Procter&Gamble

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Jonathan G. Katz, Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

RE: **Release Nos. 34-48626 and IC-26206**
File No. S7-19-03

Dear Mr. Katz:

This letter is being submitted to the U.S. Securities and Exchange Commission (the "SEC") on behalf of The Procter & Gamble Company ("P&G"). P&G is a one hundred and sixty-six year old company with a long history of strong stock performance. P&G has paid increasing dividends to its shareholders in each of the last forty-eight years, and has been paying dividends without interruption since 1890. In short, P&G has an interest in, and a long and demonstrated history of, operating in the long-term best interests of its shareholders. It is a core strategy.

P&G opposes the SEC's proposed "direct access" director nomination rule. We believe the rule represents an ill-advised re-engineering of U.S. capital markets, which is being undertaken without a legislative mandate and without adequate data. The reasons for our position are set forth in more detail below.

The SEC Lacks Authority to Adopt the Proposed Rule. The SEC's proposal presents itself as a "disclosure" proposal,[1] which is within the SEC's established jurisdiction. However, there is no question that, in fact, the proposed rule is a substantive rule concerning one of the fundamentals of corporate governance--how corporate boards are elected--an area that has historically been left to state regulation.

The Proposed Rule Will Result in "Direct Access" Rights Being Obtained for Most Companies, Not Just Those With Demonstrated Ineffectiveness in the Proxy Process. The proposed rule permits large shareholders (5% holders) to nominate one or more directors using a company's own proxy statement if certain "triggering events" have occurred. The "triggering events" are that: (1) at least one of the company's nominees for the board received

[1] Release Nos. 34-48626; IC-26206 at II.A.1.a. ("[n]othing in the proposed procedure establishes a right of security holders to nominate candidates for election to a company's board of directors; rather, the proposed procedure involves disclosure and other requirements concerning proxy materials . . . .")

"withhold" votes from more than 35% of the votes cast; or (2) that a 1% security holder submits a "direct access" proposal which receives more than 50% of the votes cast.

The SEC asserts that these "triggering events" are designed to ensure that "direct access" rights will only be granted where there is "evidence of ineffectiveness or security holder dissatisfaction with a company's proxy process."[2] This position is unsupported by data and, frankly, strikes us as unrealistic.

Human nature being what it is, institutional investors (which, for companies like P&G, are the entities which are most likely to be able to trigger and take advantage of the "direct access" rule) would have an interest in <u>always</u> having a "direct access" option to preserve their ability to act quickly if they feel it serves their interests. In fact, to the extent these Wall Street investors have fiduciary obligations to their own investors, they may feel they have a duty to ensure they have such an option.

And, as drafted, the proposed rule allows institutional investors to easily ensure they have such an option, because either triggering event is simple enough to engineer. For example, even a company as large as P&G has greater-than-1% shareholders who could place a "direct access" proposal in its proxy. And, since P&G has more than 50% institutional ownership, such a proposal could easily pass, because most institutional shareholders can be expected to have a policy to always support such proposals.

Net, we believe the SEC's stated assumption that "direct access" will only be triggered at problem companies is unsupported by data and is unrealistic. P&G is a data-based company. We believe that, while perfect information is not always available, important decisions should be made based on the best information possible. Clearly, fundamentally changing the way company boards are elected is an important decision. The SEC has not yet gathered sufficient data to make this decision.

The Proposed Rule is Not Just About the Power to Nominate Directors. Providing institutional investors with the power to nominate directors will have unintended side effects. Among other things, we believe that the ability to threaten a contested director election will provide these institutions with leverage that will be used to affect, or at least influence, the strategic decisions made by company management.

Companies generally try to avoid contentious proxy issues. This can be seen today in the frequent negotiations with individual shareholders and small groups who make proxy proposals. It seems logical to assume that there will be even more incentive to negotiate to avoid contested director elections with institutional shareholders.

The SEC may have a philosophical view that giving large shareholders more say in the strategic directions chosen by companies in which they hold stock is a good thing. We would submit, however, that there is no data to support this view.

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[2] *Id.*

First, giving the strategic direction of companies to professional managers is a fundamental tenet of U.S. capital formation. This system of capital formation has made the U.S. one of the premiere drivers of economic growth in history. Moving authority for strategic direction to groups of large shareholders has not been tried in the U.S., and the SEC has not provided data to suggest it will be successful.

Second, as has become apparent in recent years, some institutional investors tend to have a short-term, or at best, medium-term focus. In fact, some segments legitimately thrive on volatility more than steady, long-term growth. Thus, the large, institutional investors who could take advantage of the "direct access" rule can be expected to have very different interests than smaller, long-term shareholders.

Third, large institutional shareholders carry a diversified portfolio of risks. Such investors can be expected to be devoted to the overall performance of their portfolios in the short term, rather than to obtaining "best possible long-term performance" from any individual company. This, of course, diverges from the interests of smaller, long-term holders of a company's stock.

Finally, the investments of large institutional investors tend to be liquid -- i.e., they can and do move in and out of individual stocks with regularity. Thus, such investors have the ability to "abandon" companies they have pushed to make poor strategic choices, which again distinguishes such investors from smaller, long-term shareholders. In fact, several institutional investors we spoke with informally believe this ability to "vote with their feet" is sufficient and didn't believe additional regulation was required.

Not only has the SEC not provided adequate data to establish that giving large shareholders additional power over a company's strategic direction will benefit the company's shareholders as a whole, there are good reasons to believe this will not be the case.

The Proposed Rule Will Preempt More Logical Reforms That Have Not Yet Had a Chance to Demonstrate Their Effectiveness. There has been massive corporate governance reform in recent months. Among the changes are new stock exchange rules that have yet to take effect. One of these rules requires that board nominating committees be comprised solely of independent directors.[3] Another change is the SEC's recent rules regarding disclosure about company boards' nominating process.

The SEC has presented no data to indicate that these reforms will not work to ensure shareholders have an appropriate say in the election of directors.

The Mechanics of the Proposal Itself are Potentially Flawed. There are a number of troubling issues raised by the mechanics of the rule. For example, the rule permits large

[3] Both the New York Stock Exchange, Inc. and The Nasdaq Stock Market, Inc. rules now generally require nominating committees to be comprised solely of independent directors.

shareholders to use their leverage to change a company's strategic direction or to place a director on the company's board, but does nothing to require the shareholder to continue owning shares long enough to "live with" the consequences of its actions.

As another example, although the rule attempts to achieve minimal independence standards for the directors that are nominated through the "direct access" process, it does nothing to ensure such directors will act in the best interests of all shareholders, as opposed to representing specific interests. Representatives of short term shareholders will understandably advance those interests. Labor or environmental representatives will do likewise. The focus and dynamics of boards could be changed quite radically.

As a final example, the rule would require companies, such as P&G, who have stricter standards for director independence and other qualifications than are required by current law or rules to permit the election of directors who violate those higher standards. Given that the entire point of many recent reforms has been to force all companies to upgrade their standards so that directors will be more independent and more engaged, it seems counter-productive to now force companies to abandon those higher standards.

P&G would strongly urge the SEC not to adopt the proposed "direct access" rules at this time.

Very truly yours,

James J. Johnson
for The Procter & Gamble Company