**The Securities and Exchange Commission**
**Roundtable Discussion on Proposed Security Holder Nominations Rule**

**Statement of Connecticut State Treasurer, Denise L. Nappier**
**March 10, 2004**

## I. Introduction

On behalf of the Connecticut Retirement Plans and Trust Funds (CRPTF), I welcome this opportunity to discuss our views on the proposed security holder nomination rules.

As State Treasurer, I am the principal fiduciary of the $20 billion CRPTF, and, as you know from our dealings on other matters under your purview, I have a strong commitment to corporate governance -- as evidenced by the 67 shareholder resolutions I have filed since I took office in 1999. While these comments are made as State Treasurer representing our state pension fund, my views also are informed by my positions as an officer of the National Association of State Treasurers, co-chair of that organization's Committee on Corporate Governance and a Board Member of the Connecticut Chapter of the National Association of Corporate Directors.

I commend Chairman Donaldson for his strong leadership on the issue of shareholder access to the proxy and for the Commissioners and staff's commitment and diligent efforts in developing a proposed rule. This effort goes to the heart of the most important and most basic right shareholders have, and for this reason these deliberations are historic.

As you know, the CRPTF filed formal comments on the Securities and Exchange Commission ("Commission") proposal, S7-19-03, to give shareholders access to the corporate proxy to nominate directors. Those comments reflect our general support for the proposed rule, with some important modifications.

Today, I offer additional comments pertaining to the Commission proposal, as a result of further discussions regarding its ramifications and in response to specific questions asked by the Commission of participants in the *SEC Roundtable Discussion* on March 10, 2004. For the record, the Commission has also asked for general views of the consequences of the rule on funds that are not commonly viewed as large institutional investors and whether Exchange Act Schedule 13G would deter investors from nominating directors under the proposed rule.

To provide a fuller context for my remarks, let me repeat several points I made in the comments on the proposed rule, which I filed, with the Commission last December:

"The reason this rule is before the Commission is that the current process for nominating and electing directors has not worked. It has resulted in too many boards dominated by insiders, people with inherent conflicts of interest, friends and relatives of the CEO, directors with lucrative consulting contracts with the company, and interlocking directorships. Also evident is a distressing lack of diversity on many boards. The failures of boards such as Tyco, Enron, Healthsouth, WorldCom and others have cost investors billions of dollars and underscored the need for changes in the make-up of corporate boards.

Access to the company's proxy to nominate directors is not an unwarranted attack on a system that is otherwise working -- it is a necessary reform to a system that has failed too many shareholders and taxpayers too often.

That said, there are many well-governed companies that do not require such initiatives by shareholders. However, investors need better mechanisms to change governance where board members are failing in their duties to shareholders. That is what the adoption of this rule is all about."

My comments on the specifics of the proposal, as requested in the Commission's *Briefing Paper for the Roundtable*, follow:

## II. Response to Question (1): Is it appropriate to include an ownership threshold requirement for submission of an "opt-in" proposal? Is it appropriate to include an ownership threshold requirement to nominate a director under the proposed procedure?

The "opt-in provision" is essentially a shareholder resolution under the current proxy rules with two additional characteristics: (a) it would require 1% of shareholders to file such a resolution and (b) if the resolution receives over 50% of votes cast, it would place additional requirements on the company (as further described in the rule).

Under current proxy rules any shareholder who has continuously held $2,000 of stock in the company for at least one year can file a resolution. I believe that the real threshold for the "opt-in provision" should be the majority vote on the resolution itself and not shareholder ownership. Therefore, the ownership threshold for filing such a resolution should be the same as all other shareholder resolutions.

On the issue of the ownership threshold to nominate a director, in my previous comments I said:

"Although limits on the sheer number of nominees may be justified, I believe the proposed "triggers" are unreasonable -- the number of shares needed to nominate a candidate is too high and the time frame for the process to be used is too long."

The ownership threshold of 5% to nominate a director is clearly too high to make the proposal meaningful for funds of our size. To illustrate this point, the largest public equity holding in the CRPTF's portfolio is Pfizer with 5,289,678 shares accounting for $197,040,505 in market value or roughly .069% of Pfizer. It would take 14 funds with assets comparable to ours (and holding similar amount of Pfizer stock), to reach the 1% threshold, and 72 funds to reach the 5% threshold.

And, it should be noted, the CRPTF is ranked 56th by total assets among all pension funds as reported in *Pensions and Investments* published January 26, 2004, for the 12 month period ended September 30, 2003.

It is my strong view, that the 5% threshold can be significantly reduced without losing the safeguards it is meant to create. In fact, I believe it can be argued that creating a 5% threshold would establish an unreasonable barrier.

The essential result of adoption of this rule would be that shareholder nominees for the board would be included in the company's proxy materials, rather than having to undertake the significant expense of printing and distributing a separate proxy card. This will reduce shareholders' costs of running a candidate for nomination to the board by roughly $250,000. However, this is only the first step, and to support the nominee, shareholders would still face the costs of proxy solicitation and related campaign expenses if they plan to run a serious campaign. These very real costs I believe would be an additional safeguard against frivolous candidates.

I therefore feel that the 5% level proposed could and should be reduced to 1%.

## III. Question (2): Would the requirements to use Exchange Securities Act Schedule 13 G preclude investors from participating in the nomination of a director or directors under the proposed rule?

The issue with Schedule 13 G is disclosure. I favor disclosure. However, some SEC forms and requirements may be intimidating for small shareholders. The Commission should consider whether disclosure appropriate to this rule could be made easier, particularly for smaller shareholders who do not have teams of lawyers to interpret and fill out these forms.

## IV. Question (3): Will individual investors be able to aggregate effectively their securities in order to meet the more than 1% threshold to submit a triggering security holder proposal? Will individual investors be able to aggregate effectively their securities in order to meet the more than 5% threshold to nominate a director or directors under the procedure? If not, in what respects should this issue be addressed?

The comments below build on the discussion in response to the second part of question (1) above.

On the issue of whether investors can effectively aggregate their securities to reach the 1% and 5% levels, the answer is that larger funds will clearly have an advantage, and funds of the size of the CRPTF will need to work together with these larger funds in order to effectively use this proposed rule. We work together with many institutional investors with portfolios of many sizes. Given the thresholds proposed, it is clear that in almost every case some of these larger funds would need to be part of any group of investors who are looking to aggregate their securities.

Data submitted to the Commission by three of the largest public pension funds in the U.S. – CALPERS, CALSTRS and the NYSCR show that as of September 2003, combined assets of those pension funds hold over 2% of only one company. Clearly, if these three large pension funds cannot meet a 2% threshold for all but one company, it will be extremely difficult – and I would argue too difficult -- to reach a 5% threshold at all.

I understand the Commission's desire to institute certain safeguards – in the form of thresholds -- for shareholders to initiate and proceed along a process that could culminate with a director candidate being included on the company's proxy. However, I do have some concerns about the thresholds recommended at various stages along the way in the Commission proposal, and I would therefore urge a number of important modifications.

First, let me deal with the initial points of entry to the process. The Commission proposal calls for two possible ways to trigger the process. I believe that a critical revision is in order in one of them, and I would propose adding a third alternative.

- As you know, the first opt-in calls for 1% of shareholders to propose a shareholder resolution that could permit shareholders, at a succeeding annual meeting, to put forward a board candidate. That resolution, if proposed by 1% of the shareholders, must then be approved by a majority of shareholders in order to move to the second phase of this process. I do not disagree that a majority is necessary to approve it, but I believe that the threshold for introducing the shareholder resolution should be no different than for any other shareholder resolution -- any shareholder who has continuously held $2,000 of stock in the company for at least one year. Proceeding with a 1% threshold, in my view, is unnecessarily onerous, especially since this would be only the beginning of a multi-step process.

- In addition to that revised trigger, and the Commission's other proposed trigger of a 35% withhold vote, I would add a third alternative. This alternative could be utilized in cases where either a company fails to implement any majority vote resolution or there is evidence of serious management problems such as criminal indictments or restatement of earnings.

Should any one of these three hurdles be met, shareholders could move forward to the next stage, which would provide access to the proxy voting mechanism. The Commission has recommended that 5% of shareholders must agree on a candidate to proceed. I would urge you to roll that recommended level down to 1%, which I believe is more realistic to meet the Commission's objectives.

There is another, related aspect to the Commission's proposed changes in the nomination process that I would like to comment on. This relates to a new rule that was recently adopted, which I believe is in need of revision. I would urge the Commission to adjust the ownership threshold as it concerns disclosure in the nominating process, recently adopted final rule RIN 3235-AI90. The ownership threshold should be the same as the threshold for nominating directors that I discussed earlier, 1%. The adopted rule requires a company to report to shareholders on the reasons why a candidate recommended by shareholders to a nominating committee was not recommended for election to the board. As you may recall, the initial proposal for this aspect of the nominating process was 3%. The final Commission rule was set at 5%. I would recommend it be rolled back to 1%.

## V. Comments on Commission's Underlying Assumptions that Access should be Event Driven by Bad Company Actors

I urge the Commission to re-think its approach when it comes to the "appropriateness" of shareholder access to the proxy. The current approach assumes (1) there are only a few bad apples in corporate America and company failures in these few instances justifies shareholder access to the proxy, and (2) shareholders can't add value by nominating candidates; they only can have this right as a remedy to a terrible wrong.

The Commission itself has provided evidence that the first assumption is incorrect. A Commission study from 1997 to 2002 of violations of improper financial reporting found that CEOs and Presidents of companies were charged in 111 out of 227 investigations. One article reported on the Commission's findings in an article entitled, "CEOs Lead SEC's Book Cooking Parade."

Many institutional investors do not view the new listing standards and Sarbanes-Oxley as remedies for corporate misdeeds. I would venture to say that the majority of institutional investors view these new rules as a floor and not a ceiling for corporate governance standards and best practices. In contrast to the listing standards and the new accounting law, institutional investors as well as proxy voting services seek a higher standard of independence and accountability by virtue of the stricter definitions of independence contained in proxy voting policies. Shareholders' proxy voting rules also reflect a lower tolerance for conflicts of interests than the federal regulatory bodies, especially in areas related to auditing and the separation of chair and CEO.

Institutional investors have sought governance reforms such as annual election of board members and shareholder votes to approve poison pills. Neither of these reforms is in current listing standards but are among the most powerful policies a company can adopt to boost shareholder value over the long-term. One of the panelists, Lucian Arye Bebchuk, has published research with empirical data that supports the notion that market value of companies that are insulated from director removal reduces corporate value.[1]

Another argument put forth by opponents of reform is that shareholder nominations will be disruptive to board dynamics and cannot add value. This is somewhat puzzling, since it is

[1] "The Case for Shareholder Access to the Ballot" by Lucian Arye Bebchuk, the Harvard John M. Olin Discussion Paper Series, No. 428, published in *The Business Lawyer* 43-66 (2003).

current board dynamics, and a lack of accountability to shareholders, that is precisely the reason shareholders are advocating reform, as a means of increasing shareholder value.

In addition, empirical studies also show that increased board independence increases market value of companies. Several studies use board diversity by gender and race as proxies for independence, since virtually all of these individuals are invited to serve on boards as independent members. The capacity to add more value is also documented. A survey by *Catalyst* of women serving on corporate boards found that in 2003, there were 2,140 women in Fortune 500 corporate officer positions but fewer than 50 of the women sat on corporate boards.

## VI. Conclusion

The CRPTF's Proxy Voting Guidelines state that "electing directors is the most important stock ownership right that shareholders can exercise." It is shareholders who elect the directors – and the shareholders to whom the directors are responsible.

When directors are not responsive to shareholders – or when shareholders disapprove of the performance of the board – there must be an effective, accessible mechanism to change the membership of the board. The current mechanism for shareholders is to propose their own slate of directors – using their own proxy card. Realistically, that procedure is a severe barrier to shareholders' ability to nominate directors. On the other hand, an unresponsive board (and management) has unfettered access to the company's proxy and the financial resources of the company to maintain their positions. We need to bring access to the proxy into better balance.

It is my belief that institutional investors would use increased access to the company's proxy prudently and I well understand – and agree with -- the Commission's interest in assuring that such procedures would not be used frivolously. The rule you are considering –with the revisions I have advocated to the limitation you have proposed – is an essential beginning step to provide shareholders with an essential tool to unseat directors who in shareholders' view are not acting in the best interest of shareholders.

I applaud the Commission for undertaking this effort, for encouraging dialogue in the formation of these significant proposals, and would urge you to make a good idea even better by making the improvements I have discussed.

Most importantly, I would urge you to approve and implement a new rule to give shareholders real access to the proxy ballot, and real input into the membership of corporate board of directors. Thank you very much for inviting the Connecticut Retirement Plans and Trust Funds to be a part of this process. Should you require any additional information, we would be pleased to assist in your important work.