 2003. Lead directors' duties are often similar to those of an independent chairman and include: presiding at all meetings of the board at which the chairman is not present, including executive sessions of the independent directors; serving as liaison between the chairman and independent directors; approving information sent to the board; approving meeting agendas for the board; approving meeting schedules to assure that there is sufficient time for discussion of all agenda items; having authority to call meetings of the independent directors; being available for consultation and direct communication with major shareholders; and serving as interim leadership in the event of an emergency succession situation. Many companies provide information about their board leadership structures in their

corporate governance guidelines, their proxy statements or both, and the SEC recently has proposed to require disclosure about a company's leadership structure and why that structure is appropriate for the company.

Finally, various organizations are focusing on voluntary steps that companies can take to enhance independent board leadership. In the spring of 2009, the National Association of Corporate Directors, with the support of Business Roundtable, issued a set of Key Agreed Principles to Strengthen Corporate Governance for U.S. Publicly Traded Companies. One "key agreed principle" states that boards should have independent leadership, either through an independent chairman or a lead/presiding director, as determined by the independent directors. The principles further recommend that boards evaluate their independent leadership annually. In March 2009, the Chairman's Forum, an organization of non-executive chairmen of U.S. and Canadian public companies, issued a policy briefing calling on companies to appoint an independent chairman upon the succession of any combined chairman/CEO. The policy briefing recognizes, however, that particular circumstances may warrant a different leadership structure and recommends, in these instances, that companies explain to shareholders why combining the positions of chairman and CEO represents a superior approach.

Majority Voting and Annual Elections

Companies also have taken steps to enhance accountability through the adoption of majority voting standards for the election of directors and the

establishment of annual elections for directors. Historically, most U.S. public companies have used a plurality voting standard in director elections. Under plurality voting, the director nominees for available board seats who receive the highest number of "For" votes are elected. In a typical annual election, the number of nominees equals the number of available Board seats, so if at least one share is voted "For" the election or re-election of a nominee, the nominee will gain or retain a seat on the Board. Accordingly, director nominees in uncontested elections are assured election. Under a majority voting regime, a candidate must receive a majority of votes cast in order to retain his or her board seat. Majority voting thus increases shareholder influence and encourages greater board accountability.

In 2004, several labor unions and other shareholder groups began to broadly advocate that companies adopt a majority vote standard in uncontested director elections, in order to demonstrate directors' accountability to shareholders. Companies and shareholders alike recognized the merits of a majority voting standard and this corporate governance enhancement was quickly adopted by many companies. According to our 2008 Survey of Corporate Governance Trends, 75% of our member companies have adopted some form of majority voting for directors. According to the leading study on majority voting, as of October 2008, more than 70% of S&P 500 companies had adopted some form of majority voting, as compared with only 16% in

2006,[7] and mid- and small-cap companies increasingly are adopting majority voting as well.[8]

A growing number of companies have moved to annual director elections too. According to the RiskMetrics Group 2009 Board Practices survey, 64% of S&P 500 companies held annual director elections in 2008 as compared to only 44% in 2004. Likewise, 50% of S&P 1,500 companies held annual director elections in 2008, and the number of S&P 1,500 companies with classified boards had decreased to 50% in 2008 from 61% in 2004. The decrease in the prevalence of classified boards is reflected across mid- and small-cap companies as well.[9] However, as discussed below, there are reasons why some companies believe it is in the best interests of their shareholders to retain their classified boards.

One Size Does Not Fit All

While Business Roundtable consistently has worked towards enhancing corporate governance practices, we strongly believe that with respect to many of these practices a "one size fits all" approach simply will not work. Companies vary

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[7] Melissa Klein Aguilar, *Shareholder Voice Getting Louder, Stronger*, Compliance Week (Oct. 21, 2008) *available at* http://www.complianceweek.com/article/5113/shareholder-voices-getting-louder-stronger (quoting Claudia Allen, author of *Study of Majority Voting in Director Elections*).

[8] *See* Claudia H. Allen, *Study of Majority Voting in Director Elections* (Feb. 5, 2007) *available at* http://www.ngelaw.com/files/upload/majoritystudy111207.pdf.

[9] *See* RiskMetrics Group, Board Practices: The Structure of Boards of Directors at S&P 1,500 Companies (2008).

tremendously in their size, shareholder base, centralization and other factors that can change over time. Attempting to shoehorn all companies, whether it is a Fortune 50 company or a small company with a single significant shareholder, into the same corporate governance regime deprives companies and their shareholders of choices about the practices that will enable them to operate their businesses in a way that most effectively creates the jobs, products, services and benefits that improve the economic well-being of all Americans. In this regard, corporate governance initiatives intended to improve corporate functioning and protect shareholders can actually end up harming companies and the interests of the shareholders they were meant to protect. This realization has been echoed by others including the New Jersey Investment Council, which oversees the New Jersey $63 billion public pension system. The Council recently stated in a letter to SEC Chairman Mary Schapiro that it is "troubled by the proliferation of rigid prescriptive responses… which are costly, time-consuming, unresponsive to the individual fact settings surrounding specific companies and industries, and which may correlate only randomly with the creation of shareholder value."[10]

For instance, despite the increasing trend of annual director elections, some companies have concluded that it is in the best interest of their shareholders to retain a classified board. In this regard, some economic studies have found that a classified board can enhance a board's ability to negotiate the best results for shareholders in a

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[10] Letter from Orin S. Kramer, Chair, New Jersey State Investment Council to Mary Schapiro, Chairman, Securities and Exchange Commission re: comments on File S7-10-09 (July 9, 2009).

potential takeover situation by giving the incumbent directors additional opportunity to evaluate the adequacy and fairness of any takeover proposal, negotiate on behalf of all shareholders and weigh alternative methods of maximizing shareholder value.[11] In addition, classified boards can have other advantages, including greater continuity, institutional memory and stability, thereby permitting directors to take a longer-term view with respect to corporate strategy and shareholder value. Some recent proposed legislation, however, would deprive boards of directors and shareholders of this choice.[12]

Likewise, Business Roundtable believes that it is critical for boards of directors to have independent board leadership, but a single method of providing that leadership is not appropriate for all companies at all times. While some companies have separated the position of chairman of the board and chief executive officer, others have voluntarily established lead independent or presiding directors. This illustrates the need for, and advantages of, an individualized approach and demonstrates that a universally mandated approach is neither necessary nor desirable.[13] It would, in fact, deprive boards of directors, and indeed shareholders, of the flexibility to establish the

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[11] *See, e.g.,* M. Sinan Goktan et al., *Corporate Governance and Takeover Gains* (Working Paper 2008) available at http://www.fma.org/Texas/Papers/corpgov_takeovergains_fma2008.pdf; Lucian A. Bebchuk et al., *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence and Policy*, 54 Stanford L. Rev. 887-951 (2002).

[12] *See* Shareholder Bill of Rights Act of 2009 S. 1074, 111th Cong. § 3 (2009).

[13] *See* Shareholder Bill of Rights Act of 2009 S. 1074, 111th Cong. § 5 (2009) and Shareholder Empowerment Act of 2009 H.R. 2861, 111th Cong. § 2 (2009).

leadership structure that they believe will best equip their companies to govern themselves most effectively for long-term growth and value creation.

State Law is the Bedrock for Effective Corporate Governance

Historically, for more than 200 years, state corporations statutes have been the primary source of corporate law and have enabled thoughtful and effective corporate governance policies and practices to be developed. In large part, this stems from the flexibility and responsiveness of state corporate law in responding to evolving circumstances. In this regard, state corporate law is described as “enabling” because it generally gives corporations flexibility to structure their governance operations in a manner appropriate to the conduct of their business. It also preserves a role for private ordering and shareholder choice by permitting shareholder proposed bylaws to address corporate governance issues.

Where a corporation and its shareholders determine that a particular governance structure—such as a majority voting regime—is appropriate, enabling statutes permit, but do not mandate, its adoption. And when changes in state corporate law are determined to be necessary, such as to facilitate changes to a majority voting standard, states responded by amending their statutes. For example, Delaware amended its corporate law to provide that, if shareholders approve a bylaw amendment providing for a majority vote standard in the election of directors, a company’s board of directors may not amend or repeal the shareholder-approved

bylaw.[14] Other states have also amended their corporations statutes to address majority voting as well, including California, Nevada, North Dakota, Ohio, Utah and others.[15] In addition, the American Bar Association approved amendments to the Model Business Corporation Act, which 30 states have adopted, permitting a company's board or shareholders to adopt majority voting in director elections through bylaw amendments rather than through a more cumbersome process.[16]

Most recently, in April of this year, Delaware amended its corporate law to clarify the ability of companies and their shareholders to adopt proxy access bylaws, as well as bylaws providing for the reimbursement of expenses incurred by a shareholder in connection with the solicitation of proxies for the election of directors.[17] New Section 112 of the Delaware General Corporation Law permits a company to amend its bylaws to provide that shareholders may include in the company's proxy materials shareholder nominees for director positions. The bylaws may condition the obligation to include shareholder nominees on the satisfaction of eligibility requirements and/or compliance with procedures set forth in the bylaws. New Section 113 permits shareholders to adopt bylaws that require the company to reimburse expenses incurred by a

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[14] Delaware General Corporations Law § 216 (2009).

[15] *See* California Corporations Code § 708.5 (2009); Nevada General Corporation Law § 330 (2009); North Dakota Century Code § 10-35-09 (2009); Ohio General Corporation Law § 1701.55 (2009); and Utah Revised Business Corporation Act § 728 (2009).

[16] MODEL BUSINESS CORPORATION ACT § 10.22 (2006).

[17] Delaware General Corporation Law §§ 112 and 113.

shareholder in connection with the solicitation of proxies for the election of directors. The American Bar Association is considering similar amendments to the Model Business Corporation Act.[18] Like the majority voting enabling legislation described above, these reforms will allow companies and their shareholders to determine whether the costs of proxy access and proxy reimbursement outweigh the benefits for a particular company.

In contrast to the enabling approach of state corporate law, some recently proposed federal legislation in response to the financial crisis, the Shareholder Bill of Rights Act of 2009[19] and the Shareholder Empowerment Act of 2009[20], would mandate specific board structures. Such federal government intrusion into corporate governance matters would be largely unprecedented as the federal government's role in corporate governance traditionally has been limited. The Sarbanes-Oxley Act of 2002 did not change the role of the states as the primary source of corporate law; rather, it was a rare instance of federal action in the area of corporate governance.

Shareholders Have Effective Means of Influencing Corporate Governance

Under the existing corporate governance framework, shareholders have the ability to make their views known to the companies in which they invest through a variety of methods. First, many companies provide means for shareholders to

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[18] *See* Press Release, American Bar Association Section of Business Law, "Corporate Laws Committee to Address Current Corporate Governance Issues" (Apr. 29, 2009).

[19] *See* Shareholder Bill of Rights Act of 2009 S. 1074, 111th Cong. § 5 (2009).

[20] *See* Shareholder Empowerment Act of 2009 H.R. 2861, 111th Cong. § 2 (2009).

communicate with the board about various matters, including recommendations for director candidates and the director election process in general. In this regard, in 2003 the SEC adopted rules requiring enhanced disclosure about companies' procedures for shareholder communication with the board and for shareholders' recommendations of director candidates.[21] In addition, companies listed on the New York Stock Exchange must have publicized mechanisms for interested parties, including shareholders, to make their concerns known to the company's non-management directors.[22] The SEC's 2008 rules regarding electronic shareholder forums also provided additional mechanisms for communications between the board and shareholders.[23] According to a 2008 survey, board members or members of management of nearly 45% of surveyed S&P 500 companies reached out to shareholders proactively.[24]

Second, shareholders can submit proposals to be included in company proxy materials. These proposals have been an avenue for shareholders to express their views with respect to various corporate governance matters. For example, the CEO of Bank of

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[21] Disclosure Regarding Nominating Committee Functions and Communications Between Security Holders and Boards of Directors, Release No. 33-8340, 68 Fed. Reg. 69,204 (Dec. 11, 2003).

[22] NYSE Listed Company Manual § 303A.03.

[23] Electronic Shareholder Forums, Release No. 34-57172, 73 Fed. Reg. 4450 (Jan. 25, 2008). *See also* Jaclyn Jaeger, *The Rise of Online Shareholder Activism*, COMPLIANCE WEEK (Mar. 11, 2008), *available at* http://www.complianceweek.com/article/4007/the-rise-of-online-shareholder-activism (providing examples of successful online shareholder activism).

[24] Spencer Stuart Board Index at 28 (2008), *available at* http://content.spencerstuart.com/sswebsite/pdf/lib/SSBI-2006.pdf.

America stepped down as chairman of the board this year after a majority of shareholders approved a binding bylaw amendment requiring an independent chair for the company's board.[25] In addition, precatory shareholder proposals can engender dialogue between companies and shareholder proponents about corporate governance issues.[26] In this regard, an advisory vote on compensation has been implemented at several companies that received shareholder proposals on this topic.[27] Moreover, as advocates of such votes have suggested that it is a way to enhance communication between shareholders and their companies about executive compensation, many companies have responded by employing other methods to accomplish this goal. These include holding meetings with their large shareholders to discuss governance issues, as well as using surveys, blogs, webcasts and other forms of electronic communication for the same purpose.[28]

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[25] Dan Fitzpatrick and Marshall Eckblad, *Lewis Ousted as BofA Chairman*, WALL ST. J., Apr. 30, 2009, at A1.

[26] Edward Iwata, *Boardrooms Open Up to Investors' Input*, USA TODAY, Sept. 7, 2009, *available at* http://www.usatoday.com/money/companies/management/2007-09-06-shareholders-fight_N.htm.

[27] Thus far, in 2009, shareholders have submitted shareholder proposals to over 100 individual companies requesting an advisory vote on executive compensation. In response to previous years' shareholder proposals, many companies are providing shareholders with such a vote, including Aflac Incorporated, H&R Block, Inc., Jackson Hewitt Tax Service, Inc., Littlefield Corporation, RiskMetrics Group, Inc. and Zale Corporation. At least 25 other companies including Intel Corporation, Motorola, Inc. and Verizon Communications, Inc. have agreed to hold an annual advisory vote voluntarily or in response to their shareholders' concerns.

[28] A 2007 Business Roundtable survey of member companies indicated that in 2007, board members of 28% of companies met with shareholders. Another survey indicates that in 2008, board members or members of management of nearly 45% of

Third, the proliferation of "vote no" campaigns in recent years has provided shareholders with another method of making their views known and effecting change in board composition. In these low-cost, organized campaigns, shareholder activists encourage other shareholders to withhold votes from or vote against certain directors. Although "vote no" campaigns do not have a legally binding effect where the targeted company uses a plurality voting regime in an uncontested election, evidence indicates that such campaigns are nonetheless successful in producing corporate governance reform.[29] For example, following a 2008 "vote no" campaign at Washington Mutual in which several shareholder groups called for shareholders to withhold votes from certain directors, the finance committee chairman stepped down upon receiving 49.9% withheld votes.[30] In addition, a recent study of "vote no" campaigns found that targeted companies experienced improved post-campaign operating performance and increased rates of forced CEO turnover, suggesting that "vote no" campaigns are effective.[31] At companies that have adopted majority voting in director elections, "vote no" campaigns are likely to have an even greater impact.

S&P 500 companies reached out to shareholders proactively. Other companies have established email links on their website for investors to provide feedback to the compensation committee. And in April 2009, Schering-Plough Corp. submitted a survey to its shareholders to obtain their views on a variety of compensation issues.

29 *See* Joseph A. Grundfest, "*Just Vote No": A Minimalist Strategy for Dealing With Barbarians Inside the Gates*, 45 STAN. L. REV. 857 (1993).

30 RiskMetrics Group 2008 Post-Season Report, at 10 (October 2008).

31 Diane Del Guercio, *et al.*, *Do Boards Pay Attention When Institutional Investor Activists "Just Vote No"?*, JOURNAL OF FINANCIAL ECONOMICS, Oct. 2008.

Fourth, the existing framework allows shareholders to make their views known through nominating their own director candidates and engaging in election contests. In fact, they have done so recently at companies including Yahoo! Inc. and Target Corporation. "Short slate" proxy contests in which dissidents seek board representation but not full board control, have been very successful in recent years. According to a recent study conducted by the Investor Responsibility Research Center Institute, during a four-year period, short slate proxy contest dissidents were able to gain representation at approximately 75% of the companies they targeted.[32] Significantly, in the majority of these cases, dissidents found it unnecessary to pursue the contest to a shareholder vote; instead, they gained board seats through settlement agreements with the target companies.[33] Clearly the threat of proxy contests, to say nothing of the contests themselves, is an effective mechanism for shareholder nomination of directors. Moreover, the SEC adopted "e-proxy" rules in 2007 that permit companies and others soliciting proxies from shareholders to deliver proxy materials electronically, which has streamlined the proxy solicitation process and greatly reduced the costs of printing and

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[32] Chris Cernich, *et al*., Investor Responsibility Research Center Institute, Effectiveness of Hybrid Boards, at 4 (May 2009), *available at* http://www.irrcinstitute.org/pdf/IRRC_05_09_EffectiveHybridBoards.pdf.

[33] *Id.* at 4, 13 (noting that 76% of dissidents gaining representation were able to do so through settlement).

mailing proxy materials.[34] All of this has made it easier and less costly for shareholders to nominate directors themselves.

Finally, increasing numbers of companies have been amending their governing documents to allow shareholders to call special meetings of shareholders or, for companies that already allow shareholders to call meetings, to lower the thresholds required to call those meetings. Currently 45% of S&P 500 and 46% of S&P 1,500 companies[35] permit their shareholders to call special meetings, the majority of which require either 25% or a majority of the outstanding shares to call a special meeting. Beginning in 2007, shareholder proponents began submitting a large number of shareholder proposals requesting that 10%-20% of outstanding shares be able to call special meetings. The number of such proposals has increased dramatically since 2007 and these proposals have been receiving high votes.[36]

Clearly, there currently are numerous and potent methods that shareholders can use to see that their voices are heard and their views made known to the companies in which they invest. Accordingly, proposals to increase shareholder rights must be considered in the context of existing shareholder leverage and the manner in which

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[34] Internet Availability of Proxy Materials, Exchange Act Release No. 34-55146, 17 Fed. Reg. 240, 249 and 274 (March 30, 2007).

[35] Data provided by SharkRepellent.net (S&P 500) and RiskMetrics Group, Inc. (S&P 1,500) as of June 2009.

[36] Based on data from RiskMetrics Group, Inc. as of July, in 2009, shareholders have submitted special meeting shareholder proposals to 74 individual companies. The average support for these votes has been 52.3%, and 26 companies have received majority votes in support of the proposal.

shareholders vote their shares. In this regard, the extensive reliance of many institutional investors on the recommendations of the proxy advisory services must be considered. Unfortunately, these services often do not engage in company-by-company analysis when making their recommendations, applying a one-size-fits-all approach to important corporate governance decisions at individual companies.

The SEC Is Addressing Corporate Governance Matters

While, as noted above, state corporate law is central to corporate governance, the SEC plays a role in assuring that shareholders receive the information they need to make informed voting decisions, including about corporate governance matters. In this regard, earlier this month, the SEC proposed several rule changes intended to provide shareholders with additional disclosure concerning individual director experience and qualifications, board leadership structure and oversight of risk management, compensation practices and potential conflicts of interest with compensation consultants and compensation matters.

The proposed amendment relating to individual directors would require companies to provide disclosure about (1) the experience, qualifications, attributes and skills of directors and director nominees that qualify them to serve as a director and as a member of each committee on which they serve, (2) all public company directorships held by directors and director nominees during the past five years, as opposed to just current directorships (as required under the current rules), and (3) the involvement of

directors, director nominees and executive officers in legal proceedings during the prior ten years.

With regard to board leadership, the proposal would require disclosure about a company's board leadership structure and why the structure is appropriate for the company. The proposed disclosure would need to include a discussion of whether the company separates or combines the roles of the chairman and chief executive officer, whether the company has a lead independent director, and the board's role in the company's risk-management process and the effects, if any, that this role has on the company's board leadership structure.

Finally, the proposal relating to compensation consultant disclosures would require enhanced disclosure of potential conflicts of interest involving compensation consultants that provide advice to the board or compensation committee regarding executive or director compensation and also provide other services to the company. Specifically, this disclosure would need to include a discussion of (1) any other services that the compensation consultant or its affiliates provide to the company and the fees paid for such services, (2) the aggregate fees paid for advising on executive and director compensation, (3) whether the consultant was engaged for these other services by or on the recommendation of management, and (4) whether the board or compensation committee approved these other services.

We believe that this disclosure approach to matters relating to board leadership and risk oversight is far superior to the one-size-fits-all approach in proposed legislation

that would mandate the separation of the chairman and CEO position and require all public companies—no matter what size of industry—to establish a risk committee of the board.[37] Companies and their shareholders should have the choice to determine the structures that will best enable them to grow and prosper.

In addition to the corporate governance disclosure enhancements described above, the SEC also approved an amendment to NYSE Rule 452, which will prohibit brokers from voting uninstructed shares in director elections.[38] This rule amendment, which will be effective for annual meetings after January 1, 2010, is likely to have a considerable impact on the director election process, particularly for companies that have adopted a majority voting standard.

Another significant recent SEC action is the proposal to amend the proxy rules to permit shareholders to nominate directors in a company's proxy materials. If adopted, the proposed rules would establish a federal proxy access right and permit proxy access shareholder proposals. The federal process right would permit a shareholder or group of shareholders to nominate one or more directors and have those nominees included in a company's proxy materials contingent on the shareholder or group beneficially

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[37] *See* Shareholder Bill of Rights Act of 2009 S. 1074, 111th Cong. § 5 (2009) and Shareholder Empowerment Act of 2009 H.R. 2861, 111th Cong. § 2 (2009).

[38] Note that this amendment moots part of section 2 of the Shareholder Empowerment Act of 2009. *See* Shareholder Empowerment Act of 2009 H.R. 2861, 111th Cong. § 2 (2009) which would require that a broker not be allowed to vote securities on an uncontested election to the board of directors of an issuer to the extent that the beneficial owner of those securities has not provided specific instructions to the broker.

owning a certain percentage of the company's voting shares (which varies depending on a company's size) for at least one year prior to submitting the nomination. Shareholders meeting the proposal's requirements would be allowed to have their proposed nominees (up to 25% of the board) included in the company's proxy statement, on a first-come first-served basis.

In contrast to our support for the SEC's disclosure proposals, we believe that the proposed federal proxy access right could result in serious, harmful consequences, as well as being beyond the SEC's authority to adopt. First, widespread shareholder access to company proxy materials will promote a short-term focus and encourage the election of "special interest" directors who will disrupt boardroom dynamics and jeopardize long-term shareholder value. Second, the proposed rules will enhance the influence of proxy advisory firms and institutional investors, which may use the rules as leverage for advancing special interest causes and promoting policies to encourage short-term gains in stock price. Third, the increased likelihood of divisive and time-consuming annual election contests could deter qualified directors from serving on corporate boards. Fourth, shareholder-nominated directors could impede a company's ability to satisfy board composition requirements. Finally, serious questions have been raised about the ability of the current proxy voting system to handle the increasing number of proxy contests that would result from the implementation of the proxy access proposal. While the Commission's proposing release touches upon some of these issues, it fails to seriously address them. We currently are preparing a comment letter to the SEC on these proposals which will expand upon our concerns.

Conclusion

Business Roundtable is committed to enhanced corporate governance practices that enable U.S. companies to compete globally, create jobs and generate long-term economic growth. We are concerned, however, that in a rush to respond to the financial crisis, Congress, and the SEC, are considering hastily prepared and universally applicable legislation and regulation that will exacerbate some of the factors that led to the crisis. In particular, an advisory vote on compensation and proxy access could well increase the pressure on short-term performance to the detriment of long-term value creation. The flexible approaches of state corporate law, SEC disclosure and shareholder and company choice that have produced the engine of economic growth that is the American corporation should not be ignored.

Exhibit I

Principles of Corporate Governance (November 2005)

Exhibit II

The Nominating Process and Corporate Governance Committees: Principles and Commentary (April 2004)

Exhibit III

Guidelines for Shareholder-Director Communications (May 2005)

Exhibit IV

Executive Compensation: Principles and Commentary (January 2007)

Exhibit V

Principles for Responding to the Financial Markets Crisis (2009)

Exhibit VI

2008 Business Roundtable survey