NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

MEMORANDUM

TO: Senior Management Group

FROM: Dennis C. Hensley DH

DATE: September 22, 1978

RE: NYSE Comment Letter on Corporate Governance

Attached for your information is a copy of the NYSE comment letter on corporate governance.

* * *

DCH:jw
Attachment

THE New York Stock Exchange

William M. Batten
Chairman and
Chief Executive Officer

Securities and Exchange Commission
500 North Capitol Street, N.W.
Washington, D.C. 20549

September 18, 1978

Attention: Mr. George A. Fitzsimmons
Secretary

Re: Securities Exchange Act Release No. 34-14970
(File No. S7-747)

Members of the Commission:

The New York Stock Exchange is pleased to offer its comments on the proposed changes in the Commission's proxy rules described in Release No. 34-14970 (the "Release") of July 18, 1978.

In reviewing the Release we have approached the proposed changes in the proxy statement and accompanying Commission rules from the standpoint of what increased, meaningful disclosures should and can be made in a practical manner to better inform shareholders.

The New York Stock Exchange has a long record of being in the forefront of encouraging and supporting the disclosure of meaningful and useful information to investors and others. We are pleased to be able to support the Commission in its desire to provide meaningful disclosure to shareholders through proxy statements and related filings. However, in reviewing the proposed changes, we have kept in mind those instances where less is indeed more.

The overall topic addressed in the Commission's proposals -- corporate accountability -- is one which is receiving a great deal of attention.

Corporate accountability is a very complex issue. Its achievement represents the presence of a combination of many elements and conditions -- tangible and intangible, at both the board and management levels. These elements and conditions range from attitudes to the form and quality of corporate governance in terms of board oversight, composition, structure, operating procedures and corporate policies, and to the competence and independence of the board members. Because of the variety of elements and their interaction, it is virtually impossible to establish quantitative measures to determine the quality of corporate governance. This is further complicated by the diverse nature of corporations themselves, in terms of character and size.

Stockholders and the public have a right to expect a high level of corporate accountability and governance. While stockholders do not manage a corporation, they have the right to know, in general, how it is managed. Therefore, meaningful and practical disclosure of the most critical elements of corporate governance is desirable. The words meaningful and practical are important criteria. More disclosure may include information that is confusing, difficult

to interpret and may add so much to the length of proxy statements that shareholders will read less of the material than they do currently. In brief, an attempt for "full disclosure" can, in actual practice, turn out to be "non-disclosure" because there is too much material in complex language for the individual stockholder to read and understand.

The best-managed and best-governed corporations have always stressed the importance of sensitivity to shareholders' needs and rights -- not only at the board level, but throughout the management structure and in all echelons of their organizations. The best-managed and best-governed corporations have always recognized that effective shareholder communications policies must also meet reasonable tests of what is meaningful and practicable. The Exchange believes that proposals to change the existing proxy rules for publicly held corporations must also meet such tests -- and to the extent the present proposals do so, the Exchange supports them.

At the same time we hasten to add that changes in the proxy rules should not be aimed at developing a body of Federal corporate law which is essentially unrelated to the objectives of disclosure or to the mechanics of appropriate accountability; nor should they be aimed at mandating structural changes that are in the province of the

states of incorporation. In addition, changes in the information included in proxy statements should not be made to replace what can better be accomplished through the opportunity for public dialogue between shareholders and management at annual shareholder meetings.

It is within the context of meaningful and practical disclosure as a desirable objective that the views in this paper are offered.

In preparing these comments, we have not relied solely upon our own perceptions and judgments, but have solicited and obtained comments and recommendations from three Committees to the Board of Directors whose 38 individual members represent an extraordinary wealth of experience and wisdom in the practical, philosophical and legal aspects of corporate management and accountability.

Each of the following detailed Exchange responses to the Commission's specific proposals is preceded by a brief, capsule summary of both the SEC proposal and the Exchange comment.

1. Composition of Board of Directors

Summary of SEC Proposal

Identify nominees and directors as "management," "affiliated non-management" or "independent," as those terms are defined in the proposed SEC item. /Proposed Item 6(a)(6)/

Exchange Comment

Support disclosure of meaningful information about directors to enable shareholders to make judgments. Determination as to "independence" must be made by the board as is provided in the Exchange's Audit Committee policy.

Publicly held corporations should provide their shareholders with all relevant information about their directors and nominees for the board of directors. Disclosure of business associations and principal activities of directors and director-nominees should enable shareholders to make informed judgments of their own about the qualifications and independence of each. Ultimate determinations of the independence of a director on a given issue can best be made by individuals who have this background information.

This approach is an important part of the Exchange's Audit Committee Policy for listed companies which became effective earlier this year, and which the Commission and other reputable and knowledgeable commentators have commended as an innovative and important development in corporate accountability.

The Audit Committee Policy described the composition of a listed company audit committee as "...solely of directors independent of management and free from any relationship that, in the opinion of its Board of Directors, would interfere with the exercise of independent judgment as a committee member..." This policy properly

leaves to the board the task of evaluating the characteristics, qualities and relationships which define the independence of individual directors.

Similarly, "The Corporate Director's Guidebook" prepared by The Committee on Corporate Laws, Section of Corporation, Banking and Business Law of the American Bar Association describes an "unaffiliated non-management director" as someone whose qualifications "must ultimately be based on the judgment of the board..." (page 26)

These approaches recognize the importance of subjective judgments in assessing a director's independence, and the difficulty of determining a person's "independence" by applying a set of prescribed standard guidelines and numerical criteria. The judgment of qualified directors defies characterization or classification in any type of formula or quantitative criteria. Efforts to define by rigid formula such a subjective evaluation as "independence" of judgment and to classify a director on that basis in a public pejorative context could seriously misrepresent a director's or a nominee's qualifications, discourage efforts to retain and recruit the best talent for board membership and render a disservice to the shareholders and the company.

Similarly, it must be assumed that shareholders generally are capable of studying relevant facts and information about a director's associations and principal

activities, and reaching their own conclusions about the person's qualifications and capacity for independence of judgment and under current SEC requirements such relevant facts and information are given in detail to all shareholders. If this assumption of shareholder capacity for consideration of facts given to them is not valid, then one must question the value of disclosure of information to shareholders generally.

2. Disclosure Relating to Committees of the Board

Summary of SEC Proposal

Disclose whether or not the company has a standing audit, nominating and compensation committee of the board of directors. /Proposed Item 6(d)/

Exchange Comment

Support the disclosure of, and director composition of, all standing board committees.

Corporate boards establish committees, as needed, to assist the board in operating efficiently and in the discharge of its responsibilities. Therefore, the board must decide what committees it needs and what each committee should do. The board must have the right to reserve functions to itself and should not be required to delegate important functions to a committee or committees if the board is to be held accountable for its actions.

If the existence, composition and functions of all standing board committees are disclosed, it is unimportant and irrelevant to disclose the non-existence of certain

committees.

A. Committees' Functions

Summary of SEC Proposal

Compare the three committees' functions with "customary functions" described in SEC item, and disclose when they differ. /Proposed Item 6(d)/

Exchange Comment

Support company describing functions of all standing board committees.

Flexibility in the board to establish committees and delegate authority is essential to efficient functioning of a board. Similarly, the board must have the authority to determine the functions of its committees which may -- and do -- vary from company to company. Thus, it is difficult to prescribe "customary functions" for any board committees for a number of reasons. First, there are no established customs with respect to the functions of board committees, even, for example, with respect to audit committees, even though there has been considerable recent discussion and commentary on the activities of audit committees. Second, an attempt to describe customary functions where there is no established custom may perforce create the custom, a situation which is presumably not intended. Third, an attempt to delineate customary functions imposes unnecessary rigidity and inflexibility upon the board in establishing committees and delegating responsibility to committees. Fourth, the

delineation of customary functions, like other criteria, to be applied to all companies -- regardless of size, number of members of the board, issues facing or dealt with by the board -- imposes an unnecessary burden on many companies with little, if any, countervailing benefit to shareholders.

In sum, the decision as to the committees to be established and their functions and composition should be left to the board, but what the board does in that regard should be disclosed to shareholders.

B. Nominating Committee

Summary of SEC Proposal

If company has a nominating committee, disclose whether or not it will consider nominees recommended by shareholders and what procedures are to be followed. /Proposed Item 6(d)/

Exchange Comment

If a nominating committee exists, support disclosure (if it is the fact) that nominating committee will consider shareholder nominations and include procedures for doing so.

Disclosure of an existing practice that the nominating committee will consider shareholder nominations and an explanation of the procedures for doing so are sufficient for informing shareholders. It must not be forgotten that generally shareholder nominations can be entertained from the floor at annual meetings of most, if not all, publicly held companies. To mandate a negative disclosure that the nominating committee will not consider

shareholder nominations may be misleading to shareholders and leave an unreasonably pejorative implication.

Experience with shareholder nominations at many companies indicates that shareholders often nominate themselves and that shareholder nominees normally are not of the caliber that the nominating committee receives from other sources. If the purpose of the Commission's proposal in this area is to stimulate and encourage shareholder nominations -- rather than to disclose the facts as to how such nominations may be made -- a number of difficult problems are created because the Commission would be going beyond the disclosure of information to shareholders.

3. Director Attendance

Summary of SEC Proposal

Disclose the name of any director who has attended fewer than 75% of board and committee meetings since the most recent annual meeting. /Proposed Item 6(e)/

Exchange Comment

Support disclosure of directors' attendance at meetings of the board and its committees on a group reporting basis, e.g., "directors as a group attended X% of board and committee meetings."

Information about directors' overall attendance at board and committee meetings is meaningful information for shareholders. Disclosure that directors, as a group, have attended X% of board and committee meetings since the

last annual meeting would give shareholders a reasonable, practical means of assessing the over-all attention of the board to corporate affairs.

The alternative of disclosing when a particular director may have attended fewer than a fixed percentage of meetings could, in many cases, give shareholders an inaccurate impression of the director's diligence, while ignoring the fact that the director's qualitative contribution to the work of the board is far more important than the specific number or percentage of meetings attended.

While attendance is important, it should not be overemphasized, as it is but one measure of overall performance of directors. A director's attendance record is at best only one of a complex of factors relevant to a director's contribution to the company's and shareholders' best interests. Disclosure of the attendance records of individual directors may imply that a good or excellent attendance record denotes superior performance. The quality of the contribution made by individual directors, a factor that is impossible to quantify, is a determination that must of necessity be made by the board and reflected in the renomination and reelection of directors, as their terms expire.

4. Resignation of Directors

Summary of SEC Proposal

If a director resigns or declines to stand for reelection due to a disagreement relating to the company's operations, policies and practices, the company must disclose, with explanation, on 8-K and in the next proxy statement. Director to have opportunity to corroborate or disagree in a letter exhibit to 8-K. /Proposed Item 5 of Form 8-K, Item 6(f) of Schedule 14A/

Exchange Comment

Support company making available to shareholder statements made by a resigning director where the resigning director so requests. Attempts to require disclosure of reasons for director resignations and declinations to stand for reelection because of disputes are not practical.

Disclosure of a director's resignation or decision not to stand for reelection should be made when the director so requests. Thus, the director will have the opportunity to inform the shareholders of the reasons for his decision in a practical manner.

On the other hand, an attempt to compel disclosure where the director involved prefers or decides not to do so, would be counterproductive, as the reasons behind the director decision may be obscured by assigning a factual, but incomplet reason for the decision. In those instances where a director has a critical opinion of management, other directors or company policies, it is reasonable to assume that he or she will effectively express those views through the public press and will not need nor use the proxy statement or

8-K as the vehicles for telling the other side of the story. A practical middle ground would be for the company to inform shareholders when the director so requests.

5. Shareholder-Proponent Advance Consideration of Management Statement

Summary of SEC Proposal

Company to forward to shareholder-proponent, not later than 10 business days before preliminary proxy materials are filed with the SEC, copy of any management statement opposing the shareholder's proposal. /Proposed Rule 14a-8(e)/

Exchange Comment

Requirement that shareholder-proponent receive an early copy of management's statement opposing a proposal may lead to delay in SEC clearance of proxy statement and unnecessary SEC involvement in issues under dispute.

The present proxy rules provide strong disincentives for management to countenance omissions or misstatements of fact. Shareholder-proponents can seek redress from the Commission under its existing authority, and they can ask the courts to enjoin the use of proxies if omissions or misstatements are involved. Corporations are well aware of this and they recognize the necessity of accuracy in statements responding to shareholder proposals.

We agree with the Commission's observations that it should not be the purpose of advance review to provide a furth forum for debate on an issue that is the subject of a share-

holder proposal. However, since the majority of such proposals involve matters on which shareholder views are often highly subjective, the Commission and its staff could be drawn into the dispute, thus placing the Commission and staff in a difficult, if not impossible, situation. The net effect could be to delay the clearance of proxy statements and to place the Commission in the role of arbiter of shareholder-issuer disputes. In addition, the pre-filing requirement may add measurably to the expense of the preparation of proxy statements on matters not generally of interest to the vast majority of shareholders or of economic interest to the company or its shareholders.

6. Institutional Voting and Voting by Record Holders

Summary of SEC Proposal

Specified parent companies of institutional investors and broker-dealers, investment advisers and investment companies to disclose in annual reports their policies and procedures on the voting of shares held by them or their subsidiaries including whether and how beneficial owners are consulted on voting shares, and procedures for considering -- and voting record for -- contested matters. /Proposed Rule 14a-3(b)(11)/

Exchange Comment

Broker-dealers who are NYSE member firms should be exem because NYSE proxy rules specify procedures in voting shares held for others. The Commission's proposal raise serious questions as to whether it meets the criteria which should be applied: Should increased, meaningful disclosure be made to better inform shareholders?

The Exchange has had rules for many years which prescribe the procedures to be followed by broker-dealer member firms in voting shares held in "street name." For

example, Exchange Rules 450-453 prohibit a member from exercising discretion in voting street name securities unless the member has solicited instructions from the beneficial owner and the latter has failed to provide them. Moreover, members may not exercise discretion at all in proxy contests or any other matter that would materially affect the rights of shareholders or the value of their holdings. In such instances, voting instructions must be received from the beneficial owner or the shares cannot be voted.

Accordingly, Exchange members should be exempt from the proposed rule should it be adopted, since the alternative would be, for all practical purposes, a requirement for them to restate the Exchange rules in their proxy statements.

The major impact of this proposal would fall on those institutional investors subject to the jurisdiction of the Commission, that is: investment companies, parent holding companies of banks, broker-dealers, investment advisers, and certain insurance companies. Thus, some, but not all institutional investors will be subject to the requirements of the Commission's proposed rule. A second related, and more important question, is to whom is the disclosure of the information directed: the shareholder, the holder of the beneficial interest, or a person or persons who are neither?

Third, the rule, as the Commission recognizes,

might impose "... additional costs or recordkeeping burdens on affected institutions." (Release page 39)

Thus, the Commission proposal raises serious questions as to whether it meets the criteria which should be applied: Should increased, meaningful disclosure be made to better inform shareholders? We expect that other commentators more directly affected by the Commission's proposals and thus better informed concerning their value and practicability will be commenting on these and other aspects of the proposal.

7. Settlement of Election Contests

Summary of SEC Proposal

Disclose terms of any settlement of election contests between the company and any other participant in proxy contest, including cost of settlement to the company. /Proposed Item 3(b)(5) of Schedule 14A, Item 7(d) of Form 10-Q/

Exchange Comment

Disclosure of terms of settlements is unnecessary in light of the small number of such settlements and because timely disclosure would be difficult to accomplish.

The Commission's annual reports for the five-year period 1972-1976 show that, out of a potential 33,000 proxy contest situations (assuming one for each of 6,700 publicly held companies in each of the five years), only 83 election contests occurred, and only 18 resulted in settlements over that five year period.

In addition, if there were a controversy surrounding

the settlement, it would undoubtedly have been reported on a more timely basis in the public press and would be of little, if any, interest to shareholders receiving the next proxy statement, probably some months after the settlement. Disclosure on a more timely basis, such as by way of a press release, as is provided in the Exchange's company manual procedures, is a more practical approach but one which may be unrealistic for the Commission to require.

* * * *

In conclusion, as our comments indicate, there are a number of important areas where increased, meaningful disclosures should and can be made in a practical manner to better inform shareholders.

Finally, we appreciate the opportunity to comment on these proposals and look forward to a favorable Commission response to the suggestions offered.

Very truly yours,

W. M. Batten