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United States Senate

COMMITTEE ON
GOVERNMENTAL AFFAIRS

WASHINGTON, DC 20510–6250

April 23, 2003

The Honorable William H. Donaldson
Chairman
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: **Initiative to Improve Corporate Democracy**

Dear Mr. Chairman:

On April 14, 2003, the Securities and Exchange Commission (SEC) announced that its Division of Corporation Finance is undertaking a wide-ranging review of current proxy rules related to shareholder proposals with the goal of developing, by July 15th, possible reforms to improve corporate democracy. The SEC is to be commended for this initiative to increase shareholders' participation in the companies they own.

Recent failures in corporate governance at major U.S. public companies have contributed to a collapse of investor confidence in U.S. stock markets. Last year, the U.S. Senate Permanent Subcommittee on Investigations, on which I serve, conducted an in-depth inquiry into Enron Corporation and, in particular, the role of the Enron Board of Directors. After documenting multiple instances of failed oversight by the Enron Board, the Subcommittee issued a report in which it concluded the following:

> The Enron Board of Directors failed to safeguard Enron shareholders and contributed to the collapse of the company by allowing Enron to engage in high risk accounting, inappropriate conflict of interest transactions, extensive undisclosed off-the-books activities, and excessive executive compensation. The board witnessed numerous indications of questionable practices by Enron management over several years, but chose to ignore them to the detriment of Enron shareholders, employees and business associates.

Corporate governance failures at other major U.S. companies from Tyco to Sprint to Adelphia have further demoralized investors and raised numerous questions about the quality of board oversight, including why directors fail to stop questionable accounting practices, excessive executive pay, and other corporate abuses at U.S. companies.

Giving shareholders a bigger say in the companies they own, including providing shareholders with a reasonable opportunity to nominate directors, could help revitalize the independence and watchfulness of corporate boards and help restore investor confidence in U.S. corporate governance systems. One key element in this endeavor is to establish circumstances under which shareholders may gain access to corporate proxy statements to nominate a person to serve on the board of directors. Without proxy access, the only way shareholders can nominate a board candidate is through distribution of a separate ballot to shareholders. In most cases, the difficulty and expense of such a distribution effectively deprives shareholders of a voice in the nomination process, leaving company management in effective control of director nominations.

Shareholders have long pressed for a greater role in nominating directors, reasoning that a director nominated by investors would analyze issues with investor concerns in mind, would represent those concerns in boardroom discussions, and would help remind other board members that their paramount duty is to company shareholders, not management. Over ten years ago, in 1991, I introduced legislation, S. 1198, to allow shareholders with a substantial stake in a company to nominate individuals to serve on the company's board of directors. In 2002, I included an updated version of that provision in S. 2460, a corporate reform bill I introduced called the Shareholder Bill of Rights Act. Section 5(a) of that bill sought to prohibit the SEC from barring inclusion in a company proxy statement shareholder proposals which sought either to nominate a person to serve as a corporate director or to remove a sitting director. To ensure this authority was used reasonably, the provision was limited to shareholder proposals that were permitted under state law and sponsored by shareholders with not less than $1 million or 3 percent of the company's outstanding securities. Major investor groups such as the Council for Institutional Investors have endorsed similar reforms to improve the nominating process. The SEC's initiative would benefit from taking an in-depth look at these reforms to strengthen corporate democracy.

A second issue the SEC should consider as part of its initiative is strengthening the role accorded shareholder proposals to rein in excessive executive compensation. The report issued by the Permanent Subcommittee on Investigations on the Enron Board of Directors identified numerous failures by the Enron Board to exercise reasonable oversight in this area:

> The Enron Board, through its Compensation Committee, was not only informed of the company's lavish executive compensation plans, it apparently approved them with little debate or restraint. ... The evidence suggests that keeping up with competitor pay, rather than overseeing existing compensation plans, was the central objective of the Enron Compensation Committee. ... Board members indicated that they had been unaware that the company had paid out almost $750 million in cash bonuses for a year [2000] in which the company's entire net income was $975 million. Apparently, no one on the Compensation Committee had ever added up the numbers.

> The Compensation Committee appeared to have ... deferr[ed] to the compensation plans suggested by management and the company's compensation consultants.

Excessive executive pay at dozens of other major U.S. companies, including American Airlines, Healthsouth, and Oracle, shows Enron's Board is not alone in its oversight failures. Shareholders have for years been protesting inappropriate executive compensation at some of the companies they own, with limited effect on the excessive bonuses, equity awards, severance pay, and retirement benefits that have too often been lavished on CEOs and other senior officers. The SEC should consider ways of strengthening the role of shareholders in constraining excessive executive compensation, including through such means as better proxy disclosures (especially of retirement benefits), shareholder approval requirements of arrangements involving substantial company funds, possible use of binding shareholder proposals to establish compensation limits or guidelines, and, as the New York Stock Exchange has proposed in the area of equity compensation plans, restrictions on certain proxy votes by brokers absent specific shareholder instructions.

The SEC has indicated its willingness to examine proxy rules not only for shareholder proposals affecting the nomination and election process for corporate boards, but also a broader spectrum of topics of concern to U.S. shareholders. This sensitivity to investor concerns not only sends a much needed signal to the investment community, but also opens a new door to revitalizing corporate governance in the United States.

Thank you for this opportunity to offer comments on the SEC's new initiative to strengthen corporate democracy.

Sincerely,

Carl Levin

Carl Levin
Ranking Minority Member
Permanent Subcommittee on Investigations

CL:ejb

cc: SEC Commissioner Paul S. Atkins
SEC Commissioner Roel C. Campos
SEC Commissioner Cynthia A. Glassman
SEC Commissioner Harvey J. Goldschmid