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CATERPILLAR®

James B. Buda
Vice President
General Counsel and Secretary

December 19, 2003

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

Re: File No. S7-19-03

Dear Mr. Katz:

I am writing on behalf of Caterpillar Inc. concerning the Security and Exchange Commission's (Commission) proposed rule entitled *Security Holder Director Nominations* ("Proposed Rule"), and would like to voice Caterpillar's support for the opinions expressed in the comment letter submitted by the Business Roundtable. Caterpillar applauds the Commission and its staff for the thorough and expeditious manner in which it has discharged its responsibilities and would like to thank the Commission for the opportunity to comment on its Proposed Rule.

For more than 75 years, Caterpillar has been building the world's infrastructure, and in partnership with Caterpillar dealers, is driving positive and sustainable change on every continent. A Fortune 100 company, Caterpillar is the world's leading manufacturer of construction and mining equipment, diesel and natural gas engines, and industrial gas turbines. The company is a technology leader in construction, transportation, mining, forestry, energy, logistics, electronics, financing, and electric power generation.

Over the years, Caterpillar has built a solid reputation as a highly ethical company. We recognize and take seriously our role in restoring public confidence in Corporate America, including our responsibility in fostering sound corporate governance. In fact, we supported the enactment of the Sarbanes-Oxley Act of 2002, as well as the newly revised corporate governance listing standards issued by the New York Stock Exchange and NASDAQ Stock Market, Inc. We believe that these initiatives will help promote better corporate governance and more transparent business practices.

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Based on our experience, we believe that the Proposed Rule presents several areas of potential concern that warrant further consideration by the Commission. We also believe that the new Sarbanes-Oxley standards, NYSE and NASDAQ listing standards, and the demands placed on corporations and their boards by the capital markets adequately address the desired governance practices that the Proposed Rule seeks to achieve. Therefore, more time should be given for the significant governance reforms recently enacted by Congress, the Commission, and the NYSE and NASDAQ to become fully operational before the Commission adds another layer of corporate reform that could be more detrimental to corporate governance practices than beneficial.

While we commend the Commission for its tireless work in restoring investor confidence in our securities markets, we are concerned that the Proposed Rule will in effect diminish, rather than enhance, overall board effectiveness. Under state law, a board of directors is charged with a fiduciary duty to do what is in the best interest of the company and its shareholders. Because it has a fiduciary duty to the company and its shareholders, an independent nominating committee of the board is best suited to select qualified directors with the unique mixture of skills and experience needed to oversee the company. Shareholders, on the other hand, have no such fiduciary duty to either the company or its other shareholders. Under the Proposed Rule, shareholders would be given an open invitation to nominate director candidates that meet their own self-interests and undercut director accountability for fiduciary duties owed to the company and its collective shareholders.

Moreover, in nominating a candidate to the board, a nominating committee considers several factors aimed at maintaining a skills matrix of directors' talents and board requirements to help identify skill gaps on the board and desirable competencies needed to fill those gaps. In filling those gaps, nominating committees consider director candidates that possess knowledge in core areas such as accounting and finance, technology, management, marketing, international markets, and industry knowledge. If the Proposed Rule is passed, the board's skills gap could be perpetuated by the election of a shareholder nominated director who does not possess the expertise needed to complete the board's skills matrix. Therefore, in light of the new NYSE and NASDAQ listing standards, the privileges granted in the Proposed Rule could lead to board fragmentation and create divisive boards that would have difficulty functioning as a team. Such management by referendum could stifle the innovation that is an essential characteristic of American business.

Another potentially troubling aspect in the Proposed Rule is the opportunity for shareholders to nominate and elect "special interest directors" who serve to further the agendas of the shareholders who nominated them rather than the interests of the company and all of its shareholders. Directors should represent all shareholders and not just those responsible for electing them. As the Commission recently stated in its order approving listing standards for the NYSE and NASDAQ, "[t]he Commission believes that directors that are independent of management are more likely to support the nomination of qualified, independent directors." The Commission also acknowledged that a majority of independent directors "should help to serve shareholders' interests by assuring that key decisions are considered by a board comprised of a majority of individuals without relationships to the issuer that otherwise could impair their judgment." In seeking director independence, the goal should be to secure only those qualified candidates who are independent of the company, its management, <u>and</u> any shareholder, or group thereof, that could bias their abilities to serve companies and all of their shareholders. While the mandate is intended to protect shareholders from lax and unethical behavior on the part of companies and their directors, the Proposed Rule should not avail shareholders of an avenue that could be used to further personal interests and agendas, or worse yet, the possibility of effecting a change of control of the company.

Furthermore, meaningful shareholder participation in director elections is already provided under existing proxy rules. Under current proxy rules, shareholders can propose director candidates for consideration to nominating committees and also undertake their own solicitation of proxies for one or more such candidates. The current proxy rules also ensure that such shareholder solicitations provide investors with the information necessary to vote in an informed manner. While there are expenses in connection with soliciting votes, the shareholders who will benefit from the Proposed Rule (i.e., those with significant stock holdings) are the same shareholders who are best positioned to finance solicitations under the current proxy rules. In light of the Commission's recent rule enactment aimed at enhanced proxy statement disclosures on nominating committee functions and the means by which shareholders can communicate with members of the board, shareholders' abilities to communicate their director nominees to the board in the future will be greatly enhanced. Therefore, requiring a shareholder who nominates a director candidate to file and take responsibility for his or her own proxy solicitation will maintain a level of scrutiny, disclosure, and accountability that an insert in the company's proxy statement will not be able to provide.

Likewise, we believe that the Commission has underestimated the number of election contests that will occur as a result of the Proposed Rule. If current reform initiatives are not given time to take root, we believe that pushing another round of corporate reforms could potentially result in divisive, annually-contested director elections that will cause most companies to significantly expand their corporate resources in order to support board-nominated candidates and contest the election of any shareholder-nominated candidates. One example of such a situation would include nominating and electing a shareholder proposed director that causes a company to violate federal law or fail to comply with Commission, NYSE, or NASDAQ requirements (e.g., a shareholder nominated and elected director who cannot be considered a financial expert, but replaces a director who was a financial expert on the audit committee). In such a case, the company's directors would have a fiduciary duty to engage in an election contest against the shareholder's nominee. A contested election is not an ideal way to select qualified board members and could substantially disrupt corporate affairs, result in significant costs to the company, and deter well-qualified individuals who do not want to routinely stand for election in a contested situation from serving on the board at a time when the pool of candidates is already limited.

Should the Commission decide to proceed with the Proposed Rule, we ask that it consider a few significant modifications that will better accord with the Commission's stated intent of targeting a small number of unresponsive companies. Specifically, if access to company proxy materials is to be required, we suggest that the Commission revise the Proposed Rule so that its application is limited to only those companies that have not granted shareholders adequate access to an effective proxy process. As proposed, shareholder access could be triggered by a few potential events such as a majority-vote on a shareholder proposal to activate shareholder access to the proxy. While fairness dictates that these triggers should only apply to the small number of companies that have failed to respond to shareholder concerns, reality dictates that the Proposed Rule will apply to a much larger percentage of companies without regard to the fact that some of these companies already have sound governance practices in place for allowing their shareholders a voice in director nominations. In light of the realties imbedded in the Proposed Rule, it is likely that many institutional investors and entities will revise their proxy voting guidelines to support shareholder-access proposals, and many shareholders will vote in favor of such proposals at all companies, if for no other reason than to make access available in case a company is not responsive in the future. Such an outcome would unnecessarily burden all companies and not just the small percentage of companies that have been unresponsive to their shareholders' needs.

Furthermore, the third potential trigger discussed in the Proposed Rule would apply anytime a company receives a majority-vote on a proposal submitted by a one-percent shareholder, unless the board implemented the proposal within a specified time period. Adopting such a trigger would be premised on a false assumption that failure to implement a majority-vote shareholder proposal is indicative of an unresponsive or inattentive board. However, a board's failure to implement a majority-vote shareholder proposal often has nothing to do with the effectiveness (or ineffectiveness) of the company's proxy process. Under state law, a company's board has a fiduciary duty to make its own determination as to whether implementation of a shareholder proposal is in the company's best interests; automatic compliance with the results of a shareholder vote – regardless of the level of support – would violate the board's fiduciary obligations. If the third trigger were adopted, directors would feel significant pressure to avoid a contested election scenario by implementing a majority-vote shareholder proposal, regardless of their independent judgment of the company's best interest.

Additionally, the Commission should also reconsider the proposed thresholds for triggering a shareholder nomination as they are too low and present too great a risk that companies will be subject to unwarranted and unjustified attempts to control the nomination process. As proposed, the thresholds contained in the Proposed Rule will likely result in frequently contested elections that are more detrimental to the governance process than beneficial. We ask that the Commission reconsider its proposed thresholds with the goal of raising them to levels that still allow shareholders the ability to utilize the Proposed Rule, but yet limit the Proposed Rule's impact on companies that have been responsive to their shareholders. The Commission's consideration in this regard would better serve the goal of the Proposed Rule because it would assure usage of the rule only in those situations where a company has failed to serve its shareholders and not where a shareholder seeks to preserve its right for future years as discussed above.

For these reasons, and those set forth in the comment letter submitted by the Business Roundtable, we respectfully urge the Commission to reconsider the Proposal. We welcome the opportunity to discuss these issues at your convenience. If you have questions regarding this letter, please contact me at (309) 675-4428.

Sincerely,

James B. Buda

cc: Hon. William H. Donaldson, Chairman, U.S. Securities & Exch Comm
Hon. Paul Atkins, Commissioner
Hon. Roel Campos, Commissioner
Hon. Cynthia A. Glassman, Commissioner
Hon. Harvey Goldschmid, Commissioner
Giovanni P. Prezioso, General Counsel
Alan L. Beller, Director, Division of Corporate Finance