THE WALL STREET JOURNAL.

*Saturday/Sunday, January 20 - 21, 2007*

# Market Risk

## Corporations shouldn't be run like Congress.

RULE OF LAW

*By John J. Castellani*

The SEC will soon be deciding an issue that no one owning stock in an American corporation can afford to ignore. That issue—whether to grant shareholders direct access to the ballot for board candidates—could fundamentally transform the way we do business in this country, by changing the way the boards of directors of publicly traded companies are nominated and elected.

Currently, stockholders can offer proxy proposals on a range of issues, with the exception of elections of directors. The SEC has consistently upheld this exception, despite the efforts of shareholder activists and labor unions to change it. Nevertheless, in response to a lawsuit brought by the public employee union AFSCME against the insurance company AIG, the Second U.S. Circuit Court of Appeals has asked the SEC to clarify this exception.

Proponents claim that proxy access is an important step toward "shareholder democracy." This argument displays a fundamental misunderstanding—corporations were never intended to be democracies, and their decision-making process was not established to be run like a New England town meeting, where citizens gather to decide a wide range of local issues. While the stockholders own a corporation, they do not run it, and unlike management, they are not liable if something goes wrong. This basic structure has benefited American companies and shareholders, and kept our capital markets viable for generations.

Direct proxy access to director elections would turn corporate boardrooms into battlegrounds for every political issue and agenda other than the long-term growth of the companies. Giving activists direct access to company proxy materials to nominate directors would turn elections into political contests; and it would lead to the election of "special interest directors" who pander to the narrow interests of the shareholders who nominated them, including so-called "hot money" investors seeking short-term gain instead of the long-term welfare of real investors.

Don't believe it? Just look at the 350 proxy proposals submitted annually to the Business Roundtable's 160 companies alone—on every issue from genetically-engineered food to animal welfare standards—to see what's in store. Blocking inappropriate board candidates representing such interests would be tremendously disruptive, and would require the expenditure of significant shareholder resources. Worse, if the boardroom became a political arena, it would discourage qualified, independent directors from serving. To provide oversight, directors have to be able to focus on long-term goals. They are selected for their unique backgrounds and expertise, and each board member must represent the broad interest of *all* shareholders—not particular factions.

We must also keep in mind that significant reforms already have been implemented over the past few years. Past deficiencies in corporate board selection processes have been corrected in the wake of the Sarbanes-Oxley Act of 2002, which set into motion meaningful changes in corporate governance and securities regulation. A host of new laws, rules and listing standards—and the many corporate governance changes that have voluntarily been adopted by companies—have resulted in more independence and transparency in boardrooms than ever before, eliminating the need for direct access to company proxy statements. Meanwhile, the SEC has taken steps to bring greater transparency to the director nomination process, with a 2003 rule requiring companies to appoint a nominating committee of independent directors and to disclose information about related practices.

These changes have worked. In 2006, among Business Roundtable companies, 97% of nominating committees have established qualifications or criteria for directors—a 10% increase over the previous year—and 93% of nominating committees consider shareholder recommendations for board nominees.

Many companies have also implemented majority voting for directors, moving from a plurality vote system—in which a "withhold" vote was symbolic—to giving shareholders a true "yes" or "no" vote on candidates. More than 70 Business Roundtable companies have adopted a majority voting standard in director elections; and more than 150 companies now require board members to submit their resignation if more than half the votes cast are "no" or "withhold." This trend will continue, and these standards and policies provide a much greater opportunity for shareholders to have a voice in the director election process.

Today 85% of Business Roundtable company boards consist of at least 80% independent directors. We need only look at the recent high-profile board actions to change company managements for evidence that independent directors wield real power.

We have seen more improvements in corporate governance over the past five years than in the previous 50. The need now is to ensure that boards can attract and retain good directors and managers who are able to take risks, grow revenues and profits, and increase shareholder value. Turning board elections into a Congress-like decision-making body will not do this, but more likely would produce the same gridlock that afflicts Capitol Hill.

When it revisits the "shareholder access" question in the coming weeks, the SEC should reaffirm its rules to keep special interests, politics and divisiveness out of our boardrooms, and to allow corporate directors to continue their focus on what they're truly there to do, create value for all shareholders invested in companies. The stakes are extraordinarily high: the continued health of the greatest wealth-creation engine in the history of the world—the American free market system—and the institution that is its bulwark, the corporation.

*Mr. Castellani is president of the Business Roundtable.*