808:Shareholder Access to Company Proxy

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Faculty Biographies

Robert B. Lamm

Robert B. Lamm is senior vice president-corporate governance and secretary of Computer Associates International, Inc. (CA) in Islandia, New York. He is responsible for the ongoing development and implementation of CA's corporate governance programs and policies, as well as maintaining the company's relationships with institutional investors and other constituencies on governance-related topics.

Mr. Lamm was previously a shareholder of Gunster, Yoakley & Stewart, P.A., in West Palm Beach, Florida, where he served as chair of the firm's securities and corporate governance practice group. Before joining Gunster, Yoakley, he was senior vice president, general counsel and secretary of Hvde Marine Incorporated, and he previously served as vice president and secretary of W. R. Grace & Co.

Mr. Lamm is an active member of the American Society of Corporate Secretaries and he serves on the society's corporate practices committee and has served on its securities law and finance committees, as a director of the society, and as chair of its 2004 national conference committee. He is a member of the New York State Bar Association, The Florida Bar, the ABA (including its business law section and committees on corporate governance and federal regulation of securities), ACC (including its Corporate and Securities Law Committee), the National Association of Corporate Directors, the Business Roundtable Corporate Governance Coordinating Committee, the ADP steering committee, and the International Corporate Governance Network. He has also served on the advisory committee for the Council of Institutional Investors-National Association of Corporate Directors task force on improving director-shareholder communications, and on the council's working group on director and executive pay issues. Mr. Lamm is a frequent speaker on securities law, corporate governance, and related topics and a contributor to a wide variety of legal and business publications. He currently serves on the board of editors of *The Corporate Counsellor* and the board of advisors for GreatGovernance.com. Mr. Lamm is a director of the Alzheimer's Association Long Island chapter.

Mr. Lamm received a BA from Brandeis University and a JD from the University of Pennsylvania School of Law.

Bronwen Mantlo

Bronwen Mantlo is an attorney with Eli Lilly and Company in Indianapolis, where she splits her time between support of the manufacturing component and the corporate secretary's group. Her securities-related responsibilities include the company's proxy statement and legal support of Lilly's annual shareholders meeting.

Prior to joining Lilly, Ms. Mantlo worked for NeXstar Pharmaceuticals, now a part of Gilead Sciences. While with NeXstar, she was part of a small in-house group, providing counsel in a number of areas including securities, commercial transactions, IP licensing, and manufacturing.

She periodically volunteers for Legal Aid of Indiana and is a member of the Governance Council for Lilly's multi-drug resistant tuberculosis project.

Ms. Mantlo received a BA from Carleton College and a JD from Rutgers-Newark School of Law.

Tina S. Van Dam

Tina S. Van Dam is corporate secretary of The Dow Chemical Company, located in Midland, Michigan. As an attorney and member of the legal department, she is also senior managing counsel in corporate and securities law.

Ms. Van Dam is a director of the American Society of Corporate Secretaries and member of the executive steering committee and audit committee. She is currently secretary of ACC's Corporate and Securities Law Committee. She also serves on the corporate governance coordinating committee of the Business Roundtable. Professional affiliations include ABA, State Bar of Michigan, Midland County Bar Association, and American Society of Corporate Secretaries. Ms. Van Dam is experienced as a professional writer, legislative aide, and medical development officer. She has extensive volunteer and community experience in the arts, social services, and educational areas.

Ms. Van Dam received her BA, with honors, from Michigan State University. She received her JD, with honors, from the University of Michigan Law School. She also did graduate course work in marketing at the School of Business Administration, Wayne State University.

2004 Association of Corporate Counsel Annual Meeting

Panel #808 – Shareholder Access to Company Proxy
Wednesday, October 27, 2004, 9:00 – 10:30 a.m.

PRESENTATION OUTLINE

I. **The Proposed Rule ***

Brief description of environment leading to proposal.

Summary and analysis of provisions and alternatives that have been proposed:
- Triggering events.
- Qualifications of nominating shareholder(s).
- Independence of nominees.
- Process.
- Duration of trigger.

State law considerations.

II. **Related Regulatory/Governance Context**

Plurality voting.
Broker discretionary voting.
Proxy challenges.
Precatory shareholder proposals.
Current short slate rules.
Nominating committee processes and disclosures.
Evaluation of nominees.
Shareholder communications with directors.
Proxy advisory services.

III. **Practical Considerations in Implementation**

Disclosures of triggering events.
Proxy mechanics, including ADP programming and processes.
Is access a two-way street? (BRT proposal).
Universal ballot – management and dissident nominees on same ballot.
Proxy timetable changes.
Challenge of shareholder nominees.
Proxy solicitations.
Costs of implementation.
Board as collegial body.
Special interest directors.

IV. **Questions and Answers.**

**** Note that subsequent to the submission deadline for conference material, the SEC may issue rule revisions. If that occurs, the panelists will adjust their presentations accordingly.***

U.S. Securities and Exchange Commission

Proposed Rule:
Security Holder Director Nominations

SECURITIES AND EXCHANGE COMMISSION

17 CFR PARTS 240, 249 and 274

[RELEASE NOS. 34-48626; IC-26206; FILE NO. S7-19-03]

RIN 3235-AI93

SECURITY HOLDER DIRECTOR NOMINATIONS

Agency: Securities and Exchange Commission

Action: Proposed rule.

Summary: We are proposing new rules that would, under certain circumstances, require companies to include in their proxy materials security holder nominees for election as director. These proposed rules are intended to improve disclosure to security holders to enhance their ability to participate meaningfully in the proxy process for the nomination and election of directors. The proposed rules would not provide security holders with the right to nominate directors where it is prohibited by state law. Instead, the proposed rules are intended to create a mechanism for nominees of long-term security holders, or groups of long-term security holders, with significant holdings to be included in company proxy materials where there are indications that security holders need such access to further an effective proxy process. This mechanism would apply in those instances where evidence suggests that the company has been unresponsive to security holder concerns as they relate to the proxy process. The proposed rules would enable security holders to engage in limited solicitations to form nominating security holder groups and engage in solicitations in support of their nominees without disseminating a proxy statement. The proposed rules also would establish the filing requirements under the Securities Exchange Act of 1934 for nominating security holders.

Dates: Comments must be received by December 22, 2003.

Addresses: To help us process and review your comments more efficiently, comments should be sent by one method - U.S. mail or electronic mail - only. Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Comments also may be submitted electronically at the following e-mail address: rule-comments@sec.gov. All comment letters should refer to File No. S7-19-03. This number should be included in the subject line if sent via electronic mail. Electronically submitted comment letters will be posted on the Commission's Internet website (http://www.sec.gov). We do not edit personal information, such as names or electronic mail addresses, from electronic submissions. You

should submit only information that you wish to make available publicly.

For Further Information Contact: Lillian C. Brown or Grace K. Lee, Division of Corporation Finance, at (202) 824-5250, or, with regard to investment companies, John M. Faust, Division of Investment Management, at (202) 942-0721, U.S. Securities and Exchange Commission, 450 Fifth Street, NW, Washington DC 20549-0402.

Supplementary Information: We are proposing new Rule 14a-11[1] and amendments to Rules 13a-11,[2] 13d-1,[3] 14a-4,[4] 14a-5,[5] 14a-6,[6] 14a-8,[7] 14a-12,[8] 15d-11[9] and 16a-1,[10] Schedules 13G[11] and 14A,[12] and Forms 8-K,[13] 10-Q,[14] 10-QSB,[15] 10-K[16] and 10-KSB[17] under the Securities Exchange Act of 1934,[18] and Forms N-CSR[19] and N-SAR[20] under the Securities Exchange Act of 1934 and the Investment Company Act of 1940.[21] Although we are not proposing amendment to Schedule 14C[22] under the Exchange Act, the proposed amendments would affect the disclosure provided in Schedule 14C, as Schedule 14C requires disclosure of some items of Schedule 14A.

I. Introduction

A. Review of the Proxy Rules and Regulations Regarding Procedures for the Election of Directors

On April 14, 2003, the Commission directed the Division of Corporation Finance to review the proxy rules and regulations and their interpretations regarding procedures for the nomination and election of corporate directors.[23] On May 1, 2003, the Commission solicited public input with respect to the Division's review.[24] Commenters generally supported the Commission's decision to review the proxy rules and regulations with respect to director nominations and elections. Reflecting concern over corporate scandals and the accountability of corporate directors, many commenters urged the Commission to adopt rules that would provide security holders with greater access to the nomination process and the ability to exercise their rights and responsibilities as owners of their companies.[25] In addition, many of those commenters alleged that the current director nomination procedures afford little meaningful oversight to security holders and expressed a growing frustration at security holders' lack of ability to influence the membership of the boards of directors of the companies in which they invest.[26]

On July 15, 2003, after considering the views expressed by commenters, the Division of Corporation Finance provided to the Commission its report and recommended changes to the proxy rules related to the nomination and election of directors.[27] To best address many of the issues raised by commenters, the Division recommended proposed changes in two areas - disclosure related to nominating committee functions and security holder communications with boards of directors and enhanced security holder access to the proxy process relating to the nomination of directors.[28]

On August 14, 2003, we published for comment proposed rules that would implement the first of the Division's recommendations - new disclosure standards requiring more robust disclosure of the nominating committee processes of public companies, including the consideration of candidates recommended by security holders, as well as more specific disclosure of the processes by which security holders may communicate with the directors of the companies in which they invest.[29]

Today, we are proposing rules that would implement the second of the Division's recommendations. These proposals would create a mechanism for nominees of long-term security holders, or groups of long-term security holders, with significant holdings to be included in company proxy materials where there are indications that the proxy process has been ineffective or that security holders are dissatisfied with that process.

B. Prior Commission Consideration

The Commission first addressed the issue of security holder access to company proxy materials for the nomination of directors as early as 1942, when it requested that the staff review the proxy rules and submit to the Commission recommended changes.[30] The Commission solicited comments on the staff recommendations, including a proposal to revise the proxy rules to provide that "minority stockholders be given an opportunity to use the management's proxy material in support of their own nominees for directorships."[31] According to testimony of Chairman Ganson Purcell before the House Committee on Interstate and Foreign Commerce, the staff had proposed that "stockholders be permitted to use the management's proxy statement to canvass stockholders generally for the election of their own nominees for directorships, as well as for the nominees of the management."[32] Under the proposal, a company would not have been required to include more than twice as many candidates on the proxy as director positions to be filled.[33] The Commission did not adopt the proposal.[34]

In 1977, the Commission again focused on security holder access to company proxy materials regarding the nomination and election of directors during its broad review of security holder communications, security holder participation in the corporate electoral process, and corporate governance generally. In anticipation of public hearings held in September of 1977, the Commission, without formally proposing rule changes, requested comment on a number of issues, including whether "shareholders [should] have access to management's proxy soliciting materials for the purpose of nominating persons of their choice to serve on the board of directors."[35]

After the 1977 hearings, the Commission proposed and adopted amendments to the proxy rules. These amendments did not relate directly to security holder access to company proxy materials regarding the nomination and election of directors. The Commission did adopt a requirement, however, that companies state whether they have a nominating committee and, if so, whether the nominating committee will consider security holder recommendations. Although the Commission stated its intent to address "some of the more complex questions which have been raised in this proceeding relating to corporate governance and the means by which corporations can best account to shareholders and the public" and determine "what further action, if any, is appropriate with respect to shareholder communications and shareholder participation in the corporate electoral process generally,"[36] the Commission did not take further action on security holder access to company proxy materials at that time.[37] According to a 1980 staff report to the Senate, the staff concluded that, due to the emerging concept of nominating committees, the Commission should not propose and adopt a rule regarding the inclusion of security holder nominees in company proxy materials at that time.[38] The staff report recommended, however, that the staff monitor the development of nominating committees and their consideration of security holder recommendations.[39] The staff

report further cautioned that, if an insufficient number of companies adopted nominating committees or the efforts of these committees with regard to security holder nominations proved insufficient, Commission action might be necessary.[40]

In the broad proxy revisions adopted in 1992,[41] the Commission briefly revisited the security holder nominee issue in connection with amendments to the bona fide nominee rule set out in Exchange Act Rule 14a-4, which provides that no person shall be deemed a bona fide nominee "unless he has consented to being named in the proxy statement and to serve if elected."[42] In adopting the Exchange Act Rule 14a-4 amendments, the Commission noted "the difficulty experienced by shareholders in gaining a voice in determining the composition of the board of directors," but stated the following with regard to security holder access to the company's proxy materials:

> Proposals to require the company to include shareholder nominees in the company's proxy statement would represent a substantial change in the Commission's proxy rules. This would essentially mandate a universal ballot including both management nominees and independent candidates for board seats.[43]

Rather than mandating a "universal ballot," the Commission revised the bona fide nominee rule to allow security holders seeking minority board representation to "fill out" a partial or "short" slate with management nominees, thus making it easier for security holders to conduct an election contest in a non-control context. For example, if a security holder wishes to nominate only two candidates to a seven member board, Exchange Act Rule 14a-4(d) permits the security holder to choose five of management's nominees to fill out his or her ballot, provided that the security holder does not name those management nominees on his or her proxy card, but instead names only those management nominees that the security holder is opposing. Although the security holder still must disseminate and file a separate proxy statement and proxy card, he or she can now, in essence, allow security holders to vote for some of management's nominees on the non-management proxy card.

II. Proposed Changes To The Proxy Rules

A. Proposed Security Holder Director Nomination Rule

1. Background

a. Discussion

Section 14(a) of the Exchange Act[44] prohibits any person from soliciting proxies with respect to a Section 12[45]-registered security where that solicitation is in contravention of Commission rules and regulations. Section 14(a) "stemmed from the congressional belief that `fair corporate suffrage is an important right that should attach to every equity security bought on a public exchange.' It was intended to `control the conditions under which proxies may be solicited with a view to preventing the recurrence of abuses which ... [had] frustrated the free exercise of the voting rights of shareholders.'"[46] Section 14(a) authorizes the Commission to prescribe proxy solicitation rules that are "necessary or appropriate in the public interest or for the protection of investors."[47] As described and discussed below, we believe that today's proposals further the goals of Section 14,[48] in that they will help facilitate the full and informed exercise of existing

security holder nomination and voting rights through the proxy process by requiring companies to include disclosure regarding security holder nominees in company proxy materials in specified circumstances.

Based on the comments received in response to our solicitation of public input on the Division's review of the proxy rules relating to the election of directors, it is apparent that many of the issues raised in the Commission's 1977 review of the proxy rules merit reconsideration. In particular, because the disclosure requirements regarding nominating committees that were adopted in 1977 do not appear to have made the operation of those committees sufficiently transparent, we have proposed enhancements to those disclosure requirements. Further, it appears that the presence of nominating committees has not eliminated the concerns among some security holders with regard to the barriers to meaningful participation in the proxy process in connection with the nomination and election of directors.[49] Although we recognize that the self-regulatory organizations have proposed changes to their listing standards concerning nominating committees and related corporate governance issues, these proposed changes do not address the role of security holders in the nomination procedure.

Much of the public input that we have received suggests that including security holder nominees in company proxy materials would be the most direct and effective method of giving security holders a more effective role in the proxy process in connection with the nomination and election of directors.[50] This input also suggests that security holders believe that another result would be to make corporate boards more responsive and accountable to security holders, as well as, in many instances, more diverse.[51] Today, security holders generally are given an opportunity to vote only on those candidates nominated by the company. In addition, many companies use plurality rather than majority voting for board elections, which means that candidates can be elected regardless of whether they receive a majority of the security holder vote.[52] Accordingly, all board nominees generally are elected, regardless of the number of "withhold" votes by security holders. Commenters indicated that many security holders, therefore, view the proxy process as ineffective and the election of directors as a mere formality or "rubber stamp" of the board's choices presented in the company's proxy materials.[53]

Currently, a security holder or group of security holders that is dissatisfied with the leadership of a company generally must undertake a proxy contest, along with its related expenses, to put nominees before the security holders for a vote.[54] A board's nominees, on the other hand, do not bear the cost of their candidacies, which are funded out of corporate assets. While security holders can recommend a candidate to a company's nominating committee, security holder comments suggest that these recommendations rarely are effective and that, in some cases, it may be difficult for security holders to gain access to members of company boards and their committees.[55]

On the other hand, the business community and many of its legal advisors commented that giving security holders access to company proxy materials could turn every election of directors into a contest, which would be costly and disruptive to companies and could discourage some qualified board candidates from agreeing to appear on a company's slate of nominees. Because the composition of the board of directors is fundamental to a company's corporate governance, the current filing and disclosure

requirements applicable to security holders who wish to propose an alternate slate are, in the view of these commenters, more appropriate than including security holder nominees in company proxy materials.[56]

After considering the range of views on this issue, we have determined to propose new rules that would, in certain circumstances, require companies to place security holder nominees for director in company proxy materials.[57] This limited access right, which would not be available where security holders were seeking control of a board of directors or election of a director with a financial relationship to the security holder, would apply only in those instances where criteria suggest that the company has been unresponsive to security holder concerns as they relate to the proxy process. We recognize that there are many concerns regarding the operation of a security holder nomination procedure. Should we adopt such a procedure, it is our intention, therefore, to request the Commission staff to monitor that procedure and provide a report to the Commission within three years regarding the effects of the procedure and recommended improvements or modifications.

The security holder nomination procedure in proposed Exchange Act Rule 14a-11 would require any subject company to include information regarding a security holder's nominee or nominees for election as director in the company's proxy materials when the conditions of the rule are met.[58] Nothing 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 that are conditioned on the existence of such a right under state law and the occurrence of specified events.

In connection with the recent review of the proxy process, commenters discussed both significant benefits of a security holder nomination procedure and significant concerns regarding such a procedure and its potential consequences. The proposal is intended to address this broad range of procedural and substantive issues regarding the operation of the nominating procedure. While we believe that the basic concept behind the proposed procedure is simple, addressing the concerns of commenters results in a somewhat complex proposal. To assist those who wish to comment on the proposal, we have separated our description of the proposal into a number of discrete discussions. Specifically, the discussion of the proposal will address the following:

- To which companies would the proposed rule apply?
- For those companies to which the proposed rule would apply, what events must occur before the company would be required to include a security holder nominee in its proxy materials?
- What notice must a subject company give regarding the occurrence of an event that triggers operation of the proposed rule?
- Once a nomination procedure triggering event occurs at a subject company, which security holders or security holder groups may submit a nominee that the company would be required to include in its proxy materials?
- What are the eligibility requirements for a person whom a security holder or security holder group may nominate?

- What is the maximum number of security holder nominees that the company must include in its proxy materials?
- What notice must the security holder or security holder group provide to the company and file with the Commission?
- What must the company do after it receives such a notice?
- How would the liability provisions of the federal securities laws apply to statements made by the company and the nominating security holder or nominating security holder group?
- How do the other Exchange Act proxy rules apply to solicitations by the nominating security holder or nominating security holder group?
- How would the proposed rule apply to investment companies?

b. General questions

A.1. Should the Commission adopt revisions to the proxy rules to require companies to place security holder nominees in the company's proxy materials? Are the means that currently are available to security holders to address a company's perceived unresponsiveness to security holder concerns adequate?

A.2. What would be the cost to companies if the Commission adopted proxy rules requiring companies to include security holder nominees in company proxy materials?

A.3. What direct or indirect effect would this procedure have on companies' corporate governance policies relating to the election of directors? For example, will companies be more or less likely to adopt cumulative voting policies and/or elect directors annually?

2. To Which Companies Would the Proposed Rule Apply?

a. Security holders must be permitted by state law to nominate a candidate for election as a director

Proposed Exchange Act Rule 14a-11 would apply to all companies that are subject to the Exchange Act proxy rules,[59] including investment companies registered under Section 8 of the Investment Company Act ("funds").[60] However, as proposed, a company would become subject to the security holder nomination procedure in Exchange Act Rule 14a-11 only where the company's security holders have an existing, applicable state law right to nominate a candidate or candidates for election as a director. To eliminate any uncertainties in this regard, the proposed rule would state that the security holder nomination procedure would be available unless applicable state law prohibits the company's security holders from nominating a candidate or candidates for election as a director.[61] If state law permits companies incorporated in that state to prohibit security holder nominations through provisions in companies' articles of incorporation or bylaws, the proposed procedure would not be available to security holders of a company that had included validly such a provision in its governing instruments.

The regulation of proxy solicitations under the Exchange Act co-exists with state corporate law in a number of situations. For example, state corporate law allows shareholders, generally, to raise proposals at the company's

annual meeting of security holders and Exchange Act Rule 14a-8 creates a procedure for inclusion of information regarding those proposals in company proxy materials. Consistent with a basic concept underlying Exchange Act Section 14(a) - that security holders be made aware of significant matters to be decided at security holder meetings - Exchange Act Rule 14a-8 requires companies to include in their proxy materials full disclosure about and the opportunity to vote on those matters, including qualifying security holder proposals, that management knows will be presented at the annual meeting.[62] Exchange Act Rule 14a-8 accomplishes this purpose by creating a procedure that provides an opportunity for a security holder owning a relatively small amount of a company's securities to have his or her proposal placed alongside management's proposals in that company's proxy materials for presentation to a vote at a meeting of security holders.

Exchange Act Rule 14a-8 balances the costs to the company against the benefits to the company and its shareholders by including modest security holder eligibility standards, limitations on the number and types of proposals, and limitations on the number of words that the company is required to include as a discussion of the security holder proposal. Exchange Act Rule 14a-8 addresses its interaction with state corporate law by not requiring companies to include any proposal that would violate state law.[63]

Proposed Exchange Act Rule 14a-11 has a similar underlying purpose as Exchange Act Rule 14a-8 - to the extent management is aware of a security holder's intent to present a nominee for director at the company's annual meeting and state corporate law allows security holders to nominate candidates for election as director at the company's annual meeting of security holders, the proposal would establish a procedure pursuant to which a company would have to provide specified information regarding that nomination in its proxy materials. Similar to Exchange Act Rule 14a-8, proposed Exchange Act Rule 14a-11 addresses its interaction with state corporate law by premising the security holder nomination procedure upon the existence of a state law right of security holders to nominate candidates for election as directors. The proposed rule, like Exchange Act Rule 14a-8, also imposes conditions and limitations on the availability of the procedure in question.

b. Accelerated filers

We are considering as an additional element of the proposed rule, and seek comment on, whether proposed Exchange Act Rule 14a-11 should apply only to those companies that are subject to accelerated deadlines for filing Exchange Act periodic reports,[64] and investment companies registered under Section 8 of the Investment Company Act.[65] Companies that fall within the definition of "accelerated filer" in Exchange Act Rule 12b-2[66] would be subject to the security holder nomination procedure for any fiscal year in which they must file all of their periodic reports on an accelerated basis. Accordingly, the security holder nomination procedure would apply to a company after it first meets the following conditions as of the end of its fiscal year:

- The company's common equity public float was $75 million or more as of the last business day of its most recently completed second fiscal quarter;

- The company has been subject to the reporting requirements of Section 13(a)[67] or 15(d)[68] of the Exchange Act for a period of at least 12

calendar months;

- The company has previously filed at least one annual report pursuant to Section 13(a) or 15(d) of the Exchange Act; and

- The company is not eligible to use Exchange Act Forms 10-QSB and 10-KSB.[69]

We believe that appropriate security holder participation in the nomination process is important for companies of all sizes. Given the new approach that the proposed rules represent, however, we are considering whether, at least as a first step in implementing the proposed rules, companies that are not accelerated filers should be excluded from their operation. Implementing the proposed rules in this fashion would avoid the disproportionate burdens of regulation that the proposed procedure may impose on smaller companies. It also would allow our staff and the markets to gain experience with the proposed rule in an initial stage in which the rule applied only to larger companies, while we would retain the ability to expand the rule's application to all companies after gaining this experience. In addition, the information available to us suggests that interest in the proxy process is, to a significant degree, concentrated within the universe of companies that are accelerated filers. For example, of the 266 companies that submitted letters to the Division of Corporation Finance during the 2002-2003 proxy season regarding their intention to exclude security holder proposals submitted under Exchange Act Rule 14a-8, only 26 had a common equity public float of less than the $75 million threshold as specified in the definition of "accelerated filer."[70] We estimate that approximately 3,159 of the 14,484 companies filing periodic reports under the Exchange Act are "accelerated filers." Therefore, while 78% of reporting companies are not "accelerated filers," less than 10% of the companies involved in the security holder proposal process at the Commission are not "accelerated filers."

c. Questions

B.1. As proposed, the security holder nomination procedure in Exchange Act Rule 14a-11 would apply to all companies subject to the proxy rules. Would this broad application have a disproportionate impact on smaller operating companies? Are there modifications that would accommodate the needs of small entities while accomplishing the goals of the proposal? Would it instead be more appropriate to apply the procedure only to "accelerated filers" and funds? Would it be more appropriate to apply the procedure only to "accelerated filers" and funds as an initial step? If so, are there any special provisions that would be necessary for companies transitioning to "accelerated filer" status with respect to the nomination procedure in proposed Exchange Act Rule 14a-11, such as the timing of nomination procedure triggering events or the proposed disclosure requirements? Would other limitations be more appropriate, such as applying the proposed rules to all companies other than small business issuers or all companies other than those that have been subject to the proxy rules for less than a specified period of time (*e.g.*, 3 years)?

B.2. Should companies be able to take specified steps or actions that would prevent application of the proposed nomination procedure where such procedure would otherwise apply? If so, what such steps or actions would be appropriate? For example, should companies that agree not to exclude any security holder proposal submitted by an eligible security holder pursuant to Exchange Act Rule 14a-8 be exempted from application of the proposed

nomination procedure for a specified period of time? Should a company that implements all security holder proposals that receive passing votes in a given year be exempted? Conversely, should companies subject to Exchange Act Rule 14a-11 be permitted to exclude certain security holder proposals that they would otherwise be required to include? If so, what categories of proposals? For example, should the company be able to exclude proposals that are precatory, proposals that relate to corporate governance matters generally, proposals that relate to the structure or composition of boards of directors, or other proposals?

B.3. Would adoption of this procedure conflict with any state law, federal law, or rule of a national securities exchange or national securities association? To the extent you indicate that the procedure would conflict with any of these provisions, please be specific in your discussion of those provisions that you believe would be violated.

B.4. Is it appropriate to limit the availability of the proposed nomination procedure to those situations where state law permits security holders to nominate candidates for director? Is it appropriate to permit companies to limit the availability of the proposed procedure by limiting the right to nominate directors, when allowed by state law? Will the proposed procedure's reliance on the pre-existence of a state law right, combined with the possibility that companies may limit security holders' rights in this regard, adversely affect the effectiveness of the procedure? Is the proposed procedure's reliance on the pre-existence of a state law right of nomination a proper balance between federal law and state law? Regardless of the existence of a state law right to nominate candidates for director, should companies be subject to the proposed procedure?

B.5. Most companies currently use plurality voting in the election of directors; accordingly, proposed Exchange Act Rule 14a-11 is drafted assuming that in most cases plurality voting would apply to an election of directors in which the inclusion of a security holder nominee resulted in more nominees than available seats on the board of directors. What specific issues would arise in an election where state law or the company's governing instruments provided for other than plurality voting, (*e.g.*, majority voting)? Would these issues need to be addressed in revisions to the proposed rule text? If so, how?

3. What Events Must Occur Before a Company Would Be Required to Include a Security Holder Nominee in Its Proxy Materials?

a. Nomination procedure triggering events

In order to focus the impact of the proposed security holder nomination procedure on those companies where there are criteria showing that the proxy process may be ineffective, the procedure would become operative for a company only after the occurrence of one or both of the nomination procedure triggering events described below. The procedure would then remain operative for any annual meetings or special meetings held during:

- The remainder of the calendar year in which the triggering event occurs;
- The calendar year following the calendar year in which the triggering event occurs; and
- The portion of the second calendar year following the calendar year in

which the triggering event occurs, up to and including the annual meeting (or special meeting in lieu of an annual meeting) held during that calendar year.[71]

As proposed, the following events would trigger the nomination procedure:

- At least one of the company's nominees for the board of directors for whom the company solicited proxies received "withhold" votes[72] from more than 35% of the votes cast at an annual meeting of security holders held after January 1, 2004 at which directors were elected (provided, that this event may not occur in the case of a contested election to which Exchange Act Rule 14a-12(c)[73] applies or an election to which the proposed security holder nomination procedure in Exchange Act Rule 14a-11 applies); or

- A security holder proposal submitted pursuant to Exchange Act Rule 14a-8 providing that the company become subject to the security holder nomination procedure in proposed Exchange Act Rule 14a-11 (a) was submitted for a vote of security holders at an annual meeting of security holders held after January 1, 2004 by a security holder or group of security holders that held more than 1% of the company's securities entitled to vote on the proposal for one year as of the date the proposal was submitted and provided evidence of such holding to the company;[74] and (b) that "direct access" proposal received more than 50% of the votes cast on that proposal at that meeting.[75]

To be a nomination procedure triggering event, a direct access security holder proposal under Exchange Act Rule 14a-8, providing that the company become subject to proposed Exchange Act Rule 14a-11, would therefore have to be submitted by a security holder or group having more than 1% beneficial ownership for one year.[76] Under Exchange Act Rule 14a-8 procedures, such a security holder or group must, in the same manner that it provides evidence of eligibility to use the rule otherwise, provide evidence to the company at the time it submits the proposal that it meets the more than 1% and one year thresholds in order to have the proposal, if adopted, be a nomination procedure triggering event. Under proposed Exchange Act Rule 14a-11, a direct access security holder proposal adopted after January 1, 2004 could be a nomination procedure triggering event. Therefore, security holders and groups should be aware that in order for the adoption of such a proposal to be a nomination procedure triggering event, should we adopt Exchange Act Rule 14a-11 as proposed, those security holders or groups should, using the existing Exchange Act Rule 14a-8 procedures, provide evidence that they satisfy the more than 1% and one-year thresholds when they submit their proposals.

In order to facilitate an informed security holder vote with regard to security holder proposals that could trigger the security holder nomination procedure set out in Exchange Act Rule 14a-11, we have proposed an amendment to Exchange Act Rule 14a-5 that would require the company, where a security holder proposal is submitted by a more than 1% security holder who has held their securities for at least one year, to advise security holders of this fact in the proxy statement relating to the meeting at which the security holder proposal will be presented. We recommend that, pending final action on that proposal, companies make such an identification, both in their interest and in the interest of their security holders. Companies also should consider whether failure to make such an identification has any implications

[77]

under Exchange Act Rule 14a-9.—

We recognize that the proposed procedure could include other nomination procedure triggering events, such as economic performance (*e.g.*, lagging a peer index for a specified number of consecutive years), being delisted by a market, being sanctioned by the Commission, being indicted on criminal charges, having to restate earnings, or having to restate earnings more than once in a specified period. Because, however, today's proposals relate to the proxy process in connection with the nomination of directors, we are of the view that the nomination procedure triggering events should be tied closely to evidence of ineffectiveness or security holder dissatisfaction with a company's proxy process. While the nomination procedure triggering event requirement would add complexity to the operation of the rule, it also would limit the use of a security holder access rule to situations where there is evidence that the proxy process may otherwise have failed to permit security holder views to be adequately taken into account. We believe that this structure addresses best the concerns of some commenters regarding the potential adverse impact of such a nomination procedure on public companies.

In determining the appropriate thresholds to propose, we considered the importance of using nomination procedure triggering events that would provide a meaningful opportunity for security holders to trigger operation of the security holder nomination procedure against the importance of ensuring that the process is used by security holders who represent a substantial and long-term interest in the subject company. The nomination procedure triggering events that we propose strike what we believe is an appropriate balance between these interests.

The first of the nomination procedure triggers that we propose relates to the level of withhold director votes. We have proposed that the trigger require a more than 35% security holder withhold vote, based on votes cast. Based on a sample of 2,227 director elections over the past 2 years, it appears that approximately 1.1% of companies had total withhold votes in excess of 35% of the votes cast;[78] however, our data does not enable us to calculate withhold votes on a candidate-by-candidate basis. Because the data available to us suggest that the frequency of significant withhold votes is currently somewhat lower than that for majority votes on security holder proposals, as discussed below, we have proposed a lower threshold for the withhold votes trigger than the security holder proposal-based trigger. While we have selected a lower threshold, we have attempted to select a still-substantial percentage that will reflect the intent of a significant percentage of security holders rather than a small minority. In addition, we believe that it is important to recognize the possibility that withhold votes for individual directors currently may occur more frequently than the data available to us suggest, and that they may, in the future, occur more frequently if they could trigger the nomination procedure.

With regard to the more than 1% threshold with a one-year holding period that would be required of a direct access security holder proponent to trigger operation of the nomination procedure, we estimate that most companies have at least one security holder that is eligible to submit a security holder proposal that would initiate the security holder nomination procedure in proposed Exchange Act Rule 14a-11. For instance, we estimate that, of companies listed on an exchange or quoted on the Nasdaq Stock Market, 84% have at least one institution that has maintained ownership of at least 1% of the shares outstanding for one year.[79] The submission of

security holder proposals by security holders that own 1% of the shares outstanding is currently relatively rare, however. A review of a sample of 237 security holder proposals submitted in 2002 found that only three were submitted by an owner of more than 1% of the shares outstanding, with all three submitted by a single 1% owner. Of these three security holder proposals, only one received in excess of 50% of the votes cast.[80] This suggests that, while it is difficult to predict, the incidence of Exchange Act Rule 14a-11 submissions would not be overwhelming absent a significant change in the ownership levels of Exchange Act Rule 14a-8 security holder proponents, a change in their willingness to submit security holder proposals, or a willingness of smaller security holders to combine to submit proposals. At the same time, the information available to our Office of Economic Analysis suggests that security holders could aggregate their shares to reach the 1% threshold to submit a security holder proposal where those security holders feel that the proxy process has been ineffective.

Conversely, at higher percentages and holding periods, we are concerned that the trigger could be too difficult to meet and, therefore, less effective. For example, at a 3% threshold with a one-year holding period, the percentage of companies with at least one institutional investor who is able to submit a security holder proposal that triggers the nomination procedure would drop to 72%, while at a 5% threshold with a one-year holding period the percentage of companies with at least one institutional investor who is able to submit a security holder proposal that triggers the nomination procedure would drop to 57%.[81] These percentages drop to 59% and 42% respectively with a two-year holding period and 46% and 31% respectively at a three-year holding period.[82] By increasing the holding period required at the 1% threshold to 2 years, the percentage of companies with at least one institutional investor who is able to submit a security holder proposal that triggers the nomination procedure would drop to 75%, while an increase to a 3-year holding period drops the percentage to 64%.[83] The combination of this data with the requirement that an eligible security holder would have to submit a security holder proposal that is approved by the majority of the votes cast on that proposal leads us to believe that a higher ownership requirement or longer holding period could limit the availability of the direct access trigger in a manner that renders this trigger less effective.

With regard to the requirement that a direct access security holder proposal submitted by an eligible security holder must receive a majority of the votes cast at the meeting, we considered the percentage of security holder proposals that have received majority votes in prior recent years, based on both votes cast and votes outstanding. Samples of security holder proposals submitted between 2000 and 2003[84] indicate that between 28-31% of security holder proposals in the sample received 50% of the votes cast on those proposals. This percentage drops significantly if based on votes outstanding, to 8-11% of companies in the sample.[85] In light of the very low percentage of companies at which security holder proposals received a majority of votes outstanding, even without considering the low number of security holder proposals that are submitted by 1% security holders, we have proposed that the direct access proposal trigger be based on votes cast rather than votes outstanding.

b. Implementation of security holder proposals under Exchange Act Rule 14a-8 as a nomination procedure triggering event

We are considering as an additional element of the procedure, and seek comment on, whether we should include a third nomination procedure

triggering event that is premised upon a company's not implementing a security holder proposal submitted in accordance with Exchange Act Rule 14a-8, other than a direct access security holder proposal, that receives support from the majority of votes cast. As noted previously, the nomination procedure we propose today is premised upon the existence of evidence regarding the ineffectiveness of, or security holder dissatisfaction with, a particular company's proxy process. Accordingly, we seek comment on a third nomination procedure triggering event that would result in a company being subject to that procedure if:

- A security holder proposal submitted pursuant to Exchange Act Rule 14a-8, other than a direct access security holder proposal, was submitted for a vote of security holders at an annual meeting by a security holder or group of security holders that held more than 1% of the company's securities entitled to vote on the proposal for one year and provided evidence of such holdings to the company;

- The security holder proposal received more than 50% of the votes cast on that proposal; and

- The board of directors of the company failed to implement the proposal by the 120th day prior to the date that the company mailed its proxy materials for the annual meeting.[86]

Any such nomination procedure trigger would apply to all security holder proposals, regardless of whether a proposal requires board action (a "mandatory" proposal) or requests board action (a "precatory" proposal). It would be necessary for any new rule implementing such a nomination procedure triggering event to provide guidance to companies and security holders with regard to the determination of whether a proposal has been implemented. While it seems clear that a company would be deemed to have implemented a security holder proposal if the board of directors of the company takes all steps required to be taken by the board to implement the proposal, the timing of implementation may not fit properly within annual meeting cycles. For example, there likely would be situations in which a company would not be able to implement the proposal before the next annual meeting, either because the proposal cannot legally be implemented in that time period or the company would be required to take further action to implement the proposal (for example, where the security holder proposal requests action that would require a security holder vote to implement). Further, a security holder proposal may grant discretion to the board of directors or the company as to the manner in which the proposal should be implemented, either by its terms or because implementation of the proposal otherwise requires such discretion. In this case, a determination by the board that it had implemented the proposal or another mechanism for determining that a proposal had been implemented would be necessary.

In addition to the issues regarding "implementation" discussed above, a nomination procedure triggering event premised upon the implementation of a security holder proposal would need to provide a means to inform security holders regarding the date by which implementation would be necessary and a discussion of the manner in which a proposal would be deemed to have been implemented. We believe that the most appropriate means for informing investors of a potential triggering event and its impact upon the proposed nomination procedure would be in the periodic report in which the company discloses the results regarding any matter that has been put to a vote of security holders.[87] Similarly, the most appropriate manner for

determining implementation likely would be to have the board of directors of the company provide a representation on Exchange Act Form 8-K to the effect that it is the good faith judgment of those directors that the board has implemented the security holder resolution.

We are concerned that the inclusion of this third possible triggering event may affect a board's determination of how to react to or implement a security holder proposal or how to evaluate that proposal under state law. We believe, however, that an argument can be made that where a majority of votes cast by security holders favor a proposal and the board exercises its judgment not to implement it, there is an indication of ineffectiveness in, or dissatisfaction with, the proxy process. On the other hand, we are concerned that the link between the possible ineffectiveness of, or dissatisfaction with, a company's proxy process and this possible nomination procedure triggering event is more indirect than in the case of the two nominating process triggering events proposed today. A disagreement between a company's security holders and the board regarding its judgment on a proposal is a less directly linked indication of ineffectiveness relating to the director nomination and election process than a withhold vote on a director or a direct vote by security holders to provide for compliance with the nomination procedure. This is particularly the case in light of the possible diversity of subjects that can be addressed in a security holder proposal. We also are concerned about the complexity and potential for dispute regarding whether proposals are implemented.

If we decide to adopt a nomination procedure that includes this third triggering event, non-implementation of a security holder proposal submitted as described above and adopted subsequent to January 1, 2004 could be a nominating procedure triggering event. Therefore, security holders and groups should be aware that, should we adopt a nomination procedure that includes a "non-implementation" trigger, they should provide evidence to the company that they satisfy the more than 1% and one-year thresholds when they submit their proposals.[88] As discussed above, we are proposing to amend Exchange Act Rule 14a-5 to require that a company identify in its proxy materials any proposal that would, if adopted, be a nominating process triggering event. We recommend that, pending final action on that proposal, companies make such an identification, both in their interest and in the interest of their security holders. Companies also should consider whether failure to make such an identification has any implications under Exchange Act Rule 14a-9.

c. Questions

C.1. As proposed, the new procedure would require a triggering event for security holders to be able to use the security holder nomination procedure. Is this appropriate? If so, are the proposed nomination procedure triggering events appropriate? Are there other events that should trigger the procedure? For example, should the following trigger the procedure: lagging a peer index for a specified number of consecutive years; being delisted by a market; being sanctioned by the Commission; being indicted on criminal charges; or having to restate earnings once or restate earnings more than once in a specified period? Should the election of a security holder nominee as a member of a company's board of directors be deemed a triggering event in itself that would extend the process by another year or longer period of time?

C.2. How long after a nomination procedure triggering event should security

holders be able to use the nomination procedure, if not two years, as is proposed (*e.g.*, one year, three years, or longer)? Should there be other ways for the operation of the procedure to terminate at a company? If so, what other means would be appropriate? For example, should companies be able to take specified actions that would terminate operation of the nomination procedure? If so, what such actions would be appropriate?

C.3. As proposed, the nomination procedure could be triggered by withhold votes for one or more directors of more than 35% of the votes cast. Is 35% the correct percentage? If not, what would be a more appropriate percentage and why? Is it appropriate to base this trigger on votes cast rather than votes outstanding? If not, please provide a basis for the recommendation, including numeric data, where available. Is the percentage of withhold votes the appropriate standard in all cases? For example, what standard is appropriate for companies that do not use plurality voting? If your comments are based upon data with regard to withhold votes for individual directors, please provide such data in your response.

C.4. Should the nomination procedure triggering event related to direct access security holder proposals trigger the procedure only where a more than 1% holder or group submits the proposal? If not, what would be a more appropriate threshold, if any? For example, should the standards otherwise applicable for inclusion of a proposal under Exchange Act Rule 14a-8 apply? Should the required holding period for the securities used to calculate the security holder's ownership be longer than one year? If so, what is the appropriate holding period? Should that holding period be shorter than one year? If so, what is the appropriate holding period?

C.5. Are the existing methods under Exchange Act Rule 14a-8 sufficient to demonstrate that a proposal was submitted by a more than 1% security holder? If not, what other methods would be appropriate?

C.6. As proposed, a direct access security holder proposal could result in a nomination procedure triggering event if it receives more than 50% of the votes cast with regard to that proposal. Is this the proper standard? Should the standard be higher (*e.g.*, 55%, 60%, or 65%)? Should the standard be based on votes cast for the proposal as a percentage of the outstanding securities that are eligible to vote on the proposal (*e.g.*, 50% of the outstanding securities)?

C.7. Should direct access security holder proposals be subject to a higher resubmission standard than other Exchange Act Rule 14a-8 proposals? If so, what standard would be appropriate?

C.8. We have proposed that nomination procedure triggering events could occur after January 1, 2004. Is this the proper date? Should it be an earlier date? Should it be a later date?

C.9. What are the possible consequences of the use of nomination procedure triggering events? Will there be more expense and effort related to votes on direct access security holder proposals? Will there be more campaigns seeking "withhold" votes? How will any such consequences affect the operation and governance of companies?

C.10. Should companies be exempted from the security holder nomination procedure for any election of directors in which another party commences or evidences its intent to commence a solicitation in opposition subject to

Exchange Act Rule 14a-12(c) prior to the company mailing its proxy materials? If so, should the period in which security holders in such companies may use the nomination procedure be extended to the next year (assuming that a nomination procedure triggering event is required)? What should be the effect if another party commences a solicitation in opposition after the company had mailed its proxy materials?

C.11. We have discussed our consideration of and requested public comment on the appropriateness of a triggering event premised upon the company's non-implementation of a security holder proposal that receives more than 50% of the votes cast on that proposal. Should such a triggering event be included in the nomination procedure? In responding to this question, please also consider the following questions:

a. Should a security holder proposal that receives more than 50% of votes cast operate as a nomination procedure triggering event regardless of the topic of the proposal, or would it be appropriate to instead require that the proposal relate to a specified category of topics (*e.g.*, corporate governance matters)? If so, how should that specific category of topics (*e.g.*, corporate governance matters) be defined?

b. Should a security holder proposal result in a nomination procedure triggering event if it receives more than 50% of the votes cast with regard to that proposal? Should the standard be higher (*e.g.*, 55%, 60%, 65%)? Should the standard be based on votes cast for the proposal as a percentage of the outstanding securities that are eligible to vote on the proposal (*e.g.*, 50% of the outstanding securities)? Would the described means of determining whether a security holder proposal has been implemented be sufficient? Should there be a different means for determining implementation? Are there other or additional criteria that would be appropriate? Should the determination be made by the entire board of directors? Should the determination be made by the independent members of the board of directors? Should the board be given broader flexibility (*e.g.*, should it be able to represent its intention to implement a proposal)? Should the Commission or its staff (for example, the Division of Corporation Finance) play a role in this process (*e.g.*, similar to that for security holder proposals under Exchange Act Rule 14a-8)? Alternatively, what role should the courts play? What is the best record for a judicial determination?

c. Should security holders that do not agree with a company's conclusion that a proposal had been implemented have the right to contest that conclusion through a judicial proceeding? Should they have a private right of action to do so? Is there any reason to believe that security holders would not have a private right of action to contest a company's determination that a proposal has been implemented? If so, what recourse, if any, should a security holder have with regard to a company's determination?

d. Should a company be required to file an Exchange Act Form 8-K stating whether or not it implemented a security holder proposal that is eligible to trigger the rule? Is it appropriate to require that companies make such a statement on Exchange Act Form 8-K? Would this impose unnecessary liability on companies that make a determination regarding implementation of a security holder proposal with which security holders may disagree?

4. What Notice Must a Subject Company Give Regarding the Occurrence of an Event that Triggers the Operation of the Proposed Rule?

a. Disclosure on Exchange Act Forms 10-Q, 10-QSB, 10-K or 10-KSB[89]

Because the proposed security holder nomination procedure would operate only upon the occurrence of specified nomination procedure triggering events, it would be essential that the company make security holders aware when a nomination procedure triggering event has occurred. As such, the security holder nomination procedure in proposed Exchange Act Rule 14a-11 would require additional disclosures in a company's Exchange Act Form 10-Q, 10-QSB, 10-K or 10-KSB.[90] The proposed procedure would require the following:

- Each company would be required to disclose the security holder vote with regard to either of the nomination procedure triggering events in its quarterly report on Exchange Act Form 10-Q or 10-QSB for the period in which the matter was submitted to a vote of security holders or, where the nomination procedure triggering event occurred during the fourth quarter of the fiscal year, on Exchange Act Form 10-K or 10-KSB;[91] and

- Each company would be required to include in that Exchange Act Form 10-Q, 10-QSB, 10-K or 10-KSB information disclosing that it would be subject to the security holder nomination procedure as a result of such vote, if applicable.[92]

b. Questions

D.1. Will the proposed disclosure requirements in Exchange Act Forms 10-Q, 10-QSB, 10-K and 10-KSB provide adequate notice to security holders? Should additional notices be required? If so, what form should that notice take and at what time should it be made public?

D.2. Should the company's notice be filed and/or made public in some other manner? If so, what manner would be appropriate?

5. Which Security Holders or Security Holder Groups May Submit a Nominee that the Company Would Be Required to Include in Its Proxy Materials?

a. Proposed eligibility standards

To be eligible to submit a nomination in accordance with proposed Exchange Act Rule 14a-11, a security holder or group of security holders would be required to:[93]

- Beneficially own, either individually or in the aggregate, more than 5% of the company's securities that are eligible to vote for the election of directors at the next annual meeting of security holders (or, in lieu of such an annual meeting, a special meeting of security holders), with each of the securities used for purposes of calculating that ownership having been held continuously for at least two years as of the date of the nomination;[94]

- Intend to continue to own those securities through the date of that annual or special meeting;[95]

- Be eligible, as to the security holder or each member of the security holder group, to report beneficial ownership on Exchange Act Schedule 13G, rather than Exchange Act Schedule 13D,[96] in reliance on Exchange Act Rule 13d-1(b) or (c);[97] and

- Have filed an Exchange Act Schedule 13G or an amendment to Exchange Act Schedule 13G reporting their beneficial ownership as a passive or institutional investor (or group) on such schedule before or on the date of the submission of the nomination to the company, which Schedule must include a certification that the security holder or security holder group has held more than 5% of the subject securities for at least two years.[98]

The appropriate eligibility ownership threshold generated a great deal of comment in response to our solicitation of public input on the Division's review of the proxy rules.[99] While some commenters believed that all security holders should be able to access company proxy materials for the purpose of nominating directors, others advocated no ownership threshold or share ownership thresholds ranging from the $2,000 threshold required to submit an Exchange Act Rule 14a-8 proposal to substantial share ownership percentages such as 3%, 5% or 10% of a company's outstanding common stock.[100] Those who advocated no threshold or a nominal dollar amount argued that the imposition of a threshold would discriminate against smaller investors or unfairly advantage larger security holders who already may have the resources to run their own slates using the existing rules for contested elections.[101] Those who advocated a larger share ownership threshold contended that a nominating security holder should have a substantial, long-term stake in the company in order to require the use of company funds to nominate a candidate.[102] In addition, advocates of a larger share ownership threshold pointed out that the composition of the board of directors is critical to a corporation's functions and, accordingly, security holders should have to evidence a significant financial interest by satisfying a substantial ownership threshold in order to use a security holder nomination procedure that may impact that composition.[103]

We have proposed an ownership threshold of more than 5% in an effort to balance security holders' interest in being able to access company proxy materials for the purpose of nominating directors against companies' concerns about the potential disruption that some contend may result from frequent use of the process by security holders who do not represent a significant ownership stake in the subject company. We believe that a threshold of more than 5% ownership for two years strikes an appropriate balance between these interests. Roughly 42% of filers have at least one security holder that can meet this threshold individually, while roughly 50% of filers have two or more security holders that each have held at least 2% of the shares outstanding for the appropriate period and, thus, could more easily aggregate their securities in order to meet the threshold ownership requirement.[104] A higher threshold amount would result in significantly fewer filers having even one security holder who could meet the required threshold. For example, using an ownership threshold of 10% would reduce the number of companies where a single security holder could make a nomination to 13% of the companies. Further, only 18% of filers have two or more security holders that have held at least 5% of the shares for the appropriate period. This data suggest that security holders may have significant difficulty in aggregating their shares to meet a 10% ownership threshold.

b. Questions

E.1. Are the proposed thresholds for use of the proposed procedure appropriate? If not, should there be any restrictions regarding which security

holder nominees for director would be required to be disclosed in the company proxy materials under the proposed procedure? If so, should those restrictions be consistent with the ownership requirements of Exchange Act Rule 14a-8? Should those restrictions be more extensive than the minimum requirements in Exchange Act Rule 14a-8?

E.2. Is it appropriate to include a restriction on security holder eligibility that is based on percentage of securities owned? If so, is the more than 5% standard that we have proposed appropriate?
Should the standard be lower (*e.g.*, 2%, 3%, or 4%) or higher (*e.g.* 6%, 7%, 8%, 9%, 10%, 15%, 20%, or 25%)?

E.3. Should there be a restriction on security holder eligibility that is based on the length of time securities have been held? If so, is two years the proper standard? Should the standard be shorter
(*e.g.*, 1 year) or longer (*e.g.*, 3 years, 4 years, or 5 years)? Should the standard be measured by a different date (*e.g.*, 2 years as of the date of the meeting, rather than the date of nomination)?

E.4. As proposed, a nominating security holder would be required to represent its intent to hold the securities until the date of the election of directors. Is it appropriate to include such a requirement? Would it be appropriate to require the security holder to intend to hold the securities beyond the election of directors (*e.g.*, for six months after the election, one year after the election, or two years after the election) and to so represent?

E.5. Is the eligibility requirement that a security holder or security holder group must file an Exchange Act Schedule 13G appropriate? Should there be a different mechanism for putting companies and other security holders on notice that a security holder or security holder group has ownership of more than 5% of the company's securities and intends to nominate a security holder? Is it appropriate to permit the filing to be on Exchange Act Schedule 13G rather than Exchange Act Schedule 13D? If not, why not?

E.6. Should the procedure include a provision that would deny eligibility for any nominating security holder or nominating security holder group that has had a nominee included in the company materials where that nominee did not receive a sufficient number of votes (*e.g.*, 5%, 15%, 25%, or 35%) within a specified period of time in the past? If there should be such an eligibility standard, how long should the prohibition last?

E.7. Should security holders be allowed to aggregate their holdings in order to meet the ownership eligibility requirement to nominate directors? If so, is it appropriate to require that all members of a nominating security holder group individually meet the minimum holding period? Is it appropriate to require that all members of the group be eligible to file on Exchange Act Schedule 13G?

E.8. As proposed, the beneficial ownership level of a nominating security holder or nominating security holder group would be established by the Exchange Act Schedule 13G filed by that security holder or security holder group, for companies other than open-end management investment companies ("mutual funds"). Is the filing of the Exchange Act Schedule 13G sufficient evidence of ownership? If not, what additional evidence would be appropriate? Should there be an additional procedure by which disputes regarding ownership levels are resolved?

6. What Are the Requirements for the Person Whom the Eligible Security Holder or Security Holder

Group May Nominate?

a. The nomination must be consistent with applicable law and regulation

A company would not be required to include a security holder nominee in its proxy materials if the nominee's candidacy or, if elected, board membership, would violate:

- Controlling state law;
- Federal law; or
- Rules of a national securities exchange or national securities association (other than rules of a national securities exchange or national securities association that set forth requirements regarding the independence of directors). [105]

Because compliance with independence standards can depend on the overall make-up of a board, we have excluded independence standards from this requirement and have, instead, proposed a separate requirement regarding independence standards.[106] Pursuant to that separate requirement, a nominating security holder or nominating security holder group would be required to represent that the nominee meets the objective criteria for "independence" in any applicable national securities exchange or national securities association rules. For this purpose, the nominee would be required to meet the definition of "independence" that is generally applicable to directors of the company and not any particular definition of independence applicable to members of the audit committee of the company's board of directors. To the extent a rule imposes a standard regarding independence that requires a subjective determination by the board or a group or committee of the board (for example, requiring that the board of directors or any group or committee of the board of directors make a determination regarding the existence of factors material to a determination of a nominee's independence), this element of an independence standard would not have to be satisfied.[107]

b. Prohibited relationships between the nominee and the nominating security holder or group

A number of commenters expressed concerns regarding the disruptive effect a security holder nomination procedure could have on board dynamics and board operation. A number of these comments related to the potential for "special interest" or "single issue" directors that would advance the interests of the nominating security holder over the interests of security holders as a group. While we recognize this concern, we believe that the procedure we propose today under Exchange Act Rule 14a-11 should afford a security holder or group meeting the proposed standards the ability to propose a candidate for director that, in the nominating security holder's view, is more qualified than those put forward by a nominating committee, board, management, or company. We therefore propose that, to be eligible to nominate a candidate under the proposal, a nominating security holder or nominating security holder group may not have specified relationships with the nominee. We believe that the proper procedures for nomination and solicitation of proxies for a candidate that would be an interested representative of a security holder, including a security holder meeting the proposed standards under Exchange Act Rule 14a-11, are those that otherwise exist under our current proxy rules. Therefore, as proposed, each person that is a security holder nominee would be required to meet the following standards of independence from the security holder or each

member of the security holder group that has nominated such person:

- If the nominating security holder or any member of the nominating security holder group is a natural person, the nominee is not the nominating security holder, a member of the nominating security holder group, or a member of the immediate family of the nominating security holder or any member of the nominating security holder group;[108]

- If the nominating security holder or any member of the nominating security holder group is an entity, neither the nominee nor any immediate family member of the nominee has been an employee of the nominating security holder or any member of the nominating security holder group during the then-current calendar year nor during the immediately preceding calendar year;

- Neither the nominee nor any immediate family member of the nominee has, during the year of the nomination or the immediately preceding calendar year, accepted directly or indirectly any consulting, advisory, or other compensatory fee from the nominating security holder or any member of the group of nominating security holders or any affiliate of any such holder or member, provided that compensatory fees would not include the receipt of fixed amounts of compensation under a retirement plan (including deferred compensation) for prior service with such holder or any such member (provided that such compensation is not contingent in any way on continued service);

- The nominee is not an executive officer, director (or person fulfilling similar functions) of the nominating security holder or any member of the nominating security holder group, or of an affiliate of the nominating security holder or any such member of the nominating security holder group; and

- The nominee does not control the nominating security holder or any member of the nominating security holder group (or in the case of a holder or member that is a fund, an interested person of such holder or any such member as defined in Section 2(a)(19) of the Investment Company Act).

c. Relationships between the nominee, the nominating security holder or group, and the company

A number of commenters expressed concerns regarding the effect of a nomination procedure on a company's compliance with requirements that certain of its directors be "independent." Other commenters addressed the potential use of the process by nominating security holders that were acting merely as a surrogate for the company. To balance the benefits of a security holder nomination procedure against these concerns, we propose that the nominating security holder or nominating security holder group be required to include a representation regarding relationships between the nominee and the company and between the nominating security holder or nominating security holder group and the company.[109] Specifically, as proposed, each nominating security holder or each member of the group of nominating security holders would be required to represent to the company that:

- The nominee submitted under the proposed rule by that nominating security holder or group of nominating security holders satisfies the

applicable standards of a national securities exchange or national securities association regarding director independence, if any, except that, where a rule imposes a standard regarding independence that requires a subjective determination by the board or a group or committee of the board (for example, requiring that the board of directors or any group or committee of the board of directors make a determination regarding the existence of factors material to a determination of a nominee's independence), this element of an independence standard would not have to be satisfied;[110] and

- Neither the nominee nor the nominating security holder (or any member of the nominating security holder group, if applicable) has a direct or indirect agreement with the company regarding the nomination of the nominee.

Commenters have expressed concern that the use of the proposed security holder nomination procedure, by itself, may be deemed to establish a relationship between the nominating security holder or nominating security holder group and the company that would result in that holder or group being deemed an "affiliate" of the company for purposes of the federal securities laws. It is our view that the mere use of the proposed procedure should not have such an effect. Accordingly, proposed Exchange Act Rule 14a-11(a) would include an instruction making clear that a nominating security holder will not be deemed an "affiliate" of the company under the Securities Act of 1933[111] or the Exchange Act solely as a result of nominating a director or soliciting for the election of such a director nominee or against a company nominee pursuant to the security holder nomination procedure.[112] In addition, where a security holder nominee is elected, and the nominating security holder or nominating security holder group does not have an agreement or relationship with that director, otherwise than relating to the nomination, the nominating security holder or nominating security holder group would not be deemed an affiliate solely by virtue of having nominated that director under the proposed rules.

d. Questions

F.1. Should there be any other or additional limitations regarding nominee eligibility? Would any such limitations undercut the stated purposes of the proposed process? Are any such limitations necessary? If so, why?

F.2. Is it appropriate to use compliance with state law, federal law, and listing standards as a condition for eligibility?

F.3. Should there be requirements regarding independence from the company? Should the fact that the nominee is being nominated by a security holder or security holder group, combined with the absence of any direct or indirect agreement with the company, be a sufficient independence requirement?

F.4. How should any independence standards be applied? Should the nominee and the nominating security holder or nominating security holder group have the full burden of determining the effect of the nominee's election on the company's compliance with any independence requirements, even though those consequences may depend on the outcome of any election and may relate to the outcome of the election with regard to nominees other than security holder nominees?

F.5. Are the proposed standards with regard to independence appropriate? If not, what standards would be appropriate? If these limitations generally are appropriate, are there instances where they should not apply?

F.6. Where a company is subject to an independence standard of a national securities exchange or national securities association that includes a subjective component (*e.g.*, subjective determinations by a board of directors or a group or committee of the board of directors), should the security holder nominee be subject to those same requirements as a condition to nomination?

F.7. As proposed, a nominating security holder or nominating security holder group would be required to represent that the security holder nominee satisfies applicable standards of a national securities exchange or national securities association regarding director independence, except where a rule imposes a standard regarding independence that requires a subjective determination by the board or a group or committee of the board. What independence requirements should be used if the company is listed on more than one market with such independence requirements? Should the nominating security holder or nominating security holder group have the discretion to choose the applicable standards? Should the company have discretion to choose the applicable standards? Should all the standards of all markets on which shares are traded apply? Should the more stringent standards apply?

F.8. Should there be requirements regarding independence of the nominee from the nominating security holder, nominating security holder group, or the company? If so, are the proposed limitations appropriate? What other or additional limitations would be appropriate? If these limitations generally are appropriate, are there instances where they should not apply?

F.9. Should there be any standards regarding separateness of the nominee and the nominating security holder or nominating security holder group? Would such a limitation unnecessarily restrict access by security holders to the proxy process? If such standards are appropriate, are the proposed standards the proper standards? Should other standards be included? Should any of the proposed standards be eliminated?

F.10. Should there be a prohibition, as is proposed, on any affiliation between nominees and nominating security holders or nominating security holder groups? If so, are the proposed rules appropriate? For example, we have proposed a definition of "immediate family" that is consistent with the existing disclosure requirement under Item 401(d) of Regulation S-K. Is this the appropriate definition for purposes of addressing relationships between the nominee and the nominating security holder or nominating security holder group? If not, what definition would be more appropriate?

F.11. Should there be exceptions to the prohibition on any affiliation between nominees and nominating security holders or nominating security holder groups? If so, what exceptions would be appropriate?

F.12. Is the two-year prohibition on payments from nominating security holders to nominees appropriate? Should it be longer (*e.g.*, 3 years, 4 years, or 5 years) or shorter (*e.g.*, 1 year)? Should there be exceptions to this prohibition? If so, what exceptions would be appropriate?

F.13. Is the prohibition on direct or indirect agreements between companies

and nominating security holders appropriate? Would such a prohibition inhibit desirable negotiations between security holders and boards or nominating committees regarding nominees for directors? Should the prohibition provide an exception to permit such negotiations? If so, what should the relevant limitations be?

F.14. Should there be a nominee eligibility criterion that would exclude an otherwise eligible nominee or nominating security holder or nominating security holder group where that nominee (or a nominee of that security holder or security holder group) has been included in the company's proxy materials as a candidate for election as director but received a minimal percentage of the vote? If so, what would be the appropriate standard (*e.g.*, 5%, 15%, 25%, or 35%)?

F.15. As proposed, the rule includes a safe harbor providing that nominating security holders will not be deemed "affiliates" solely as a result of using the security holder nomination procedure. This safe harbor would apply not only to the nomination of a candidate, but also where that candidate is elected, provided that the nominating security holder or nominating security holder group does not have an agreement or relationship with that director otherwise than relating to the nomination. Is it appropriate to provide such a safe harbor for security holder nominations? Should the safe harbor continue to apply where the nominee is elected?

7. How Many Security Holder Nominees Must the Company Include in Its Proxy Materials?

a. Proposed limitation

We do not intend the security holder nomination procedure in proposed Exchange Act Rule 14a-11 to be available for any security holder or security holder group that is seeking control of a company. The existing procedures regarding contested elections of directors are intended to continue to fulfill that purpose.[113] The elements of this aspect of the proposal insofar as they relate to eligibility to use Exchange Act Schedule 13G are discussed below.

As proposed, a company would be required to include one security holder nominee if the total number of members of the board of directors is eight or fewer, two security holder nominees if the number of members of the board of directors is greater than eight and less than 20 and three security holder nominees if the number of members of the board of directors is 20 or more. The proposal would have a separate standard for companies with classified or "staggered" boards of directors. Where a company has a director (or directors) currently serving on its board of directors who was elected as a security holder nominee, and the term of that director extends past the date of the meeting of security holders for which the company is soliciting proxies, the company would not be required to include on its proxy card more security holder nominees than could result in the total number of directors serving on the board that were elected as security holder nominees being greater than one if the total number of members of the board of directors is eight or fewer, two if the number of members of the board of directors is greater than eight and less than 20 and three if the number of members of the board of directors is 20 or more.[114]

The proposed security holder nomination procedure would address situations where more than one security holder or group of security holders would be eligible to nominate a person or persons to a company's board of directors pursuant to the proposed rule. In those situations, the company would be required to include in its proxy statement and form of proxy the nominee or

nominees of the security holder or security holder group with the largest beneficial ownership (as reported on Exchange Act Schedule 13G) at the time of the delivery of the nominating security holder's notice of intent to nominate a director pursuant to the rule, up to and including the total number required to be included by the company.[115] We believe this method of determining which security holder or security holder group's nominees are included in the company's proxy materials is appropriate, as it relates directly to the level of interest in the company of the nominating security holder or the nominating security holder group.

b. Questions

G.1. Is it appropriate to include such a limitation on the number of security holder nominees? If not, how would the proposed rules be consistent with our intention not to allow the proposed procedure to become a vehicle for changes in control?

G.2. If there should be a limitation, is the proposed limitation appropriate? Should the number of security holder nominees be higher or lower? Should the limitation instead be based on the total percentage of the board that the security holder nominees would comprise? Should the limitation be the greater or lesser of the number or a specified percentage, rather than a set number, as proposed? Is it appropriate to permit more than one security holder nominee regardless of the size of the company's board of directors?

G.3. Should the number increase during the second year of the proposed procedure? Should the number decrease during the second year of the proposed procedure?

G.4. The proposal contemplates taking into account incumbent directors in the case of classified or "staggered" boards for purposes of determining the maximum number of security holder nominees. Is that appropriate? Should there be a different procedure to account for such incumbent directors? Also with regard to staggered boards, should the procedure address situations in which, due to a staggered board, fewer director positions are up for election than the maximum permitted number of security holder nominees? If so, how?

G.5. We have proposed a limitation that permits the security holder or security holder group with the largest beneficial ownership to include its nominee(s) where there is more than one eligible nominating security holder or nominating security holder group. Is this proposed procedure appropriate? If not, should there be different criteria for selecting the security holder nominees (*e.g.*, length of security ownership, date of the nomination, random drawing, allocation among eligible nominating security holders or security holder groups, etc.)? Rather than using criteria such as that proposed, should the company's nominating committee have the ability to select among eligible nominating security holders or security holder groups?

G.6. Rather than a limitation on the maximum number of security holder nominees, should there be only a limitation on the number of security holder nominees that may be elected?

8. What Notice Must the Nominating Security Holder or Nominating Security Holder Group Provide to the Company and File with the Commission?

a. Notice to the company

To have a nominee included in the company's proxy statement and form of proxy, we propose that the nominating security holder or nominating security holder group be required to provide notice to the company of its intent to require that the company include that security holder's nominee on the company's proxy card no later than 80 days before the date that the company mails its proxy materials for the annual meeting.[116] This notice would be required to include:

- A representation that the nominating security holder is eligible to submit a nominee under the security holder nomination procedure;[117]
- A statement that, to the knowledge of the nominating security holder or group, the candidate's nomination or service on the board, if elected, would not violate controlling state law, federal law, or listing standards (other than a standard relating to independence);[118]
- A representation that the nominee meets the objective criteria for independence from the company that are set forth in applicable rules of a national securities exchange or national securities association;[119]
- Representations regarding the absence of a prohibited relationship between the nominee and the nominating security holder or nominating security holder group;[120]
- A representation that neither the nominee nor the nominating security holder (or any member of the nominating security holder group, if applicable) has a direct or indirect agreement with the company regarding the nomination of the nominee;[121]
- A copy of the nominating security holder's or nominating security holder group's filed Exchange Act Schedule 13G indicating ownership of more than 5% of the appropriate class of the company's securities;[122]
- A representation that the nominating security holder or each member of the nominating security holder group was eligible to report its security ownership on Exchange Act Schedule 13G in reliance on Exchange Act Rule 13d-1(b) or (c);[123]
- A representation that more than 5% of the appropriate class of the company's securities, as reflected in the Exchange Act Schedule 13G of the nominating security holder or nominating security holder group, have been held continuously for at least two years and that the nominating security holder or nominating security holder group intends to continue to own those securities through the date of the subject election of directors;[124]
- A statement from the nominee that the nominee consents to be named in the company's proxy statement and to serve on the board if elected, for inclusion in the company's proxy statement;[125]
- Disclosure about the nominee complying with the requirements of Item 7(a), (b) and (c) and, for investment companies, Item 22(b) of Exchange Act Schedule 14A, for inclusion in the company's proxy statement;[126]
- Any of the following information with regard to each nominating

security holder or member of a nominating security holder group that is not included in the Exchange Act Schedule 13G, for inclusion in the company's proxy statement:[127]

- Name and business address;

- Present principal occupation or employment and the name, principal business and address of any corporation or other organization in which such employment is carried on;

- The amount of each class of securities of the company that the individual owns beneficially, directly or indirectly, determined in accordance with Exchange Act Rule 13d-3;[128]

- Whether or not, during the past ten years, the individual has been convicted in a criminal proceeding (excluding traffic violations or similar misdemeanors) and, if so, the dates, the nature of the conviction, the name or other disposition of the case; and whether the individual has been involved in any other legal proceeding during the past five years, as specified in Item 401(f) of Regulation S-K;[129] and

- The methods by which the nominating security holder or nominating security holder group may solicit security holders, including any website address on which the nominating security holder or nominating security holder group may publish soliciting materials.[130]

b. Filing with the Commission

The nominating security holder or the nominating security holder group would be required to file the notice described in the preceding section, excluding the already-filed Exchange Act Schedule 13G, with the Commission. This notice would be viewed as soliciting material of the nominating security holder or nominating security holder group, in that much of the information included in the notice would ultimately be disseminated to security holders in the company's proxy statement. Accordingly, the notice as filed with the Commission would be subject to the provisions of Exchange Act Rule 14a-9. We contemplate that this solicitation would be made in accordance with the exemption set out in proposed Exchange Act

Rule 14a-11(f)(2). The notice would be filed with the Commission in the following manner:[131]

- The filing would include a cover page in the form set forth in Exchange Act Schedule 14A, as proposed to be amended, with the appropriate box on the cover page marked;

- The filing would be made under the subject company's Exchange Act file number;[132] and

- The nominating security holder or nominating security holder group would be required to make the filing no later than two business days after providing the notice to the company.

c. Questions

H.1. Are the proposed content requirements of the notice appropriate? Are

there matters included in the notice that should be eliminated? Are there additional matters that should be included? For example, is there additional information that should be included with regard to the nominating security holder or nominating security holder group (*e.g.*, disclosure similar to that required from participants in solicitations in opposition with regard to contracts, arrangements or understandings relating to the company's securities), or with regard to the security holder nominee?

H.2. Are the required representations appropriate? Should there be additional representations? Should any of the proposed representations be eliminated?

H.3. Is it appropriate to require that the notice (other than the copy of the Exchange Act Schedule 13G included in that notice) be filed with the Commission? Should additional or lesser information be filed with the Commission and be made publicly available? Is the proposed filing requirement appropriate? For example, should the notice be filed as an exhibit to an amendment to the nominating security holder or nominating security holder group's Exchange Act Schedule 13G?

H.4. When should the notice be required to be filed with the Commission? Should it be required to be filed at the time it is provided to the company? Should it be required to be filed within a specified period of time, such as two business days, after it is provided to the company, as is proposed? Should the information in the notice that is included in the company's proxy statement instead be filed on or about the date that the company releases its proxy statement to security holders?

H.5. What should be the consequence to the nominating security holder or nominating security holder group of submitting the notice to the company after the deadline? Should such a late submission render the nominating security holder or nominating security holder group ineligible to use the nomination procedure, as is currently proposed under the rule? What should be the consequence to the nominating security holder or nominating security holder group of filing the notice with the Commission late? Should such late filing be viewed exclusively as a violation of Exchange Act Rule 14a-6 or should it affect eligibility to use the nomination procedure? Should the failure of a nominating security holder or nominating security holder group to file the notice with the Commission be viewed exclusively as a violation of Exchange Act Rule 14a-6 or should it affect eligibility to use the nomination procedure?

H.6. The proposed notice requirements address both regularly scheduled annual meetings and circumstances where a company may not have held an annual meeting in the prior year or has moved the date of the meeting more than 30 days from the prior year. Under these circumstances, what is the appropriate date by which a nominating security holder must submit their notice to the company? We have proposed a standard similar to that currently used in connection with the Exchange Act Rule 14a-8 security holder proposal process. Is such a standard appropriate? If not, what standard would be more appropriate?

H.7. As proposed, Exchange Act Rule 14a-11 includes a number of notice and other timing requirements. Should these timing requirements incorporate or otherwise address any advance notice provisions under state law or a company's governing instruments? If so, should any advance notice provisions govern? Should they instead be provided as an alternative to the

timing provisions set out in the rule?

9. What Must the Company Do After It Receives a Notice From a Nominating Security Holder or a Nominating Security Holder Group Under Proposed Exchange Act Rule 14a-11?

a. Proposed procedure

We propose that a company that receives a nominee from a nominating security holder or nominating security holder group under the security holder nomination procedure in Exchange Act Rule 14a-11 would determine whether the nominating security holder or nominating security holder group has complied with proposed Exchange Act Rule 14a-11 and whether the nominee satisfies each of the requirements of the proposed procedure. Unless a company determines that it is not required to include a nominee from a nominating security holder or nominating security holder group in its proxy materials, the company would be required to include information regarding the security holder nominee in the company's proxy statement that it sends to its security holders, including the website address on which the nominating security holder or nominating security holder group intends to solicit in favor of its nominee, and include the name of the nominee on the company's proxy card that is included in those materials.[133] The proposed procedure specifies the information regarding that nominee that the company must include in its proxy materials.[134]

In addition to required disclosures related to each director candidate, companies may wish to include statements in the proxy statement supporting company nominees and/or opposing the nominating security holder or nominating security holder group nominee or nominees. While we believe that companies should be able to include such disclosure in the proxy statement, provided that it complies with Exchange Act Rule 14a-9, we also are of the view that nominating security holders or nominating security holder groups should be afforded the same opportunity, if the company chooses to include such a statement. Accordingly, we are proposing that if the company includes any such statement in its proxy materials, other than a mere recommendation to vote in favor of or withhold votes from specified candidates, a nominating security holder or nominating security holder group would be given the opportunity to include in the company's proxy statement a statement of support for the security holder nominee or nominees, of a length not to exceed 500 words.[135] Should the company choose not to make any statement in its proxy statement supporting company nominees and/or opposing the security holder nominee or nominees, other than the mere recommendation described above, the company would not be required to include in its proxy statement the nominating security holder's supporting statement. In either case, both the company and the nominating security holder or nominating security holder group would be able to solicit in favor of their nominees outside the proxy statement, for example on a designated website, provided that such solicitations were made within the parameters of the applicable proxy rules.

With regard to the company's proxy card, similar to the current practice with regard to security holder proposals submitted pursuant to Exchange Act Rule 14a-8, the company could identify any security holder nominees as such and recommend that security holders vote against, or withhold votes from, those nominees and in favor of the management nominees on the form of proxy. The company must otherwise present the nominees in an impartial manner in accordance with Exchange Act Rule 14a-4. Under the current rules, a company may provide security holders with the option to vote for or withhold authority to vote for the company's nominees as a

group, provided that security holders also are given a means to withhold authority for specific nominees. In our view, this option would not be appropriate where the company's proxy card includes security holder nominees, as grouping the company's nominees may make it easier to vote for all of the company's nominees than to vote for the security holder nominees in addition to some of the company nominees. Accordingly, the proposed rules would not permit a company to provide security holders the option of voting for or withholding authority to vote for the company nominees as a group, but would instead require that each candidate be voted on separately.[136]

A company may determine that it is not required to include a nominee from a nominating security holder or nominating security holder group in its proxy materials if it determines any of the following:

- The security holder nomination procedure in proposed Exchange Act Rule 14a-11 is not applicable to the company;
- The nominating security holder or nominating security holder group has not complied with the requirements of the procedure;
- The nominee does not meet the requirements of the procedure;
- Any representation required to be included in the notice to the company is false in any material respect; or
- The company has received more nominees than it is required to include by proposed Exchange Act Rule 14a-11 and the nominating security holder or nominating security holder group is not entitled to have its nominee included in that situation.[137]

The nominating security holder or nominating security holder group would need to be made aware of the company's determination whether or not to include the security holder nominee in sufficient time to consider the validity of any determination to exclude the nominee. As such, the company would be required to notify the nominating security holder or nominating security holder group, in writing, of its determination. As proposed, the company would have to provide this notice promptly, but in no case less than 30 calendar days before the date of the company's proxy statement released to security holders in connection with the previous year's annual meeting and, where the company did not hold an annual meeting in the previous year, or if the date of this year's annual meeting has been changed by more than 30 days from the date of the previous year's meeting, then the notice must be provided a reasonable time before the company mails its proxy materials for the current year. If the company determines that it is entitled to exclude the nominee, the notice must include the following information regarding the company's determination:

- A description of the determination made by the company's board of directors, including an affirmative statement of its determination not to include that specific nominee;
- A discussion of the specific requirement or requirements of Exchange Act Rule 14a-11 that the company's board of directors has determined permit the company not to include that specific nominee; and
- A discussion of the specific basis for the belief of the company's board

of directors that the company is permitted to not include that specific nominee.

The company would be required to include in its proxy statement for the meeting for which the nominee was submitted a statement that it has made such a determination as well as disclosure of the information relating to that determination that the company included in the notice to the nominating security holder.

If the company determines that it must include the security holder nominee, it would be required to advise the nominating security holder or nominating security holder group of this determination and state whether the company intends to include in its proxy statement disclosure opposing the security holder nominee and/or supporting company nominees. If the company intends to include such a statement, it must advise the nominating security holder or nominating security holder group that it may submit a statement of not more than 500 words supporting the security holder nominee(s). The company also must advise the nominating security holder or nominating security holder group of the date by which this statement must be provided to the company, which could not be less than 10 business days from the date of the company's notice to the security holder. The nominating security holder or nominating security holder group's supporting statement would be viewed as soliciting material and would therefore be required to be filed as such by the nominating security holder in accordance with proposed Exchange Act Rule 14a-11(f)(2) and proposed Exchange Act Rule 14a-6(p), on or about the date that the company's proxy statement is first released to security holders.

b. Questions

I.1. Is it appropriate to require that the company include in its proxy statement a supporting statement by the nominating security holder or nominating security holder group? If so, is it appropriate to limit this requirement to instances where the company wishes to make a statement opposing the nominating security holder's nominee or nominees and/or supporting company nominees? Is it appropriate to limit the supporting statement to 500 words? If not, what limit, if any, is more appropriate? Is it appropriate to require filing of the statement on the date that the company releases its proxy statement to security holders? If not, what filing requirement would be appropriate?

I.2. Is it appropriate for the company to make the specified determinations regarding the basis on which a nominee would not be included? By what means should a company's determination be subject to review? By the courts? Should there be an explicit statement by the Commission regarding this review? Should any determination by the company be subject to review by the Commission or its staff? Should there be an explicit provision for such review, as, for example, with security holder proposals under Exchange Act Rule 14a-8?

I.3. Proposed Exchange Act Rule 14a-11(a)(3) provides that a company is not required to include a security holder nominee where either: (a) the nominee's candidacy or, if elected, board membership, would violate controlling state law, federal law or rules of a national securities exchange or national securities association, (b) the nominating security holder's notice is not adequate, (c) any representation in the nominating security holder's notice is false in any material respect, or (d) the nominee is not required to

be included in the company's proxy materials due to the proposed limitation on the number of nominees required to be included. Instruction 4 to proposed Exchange Act Rule 14a-11(a)(3) provides that the company shall determine whether any of these events have occurred. Should the nomination procedure include a procedure for a company to gather information additional to that included in the notice that is reasonably necessary for the company to make its determination in this regard? If so, please respond to the following additional questions.

a. Should the company be provided with a maximum amount of time to request specific information (*e.g.*, three days, five days, one week, two weeks, or one month)?

b. Should nominating security holders and/or nominees be provided with a maximum amount of time to respond to such a request (*e.g.*, three days, five days, one week, two weeks, or one month)?

c. Should the procedure prescribe the type of information that a company may request from a nominating security holder or nominee? Should the procedure specify those representations in the nominating security holder's notice to the company with regard to which the company may request information?

d. Should the procedure include a method for a company to obtain follow-up information after a nominating security holder or nominee submits an initial response? If so, should that follow-up method have similar time frames and informational standards to those related to the initial request and response?

e. Should the rule explicitly state that a nominee may be excluded from a company's proxy materials if the nominating security holder or nominee does not provide the requested information in the required timeframe, or if the information does not confirm the representations included in the notice to the company, or is it sufficient to rely on the proposed provision that permits the exclusion of nominees when a representation is false in any material respect? In order to facilitate reliance on this proposed provision if a nominating security holder or nominee fails to provide requested information, would it be appropriate to require that a nominating security holder represent that the nominating security holder or nominee will respond to a request by the company for information that is reasonably necessary to confirm the accuracy of representations of the nominating security holder?

f. Should this procedure be the same for operating companies,

registered investment companies, and business development companies? Should there be unique procedures for different types of entities? If so, what is unique to a particular type of entity that would require a unique procedure?

I.4. As proposed, the company must provide the nominating security holder or nominating security holder group with notice of its determination whether to include in its proxy statement the security holder nominee by a date that will generally fall approximately 30 days prior to the date the company will mail its proxy statement. Does this requirement allow the nominating security holder or nominating security holder group adequate time to contest a company's determination with regard to a potential security holder nominee? If not, what timing would be more appropriate? Is the timing

requirement with regard to the nominating security holder's submission of its statement of support to the company appropriate? If not, what timing would be appropriate?

I.5. As proposed, the rule would not provide a mechanism by which a nominating security holder or nominating security holder group could "cure" a defective notice. Would such a "cure" period, similar to that currently provided under Exchange Act Rule 14a-8, be appropriate? If so, how and by what date should a company be required to notify a nominating security holder or nominating security holder group of a defect in the notice? How long should the nominating security holder or nominating security holder group have to cure any defects? Are there any defects that would not require notice by the company, for example, where a defect could not be remedied?

I.6. As proposed, inclusion of a security holder nominee in the company's proxy materials would not require the company to file a preliminary proxy statement provided that the company was otherwise qualified to file directly in definitive form. In this regard, the proposed rules make clear that inclusion of a security holder nominee would not be deemed a "solicitation in opposition." Is it appropriate to view the inclusion of a nominee in this manner or should the inclusion of a nominee instead be viewed as a solicitation in opposition that would require a company to file its proxy statement in preliminary form? Should we view inclusion of a security holder nominee as a solicitation in opposition for other purposes (*e.g.*, expanded disclosure obligations)?

I.7. As proposed, the rule would prohibit companies from providing security holders the option of voting for the company's slate of nominees as a whole. Should we allow companies to provide that option to security holders? Are any other revisions to the form of proxy appropriate?

10. How Would the Liability Provisions in the Federal Securities Laws Apply to Statements Made By the Company and the Nominating Security Holder or Nominating Security Holder Group?

a. Exchange Act Liability For Statements

It is our intent that the nominating security holder or nominating security holder group be liable for any false or misleading statements included in the notice provided to the company by the nominating security holder or nominating security holder group. The proposed rules contain express language, modeled on Exchange Act Rule 14a-8(l)(2),[138] providing that the company would not be responsible for that disclosure.[139]

b. Securities Act and Exchange Act liability resulting from incorporation by reference

As proposed, the security holder nomination procedure would provide that any information that is provided to the company in the notice from the nominating security holder or nominating security holder group (and, as required, filed with the Commission by the nominating security holder or nominating security holder group) and then included in the company's proxy materials would not be incorporated by reference into any filing under the Securities Act or the Exchange Act unless the company determines to incorporate that information by reference specifically into that filing.[140] However, to the extent the company does so incorporate that information by reference, we would consider the company's disclosure of that information as the company's own statement for purposes of the antifraud and civil liability provisions of the Securities Act or the Exchange Act, as applicable.

c. Questions

J.1. Is it appropriate to characterize the statements in the nominating security holder's notice as the nominating security holder's representations and not the company's? Does the proposal make clear that the nominating security holder would be responsible for the information submitted to the company? Should the proposal characterize these statements differently? If so, please explain in what manner.

J.2. Does the proposal make clear the company's responsibilities when it includes such information in its proxy materials? Should the proposal include language otherwise addressing a company's responsibility for repeating statements that it knows are not accurate?

J.3. Should information provided by nominating security holders or nominating security holder groups be deemed incorporated by reference into Securities Act or Exchange Act filings? Why?

11. How Do the Other Exchange Act Proxy Rules Apply to Solicitations By the Nominating Security Holder or Nominating Security Holder Group?

a. Discussion

As proposed, Exchange Act Rule 14a-11 would permit security holders to form groups that would aggregate their securities in order to meet the minimum ownership threshold of more than 5% to nominate a director candidate under the rule. Accordingly, we anticipate that security holders would, in many instances, engage in communications with other security holders in an effort to form these nominating security holder groups that would be deemed solicitations under the proxy rules. In an effort to facilitate these types of communications, we are proposing a limited exemption from certain of the proxy rules that would enable security holders to communicate for the limited purpose of forming a nominating security holder group without filing and disseminating a proxy statement. To qualify for the exemption, security holders would have two options. The communications would be made either to a limited number of security holders or, in the alternative, to an unlimited number of security holders, provided that the communication is limited in content, as described below, and filed with the Commission.[141]

As proposed, Exchange Act Rules 14a-3 to 14a-6(o),[142] 14a-8, and 14a-10 to 14a-15[143] would not apply to any solicitation by or on behalf of any security holder in connection with the formation of a nominating security holder group, provided that:

- The total number of persons solicited is not more than 30; or
- Each written communication includes no more than:

  - A statement of the security holder's intent to form a nominating security holder group in order to nominate a director under the proposed rule;

  - The percentage of securities that the security holder beneficially owns or the aggregate percentage owned by any group to which the security holder belongs; and

  - The means by which security holders may contact the soliciting party;

and

- Any soliciting material published, sent or given to security holders in accordance with this paragraph is filed with the Commission by the nominating security holder, under the company's Exchange Act file number, no later than the date the material is first published, sent or given to security holders.[144] The soliciting material would be required to include a cover page in the form set forth in Exchange Act Schedule 14A, with the appropriate box on the cover page marked.

Both the nominating security holder or nominating security holder group and the company may wish to solicit in favor of their nominees for director by various means, including U.S. mail, electronic mail, and website postings. While the company ultimately would file a proxy statement and could therefore rely on the existing proxy rules to solicit outside the proxy statement,[145] security holders could be limited in their soliciting activities under the current proxy rules. Accordingly, we are proposing a new exemption to the proxy rules providing that

solicitations by or on behalf of a nominating security holder or nominating security holder group in support of a nominee placed on the company's proxy card in accordance with the proposed rule, would not be subject to Exchange Act Rules 14a-3 to 14a-6(o), 14a-8, and 14a-10 to 14a-15, provided that:

- The soliciting party does not, at any time during such solicitation, seek directly or indirectly, either on its own or another's behalf, the power to act as proxy for a security holder and does not furnish or otherwise request, or act on behalf of a person who furnishes or requests, a form or revocation, abstention, consent or authorization;

- Each written communication includes:

  - The identity of the nominating security holder or nominating security holder group and a description of his or her direct or indirect interests, by security holdings or otherwise;

  - A prominent legend in clear, plain language advising security holders that a security holder nominee is or will be included in the company's proxy statement and to read the company's proxy statement when it becomes available because it includes important information. The legend also must explain to security holders that they can find the proxy statement, other soliciting material and any other relevant documents, at no charge on the Commission's website; and

- Any soliciting material published, sent or given to security holders in accordance with this paragraph must be filed by the nominating security holder or nominating security holder group with the Commission, under the company's Exchange Act file number, no later than the date the material is first published, sent or given to security holders.[146] Three copies of the material would at the same time be filed with, or mailed for filing to, each national securities exchange upon which any class of securities of the company is listed and registered. The soliciting material would be required to include a cover page in the form set forth in Exchange Act Schedule 14A, with the appropriate box on the cover page marked.[147]

b. Questions

K.1. What requirements should apply to soliciting activities conducted by a nominating security holder? In particular, what filing requirements and specific parameters should apply to any such solicitations? For example, we have proposed that certain solicitations by security holders seeking to form a nominating security holder group be limited to no more than 30 security holders. Is this limitation appropriate? If not, what limitation would be appropriate, if any (*e.g.*, fewer than 10 security holders, 10 security holders, 20 security holders, 40 security holders, more than 40 security holders)? In addition, is the alternate, content-based limitation appropriate? If not, what limitations would be more appropriate?

K.2. Should communications in connection with a direct access security holder proposal, for example by security holders seeking to form a more than 1% group to submit a security holder proposal, be included in the exemption provided for communications between security holders seeking to form a nominating security holder group? Would such an exemption be necessary and/or appropriate? If so, what parameters should apply?

K.3. Should all soliciting materials be filed with the Commission on the date of first use? For example, as proposed, security holder communications that are limited to no more than 30 security holders would be filed with the Commission. Would such filing render the limitation unworkable in that the communication would be readily accessible to security holders on EDGAR?

K.4. We contemplate that solicitations in connection with elections involving Exchange Act Rule 14a-11 could involve electronic means. We have provided that, where requested, the company would include in its proxy materials the website address where solicitation materials related to a security holder nominee may be found. Are there other steps that we should take to provide for or encourage the use of electronic means for these elections?

12. How Would the Proposed Rule Apply to Investment Companies?

a. Application of the security holder nomination procedure to investment companies

We are proposing to apply the security holder nomination procedure in proposed Exchange Act Rule 14a-11 to funds. Funds currently are required to comply with the proxy rules under the Exchange Act when soliciting proxies, including proxies relating to the election of directors.[148] As in the case of operating companies, the proposed rules are intended to improve the ability of fund security holders to participate meaningfully in the nomination and election of directors. The nomination procedure would apply to funds in the same manner that it would apply to operating companies, with the following modifications to reflect the different circumstances and reporting requirements applicable to funds.

As in the case of operating companies, the proposed nomination procedure would become operative for a fund only after the occurrence of one or both of the nomination procedure triggering events described above.[149] Funds would be required to provide disclosure regarding the occurrence of these nomination procedure triggering events parallel to that required for operating companies. However, because funds do not file quarterly reports on Exchange Act Form 10-Q, the disclosure would be included on Form N-CSR, which funds file semi-annually.[150] We also are proposing to require disclosure in Form N-CSR regarding each matter submitted to a vote of

security holders similar to that currently required by Item 4 of Part II of Exchange Act Form 10-Q, and to delete as duplicative Item 77C of Form N-SAR, which currently requires similar disclosure.[151]

As with operating companies, if the fund did not hold an annual meeting during the prior year, or if the date of the meeting has changed more than 30 days from the prior year, then the nominating security holder would be required to provide notice a reasonable time before the fund mails its proxy materials for the current year, as specified by the fund in an Exchange Act Form 8-K filed pursuant to proposed Item 13.[152] The fund also would be required to disclose the date of the meeting in Item 13 of Exchange Act Form 8-K. Although funds generally are not required to file on Exchange Act Form 8-K, we are proposing to require them to file on Exchange Act Form 8-K for this limited purpose, in order to help ensure that security holders are made aware in a timely manner of the date by which they must submit a notice of intent to nominate a director.[153]

The proposals would require any nominating security holder or group of security holders to represent that its nominee to the board of a fund is not an "interested person" of the fund as defined in Section 2(a)(19) of the Investment Company Act, rather than independent under the listing standards of a national securities exchange or national securities association, as in the case of operating companies.[154] This "interested person" test also would apply to nominees by a security holder or security holder group for election to the board of directors of a business development company.[155] We are proposing to substitute the Section 2(a)(19) test for the test applied to operating companies because this test is tailored to capture the broad range of affiliations with investment advisers, principal underwriters, and others that are relevant to "independence" in the case of funds.

Because security holders of a mutual fund are not required to file Exchange Act Schedule 13G, the proposals would require a nominating security holder or security holder group for a mutual fund to include the following information, similar to certain information that would otherwise be required on Exchange Act Schedule 13G, as part of the notice to the fund of the security holder's intent to require its nominee on the company's proxy card:[156]

- The percentage of each class of securities of the fund that the individual owns beneficially, directly or indirectly, and the number of shares as to which the person has:

  - Sole power to vote or to direct the vote;

  - Shared power to vote or to direct the vote;

  - Sole power to dispose or to direct the disposition of such shares; and

  - Shared power to dispose or to direct the disposition of such shares;[157] and

- A certification, signed by each person on whose behalf the notice is filed or his or her authorized representative, that the securities have been held continuously for at least three years.[158]

This information would be in addition to the information required to be included in the security holder notice by any nominating security holder or member of a nominating security holder group.[159] The security holder notice, as well as any soliciting material published, sent, or given to security holders in connection with the formation of a nominating security holder group, would be required to be filed under the fund's Investment Company Act file number.[160]

We note that the proposed security holder nomination procedure is consistent with the provisions in several of our exemptive rules under the Investment Company Act that require independent directors of funds relying on those rules to select and nominate any other independent directors.[161] As discussed above, the proposed security holder nomination procedure is premised upon the existence of a state law right of security holders to nominate candidates for election as directors. [162] As we have previously stated, the exemptive rule provision requiring independent directors to select and nominate any other independent director was not intended to supplant or limit the ability of fund security holders under state law to nominate independent directors.[163]

b. Questions

L.1. Should the proposed security holder nomination procedure apply to funds? If so, to which funds should it apply? Are there any aspects of the proposed nomination procedure that should be modified in the case of funds?

L.2. Should we apply the "interested person" standard of Section 2(a)(19) of the Investment Company Act with respect to the representation that a security holder nominee be independent from a company that is a fund? Should the "interested person" standard also apply to security holder nominees for election to the board of directors of a business development company? Should we instead apply a different independence standard to funds or business development companies, such as the definition of independence in Exchange Act Rule 10A-3?[164]

L.3. Is it appropriate to require a nominating security holder or group of security holders of a mutual fund to provide disclosure of its 5% beneficial ownership of the fund's securities in its notice to the fund of its intent to require its nominee on the fund's proxy card? If so, what requirements from Exchange Act Schedule 13G (or other information) should be required to be included in the notice? Should such a security holder or group instead be required to file on Exchange Act
Schedule 13G upon reaching the 5% beneficial ownership threshold, in order to provide the fund with notice in advance that the security holder or group has reached this threshold? If so, are there any requirements of Exchange Act Schedule 13G that should be modified for this purpose?

L.4. Are the triggering events proposed for use of the security holder nomination procedure appropriate for funds? Are there other nomination procedure triggering events that should be used?

L.5. Should a fund be required to provide disclosure on Form N-CSR of whether it would be subject to the security holder nomination procedure as a result of a security holder vote with regard to any of the nomination procedure triggering events, and the required disclosure regarding such a nomination procedure triggering event? Will this disclosure allow sufficient time for a security holder to effectively exercise the nomination procedure?

Should this disclosure instead be required on a different form?

L.6. We are proposing to delete as duplicative Item 77C of Form N-SAR, which currently requires disclosure regarding matters submitted to a vote of security holders similar to that required by Item 4 of Part II of Exchange Act Form 10-Q, and move this disclosure to Form N-CSR. Should this disclosure remain in Form N-SAR?

L.7. Should a fund be required to disclose on Exchange Act Form 8-K the date by which a security holder or security holder group must submit the notice to the fund of its intent to require its nominees on the fund's proxy card? Should funds instead be permitted to provide this disclosure in a different manner?

B. Related Rule Changes

1. Beneficial Ownership Reporting Requirements

a. Discussion

Any person who is directly or indirectly the beneficial owner of more than 5% of a class of equity securities registered under Section 12 of the Exchange Act must report that ownership by filing an Exchange Act Schedule 13D with the Commission.[165] There are exceptions to this requirement, however, that permit such a person to report that ownership on Exchange Act Schedule 13G rather than Exchange Act Schedule 13D.[166] One exception permits filings on Exchange Act Schedule 13G for a specified list of qualified institutional investors who have acquired the securities in the ordinary course of their business and not with the purpose nor with the effect of changing or influencing control of the company. A second exception applies to persons who are not specified in the first exception. These beneficial owners of more than 5% of a subject class of securities may file on Exchange Act Schedule 13G if they have not acquired the securities with the purpose nor with the effect of changing or influencing control of the company and they are not directly or indirectly the beneficial owner of 20% or more of the subject class of securities.

Two of the eligibility requirements for a nominating security holder or nominating security holder group under proposed Exchange Act Rule 14a-11 relate to that security holder or group filing an Exchange Act Schedule 13G to report their ownership. The first is that the security holder or group would have to be eligible to report their ownership on Exchange Act Schedule 13G, rather than Exchange Act Schedule 13D. The second is that the security holder or group would be required to have filed an Exchange Act Schedule 13G to report their ownership by the date that the nominating security holder or nominating security holder group submits its notice of intent to nominate a director to the company.[167]

Central to Exchange Act Schedule 13G eligibility is that the security holder be a passive investor that has acquired the securities without the purpose nor with the effect of changing or influencing control of the company. In addition, security holders who are filing as qualified institutional investors must have acquired the securities in the ordinary course of their business. We believe that the formation of a security holder group solely for the purpose of nominating a director pursuant to proposed Exchange Act Rule 14a-11, the nomination of a director, soliciting activities in connection with such a nominee, or having a nominee elected as a director under the proposed procedure, should not be viewed as having a purpose or effect of

changing or influencing control of the company. We therefore believe that beneficial owners who engage in these activities should be permitted to report on Exchange Act Schedule 13G, rather than Exchange Act Schedule 13D. Accordingly, we are proposing to add an instruction to the description of the first and second categories of persons who may report their ownership on Exchange Act Schedule 13G to make clear our belief that a beneficial owner who acquires or holds a company's securities in connection with a nomination, soliciting activities, or election of a nominee under Exchange Act Rule 14a-11 should not be deemed to have a purpose or effect of changing or influencing the control of the company solely by virtue of making the nomination or engaging in such activities. Any activity other than those provided for under Exchange Act Rule 14a-11 would make these instructions inapplicable.

To enable the functioning of the proposed procedure, we also propose to amend Exchange Act Schedule 13G to require that the security holder or group certify that they have owned at least the required more than 5% amount of the securities for the minimum time period of two years required in proposed Exchange Act Rule 14a-11. A security holder or group of security holders that previously had filed an Exchange Act Schedule 13G would be required to amend that Schedule to provide the required certification to make a nomination under proposed Exchange Act Rule 14a-11.[168] Upon termination of the nominating security holder group, the group would file a final amendment to the Exchange Act Schedule 13G disclosing termination of the group and, therefore, the group's filing obligation on Exchange Act Schedule 13G.[169] As is currently the case in determining that a group has been formed and a group filing is therefore required, the group would be required to file as such only so long as the security holders comprising that group continue to have an agreement to act together for the purpose of acquiring, holding, voting or disposing of the company's equity securities.[170]

b. Questions

M.1. The proposal would provide that a security holder or security holder group would not, solely by virtue of nominating a director under proposed Exchange Act Rule 14a-11, soliciting on behalf of that candidate, or having that candidate elected, be viewed as having acquired securities for the purpose or effect of changing or influencing the control of the company. This provision would then permit those holders or groups of holders to report their ownership on Exchange Act Schedule 13G, rather than Exchange Act Schedule 13D. Is this approach appropriate? Should other conditions be required to be satisfied? If so, what other conditions?

M.2. Should nominating security holders, including groups, be deemed to have a "control" purpose that would create additional filing and disclosure requirements under the Exchange Act beneficial ownership reporting standards?

M.3. As proposed, security holders that intend to nominate a director pursuant to Exchange Act Rule 14a-11 would be required to disclose this intent on Exchange Act Schedule 13G. Those filers who originally filed an Exchange Act Schedule 13G without an Exchange Act Rule 14a-11 intent would be required to amend their Exchange Act Schedule 13G to disclose such intent if it exists. Is it appropriate to require such an amendment by existing filers? If not, how should such filers indicate their intent to make a nomination pursuant to Exchange Act Rule 14a-11? Are the security holder

notice requirements of Exchange Act Rule 14a-11(c) sufficient for this purpose? Intent to use the nomination procedure would be evidenced in both new filings and amendments to already-filed Schedules by the beneficial owner checking the box on the cover page of the Schedule to identify the filing as having been made in connection with a nomination under the procedure and by making the proposed new certification regarding ownership of the required amount of company securities. Is this sufficient notice of the beneficial owner's intent to use the nomination procedure? Should we also require new disclosure related to such intent in a new item requirement to the Schedule? Would this be appropriate in light of the fact that Exchange Act Schedule 13G currently does not require such "purpose" disclosure?

M.4. As proposed, nominating security holders and nominating security holder groups would be required to amend their Exchange Act Schedule 13G filings in accordance with the existing timing requirements for qualified institutional investors and passive investors. Should we instead require that such filers amend on a more expedited basis? For example, should such filers be required to report changes in the information reported previously promptly after such change or within another, specified period of time? Should amendments be limited to material changes in the information reported if such an expedited requirement is used? Should the election as director of a nominating security holder group's nominee be deemed the termination of that group (provided that the group does not have an agreement to act together for some other purpose)? Should such an election require an amendment to the nominating security holder or nominating security holder group's Exchange Act Schedule 13G?

M.5. Are there any qualified institutional investors under Exchange Act Rule 13d-1(b) that would be qualified to file on Exchange Act Schedule 13G but should not be included in the category of filers who may nominate a director using the proposed procedure? If so, please explain why.

M.6. A related issue with regard to beneficial ownership reporting is whether the withhold votes nomination procedure trigger may result in increased numbers of "vote no" campaigns by security holders who are attempting to trigger the nomination procedure. The possibility of triggering Exchange Act Schedule 13D reporting requirements currently may have a chilling effect on security holders who otherwise would organize such an effort. With regard to this concern, do the current rules under Exchange Act Regulation 13D have such a chilling effect? Are the current rules sufficient to determine when such activities should require additional security holder filings? Should security holders who organize such a campaign be deemed to have a control purpose or effect that would necessitate filing on Exchange Act Schedule 13D rather than Exchange Act Schedule 13G? Should we issue specific guidance with regard to these "vote no" campaigns and the beneficial ownership reporting requirements generally? Should any such guidance be limited to circumstances where the security holder engaging in the "vote no" campaign does so solely to trigger the security holder nomination procedure?

2. Exchange Act Section 16

a. Proposed amendments to rules under Exchange Act Section 16

Eligible security holder groups under proposed Exchange Act Rule 14a-11 may be concerned that using the proposed nomination procedure will subject them to Section 16 of the Exchange Act.[171] Exchange Act Section 16 applies to every person who is the beneficial owner of more than 10% of any class

of equity security registered under Section 12 of the Exchange Act ("10% owners"), and each officer and director (collectively with 10% owners, "insiders") of the issuer of such security. Generally:

- Exchange Act Section 16(a) requires an insider to file an initial report with the Commission disclosing his or her beneficial ownership of all equity securities of the issuer upon becoming an insider. To keep this information current, Exchange Act Section 16(a) also requires insiders to report changes in such holdings, in most cases within two business days following the transaction.[172]

- Exchange Act Section 16(b) provides the issuer (or security holders suing on behalf of the issuer) a private right of action to recover from an insider any profit realized by the insider from any purchase and sale (or sale and purchase) of any equity security of the issuer within any period of less than six months.[173]

- Exchange Act Section 16(c) makes it unlawful for an insider to sell any equity security of the issuer if the insider: (1) does not own the security sold; or (2) owns the security, but does not deliver it against the sale within specified time periods.[174]

We do not believe that a group formed solely for the purpose of nominating a director pursuant to proposed Exchange Act Rule 14a-11, soliciting in connection with the election of that nominee, or having that nominee elected as a director, would be the type of group that should be viewed as being aggregated together for purposes of Exchange Act Section 16. Their actions are fully disclosed and are not for a "control" purpose, and they clearly do not have presumed "insider" status. Moreover, we believe it would be a disincentive to using the proposed security holder nomination procedure if security holders forming a group to nominate a director could become subject to Exchange Act Section 16 once the group owned over 10% of the company's equity securities. Accordingly, we are proposing an amendment to Exchange Act Rule 16a-1(a)(1), the rule that defines who is a 10% owner for Exchange Act Section 16 purposes, to exclude an Exchange Act Rule 14a-11 nominating security holder group from the definition.[175] These groups would remain subject to the general condition of the rule that they not have the purpose or effect of changing or influencing control of the issuer, but a note to Exchange Act Rule 16a-1(a)(1) would provide that members of nominating security holder groups would not be deemed to have a control purpose or effect solely by virtue of group membership.[176] We are not proposing to exclude from the definition of beneficial ownership for purposes of Exchange Act Section 16 security holders whose individual ownership exceeds 10% and are not otherwise excluded under the current rule.

Some security holders, particularly institutions and other entities, may be concerned that successful use of the proposed nomination procedure to elect a director may result in the nominating person also being deemed a director under the "deputization" theory developed by courts in Exchange Act Section 16(b) short-swing profit recovery cases.[177] Under this theory it is possible for a person to be deemed a director subject to Exchange Act Section 16, even though the issuer has not formally elected or otherwise named that person a director. The judicial decisions in which this theory was applied do not establish precise standards for determining when "deputization" may exist. However, the express purpose of Exchange Act Section 16(b) is to prevent the unfair use of information by insiders through their relationships

178

to the issuer.— Accordingly, one factor that courts may consider in determining if Exchange Act Section 16(b) liability applies is whether, by virtue of the "deputization" relationship, the "deputizing" entity's transactions in issuer securities may benefit from the deputized director's access to inside information.[179]

Proposed Exchange Act Rule 14a-11 includes standards for establishing the independence of the nominee from the nominating security holder, or members of the nominating security holder group, as applicable. We believe that, given these independence standards the "deputization" theory, whereby the beneficial ownership of a security holder or group is imputed to a "deputized" director (and director status imputed to the security holder or group), should not apply. In considering the proposed independence standards, discussed in Section II.A.8, above, commenters also should consider the director by "deputization" theory, and whether the proposed standards should be modified in any way to make it less likely that in Exchange Act Section 16(b) cases courts would find nominating security holders to be "deputized" directors in circumstances where liability should not apply.

b. Questions

N.1. Would the proposed Exchange Act Rule 16a-1(a)(1) amendments address nominating security holders and nominating security holder groups appropriately? Should the proposed exclusion be based on any additional or different conditions?

N.2. If the Commission adopts a security holder nomination rule with an eligibility threshold of 10% or greater, would Exchange Act Section 16 reporting and short swing profit liability deter the formation of nominating security holder groups?

C. General Request for Comment

We request and encourage any interested person to submit comments regarding:

- the proposed amendments that are the subject of this release;
- additional or different changes; or
- other matters that may have an effect on the proposals contained in this release.

We request comment from the point of view of companies, investors and other market participants. With regard to any comments, we note that such comments are of great assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments.

III. Paperwork Reduction Act

A. Background

The proposed amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995.[180] We are submitting the proposal to the Office of Management and Budget for review in accordance with the PRA.[181] The titles for the collections of information

are:

(1) "Proxy Statements - Regulation 14A (Commission Rules 14a-1 through 14a-15 and Schedule 14A)" (OMB Control No. 3235-0059);

(2) "Information Statements - Regulation 14C (Commission Rules 14c-1 through 14c-7 and Schedule 14C)"[182] (OMB Control No. 3235-0057);

(3) "Securities Ownership - Regulation 13D and 13G (Commission Rules 13d-1

through 13d-7 and Schedules 13D and 13G)" (OMB Control No. 3235-0145);

(4) "Form 10-K" (OMB Control No. 3235-0063);

(5) "Form 10-KSB" (OMB Control No. 3235-0420);

(6) "Form 10-Q" (OMB Control No. 3235-0070);

(7) "Form **10-QSB**" (OMB Control No. 3235-0416);

(8) "Form 8-K" (OMB Control No. 3235-0060);

(9) "Form N-CSR under the Investment Company Act of 1940 and Securities Exchange Act of 1934, Certified Shareholder Report" (OMB Control No. 3235-0570);

(10) "Form N-SAR under the Investment Company Act of 1940, Semi-Annual Report for Registered Investment Companies" (OMB Control No. 3235-0330); and

(11) "Rule 20a-1 under the Investment Company Act of 1940, Solicitations of Proxies,

Consents, and Authorizations" (OMB Control No. 3235-0158).

These regulations, rules and forms were adopted pursuant to the Exchange Act and the Investment Company Act and set forth the disclosure requirements for securities ownership reports filed by investors and proxy and information statements,[183] periodic reports and current reports filed by companies to ensure that investors are informed and can make informed voting or investing decisions. The hours and costs associated with preparing, filing and sending these schedules and forms constitute reporting and cost burdens imposed by each collection of information. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

B. Summary of Proposed Amendments

The proposed rules would, under certain limited circumstances, require companies to include in their proxy materials security holder nominees for election as director. Specifically, the proposed rules would create a mechanism for nominees of long-term security holders, or groups of long-term security holders, with significant holdings to be included in company proxy materials where security holders are permitted under state law to nominate directors and where evidence suggests that the company has been unresponsive to security holder concerns as they relate to the proxy process. For purposes of the PRA, we estimate the total annual incremental

paperwork burden for operating companies, funds and security holders that would be required under our proposed rules to be approximately 1,793 hours of personnel time for operating companies, funds and security holders and a cost of approximately $409,000 for the services of outside professionals.[184] As discussed further below, these total costs include all additional disclosure burdens associated with the proposed rules including burdens related to the triggering events, notice requirements and direct access itself.[185] Compliance with the proposed requirements would be mandatory. There would be no mandatory retention period for the information disclosed, and responses to the disclosure requirements would not be kept confidential.

1. Applicability of Proposed Exchange Act Rule 14a-11

a. State law considerations

The proposed rules would apply only where the company's security holders are permitted under state law to nominate a candidate or candidates for election as a director. We do not know the precise number of states that prohibit security holders from nominating a candidate or candidates for election as director or the number of companies that are permitted to and do/or (would) include a prohibition against nominating a candidate or candidates in their articles of incorporation or bylaws. We request comment and supporting empirical data, for purposes of the PRA, on any existing, applicable state law provisions that would prohibit security holders or security holder groups from nominating a candidate or candidates for election as director.

b. Nomination procedure triggering events

The proposed security holder nomination procedure would become operative for the company only after the occurrence of one or both of the following two nomination procedure triggering events:

- At least one of the company's nominees for the board of directors for whom the company solicited proxies received "withhold" votes from more than 35% of the votes cast at an annual meeting of security holders held after January 1, 2004, at which directors were elected (provided, that this event may not occur in the case of a contested election to which Exchange Act Rule 14a-12(c) applies or an election to which the proposed security holder nomination procedure in Exchange Act Rule 14a-11 applies); or

- A security holder proposal submitted pursuant to Exchange Act Rule 14a-8 providing that the company become subject to the security holder nomination procedure in proposed Exchange Act Rule 14a-11 (a) was submitted for a vote of security holders at an annual meeting of security holders held after January 1, 2004 by a security holder or group of security holders that held more than 1% of the company's securities entitled to vote on the proposal for one year as of the date the proposal was submitted and provided evidence of such holding to the company; and (b) that "direct access" proposal received more than 50% of the votes cast on that proposal at that meeting.

Exchange Act Schedule 14A prescribes the information that a company must include in its proxy statement to ensure that security holders are provided material information relating to voting decisions. Exchange Act Schedule 14C prescribes the information that a company that is registered under Section

12 of the Exchange Act must include in its information statement in advance of a security holders' meeting when it is not soliciting proxies from its security holders, including the taking of corporate action by written authorization or consent of security holders. Exchange Act Rule 14a-8 requires the company to include a security holder proposal in its Exchange Act Schedule 14A or 14C unless the security holder has not complied with the procedural requirements in Exchange Act Rule 14a-8 or the proposal falls within one of the 13 substantive bases for exclusion in Exchange Act Rule 14a-8. Investment Company Act Rule 20a-1 requires registered investment companies to comply with Exchange Act Regulation 14A or 14C, as applicable.[186]

For purposes of the PRA, we estimate the total annual incremental paperwork burden for operating companies and security holders or security holder groups to prepare the disclosure that would be required under this portion of the proposed rules to be approximately 648 hours of personnel time and a cost of approximately $64,800 for the services of outside professionals.[187] These burdens and costs include the new disclosure requirement that the company notify security holders that it has received a proposal seeking direct access by a more than 1% security holder who has held the securities for at least one year. They also include the burdens and costs associated with the Exchange Act Rule 14a-8 security holder proposal process, including the security holder or security holder groups' preparation of the security holder proposal, the company's preparation of a no-action request, if applicable, and the company's preparation of the statement of opposition if the proposal is included in the proxy materials.[188] Because Exchange Act Rule 14a-8 already requires companies to have a process for reviewing security holder proposals, the proposed amendments should not impose new incremental burdens and costs on companies in connection with such reviews or with training personnel.

We believe that the annual incremental PRA burden due to the triggering events is likely to arise from the submission of Exchange Act Rule 14a-8 security holder proposals by holders of 1% or more of a company's securities providing that the company become subject to the security holder nomination procedure in proposed Exchange Act Rule 14a-11. We estimate that the number of such proposals would be 54.[189] We estimate an annual incremental disclosure burden of 1 hour for each company to disclose that it has received a security holder proposal seeking direct access by an over 1% security holder who has held the securities for one year, for a total of 54 hours. We estimate that the annual incremental disclosure burden for the proponent's preparation of the proposal and the Exchange Act Rule 14a-8 no-action process would average 15 hours per proposal, for a total of 810 hours.[190]

We do not believe that there would be any increased paperwork burden under this portion of the proposed rules for the triggering event related to company nominees for directors who receive over 35% "withhold" votes.

We estimate that this total burden of 864 hours would result in 648 hours of internal time and $64,800 of outside costs.

2. Notice Requirements

Proposed Exchange Act Rule 14a-11 would require each company to disclose the following:

- Each company would be required to disclose the security holder vote with regard to any of the nomination procedure triggering events in its quarterly report on Exchange Act Form 10-Q or 10-QSB for the period in which the matter was submitted to a vote of security holders; where the nomination procedure triggering event occurred during the fourth quarter of the fiscal year, on Exchange Act Form 10-K or 10-KSB; or semi-annually on Investment Company Act Form N-CSR, in the case of a fund;[191] and

- Each company would be required to include in that Exchange Act Form 10-Q, 10-QSB, Exchange Act Form 10-K or 10-KSB, or Investment Company Act Form N-CSR, information disclosing that it would be subject to the security holder nomination procedure as a result of such vote, if applicable.

If the company did not hold an annual meeting during the previous year, or if the date of the current year's annual meeting has been changed by more than 30 days from the previous year's annual meeting, the company would be required to disclose the date by which security holders must submit their notice to require that the company include the security holder's nominee on the company's proxy card.

For purposes of the PRA, we estimate the annual incremental paperwork burden for companies to prepare the disclosure that would be required under this portion of the proposed rules to be approximately 86 hours of company personnel time and a cost of approximately $8,700 for the services of outside professionals.[192] This estimate includes the company's cost to disclose the security holder vote with regard to a security holder proposal seeking direct access,[193] the company's cost to disclose that it would be subject to the security holder nomination procedure, if applicable, and the company's cost to disclose the date of the annual meeting if the company did not hold an annual meeting during the prior year or if the date of the meeting changed by more than one year. This estimate includes the time and the cost of preparing disclosure that has been appropriately reviewed by executive officers, the disclosure committee, in-house counsel, outside counsel, and members of the board of directors.

As noted above, we estimate that 54 companies would receive a direct access security holder proposal, which we estimate would average approximately 0.5 hours burden hours, for a total of 27 hours. We estimate that 73 companies would need to disclose that they are subject to the security holder nomination procedure, which we estimate would average approximately 1 burden hour, for 73 hours annually.[194] We estimate that 3 of these 73 companies would need to file the Exchange Act Form 8-K because the company did not hold an annual meeting during the prior year or the date of the annual meeting has changed more than 30 days from the prior year.[195] We estimate 5 burden hours to prepare, review and file the Exchange Act Form 8-K, for a total of 15 hours.

This total burden of 115 hours corresponds to 86 hours of internal time and $8,700 in outside costs.

3. Exchange Act Rule 14a-11 Nomination Procedure

To be eligible to submit a nomination in accordance with proposed Exchange Act Rule 14a-11, a security holder or group of security holders would be required to:

- Beneficially own, either individually or in the aggregate, more than 5% of the company's securities that are eligible to vote for the election of directors at the next annual meeting of security holders (or, in lieu of such an annual meeting, a special meeting of security holders), with each of the securities used for purposes of calculating that ownership having been held continuously for at least two years as of the date of the nomination and intend to continue to own those securities through the date of that annual or special meeting;

- Be eligible, as to the security holder or each member of the security holder group, to report beneficial ownership on Exchange Act Schedule 13G and have filed an Exchange Act Schedule 13G or an amendment to Exchange Act Schedule 13G reporting their beneficial ownership as a passive or institutional investor (or group), which Schedule must include a certification that the security holder or security holder group has held more than 5% of the subject securities for at least two years;[196] and

- Provide notice to the company of its intent to require that the company include that security holder's nominee(s) on the company's proxy card and make certain representations and provide information about the candidate or candidates.

Unless the company determines that it is not required to include a nominee from a nominating security holder or nominating security holder group in its proxy materials, the company would be required to include information regarding the security holder nominee in the company's proxy statement. In addition, if the company chooses to include statements supporting company nominees and/or opposing the nominating security holder's nominees, nominating security holders would be afforded the same opportunity. If the company determines that it is not required to include a nominee in its proxy materials, it must provide notice of its determination.

For purposes of the PRA, we estimate the total annual incremental paperwork burden for operating companies and security holders or security holder groups to prepare the disclosure that would be required under this portion of the proposed rules to be approximately 668 hours of personnel time and a cost of approximately $282,600 for the services of outside professionals.[197] This estimate includes the security holder or security holder group's preparation of the nominating security holder or nominating security holder group's notice to the company of its intent to require that the company include that security holder's nominee on the company's proxy card; the security holder or security holder group's preparation and filing of an Exchange Act Schedule 13G and the related certification; and the security holder or security holder group's preparation of a statement of support for its candidate or candidates and/or opposition to the company's nominees, if applicable. This estimate also includes the company's preparation and review of the information to be included in the proxy materials if a nominee is to be included in the proxy materials, and the company's preparation and review of its statement of opposition to the security holder's nominee, if applicable. If the company determines that the security holder's nominee can be excluded from the proxy materials, this annual incremental burden also includes the company's preparation of the notice as to why the nominee is not eligible.

We estimate that the proposed access rule would be triggered in 73

companies, and in 45 of these companies at least one security holder or security holder group would make a nomination.[198] Further, we estimate that, in companies where a nomination is made, an average of 2 security holders or security holder groups would submit a nomination. We estimate that the disclosure burden for each of these 90 nominating security holders or nominating security holder groups to provide notice of its intent to require that the company include the security holder's nominee in the company's proxy materials would be approximately 4 hours, for a total of 360 hours. We also estimate that the disclosure burden for these 90 security holders or security holder groups to review and file an Exchange Act Schedule 13G and certification would be approximately 12 hours, for a total of 1,080 hours.

In order to conservatively estimate the PRA burden, we estimate that 49 nominees would be excluded from the proposed Exchange Act Rule 14a-11 nomination procedure.[199] We estimate that the annual disclosure burden for companies to notify the 49 nominating security holders or nominating security holder groups of their determination not to include the nominee(s) in its proxy materials would be 1 hour, for a total of 49 hours. We estimate the annual disclosure burden for companies to include the remaining 41 nominees in their proxy materials to be 1 burden hour, for a total of 41 hours. Of these 41 companies, we estimate that 20 companies would include a statement with regard to the security holder nominee or nominee.[200] We estimate that this burden would be approximately 2 hours. Similarly, we estimate the disclosure burden for the security holder or security holder group to prepare a statement of support for its nominee or nominees to be approximately 2 burden hours.[201]

We estimate that this total burden of 1,610 hours would result in 668 hours of internal time and $282,600 of outside costs.

All of the figures above are estimates because there is no reliable way to predict how many more security holder proposals would be submitted based on the proposed amendments, how often the events would be triggered or how many security holders would be able to meet the applicable requirements (*e.g.*, minimum ownership threshold). We request comment and supporting empirical data on whether, for purposes of the PRA, there likely would be an increase in the number of Exchange Act Rule 14a-8 security holder proposals that companies receive as a result of creating triggering events to activate the nomination procedure; how often the triggering events likely would be triggered; and how likely it would be for security holders or security holder groups to be able to meet the requirements under proposed Exchange Act Rule 14a-11. We also request comment and supporting empirical data on the costs of submitting a no-action request.

C. Revisions to PRA Reporting and Cost Burden Estimates

Table 1 below illustrates the incremental annual compliance burden of the collection of information in hours and in cost for securities ownership reports filed by investors and proxy and information statements, periodic reports and current reports under the Exchange Act. [202] The burden was calculated by multiplying the estimated number of responses by the estimated average number of hours each entity spends completing the form. We estimate that 75% of the burden of preparation of the proxy and information statement, periodic reports and current reports is carried by the company and security holder or security holder groups internally and that

25% of the burden of preparation is carried by outside professionals at an average cost of $300 per hour. We estimate that 100% of the burden for preparing Form N-SAR is carried by the fund. We estimate that 25% of the burden of preparation of securities ownership filings is carried by the security holder or security holder groups internally and that 75% of the burden of preparation is carried by outside professionals at an average cost of $300 per hour. The portion of the burden carried by outside professionals is reflected as a cost, while the portion of the burden carried internally by the company and security holder or security holder groups is reflected in hours.[203]

Table 1: Calculation of Incremental PRA Burden Estimates[204]

	Annual Responses	Annual Responses Affected	Incremental Hours/ Form	Incremental Burden	75% Company	25% Professional	$300 Prof. Cost
		(A)	(B)	(C)=(A) × (B)	(D)=(C) × 0.75	(E)=(C) × 0.25	(F)=(E) × $300
SCH 14A***	7,188	104	12.56	1,306	980	326	$97,800
SCH 14C***	446	7	12.56	88	66	22	$6,600
FORM 10-K*	8,484	28	0.9	25	19	6	$1,800
FORM 10-Q*	23,743 (7,914 respondents)	83	0.9	75	56	19	$5,700
FORM 8-K	333,915 (13,200 respondents)	3	5	15	11	4	$1,200
FORM N-CSR	6658 (3829 respondents)	281	0.575	161.5	21.1	40.4	$12,120
Rule 20a-1**	1,058	24	22.75	546	410	136	$40,800
	Annual Responses	**Annual Responses Affected**	**Incremental Hours/ Form**	**Incremental Burden**	**25% Company**	**75% Professional**	**$300 Prof. Cost**
SCH 13G	9,500	90	12	1,080	270	810	$243,000
	Annual Responses	**Annual Responses Affected**	**Incremental Hours/ Form**	**Incremental Burden**	**100% Company and Security Holders**	**0% Professional**	**$300 Prof. Cost**
FORM N-SAR	9306 (4653 respondents)	281	(0.5)	(140.5)	(140.5)	0	0
Total				**3,156**	**1792.6**	**1363.4**	**$409,020**

* These figures have been prorated across all the estimated number of responses affected.

** We have reflected the security holder's provision of notice to the company of its intent to require the company to include the security holder's nominee on the company's proxy card as a burden under Exchange Act Schedules 14A and 14C and Rule 20a-1.

D. Solicitation of Comment

Pursuant to 44 U.S.C. 3506(c)(2)(B), we solicit comments to: (i) evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (ii) evaluate the accuracy of our estimate of the burden of the proposed collection of information; (iii)

determine whether there are ways to enhance the quality, utility and clarity of the information to be collected; and (iv) evaluate whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on the collection of information requirements should direct the comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should send a copy to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609, with reference to File No. S7-19-03. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7-19-03, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services, 450 Fifth Street, NW, Washington, DC 20549. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this release. Consequently, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

IV. COST-BENEFIT ANALYSIS

A. Background

On April 14, 2003, the Commission directed the Division of Corporation Finance to review the proxy rules and regulations and their interpretations regarding procedures for the nomination and election of corporate directors[205] and on May 1, 2003, the Commission solicited public input on the Division's review.[206] On July 15, 2003, after considering the views expressed by commenters, the Division of Corporation Finance provided to the Commission its report and recommended changes to the proxy rules related to the nomination and election of directors.[207] To best address many of the issues raised by commenters, the Division recommended changes in two areas - disclosure related to nominating committee functions and security holder communications with boards of directors and enhanced security holder access to the proxy process relating to the nomination of directors.[208] On August 14, 2003, we published for comment proposed rules that would implement the first of the Division's recommendations - new disclosure standards requiring more robust disclosure of the nominating committee processes of public companies, including the consideration of candidates recommended by security holders, as well as more specific disclosure of the processes by which security holders may communicate with the directors of the companies in which they invest.[209] Today, we are proposing rules that would implement the second of the Division's recommendations. These proposed rules would require companies to include in their proxy materials security holder nominees for election as director under certain limited circumstances.

Under the existing structure, security holders generally can have input in the director nomination procedure in two ways: undertake an election contest and recommend candidates to the nominating committee. In the broad proxy revisions adopted in 1992, the Commission eased the requirements for security holders conducting an election contest in a non-control context when it revised Exchange Act Rule 14a-4(d) to allow security holders

seeking minority board representation to "fill out" a partial or "short" slate with management nominees. Under the current proxy rules, these security holders still must disseminate and file a separate proxy statement. Although commenters noted the availability of this existing alternative, many other commenters noted the prohibitive expense in conducting an election contest.[210] Pursuant to a company's bylaws, security holders also may recommend board candidates to the nominating committee. Several commenters noted that this process is not effective and expressed the view that nominating committees rarely include security holder candidates in company proxy materials.[211]

After reviewing the existing proxy rules and comments from the public, we are proposing rules that would create a mechanism for nominees of long-term security holders, or groups of long-term security holders, with significant holdings to be included in company proxy materials. The intent of the proposed amendments is to improve the ability of security holders to participate meaningfully in the nomination and election of directors where evidence suggests that the company has been unresponsive to security holder concerns as they relate to an effective proxy process. Greater security holder involvement also may increase director accountability and responsiveness to security holders and their concerns.

The Commission has considered a variety of reforms to achieve its regulatory objectives. As one possible approach, we considered requiring companies to include a separate security holder proxy card in the company mailing. Alternatively, we considered amending Exchange Act Rule 14a-8(i)(8)[212] to allow security holder proposals requesting access to the company's proxy card for the purpose of making nominations. Based on comments we have received to date, we believe that requiring companies to include in their proxy materials security holder nominees for election as director under certain limited circumstances would best address the concerns raised by commenters and would provide the most benefit for the least cost.

B. Potential Benefits of the Proposed Rules

The proposed amendments may serve to align the interests of the board and security holders, thereby giving investors greater confidence that the board is serving the interest of security holders, even if the provisions of the rule are rarely used.[213] This alignment can occur in three ways. First, the presence of triggering events, as described below, may improve the responsiveness of boards to security holder preferences. Second, the disclosure requirements may enable investors to better understand and evaluate the performance of the board. Third, the ability of relatively large and long-term security holders to make a board nomination that is included in the company's proxy materials may improve corporate governance by enhancing security holders' ability to participate meaningfully in the proxy process.

The security holder nomination procedure would become operative only if one or both of the following triggering events occur:

- At least one of the company's nominees for the board of directors for whom the company solicited proxies received "withhold" votes from more than 35% of the votes cast at an annual meeting of security holders; or

- A security holder proposal submitted pursuant to Exchange Act Rule 14a-8 providing that the company become subject to the security holder nomination procedure in proposed Exchange Act Rule 14a-11 (a) was submitted for a vote of security holders at an annual meeting of security holders by a security holder or group of security holders that held more than 1% of the company's securities entitled to vote on the proposal for one year as of the date the proposal was submitted and provided evidence of such holding to the company; and (b) that "direct access" proposal received more than 50% of the votes cast on that proposal at that meeting.

Allowing security holders access to company proxy materials in these two circumstances would limit the use of proposed Exchange Act Rule 14a-11 to companies where there is evidence indicating ineffectiveness of or dissatisfaction with the proxy process. In addition, the triggering events may serve to make boards more responsive to security holder concerns and security holder dissatisfaction with directors in cases where companies wish to avoid triggering the procedure in proposed Exchange Act Rule 14a-11.

Under the proposed rules, a company would be required to disclose the security holder vote with respect to either of the triggering events and whether the company would be subject to proposed Exchange Act Rule 14a-11. These proposed notice requirements may benefit security holders by providing greater transparency of the level of security holder discontent with the company's nominees and the degree to which security holders believe a company is responsive to security holder concerns.

In those cases where proposed Exchange Act Rule 14a-11 is triggered, requiring companies to include nominees of larger, long-term security holders or groups of security holders may benefit security holders by allowing them to have greater input in the nomination procedure where there is evidence indicating that the proxy process may be ineffective. Greater security holder input may lead to better performing boards whose interests are better aligned with security holders. When a security holder nominee is elected to a board, commenters were also of the opinion that this may lead to a more diverse board that could offer a fresh perspective and improve boardroom dynamics.[214]

C. Potential Costs of the Proposed Rules

The proposed rules may impose additional direct costs. For purposes of the PRA, we estimate that the annual incremental burden to prepare the required disclosure would be approximately 1,828 hours of personnel time for operating companies, funds, and security holders, which translates into an estimated cost of $155,400 ($1,200 per company affected).[215] We also estimate a cost of approximately $398,400 for the services of outside professionals ($3,000 per company affected).[216]

As we noted above, under the current rules, security holders generally can participate in the director nomination procedure only by recommending candidates to the nominating committee or by undertaking an election contest. As previously noted, commenters have found the first alternative to be largely ineffective and the latter to be too costly. Given the high costs associated with undertaking an election contest, many of the costs of the proposed rules to companies would be offset by the cost to security holders of undertaking an election contest.

For example, companies may incur additional printing and mailing costs if there is an increase in the number of security holder proposals seeking direct access that companies receive and must include in their proxy materials. Companies also may incur incremental printing and mailing costs to include the name and background information of security holder nominees in their proxy materials. In 1998, when the Commission last sought comment on a proxy rule amendment, companies reported that the average cost of printing and mailing security holder proposals was approximately $50,000.[217] In response to our May 203 request for public input, one commenter noted that increasing the weight of a company's proxy materials by two ounces could increase the cost of mailing 100,000 packages by $308,825.[218] The additional incremental printing and mailing costs would vary based on the number of security holder proposals that are required to be included in a company's proxy materials, the number of security holder nominees that are required to be included in company proxy materials and the size and weight of a company's existing proxy statement.

The additional incremental cost of printing and mailing security holder proposals seeking direct access and including security holder or security holder nominees in the company's proxy material would likely represent costs that would otherwise be borne by security holders to print and mail their own complete proxy statement when a security holder undertakes an election contest.

There also may be increased costs associated with additional solicitations by both companies and security holders. Companies may increase solicitations to vote against security holder proposals or to vote for their slate of directors. Security holders may also increase solicitations to vote for security holder proposals or to withhold votes for a company's directors. Similarly, companies may also increase their costs for solicitations if security holders or security holder groups undertake election contests. For the purposes of the PRA, we estimate that the proposed Exchange Act Rule 14a-11 nomination procedure would occur in 41 incidences for operating companies and 9 incidences for funds.

There also may be a cost if the proposed rules serve to influence corporate behavior. Commenters argued that there is no evidence that security holder access would lead to better managed companies.[219] To the extent that there is a change in corporate behavior, companies may incur additional costs in instituting more responsive policies and procedures to address security holder concerns. Commenters also were concerned that the time a company spends on its security holder relations could lessen the time that boards would have to engage in strategic and long-term thinking.[220] Such a decrease in the time spent by a board on overseeing the management of a company may negatively affect the value of security holders' investments.

In those cases where proposed Exchange Act Rule 14a-11 would be triggered, commenters also were concerned that security holder access may discourage qualified board members from running.[221] If a security holder nominee is elected, commenters were further concerned that the security holder-nominated director may disrupt boardroom dynamics and polarize the board.[222] In particular, commenters expressed concern that the security holder access rule could be used by special interest groups who have interests that are different from security holders generally.[223] Any potential degradation in the quality of the individuals on the board may decrease the value of security holder investments.

D. Small Business Issuers

Although the proposed rules apply to small business issuers, we do not anticipate any significant impact on them. Small businesses historically have received fewer security holder proposals than larger issuers.[224] Further, the number of security holder proposals that generally receive a majority vote, the number of directors that receive 35% "withhold" votes, and the percentage of nominating security holders that meet the ownership threshold and holding periods may be lower for small business issuers than other issuers since insiders generally hold a large percentage of shares in small businesses.[225] While we recognize that issues of corporate accountability and security holder rights may affect small companies as much as they affect large companies, we have included a specific request for comment regarding whether only those operating companies that fall within the definition of "accelerated filer" in Exchange Act Rule 12b-2 should be subject to the security holder nomination procedure. Implementing the proposed rule in this fashion would avoid the disproportionate burdens of regulation that the proposed procedure may impose on smaller companies. It also would allow our staff and the markets to gain experience with the proposed rule in an initial stage in which the rule applied only to larger companies, while we would retain the ability to expand the rule's application to all companies after gaining this experience. In addition, the information available to us suggests that interest in the proxy process is, to a significant degree, concentrated within the universe of companies that are accelerated filers.

E. Request for Comments

We are sensitive to the costs and benefits imposed by our rules, and have identified certain costs and benefits imposed by these proposals. We request comment on all aspects of this cost-benefit analysis, including identification of any additional costs and benefits. We encourage commenters to identify and supply relevant data concerning the costs and benefits of the proposed amendments. We also request comment on the following specific concerns:

O.1. We solicit quantitative data to assist our assessment of the benefits and costs of enhanced security holder access to company proxy materials when there has been a demonstrated failure in the proxy process. Will proposed Exchange Act Rule 14a-11 increase director accountability and responsiveness? If so, what costs would be incurred in instituting responsive policies and procedures? Will more accountability and responsiveness lead to better managed boards? What effects, if any, would increased accountability and responsiveness have on the board's time spent in its duties overseeing management?

O.2. We solicit quantitative data on the potential increases, if any, of security holder proposals under Exchange Act Rule 14a-8 as a result of these proposed rules. We also solicit quantitative data on how often the two triggering events that would activate proposed Exchange Act Rule 14a-11 would occur.

O.3. We solicit quantitative date on the time and cost spent in preparing a no-action request to exclude a proposal under Exchange Act Rule 14a-8, the incremental cost spent to print and mail such a security holder proposal and to include a security holder nominee and his/her background information in the proxy materials, and the cost borne by both companies and security holders to solicit security holders regarding a direct access security holder

proposal and election of a nominee or nominees to the board.

V. Consideration of Burden on Competition and Promotion of Efficiency, Competition and Capital Formation

Section 23(a)(2) of the Exchange Act[226] requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. In addition, Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. The proposed rules are intended to provide security holders with information about security holder nominees in company proxy materials where there has been evidence of an ineffective proxy process. The proposed rules should increase the transparency of security holder concerns and boards responsiveness to those concerns, increase investor confidence, and potentially cause companies to be better managed. Companies may consider their existing policies and responses to security holder concerns in relation to the policies and responses of other companies. As a result, companies may compete to adopt policies and procedures that effectively balance security holder and director interests and therefore attract investors.

The notice requirements of the proposed rules would enable investors to compare companies' responsiveness to security holder proposals and compare security holders' general level of satisfaction with companies' nominees for director. Investors may place a premium on companies that are more responsive to security holder concerns and whose boards' interests are more closely aligned with those of security holders.

In addition, if a company is required to include a security holder nominee in its proxy materials, there may be increased competition for board positions. To the extent that this would discourage less-qualified candidates from running or, alternatively, would increase the quality of board members due to increased competition, investors may be more or less willing to invest in those companies where proposed Exchange Act Rule 14a-11 has been triggered.

We request comment regarding the degree to which our proposed disclosure requirements would create competitively harmful effects upon public companies, and how to minimize those effects. We also request comment on any disproportionate cross-sectional burdens among the firms affected by our proposals that could have anti-competitive effects.

Section 3(f) of the Exchange Act[227] and Section 2(c) of the Investment Company Act[228] require us, when engaging in rulemaking that requires us to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation.

One possible adverse impact on efficiency, competition and capital formation is that boards may devote less time to overseeing the management of companies because they are spending more time on security holder relations. We believe, however, that the proposed rules may increase director accountability and responsiveness, which would lead to better corporate governance and better-managed boards. As a result, we believe that these measures ultimately may serve to enhance investors' value. In addition, we believe that investors may be able to evaluate a

company's board of directors more effectively and make more informed investment decisions. We believe that, as a consequence of these developments, there may be some positive impact on the efficiency of markets and capital formation. The possibility of these effects, their magnitude if they were to occur and the extent to which they would be offset by the costs of the proposals are difficult to quantify. We request comment on these matters and how the proposed amendments, if adopted, would affect efficiency and capital formation. Commenters are requested to provide empirical data and other factual support to the extent possible.

VI. Initial Regulatory Flexibility Act Analysis

This Initial Regulatory Flexibility Act Analysis has been prepared in accordance with 5 U.S.C. 603. It relates to proposed revisions to the rules and forms under the Exchange Act and the Investment Company Act that would, under certain limited circumstances, require companies to include in their proxy materials security holder nominees for election as director. The proposals are intended to improve the ability of security holders to participate meaningfully in the nomination and election of directors.

A. Reasons for the Proposed Action

On April 14, 2003, the Commission directed the Division of Corporation Finance to review the proxy rules and regulations and their interpretations regarding procedures for the nomination and election of corporate directors[229] and on May 1, 2003, the Commission solicited public input on the Division's review.[230] On July 15, 2003, after considering the views expressed by commenters, the Division of Corporation Finance provided to the Commission its report and recommended changes to the proxy rules related to the nomination and election of directors.[231] To best address many of the issues raised by commenters, the Division recommended changes in two areas - disclosure related to nominating committee functions and security holder communications with boards of directors and enhanced security holder access to the proxy process relating to the nomination of directors.[232]

On August 14, 2003, we published for comment proposed rules that would implement the first of the Division's recommendations - new disclosure standards requiring more robust disclosure of the nominating committee processes of public companies, including the consideration of candidates recommended by security holders, as well as more specific disclosure of the processes by which security holders may communicate with the directors of the companies in which they invest.[233] Today, we are proposing rules that would implement the second of the Division's recommendations. These proposals would create a mechanism for long-term security holders, or groups of long-term security holders, with significant holdings to access company proxy materials to nominate directors.

B. Objectives

The proposed amendments have two primary objectives. The first objective is to improve the ability of security holders to participate meaningfully in the nomination and election of directors. The second objective is to meet the first objective without unduly burdening companies. We seek to limit the cost and burden on companies by limiting the proposed security holder nomination procedure to only those companies:

- Where the company's security holders are permitted under state law to nominate a candidate or candidates for election as directors;

- Where there are criteria showing that the proxy process may be ineffective - specifically, only after the occurrence of one or both of the following triggering events:

  - At least one of the company's nominees for the board of directors for whom the company solicited proxies received "withhold" votes from more than 35% of the votes cast at an annual meeting of security holders; or

  - A security holder proposal submitted pursuant to Exchange Act Rule 14a-8, providing that the company become subject to the security holder nomination procedure in proposed Exchange Act Rule 14a-11 (a) was submitted for a vote of security holders at an annual meeting of security holders by a security holder or group of security holders that held more than 1% of the company's securities entitled to vote on the proposal for one year as of the date the proposal was submitted and provided evidence of such holding to the company; and (b) that "direct access" proposal received more than 50% of the votes cast on that proposal at that meeting; and

- Where the nominating security holder or group of security holders demonstrate continuous beneficial ownership of more than 5% of the company's securities for at least two years as of the date of the nomination.

These limitations would lower the cost to companies while still improving the ability of security holders to participate meaningfully in the nomination and election of directors. This increased participation may improve corporate governance by increasing director accountability and responsiveness and aligning the interests of the board and security holders, thereby, giving investors greater confidence that the board is serving the interest of security holders. This may, in turn, enhance the value of security holders' investments.

C. Legal Basis

We are proposing amendments to the forms and rules under the authority set forth in Sections 3(b), 10, 13, 14, 15, 16, 23(a) and 36 of the Securities Exchange Act of 1934, as amended, and Sections 10, 20(a) and 38 of the Investment Company Act of 1940, as amended.

D. Small Entities Subject to the Proposed Rules

The proposals would affect companies that are small entities. Exchange Act Rule 0-10(a)[234] defines a company to be a "small business" or "small organization" for purposes of the Regulatory Flexibility Act if it had total assets of $5 million or less on the last day of its most recent fiscal year.[235] We estimate that there were approximately 2,500 public companies, other than investment companies, that may be considered small entities. We estimate from information compiled by the Commission staff that there are less than 25 listed investment companies and less than 25 non-listed investment companies that are small entities that file proxy statements. As discussed below, we believe that the proposals would affect virtually no small entities that are reporting companies.

As noted above, the number of security holder proposals that receive a majority vote, the number of directors that receive 35% withhold votes, and the percentage of nominating security holders that meet the ownership threshold and holding periods may be more infrequent for small entities because insiders may hold a larger percentage of shares in such entities.[236]

We request comment on the number of small entities that would be impacted by our proposals, including any available empirical data.

E. Reporting, Recordkeeping and Other Compliance Requirements

The proposed rules are expected to impact a limited number of companies because the nomination procedure would be triggered only where there are criteria showing that the proxy process may be ineffective. For purposes of the PRA, we estimate that the proposed nomination procedure would be triggered at only 73 operating companies and 14 funds and that only 41 operating companies and 9 funds would be subject to that procedure. Given the limited number of security holder proposals received by small entities and the ownership makeup of smaller entities, the proposed rules are likely to have virtually no impact on small entities.

For purposes of the PRA, we estimate that the highest hourly burden for the company and the security holder to disclose the required information would be 43.5 if the nomination procedure is triggered, notice by the company that the nomination procedure is triggered is provided, notice that the upcoming annual meeting has changed by more than 30 days is provided, notice by the security holder or security holder group that it is seeking to use the procedure is provided, an Exchange Act Schedule 13G is filed and is provided, the company determines to include the proposal and the company provides a statement opposing the security holder nominee or nominees and/or supporting the company nominees, and the security holder also provides such a statement. This translates to a cost of $2,300, as a monetization of burden, to be carried by the company internally and a cost of $5,100 to be paid by a third party. A cost of $7,400 per small entity may not constitute a significant economic impact. That conclusion is based on our analysis of 1,245 small entities available on the Compustat database. We found that the average revenue of those small entities is $2.07 million per company. Therefore, among larger "small entities," the estimated $7,400 compliance expense would constitute approximately 0.003% of a small entity's revenues. If small entities are impacted, there may be a greater impact on smaller "small entities."

We encourage written comments regarding this analysis. We solicit comments as to whether the proposed changes could have an effect that we have not considered. We request that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of the impact. We also note that we are considering as an additional element of the proposed rule, and seek comment on, whether proposed Exchange Act Rule 14a-11 should apply only to those companies that are subject to the accelerated deadlines for filing Exchange Act periodic reports, and investment companies registered under Section 8 of the Investment Company Act.

F. Duplicative, Overlapping or Conflicting Federal Rules

We believe that there are no rules that conflict with or completely duplicate the proposed rules.

G. Significant Alternatives

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish the stated objective, while minimizing any significant adverse impact on small entities. In connection with the proposed amendments, we considered the following amendments:

1. The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities;

2. The clarification, consolidation or simplification of disclosure for small entities; and

3. An exemption for small entities from coverage under the proposals.

The Commission has considered a variety of reforms to achieve its regulatory objectives. As one possible approach, we considered requiring companies to include the security holder's proxy card in the company mailing. Alternatively, we considered amending Exchange Act Rule 14a-8(i)(8)[237] to allow security holder proposals requesting access to the corporation's proxy card for the purpose of making nominations. We also have included a specific request for comment regarding whether only those operating companies that fall within the definition of "accelerated filer" in Exchange Act Rule 12b-2 should be subject to the security holder nomination procedure. We believe that the current proposals are the most cost-effective initial approach to address specific concerns related to small entities, as small entities may be less likely to be impacted by proposed Exchange Act Rule 14a-11 because of their limited receipt of security holder proposals and their ownership makeup.

In addition, an exemption or separate requirements for small entities may not address issues of corporate accountability and security holder rights that may affect small entities as much as they would affect large companies. Accordingly, it may be more appropriate to allow for the nomination procedure at small entities, where there has been evidence indicating ineffectiveness in the proxy process. The establishment of any differing compliance or reporting requirements or timetables or any exemptions for small business issuers may not be in keeping with the objectives of the proposed rules.

H. Solicitation of Comment

We encourage comments with respect to any aspect of this Initial Regulatory Flexibility Analysis. In particular, we request comments regarding: (i) the number of small entities that may be affected by the proposals; (ii) the existence or nature of the potential impact of the proposals on small entities discussed in the analysis; and (iii) how to quantify the impact of the proposed rules. Commenters are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. Such comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, or, in the alternative, a certification under Section 605(b) of the Regulatory Flexibility Analysis, if the proposals are adopted, and will be placed in the same public file as comments on the proposed amendments themselves.

VII. Small Business Regulatory Enforcement Fairness Act

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996,[238] a rule is "major" if it has resulted, or is likely to result in:

- An annual effect on the economy of $100 million or more;
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effects on competition, investment or innovation.

We request comment on whether our proposals would be a "major rule" for purposes of SBREFA. We solicit comment and empirical data on: (a) the potential effect on the U.S. economy on an annual basis; (b) any potential increase in costs or prices for consumers or individual industries; and (c) any potential effect on competition, investment or innovation.

VIII. Statutory Basis and Text of Proposed Amendments

The amendments are proposed pursuant to Sections 3(b), 10, 13, 14, 15, 16, 23(a) and 36 of the Securities Exchange Act of 1934, as amended, and Sections 10, 20(a) and 38 of the Investment Company Act of 1940, as amended.

List of Subjects

17 CFR Parts 240 and 249

Reporting and recordkeeping requirements, Securities.

17 CFR Part 274

Investment companies, Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, the Securities and Exchange Commission proposes to amend Title 17, chapter II of the Code of Federal Regulations as follows:

PART 240 - GENERAL RULES AND REGULATION, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for Part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 79q, 79t, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, 7202, 7241, 7262, and 7263; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

2. The authority citation following §§ 240.13d-1, 240.13d-102, 240.14a-4 and 240.14a-5 are removed.

3. Section 240.13a-11 is amended by revising paragraph (b) to read as follows:

§240.13a-11 Current reports on Form 8-K (§249.308 of this chapter).

* * * * *

(b) This section shall not apply to foreign governments, foreign private issuers required to make reports on Form 6-K (17 CFR 249.306) pursuant to §240.13a-16, issuers of American Depositary Receipts for securities of any foreign issuer, or investment companies required to file reports pursuant to §270.30b1-1 of this chapter under the Investment Company Act of 1940, except where such an investment company is required to file:

(1) Notice of a blackout period pursuant to §245.104 of this chapter; or

(2) Disclosure pursuant to Instruction 5 to §240.14a-11(a) of the date by which a security holder or security holder group must submit the notice required pursuant to §240.14a-11(c).

4. By amending §240.13d-1 by adding an Instruction after paragraph (c)(3) to read as follows:

§240.13d-1 Filing of Schedules 13D and 13G.

* * * * *

(c) (3) * * *

Instruction to paragraphs (b) and (c): For purposes of paragraphs (b) and (c), a beneficial owner who acquires or holds a registrant's securities in connection with a nomination under §240.14a-11 will not be deemed to have a purpose or effect of changing or influencing the control of the registrant solely by virtue of acquiring or holding the securities in connection with a director nomination pursuant to §240.14a-11, a solicitation for the election of that director nominee and/or against a registrant nominee, or the election of that director nominee.

* * * * *

5. By amending §240.13d-102 to:

a. Add a box on the cover page after the box titled "[ ] Rule 13d-1(d)"; and

b. Add paragraph (c) to Item 10 before the "Signature" section.

The additions read as follows:

§240.13d-102 Schedule 13G - Information to be included in statements filed pursuant to §240.13d-1(b), (c), and (d) and amendments thereto filed pursuant to §240.13d-2.

* * * * *

[ ] Rule 13d-1(b) or (c), filed in connection with Rule 14a-11

* * * * *

Item 10. Certifications

(a) * * *

(c) The following certification shall be included, in addition to the

certification required under paragraph (a) or (b) of this Item, as applicable, if the statement is filed in connection with a security holder nomination pursuant to §240.14a-11:

By signing below, I further certify that __% of the securities referred to above have been held continuously for at least 2 years.

Instruction to paragraph (c).

The percentage of securities listed above shall be used both for the purpose of determining eligibility to submit a security holder nomination pursuant to §240.14a-11 and, where more than one eligible security holder or security holder group provides notice of its intention to submit a nomination pursuant to §240.14a-11, for the purpose of determining the security holder or security holder group with the largest percentage of subject securities.

* * * * *

6. By amending §240.14a-4 to:

a. Revise the first sentence of paragraph (b)(2); and

b. Add a sentence to the end of the paragraph following paragraph (b)(2)(iv), immediately preceding the Instructions.

The revision and addition read as follows:

§240.14a-4 Requirements as to proxy.

* * * * *

(b) * * *

(2) A form of proxy that provides for the election of directors must set forth the names of persons nominated for election as directors, including any person whose nomination by a security holder or security holder group satisfies the requirements of §240.14a-11. * * *

* * * * *

(iv) * * * Means to grant authority to vote for any nominees as a group or to withhold authority for any nominees as a group may not be provided if the proxy card includes one or more security holder nominees in accordance with §240.14a-11.

* * * * *

7. By amending §240.14a-5 to add paragraphs (g) and (h) to read as follows:

§240.14a-5 Presentation of information in proxy statement.

* * * * *

(g) If the proxy statement includes a security holder proposal providing that the registrant become subject to the security holder nomination procedure in §240.14a-11 that was submitted pursuant to §240.14a-8 by any security holder or group of security holders that has held more than 1% of the

securities entitled to vote on that proposal for at least one year as of the date of the nomination and has provided evidence of such holding to the registrant, the registrant must disclose that the security holder vote on that proposal may determine whether the registrant will become subject to the security holder nomination procedure pursuant to §240.14a-11 for the annual (or, in lieu of annual, special) meetings at which directors are elected during the remainder of the calendar year in which the subject vote was held, the following calendar year and the portion of the next calendar year up to and including the annual meeting (or special meeting held in lieu of an annual meeting) during that calendar year.

(h) If the registrant received a security holder nomination that indicated that it was submitted pursuant to §240.14a-11 and the registrant determined that it was not required to include that nominee in its proxy materials, describe the determination made by the registrant's board of directors (including an affirmative statement of its determination not to include that specific nominee), discuss the specific provisions of §240.14a-11 that the registrant's board of directors relied upon to exclude the nominee, and discuss the specific basis for the belief of the registrant's board of directors that the registrant is permitted to not include that nominee in its proxy materials.

8. By amending §240.14a-6 to:

a. Redesignate paragraphs (a)(4), (a)(5) and (a)(6) as paragraphs (a)(5), (a)(6) and (a)(7) respectively;

b. Add new paragraph (a)(4);

c. Add a sentence at the end of Note 3; and

d. Add paragraphs (p) and (q).

The additions read as follows:

§240.14a-6 Filing requirements.

(a) * * *

(4) The name of a security holder nominee is included pursuant to §240.14a-11.

* * * * *

Note 3. Solicitation in Opposition. * * * The inclusion of a security holder nominee in the registrant's proxy materials pursuant to §240.14a-11 does not constitute a "solicitation in opposition," even if the registrant opposes the security holder nominee and solicits against the security holder nominee and in favor of a registrant nominee.

* * * * *

(p) Solicitations subject to §240.14a-11. Solicitations that are published or sent or given to security holders in connection with §240.14a-11 must be filed with the Commission as specified in that section.

(q) Security holder notice of intent to nominate a candidate for director under

§240.14a-11. Any notice sent to a registrant by a security holder or group of security holders indicating an intent to nominate a candidate for director in accordance with the procedure set forth in §240.14a-11 must be filed with the Commission no later than two business days after it is first provided to the registrant. For purposes of Regulation 14A (§240.14a-1 - 103), the notice filed pursuant to this requirement shall be deemed a solicitation.

9. By amending §240.14a-8 to:

a. Revise paragraph (i)(8); and

b. Add an Instruction to paragraph (i)(11).

The revision and addition read as follows:

§240.14a-8 Security holder proposals.

* * * * *

(i) * * *

(8) Relates to election: If the proposal relates to an election for membership on the company's board of directors or analogous governing body, except that a company may not exclude a proposal that would subject the company to §240.14a-11 on the basis of this paragraph;

* * * * *

(11) * * *

Instruction to paragraph (i)(11): For purposes of this paragraph, a proposal requesting that the company become subject to the security holder nomination procedure set out in §240.14a-11 that is submitted by a more than 1% security holder may not be excluded on the basis that it duplicates a previously submitted proposal by a security holder that holds 1% or less of the registrant's securities. In this instance, the earlier submitted proposal by a security holder that holds 1% or less of the registrant's securities may be excluded under this paragraph.

* * * * *

10. By adding text to §240.14a-11 to read as follows:

§240.14a-11 Security holder nominations.

(a) Applicability. In connection with an annual meeting of security holders (or, in lieu of an annual meeting, a special meeting) at which directors are elected, a registrant will be required to include in its proxy statement and form of proxy the name of a person or persons nominated by a security holder or group of security holders for election to the board of directors and include in its proxy statement the disclosure about such nominee or nominees and the nominating security holder or holders that is specified in paragraphs (c)(7), (c)(8), (c)(9) and (c)(10) of this section and, if the registrant includes a statement supporting the registrant's nominee(s) and/or opposing the security holder nominee or nominees, at the election of the nominating security holder or nominating security holder group, a statement of support for the security holder nominee or nominees, of a length not to exceed 500 words, provided that:

(1) Applicable state law does not prohibit the registrant's security holders from nominating a candidate or candidates for election as a director;

(2) One or more of the following events has occurred during the calendar year in which the meeting that is the subject of the proxy statement is being held or during either of the preceding two calendar years:

(i) At least one of the registrant's nominees for the board of directors for whom the registrant solicited proxies received "withhold" votes from more than 35% of the votes cast at an annual meeting of security holders (or, in lieu of an annual meeting, a special meeting) held after January 1, 2004, at which directors were elected (provided, that this event will be deemed not to occur with regard to any contested election to which §240.14a-12(c) applies or an election to which this section applies); or

(ii) A security holder proposal providing that the registrant become subject to

§240.14a-11 that was submitted pursuant to §240.14a-8 by a security holder or group of security holders that held more than 1% of the securities entitled to vote on that proposal for at least one year as of the date the proposal was submitted and provided evidence of such holding to the registrant, received more than 50% of the votes cast on that proposal at an annual meeting of security holders (or, in lieu of an annual meeting, a special meeting) held after January 1, 2004; and

(3) No security holder nominee is required to be included on the registrant's proxy card, and no disclosure regarding such nominee is required to be included in the registrant's proxy statement, in the event of one or more of the following:

(i) The nominee's candidacy or, if elected, board membership, would violate controlling state law or federal law or rules of a national securities exchange or national securities association applicable to the registrant (other than rules of a national securities exchange or national securities association regarding director independence);

(ii) Any information required to be included in the notice to the registrant required pursuant to paragraph (c) of this section is not so included;

(iii) Any representation required to be included in the notice to the registrant required pursuant to paragraph (c) of this section is false in any material respect; or

(iv) A nominee is not required to be included pursuant to the provisions of paragraph (d) of this section limiting the number of nominees required to be included.

Instructions to paragraph (a).

1. For purposes of paragraph (a)(2)(ii) of this section, the amount of a person's security ownership and the duration of that ownership shall be calculated as of the date that person submits the proposal to the registrant.

2. For purposes of paragraph (a)(2)(ii) of this section, only votes for and against a proposal shall be included in the calculation of the security holder vote on that proposal. Accordingly, abstentions and broker non-votes will

not be included in this calculation.

3. A nominating security holder will not be deemed an "affiliate" of the registrant under the Securities Act of 1933 (15 U.S.C 77a et. seq.) or the Securities Exchange Act of 1934 (15 U.S.C. 78a et. seq.) solely as a result of nominating a director or soliciting for the election of such a director nominee or against a registrant nominee pursuant to this section. Where a security holder nominee is elected, and the nominating security holder or nominating security holder group does not have an agreement or relationship with that director, otherwise than relating to the director's nomination pursuant to §240.14a-11, solicitation for the election of the director nominee or against a registrant nominee, or the election of the director nominee, the nominating security holder or nominating security holder group will not be deemed an affiliate solely by virtue of having nominated that director.

4. The registrant shall determine whether any of the events permitting exclusion of a security holder nominee has occurred and shall notify the nominating security holder or nominating security holder group whether the registrant will include or exclude the security holder nominee. In the event that a registrant determines that it shall exclude the nominee, the registrant shall provide such notice promptly, but in no case less than 30 calendar days before the date of the registrant's proxy statement released to security holders in connection with the previous year's annual meeting and, where the registrant did not hold an annual meeting in the previous year, or if the date of this year's annual meeting has been changed by more than 30 days from the date of the previous year's meeting, the notice must be provided a reasonable time before the registrant mails its proxy materials for the current year. If the registrant determines that it is entitled to exclude the nominee, the notice must include (a) a description of the determination made by the registrant's board of directors, including an affirmative statement of its determination not to include that specific nominee; (b) a discussion of the specific requirement or requirements of §240.14a-11 that the registrant's board of directors have determined permit the registrant not to include that specific nominee; and (c) a discussion of the specific basis for the belief of the registrant's board of directors that the registrant is permitted to not include that specific nominee. The registrant also must include in its proxy statement for the meeting for which the nominee was submitted a statement that it has made such an exclusion and provide the information included in the notice to the nominating security holder with regard to the basis for its determination to exclude the nominee. The exclusion of a security holder nominee by a registrant where that exclusion is not permissible under §240.14a-11(a)(3) shall be a violation of this section. If the registrant determines that it must include the security holder nominee, it must advise the nominating security holder or nominating security holder group of this determination and state whether the registrant intends to include in its proxy statement disclosure supporting the registrant's nominees and/or opposing the security holder nominee. If the registrant intends to include such a supporting statement and/or opposing statement, it must advise the nominating security holder or nominating security holder group that it may submit a statement of no more than 500 words supporting the security holder nominee. The registrant also must advise the nominating security holder or nominating security holder group of the date by which this statement must be provided to the registrant, which shall be not less than 10 business days from the date of the registrant's notice to the security holder. A statement by the registrant that it recommends a vote for its nominees and/or against the nominating security

holder or nominating security holder group's nominee or nominees will not be deemed an opposing or supporting statement for purposes of this requirement.

5. If any of the events described in paragraph (a)(2) of this section occur, and the registrant did not hold an annual meeting the previous year, or if the date of the current year's annual meeting has been changed by more than 30 days from the date of the previous year's annual meeting, the registrant must disclose pursuant to Item 13 of Form 8-K (§249.308 of this chapter) the date by which a security holder or security holder group must submit the notice required pursuant to paragraph (c) of this section, which date shall be a reasonable time prior to the date the registrant mails its proxy materials for the meeting.

(b) Nominating security holder eligibility. A security holder or group of security holders nominating a person or persons must satisfy the following requirements:

(1) The security holder individually, or the security holder group in the aggregate, must beneficially own more than 5% of the registrant's securities that are eligible to vote for the election of directors at that annual meeting of securities (or, in lieu of such an annual meeting, a special meeting of security holders);

(2) The security holder or each member of the security holder group must have held the securities that are used for purposes of determining the more than 5% ownership threshold required by paragraph (b)(1) of this section continuously for at least two years and intend to continue to hold those securities through the date of the subject election of directors;

(3) In the case of a registrant that is not an open-end investment company registered under the Investment Company Act of 1940, the security holder or each member of the security holder group must meet the requirements set out in §240.13d-1(b) or (c) to file on Schedule 13G (§240.13d-102); and

(4) In the case of a registrant that is not an open-end investment company registered under the Investment Company Act of 1940, the nominating security holder or the nominating security holder group must have reported its beneficial ownership on Schedule 13G (§240.13d-102), including the certification required by Item 10(c) of Schedule 13G, or have amended a previously filed Schedule 13G to include the certification required by Item 10(c) of Schedule 13G, before or on the date of sending the notice specified in paragraph (c) of this section. Notwithstanding the provisions of Schedule 13G, the Schedule 13G filed in satisfaction of this requirement must set forth information demonstrating compliance with the requirements of paragraphs (b)(1) and (b)(2) of this section and disclose the filing person's intention to nominate one or more directors under §240.14a-11.

(c) Security holder notice. In order to have a nominee included in the registrant's proxy statement and proxy card, the nominating security holder must provide notice to the registrant of its intent to require that the registrant include that security holder's nominee on the registrant's proxy card no later than 80 days before the date that the registrant mailed its proxy materials for the prior year's annual meeting, except that, if the registrant did not hold an annual meeting during the prior year, or if the date of the meeting has changed more than 30 days from the prior year, then the nominating security holder must provide notice a reasonable time

before the registrant mails its proxy materials, as specified by the registrant in a Form 8-K (§249.308 of this chapter) filed pursuant to Item 13 of Form 8-K. This notice must include:

(1) A representation that, to the knowledge of the nominating security holder or group, the nominee's candidacy or, if elected, board membership, would not violate controlling state law or federal law or rules of a national securities exchange or national securities association applicable to the registrant (other than rules of a national securities exchange or national securities association regarding director independence);

(2) A representation that the nominating security holder or nominating security holder group satisfies the conditions in paragraph (b) of this section;

(3) A representation that:

(i) If the nominating security holder or any member of the nominating security holder group is a natural person, the nominee is not the nominating security holder, a member of the nominating security holder group, or a member of the immediate family of the nominating security holder or any member of the nominating security holder group;

(ii) If the nominating security holder or any member of the nominating security holder group is an entity, neither the nominee nor any immediate family member of the nominee has been an employee of the nominating security holder or any member of the nominating security holder group during the then-current calendar year nor during the immediately preceding calendar year;

(iii) Neither the nominee nor any immediate family member of the nominee has accepted during the then-current calendar year or during the immediately preceding calendar year directly or indirectly any consulting, advisory, or other compensatory fee from the nominating security holder or any member of the nominating security holder group or any affiliate of any such holder or any such member, provided that compensatory fees do not include the receipt of fixed amounts of compensation under a retirement plan (including deferred compensation) for prior service with the nominating security holder or nominating security holder group member (provided that such compensation is not contingent in any way on continued service); and

(iv) Such nominee:

(A) Is not an executive officer or director (or person performing similar functions) of the nominating security holder or any member of the nominating security holder group, or of an affiliate of such holder or any such member; and

(B) Does not control the nominating security holder or any member of the nominating security holder group (or in the case of a holder or member that is an investment company, an interested person of such holder or any such member as defined in section 2(a)(19) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(19));

Instruction to paragraph (c)(3). For purposes of paragraph (c)(3) of this section, "immediate family" shall include any person related to the nominee by blood, marriage, or adoption, not more remote than first cousin.

(4) In the case of a registrant other than an investment company, a

representation that the nominee meets the objective criteria for "independence" of the national securities exchange or national securities association rules applicable to the registrant, if any, and, in the case of a registrant that is an investment company, a representation that the nominee is not an "interested person" of the registrant as defined in section 2(a)(19) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(19));

Instruction to paragraph (c)(4). For this purpose, the nominee would be required to meet the definition of "independence" that generally is applicable to directors of the registrant and not any particular definition of independence applicable to members of the audit committee of the registrant's board of directors. To the extent a national securities exchange or national securities association rule imposes a standard regarding independence that requires a subjective determination by the board or a group or committee of the board (for example, requiring that the board of directors or any group or committee of the board of directors make a determination regarding the existence of factors material to a determination of a nominee's independence), that standard would not have to be satisfied.

(5) A representation that neither the nominee nor the nominating security holder or, where there is a nominating security holder group, the members of the nominating security holder group, has a direct or indirect agreement with the registrant regarding the nomination of the nominee;

(6) In the case of a registrant that is not an open-end investment company registered under the Investment Company Act of 1940, a copy of the Schedule 13G (§240.13d-102) filed by the nominating security holder or nominating security holder group in satisfaction of the requirement in paragraph (b)(4) of this section;

(7) A statement from the nominee that the nominee consents to be named in the registrant's proxy statement and form of proxy and, if elected, to serve on the registrant's board of directors, for inclusion in the registrant's proxy statement;

(8) Disclosure about the nominee providing all of the information necessary to comply with the disclosure requirements of Item 7(a), (b) and (c) and, for investment companies, Item 22(b) of Schedule 14A (§240.14a-101), as applicable, for inclusion in the registrant's proxy statement;

(9) Any of the following information with regard to each nominating security holder or member of a nominating security holder group that is not included in the Schedule 13G (§240.13d-102), for inclusion in the registrant's proxy statement:

(i) Name and business address;

(ii) Present principal occupation or employment and the name, principal business and address of any corporation or other organization in which such employment is carried on;

(iii) The amount of each class of securities of the registrant that the individual owns beneficially, directly or indirectly, determined in accordance with §240.13d-3; and

(iv) Whether or not, during the past ten years, the individual has been convicted in a criminal proceeding (excluding traffic violations or similar

misdemeanors) and, if so, the dates, the nature of the conviction, the name or other disposition of the case; and whether the individual has been involved in any other legal proceeding during the past five years, as specified in Item 401(f) of Regulation S-K (§229.10 of this chapter);

Instruction to paragraph (c)(9). Where the nominating security holder is a general or limited partnership, syndicate or other group, the information called for in §240.14a-11(c)(9) must be given with respect to (i) each partner of the general partnership; (ii) each partner who is, or functions as, a general partner of the limited partnership; (iii) each member of the syndicate or group; and (iv) each person controlling the partner or member. If the nominating security holder is a corporation or if a person referred to in (i), (ii), (iii) or (iv) of this Instruction is a corporation, the information called for in §240.14a-11(c)(9) must be given with respect to (a) each executive officer and director of the corporation; (b) each person controlling the corporation; and (c) each executive officer and director of any corporation or other person ultimately in control of the corporation.

(10) The methods by which the nominating security holder or nominating security holder group may solicit security holders, including, at the election of the nominating security holder or nominating security holder group, any website address on which the nominating security holder or nominating security holder group may publish soliciting materials; and

(11) In the case of a registrant that is an open-end investment company registered under the Investment Company Act of 1940, the following information with regard to each nominating security holder or member of a nominating security holder group, in addition to the information required by paragraph (c)(9) of this section:

(i) The percentage of each class of securities of the registrant that the individual owns beneficially, directly or indirectly, determined in accordance with §240.13d-3, and the number of shares as to which the person has:

(A) Sole power to vote or to direct the vote;

(B) Shared power to vote or to direct the vote;

(C) Sole power to dispose or to direct the disposition of such shares; and

(D) Shared power to dispose or to direct the disposition of such shares; and

Instruction to paragraph (c)(11)(i).

For purposes of paragraph (c)(11)(i) of this section, any person, in determining the amount of outstanding securities of a class of equity securities, may rely upon information set forth in the investment company's most recent report on Form N-CSR (§§ 249.331 and 274.128) filed with the Commission pursuant to the Securities Exchange Act of 1934 and the Investment Company Act of 1940, unless he or she knows or has reason to believe that the information contained therein is inaccurate.

(ii) The following certification and signature, signed by each person on whose behalf the notice is filed or his or her authorized representative. If the notice is signed on behalf of a person by his or her authorized representative other than an executive officer or general partner of the filing person, evidence of the representative's authority to sign on behalf of such person shall be filed with the notice, provided, however, that a power

of attorney for this purpose which is already on file with the Commission may be incorporated by reference. The name and any title of each person who signs the notice shall be typed or printed beneath his or her signature:

Certification

By signing below, I certify that __% of the securities referred to above have been held continuously for at least 2 years.

Signature

After reasonable inquiry and to the best of my knowledge and belief, I certify that the information set forth in this statement is true, complete and correct.

_____

Date

_____

Signature

_____

Name/Title

Instruction to paragraph (c)(11)(ii). The percentage of securities listed in the certification in paragraph (c)(11)(ii) of this section shall be used both for the purpose of determining eligibility to submit a security holder nomination pursuant to this section and, where more than one eligible security holder or security holder group provides notice of its intention to submit a nomination pursuant to this section, for the purpose of determining the security holder or security holder group with the largest percentage of subject securities.

Instruction to paragraph (c). Refer to §240.14a-6(q) with regard to the obligation of the nominating security holder or nominating security holder group to file certain of the information specified in this paragraph (c) with the Commission.

(d) Number of security holder nominees.

(1) The registrant is not required to include in its proxy statement and form of proxy more than:

(i) One security holder nominee where the total number of members of the registrant's board of directors is eight or fewer;

(ii) Two security holder nominees where the total number of members of the registrant's board of directors is greater than eight and less than 20; and

(iii) Three security holder nominees where the total number of members of the registrant's board of directors is 20 or more;

(2) Provided that, where the registrant has one or more directors currently serving on its board of directors who were elected as a security holder nominee pursuant to this section, and the term of that director or directors extends past the date of the meeting of security holders for which it is

soliciting proxies, the registrant will not be required to include in the proxy statement or form of proxy more security holder nominees than could result in the total number of directors who were elected as security holder nominees pursuant to §240.14a-11 and serving on the board being greater than:

(i) One where the total number of members of the board of directors is eight or fewer;

(ii) Two where the total number of members of the board of directors is greater than eight and less than 20; and

(iii) Three where the total number of members of the board of directors is 20 or more; and

(3) In the event that more than one security holder or group of security holders is otherwise permitted to nominate a person or persons to a registrant's board of directors pursuant to §240.14a-11, the registrant shall include in the proxy statement and form of proxy the nominee or nominees of the security holder or security holder group with the largest two-year beneficial ownership at the time of the delivery of the notice specified in paragraph (c) of this section, as specified in the filed Schedule 13G (§240.13d-102), up to and including the total number required to be included by the registrant.

Instructions to paragraph (d).

1. If a nominee, a nominating security holder or any member of a nominating security holder group has any direct or indirect agreement with the registrant or any affiliate of the registrant regarding the nomination of a candidate for election as a member of the registrant's board of directors, any such nominee or any nominee of such nominating security holder or nominating security holder group shall not be included in calculating the number of nominees required under this section.

2. For purposes of paragraph (d)(3) of this section, the registrant must rely on the beneficial ownership percentage reported in the nominating security holder's filed Schedule 13G, except where the registrant has reason to believe that the beneficial ownership reported in the Schedule 13G is inaccurate.

(e) Liability for false or misleading statements. The registrant is not responsible for any information in the notice from the nominating security holder or nominating security holder group pursuant to paragraph (c) of this section or otherwise provided by the nominating security holder or nominating security holder group.

(f) Exempt solicitations. Sections 240.14a-3 to 240.14a-6(o), 240.14a-8, 240.14a-10 and 240.14a-12 to 240.14a-15 do not apply to the following:

(1) Any solicitation by or on behalf of any security holder in connection with the formation of a nominating security holder group pursuant to §240.14a-11, provided that:

(i) The total number of persons solicited is not more than 30; or

(ii) Each written communication includes no more than:

(A) A statement of each soliciting security holder's intent to form a nominating security holder group in order to nominate a director under §240.14a-11;

(B) The percentage of securities that each soliciting security holder beneficially owns or the aggregate percentage owned by any group to which the security holder belongs; and

(C) The means by which security holders may contact the soliciting party; and

(iii) Any soliciting material published, sent or given to security holders in accordance with this paragraph is filed with the Commission by the soliciting party, under the registrant's Exchange Act file number, or, in the case of a registrant that is an investment company registered under the Investment Company Act of 1940, under the registrant's Investment Company Act file number, no later than the date the material is first published, sent or given to security holders. The soliciting material must include a cover page in the form set forth in Schedule 14A (§240.14a-101) and the appropriate box on the cover page must be marked; and

(2) Any solicitation by or on behalf of a nominating security holder or nominating security holder group in support of a nominee placed on the registrant's proxy card in accordance with §240.14a-11, provided that:

(i) The soliciting party does not, at any time during such solicitation, seek directly or indirectly, either on its own or another's behalf, the power to act as proxy for a security holder and does not furnish or otherwise request, or act on behalf of a person who furnishes or requests, a form of revocation, abstention, consent or authorization;

(ii) Each written communication includes:

(A) The identity of each nominating security holder and a description of his or her direct or indirect interests, by security holdings or otherwise;

(B) A prominent legend in clear, plain language advising security holders that a security holder nominee is or will be included in the registrant's proxy statement and to read the registrant's proxy statement when it becomes available because it includes important information (or, if the registrant's proxy statement is publicly available, advising security holders of that fact and encouraging security holders to read the registrant's proxy statement because it includes important information). The legend also must explain to security holders that they can find the registrant's proxy statement, and any other relevant documents, at no charge on the Commission's website; and

(iii) Any soliciting material published, sent or given to security holders in accordance with this paragraph must be filed by the nominating security holder with the Commission, under the registrant's Exchange Act file number, or, in the case of a registrant that is an investment company registered under the Investment Company Act of 1940, under the registrant's Investment Company Act file number, no later than the date the material is first published, sent or given to security holders. Three copies of the material must at the same time be filed with, or mailed for filing to, each national securities exchange upon which any class of securities of the registrant is listed and registered. The soliciting material must include a cover page in the form set forth in Schedule 14A (§240.14a-101) and the

appropriate box on the cover page must be marked.

Instruction to paragraph (f)(2). If the information required by paragraph (f)(2)(ii)(A) is presented in a Schedule 13G filed electronically with the Commission, the written communication will be deemed to satisfy the requirements of that paragraph if it states that the information is presented in a Schedule 13G, presents the file number and file date for the Schedule 13G, and presents a direct Internet address where that Schedule 13G may be located.

11. By amending §240.14a-12 to add Instruction 3 to read as follows:

§240.14a-12 Solicitation before furnishing a proxy statement.

* * * * *

Instructions to §240.14a-12:

* * * * *

3. Solicitations by a nominating security holder or nominating security holder group that are made in connection with a §240.14a-11 nomination will not be deemed a solicitation in opposition subject to §240.14a-12(c).

12. Amend §240.14a-101 by:

a. Adding on the cover page two boxes before the box "Soliciting Material under §240.14a-12";

b. Adding paragraph (i) to Item 7; and

c. Revising the reference "paragraphs (d)(3), (f) and (g)" in the introductory text of paragraph (b) of Item 22 to read "paragraphs (d)(2), (d)(3), (f), (g), (h), and (i)".

The additions and revision read as follows:

§240.14a-101 - Schedule 14A. Information required in proxy statement.

SCHEDULE 14A INFORMATION

* * * * *

[ ] Soliciting Material under §240.14a-11

[ ] Nominating Security Holder Notice Under §240.14a-11(c)

* * * * *

Item 7. Directors and executive officers. * * *

* * * * *

(i) If a security holder nominee or nominees are submitted to the registrant and the registrant is not permitted to exclude the nominee or nominees pursuant to the provisions of §240.14a-11, the registrant must include the disclosure required from the nominating security holder under §240.14a-11(c)(7), (c)(8), (c)(9), (c)(10) and (c)(11), with regard to the nominee and

the nominating security holder. In addition, if the registrant includes a statement supporting the registrant nominee(s) and/or opposing the security holder nominee, the registrant must also include, at the election of the nominating security holder or nominating security holder group, a statement of support for the security holder nominee, of a length not to exceed 500 words, in accordance with §240.14a-11.

Instruction to Item 7(i). The information disclosed pursuant to paragraph (i) will not be deemed incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates that information by reference.

* * * * *

13. Section 240.15d-11 is amended by revising paragraph (b) to read as follows:

§240.15d-11 Current reports on Form 8-K (§249.308 of this chapter).

* * * * *

(b) This section shall not apply to foreign governments, foreign private issuers required to make reports on Form 6-K (17 CFR 249.306) pursuant to §240.15d-16, issuers of American Depositary Receipts for securities of any foreign issuer, or investment companies required to file reports pursuant to §270.30b1-1 of this chapter under the Investment Company Act of 1940, except where such an investment company is required to file:

(1) Notice of a blackout period pursuant to §245.104 of this chapter; or

(2) Disclosure pursuant to Instruction 5 to §240.14a-11(a) of the date by which a security holder or security holder group must submit the notice required pursuant to §240.14a-11(c).

14. By amending §240.16a-1 to revise paragraph (a)(1) up to the "Note to Paragraph (a)" to read as follows:

§240.16a-1 Definition of Terms.

(a) * * *

(1) (i) Solely for purposes of determining whether a person is a beneficial owner of more than ten percent of any class of equity securities registered pursuant to section 12 of the Act (15 U.S.C. 78l), the term "beneficial owner" means any person who is deemed a beneficial owner pursuant to Section 13(d) of the Act (15 U.S.C 78m) and the rules thereunder, except that the institutions or persons specified in paragraph (a)(1)(ii) of this section are not deemed the beneficial owner of securities of such class:

(A) That are acquired by such institutions or persons without the purpose or effect of changing or influencing control of the issuer or engaging in any arrangement subject to §240.13d-3(b); and

(B) With respect to the institutions or persons specified in paragraphs (a)(1)(ii)(A) through (a)(1)(ii)(J) of this section, that are held for the benefit of third parties or in customer or fiduciary accounts in the ordinary course of business (or in the case of an employee benefit plan specified in paragraph (a)(1)(ii)(F) of this section, that are allocated to plan participants

where participants have voting power).

(ii) (A) A broker or dealer registered under section 15 of the Act (15 U.S.C. 78o);

(B) A bank as defined in section 3(a)(6) of the Act (15 U.S.C. 78c(a)(6));

(C) An insurance company as defined in section 3(a)(19) of the Act (15 U.S.C. 78c(a)(19));

(D) An investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8);

(E) Any person registered as an investment adviser under section 203 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3) or under the laws of any state;

(F) An employee benefit plan as defined in section 3(3) of the Employee Retirement Income Security Act of
1974, as amended, 29 U.S.C. 1001 et seq. ("ERISA") that is subject to the provisions of ERISA, or any such plan that is not subject to ERISA that is maintained primarily for the benefit of the employees of a state or local government or instrumentality, or an endowment fund;

(G) A parent holding company or control person, provided the aggregate amount held directly by the parent or control person, and directly and indirectly by their subsidiaries or affiliates that are not persons specified in paragraphs (a)(1)(ii)(A) through (J) of this section, does not exceed one percent of the securities of the subject class;

(H) A savings association as defined in section 3(b) of the Federal Deposit Insurance Act (12 U.S.C. 1813);

(I) A church plan that is excluded from the definition of an investment company under section 3(c)(14) of the Investment Company Act of 1940 (15 U.S.C. 80a-3(c)(14);

(J) A group, provided that all the members are persons specified in §240.16a-1(a)(1)(ii)(A) through (I); and

(K) Members of a nominating security holder group formed in accordance with §240.14a-11.

Note to paragraph (a)(1)(ii)(K). Members of a security holder group formed in order to nominate a director under §240.14a-11 are not deemed to have the purpose or effect of changing or influencing control of the issuer solely by virtue of such group membership or by virtue of a director nomination pursuant to §240.14a-11, a solicitation for the election of that director nominee or against that registrant nominee, or the election of that director nominee.

* * * * *

PART 249 - FORMS, SECURITIES EXCHANGE ACT OF 1934

15. The authority citation for Part 249 continues to read in part as follows:

Authority: 15 U.S.C. 78a et seq., 7202, 7233, 7241, 7262, 7264, and 7265;

and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

16. By amending Form 8-K (referenced in §249.308) to:

a. Add a sentence at the end of General Instruction B.1; and

b. Add Item 13 before the "Signature" section.

The additions read as follows:

Note: The text of Form 8-K does not, and this amendment will not, appear in the Code of Federal Regulations.

Form 8-K

* * * * *

GENERAL INSTRUCTIONS

* * * * *

B. Events to be Reported and Time for Filing of Reports

1. * * * A report pursuant to Item 13 is to be filed promptly after the registrant determines the anticipated meeting date.

* * * * *

INFORMATION TO BE INCLUDED IN THE REPORT

* * * * *

Item 13. Security Holder Nominations Pursuant to Exchange Act Rule 14a-11

If any of the events described in §240.14a-11(a)(2) occur, and the registrant did not hold an annual meeting the previous year, or if the date of this year's annual meeting has been changed by more than 30 days from the date of the previous year's meeting, then the registrant is required to disclose the date by which a security holder or security holder group must submit the notice required pursuant to §240.14a-11(c), which date shall be a reasonable time before the registrant mails its proxy materials for the meeting.

17. By amending Item 4 to "Part II - Other Information" of Form 10-Q (referenced in §249.308a) to:

a. Revise paragraph (d); and

b. Add paragraph (e).

The revision and addition read as follows:

Note: The text of Form 10-Q does not, and this amendment will not, appear in the Code of Federal Regulations.

Form 10-Q

* * * * *

Part II - Other Information

* * * * *

Item 4. Submission of Matters to a Vote of Security Holders.

* * * * *

(d) A description of the terms of any settlement between the registrant and any other participant (as defined in Instruction 3 to Item 4 of Schedule 14A (§240.14a-101) of Regulation 14A under the Act) terminating any solicitation subject to §240.14a-12(c), including the cost or anticipated cost to the registrant.

(e) If the meeting involved the election of directors or a vote on a security holder proposal under §240.14a-8 and, as a result of that vote, the registrant will become subject to the security holder nomination procedure in §240.14a-11, provide disclosure of that result and disclose that the registrant will be subject to §240.14a-11 for the annual (or, in lieu of annual, special) meetings at which directors are elected during the remainder of the calendar year in which the subject vote was held, the following calendar year and the next calendar year up to and including the annual meeting (or special meeting in lieu of an annual meeting) during that calendar year, and state the date by which security holders must submit their nominations.

* * * * *

18. By amending Item 4 to "Part II - Other Information" of Form 10-QSB (referenced in §249.308b) to:

a. Revise paragraph (d); and

b. Add paragraph (e).

The revision and addition read as follows:

Note: The text of Form 10-QSB does not, and this amendment will not, appear in the Code of Federal Regulations.

Form 10-QSB

* * * * *

Part II - Other Information

* * * * *

Item 4. Submission of Matters to a Vote of Security Holders.

* * * * *

(d) A description of the terms of any settlement between the registrant and any other participant (as defined in Instruction 3 to Item 4 of Schedule 14A

(§240.14a-101) of Regulation 14A under the Act) terminating any solicitation subject to §240.14a-12(c), including the cost or anticipated cost to the registrant.

(e) If the meeting involved the election of directors or a vote on a security holder proposal under §240.14a-8 and, as a result of that vote, the registrant will become subject to the security holder nomination procedure in §240.14a-11, provide disclosure of that result and disclose that the registrant will be subject to §240.14a-11 for the annual (or, in lieu of annual, special) meetings at which directors are elected during the remainder of the calendar year in which the subject vote was held, the following calendar year and the next calendar year up to and including the annual meeting (or special meeting in lieu of an annual meeting) during that calendar year, and state the date by which security holders must submit their nominations.

* * * * *

19. By amending Item 4 to Part I of Form 10-K (referenced in §249.310) to:

a. Revise paragraph (d); and

b. Add paragraph (e).

The revision and addition read as follows:

Note: The text of Form 10-K does not, and this amendment will not, appear in the Code of Federal Regulations.

Form 10-K

* * * * *

Part I

* * * * *

Item 4. Submission of Matters to a Vote of Security Holders.

* * * * *

(d) A description of the terms of any settlement between the registrant and any other participant (as defined in Instruction 3 to Item 4 of Schedule 14A (§240.14a-101) of Regulation 14A under the Act) terminating any solicitation subject to §240.14a-12(c), including the cost or anticipated cost to the registrant.

(e) If the meeting involved the election of directors or a vote on a security holder proposal under §240.14a-8 and, as a result of that vote, the registrant will become subject to the security holder nomination procedure in §240.14a-11, provide disclosure of that result and disclose that the registrant will be subject to §240.14a-11 for the annual (or, in lieu of annual, special) meetings at which directors are elected during the remainder of the calendar year in which the subject vote was held, the following calendar year and the next calendar year up to and including the annual meeting (or special meeting in lieu of an annual meeting) during that calendar year, and state the date by which security holders must submit their nominations.

* * * * *

20. By amending Item 4 to Part I of Form 10-KSB (referenced in §249.310b) to:

a. Revise paragraph (d); and

b. Add paragraph (e).

The revision and addition read as follows:

Note: The text of Form 10-KSB does not, and this amendment will not, appear in the Code of Federal Regulations.

Form 10-KSB

* * * * *

Part I

* * * * *

Item 4. Submission of Matters to a Vote of Security Holders.

* * * * *

(d) A description of the terms of any settlement between the registrant and any other participant (as defined in Instruction 3 to Item 4 of Schedule 14A (§240.14a-101) of Regulation 14A under the Act) terminating any solicitation subject to §240.14a-12(c), including the cost or anticipated cost to the registrant.

(e) If the meeting involved the election of directors or a vote on a security holder proposal under §240.14a-8 and, as a result of that vote, the registrant will become subject to the security holder nomination procedure in §240.14a-11, provide disclosure of that result and disclose that the registrant will be subject to §240.14a-11 for the annual (or, in lieu of annual, special) meetings at which directors are elected during the remainder of the calendar year in which the subject vote was held, the following calendar year and the next calendar year up to and including the annual meeting (or special meeting in lieu of an annual meeting) during that calendar year, and state the date by which security holders must submit their nominations.

* * * * *

PART 249 - FORMS, SECURITIES EXCHANGE ACT OF 1934

PART 274 - FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

21. The authority citation for Part 274 continues to read, in part, as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78l, 78m, 78n, 78o(d), 80a-8, 80a-24, 80a-26, and 80a-29, unless otherwise noted.

* * * * *

22. By amending Form N-SAR (referenced in §§ 249.330 and 274.101) by:

a. Removing and reserving sub-item 77C;

b. Removing and reserving the Instruction to sub-item 77C in Instructions to Specific Items (referenced in §§ 249.330 and 274.101); and

c. Revising the Instruction to sub-item 102B in Instructions to Specific Items.

The revision reads as follows:

Note: The text of Form N-SAR does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM N-SAR

* * * * *

Instructions to Specific Items

* * * * *

Sub-Item 102B: Submission of matters to a vote of security holders

If any matter has been submitted to a vote of security holders during the period covered by this report, through the solicitation of proxies or otherwise, furnish the following information:

(a) The date of the meeting and whether it was an annual or special meeting.

(b) If the meeting involved the election of directors, the name of each director elected at the meeting and the name of each other director whose term of office as a director continued after the meeting.

(c) A brief description of each matter voted upon at the meeting and state the number of votes cast for, against or withheld, as well as the number of abstentions and broker non-votes, as to each such matter, including a separate tabulation with respect to each nominee for office.

(d) A description of the terms of any settlement between the registrant and any other participant (as defined in Instruction 3 to Item 4 of Schedule 14A (§240.14a-101) of Regulation 14A under the 1934 Act) terminating any solicitation subject to Rule 14a-12(c) under the 1934 Act (17 CFR 240.14a-12(c)), including the cost or anticipated cost to the registrant.

(e) If the meeting involved the election of directors or a vote on a security holder proposal under §240.14a-8 under the 1934 Act (17 CFR 240.14a-8) and, as a result of that vote, the registrant will become subject to the security holder nomination procedure in Rule 14a-11 under the 1934 Act (17 CFR 240.14a-11), provide disclosure of that result and disclose that the registrant will be subject to Rule 14a-11 under the 1934 Act for the annual (or, in lieu of annual, special) meetings at which directors are elected during the remainder of the calendar year in which the subject vote was held, the following calendar year and the next calendar year up to and including the annual meeting (or special meeting in lieu of an annual meeting) during that calendar year, and state the date by which security holders must submit their nominations.

Instructions:

1. If any matter has been submitted to a vote of security holders otherwise than at a meeting of such security holders, corresponding information with respect to such submission shall be furnished. The solicitation of any authorization or consent (other than a proxy to vote at a stockholders' meeting) with respect to any matter shall be deemed a submission of such matter to a vote of security holders within the meaning of this item.

2. Paragraph (a) need be answered only if paragraph (b) or (c) is required to be answered.

3. Paragraph (b) need not be answered if (i) proxies for the meeting were solicited pursuant to Regulation 14A under the 1934 Act, (ii) there was no solicitation in opposition to the management's nominees as listed in the proxy statement, and (iii) all of such nominees were elected. If the registrant did not solicit proxies and the board of directors as previously reported to the Commission was re-elected in its entirety, a statement to that effect in answer to paragraph (b) will suffice as an answer thereto.

4. Paragraph (c) must be answered for all matters voted upon at the meeting, including both contested and uncontested elections of directors.

5. If the registrant has furnished to its security holders proxy soliciting material containing the information called for by paragraph (d), the paragraph may be answered by reference to the information contained in such material.

6. If the registrant has published a report containing all of the information called for by this item, the item may be answered by a reference to the information contained in such report.

23. By amending Form N-CSR (referenced in §§ 249.331 and 274.128) by adding text to Item 8 to read as follows:

Note: The text of Form N-CSR does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM N-CSR

* * * * *

Item 8. Submission of Matters to a Vote of Security Holders.

If any matter has been submitted to a vote of security holders during the period covered by this report, through the solicitation of proxies or otherwise, furnish the following information:

(a) The date of the meeting and whether it was an annual or special meeting.

(b) If the meeting involved the election of directors, the name of each director elected at the meeting and the name of each other director whose term of office as a director continued after the meeting.

(c) A brief description of each matter voted upon at the meeting and state the number of votes cast for, against or withheld, as well as the number of

abstentions and broker non-votes, as to each such matter, including a separate tabulation with respect to each nominee for office.

(d) A description of the terms of any settlement between the registrant and any other participant (as defined in Instruction 3 to Item 4 of Schedule 14A (§240.14a-101) of Regulation 14A under the Exchange Act) terminating any solicitation subject to Rule 14a-12(c) under the Exchange Act (17 CFR 240.14a-12(c)), including the cost or anticipated cost to the registrant.

(e) If the meeting involved the election of directors or a vote on a security holder proposal under §240.14a-8 under the Exchange Act (17 CFR 240.14a-8) and, as a result of that vote, the registrant will become subject to the security holder nomination procedure in Rule 14a-11 under the Exchange Act (17 CFR 240.14a-11), provide disclosure of that result and disclose that the registrant will be subject to Rule 14a-11 under the Exchange Act for the annual (or, in lieu of annual, special) meetings at which directors are elected during the remainder of the calendar year in which the subject vote was held, the following calendar year and the next calendar year up to and including the annual meeting (or special meeting in lieu of an annual meeting) during that calendar year, and state the date by which security holders must submit their nomination.

Instructions.

1. If any matter has been submitted to a vote of security holders otherwise than at a meeting of such security holders, corresponding information with respect to such submission shall be furnished. The solicitation of any authorization or consent (other than a proxy to vote at a stockholders' meeting) with respect to any matter shall be deemed a submission of such matter to a vote of security holders within the meaning of this item.

2. Paragraph (a) need be answered only if paragraph (b) or (c) is required to be answered.

3. Paragraph (b) need not be answered if (i) proxies for the meeting were solicited pursuant to Regulation 14A under the Exchange Act, (ii) there was no solicitation in opposition to the management's nominees as listed in the proxy statement, and (iii) all of such nominees were elected. If the registrant did not solicit proxies and the board of directors as previously reported to the Commission was re-elected in its entirety, a statement to that effect in answer to paragraph (b) will suffice as an answer thereto.

4. Paragraph (c) must be answered for all matters voted upon at the meeting, including both contested and uncontested elections of directors.

5. If the registrant has furnished to its security holders proxy soliciting material containing the information called for by paragraph (d), the paragraph may be answered by reference to the information contained in such material.

6. If the registrant has published a report containing all of the information called for by this item, the item may be answered by a reference to the information contained in such report.

* * * * *

By the Commission.

Margaret H. McFarland
Deputy Secretary

Date: October 14, 2003

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1 17 CFR 240.14a-11.

2 17 CFR 240.13a-11.

3 17 CFR 240.13d-1.

4 17 CFR 240.14a-4.

5 17 CFR 240.14a-5.

6 17 CFR 240.14a-6.

7 17 CFR 240.14a-8.

8 17 CFR 240.14a-12.

9 17 CFR 240.15d-11.

10 17 CFR 240.16a-1.

11 17 CFR 240.13d-102.

12 17 CFR 240.14a-101.

13 17 CFR 249.308.

14 17 CFR 249.308a.

15 17 CFR 249.308b.

16 17 CFR 249.310.

17 17 CFR 249.310b.

18 15 U.S.C. 78a *et seq*.

19 17 CFR 249.331 and 17 CFR 274.128.

20 17 CFR 249.330 and 17 CFR 274.101.

21 15 U.S.C. 80a *et seq*.

22 17 CFR 240.14c-101.

23 *See* Press Release No. 2003-46 (April 14, 2003).

24 *See* Release No. 34-47778 (May 1, 2003) [68 FR 24530]. In addition to receiving written comments, the Division spoke with a number of interested parties representing security holders, the business community, and the legal community. Each of the comment letters received, memoranda documenting the Division's meetings, and a summary of the comments are included on the

Commission's website, (http://www.sec.gov), in comment file number S7-10-03. [Summary of Comments in Response to the Commission's Solicitation of Public Views Regarding Possible Changes to the Proxy Rules (July 15, 2003).]

25 *See* 2003 Summary of Comments.

26 *See id*.

27 *See* Staff Report: Review of the Proxy Process Regarding the Nomination and Election of Directors, Division of Corporation Finance (July 15, 2003).

28 *See id*.

29 *See* Release No. 34-48301 (August 14, 2003) [68 FR 48724].

30 *See Securit[ies] and Exchange Commission Proxy Rules: Hearings on H.R. 1493, H.R. 1821, and H.R. 2019 Before the House Comm. on Interstate and Foreign Commerce*, 78th Cong., 1st Sess., at 17-19 (1943) (testimony of Chairman Ganson Purcell).

31 Release No. 34-3347 (December 18, 1942).

32 *Securit[ies] and Exchange Commission Proxy Rules: Hearings*, at 19.

33 *See id*. at 157.

34 The Commission did not provide an explanation for its determination, stating simply that, "a

number of the suggestions proposed by the staff were not adopted," including the suggestion related to security holder access to company proxy materials. *See* Release No. 34-3347 (December 18, 1942).

35 Release No. 34-13482 (April 28, 1977) [42 FR 23901], in which the Commission also asked:

(a) what criteria should be applied to nominating security holders;

(b) what disclosures should be required of nominating security holders;

(c) whether security holder nominations are permissible under state law; and

(d) whether a meaningful distinction can be drawn

between control and non-control nominations.

See also Release No. 34-13901 (August 29, 1977) [42 FR 44860], in which the Commission published the final schedule of issues to be considered at the hearings, which included:

(a) whether security holders should have access to the company's proxy soliciting materials for the purpose of nominating directors;

(b) whether security holder nominations are permissible under state law and consistent with Congressional intent in enacting Exchange Act Section 14(a);

(c) what type of rule would be most appropriate and what criteria should be applied to nominating security holders;

(d) whether the proxy rules should apply to soliciting activities by a nominating security holder; and

(e) whether nominating security holders should be subject to the then-existing rules governing election contests.

36 Release No. 34-14970 (July 18, 1978) [43 FR 31945]. *See also* Release No. 34-15384 (December 6, 1978) [43 FR 58522].

37 *See id*.

38 The Task Force on Corporate Accountability was formed as an outgrowth of the review of the proxy rules that began in 1977. The work of the Task Force culminated in the Staff Report on Corporate Accountability, completed and presented to the Senate Committee on Banking, Housing, and Urban Affairs. *Division of Corporation Finance, Securities and Exchange Comm'n, Staff Report on Corporate Accountability* (Sept. 4, 1980) (printed for the use of Senate Comm. on Banking, Housing, and Urban Affairs, 96th Cong., 2d Sess.), at A60-65.

39 The *Staff Report on Corporate Accountability* states: "all nominating committees should be open to suggestions of nominees from shareholders." *Id*. at A56.

40 With regard to security holder nominations, the staff recommended, "If there is not a substantial increase in

the percentage of companies with independent nominating committees who consider shareholder nominations, the Commission should authorize the staff to develop a rule to require companies to adopt a procedure for considering shareholder nominations." *Id*. at A69. *See also id.* at A60-65.

41 *See* Release No. 34-31326 (October 16, 1992) [57 FR 48276].

42 17 CFR 240.14a-4(d)(4).

43 Release No. 34-31326 (October 16, 1992).

44 15 U.S.C. 78n(a).

45 15 U.S.C. 78*l*.

46 *J. I. Case Co. v. Borak*, 377 U.S. 426, 431 (1964) (citing H.R. Rep. No. 1383, 73rd Cong., 2d Sess. 13-14). *See also Medical Comm. for Human Rights v. SEC*, 432 F.2d 659, 676 (D.C. Cir. 1970), vacated as moot, 404 U.S. 403 (1972) ("Congress intended by its enactment of section 14...to give true vitality to the concept of corporate democracy.").

47 15 U.S.C. 78n(a). *Cf*. *Medical Committee*, 432 F.2d at 671 ("Through section 14 of the Act, Congress has invested the Securities and Exchange Commission with sweeping authority to regulate the solicitation of corporate proxies.").

48 Professors Loss and Seligman have described the Commission's rules promulgated under this section as "designed ... to make the proxy device the closest practicable substitute for attendance at the [shareholder] meeting." Loss & Seligman, Chapter 6.C.2.b. Securities Regulation (3d ed.).

49 In our discussion of the proxy rules and our proposals, we use the term "security holders," which is the term used currently throughout our proxy rules. For purposes of our proposals, the term generally refers to shareholders having a right to vote at the meeting and on the matter in question.

50 *See* 2003 Summary of Comments.

51 *See id*.

52 Under plurality voting, the candidate with the greatest number of votes is elected; therefore, in an election in which there are the same number of nominees as there

are board positions open, each nominee receiving even a single vote will be elected, regardless of the number of votes "withheld" from a candidate.

53 *See* 2003 Summary of Comments.

54 Under some circumstances, security holders may be able to effect change in board membership through security holder lawsuits. For example, security holders at Hanover Compressor Company and Homestore, Inc. recently obtained the right to nominate candidates for the boards of directors as a result of the settlement of security holder lawsuits against each of these companies. *See* Hanover Compressor Company, Form 8-K filed May 13, 2003 and Homestore, Inc., Form 8-K filed August 13, 2003.

55 *See* 2003 Summary of Comments.

56 *See id*.

57 These proposals are in addition to the enhanced disclosure requirements that we proposed on August 14, 2003. *See* Release No. 34-48301 (August 14, 2003).

58 *See* proposed Exchange Act Rule 14a-11(a). These nominees would then also be included on a company's form of proxy in accordance with the requirements of Exchange Act Rule 14a-4. We have proposed two amendments to Exchange Act Rule 14a-4(b)(2) [17 CFR 240.14a-4(b)(2)]. The first proposed amendment would require a company to include in its form of proxy those security holder nominees that satisfy the requirements of proposed Exchange Act Rule 14a-11. The second proposed amendment would prohibit companies from providing a means to vote for its nominees for director as a group where the form of proxy includes such a security holder nominee or nominees.

59 Exchange Act Rule 3a12-3 [17 CFR 240.3a12-3] exempts foreign private issuers from the Commission's proxy rules. As such, the proposed procedure would not apply to foreign private issuers.

60 15 U.S.C. 80a-8. *See* Section II.A.12., below, for a discussion of the specific application of the proposal to registered investment companies and business development companies.

61 This provision is set forth in proposed Exchange Act Rule 14a-11(a)(1).

62 Exchange Act Rule 14a-8 generally requires the company

to include the proposal of an eligible security holder who has complied with the rule's procedural requirements. The company is not required to include the proposal if it falls within one of the 13 substantive bases for exclusion set forth in the rule.

63 *See* Exchange Act Rule 14a-8(i)(1) and (2) [17 CFR 240.14a-8(i)(1)-(2)].

64 *See* Release No. 33-8128 (September 5, 2002) [67 FR 56861]. The deadline for filing quarterly reports on Exchange Act Form 10-Q for these "accelerated filers" is set forth in General Instruction A.1.a. of that form. The deadline for filing annual reports on Exchange Act Form 10-K for these "accelerated filers" is set forth in General Instruction A.(2)(a) of that form.

65 *See* Section II.A.12., below.

66 17 CFR 240.12b-2.

67 15 U.S.C. 78m(a).

68 15 U.S.C. 78o(d).

69 Once a company becomes an accelerated filer, it remains an accelerated filer subject to shortened deadlines unless and until it subsequently becomes eligible to use Exchange Act Forms 10-QSB and 10-KSB for its annual and quarterly reports. In that situation, the issuer would cease to be an accelerated filer unless and until it again meets the accelerated filer criteria.

70 Source: SEC and Compustat.

71 It is our intention that the procedure would remain available for the two annual meetings following the occurrence of a nomination procedure triggering event. Because there are a number of variables that could impact this application, such as special meetings being held instead of annual meetings or a delay in the date of a later annual meeting, we have proposed that the procedure be operative during the period described.

72 Because of plurality voting, in the election of directors security holders may vote for or withhold authority to vote for each nominee rather than vote for, against or abstain, as is the case for other matters to be voted on by security holders. *See* Exchange Act Rule 14a-4(b)(2).

73 17 CFR 240.14a-12(c).

74 The staff has informed us that it intends to take the

position that such a proposal is not excludable under Exchange Act Rule 14a-8(i)(8) [17 CFR 240.14a-8(i)(8)]. To clarify the applicability of this provision in the context of proposed Exchange Act Rule 14a-11, we are proposing an amendment to Exchange Act Rule 14a-8(i)(8) that would, if adopted, make clear that a company may not rely on the exclusion permitted by that paragraph (*i.e.*, the exclusion for proposals relating to the election of directors) to exclude a proposal that the company become subject to the procedure in proposed Exchange Act Rule 14a-11. The requirements and exclusions in the remainder of Exchange Act Rule 14a-8 would, of course, continue to apply to any such security holder proposal. Although we are proposing a security holder nomination procedure in this release, we are not reviewing or revising the position taken by the Division of Corporation Finance regarding the application of Exchange Act Rule 14a-8(i)(8) to security holder proposals that would have the effect of creating a security holder nomination procedure, other than a direct access proposal (as described above). *See*, *e.g.*, Division of Corporation Finance no-action letters to Citigroup, Inc. (January 31, 2003) and AOL Time Warner (February 29, 2003).

75 The votes cast on a proposal would be calculated in the same manner as for Exchange Act Rule 14a-8 proposals. Accordingly, only votes for and against a proposal would be
included in the calculation of the security holder vote. *See* Instruction 2 to proposed Exchange Act Rule 14a-11(a). For a further explanation of this calculation, *see* also Section F.4. of Staff Legal Bulletin No. 14 (July 13, 2001).

76 Exchange Act Rule 14a-8(i)(11) [17 CFR 240.14a-8(i)(11)] permits companies to exclude duplicative security holder proposals. We have proposed an instruction to Exchange Act Rule 14a-8(i)(11) to specify that, where a company receives more than one "direct access" security holder proposal, the company would not be permitted by that rule to exclude a direct access proposal received by a holder of more than 1% of the company's securities.

77 17 CFR 240.14a-9.

78 Sample data provided by Automated Data Processing, Inc.; sample data relate to companies traded on the New York Stock Exchange, the American Stock

Exchange, and the Nasdaq Stock Market. For each election, the number of "yes" votes and withhold votes received are totaled across all candidates on the proxy and then are reported. Thus, the level of withhold votes received on average across all candidates in a given election can be calculated, but not the outcome candidate-by-candidate. The result is that the number of elections in which a specific candidate received a certain number of withhold votes may be larger than the data presented here. This is due to the dilution experienced in elections where one candidate receives substantially more withhold votes than others on the same proxy.

79 Based on analysis of the Vickers Stock Research Form 13-F filings database for 2002. Consistent with the Form 13-F filings, the holdings of different funds within a mutual fund family have been combined when considering the size of an institution's ownership position. This data is limited to U.S.-based companies with common equity trading on the NYSE, AMEX, or Nasdaq markets as of December 31, 2002.

80 Sample data provided by Georgeson Shareholder Communications Inc. The holdings of the proponent of the security holder proposal were taken from Vickers.

81 Based on an analysis of the Vickers Form 13-F filings database for 2002. Consistent with the Form 13-F filings, the holdings of different funds within a mutual fund family have been combined when considering the size of an institution's ownership position. This data is limited to U.S.-based companies with common equity trading on the NYSE, AMEX, or Nasdaq markets as of December 31, 2002.

82 *Id*.

83 *Id*.

84 ADP sample based on 926 proposals for 2002-2003; Investor Responsibility Research Center sample based on 818 governance-related proposals from 2000-2002; Georgeson sample based on 597 proposals from 2000-2002.

85 ADP and IRRC provided vote outcomes both by votes cast and votes outstanding, whereas the Georgeson sample provided only votes cast.

86 As is currently required in Exchange Act Rule 14a-8, this date would be calculated by determining the release date disclosed in the previous year's proxy statement,

increasing the year by one, and counting back 120 calendar days.

87 For example, the company could describe the proposal in that Exchange Act report and discuss the operation of the proposed security holder nomination procedure in that situation, including the topic of the security holder proposal, the date by which the company would become subject to the security holder nomination procedure if it has not yet implemented the proposal, and any obligation of the company to continue to inform security holders regarding the implementation of the proposal.

88 Security holders should use existing Exchange Act Rule 14a-8 procedures to provide evidence of ownership.

89 In addition to the proposed additions to Exchange Act Forms 10-Q, 10-QSB, 10-K and 10-KSB that we discuss in this section, we also have proposed corrective revisions to these forms to update outdated references to Exchange Act Rule 14a-11 that currently appear in Paragraph (d) of Item 4 of Part II to Forms 10-Q and 10-QSB and Paragraph (d) of Item 4 of Part I to Forms 10-K and 10-KSB.

90 In lieu of Forms 10-Q, 10-QSB, 10-K or 10-KSB, registered investment companies ("funds") would provide the additional disclosure on Form N-CSR. *See* Section II.A.12., below.

91 Item 4 of Part II to Exchange Act Forms 10-Q and 10-QSB and Item 4 of Part I to Exchange Act Forms 10-K and 10-KSB currently require that companies disclose the results of the voting on all matters submitted to a vote of security holders during the period covered by the report. We have proposed an addition to this provision that would require disclosure of specific information relating to the security holder nomination procedure in proposed Item 4(e) of Part II to Exchange Act Forms 10-Q and 10-QSB and proposed Item 4(e) of Part I to Exchange Act Forms 10-K and 10-KSB.

92 *See* proposed Item 4(e) of Part II to Exchange Act Forms 10-Q and 10-QSB and proposed Item 4(e) of Part I to Exchange Act Forms 10-K and 10-KSB.

93 The manner in which a nominating security holder or nominating security holder group would establish its eligibility to use the procedure in proposed Exchange Act Rule 14a-11 is discussed in Section II.8.a., below.

94 *See* proposed Exchange Act Rule 14a-11(b)(1)-(2).

95 The requirement regarding the nominating security holder's intent to continue to own the securities is set forth in proposed Exchange Act Rule 14a-11(b)(2). The nominating security holder would be required to include a representation regarding this intent in its notice to the company, pursuant to proposed Exchange Act Rule 14a-11(c)(2).

96 17 CFR 240.13d-101.

97 17 CFR 240.13d-1(b)-(c). This requirement is set forth in proposed Exchange Act Rule 14a-11(b)(3). The nominating security holder would be required to include a representation regarding this eligibility in its notice to the company, pursuant to proposed Exchange Act Rule 14a-11(c)(2). This requirement would not apply in the case of an open-end management investment company ("mutual fund") because security holders of mutual funds are not required to file Exchange Act Schedules 13D or 13G. *See* Exchange Act Rules 13d-1(a) and (i) [17 CFR 240.13d-1(a) and (i)] (requiring any person who is directly or indirectly the beneficial owner of more than 5% of a class of equity securities to file with the Commission a statement containing the information required by Exchange Act Schedule 13D, and defining "equity security" to mean any equity security of a class which is registered pursuant to Section 12 of the Exchange Act [15 U.S.C. 78*l*], or any equity security of any insurance company which would have been required to be so registered except for the exemption contained in Section 12(g)(2)(G) of the Exchange Act [15 U.S.C. 78l(g)(2)(7)], or any equity security issued by a closed-end investment company registered under the Investment Company Act).

98 This requirement is set forth in proposed Exchange Act Rule 14a-11(b)(4). A nominating security holder or group for a mutual fund would be required to file information reporting the security holder or group's beneficial ownership as part of the security holder's notice to the fund, pursuant to proposed Exchange Act Rule 14a-11(c)(11). *See* Section II.A.12., below.

99 *See* 2003 Summary of Comments.

100 *See id*.

101 *See id*.

102 *See id*.

103 *See id*.

104 Based on analysis of the Vickers Form 13-F filings database for 2002. Consistent with the Form 13-F filings, the holdings of different funds within a mutual fund family have been combined when considering the size of an institution's ownership position. This data is limited to U.S.-based companies with common equity trading on the NYSE, AMEX, or Nasdaq markets as of December 31, 2002.

105 This requirement is set forth in proposed Exchange Act Rule 14a-11(a)(3)(i). Pursuant to proposed Exchange Act Rule 14a-11(c)(1), the notice to the company by the nominating security holder or nominating security holder group would be required to include a representation that the nominee's candidacy or, if elected, board membership, would not violate any of the specified provisions.

106 As proposed, there would not be a separate standard regarding the security holder nominee's compliance with the applicable independence requirements of a national securities exchange or national securities association. Rather, compliance with these existing independence standards would be established through the inclusion in the notice to the company by the nominating security holder or nominating security holder group of a representation that the nominee satisfies the existing standard. This representation is required in proposed Exchange Act Rule 14a-11(c)(4). In the case of a fund, a nominating security holder or group would be required to represent that its nominee is not an "interested person" of the fund as defined in Section 2(a)(19) of the Investment Company Act. [15 U.S.C. 80a-2(a)(19)]. *See* Section II.A.12., below.

107 *See* the Instruction to proposed Exchange Act Rule 14a-11(c)(4). This proposed standard is discussed further in Section II.A.6.c., below.

108 For these purposes, "immediate family" would be defined in a manner that is consistent with the definition of "family member" that requires disclosure under Item 401(d) of Regulation S-K [17 CFR 228.401(d)].

109 This representation would be required in the nominating security holder's notice to the company, pursuant to proposed Exchange Act Rule 14a-11(c)(5). Instruction 1 to proposed Exchange Act Rule 14a-11(d) clarifies that any nominee about which the nominating security holder

is not able to make this representation shall not be counted in calculating the number of security holder nominees for purposes of proposed Exchange Act Rule 14a-11(d).

110 For example, the NYSE proposed listing standards include both subjective and objective components in defining an "independent director." Section 303A(2)(a) provides that no director will qualify as "independent'" unless the board of directors "affirmatively determines that the director has no material relationship with the listed company (either directly or as a partner, shareholder or officer of an organization that has a relationship with the company)." Section 303A(2)(b) provides that "a director who receives, or whose immediate family member receives, more than $100,000 per year in direct compensation from the listed company, other than director and committee fees and pension or other forms of deferred compensation for prior service (provided such compensation is not contingent in any way on continued service), is presumed not to be independent until five years after he or she ceases to receive more than $100,000 per year in such compensation." *See* Release No. 34-47672 (April 11, 2003). In the case of a fund, a nominating security holder or group would be required to represent that its nominee is not an "interested person" of the fund as defined in Section 2(a)(19) of the Investment Company Act. *See* Section II.A.12., below.

111 15 U.S.C. 77a *et seq*.

112 This safe harbor is set forth in Instruction 3 to proposed Exchange Act Rule 14a-11(a). The safe harbor is intended to operate such that the determination of whether a holder or group is an "affiliate" of the company would continue to be made based upon all of the facts and circumstances regarding the relationship of the holder or group to the company, other than such holder's or group's activities under the proposed security holder nomination procedure.

113 *See, e.g.*, Exchange Act Rule 14a-12(c).

114 Based on a sample of 1,439 public companies provided by IRRC to our Office of Economic Analysis, in 2002, the median board size was 9, with boards ranging in size from 4 to 24 members. Approximately 42% of the boards in the sample had 8 or fewer directors, approximately 58% had between 9 and 19 directors, and

less than 1% had 20 or more directors.

115 This requirement is set forth in proposed Exchange Act Rule 14a-11(d)(3).

116 As is currently required in Exchange Act Rule 14a-8, this date would be calculated by determining the release date disclosed in the previous year's proxy statement, increasing the year by one, and counting back the required number of calendar days. If the company did not hold an annual meeting during the prior year, or if the date of the meeting has changed more than 30 days from the prior year, then the nominating security holder would be required to provide notice a reasonable time before the company mails its proxy materials for the current year, as specified by the company in an Exchange Act Form 8-K filed pursuant to proposed Item 13.

117 The eligibility standards for nominating security holders are set forth in proposed Exchange Act

Rule 14a-11(b). This representation would be included in the nominating security holder's notice pursuant to proposed Exchange Act Rule 14a-11(c)(2).

118 Proposed Exchange Act Rule 14a-11(a)(3)(i) requires that the nomination not violate these standards. This representation would be included in the nominating security holder's notice pursuant to proposed Exchange Act Rule 14a-11(c)(1).

119 This representation would be included in the nominating security holder's notice pursuant to proposed Exchange Act Rule 14a-11(c)(4). In the case of a fund, a nominating security holder or group would be required to represent that its nominee is not an "interested person" of the fund as defined in Section 2(a)(19) of the Investment Company Act. *See* Section II.A.12., below.

120 This representation would be included in the nominating security holder's notice pursuant to proposed Exchange Act Rule 14a-11(c)(3).

121 This representation would be included in the nominating security holder's notice pursuant to proposed Exchange Act Rule 14a-11(c)(5).

122 Proposed Exchange Act Rule 14a-11(b)(4) would require that the nominating security holder or nominating security holder group to have filed this Exchange Act Schedule 13G. A copy of this Exchange Act Schedule 13G

would be included in the nominating security holder's notice pursuant to proposed Exchange Act Rule 14a-11(c)(6). This requirement would not apply in the case of a company that is a mutual fund because security holders of mutual funds are not required to file Exchange Act Schedule 13G. *See* Exchange Act Rules 13d-1(a) and (i). A nominating security holder or group for a mutual fund would be required to file information reporting the security holder or group's beneficial ownership as part of the security holder's notice to the fund pursuant to proposed Exchange Act Rule 14a-11(c)(11). *See* Section II.A.12., below.

123 Proposed Exchange Act Rule 14a-11(b)(3) requires that the nominating security holder or nominating security holder group satisfy this standard. This representation would be included in the nominating security holder's notice pursuant to proposed Exchange Act Rule 14a-11(c)(2). This requirement would not apply in the case of a company that is a mutual fund because security holders of mutual funds are not required to file Exchange Act Schedule 13G. *See* Exchange Act Rules 13d-1(a) and (i); Section II.A.12., below.

124 Proposed Exchange Act Rules 14a-11(b)(1) and 14a-11(b)(2) require that the nominating security holder meet these standards. This representation would be included in the nominating security holder's notice pursuant to proposed Exchange Act Rule 14a-11(c)(2). For companies that are mutual funds, this representation is modified to reflect the fact that security holders of mutual funds are not required to file Exchange Act Schedule 13G. *See* Exchange Act Rules 13d-1(a) and (i); Section II.A.12., below.

125 This statement would be included in the nominating security holder's notice pursuant to proposed Exchange Act Rule 14a-11(c)(7).

126 This information would be included in the nominating security holder's notice pursuant to proposed Exchange Act Rule 14a-11(c)(8). This information would identify the nominee, describe certain legal proceedings, if any, related to the nominee, and describe certain of the nominee's transactions and relationships with the company. *See* paragraphs (a), (b), and (c) of Item 7 of Exchange Act Schedule 14A. With respect to a nominee for director of a fund, the disclosure would include certain basic information about the nominee and any arrangement or understanding between the nominee

and any other person pursuant to which he was selected as a nominee; information about the positions, interests, and transactions and relationships of the nominee and his immediate family members with the fund and persons related to the fund; information about the amount of equity securities of funds in a fund complex owned by the nominee; and information describing certain legal proceedings related to the nominee, including legal proceedings in which the nominee is a party adverse to, or has a material interest adverse to, the fund or any of its affiliated persons. *See* paragraph (b) of Item 22 of Exchange Act Schedule 14A.

127 This information would be included in the nominating security holder's notice pursuant to proposed Exchange Act Rule 14a-11(c)(9). Where the nominating security holder is an entity rather than an individual, the required disclosure would be provided with regard to the control persons of the entity. For example, if the nominating security holder is a corporation, the information called for in Exchange Act Rule 14a-11(c)(9) must be given with respect to each executive officer and director of the corporation, each person controlling the corporation, and each executive officer and director of any corporation or other person ultimately in control of the corporation. *See* the Instruction to proposed Exchange Act Rule 14a-11(c)(9).

128 17 CFR 240.13d-3.

129 17 CFR 229.401(f).

130 This information would be included in the nominating security holder's notice pursuant to proposed Exchange Act Rule 14a-11(c)(10).

131 The requirement to file this information with the Commission is set forth in proposed Exchange Act Rule 14a-6(q).

132 For a fund, the filing would be made under the subject company's Investment Company Act file number. *See* Section II.A.12., below.

133 These requirements are set forth in proposed Exchange Act Rule 14a-11(a) and proposed amendments to Exchange Act Rule 14a-4(b)(2).

134 This information is specified in proposed Item 7(i) of Exchange Act Schedule 14A.

135 Under the proposed rules, inclusion of a security holder nominee in the company's proxy materials would not require the company to file a preliminary proxy statement provided that the company was otherwise qualified to file directly in definitive form. In this regard, the proposed rules make clear that inclusion of a security holder nominee would not be deemed a solicitation in opposition. *See* proposed revisions to Exchange Act Rule 14a-6(a)(4) and Note 3 to that rule.

136 We anticipate that companies would continue to be able to solicit discretionary authority to vote a security holder's shares for the company nominees, as well as to cumulate votes for the company nominees in accordance with applicable state law, where such state law provides for cumulative voting.

137 *See* proposed Exchange Act Rule 14a-11(a).

138 17 CFR 240.14a-8(l)(2).

139 *See* proposed Exchange Act Rule 14a-11(e). Exchange Act Rule 14a-8(l)(2) applies with respect to proposals and supporting statements that are submitted by shareholders and then required to be repeated in the company's proxy materials by Exchange Act Rule 14a-8. In this regard, Exchange Act Rule 14a-8 states that "the company is not responsible for the contents of [the shareholder proponent's] proposal or supporting statement."

140 *See* the Instruction to proposed Item 7(i) of Exchange Act Schedule 14A.

141 *See* proposed Exchange Act Rule 14a-11(f)(1).

142 17 CFR 240.14a-3 - 14a-6(o).

143 17 CFR 240.14a-10 - 14a-15.

144 For a fund, the filing would be made under the subject company's Investment Company Act file number. *See* Section II.A.12., below.

145 *See* Exchange Act Rule 14a-12.

146 For a fund, the filing would be made under the subject company's Investment Company Act file number. *See* Section II.A.12., below.

147 *See* proposed Exchange Act Rule 14a-11(f)(2).

148 *See* Investment Company Act Rule 20a-1 [17 CFR 270.20a-1] (requiring funds to comply with Regulation

14A, Schedule 14A, and all other rules and regulations adopted pursuant to Section 14(a) of the Exchange Act that would be applicable to a proxy solicitation if it were made in respect of a security registered pursuant to Section 12 of the Exchange Act).

149 *See* Section II.A.3., above.

150 Proposed Item 8 of Form N-CSR.

151 Proposed Items 8(a), (b), (c), and (d) of Form N-CSR. Small business investment companies, which are not required to file Form N-CSR, would provide the required disclosure regarding matters submitted to a vote of security holders, and the new disclosure regarding the occurrence of any of the nomination procedure triggering events, under Item 102B of Form N-SAR. *See* proposed Instruction to Item 102B of Form N-SAR.

152 Proposed Item 13 of Exchange Act Form 8-K; Instruction 5 to proposed Exchange Act Rule 14a-11(a).

153 *See* proposed Exchange Act Rule 13a-11(b)(2) and 15d-11(b)(2).

154 *See* proposed Exchange Act Rule 14a-11(c)(4); 15 U.S.C. 80a-2(a)(19).

155 Business development companies are a category of closed-end investment company that are not registered under the Investment Company Act, but are subject to certain provisions of that Act. *See* Sections 2(a)(48) and 54-65 of the Investment Company Act [15 U.S.C. 80a-2(a)(48) and 80a-53-64].

156 *See* proposed Exchange Act Rule 14a-11(c)(11).

157 For purposes of determining the amount of outstanding securities of a class of equity securities, the security holder generally could rely upon information set forth in the fund's most recent report on Form N-CSR. *See* proposed Instruction to Exchange Act Rule 14a-11(c)(11)(i).

158 *See* proposed Exchange Act Rule 14a-11(c)(11)(ii).

159 *See* proposed Exchange Act Rule 14a-11(c)(9).

160 *See* proposed Exchange Act Rules 14a-11(f)(1)(iii) and 14a-11(f)(2)(iii).

161 *See* Release No. IC-24816 (Jan. 2, 2001) [66 FR 3734, 3737] (adopting a requirement that independent directors of funds select and nominate any other

independent directors as a condition of relying on Investment Company Act Rules 10f-3, 12b-1, 15a-4(b)(2), 17a-7, 17a-8, 17d-1(d)(7), 17e-1, 17g-1(j), 18f-3, or 23c-3).

162 *See* Section II.A.2.a., above.

163 *See* Release No. IC-24816 (Jan. 2, 2001) [66 FR 3734, 3737].

164 17 CFR 240.10A-3.

165 *See* Exchange Act Rule 13d-1.

166 *See*, *e.g.*, Exchange Act Rules 13d-1(b) and 13d-1(c).

167 This requirement would not extend the date by which the beneficial ownership report is otherwise due under Exchange Act Regulation 13D.

168 The percentage of securities listed in such certification will be used not only to determine eligibility to submit a security holder nomination pursuant to proposed Exchange Act Rule 14a-11, but also to determine the security holder or security holder group with the largest percentage of eligible subject securities where more than one security holder or security holder group provides notice of its intention to submit a nomination pursuant to proposed Exchange Act Rule 14a-11 and is otherwise eligible to do so.

169 This and other amendments would be filed in accordance with the existing timing requirements for beneficial holders who qualify as either qualified institutional investors or passive investors.

170 *See* Exchange Act Rule 13d-5(b)(1) [17 CFR 240.13d-5(b)(1)].

171 15 U.S.C. 78p.

172 Exchange Act Section 16(a) [15 U.S.C. 78p(a)].

173 Exchange Act Section 16(b) [15 U.S.C. 78p(b)].

174 Exchange Act Section 16(c) [15 U.S.C. 78p(c)].

175 Proposed Exchange Act Rule 16a-1(a)(1)(i). Exchange Act Rule 16a-1(a)(1) also would be reorganized for clarity.

176 Exchange Act Rule 16a-1(a)(1) [17 CFR 240.16a-1(a)(1)] also contains a general condition that the securities be

held for the benefit of third parties or in customer or fiduciary accounts in the ordinary course of business, but this condition would not be applicable to nominating security holder groups. We believe that the requirement that they qualify for Exchange Act Schedule 13G rather than Exchange Act Schedule 13D provides adequate protection in this area.

177 *See Feder v. Martin Marietta*, 406 F.2d 260 (2d Cir.), cert. denied, 396 U.S. 1036 (1970); *Blau v. Lehman*, 368 U.S. 403 (1962); and *Rattner v. Lehman*, 193 F.2d 564 (2d Cir. 1952).

178 Exchange Act Section 16(b) begins: "For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer ...."

179 *See*, *e.g.*, *Feder v. Martin Marietta*, at note 177, above.

180 44 U.S.C. 3501 *et seq.*

181 44 U.S.C. 3507(d) and 5 CFR 1320.11.

182 Exchange Act Schedule 14C requires disclosure of some items of Exchange Act Schedule 14A. Therefore, while we are not proposing to amend the text of Exchange Act Schedule 14C, the proposed amendments to Exchange Act Schedule 14A must also be reflected in the PRA burdens for Exchange Act Schedule 14C.

183 The proxy rules apply only to domestic companies with equity securities registered under Section 12 of the Exchange Act and to investment companies registered under the Investment Company Act. There is a discrepancy between the number of annual reports by reporting companies and the number of proxy and information statements filed with the Commission in any given year. This is because some companies are subject to reporting requirements by virtue of Section 15(d) of the Exchange Act, and therefore are not covered by the proxy rules. In addition, companies that are not listed on a national securities exchange or traded on the Nasdaq Stock Market may not hold annual meetings and therefore would not be required to file a proxy or information statement.

184 For convenience, the estimated PRA hour burdens have been rounded to the nearest whole number, and the estimated PRA cost burdens have been rounded to the nearest $100. In connection with other recent rulemakings, we have had discussions with several

private law firms to estimate an hourly rate of $300 as the cost of outside professionals that assist companies and security holders (or security holder groups) in preparing these disclosures.

185 The paperwork burden for funds will be discussed in the footnotes to Sections III.B.1-3., below.

186 The annual responses to Investment Company Act Rule 20a-1 reflect the number of proxy and information

statements that are filed by funds.

187 For funds, we estimate that 14 Exchange Act Rule 14a-8 security holder proposals seeking direct access will be submitted by holders of 1% or more of a fund's securities each year. We estimate that the incremental disclosure burden will be 1 hour for each fund to disclose on Exchange Act Schedule 14A that it has received a direct access security holder proposal by a more than 1% security holder who has held the securities for at least one year, for a total of 14 hours. We estimate that the annual incremental disclosure burden for the proponent's preparation of the proposal and the Exchange Act Rule 14a-8 no-action process would average 15 hours per proposal, for a total of 210 hours (14 proposals × 15 hours). Hence, the total burden would be 224 hours (14 hours + 210 hours), corresponding to 168 hours of personnel time and $16,800 of costs for services of outside professionals. This burden would be added to the PRA burden of Rule 20a-1.

188 We recognize that a company that receives a security holder proposal has no obligation to make a

no-action request under Exchange Act Rule 14a-8 unless it intends to exclude the proposal from its proxy materials. Similarly, we recognize that a company is not obligated to provide a statement of opposition.

189 We estimate that 5% of the total number of security holder proposals received will be direct access proposals. Based on an IRRC estimate that there will be 1,070 security holder proposals submitted in 2003, this corresponds to 54 proposals.

190 We estimate an annual incremental disclosure burden of approximately 25 hours for each Exchange Act Rule 14a-8 no-action request that a company makes. The Division of Corporation Finance received 465 Exchange Act Rule

14a-8 proposals in the 2002 proxy season. Based on the statistic provided by IRRC that 802 security holder proposals were filed in the 2002 proxy season, we estimate that companies will seek no-action relief on 58% of the proposals received. 58% of 25 hours would correlate to 15 hours for each security holder proposal that a company receives.

191 We are proposing that funds be required to provide disclosure on Form N-CSR regarding each

matter submitted to a vote of security holders and to delete as duplicative Item 77C of Form N-SAR, which currently requires similar disclosure. We estimate that 281 matters submitted for a vote of security holders were disclosed on Item 77C of Form N-SAR during the most recent 12 months. We estimate that the removal of Item 77C will decrease the PRA burden for Form N-SAR by 0.5 hours per filing, or 140.5 hours total. This burden of 140.5 hours will be added to Form N-CSR under our proposals, together with the proposed new disclosure regarding the nomination procedure triggering events.

192 For funds, we estimate that 14 funds will be required to provide disclosure on Form N-CSR regarding a direct access security holder proposal each year, which we estimate would average approximately 0.5 burden hours, for a total of 7 hours. We estimate that 14 funds will need to disclose on Form N-CSR that they are subject to the security holder nomination procedure, which we estimate would average approximately 1 burden hour, for 14 hours total. Hence, the total burden would be 21 hours (7 hours + 14 hours), corresponding to 16 hours of fund personnel time and $1,500 for the services of outside professionals. This burden would be added to the PRA burden of Form N-CSR.

193 Item 4 of Part II of Exchange Act Forms 10-Q and 10-QSB and Item 4 of Part I of Exchange Act Forms 10-K and 10-KSB currently require that companies disclose the results of the voting on all matters submitted to a vote of security holders during the period covered by the report. Because security holders would be allowed to submit a direct access proposal under Exchange Act Rule 14a-8 as a result of the proposed rules, there would be an annual incremental disclosure burden to disclose the vote on this proposal.

194 Our best estimate is that 1.1% of U.S. exchange-traded

companies have director withhold votes of more

than 35%, which corresponds to approximately 57 companies. We combine this estimate with our estimate that 30% of companies will receive direct access proposals from holders of more than 1% of the companies' securities that will pass, which corresponds to 16 proposals.

195 Based on a review of 1,255 companies' annual meeting dates, we estimate that 3.75% of companies' annual meeting dates changed by more than 30 days from the prior year. 3.75% of 73 companies would correspond to roughly 3 companies that would be required to file a Form 8-K. Source: IRRC.

196 A nominating security holder or security holder group of a mutual fund would be required to file

information reporting the security holder or security holder group's beneficial ownership as part of the security holder's notice to the fund, pursuant to proposed Exchange Act Rule 14a-11(c)(11).

197 For funds, we estimate that the proposed access rule would be triggered in 14 funds each year, and in 9 of these funds at least one security holder or security holder group will make a nomination. Further, we estimate that, in funds where a nomination is made, an average of 2 security holders or groups will submit a nomination. We estimate that the disclosure burden for each of these 18 security holders or groups to provide notice of its intent to require that the fund include the security holder's nominee on the fund's proxy card would be approximately 4 hours, for a total of 72 hours. We also estimate that the disclosure burden for these 18 security holders or groups to review and file an Exchange Act Schedule 13G (in the case of a closed-end fund) or the portion of the notice to the fund requiring disclosure of beneficial ownership similar to Exchange Act Schedule 13G (in the case of a mutual fund) and the accompanying certification would be approximately 12 hours, for a total of 216 hours. This burden would be added to the PRA burden of Rule 20a-1.

198 Based on data on the size of institutional shareholdings, we estimate that approximately 50% of companies

that receive over 35% of withhold votes for one of their nominees would have an individual security holder or

security holder group with 5% of the shares outstanding that would be able to make a nomination. This would correspond to 29 companies. We estimate that all of the companies that receive a direct access proposal that passes will have an individual security holder or security holder group with 5% of the shares outstanding since security holders who submit an access proposal would likely do so only if they are confident that a group will make a nomination. This would correspond to 16 companies.

199 The proposed rules contemplate that the company only would be required to include in its proxy statement

and form of proxy the nominee or nominees of the security holder or security holder group with the largest beneficial ownership. As such, only 45 of the 90 nominating security holders or security holder groups would be eligible to nominate a candidate or candidates to the board. Further, although there is no reliable way to predict the number of companies that would determine that they are not required to include a nominee in their proxy materials due to the nominee being ineligible under proposed Exchange Act Rule 14a-11, we estimate that approximately 10% of companies would make this determination.

200 There is no way to determine how many companies would choose to include a statement regarding the

security holder nominee or nominees. We estimate that 50% of companies would include such a statement.

201 For funds, we estimate that 10 nominees will be excluded from the security holder nomination procedure each year, and the annual disclosure burden for a fund to notify the 10 nominating security holders or groups of the fund's determination not to include the nominee in its proxy materials would be 1 hour, for a total of 10 hours. We estimate that the annual disclosure burden for a fund to include the remaining 8 nominees in its proxy materials to be 1 burden hour, for a total of 8 hours. Of these 8 funds, we estimate that 4 funds and nominating security holders will include a statement with regard to the security holder nominee or nominees and the disclosure burden would be approximately 4 hours, for a total of 16 hours. The total burden with respect to the Exchange Act Rule 14a-11 nomination procedure would be 322 hours (72 hours + 216 hours + 10 hours +

8 hours + 16 hours), corresponding to 242 hours of fund personnel time and $24,000 for the services of outside professionals. See note 197, above. This burden also would be added to the PRA burden of Rule 20a-1.

202 As discussed further below, we estimate that no small businesses will be affected by the proposed rule so

we did not include any PRA estimates for the Form 10-QSB and Form 10-KSB.

203 The estimated PRA burdens have not been rounded to the nearest whole number and $100 in order to

accurately reflect figures in the text.

204 The incremental burden estimate for Form N-CSR includes 140.5 hours (281 responses × 0.5 hours per response) transferred in connection with the deletion of Item 77C of Form N-SAR. This Item currently requires disclosure regarding each matter submitted to a vote of security holders. In addition, the burden for Form N-CSR includes disclosure parallel to that proposed with respect to the nomination procedure triggering events on Forms 10-Q and 10-K. As discussed above, we estimate that the disclosure burden would be 21 hours for this nomination procedure disclosure. Thus, we estimate that the incremental burden estimate for Form N-CSR will increase by a total of 161.50 hours (140.5 hours + 21 hours) or 0.57 hours per response (161.5 hours/281 responses) as a result of the required disclosure in this proposed rulemaking. We estimate, however, that the net incremental burden increase for funds to comply with Form N-SAR and Form N-CSR would be 21 hours.

The incremental burden estimate for Rule 20a-1 includes the disclosure that would be required on Exchange Act Schedule 14A, discussed above, with respect to funds. We estimate that the burden associated with these disclosure requirements would be 546 hours (224 hours + 322 hours) or 22.75 hours per response (546 hours/ 24 responses) as a result of the required disclosure in this proposed rulemaking.

205 *See* Press Release No. 2003-46 (April 14, 2003).

206 *See* Release No. 34-47778 (May 1, 2003).

207 *See* Staff Report: Review of the Proxy Process Regarding the Nomination and Election of Directors, Division of Corporation Finance (July 15, 2003).

208 *See id*.

209 *See* Release No. 34-48301 (August 14, 2003).

210 *See* 2003 Summary of Comments.

211 *See id*.

212 Exchange Act Rule 14a-8(i)(8) permits a company to exclude a security holder proposal from its proxy statement if the proposal "relates to an election for membership on the company's board of directors or analogous governing body."

213 *See* 2003 Summary of Comments. Several commenters noted that better corporate governance would increase the long-term value of security holders' investments in companies.

214 *See* 2003 Summary of Comments.

215 We estimate the average hourly cost of in-house personnel to be $85. This cost estimate is based on data

obtained from *The SIA Report on Management and Professional Earnings in The Securities Industry* (Oct. 2001).

216 The cost may vary from company to company. The total dollar costs have been prorated across all

companies, funds and security holders affected. We estimate that 111 operating companies and 24 funds will be impacted by some aspect of the proposed rules. These figures differ slightly from the PRA figures reflected in the Calculation of Incremental PRA Burden Estimates table because they do not reflect the number of funds affected by the removal of Item 77C from Form N-SAR and the transfer of the burden of 140.5 hours associated with Item 77C to Form N-CSR. This transfer does not result in any net new costs to funds.

217 *See* Release No. 34-40018 (May 21, 1998) [63 FR 29106].

218 *See* 2003 Summary of Comments. The response may have accounted for the printing of more than one proposal.

219 *See id*.

220 *See id.*

221 *See id.*

222 *See id.*

223 *See id.* Although the proposed rules address the issue of special interest directors by requiring that the

nominating security holder be independent from the security holder nominee, there still may be concern that the security holder nominee is informally beholden to the nominating security holder.

224 Of the 266 companies that submitted letters to the Division of Corporation Finance during the 2002-

2003 proxy season regarding their intentions to exclude a security holder proposal submitted under Exchange Rule 14a-8, only 26 had a common equity public float of less than the $75 million threshold in the definition of "accelerated filer." Accordingly, the number of small businesses issuers would be even less than that figure.

225 *See* James S. Ang, Rebel A. Cole, & James Wuh Lin, *Agency Costs and Ownership Structure*, The Journal of Finance, Volume LV. No. 1, 81, 96 (February 2000). Based on a sample size of 1,708 small companies, defined as companies with $6 million in sales, on average, 73% of these companies had one family that owned 50% or more of the company.

226 15 U.S.C. 78w(a)(2).

227 15 U.S.C. 78c(f).

228 15 U.S.C. 80a-2(c).

229 *See* Press Release No. 2003-46 (April 14, 2003).

230 *See* Release No. 34-47778 (May 1, 2003).

231 *See* Staff Report: Review of the Proxy Process Regarding the Nomination and Election of Directors, Division of Corporation Finance (July 15, 2003).

232 *See id*.

233 *See* Release No. 34-48301 (August 14, 2003).

234 17 CFR 240.0-10(a).

235 An investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of $50

million or less as of the end of its most recent fiscal year. 17 CFR 270.0-10.

236 Ang *et al*, above at note 225.

237 Exchange Act Rule 14a-8(i)(8) permits a company to exclude a security holder proposal from its proxy statement if the proposal "relates to an election for membership on the company's board of directors or analogous governing body."

238 Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996).

http://www.sec.gov/rules/proposed/34-48626.htm

Home | Previous Page

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U.S. Securities and Exchange Commission

SUMMARY OF COMMENTS: In Response to the Commission's Proposed Rules Relating to Security Holder Director Nominations

Exchange Act Release No. 34-48626
Investment Company Act Release No. 26206
File No. S7-19-03

Prepared by:
Division of Corporation Finance
March 5, 2004

Table of Contents

I. List of Commenters

Academics

1.	Susan E. Dudley	George Mason University	
2.	Wendy L. Gramm	George Mason University	
3.	Comments of Lucian A. Bebchuk, William J. Friedman and Alicia Townsend Friedman Professor, Harvard Law School; John C. Coates IV, Professor, Harvard Law School; Dwight B. Crane, George Fisher Baker, Jr. Professor, Harvard Business School; Alexander Dyck, Associate Professor, Harvard Business School; Boris Groysberg, Assistant Professor, Harvard Business School; Brian J. Hall, Professor, Harvard Business School; Paul M. Healy, James R. Williston Professor, Harvard Business School; Howell Jackson, Finn M.W. Caspersen	Harvard Law School; Harvard Business School	("Harvard")

	and Household International Professor, Harvard Law School; W. Carl Kester, Professor, Harvard Business School; Rakesh Khurana, Assistant Professor, Harvard Business School; Reinier H. Kraakman, Ezra Ripley Thayer Professor, Harvard Law School; Jay W. Lorsch, Louis E. Kirstein Professor, Harvard Business School; Krishna G. Palepu, Ross Graham Walker Professor, Harvard Business School; Mark J. Roe, David Berg Professor, Harvard Law School; Guhan Subramanian, Joseph Flom Assistant Professor, Harvard Law School, December 3, 2003		
4.	Lucian A. Bebchuk	Harvard Law School	("Bechuk")
5.	Alicia Townsend	Harvard Law School	
6.	Donald G. Margotta	Northeastern University	
7.	James L. Bicksler	Rutgers University	
8.	Joseph A. Grundfest	Stanford Law School	("Grundfest")

9.	Kenneth Scott	Stanford Law School	("Shadow Reg. Comte.")
10.	Jayne Elizabeth Zanglein	The College of New Jersey	("Zanglein")
11.	Stephen M. Bainbridge	UCLA School of Law	("Bainbridge")
12.	Randall S. Kroszner	University of Chicago	

Associations

13.	America's Community Bankers		("ACB")
14.	American Bar Association Monday, November 03, 2003		("ABA")
15.	American Bar Association Wednesday, January 07, 2004		("ABA")
16.	American Society of Corporate Secretaries		("ASCS")
17.	Association of BellTel Retirees Inc.		("ABTR")
18.	Association of US West Retirees		("AVSWR")
19.	Association for Investment Management and Research		("AIMR")
20.	Association of Corporate Counsel		("ACC")
21.	Committee on Securities Regulation, New York State Bar Association		("NYSBAR")
22.	Corporations Committee, Business Law,		("California State Bar of California Bar")

	State	
23.	Financial Services Roundtable	("FSR")
24.	HR Policy Association	("HR Policy")
25.	Independent Corporate Directors Association	("ICDA")
26.	Independent Community Bankers of America	("ICBA")
27.	Investment Company Institute	("ICI")
28.	Manufacturers Alliance/MAPI Inc.	("MAPI")
29.	National Association of Real Estate Investment Trusts	("NAREIT")
30.	National Association of Corporate Directors	("NACD")
31.	National Coalition for Corporate Reform	("NCCR")
32.	New Jersey League of Community Bankers	
33.	Software & Information Industry Association	("Software and Information")
34.	Task Force on Security Holder Director Nominations, The New York City Bar Association	("NYCBAR")
35.	The Business	("BRT")

	Roundtable Monday, November 17, 2003		
36.	The Business Roundtable Friday, November 21, 2003		
37.	The Business Roundtable Monday, December 22, 2003		
38.	The Employment Policy Foundation		("EPF")
39.	United States Chamber of Commerce Thursday, December 11, 2003		("CC")
40.	United States Chamber of Commerce Friday, December 19, 2003		

Corporations, Corporate Executives, and Corporate Directors

41.	3M Company	W. James McNerney, Jr.	("McNerney")
42.	Abbott Laboratories	Miles D. White	("Abbott")
43.	Accenture, Ltd.	Joe W. Forehand	("Accenture")
44.	Aetna	William J. Casazza	("Aetna")
45.	Agilent Technologies	Edward W. Barnholt	("Agilent")
46.	Alltel Corporation	Joe T. Ford	("Alltel")
47.	Amalgamated Bank Long View Funds	Gabriel P. Caprio	("Longview")
48.	American	Maurice R.	("AIG")

	International Group, Inc.	Greenberg	
49.	AMGEN, Inc.	Kevin W. Sharer	("AMGEN")
50.	Anadarko Petroleum Corporation Wednesday, December 10, 2003	John R. Butler	("Butler")
51.	Anadarko Petroleum Corporation Friday, December 12, 2003	James T. Hackett	
52.	Anadarko Petroleum Corporation Monday, December 15, 2003	Robert J. Allison	
53.	Apache Corporation	Raymond Plank	("Apache")
54.	Armstrong Holdings, Inc.	Walter T. Gangl	("Armstrong")
55.	Ashland, Inc.	Richard P. Thomas	("Ashland")
56.	ATA Holdings Corp.	Brian T. Hunt	
57.	Axcelis Technologies		
58.	Bowes, Inc.; Dayton Power and Light Company		
59.	Box USA	Roger W. Stone	
60.	Cadence Design Systems, Inc.	R. Raymond Bingham	
61.	Callaway Golf Company	Brian P. Lynch	("Callaway")
62.	Capital Guardian Trust Company	Eugene P. Stein	("Capital Guardian")
63.	Caterpillar Inc. Thursday,	James B. Buda	("Caterpillar")

	December 04, 2003		
64.	Caterpillar Inc. Friday, December 12, 2003	John R. Brazil	("Brazil")
65.	Caterpillar Inc. Thursday, December 18, 2003	James B. Buda	("Caterpillar")
66.	Cendant Corporation	Robert E. Nederlander	
67.	Chemung Financial Corp.	Jane Adamy	
68.	CIGNA Corporation Friday, December 19, 2003	Judith E. Soltz	
69.	CIGNA Corporation Friday, January 02, 2004	("Cigna")	
70.	Cleco Corporation	("Cleco")	
71.	Compass Bancshares, Inc.	Jerry W. Powell	("Compass")
72.	ConocoPhillips Friday, October 03, 2003	Stephen F. Gates	("ConocoPhillips")
73.	ConocoPhillips Friday, December 19, 2003	Stephen F. Gates	("ConocoPhillips")
74.	ConocoPhillips Wednesday, December 31, 2003	James J. Mulva	
75.	Convergys Corporation	James F. Orr	("Convergys")
76.	Cummins, Inc.	J. Lawrence Wilson	("Cummins")
77.	CUNA Mutual Life	Michael B. Kitchen	
78.	Delphi Corporation Tuesday, December 09, 2003	Logan G. Robinson	("Delphi")

79.	Delphi Corporation Wednesday, December 10, 2003	J.T. Battenberg, III	
80.	Eastman Chemical Company	Brian L. Henry	("Eastman")
81.	Eaton Corporation, Graphic Packaging Corporation and Cambrex Corporation	John R. Miller	("Miller")
82.	Eli Lilly and Company	Alecia A. DeCourdreaux	("Lilly")
83.	EMC Corporation Monday, December 22, 2003	Gail Deegan	("Deegan")
84.	EMC Corporation Monday, December 22, 2003	Alfred Zeien	("Zeien")
85.	EMC Corporation Friday, December 19, 2003	EMC Corporation	
86.	Emerson Electric Co. Monday, December 15, 2003	Harley Smith	("Harley Smith")
87.	Emerson Electric Co. Monday, December 15, 2003	("Emerson")	
88.	Ernie Green, Ernie Green Industries, Inc.		
89.	Exelon Corporation	M. Walter D'Alessio	("Exelon")
90.	FedEx Corporation	Kenneth R. Materson	("Fedex")
91.	FirstEnergy Corp.	("FirstEnergy")	

92.	Fluor Corporation	Lawrence N. Fisher	
93.	General Electric Co.	Jeffrey R. Immelt	
94.	General Mills	Judith Richards Hope	("General Mills")
95.	General Motors Corporation	Philip A. Laskawy	
96.	Georgeson Shareholder Communications, Inc.	John C. Wilcox	("Georgeson")
97.	Georgia-Pacific	A.D. Correll	("Georgia Pacific")
98.	IndyMac Bancorp, Inc.	Stephanie S. Irey	
99.	Intel Corporation	Cary Klafter	("Intel")
100.	Intel Corp., Charles Schwab Corp.	David B. Yoffie	
101.	Inter-Con Security Systems, Inc.	Enrique Hernandez	
102.	International Kellogg Company	Jim Markey	("Kellog")
103.	International Paper Company Monday, December 22, 2003	Maura S. Smith	("International Paper")
104.	International Paper Company Monday, December 22, 2003	James Melican	("Melican")
105.	J.P. Morgan Chase & Co.	Anthony J. Horan	("JP Morgan")
106.	J.P. Morgan Fleming	David Paterson	("JPMorgan Fleming")
107.	Kerr-McGee Corporation Monday, December 08,	Luke R. Corbett	("Kerr-McGee")

	2003		
108.	Kerr-McGee Corporation Monday, December 22, 2003	Gregory F. Pilcher	("Pilcher")
109.	KeyCorp		
110.	Lend Lease Rosen Real Estate Securities LLC		
111.	McDATA Corporation	Thomas O. McGimpsey	("McDATA")
112.	McDonald's Corporation, Inc.	McDonald's Corporation	
113.	MDU Resources	Lester H. Loble, II	("MDU")
114.	Mestek, Inc.	John E. Reed	("Mestek")
115.	Microsoft Corporation	John A. Seethoff	("Microsoft")
116.	Minerals Technologies Inc.	Paul Saueracker	
117.	Nationwide Corporation	W.G. Jurgensen	
118.	Norfolk Southern Corporation	Joseph C. Dimino	
119.	Northern Trust Corporation	William A. Osborn	("Osborn")
120.	NSTAR	Douglas S. Horan	("NSTAR")
121.	Office Depot, Inc.	Bruce Nelson	("Office Depot")
122.	Ovation Pharmaceuticals Inc.	Wilbur Gantz	("Gantz")
123.	PACCAR, Inc.	G. Glen Morie	
124.	Pfizer, Inc.	Henry A. McKinnell, Jr.	("McKinnell")
125.	PPG Industries, Inc.	Michael C. Hanzel	("PPG")
126.	Praxair, Inc.	Dennis H. Reilley	

127.	Praxair, Inc. Monday, December 08, 2003	Praxair, Inc.	("Praxair")
128.	Procter and Gamble Company	James J. Johnson	
129.	Progress Energy	William Cavanaugh	("Progress")
130.	Prudential Financial, Inc.	Kathleen M. Gibson	
131.	Questar Corporation	Connie C. Holbrook	("Questar")
132.	Republic Services, Inc.	("Republic Services")	
133.	Rural/Metro Corporation	Frank L. Fernandez	("Rural Metro")
134.	Sandy Spring Bank	Theresa A. Cornish	
135.	Sears, Roebuck and Co. Wednesday, December 10, 2003	W. James Farrell	("Sears")
136.	Sears, Roebuck and Co. Monday, December 22, 2003	Andrea Zopp	
137.	Sprint Corporation	Gary D. Forsee	("Sprint")
138.	Target Corporation	James T. Hale	("Target")
139.	The Allstate Corporation	Emma M. Kalaidjian	("Allstate")
140.	The Charles Schwab Corporation	McMillen, R. Scott	("Schwab")
141.	The Home Depot, Inc.	("Home Depot")	
142.	The Liberty Corporation	Hayne Hipp	("Liberty")
143.	Trex Company, Inc.	Lynne MacDonald	

144.	Tribune Company Tuesday, December 02, 2003	("Tribune")	
145.	Tribune Company Thursday, December 18, 2003		
146.	United Parcel Service, Inc.	Michael L. Eskew	
147.	Valero Energy Corporation	Jay D. Browing	("Valero")
148.	W.W. Grainger Inc. Tuesday, December 16, 2003	W.W. Grainger, Inc.	
149.	W.W. Grainger Inc. Tuesday, December 16, 2003	Jim Slavik	("Slavik")
150.	W.W Grainger Inc. Tuesday, December 16, 2003	Janience Webb	("Webb")
151.	Weis Market, Inc.	Robert F. Weis	
152.	Wells Fargo & Company	Laurel A. Holschuh	("Wells Fargo")
153.	WorldWide PCE	Richard L. Wise	

Form Letter Types

154.	24 individuals or entities using Letter Type A		("Letter Type A")
155.	136 individuals or entities using Letter Type B		("Letter Type B")
156.	4,127 individuals or entities using Letter Type C		("Letter Type C")
157.	8 individuals or entities using Letter Type D		("Letter Type D")

158. 357 individuals or entities using Letter Type E ("Letter Type E")

159. 3 individuals or entities using Letter Type F ("Letter Type F")

160. 185 individuals or entities using Letter Type G ("Letter Type G")

161. 7 individuals or entities using Letter Type H ("Letter Type H")

162. 5,853 individuals or entities using Letter Type I ("Letter Type I")

163. 34 individuals or entities using Letter Type J ("Letter Type J")

164. 13 individuals or entities using Letter Type K ("Letter Type K")

165. 4 individuals or entities using Letter Type L ("Letter Type L")

166. 251 individuals or entities expressing brief sentiments of support; Letter Type M ("Letter Type M")

167. 38 individuals or entities using Letter Type N ("Letter Type N")

168. 1,470 individuals or entities using Letter Type ("Letter Type O")

169. 4 individuals or entities using Letter Type P ("Letter Type P")

170. 4 individuals or entities using Letter Type Q ("Letter Type Q")

171. 5 individuals or entities using ("Letter Type R")

Letter Type R

172. 4 individuals or entities using Letter Type S ("Letter Type S")

173. 4 individuals or entities using Letter Type T ("Letter Type T")

174. 35 individuals or entities using Letter Type U ("Letter Type U")

Individual

175. Eleanor Bloxham ("Bloxham")

176. Jonathan W. Clark

177. Kay R.H. Evans ("Evans")

178. Dan M. Ignall ("Ignall")

179. William Schaff ("Schaff")

180. Shelley Smith ("S. Smith")

181. Doug Smith

182. Jim Wagner ("Wagner")

183. Carl Aiello

184. Thomas Anderson

185. Rev. Joshua M. Angelus ("Rev. Angelus")

186. Richard H. Ayers ("Ayers")

187. Gordon Bader ("Bader")

188. Andrew Bain ("Bain")

189. William Baker

190. Leigh Bangs

191. John Barmack

192. Michael Beckner

193. Dan Berarducci

194. Tim Bush

195. Joan Caine

196. Peggy Campbell

197. Carmen Campollo

198. Charles Capito ("Capito")
199. Megan P. Caposel ("Caposel")
200. Cataldo Stolfa
201. Jane Chamberlain
202. John Chevedden ("Chevedden")
203. Judith Claire
204. Sally Chase Clark ("Clark")
205. Harry Clarke
206. Richard W. Cohen
207. Eliot Cohen ("Cohen")
208. David Cole
209. Peter Collinge ("Collinge")
210. Wally Collins
211. Matthew Corbet ("Corbet")
212. Richard Cornelison
213. Robert Cornish
214. John A. Dal Pan
215. Evelyn Y. Davis ("Davis")
216. Laurence R. Davis
217. Pamela de Liz
218. Le Roy Dockter
219. T.W. Doyle
220. Gary K. Duberstein ("Duberstein")
221. Emil Rossi
222. Sandra Ernest
223. Alex Faber ("Faber")
224. Michael Fanning ("Fanning")
225. Scott Fettig
226. Trina Fischer
227. Geoffrey F. Foisie
228. John Fortier ("Fortier")
229. Jim Gale
230. Christine M.

Gallagher

231. Mark S. Gardiner ("Gardiner")
232. Erica L. George
233. Lori-jean Gille
234. Martin Glotzer
235. Steven Golden
236. Phillip Goldstein
237. Albert Goodis
238. Sarah Gorin ("Gorin")
239. Mark Gregory ("Gregory")
240. Andrew Grove
241. Jennette Gudgel
242. Michael Gunderson
243. Carl T. Hagberg ("Hagberg")
244. Albert and Marilyn Hall
245. Richard Hall ("Hall")
246. Caryl Hansen
247. Justin Hart
248. Joseph Harty
249. Heather Hipp
250. Jonathan Hoban ("Hoban")
251. Roger L. Howe ("Howe")
252. R. Hughes
253. Reed Hundt ("Hundt")
254. Dan M Ingall
255. Roger Javens
256. Karen Johnson ("Johnson")
257. Dixie Johnson
258. David B Kahn
259. Bruce Kallos
260. Lindsey Key
261. Kurt Kiebler ("Kiebler")

262.	Carrell R. Killebrew, Jr.	("Killebrew")
263.	John Kirk	("Kirk")
264.	Roger Klein	
265.	Charles J. Knight	
266.	Gary Koski	
267.	Scott Kravitz	
268.	Nathan Kubel	
269.	Dale Lamm	
270.	Kate Lehman Landishaw	("Landishaw")
271.	Michael Lawler	
272.	Dr. Dan Lawlor, M.D.	
273.	Karen and John Lemes	
274.	Andrew N. Lenz	("Lenz")
275.	Bob Leppien	
276.	Roberta and Maishe Levitan	
277.	Tim Lugbill	
278.	Jerry Lyon	
279.	Alexander Mar	
280.	Carol Mattson	
281.	Sarah McFadden	
282.	Jane McGehee	
283.	Donald McHenry	
284.	Vera McLean	
285.	James McRitchie	
286.	George Misail	
287.	Kendra Mon	
288.	Robert A.G. Monks	
289.	Malcolm S. Morris	("Morris")
290.	Robert S. Morrison	
291.	Harry L Morton	("Morton")

292. Les Myers
293. Chris Nelson
294. Deborah J Nelson
295. Phil Nicholas, Jr. ("Nicholas")
296. Aaron Niedermayer
297. Jennifer S. O'Dell ("O'Dell")
298. Chris Owens
299. Charles R. Partridge ("Partridge")
300. Rajnikant Patel
301. George Pavloff
302. Jeff Pelletier ("Pelletier")
303. Victor A. Pelson
304. James Petroff
305. Floyd Pickrell
306. Donald Pierce
307. Bill Podley
308. Andrew Randall ("Randall")
309. Tracey Coker Rembert ("Rembert")
310. Sidney A. Ribeau
311. Gregor Riesser, PhD
312. Cecil E. Roberts
313. Aaron Rosenthal
314. Nick Rossi
315. Victor Rossi
316. Chris Rossi
317. Veena Sadana
318. Richard Sampson
319. Thomas C. Sanger ("Sanger")
320. John Santoro
321. Jack Saucier

322. Stephanie Schaaf
323. Ronald C. Schick
324. Payson Schwin
325. Michael Scott ("Scott")
326. Mark A. Sear
327. Howard Sherman
328. John Sherrill
329. Tomas J. Simon
330. Anil Singhal
331. Michael Sprinker ("Sprinker")
332. B. Stennett
333. Judith M. Stone
334. Gail H. Stone
335. John Szczur ("Szczur")
336. Gary Tannahill ("Tannahill")
337. Ken Thomas ("Thomas")
338. Jim Thomas
339. Vicky Thomas
340. Paul Tomasik ("Tomasik")
341. David Toy
342. Joseph Traugott ("Traugott")
343. Anthony Tucci
344. Jim Turner
345. Sandra K. Tuttle
346. Patrick Von Bargen
347. Jim & Virginia Wagner ("Wagners")
348. David S. Wakelin
349. Peter Wall
350. David D. Watson
351. Marc D. Weinber
352. Jerrie Wells
353. Jennifer Winters ("Winters")

354. Joy Wood ("Wood")
355. Christianna Wood
356. John Young ("Young")
357. Francisco Zamora
358. Kristen Zehner ("Zehner")
359. Mike Zucker ("Zucker")

Investment Advisors and Managers

360. Peter Montagnon ("Montagnon")
361. Alliance Capital Management L.P. ("Alliance Capital")
362. Amalgamated Bank Long View Funds ("Longview")
363. Aronson+Ortiz, LP
364. Clean Yield Asset Management ("Clean Yield")
365. Creative Investment Research, Inc. ("CIR")
366. DNP Select Income Fund ("DNP Select")
367. EndPoint Late-Stage Funds
368. HGK Asset Management, Inc.
369. Iridian Asset Management LLC ("Iridian")
370. Karpus Management Inc.
371. KDP Investment Advisors ("KDP")
372. LIATI Group LLC
373. LSV Asset Management ("LSV Asset")
374. Marshfield Associates
375. Millcap Advisors, LLC

376.	Morley Management	("Morley")
377.	Newground Investment Services	("Newground")
378.	Relational Investors LLC	("Relational")
379.	Scott & Stringfellow, Inc.	
380.	Shamrock Holdings, Inc.	("Shamrock")
381.	Stanford Management Company	("Gilbertson")
382.	T. Rowe Price Associates, Inc.	("T. Rowe")
383.	The Mexico Equity and Income Fund, Inc.,	
384.	Tweedy, Browne Company LLC	
385.	Waddell & Reed Financial Inc.	
386.	Wyser-Pratte & Co.	("Wyser-Pratte")

Law Firms and Attorneys

387.	Blackwell Sanders Peper Martin LLP	("Blackwell Sanders")
388.	Debevoise & Plimpton LLP	("Debevoise")
389.	Lyle Ganske, Christopher Kelley, Robert Profusek (JonesDay)	("Ganske, Kelley & Profusek")
390.	Kent Benson, Esq.	
391.	Peter Clauss, J. Peter Wolf (Pepper Hamilton LLP)	("Clauss & Wolf")
392.	Sidley Austin	("Sidley Austin")

Brown & Wood LLP

393. Simpson Thacher & Bartlett LLP ("Simpson Thatcher")

394. Sullivan & Cromwell LLP ("Sullivan")

395. Wachtell, Lipton, Rosen & Katz ("Wachtell")

396. Wolf Haldenstein Adler Freeman & Herz LLP ("Wolf Haldenstein")

Miscellaneous

397. Anonymous reviewer

398. Anonymous reviewer

399. Anonymous reviewer

400. Comments of a reviewer (illegible signature)

401. Jules Family

Security Holder Resource Provider

402. Committee of Concerned Shareholders Wednesday, October 08, 2003 ("CCS")

403. Committee of Concerned Shareholders Tuesday, November 18, 2003 ("CCS")

404. CorpGov.Net; James McRitchie, Editor Sunday, November 16, 2003 ("McRitchie")

405. CorpGov.Net; James McRitchie, Editor

Monday, December 22, 2003

406. Institutional Shareholder Services ("ISS")

407. The Corporate Library ("Corporate Library")

Social, Environmental and Religious Funds and Related Service Providers

408. Calvert Group, Ltd. ("Calvert")

409. Christain Brothers Investment Services Inc. ("CBIS")

410. Coalition for Environmentally Responsible Economics ("CERES")

411. Domini Social Investments LLC ("Domini")

412. Jessie Smith Noyes Foundation ("Noyes Foundation")

413. Responsible Wealth ("Responsible Wealth")

414. Rockefeller & Co. Inc.

415. Social Investment Forum Ltd. ("SIF")

416. The Nathans Cummings Foundation Trust ("Cummings")

417. Trillium Asset Management Corporation ("Trillium")

418. Unitarian Universalist Association

419. Walden Asset Management ("Walden")

420. Woodard & Curran

State & Federal Government Representatives

421.	Alan G. Hevesi	Comptroller of the State of New	("Hevesi")
422.	William C. Thompson, Jr.	Comptroller of the City of New York	("Thompson")
423.	Dale McCormick	Maine, Office of the Treasurer of State	("Maine Treasurer")
424.	Mark E. Amodei	Nevada State Senator	
425.	Richard Moore	North Carolina Treasurer	
426.	Chuck Blasdel	Ohio House of Representatives	
427.	Chris Widener	Ohio House of Representatives	
428.	Jeff Jacobson	Ohio Senate	
429.	Randall Edwards	Oregon State Treasurer	
430.	Jason Geddes	State of Nevada Assembly	
431.	Gregory F. Lavelle	State Representative, 11th District, State of Delaware	
432.	Steve Stivers	State Senator, Ohio	
433.	Carl Levin	United States Senate	("Sen. Carl Levin")

U.S. Securities and Exchange Commission

434.	David G. Nason Wednesday, October 15, 2003	Counsel to Commissioner Atkins	
435.	Russell Mancuso Friday, October 31, 2003	Counsel to Chairman Donaldson	
436.	David G. Nason	Counsel to	

	Saturday, December 06, 2003	Commissioner Atkins
437.	Brian A. Stern Monday, December 22, 2003	Counsel to Commissioner Glassman
438.	Brian A. Stern Monday, December 22, 2003	Counsel to Commissioner Glassman
439.	Brian A. Stern Monday, December 22, 2003	Counsel to Commissioner Glassman
440.	David G. Nason Friday, February 06, 2004	Counsel to Commissioner Atkins
441.	Consuelo J. Hitchcock Wednesday, December 03, 2003	Division of Corporate Finance
442.	Lillian Brown Monday, December 22, 2003	Special Counsel, Office of Mergers and Acquisitions, Division of Corporation Finance

Unions, Pension Funds, Institutional Investors, Institutional Investor Associations, and Governmental Representatives

443.	American Federation of State, County and Municipal Employees	("AFSCME")
444.	American Federation of Musicians and Employers' Pension Fund	
445.	American Federation of	("AFL-CIO")

	Labor and Congress of Industrial Organizations	
446.	Arkansas State Police Retirement System	
447.	Arkansas State Judicial Retirement System	
448.	Bricklayers and Trowel Trades International Pension Fund	
449.	California Public Employees' Retirement System	("CalPERS")
450.	City of Hartford Pension Commission	("Hartford")
451.	City of Miami	
452.	College Retirement and Equities Fund	("TIAA-CREF")
453.	Colorado Public Employees' Retirement Association	("Colorado PERA")
454.	Committee on Investment of Employee Benefit Assets	("CIEBA")
455.	Communications Workers of America	("CWA")
456.	Connecticut Retirement Plans & Trust Funds	("CRPTF")
457.	Council of Institutional Investors Wednesday, December 03, 2003	("CII")

458. Council of Institutional Investors Friday, December 12, 2003

459. CWA/ITU Negotiated Pension Plan

460. Delaware State Representative

461. District of Columbia Retirement Board ("DCRB")

462. Educational Employees' Supplementary Retirement System of Fairfax County

463. Fire Fighters and Police Officers' Retirement

464. General Teamsters, Chauffers and Helpers, Local No. 378

465. Hermes Pensions Management Limited ("Hermes")

466. IBEW Local Union 308

467. IBEW Local Union 308

468. IBEW Local Union 606

469. IBEW Local Union 26

470. IBEW Local Union 269

471. IBEW Local Union

430

472. IBEW Local Union 110

473. IBEW Local Union 428 (Danny Kane) Monday, December 22, 2003 ("Kane")

474. International Corporate Governance Network

475. International Brotherhood of Teamsters ("IBT")

476. International Brotherhood of Electrical Workers Wednesday, December 17, 2003

477. Laborers' International Union of North America

478. Lawndale Capital Management, LLC ("Lawndale")

479. London Pensions Fund Authority, UK

480. Los Angeles County Employees Retirement Association ("LACERS")

481. Missouri State Employees' Retirement System; Teachers' Retirement System of Louisiana; Public Employees Retirement System of Ohio; New Hampshire Retirement System; Arkansas Public Employees Retirement ("38 retirement Systems")

System; Public School Retirement System of Missouri; Kentucky Teachers' Retirement System; Washington State Depart. of Retirement Systems; Minnesota State Retirement System; Kansas Public Employees Retirement System; New Mexico Public Employees Retirement Assn.; Tennessee Consolidated Retirement System; California State Teachers' Retirement System; North Dakota Public Employees' Retirement System; Maine State Retirement System; Pennsylvania State Employees' Retirement System; Minnesota Teachers Retirement Association; Montana Teachers' Retirement System; Illinois Teachers' Retirement System; Fairfax County, Virginia; Teachers' Retirement

System of Oklahoma; Indiana State Teachers' Retirement Fund; North Dakota Retirement and Investment Office; Iowa Public Employees Retirement System; Minneapolis Teachers' Retirement Fund Association; New York State Teachers' Retirement System; Public Employees' Retirement System of Mississippi; Wisconsin Department of Employee Trust Funds; Duluth Teachers' Retirement Fund Association; Nebraska Public Employees Retirement System; Vermont State Retirement System; Washington State Investment Board; Oklahoma Public Employees Retirement System; Maryland Retirement System; Montana Public Employee Retirement Administration; Wyoming Retirement

System; Colorado Public Employees Retirement Assn.; South Carolina Retirement Systems; Retirement Systems of Alabama

482. National Association of State Retirement Administrators

483. National Association of Pension Funds ("NAPF")

484. National Council on Teacher Retirement

485. Office of Advocacy, United States Small Business Administration ("USSBA")

486. Ohio Public Employees Retirement System ("ORS")

487. Pennsylvania State Employees' Retirement ("SERS")

488. Railways Pension Trustee Company Limited ("Railways")

489. San Diego Electrical Pension Trust

490. San Diego City Employees' Retirement System ("SDCERS")

491. SEIU National Industry Pension Fund

492.	State Board of Administration of Florida	("SBDFla")
493.	State Teachers Retirement System of Ohio	("STRS Ohio")
494.	Stichting Pensioenfonds ABP, Netherlands; Investment Management, Co-operative Insurance Society, United Kingdom (UK); Henderson Global Investors, UK; ISIS Asset Management PLC, UK; Investment Management Limited, UK; RAILPEN Investments, UK; Shell Pensions Management Services Limited, UK; Standard Life Investments, UK; Timber Industry Superannuation Scheme, Australia; UniSuper Limited, Australia; Universities Superannuation Scheme Ltd, UK	("Foreign Institutional Shareholders")
495.	Teachers' Retirement System of the City of New York	
496.	Teamster's Central States Southeast and Southwest Areas Health and Welfare and Pension Funds	

497.	Teamsters Local 728	("Teamsters 728")
498.	TIAA-CREF	("TIAA-CREF")
499.	UNITE	("UNITE")
500.	United Brotherhood of Carpenters and Joiners of America	("UBC")
501.	United National Retirement Fund and Textile Workers Pension Fund	
502.	Virginia Retirement System	
503.	Western Conference Pension Fund	
504.	Wisconsin Coalition of Annuitants	

II. Overview

In Exchange Act Release No. 34-48626 (October 14, 2003), the Commission solicited comment in connection with proposed rules that would, under certain circumstances, require companies to include in their proxy materials security holder nominees for election as director.[1] The commenters who responded were comprised of the following groups:[2]

- 185 individuals;
- 13 social, environmental, and religious funds and related service providers;
- 62 unions, pension funds, governmental representatives, institutional investors, and institutional investor associations;
- 10 law firms and attorneys;
- 113 corporations, corporate executives, and corporate directors;
- 24 associations;
- 27 investment advisors and managers;
- 21 Form Letter Types (representing approximately 12,582 individuals or entities);
- 4 security holder resource providers;
- 13 state or federal governmental representatives;
- 12 academics; and
- 5 miscellaneous.

A significant majority of the commenters, comprising virtually all of the unions; pension funds; social, environmental, and religious funds; a majority of institutional investors and institutional investor associations; a majority of investment advisers and managers; and a majority of individuals, supported the proposed rules. The exceptions were

corporations, corporate executives, and corporate directors; law firms and attorneys; and most of the associations (primarily business associations), which were nearly unanimous in their opposition to the proposed rules.

The majority of commenters that favored the proposed rules ("Favoring Commenters") identified the recent corporate scandals as symptomatic of an overall problem in the system of corporate governance. Although a number of these commenters acknowledged the importance of recent initiatives under the Sarbanes-Oxley Act of 2002, and to a lesser extent the markets' amendments to listing standards and the Commission's efforts related to the transparency of nominating committee functions and communications between security holders and boards of directors, in addressing director conflicts of interests and accountability, a majority were of the view that greater accountability of board members to security holders was a necessary step in addressing these systemic issues.

Favoring Commenters expressed general dissatisfaction with the effectiveness of the current alternatives to effect changes in corporate governance, including conducting election contests, submitting security holder proposals under Exchange Act Rule 14a-8, submitting nominee candidates to the nominating committee, and communicating privately or publicly with the board about security holder concerns. As such, the commenters supported the proposed change to the proxy rules to require companies, under certain circumstances, to include in their proxy materials security holder nominees for election to the board.

A substantial majority of the commenters who opposed the rules ("Opposing Commenters"), on the other hand, recommended that the Commission not adopt or defer implementing the proposed rules until the Commission has had time to assess the impact of the Sarbanes-Oxley Act of 2002, the markets' amendments to their listing standards, and the Commission's own recent reforms. These commenters also expressed concern over purported detrimental effects that the proposed rules would have on companies and their boards. For example, commenters stated that the proposed rules, among other things, would facilitate special interest directors, disrupt and polarize boards, discourage qualified candidates from serving on boards, encourage the likelihood of costly election contests and result in director nominees who do not meet legal requirements, and diminish board accountability by bypassing companies' nominating committees.

A number of commenters also noted that the nomination and election of directors is an area governed generally by state law and, accordingly, questioned the weight of federal rules in an area that is traditionally governed by state law. A number of commenters also questioned the Commission's statutory authority to promulgate the proposed rules.

The portions of the proposed rules that generated the most extensive comment are addressed below.

To Which Companies Would the Proposed Rules Apply

Commenters that addressed this issue were close to evenly split on the application of the proposed rules. A slight majority of the commenters believed that the Commission should restrict application of the proposed rules to accelerated filers or to similarly large, sophisticated issuers. Several of these commenters favored application of the proposed rules to a limited sample of sophisticated issuers on a trial basis. The remainder of the commenters believed that the proposed rules should not be restricted to accelerated filers and should apply to all companies subject to the proxy

rules.

Triggering Events - What Events Must Occur Before the Company Would Be Required to Include a Security Holder Nominee in Its Proxy Materials

Triggering Events Generally

Favoring Commenters overwhelmingly opposed the "triggering events," either in general or as currently drafted. Favoring Commenters that opposed triggering events *on principle* believed that any triggering events would undercut unfettered access to an issuer's proxy materials, which they viewed as a fundamental right attached to share ownership. Favoring Commenters that opposed the triggering events *as drafted* believed that: (1) the high ownership thresholds would render proxy access beyond the reach of most security holders, including even the largest pension funds and institutional investors; and (2) the two-step, two-year process required to elect a director under the proposed triggers is too lengthy.

In order to strengthen the proposal and enhance its effectiveness, Favoring Commenters generally supported relaxation of some of the obstacles raised by the triggering events. In this regard, the majority of commenters that addressed the proposed threshold requiring a withhold vote for one or more directors of more than 35% of the votes cast believed the threshold was too high. Support was strongest for a threshold requiring a withhold vote for one or more directors of only more than 20% of the votes cast. A slight majority of commenters that addressed the 1% ownership threshold for the security holder direct access proposal believed it, also, was too high. Support was strongest for requiring security holders or security holder groups to meet an ownership threshold similar to that set forth in Exchange Act Rule 14a-8.

Opposing Commenters, on the other hand, believed that, if adopted, the rules should require revised triggering events that are objective and narrowly tailored to limit their impact to only those issuers that truly demonstrate a significant level of security holder dissatisfaction with the proxy process. The significant majority of the commenters that favored the triggering events believed that the "withhold votes trigger," if significantly revised to protect adequately responsive issuers, was more appropriate than the "direct access trigger." These commenters believed that, as drafted, the direct access triggering event contains several unacceptable flaws, including: (1) it is overbroad in its sweep because it would be available to all security holders of all public issuers, not only those issuers with an ineffective proxy process; (2) the 1% ownership threshold is too low and would facilitate a deluge of direct access proposals; and (3) it fails to acknowledge the impact that institutional investor voting practices will have on the number of direct access proposals.

The "Third Triggering Event"

A majority of commenters that responded to the Commission's inquiries regarding a third triggering event strongly urged the Commission to refrain from adopting a trigger based on non-implementation of a security holder proposal that receives more than 50% of the votes cast on that proposal. The most commonly cited objections to this triggering event were: (1) a general disagreement with the automatic assumption that a failure to implement a precatory security holder proposal is indicative of security holder dissatisfaction or a failure of the proxy process; and (2) potential conflicts between boards of directors charged with a fiduciary obligations under state law to make an independent judgment and security holder proposals that may not be in a company's best interests.

A minority of commenters that responded to the Commission's inquiries regarding a third triggering event believed that non-implementation of a security holder proposal indicates clearly an ineffectiveness of, or a security holder dissatisfaction with, an issuer's proxy process.

Additional Triggers

In light of the "two-year delay" attendant to the triggering events, a large number of commenters supported revisions that would permit more immediate security holder access to a company's proxy materials upon events or circumstances in addition to those set forth in the proposed triggering events.[3] The vast majority of commenters that supported more immediate access supported either triggering events based on the occurrence of specific events related to poor performance and/or poor governance or access to the proxy based solely on the share ownership of a security holder or security holder group. Support was slightly stronger for additional triggering events based on the occurrence of specific events related to poor performance and/or poor governance. Among the specific events most commonly suggested as additional triggers were the following:

- Issuer non-response to security holder proposals receiving a majority vote;
- Commission enforcement actions, including negotiated settlements;
- Material restatements of financial reports;
- Delisting by a market;
- Significant underperformance relative to an applicable peer group for an extended period of time; and
- Indictment of the issuer, or any executive or director on criminal charges directly related to his or her corporate duties.

The level of ownership most commonly cited as appropriate to entitle a security holder or security holder group to, upon its own motion, submit director nominees was at least 5% of the voting shares. An almost equivalent number of commenters, however, supported a higher level of ownership, but could not agree on the proper threshold, with support existing for thresholds ranging from 6% of the voting shares to 15% of the voting shares.[4]

Duration of the Process After a Triggering Events

With regard to the question of how long after a nomination procedure triggering event security holders should be able to use the nomination procedure, a significant majority of the commenters that addressed the issue believed that the procedure should be available for a period of longer than two years. Support was strongest for a period of five years. A minority of the commenters that addressed the issue believed that the nomination procedure should apply only to the annual meeting of security holders (or special meeting in lieu of an annual meeting) following the meeting at which a triggering event occurs.

Upon the Occurrence of a Triggering Event at a Subject Company, Which Security Holders or Security Holder Groups May Submit a Nominee

Most of the commenters that submitted substantive, targeted responses to this question acknowledged that eligibility to submit a nominee should be based on long-term ownership by a large security holder or group of security holders. A majority of these commenters, nonetheless, believed that the proposed ownership thresholds were too high.

Of the commenters that offered alternative thresholds, the letters evidenced a wide range of opinion. Support for a minimum ownership threshold of 3% was strongest, with eighteen commenters. Nine commenters recommended a minimum threshold of 5%; seven commenters supported a minimum threshold of 1%; five commenters recommended a minimum threshold of 10%; and three commenters recommended a minimum threshold of 25%.

The majority of commenters, notwithstanding whether they generally favored or objected to the proposed rules, supported the proposed eligibility standard requiring nominating security holders or nominating security holder groups to have held the securities at issue for at least two years. Furthermore, there was near unanimous agreement that such holders or groups should be required to continue to hold the securities at least until the date of the election of directors. Commenters, however, disagreed on whether nominating security holders or nominating security holder groups should be required to hold the securities beyond the date of the election of the directors. A majority, comprised exclusively of commenters that generally disfavored the proposed rules, believed that nominating security holders should be required to represent their intent to continue to satisfy the requisite ownership threshold for the duration of their nominee's service on the board.

Eligibility Requirements for a Person Whom a Security Holder or Security Holder Group May Nominate

Issues regarding the eligibility of security holder nominees generated significant comment, particularly as they related to: (1) whether the proposed rules should include additional limitations regarding nominee eligibility; and (2) whether the requirements regarding independence of the nominee from the nominating security holder, nominating security holder group, or company were appropriate. Opposing Commenters focused on the first issue noted above, while Favoring Commenters expressed more concern with the second issue.

Approximately a dozen commenters that objected generally to the proposed rules believed that there should be additional limitations related to nominee eligibility. Prospective security holder nominees, according to these commenters, should be required to meet any additional objective director qualifications set forth in an issuer's organizational documents, provided such qualifications would apply equally to all board members and be administered in good faith by the board of directors. A portion of these commenters further believed that prospective security holder nominees should be required to meet any additional objective director independence standards adopted by the company.

Over two-dozen Favoring Commenters expressed serious concern and/or outright disagreement with the requirements regarding independence of the nominee from the nominating security holder, nominating security holder group, or company. These commenters noted that the proposed requirements would hold a candidate suggested by a security holder or security holder group to a different independence standard than board-nominated candidates. Furthermore, the commenters noted that the proposed requirements would inhibit large security holders from seeking seats on boards as part of actively managed governance strategies. Accordingly, the Favoring Commenters questioned the fairness and wisdom of the proposed eligibility requirements.

Maximum Number of Security Holder Nominees

Commenters were unanimous in recognizing that the proposed rules were not intended to become a method to effect a change in control. Nevertheless, the significant majority of commenters that addressed the issue of the appropriate number of security holder nominees believed that the proposed limitation was too low. The commenters, primarily pension funds, persons or entities affiliated with pension funds and, to a lesser extent, individuals, were in agreement that the number of security holder nominees in no event should be less than two. Broad support was evidenced for each of two separate suggestions that would set the number of security holder nominees permitted by the proposed rules at either: (1) "one less than half" the eligible board seats in any given election cycle; or (2) two directors or 35% of the board, whichever is greater.

A minority of commenters believed that the proposed limitations were too generous. Several recommended that the proposed limitation be lowered to one nominee, regardless of the board's size. Several other commenters, recognizing the prevalence of staggered boards and data indicating that the median public company board size is nine directors, suggested that the number of security holder nominees that a company would be required to include in its proxy materials should be one for a company with a board of nine or fewer directors, two for a board of between 10 and 20 directors and three for a board of over 20 directors.

III. General questions

A.1. Should the Commission adopt revisions to the proxy rules to require companies to place security holder nominees in the company's proxy materials? Are the means that currently are available to security holders to address a company's perceived unresponsiveness to security holder concerns adequate?

The substantial majority of commenters believed that the Commission should adopt the proposed nomination procedure requiring issuers to place security holder nominees in their proxy materials.[5] These commenters were comprised of nearly all of the unions; pension funds; social, environmental, and religious funds; a majority of institutional investors and institutional investor associations; a majority of investment advisers and managers; and a majority of individuals.

A number of commenters noted above expressed dissatisfaction with the effectiveness of the current alternatives to effect changes in corporate governance, such as conducting election contests, submitting shareholder proposals under Exchange Act Rule 14a-8, submitting candidates to an issuer's nominating committee, or engaging an issuer's management in private and/or public dialogue.[6] In this regard, one commenter noted that the current alternatives available to shareholders to impact meaningfully director nominations "have not worked for decades" and, notwithstanding the recent reforms aimed at strengthening the independence of issuer nominating committees, still "are not working."[7] The commenter stated, "Some companies don't have nominating committees, others won't accept shareowner nominations for directors, and our members' sense is that shareowner-suggested candidates-whether or not submitted to all-independent nominating committees-are rarely given serious consideration."[8]

One commenter stated the alternatives were "inadequate, inefficient, and expensive."[9] Another commenter similarly believed that the current options for dissatisfied shareholders are prohibitively expensive.[10] This commenter noted,

> Shareholders can sell the stock at what they perceive to be a substantial discount. Or they can run their own slate of candidates, paying 100 percent of the costs, which may come to hundreds of thousands or even millions of dollars, for only a pro rata share of any increase in shareholder value as a result of the contested election. Meanwhile, management will spend the shareholders' money to fight them. This is not a level playing field. It is close to perpendicular.[11]

Another commenter further addressed contested solicitations to replace directors.[12] Drawing on a study it conducted regarding the instances of contested solicitations from 1996-2002, the commenter found that the incidence of attempts by shareholders to replace incumbent directors with a slate that presumably would achieve greater performance and accountability was "more rare than commonly recognized."[13] The commenter found that during the relevant period 215 contested solicitations took place, or approximately 30 per year.[14] The majority of the cases, however, did not involve attempts to replace the board with a new, more responsive board, but rather involved a possible sale of the issuer, proposed bylaw amendments, or possible opening or restructuring of a closed-end fund.[15] According to the commenter, contests over the team of directors that would run the issuer in the future occurred in about 80 companies and most of the issuers where contests occurred were small. In particular, only 10 issuers, or less than two a year on average, had in the year of the contested solicitation a market capitalization exceeding $200 million. Thus, the commenter noted, "[T]he safety valve of potential ouster via the ballot is currently not working. In the absence of an attempt to acquire the company, the prospect of being removed in a proxy contest is far too remote to provide the safety valve on which our corporate governance system is supposed to rely."[16]

A minority of commenters, on the other hand, believed that the Commission should not require issuers to include security holder nominees in their proxy materials to nominate directors. Representing the minority was a significant majority of the corporations and corporate executives and directors; a significant majority of law firms and attorneys; and most of the associations (primarily business associations). The commenters believed that adequate mechanisms already exist whereby security holders may effect changes in corporate governance. These commenters most frequently pointed to election contests under the current proxy rules;[17] security holder proposals submitted under Exchange Act Rule 14a-8;[18] and submission of candidates as potential board nominees to an issuer's nominating committee, which many commenters noted would be comprised entirely of independent directors as a result of recent governance reforms.[19] Commenters further highlighted public or private negotiations with an issuer's management,[20] tender offers,[21] and submission of a nominee candidate at an issuer's annual meeting.[22]

A.2. What would be the cost to companies if the Commission adopted proxy rules requiring companies to include security holder nominees in company proxy materials?

The majority of Favoring Commenters did not address directly the cost to companies. Of the several that chose to address the costs, a general consensus existed that any increase in costs related to the nomination procedure would be limited and would be outweighed by the value of enhanced director accountability.[23] Several reasons were cited as the

bases for this belief. First, the commenters did not believe the nomination procedure would be subject to extensive use. In this regard, one commenter stated that the nomination procedure "[would] be a tool of last resort."[24] Similarly, two large institutional investors pledged that they would utilize the nomination procedure only after all other steps have failed to produce results.[25] Second, the commenters noted that the proposal would simply permit shareowners the ability to access existing proxy material, and would not force issuers to produce separate proxy statements.[26] The commenters acknowledged that some issuers might spend significant resources in response to a shareowner nominee, but insisted that these costs were discretionary and stated that it was not appropriate to consider such potential expenses as a negative consequence of the proposal.[27]

From a security holder's perspective, one of the Favoring Commenters noted that the nomination procedure provided obvious benefits in that it would eliminate the need for costly mailings of proxy materials.[28]

The majority of Opposing Commenters, similar to the majority that supported the proposal, did not address directly the cost to companies. However, several commenters that did address directly the costs believed that the Commission has significantly underestimated such costs.[29] First, the commenters believed that many issuers would consider opt-in shareholder proposals as contested events and would expend additional resources to review, challenge, and attempt to defeat such proposals.[30] The commenters further believed that challenges to the opt-in shareholder proposals via no-action requests in an attempt to have them excluded would consume significant financial, administrative, and professional resources.[31] The drain on resources would be magnified if, as predicted by the commenters, the number of opt-in shareholder proposals significantly exceeds the Commission's estimates.[32]

Second, several of the Opposing Commenters believed that issuers affected by the proposal would incur printing and mailing costs that likely would outpace current printing and mailing expenditures. [33] Finally, dozens of Opposing Commenters suggested that the proposal has the potential to turn every director election into an election contest.[34] In this regard, these commenters noted that pursuant to their fiduciary duties, company directors often would be forced to expend all necessary and permissible resources to defeat unqualified
or under-qualified security holder nominees.[35]

A.3. What direct or indirect effect would this procedure have on companies' corporate governance policies relating to the election of directors? For example, will companies be more or less likely to adopt cumulative voting policies and/or elect directors annually?

Although not directly responsive to the above question, a large number of Favoring Commenters believed that among the most, if not the most, important benefits that would derive from the proposal would be increased accountability of boards to investors.[36] A number of these commenters believed that the increased accountability necessarily would result in a number of positive developments for corporate governance policies relating to the election of directors. Six commenters anticipated improved communications between company boards and security holders.[37]

At least four commenters were more specific and suggested that companies would be more likely to respond to clear shareholder mandates

and/or adopt best practice corporate governance structures.[38] One of these commenters noted that company boards already appear to have developed a greater willingness to respond to shareholder mandates.[39] Another of the commenters noted,

> Companies should be inclined to adopt standards of corporate governance that are commonly accepted and be more responsive to shareholder concerns that present at the ballot, such as elimination of classified boards, separation of chair and chief executive officer positions, [and] shareholder approval of poison pills. In addition, the adoption of such a rule should improve the quality of the corporate board election nominating process.[40]

One Favoring Commenter suggested that the proposed nomination procedure would operate as a "deterrent" against companies nominating "the usual suspects" and would instead cause the nomination of director candidates that would vigorously serve the interests of all shareholders.[41] Another commenter expressed a similar sentiment and stated that the proposal would have a "dramatic impact on the quality of corporate nominating and perhaps most important re-nominating processes."[42]

A significant number of Opposing Commenters believed that the nomination procedure would undercut the role of the board and its nominating committee in the critical process of nominating director candidates.[43] Moreover, these commenters believed that bypassing the nominating committee would diminish board accountability to shareholders.[44]

One Opposing Commenter believed that issuers would be reluctant to make necessary changes or discretionary enhancements to their governance policies relating to the election of directors until the final rules have been in place and their impact is measured, a period the commenter estimated would span at least five years.[45] Another commenter voiced a similar opinion by stating that a security holder nominee that won election to a board would face a fragmented or balkanized board (an outcome anticipated by a number of opponents of the nomination procedure[46]) unlikely to make any substantive changes to its corporate governance, such as moving from a classified board to annual elections, that would weaken the board's position in negotiations with potential acquirors.[47]

Two commenters noted that, upon the election of a security holder nominee, board meetings might become perfunctory, with the real business of the board conducted outside the boardroom, likely in special committees or caucuses from which the new security holder representative would be excluded.[48]

IV. To which companies would the proposed rule apply?

B.1. As proposed, the security holder nomination procedure in Exchange Act Rule 14a-11 would apply to all companies subject to the proxy rules. Would this broad application have a disproportionate impact on smaller operating companies? Are there modifications that would accommodate the needs of small entities while accomplishing the goals of the proposal? Would it instead be more appropriate to apply the procedure only to "accelerated filers" and funds? Would it be more appropriate to apply the procedure only to "accelerated filers" and funds as an initial step? If so, are there any special provisions that would be necessary for companies transitioning to "accelerated filer" status with respect to the nomination procedure in proposed Exchange Act Rule 14a-11, such as the timing of nomination procedure triggering events or the proposed disclosure

requirements? Would other limitations be more appropriate, such as applying the proposed rules to all companies other than small business issuers or all companies other than those that have been subject to the proxy rules for less than a specified period of time (e.g., 3 years)?

At least eight commenters believed the proposal would have a disproportionate impact on smaller issuers and urged the Commission to restrict application of the proposed rules to accelerated filers.[49] These commenters believed that the proposed rules generally would saddle smaller companies with considerable costs and other burdens that would outweigh the consequent benefits afforded their shareholders. Two of these commenters urged that the Commission forgo any rules that would "transition" or "phase in" smaller issuers.[50] These commenters believed that the costs to non-accelerated filers and the limited benefits that would accrue to security holders as a result of the proposed rules would in all likelihood persist indefinitely into the future, regardless of whether application of the rules was phased in.[51] Another of the commenters, however, favored a "transition" provision that would gradually expand the reach of the proposal to all filers.[52] The commenter did not provide details on how the "transition" would work.[53]

At least thirteen commenters believed the proposed rules should not be restricted to accelerated filers and should apply to all companies subject to the proxy rules.[54] One commenter that favored an expansive application of the rule believed it would not be equitable to carve out smaller issuers and dismissed concerns raised about the potential financial impact on such issuers.[55] This commenter noted,

> If a company benefits from the advantages of public ownership and trading then it should be held to the same high standard of investor protection regardless of size. In response to concerns of a smaller company's financial limitations, note that the proposed rule only mandates inclusion of alternative candidates in management's proxy. This in itself is not a substantial cost burden on any size company. The rule does not mandate the company to expend monies campaigning for management's slate. That is a decision for each company's board to individually weigh in the proper exercise of its fiduciary duties.[56]

At least three commenters favored application of the proposed rules to a limited sample of issuers on a trial basis.[57] One of these commenters suggested a sample trial on "as small of group as possible."[58] Another commenter suggested a limited sample involving the largest 500 to 1000 companies.[59] The last commenter supported a trial program targeting a limited number of companies that demonstrate "objective earmarks of poor governance."[60]

A number of additional comments were received supporting application of the rules to "relatively large companies,"[61] companies with a market capitalization in excess of $900 million,[62] and companies with a market capitalization in excess of $1 billion.[63]

Finally, one commenter stated that sufficient evidence did not exist to make an "informed judgment" on which issuers should be subject to the proposed rules.[64]

B.2. Should companies be able to take specified steps or actions that would prevent application of the proposed nomination procedure where such

procedure would otherwise apply? If so, what such steps or actions would be appropriate? For example, should companies that agree not to exclude any security holder proposal submitted by an eligible security holder pursuant to Exchange Act Rule 14a-8 be exempted from application of the proposed nomination procedure for a specified period of time? Should a company that implements all security holder proposals that receive passing votes in a given year be exempted? Conversely, should companies subject to Exchange Act Rule 14a-11 be permitted to exclude certain security holder proposals that they would otherwise be required to include? If so, what categories of proposals? For example, should the company be able to exclude proposals that are precatory, proposals that relate to corporate governance matters generally, proposals that relate to the structure or composition of boards of directors, or other proposals?

At least eight commenters stated that it was not appropriate for companies to take actions that prevent application of the proposed nomination procedure when it would otherwise apply.[65] All of these commenters were in general agreement that any carve-outs would significantly undercut the effectiveness of the rule.[66] One of the commenters noted that it supported additional triggers in the rule and therefore was unable to support exempting issuers from application of the nominating procedure if they implement all shareowner proposals passed by majority vote in any given year.[67]

Three Opposing Commenters stated that it was not appropriate to exempt issuers from application of the proposed nomination procedure for a specified period of time if the issuer agreed not to exclude any security holder proposal submitted by an eligible security holder pursuant to Exchange Act Rule 14a-8.[68] One of the commenters thought any exemption based on the blanket acceptance of security holders' proposals submitted under Exchange Act Rule 14a-8 risked the introduction of "inappropriate incentives."[69] This commenter cautioned, "[T]he board of directors must be able to make business judgments on the merits of a proposal, without the presence of unrelated incentives, such as the perceived need to avoid the application of the access procedure to the company."[70] Another of the commenters stated that such an exemption likely would result in a number of shareholder proposals that in no way benefit security holders being included in the issuer's proxy materials.[71]

One commenter expressed support for allowing issuers to exclude precatory shareholder proposals in any election cycle in which proposed Exchange Act Rule 14a-11 has been triggered.[72] Another commenter recommended a similar approach that would allow issuers to exclude shareholder proposals relating to the procedures for election of directors in any election cycle in which proposed Exchange Act Rule 14a-11 has been triggered.[73] Another commenter stated that if the Commission adopts the proposed nominating procedure, all Exchange Act Rule 14a-8 proposals on corporate governance matters should be eliminated.[74]

Three commenters suggested that if a director who has received a more than 35% "withhold" vote resigns prior to the end of the fiscal year, the proposed nomination procedure should not be triggered.[75]

At least five commenters expressed support for a variety of methods by which an issuer could exempt itself
from application of the proposed rules.[76] One of these commenters proposed a series of exemptions.[77] First, the commenter proposed exempting an issuer from the nomination procedure and the triggering

events if the issuer has included on behalf of a 5% security holder or group of security holders the maximum number of nominees permitted by paragraph (d) of proposed Exchange Act Rule 14a-11.[78]

Second, the commenter proposed exempting an issuer if its security holders have voted to exempt the company from the new rule or approved an alternative access procedure.[79] In this regard, the commenter noted, "Since the rule's basic purpose is to enhance the shareholders' ability to influence the proxy process, it would seem only logical to allow shareholders to `opt out' of the proxy access procedure if they wish or to approve a different kind of proxy access procedure."[80] Three additional commenters generally agreed and stated that issuers should be encouraged to establish procedures regarding security holder nominees and access to the board's proxy materials that may be different but are not less favorable in material respects than those established by rules of the Commission.[81]

Third, the commenter proposed exempting controlled companies (*i.e.,* issuers where more than 50% of the voting power is held by an individual, a group, or another company) from application of the nomination procedure and the triggering events.[82] Three additional commenters supported the exemption of controlled companies.[83] These commenters believed it would be futile to subject to the rule companies where a controlling shareholder or group has the ability to elect all directors.[84]

Fourth, the commenter supported exempting issuers that have recently become public companies for the three annual shareholder meetings following the consummation of the IPO.[85] The commenter stated that it would be "unwarranted and counterproductive" for a new public issuer to be burdened with the access procedure at the same time as it, in all likelihood, is working to recruit independent directors and to resolve basic organizational issues.[86]

One commenter suggested that the Commission revise the proposed nomination process to include "safeguards" to prevent the process from being used as leverage by special interest groups.[87] Rather than exempting certain issuers via limited carve-outs, the commenter suggested that Commission "add preconditions that would apply prior to the right to use the triggers."[88] One suggested precondition was an electronic "town hall meeting."[89] The town hall meeting process could be triggered in two ways: (1) any majority vote of the outstanding shares on any shareholder proposal on any subject; or (2) a written request by holders of at least 5% of the outstanding shares, held for one full calendar year prior to the proposal, who state that they intend to hold for an additional full calendar year after the request and who state publicly the reasons for their belief that a board is ineffective.[90] Senior management and board committee chairs would be required to attend. Institutional and retail security holders would be extended invitations to attend and participate in person if such holders could demonstrate a pre-determined level of ownership. The commenter believed the town hall meeting concept would "facilitate meaningful interaction among shareholders, directors, and management."[91] The triggers for the new nomination procedure could be initiated at the annual meeting that followed the completion of the town hall meeting, but only if the security holders wishing to activate the triggers certified in writing that they believed the board had failed to make a good faith effort to address the concerns articulated at the town hall meeting.[92]

A second precondition suggested by the commenter was also based upon encouraging interaction and dialogue between the issuer and security holders.[93] The commenter proposed that security holders initiating a trigger for the proposed nomination procedure should be required to disclose publicly their concerns with the effectiveness of the board as a precondition.[94] According to the commenter, if the final rules include a town hall meeting, then security holders wishing to trigger the nomination process would be required to disclose publicly that there had been no good faith effort by the board to address the concerns raised at the town hall meeting. If the final rules do not require a town hall meeting, then the security holders would disclose publicly how the board was not effective in specified circumstances.[95]

Finally, one commenter proposed a series of carve-outs that would apply to the third triggering event, should the Commission adopt such a trigger.[96] First, the commenter suggested that if a significant percentage of security holders, perhaps 35% of the votes cast, voted against the security holder proposal that was the basis for the third trigger being initiated, then the failure of the board of directors to implement that proposal should not be a triggering event.[97] Second, if a majority of an issuer's independent directors determined that a proposal should not be implemented, the commenter stated that the failure to implement the proposal should not qualify as a triggering event.[98] Third, the commenter suggested that if a board of directors decides not to implement a proposal in reliance upon a legal opinion that they are not required or not permitted to do so under controlling state law, then the failure to implement would not be a triggering event.[99]

B.3. Would adoption of this procedure conflict with any state law, federal law, or rule of a national securities exchange or national securities association? To the extent you indicate that the procedure would conflict with any of these provisions, please be specific in your discussion of those provisions that you believe would be violated.

At least twelve commenters suggested that the proposed nomination procedure would exceed the Commission's statutory authority under Exchange Act Section 14(a) and the other statutory provisions cited as authority for the new rule.[100] The commenters noted that neither Exchange Act Section 14(a) nor the other statutory provisions authorize the Commission to regulate corporate governance.[101] These commenters stated that the nomination procedure - by creating a right in certain shareholders to solicit proxies for their director nominees in the issuer's proxy materials, at the issuer's expense, under specified circumstances and conditions - constituted impermissible substantive regulation rather than regulation based on disclosure and process.[102] One commenter noted, "Under the guise of disclosure, the Commission would be effectively adopting federal corporate governance standards that would provide certain large shareholders with a new federal substantive right of shareholder access that does not generally exist under state law."[103]

Two commenters stated that the limitation of the proposed rule solely to issuers organized in states where shareholders are not prohibited from making nominations does not alter the conclusion that the proposed rule would create a new substantive right.[104]

Three commenters disputed the Commission's attempts to analogize the proposed rules to other proxy rules, *i.e.*, Exchange Act Rule 14a-8, promulgated under the Exchange Act. [105] The commenters believed that it

was not appropriate to use Exchange Act Rule 14a-8 as precedent for the creation of the access rights set forth in the proposed nomination procedure because Exchange Act Rule 14a-8 specifically excludes, among other things, proposals related to director elections.[106]

Three commenters believed that the Commission did not exceed its authority under Exchange Act Section 14(a).[107]

A number of commenters suggested that the Commission's proposal would violate the Administrative Procedure Act (APA).[108] The commenters believed that permitting the inclusion in an issuer's proxy materials of an opt-in shareholder proposal before the Commission has completed its rulemaking would raise issues under the notice and comment requirements of the APA.[109] One commenter stated,

> [I]t is inconsistent with the notice and comment requirements of the Administrative Procedure Act to attempt to compel regulated entities to take steps that are not required by law now, and that would only be required if the rulemaking now underway resulted in a final rule in which the pertinent provisions of the proposals were retained without material change.[110]

Two of the commenters further believed that the nomination procedure might violate other relevant constraints with respect to the Commission's rulemaking responsibilities, including the Exchange Act; Executive Order 12,866, 58 Fed. Reg. 51,735 (1993), as amended by Executive Order No. 13,258, 67 Fed. Reg. 9385 (2002); Paperwork Reduction Act of 1995, 44 U.S.C. § 3501 *et seq;* Regulatory Flexibility Act of 1980, 5 U.S.C. § 601 *et seq.*; Small Business Regulatory Enforcement Act of 1996, P.L. 104-121, tit. II, 110 Stat. 857 (1996); Executive Order 13,272, 67 Fed. Reg. 53,461 (2002); and Executive Order 12,988, 61 Fed. Reg. 4,729 (1996). [111]

A number of commenters stated that the proposed nomination procedure would raise significant issues involving inconsistency with applicable state corporate law.[112] Six commenters stated that the nomination procedure effectively would create, in contravention of state law provisions that require shares of the same class to carry the same rights,[113] different classes of shareholders within a single class of shares, with different rights regarding, among other things, director nominations and the use of company funds and resources.[114] These commenters also believed that the nomination procedure generally would interfere with the state law duty and responsibility of directors to manage the business and affairs of the corporation, including the process of considering and nominating qualified directors.[115]

One commenter stated that the proposed nomination procedure would provide beneficial owners with substantive rights to which they are not entitled under California state law.[116] In particular, the commenter noted that the proposed rules would grant beneficial owners the direct right to nominate directors. The commenter noted that under California state law only record holders of a corporation's shares have the right to vote or take action as shareholders under the Code.[117]

One commenter sought to preempt a potential conflict with existing state law.[118] This commenter noted that many states permit shareholders to remove directors with or without cause.[119] The commenter recommended that the Commission indicate that the proposal is not intended to affect those state laws and that any existing right to remove a director under

state law would continue to apply.[120]

B.4. Is it appropriate to limit the availability of the proposed nomination procedure to those situations where state law permits security holders to nominate candidates for director? Is it appropriate to permit companies to limit the availability of the proposed procedure by limiting the right to nominate directors, when allowed by state law? Will the proposed procedure's reliance on the pre-existence of a state law right, combined with the possibility that companies may limit security holders' rights in this regard, adversely affect the effectiveness of the procedure? Is the proposed procedure's reliance on the pre-existence of a state law right of nomination a proper balance between federal law and state law? Regardless of the existence of a state law right to nominate candidates for director, should companies be subject to the proposed procedure?

At least five commenters believed that the proposed nomination procedure, ideally, should be universally available regardless of state law.[121] Two commenters recognized that it was appropriate for the Commission to be "sensitive" to situations where state law is in direct conflict with the proposed rules, but the commenters, nonetheless, stated that it was not appropriate "to require permissive state law for the application of the proposed procedure."[122]

One commenter urged that the proposed nomination procedure should not apply where it is inconsistent
with a company's jurisdiction of incorporation.[123] As drafted, paragraph (a)(1) of the proposed Exchange Act Rule 14a-11 provides that the nomination procedure will apply only if applicable state law does not prohibit an issuer's security holders from nominating candidates for election as director. The commenter stated that this provision should be revised to refer not only to applicable state law, "but also to the law of a company's country of incorporation in order to address the case of companies who are organized in non-U.S. jurisdictions but do not meet the definition of a `foreign private issuer' under Exchange Act Rule 3b-4 and are therefore not exempt from the proxy rules."[124] The commenter further urged that the reference to "state" should be modified to include the District of Columbia and U.S. territories and possessions.[125]

Three commenters were comfortable that the proposed rules generally evidenced a proper balance between federal and state law, nevertheless, the commenters sought clarification from the Commission that the proposed nomination procedure was inapplicable not only when in conflict with state law, but also when inconsistent with an issuer's organizational documents validly adopted under state law.[126] These commenters believed the text of the proposed rules, when compared against the Commission's intent as set forth in the Proposing Release, needlessly left room for uncertainty. In this regard, one commenter stated, "Based on [the proposed rule's] language, it could be argued that only state law-and not a company's governing documents-can be the source of a prohibition on shareholder nominations."[127]

At least eleven commenters believed that the proposed procedure's reliance on the pre-existence of a state law right, combined with an issuer's ability to limit a security holder's right in this regard, would adversely impact the effectiveness of the procedure.[128] Commenters believed that issuers might be encouraged to change their state of incorporation to evade the requirements of the proposed procedure,[129] and, as such, state legislatures might be pressured to respond by amending

their laws to prohibit security holder nominations or otherwise establish obstacles to the nomination process.[130] According to one commenter, "The result of such state actions would reduce the existing rights of shareholders to nominate directors and conceivably leave the shareholders with fewer rights than they had before the proposed rules were enacted."[131]

In response to the possibility that states might be pressured into adopting new laws banning or limiting security holder nominations, several commenters requested that the Commission require prompt Exchange Act Form 8-K disclosure of any bylaw or charter amendments or state law changes impacting the effectiveness of the shareholder nomination mechanism.[132]

B.5. Most companies currently use plurality voting in the election of directors; accordingly, proposed Exchange Act Rule 14a-11 is drafted assuming that in most cases plurality voting would apply to an election of directors in which the inclusion of a security holder nominee resulted in more nominees than available seats on the board of directors. What specific issues would arise in an election where state law or the company's governing instruments provided for other than plurality voting, (e.g., majority voting)? Would these issues need to be addressed in revisions to the proposed rule text? If so, how?

Only one commenter responded to the above questions.[133] The commenter did not address directly the questions, but rather noted, "It appears that plurality voting would be the most reasonable means of electing directors under the proposed rules, especially since companies tend to use plurality voting anyway."[134]

V. For those companies to which the proposed rule would apply, what events must occur before the company would be required to include a security holder nominee in its proxy materials?

C.1. As proposed, the new procedure would require a triggering event for security holders to be able to use the security holder nomination procedure. Is this appropriate? If so, are the proposed nomination procedure triggering events appropriate? Are there other events that should trigger the procedure? For example, should the following trigger the procedure: lagging a peer index for a specified number of consecutive years; being delisted by a market; being sanctioned by the Commission; being indicted on criminal charges; or having to restate earnings once or restate earnings more than once in a specified period? Should the election of a security holder nominee as a member of a company's board of directors be deemed a triggering event in itself that would extend the process by another year or longer period of time?

The questions noted above elicited a significant number of comments. The types of responses were based largely on whether the commenter favored or objected to the proposed nomination procedure. A large number of the commenters that favored permitting security holders to participate meaningfully in the proxy process were opposed to the triggering events, which they viewed generally as unnecessary burdens that would severely limit the impact of the proposed rule. On the other hand, commenters that objected to the proposed rule believed that, if adopted, the rule should require triggering events that are objective and narrowly tailored to limit the rule's impact only to issuers that truly demonstrate a significant level of security holder dissatisfaction with the proxy process. A more detailed analysis of the various responses is set forth below.

At least forty-four commenters stated that triggering events of any kind

are not appropriate.[135] These commenters believed that triggering events undercut what should be a fundamental right of security holders - unfettered access to an issuer's proxy materials to submit nominees for election to the board of directors.[136]

At least seventy-eight commenters stated that the two proposed triggering events were not appropriate.[137] Another fifteen commenters expressed significant concern about the proposed triggering events.[138] The substantial majority of these commenters were in agreement that the proposed triggers were inappropriate or inadequate primarily for two reasons: (1) the ownership thresholds contained in the triggering events were too onerous and would prevent many security holders, even institutional security holders, from using the nomination procedure;[139] and (2) the two-step, two-year process required to elect a director under the proposed triggering events is too lengthy when the value of security holders' assets is put at risk.[140]

At least two commenters believed that the two proposed triggering events were appropriate.[141] One of these commenters stated that the two proposed triggers "strike an appropriate balance between the objectives of providing greater security holder access to the corporate proxy and ensuring that the security holder nomination procedures are not abused."[142]

To the extent there was support for triggering events, it came almost exclusively from commenters that preferred that the proposed rule be withdrawn.[143] Notwithstanding their objections to the rule, these commenters stated that any rule, if adopted, necessarily must include revised triggering events to ensure that the new rule would come into play only when objective criteria indicated a failed or ineffective proxy process.[144] In this regard, one commenter noted, "Without a meaningful triggering event, the procedure would apply to all companies regardless of whether such a fundamental change in corporate governance involved in providing direct access is necessary or even desirable."[145]

While support for objective, narrowly tailored triggers was evident, many of the commenters favored one of the triggering events at the expense of the other. A substantial difference of opinion, however, existed as to which of the triggers was more appropriate. The vast majority of the commenters that favored the triggers believed that the withhold votes trigger, if significantly revised to protect adequately responsive issuers, was more appropriate than the opt-in security holder proposal trigger.[146]

In particular, those in favor of the withhold votes trigger identified several purported flaws with the opt-in shareholder proposal trigger event that rendered the trigger, in their eyes, unacceptable and/or less desirable.[147] First, the commenters believed that because the opt-in shareholder proposal triggering event would be available to all security holders of all public issuers, not only those issuers with an ineffective proxy process, it would not meet the proposed rule's stated objective of targeting only those issuers with an ineffective proxy process.[148] In this regard, one commenter noted, "[I]t does not require the proposing shareholder to provide, and does not by itself constitute, evidence that the company has been unresponsive to shareholder concerns."[149]

Second, the commenters believed that the Commission has underestimated substantially the number of security holders that are likely to file opt-in shareholder proposals.[150] Commenters noted, in particular, that the

relative ease with which security holders will be able to aggregate their holdings to reach the 1% threshold, as well as the lack of any material attendant costs, would impact dramatically the number of opt-in shareholder proposals.[151]

Third, the commenters believed that the Commission has failed to recognize the impact that institutional investor voting practices will have on the number of opt-in shareholder proposals.[152] Institutional investors, according to the commenters, might develop internal voting guidelines or follow voting guidelines provided by third-party vendors to automatically vote in favor of such proposals without any consideration of the underlying performance and/or responsiveness of the subject company.[153] A number of commenters were concerned particularly about the influence of ISS if it, as anticipated by the commenters, revises its proxy voting guidelines to support opt-in shareholder proposals at all issuers.[154]

Finally, one commenter believed that, as structured, the opt-in shareholder proposal trigger was not appropriate because security holders or security holder groups are not required to first demonstrate that they have submitted a proposed nominee to the nominating committee of a relevant issuer and had that candidate rejected.[155]

Several commenters that favored triggering events believed that the opt-in shareholder proposal trigger, if significantly revised to protect adequately responsive issuers, was more
appropriate than the withhold votes trigger.[156] The commenters expressed three primary concerns with the proposed withhold votes trigger that made such a trigger inappropriate and/or less desirable. First, the commenters believed that a withhold vote for any one director might have nothing to do with security holder dissatisfaction with the proxy process.[157] According to the commenters, the triggering event is vulnerable to those who seek to access the issuer's proxy materials, but cloak their aspirations with the pretext of dissatisfaction with a particular director.[158] Second, the withhold votes trigger would not give a company's board and its nominating committee the opportunity to respond to security holder concerns about a director before the company's proxy process is deemed ineffective.[159] Third, sponsors of a withhold votes campaign are not required to give any notice to the issuer or to security holders of their campaign or their reasons for it, nor will they have to make any filings with the Commission so long as they do not solicit proxies (which are not needed for withholding votes) and do not form a 5% or greater group.[160]

At least twenty-one commenters, concerned that the two-year process contemplated by the triggers is too lengthy, supported additional triggering events that do not require a security holder sponsored event.[161] The commenters highlighted a variety of specific events that should trigger the nomination procedure for the next shareholder meeting at which directors will be elected. In the words of one commenter, "Each of these criteria is consistent with cases where shareowners have reason to be dissatisfied with the existing board or management."[162] Among the specific events suggested as additional triggers were the following:

- Issuer non-response to security holder proposals receiving a majority vote;[163]
- Commission enforcement actions, including negotiated settlements;[164]
- Material restatements of financial reports;[165]

- Delisting by a market;[166]
- Significant underperformance relative to an applicable peer group for an extended period of time;[167]
- Indictment of the issuer, or any executive or director on criminal charges directly related to his or her corporate duties;[168]
- Bankruptcy;[169]
- Civil fines, penalties, damages or sanctions for violating federal or state law;[170]
- Significant or prolonged share price decline;[171] and
- Significant increases in CEO or executive officer compensation.[172]

At least eighteen commenters agreed that the two-year process contemplated by the triggering events is too lengthy, but recommended an additional, more timely method of access based upon level of share ownership rather than or in addition to the occurrence of one or several of the events set forth above.[173] In this regard, one of the commenters noted, "We recommend . . . an override feature that would enable very substantial shareholders to respond with appropriate speed to redress urgent and egregious problems, such as financial malfeasance, insider trading or other criminal conduct."[174] Shareholders evidencing the appropriate level of ownership would be entitled to submit director nominees for the next shareholder meeting at which directors will be elected. The commenters, however, differed on the proper level of ownership necessary to trigger the additional "immediate access trigger."

- One commenter did not identify a specific level of ownership.[175]
- One commenter proposed that a security holder or security holder group own at least 3% of the voting shares.[176]
- Three commenters proposed that a security holder or security holder group own at least between 3%-6% of the voting shares.[177]
- Seven commenters proposed that a security holder or security holder group own at least 5% of the voting shares.[178]
- One commenter proposed that a security holder or security holder group own at least 5% or $1 billion in "share value."[179]
- One commenter proposed that a security holder or security holder group own at least 6% of the voting shares.[180]
- Four commenters proposed that a security holder or security holder group own at least 10% of the voting shares.[181]
- One commenter proposed that a security holder or security holder group own at least 15% of the voting shares.[182]
- One commenter proposed that a security holder own at least 10% of the voting shares and a security holder group own at least 20% of the voting shares.[183]

Two commenters addressed whether the election of a security holder nominee as a member of a company's board of directors should be deemed a triggering event in itself that would extend the process by another year or longer period of time.[184] The commenters recommended that unless the rule is revised to apply for a period of at least five years following a triggering event, the election of a security holder nominee as a member of a company's board of directors should be deemed a triggering event that would extend the process by another year or longer period of time.[185]

C.2. How long after a nomination procedure triggering event should security holders be able to use the nomination procedure, if not two years, as is proposed (e.g., one year, three years, or longer)? Should there be other ways for the operation of the procedure to terminate at a company? If so, what other means would be appropriate? For example, should companies be able to take specified actions that would terminate operation of the nomination procedure? If so, what such actions would be appropriate?

At least fifteen commenters stated that the nomination procedure should be available for a period longer than two years.[186] Five of the comments provided no alternative,[187] but nine of the commenters favored a period of at least five years.[188] One of the commenters favored a period ranging from three to five years.[189] Two of the commenters stated that if a period of at least five years is provided for the application of the rule following a trigger, it would be acceptable to permit companies to submit to a vote of its security holders a proposal during that period to eliminate the procedure.[190]

At least six commenters stated that the nomination procedure should apply only to the annual meeting of shareholders (or special meeting in lieu of an annual meeting) following the meeting
at which a triggering event occurs.[191] These commenters generally believed that an issuer should not be burdened by two contested elections as a result of the same triggering event.[192] One of the commenters urged, "[T]he access procedure should apply only to the shareholder meeting following the occurrence of a triggering event and, in any case, should not continue into a second year if a shareholder nominee is elected at the first annual meeting."[193]

Two commenters chose to address the potential that an issuer might face successive opt-in proposals at a time when that issuer is already subject to the nomination procedure as a result of an earlier, successful opt-in shareholder proposal.[194] In such an instance, the commenters urged that the rule should not permit an opt-in shareholder proposal to be presented for a vote at the next shareholders' meeting since there will automatically be access at that meeting and the meeting that follows.[195]

C.3. As proposed, the nomination procedure could be triggered by withhold votes for one or more directors of more than 35% of the votes cast. Is 35% the correct percentage? If not, what would be a more appropriate percentage and why? Is it appropriate to base this trigger on votes cast rather than votes outstanding? If not, please provide a basis for the recommendation, including numeric data, where available. Is the percentage of withhold votes the appropriate standard in all cases? For example, what standard is appropriate for companies that do not use plurality voting? If your comments are based upon data with regard to withhold votes for individual directors, please provide such data in your response.

At least thirty-two commenters believed that the proposed threshold requiring a withhold vote of at least 35% of the votes cast was too high.[196] In support of their contention that the threshold was inappropriate, three commenters cited a statistical sample of director elections consisting of 308 companies.[197] The sample consisted of 100 S&P 500 large cap issuers, 100 S&P mid-cap issuers and 108 S&P small cap issuers. According to the commenters, the percentage of issuers within the sample that had withhold votes of 35% or more of votes cast was approximately 1.9%, which is in line with the percentages put
forth in the Commission's proposing release.[198] The commenters, however, highlighted data in the sample showing that there were no S&P 500 large cap issuers that had total withhold votes of 35% or more votes cast, while 2% of the mid cap issuers and almost 4% of the small cap issuers did.[199] In light of such data, the commenters reasoned that it was not likely that investors using the 35% withhold vote could trigger access to the proxy at large cap companies.[200] If the nomination procedure were limited to accelerated filers, the commenters worried that the limitation would further diminish the impact of the withhold trigger since most accelerated issuers are large cap issuers.[201]

Twenty-five of the commenters that objected to the 35% threshold believed that the nomination procedure should be triggered by withhold votes for one or more directors of more than 20% of the votes cast.[202] Several of the commenters cited data from the statistical sample referenced above that indicated that a 20% withhold vote was achieved at approximately 15% percent of the issuers within the sample, including 13% of the large cap issuers.[203] Regarding the diminished threshold, another commenter stated, "[A] threshold of 20% would be more appropriate and would maintain the balance between demonstrating significant shareowner dissatisfaction on one hand and yet still ensuring that the process would provide a reasonable opportunity for shareowners to trigger the nominating procedure."[204]

The remainder of the commenters that objected to the 35% withhold threshold differed in their opinions as to the proper threshold or did not identify an alternative threshold. Thresholds of 10%[205] and 5%[206] were each supported by one commenter. Four commenters supported a threshold of 25%.[207] Three commenters did not provide an alternative threshold.[208]

At least twenty commenters believed that the proposed threshold requiring a withhold vote of at least 35% of the votes cast was too low.[209] The commenters cited a number of reasons for objecting to the proposed threshold; most of the responses, however, focused on three purported flaws inherent to the proposed threshold for the withhold vote. First, commenters stated that the proposed threshold does not adequately take into account the realities of the current proxy process, particularly the existence of inflexible voting guidelines and/or the influence of proxy advisory services, and the impact that the process will have on the highly concentrated institutional ownership in most large public issuers.[210] In this regard, several commenters stated that large institutional investors often follow automatically either their own pre-determined guidelines for withholding votes or similar pre-determined recommendations of proxy advisory services.[211] According to one commenter,

> Consequently, a 35% withhold threshold can easily be reached in the complete absence of any factors indicating an ineffective proxy process and although the company's performance has been

> stellar and shareholder value has been significantly enhanced. Such an event will regularly occur not because a board has been unresponsive to shareholder concerns, but simply because it is the by-product of the proxy process and the voting practices of institutional investors.[212]

Second, commenters stated that the proposed threshold was inappropriate because it might be triggered despite the fact that a director, or even the entire board, received the voting support of a majority of security holders.[213] One commenter noted that if more than 77% of the shares entitled to vote do so, a director can receive an absolute majority of votes entitled to be cast and still receive a 35% withheld vote.[214]

Third, commenters expressed concern that voting standards based on votes cast will be impacted heavily by any determination that excludes broker non-votes.[215] According to these commenters, if broker non-votes are excluded from any tabulation of votes related to the triggering events or if the "10 day rule"[216] is abolished, the overall number of votes cast would decrease significantly because beneficial owners of shares held in street name who do not give voting instructions to their brokers would no longer have votes cast on their behalf.[217] As a consequence, the number of votes cast would no longer constitute a representative base of shareholders of the company. More importantly, in the eyes of the commenters, the threshold for withhold votes would be substantially easier to trigger.[218]

The commenters that believed the 35% withhold threshold was too low differed in their opinions as to the proper threshold[219] or, in the case of one commenter,[220] did not identify an alternative threshold. The alternatives are discussed below:

- Three commenters stated that the threshold should require a withhold vote in excess of 50% of the votes cast.[221]
- Four commenters stated that the threshold should require a withhold vote in excess of 50% of the outstanding shares.[222]
- Two commenters stated that the threshold should require a withhold vote in excess of 50% of the outstanding shares and a subsequent board determination to re-nominate the relevant director.[223]
- One commenter stated that the threshold should require a withhold vote in excess of 50% of the outstanding shares with respect to at least a majority of the management supported nominees.[224]
- One commenter stated that the threshold should require a withhold vote in excess of 50% of the outstanding shares with respect to at least a third of the candidates up for election.[225]
- One commenter stated that the threshold should require a withhold vote in excess of 50% of the outstanding shares for two consecutive years with respect to three or more board nominees standing for election.[226]

Three commenters believed the 35% threshold as proposed was appropriate.[227] Six commenters believed that the 35% threshold related to the withhold votes triggering event is generally appropriate, provided the triggering event is revised in a number of ways.[228] For example, one

commenter supported the 35% threshold, so long as broker non-votes are excluded from any calculation used to determine whether the threshold for the withhold votes triggering event has been reached.[229] Another commenter believed that the threshold was appropriate only if security holders are in some manner informed in advance of the impact of the withhold vote, ideally via the proxy card.[230]

Four commenters expressed concern that the withholding of votes for only one director was not a reliable indication of security holder dissatisfaction with the issuer, the board, and/or the proxy process.[231] Receipt of a significant percentage of withhold votes by one director, for instance, might relate solely to circumstances peculiar to that director or to efforts by institutional investors or special interests to obtain a "costless option" that might be exercised in the future, if necessary.[232] Accordingly, the four commenters urged that the triggering event apply only when votes are withheld from a majority of the directors up for election.[233]

Notwithstanding the modification noted immediately above, three of the four commenters favored adding additional protections to the withhold votes triggering event.[234] One commenter recommended that the percentage of withhold votes represent at least 35% of the voting power entitled to vote at that election.[235] This commenter further recommended that the receipt of withhold votes amounting to 35% of the votes cast not be considered a triggering event with respect to a director if that director received a favorable vote of the majority of the votes cast on the election of the director.[236]

Another of the commenters did not address whether the withhold votes should represent a minimum percentage of an issuer's shares entitled to vote, but recommended that the receipt of withhold votes amounting to 35% of the votes cast not be considered a triggering event with respect to a director if that director received a favorable vote from the holders of a majority of the shares outstanding.[237]

Another of the commenters urged that the number of withhold votes represent at least 25% of all the outstanding shares of the issuer.[238] The commenter also urged that the receipt of withhold votes amounting to 35% of the votes cast not be considered a triggering event with respect to a director if that director received a favorable vote from the holders of a majority of the shares outstanding.[239]

In the event the Commission determined that the withhold votes triggering event would not be applied to a majority of the directors, one of the commenters referenced above recommended that the trigger be amended to include additional protections.[240] First, the rule should require the receipt of 35% withhold votes for a number of directors equal to the maximum number of shareholder nominees the company may be required to include in its proxy materials under the rule (*i.e.,* the number of permitted security holder nominees that could be placed on the ballot could not exceed the number of directors that had received withhold votes in excess of 35%).[241] Second, the threshold percentage under the withhold votes trigger would be calculated based upon votes outstanding, not votes cast.[242] Third, the withhold votes triggering event should not apply to any election of directors where a shareholder nominee is on the ballot due to the prior occurrence of a triggering event.[243]

Two commenters did not address the proper threshold for a withhold vote, but did offer their positions on issues related to calculating the withhold

vote. One commenter urged that the proper threshold should be a percentage of the outstanding stock or, at a minimum, a percentage of the votes present and entitled to vote at the meeting.[244] The second commenter suggested that if the Commission retains a threshold based on a percentage of votes cast rather than outstanding, the threshold should be based on a percentage of votes cast only when shareholders owning a specified minimum percentage of outstanding shares vote on the issue.[245]

Several commenters responded to the issue of whether the withhold vote triggering event was viable or advisable in the case of an issuer that did not use plurality voting. Two commenters stated that there was no reason to differentiate between issuers using plurality voting and issuers using majority voting.[246] Two commenters, however, expressed concern that for issuers that used cumulative voting application of the withhold votes trigger would present distinct problems, particularly with regard "to the allocation and tallying of votes, as well as the form and content of the proxy card."[247] As such, both commenters urged that should the Commission adopt the withhold votes trigger, the final rule should specify that the cumulation of shares is not permissible with respect to the withhold vote tabulation.[248]

C.4. Should the nomination procedure triggering event related to direct access security holder proposals trigger the procedure only where a more than 1% holder or group submits the proposal? If not, what would be a more appropriate threshold, if any? For example, should the standards otherwise applicable for inclusion of a proposal under Exchange Act Rule 14a-8 apply? Should the required holding period for the securities used to calculate the security holder's ownership be longer than one year? If so, what is the appropriate holding period? Should that holding period be shorter than one year? If so, what is the appropriate holding period?

A slight majority of the commenters that addressed specifically the required ownership thresholds related to opt-in security holder proposals thought the 1% threshold is too high.[249] Many of the commenters stated that the ownership level of the security holders or security holder groups sponsoring the opt-in shareholder proposal is not relevant.[250] The critical factor, instead, is whether the opt-in shareholder proposal garners the support of a majority of the votes necessary to trigger the nomination procedure.[251] The commenters, nonetheless, were unanimous in their support for at least some type ownership threshold.[252] The commenters, if they chose to identify an alternative threshold (many did not), differed on what would be a proper ownership threshold.

- Thirteen commenters believed the 1% ownership threshold is too high, but the commenters did
  not offer an alternative ownership threshold.[253]

- Two commenters offered only a general suggestion that the nomination procedure be open to "all long-term shareholders."[254]

- One commenter urged only that the thresholds should be "fair."[255]

- Ten commenters favored an ownership threshold based on the thresholds set forth in Exchange Act Rule 14a-8.[256] Two of these commenters stated that if the Commission chooses a threshold different from that expressed in Exchange Act Rule 14a-8, they would favor a threshold of 0.25%.[257]

- One commenter favored an ownership threshold of 0.50%.[258]

Several commenters expressed general satisfaction with the 1% threshold.[259]

A significant minority of the commenters that addressed specifically the required ownership thresholds related to opt-in security holder proposals thought the 1% threshold is too low.[260] Many of the commenters believed that the 1% threshold would be too easily achieved and would not necessarily indicate security holder dissatisfaction or issuer unresponsiveness.[261] Many of the commenters also expressed concern that the proposed threshold would give a variety of security holders the ability to threaten to bring an opt-in shareholder proposal in order to gain leverage and push for short-term concessions that would not benefit the company and its security holders as a whole.[262]

The commenters that believed that the proposed 1% threshold is too low differed on what was a proper ownership threshold.

- Three commenters did not identify a proper threshold.[263]
- One commenter believed a threshold of 2% is appropriate.[264]
- One commenter favored a threshold of 5% if a security holder initiates the trigger acting alone. If a group of security holders initiates a trigger, the commenter favored a threshold of 3%.[265]
- Nine commenters favored a threshold of 5%.[266]
- One commenter favored a threshold of 10%.[267]
- Three commenters favored a threshold of 25%.[268]

A majority of the commenters that chose to address specifically the required holding period provisions related to opt-in security holder proposals thought the one year holding period was appropriate.[269]

One commenter believed that a holding period requirement of any consequence was not necessary and suggested that the Commission retain only the ownership threshold.[270]

At least nine commenters believed a holding period of two years was more appropriate than the proposed one-year holding period.[271] Two commenters supported a holding period of two years and a stated intent to continue to hold the securities for two calendar years after the year in which the trigger is initiated.[272] One commenter suggested a holding period of three years.[273] Two commenters suggested a holding period of five years.[274]

One commenter sought clarification regarding the 1% ownership threshold for those situations where a company has two or more classes of shares, with each class having a different voting power.[275] In those instances, the commenter believed that in order to trigger the direct access proposal, the security holder or security holder group should own more than 1% of the class entitled to elect a majority of directors.[276] In addition, the commenter urged that the proposed rule be revised to clarify that the share ownership and holding period should be determined based on the company's quarterly or annual reports filed during the relevant period (similar to the manner

provided in Exchange Act Rule 13d-1(j)). The commenter noted, "This will avoid a situation where a shareholder who has reached the more than 1% ownership level shortly before submitting the proposal as a result of a reduction in the number of outstanding shares, such as due to share repurchases by the company, will be eligible to make a direct access proposal."

Given that the stated purpose of the opt-in shareholder proposal is not intended to be part of a plan effectuate a change in control, two commenters urged that the Commission add a requirement that any security holder seeking to submit an opt-in shareholder proposal cannot have filed an Exchange Act Schedule 13D with respect to the issuer's shares.[277] One of these commenters also believed it appropriate that the proponent of the direct access proposal provide the information required by Items 2, 4, 7, 8, and 10 of Exchange Act Schedule 13G.[278]

C.5. Are the existing methods under Exchange Act Rule 14a-8 sufficient to demonstrate that a proposal was submitted by a more than 1% security holder? If not, what other methods would be appropriate?

At least four commenters responded to the questions posed above.[279] Three of the commenters believed that existing methods under Exchange Act Rule 14a-8 were sufficient to demonstrate that a proposal was submitted by a more than 1% security holder.[280] One commenter disagreed.[281] This commenter stated that only beneficial owners, representing the real economic interest in the issuer, should be permitted to nominate director candidates under the proposed rules.[282] According to this commenter:

> Intermediaries, custodians and other agents should be disqualified from acting without authorization from the ultimate beneficial owner. To enforce this requirement, there must be an unbroken chain of authorizations from the registered share position back through each successive intermediary layer to reach the beneficial owner. Each step in this chain of authorizations should be transparent, fully documented and verifiable. There should also be a form of certification of beneficial ownership to be completed by the person(s) claiming that authority. This information will be additionally useful in determining whether the proposed candidate has any conflicts of interest and in verifying whether the candidate fulfills the independence requirements set forth in the proposed rule and in applicable listing standards.[283]

C.6. As proposed, a direct access security holder proposal could result in a nomination procedure triggering event if it receives more than 50% of the votes cast with regard to that proposal. Is this the proper standard? Should the standard be higher (e.g., 55%, 60%, or 65%)? Should the standard be based on votes cast for the proposal as a percentage of the outstanding securities that are eligible to vote on the proposal (e.g., 50% of the outstanding securities)?

One commenter stated that the proposed standard requiring 50% of the votes cast for a successful opt-in shareholder proposal is too high.[284] The commenter did not offer an alternative.[285]

At least four commenters stated that the proposed standard was appropriate.[286] These commenters strongly supported maintaining a [287]

triggering standard based on votes cast, rather than votes cast.— One commenter noted that if the Commission adopted a standard based on "votes outstanding," rather than "votes cast," the standard undoubtedly would cause issuers to adopt higher voting standards to the detriment of all shareowners.[288] Another commenter noted that the majority of management proposals, including those related to the election of directors, equity compensation plans and other compensation plans, only need approval of a majority of votes cast.[289]

Twelve commenters favored a standard that would require an opt-in shareholder proposal to obtain in excess of 50% of votes outstanding.[290] These commenters cited several reasons for favoring a standard based on votes outstanding rather than votes cast. First, several of the commenters equated the potential impact of the opt-in proposal with an amendment to a corporation's governance documents.[291] Thus, the commenters believed that the vote required for an opt-in shareholder proposal should be comparable and analogous to the voting requirements for charter amendments, which, in most cases, would require the affirmative vote of a majority of the outstanding shares.[292] Second, commenters believed that a votes cast standard in certain circumstances might produce results that do not represent accurately the views of a company's shareholder base. For instance, one commenter noted, "[A] low shareholder turnout (particularly when coupled with low quorum requirements) could result in an anomaly of as few as 25% of shares entitled to vote (or lower percentages with lower quorums) deciding questions of fundamental governance rights."[293] Third, commenters believed that the votes cast standard ignores the possibility that brokers will not exercise the discretion granted to them under NYSE Rule 452 and will not vote on opt-in shareholder proposals without specific instructions from beneficial holders or that the proposed rule will be interpreted so that brokers will not have discretion to vote without instructions.[294] One commenter noted, "The result, were this to occur, would be to reduce greatly the number of votes cast on an opt-in proposal, without affecting the quorum count and to undermine further the meaningfulness of achieving a 50% vote standard."[295] Fourth, commenters believed that the standard based upon votes cast ignores the possibility that many institutional investors will adopt structured voting policies that will vote in favor of all opt-in shareholder proposals, without consideration of facts and circumstances unique to the company in question.[296]

One commenter favored a standard requiring a majority of outstanding shares voted in favor of an opt-in shareholder proposal, without the ability to count broker non-votes.[297]

One commenter stated that, given the control exercised over a typical board meeting by ISS, the appropriate standard was 50% of the outstanding shares or 60% of the shares voting.[298] One commenter suggested a standard based both on votes cast and votes outstanding. A successful opt-in shareholder proposal would require support of 66.67% of votes cast, provided that 50% of shares outstanding have been voted on the proposal.[299]

Finally, two commenters did not address the proper percentage threshold for an opt-in shareholder proposal, but rather offered suggestions regarding calculating that threshold percentage based on votes cast or votes outstanding. One commenter supported a standard based on a percentage of votes outstanding, or, at a minimum, a percentage of votes present and entitled to vote at the meeting.[300] The commenter, similar to a number of the commenters noted above, was concerned that an opt-in

shareholder proposal might result in a large number of broker non-votes.[301] As such, this commenter believed that relying solely on votes cast would not reflect accurately the views of all of the company's shareholders.[302] The second commenter suggested that if the Commission retains a threshold based on a percentage of votes cast rather than votes outstanding, the threshold should be based on a percentage of votes cast only when shareholders owning a specified minimum percentage of outstanding shares vote on the issue.[303]

C.7. Should direct access security holder proposals be subject to a higher resubmission standard than other Exchange Act Rule 14a-8 proposals? If so, what standard would be appropriate?

At least four commenters stated that opt-in shareholder proposals should not be subject to a resubmission standard greater than that set forth in Exchange Act Rule 14a-8.[304]

At least seven commenters disagreed and urged that opt-in security holder proposals should be subject to a higher resubmission standard than other Exchange Act Rule 14a-8 proposals.[305] Two commenters, citing a belief that other security holders should not be penalized by costs and distractions associated with an opt-in proposal that failed to garner significant support, recommended a resubmission standard that would require an opt-in shareholder proposal to achieve the support of 20% of outstanding shares in the first year and 40% of outstanding shares in the second year, with no resubmission for five years if those thresholds are not met.[306] Another commenter recommended that the Commission permit issuers to exclude opt-in shareholder proposals for two years (the same period of time the nomination procedure would be triggered if an opt-in shareholder proposal were approved) following a vote in which less than 25% of shares outstanding voted in favor of such a proposal.[307]

Two commenters recommended prohibiting resubmission of an opt-in proposal for three years, if the proposal received less than the required approval.[308] One commenter recommended prohibiting resubmission of an opt-in proposal for five years, if the proposal received less than the required approval.[309] One commenter favored a resubmission standard for opt-in proposals, but did not elaborate on any minimum level of required support.[310]

One commenter chose to address resubmission standards in the context of the withhold votes trigger.[311] This commenter believed it was not appropriate to subject issuers and their security holders to withhold votes campaigns on a continuous basis.[312] The commenter recommended that if a withhold votes campaign against any of the board's nominees fails to trigger access, then the triggering event would not apply for the next two annual meetings.[313]

C.8. We have proposed that nomination procedure triggering events could occur after January 1, 2004. Is this the proper date? Should it be an earlier date? Should it be a later date?

The vast majority of commenters strongly urged the Commission not to use January 1, 2004 as an effective "start date" for the triggers.[314] Issuers that will be impacted by the January 1, 2004 start date, in fact, were unanimous in their objection to the date.[315]

Commenters offered a number of reasons that a date of January 1, 2004 is not appropriate. Foremost, commenters stated that it would be fundamentally unfair and unmanageable to have the spring 2004 proxy season serve as a generator of "triggering events" when the contents of the final rule are unknown.[316] In this regard, commenters noted that the proposed rules likely will require that companies place opt-in proposals in their proxy materials to be distributed to security holders before the general details of the rule are finalized.[317] Until the contents of the final rule are agreed upon and duly noticed, however, commenters stated that proxy disclosure related to the opt-in proposals cannot be complete or accurate.[318]

Second, several commenters noted that in order to facilitate opt-in proposals the Commission intends to amend Exchange Act Rule 14a-8(i)(8) to provide that such proposals are not excludable under that rule.[319] The commenters were troubled by the Division's intent to apply Exchange Act Rule 14a-8(i)(8) as proposed to be amended (thus permitting direct access proposals) prior to adoption of proposed Exchange Act Rule 14a-11.[320] One commenter recognized the Commission's authority to amend its rules, but questioned "whether, pending

the effectiveness of those amendments, the Staff has the authority to `interpret' the Rule as proposed to be amended when that interpretation flies in the face of the plain meaning of the rule and the way it has been applied historically."[321]

Third, two commenters noted that proposed Exchange Act Rule 14a-1l(a)(2)(ii) imposes different requirements on security ownership for a proposing shareholder from those that currently apply to proposing shareholders under Exchange Act Rule 14a-8, thereby raising an issue as to whether opt-in proposals as contemplated conform to Exchange Rule 14a-8.[322] The commenters believed that Exchange Act Rule 14a-8 must be amended accordingly before the proponent of an opt-in proposal submitted under the rule that is less than a 1% stockholder can be disqualified.[323]

Although not generally supportive of the necessity of triggering events, two Favoring Commenters stated that if the final rule included triggers then January 1, 2004 was an appropriate start date.[324] Two additional commenters suggested that any triggering event "in the preceding three year period" should be applicable to the extent permitted by law.[325] In the alternative, these commenters urged that the nomination procedure and the triggering events be effective no later than January 1, 2004.[326]

C.9. What are the possible consequences of the use of nomination procedure triggering events? Will there be more expense and effort related to votes on direct access security holder proposals? Will there be more campaigns seeking "withhold" votes? How will any such consequences affect the operation and governance of companies?

Responses to the above questions were significantly influenced, in number and content, by whether the commenter supported the new nomination procedure or opposed it.

Few Favoring Commenters addressed directly the questions at issue. One commenter believed that company directors likely would endure greater scrutiny and more frequent withhold vote campaigns if the new nominating procedure is adopted, which the commenter called "an ancillary benefit of the proposed rule."[327] This commenter, however, believed that adoption of the nominating procedure would not result in a significant difference in the resources dedicated to shareholder proposals.[328] The commenter also believed that the proposed nominating procedure will impact positively the governance of public companies.[329] This commenter stated, "Not only will companies be much more inclined to adopt rigorous nominating and re-nominating standards, they will also be highly inclined to adopt majority vote shareowner proposals and generally be more accountable to owners."[330]

Another commenter dismissed concerns that the triggering events, as currently structured or even with diminished thresholds, would "open the floodgates" and result in a significant increase in the number of opt-in proposals.[331] This commenter was also dismissive of concerns that the nomination procedure might have the unintentional consequence of increasing the power of proxy advisory firms, particularly ISS.[332] In this regard, the commenter stated that: (1) the largest institutional money managers have their own voting guidelines and, contrary to the assertions of many issuers, do not blindly follow the recommendations of proxy advisory services; (2) approximately 70% of the equity holdings of all institutional investors are held by "corporate pension funds, mutual funds, bank trust funds and insurance companies," which tend generally to support management's voting recommendations; and (3) the number of institutional investors, particularly mutual funds, that will adopt voting based on their own guidelines likely will increase in the future as a consequence of the Commission's recent requirements addressing the transparency of proxy votes by mutual funds and money managers.[333]

The majority of Opposing Commenters believed that there would be a significant increase in the number of withhold vote campaigns and opt-in proposals, which would necessitate and/or cause a commensurate increase in funds and other resources expended by issuers to analyze, process, and if necessary, oppose such measures.[334] These commenters expressed concern that the triggers would not be a method by which security holders would express dissatisfaction with the issuer, the board, or the proxy process, but rather a means to an end. In short, issuers believed that special interests, at little or no cost to themselves, might use the triggers strategically to serve other goals.[335] Opposing Commenters were further concerned that, given

what they viewed as low thresholds, the impact of proxy advisory firms on the voting process would be substantial.[336]

C.10. Should companies be exempted from the security holder nomination procedure for any election of directors in which another party commences or evidences its intent to commence a solicitation in opposition subject to Exchange Act Rule 14a-12(c) prior to the company mailing its proxy materials? If so, should the period in which security holders in such companies may use the nomination procedure be extended to the next year (assuming that a nomination procedure triggering event is required)? What should be the effect if another party commences a solicitation in opposition after the company had mailed its proxy materials?

At least six commenters stated that issuers should be exempted from the security holder nomination procedure for any election of directors in which another party commences or evidences its intent to commence a solicitation in opposition subject to Exchange Act Rule 14a-12(c) prior to the company mailing its proxy materials.[337]

One of the commenters urged that the nomination procedure should not be extended following a contested solicitation.[338] This commenter believed that after the contested solicitation security holders must first evaluate the new management (or prior management) of the issuer before the proposed nomination procedure is again invoked.[339]

Two of the commenters requested expansion of the proposed rules to provide that neither the triggering events nor procedure in the proposed rule (if previously triggered) should apply to an election in which another party commences a solicitation in opposition.[340] One of the two commenters noted:

> While the proposed rule currently provides that the withhold votes triggering event will not occur with regard to any contested election to which Rule 14a-12(c) applies, it should also provide that the subsequent commencement of a solicitation in opposition would nullify the earlier triggering event since it will provide shareholders with an alternative avenue of expressing dissatisfaction with the company's board of directors or proxy process.[341]

The commenter also urged that the Commission further expand the proposed rule to provide that the nomination procedure will not apply beginning at the time of public announcement of any merger, acquisition or similar transaction involving a recapitalization or any tender offer for the company's securities eligible to vote for directors, and the company should be exempt from the application of the triggering events until the consummation (or withdrawal or termination) of any such transaction.[342]

One commenter attempted to address the issues related to a scenario wherein another party commences a solicitation in opposition after the company has mailed its proxy materials.[343] The commenter expressed a preference for nullifying the inclusion of the security holder nominee or nominees in such an event.[344] Announcement and proper communication of such nullification would be left to the company, presumably under procedures established by the Commission.[345]

At least two commenters did not believe it was appropriate to exempt issuers from the security holder nomination procedure for any election of directors in which another party commences or evidences its intent to commence a solicitation in opposition subject to Exchange Act Rule 14a-12(c) prior to the company mailing its proxy materials. These commenters believed that votes withheld from the company nominee(s) in this event still would accurately represent shareowner dissatisfaction.[346]

C.11. We have discussed our consideration of and requested public comment on the appropriateness of a triggering event premised upon the company's non-implementation of a security holder proposal that receives more than 50% of the votes cast on that proposal. Should such a triggering event be included in the nomination procedure? In response to this question, please consider the following questions (discussed separately below).

At least forty commenters, a majority of those that responded to the above question, believed that a "third triggering event" was not appropriate and strongly urged the Commission to

refrain from adopting a trigger based on non-implementation of a security holder proposal that receives more than 50% of the votes cast on that proposal.[347] Commenters cited a number of reasons behind their objection to the third triggering event. First, commenters stated that an automatic assumption that a failure to implement a precatory security holder proposal is indicative of security holder dissatisfaction or a failure of the proxy process is erroneous.[348] In this regard, one commenter noted that with regard to security holder proposals, "[S]hareholders vote with lockstep consistency, pursuant to standardized voting policies, without regard to differences in company performance, governance ratings or other variables. These automatic voting practices suggest that, contrary to the Commission's assumption, voting results on shareholder proposals reveal little
about shareholder attitudes toward company fundamentals."[349]

Second, given the increased significance that undoubtedly would attach to security holder proposals, commenters stated that not only would the number of such proposals increase, but disputes regarding the eligibility of the proposals also would become more common.[350] The heightened significance of the security holder proposals also would permit proponents of the proposals greater leverage to extract negotiated settlements from companies that might not be in the interests of all security holders.[351]

Third, a trigger based on non-implementation of a security holder proposal would raise issues of federalism, in that the "imposition under federal law of governance consequences for failure to implement proposals that are only permitted as precatory under state corporation law would be an encroachment on state law and therefore of questionable authority."[352]

Fourth, boards of directors have fiduciary obligations under state law to make an independent judgment whether security holder proposals are in the company's best interests and should not and cannot comply automatically with the results of a security holder vote, regardless of the level of support.[353]

Fifth, implementation issues related to security holder proposals might prove intractable.[354] One commenter warned that implementation issues would necessitate the creation of a new dispute resolution structure "that would rival, and we believe far surpass, the problems created by adjudicating the propriety of [Exchange Act] Rule 14a-8."[355]

At least thirty-two commenters voiced their support for a third trigger based on non-implementation of a security holder proposal that receives more than 50% of the votes cast on that proposal.[356] One of the commenters stated,

> We believe there is no more direct link than the one between the non-implementation of a shareowner proposal and the Commission's rationale for the proposed rule - providing a mechanism for long-term shareowners to influence companies where there are indications that the proxy process has been ineffective or where there is dissatisfaction with the proxy process. If a shareowner's proposal passes but is not implemented - often times year after year - obviously the proxy process is ineffective.[357]

Another commenter stated that a majority vote on a security holder proposal is "a strong directive from the owners of the company to act on particular issue." Ignoring such a directive, especially more than once, according to this commenter clearly is indicative of an ineffective proxy process.[358] One commenter believed the trigger should be expanded to include any proposal submitted by any security holder meeting the requirements of Exchange Act Rule 14a-8, rather than being limited only to proposals submitted by security holders or security holder groups owning 1% of the voting securities of the relevant issuer.[359]

a. Should a security holder proposal that receives more than 50% of votes cast operate as a nomination procedure triggering event regardless of the topic of the proposal, or would it be appropriate to instead require that the proposal relate to a specified category of topics (e.g., corporate governance matters)? If so, how should that specific category of topics (e.g., corporate governance matters) be defined?

Four commenters believed that the third triggering event should apply regardless of the topic
[360]

of the proposal.— One of the commenters noted that to the extent a proposal receives in excess of 50% of the votes, one could infer that the topic of the proposal was sufficiently important to the security holders to merit implementation by the company.[361] Two commenters, on the other hand, urged that, if the third trigger is adopted, it should solely and directly relate to "bona fide corporate governance proposals containing objective criteria for implementation, which criteria are capable of being satisfied within the specified time period."[362]

b. Should a security holder proposal result in a nomination procedure triggering event if it receives more than 50% of the votes cast with regard to that proposal? Should the standard be higher (e.g., 55%, 60%, 65%)? Should the standard be based on votes cast for the proposal as a percentage of the outstanding securities that are eligible to vote on the proposal (e.g., 50% of the outstanding securities)? Would the described means of determining whether a security holder proposal has been implemented be sufficient? Should there be a different means for determining implementation? Are there other or additional criteria that would be appropriate? Should the determination be made by the entire board of directors? Should the determination be made by the independent members of the board of directors? Should the board be given broader flexibility (e.g., should it be able to represent its intention to implement a proposal)? Should the Commission or its staff (for example, the Division of Corporation Finance) play a role in this process (e.g., similar to that for security holder proposals under Exchange Act Rule 14a-8)? Alternatively, what role should the courts play? What is the best record for a judicial determination?

Three commenters believed that it is appropriate for a security holder proposal that received at least 50% of the votes cast to result in a triggering event.[363] Two commenters, on the other hand, believed that the standard should be based on votes outstanding, rather than votes cast.[364]

With regard to implementation, two commenters urged that the independent members of the board provide the determination that the proposal has been implemented.[365] The commenters further urged that the requisite certification provide adequate disclosure to determine how the board members came to their conclusion.[366]

Two commenters suggested a period of six months from the meeting date for the board to act on the relevant proposal with regard to the timing of implementation.[367] The commenters viewed the six month period as an equitable balance of the board's need for adequate time to take action and security holders' need to prepare for the nominating procedure at the following meeting, should the trigger be activated.[368] Where the relevant proposal would take additional time to implement, such as a proposal asking the board to seek shareholder approval at the next annual meeting to declassify, the commenters suggested that the board be permitted to simply commit within the six month time period to taking the action necessary to satisfy the proposal in the appropriate time frame.[369]

With regard to disputed implementations of security holder proposals, three commenters urged that there be some form of appeal available to security holders to challenge the companies' determinations that the proposals at issue had been implemented adequately.[370] The appeal mechanism preferably would be the entity charged with mediating and resolving any disputes, which the commenters believed would be few in number.[371]

c. Should security holders that do not agree with a company's conclusion that a proposal had been implemented have the right to contest that conclusion through a judicial proceeding? Should they have a private right of action to do so? Is there any reason to believe that security holders would not have a private right of action to contest a company's determination that a proposal has been implemented? If so, what recourse, if any, should a security holder have with regard to a company's determination?

Two commenters believed that security holders that do not agree with a company's conclusion regarding implementation should have the ability to challenge the company's actions or lack thereof in court, where the Commission has heard and decided against the security holder.[372] One of the commenters added, "To the extent current law is ambiguous on this point, the proposed rule should address the issue."[373] Two other commenters, however, disagreed and

[374]

believed that there should be no private right of action associated with non-implementation.—

d. Should a company be required to file an Exchange Act Form 8-K stating whether or not it implemented a security holder proposal that is eligible to trigger the rule? Is it appropriate to require that companies make such a statement on Exchange Act Form 8-K? Would this impose unnecessary liability on companies that make a determination regarding implementation of a security holder proposal with which security holders may disagree?

In regard to implementation, four commenters believed it was acceptable to require that a board represent in an Exchange Act Form 8-K. whether it has implemented a proposal that has passed by greater than 50% of votes cast.[375]

One commenter agreed that a company should be required to report to security holders what actions, if any, the board of directors has taken with regard to any shareholder proposal that received a majority security holder vote at the company's annual meeting.[376] The commenter, however, supported disclosure via an Exchange Act Form 10-Q quarterly report issued following the annual meeting at which the majority vote was recorded.[377] The commenter noted that subsequent disclosure via an Exchange Act Form 10-Q quarterly report or proxy statement might be required.[378]

VI. What notice must a subject company give regarding the occurrence of an event that triggers operation of the proposed rule?

D.1. Will the proposed disclosure requirements in Exchange Act Forms 10-Q, 10-QSB, 10-K and 10-KSB provide adequate notice to security holders? Should additional notices be required? If so, what form should that notice take and at what time should it be made public?

The above questions elicited responses from at least eleven commenters.[379] All but two of these commenters generally considered the proposed disclosure requirements in Exchange Act Forms 10-Q, 10-QSB, 10-K, 10-KSB adequate notice to shareholders.[380] Two of the commenters qualified their statements of support for the current approach by stating that company Exchange Act periodic reports should be consistently "tagged" or "identified" so that investors should readily locate the relevant information.[381]

Three of the aforementioned commenters urged that company notice of triggering events should be limited to Exchange Act periodic reports.[382] In support of this position, one of the three commenters stated:

> Th[e] notice obligation should not be extended to require a report on [Exchange Act] Form 8-K or other public notice. If notice of a triggering event were required in a [Exchange Act] Form 8-K or another public notice, shareholders would need to monitor those outlets regularly to determine whether a trigger had occurred, rather than simply reviewing periodic filings on a quarterly basis. In addition, public companies already must file periodic reports; an alternative notice mechanism would result in an additional filing obligation for subject companies, without a corresponding additional benefit to shareholders.[383]

The dissenting viewpoint was voiced by two commenters that believed that given the importance of the voting process, the Commission should require "real-time" disclosure of the results of the voting at the annual or special meeting.[384] The commenters suggested that the Commission require companies to publish their notice via a press release or company web posting and also file an Exchange Act Form 8-K or "new post-election report filing."[385] The commenters further suggested that any real-time disclosure include "the best available results of the voting at the annual meeting (including a breakout, if applicable, of broker votes) and an estimate of the total expenditure made by the company on its solicitation efforts."[386] "Follow-up quarterly filings," according to the commenters, "would provide investors with the official certified vote results and a full accounting (line-item breakouts, for example, of out-of-pocket solicitation costs) of the expenditures made by the issuer with regard to the proxy solicitation."[387]

D.2. Should the company's notice be filed and/or made public in some other manner? If so, what manner would be appropriate?

To the extent commenters addressed the above questions, the vast majority suggested any additional notification be accomplished primarily via company website.[388]

VII. Once a nomination procedure triggering event occurs at a subject company, which security holders or security holder groups may submit a nominee that the company would be required to include in its proxy materials?

E.1. Are the proposed thresholds for use of the proposed procedure appropriate? If not, should there be any restrictions regarding which security holder nominees for director would be required to be disclosed in the company proxy materials under the proposed procedure? If so, should those restrictions be consistent with the ownership requirements of Exchange Act Rule 14a-8? Should those restrictions be more extensive than the minimum requirements in Exchange Act Rule 14a-8?

The above questions elicited an extensive amount of comment. A substantial majority of the commenters believed that the proposed ownership thresholds were too high.[389] This substantial majority was due primarily to the comments of 5600 individuals or entities that signed a Letter Type that objected to "high ownership thresholds" and urged to Commission "reject [such] overly constraining barriers."[390] Notwithstanding the viewpoint expressed in the aforementioned Letter Type, a majority of the remaining commenters either explicitly or implicitly recognized that unfettered proxy access would not serve the interests of security holders or issuers.[391] These commenters generally were in further agreement that any ownership restrictions should be more extensive than those set forth in Exchange Act Rule 14a-8 and, instead, favored eligibility based on a long-term ownership by a large security holder or group of security holders.[392]

One commenter desired an additional restriction on security holder eligibility not tied to any ownership threshold.[393] This commenter believed that a nominating security holder, or a representative that is qualified under state law to nominate a candidate on such security holder's behalf, should attend the company's annual meeting and nominate any candidate(s) in person.[394] The commenter pointed out that this proposed requirement generally would be consistent with state law and company bylaws and would parallel Exchange Act Rule 14a-8(h), which requires that proponents or their representatives attend the annual meeting to present security holder proposals.[395] As with Exchange Act Rule 14a-8(h)(3), this commenter believed that if the nominating security holder(s) or a qualified representative failed without good cause to appear and nominate the candidate, the issuer should be permitted to exclude from its proxy materials in the following two years all nominees submitted by that security holder or group of security holders.[396]

E.2. Is it appropriate to include a restriction on security holder eligibility that is based on percentage of securities owned? If so, is the more than 5% standard that we have proposed appropriate? Should the standard be lower (e.g., 2%, 3%, or 4%) or higher (e.g. 6%, 7%, 8%, 9%, 10%, 15%, 20%, or 25%)?

The questions above elicited a significant response. A substantial majority of the commenters, as noted above, believed the proposed ownership thresholds were too high.[397] These commenters, however, did not propose an alternate threshold.

Those commenters that did not send one of the Letter Types referenced above, sent letters evidencing a wide range of opinion. At least two commenters recommended a $2000 minimum threshold, similar to the requirement under Exchange Act Rule 14a-8.[398] At least nine commenters recommended a 1% minimum threshold.[399] One of these commenters was amenable to raising the minimum threshold to 3% if the Commission abandoned the current "triggers."[400] One commenter proposed a minimum threshold of 2%.[401]

At least nineteen commenters urged a minimum threshold of no more than 3%.[402] These commenters generally believed the 5% threshold is too onerous and will preclude many security holders, including many institutional investors, from using the nomination procedure.[403] One of the commenters pointed to the current holdings of the three largest institutional investors to support this contention. According to this commenter:

> An analysis of the current holdings of the three largest institutional investors - CalPERS, CalSTRS and NYSCRF - show that combined ownership exceeds 2% in only one instance, and exceeds 1.5% in only twelve instances. Since these three investors represent one-third of the holdings of all public institutional investors, it appears it would be necessary to assemble a group of nearly all public pension funds to achieve 5% ownership.[404]

At least nine commenters believed that the 5% minimum threshold was appropriate.[405] Another commenter supported the 5% threshold, but believed there should be an alternative threshold for any security holder or group that owned in excess of $1 billion of "share value."[406]

One of the nine commenters, however, sought clarification regarding the 5% ownership threshold for those situations where a company has two or more classes of shares, with each class having different voting power.[407] In those instances, the commenter believed that in order to be a qualifying nominating security holder or group, the holder or group should own more than 5% of the class entitled to elect a majority of directors.[408] Alternatively, security holders of either class meeting the threshold could be allowed to make nominations, but the rule should be clarified to provide that in cases where two such shareholders make a nomination, only the nominee or nominees of the security holder with the greater voting power should be required to be included in the company's proxy materials.[409] In addition, the commenter urged that the proposed rule be revised to clarify that the share ownership and holding period should be determined based on the company's quarterly or annual reports filed during the relevant period (similar to the manner provided in Exchange Act Rule 13d-1(j)).[410]

In addition to the eligibility standard based on ownership of shares, one commenter urged the Commission to consider establishing an alternate criterion based on ownership of shares having a value in excess of $50 million.[411]

Another commenter believed that the minimum ownership threshold should be a sliding percentage scale for the nominating group, dependent on: (1) whether the nominator is an individual or group; and (2) how widely the stock is held.[412] The ownership percentage threshold for a group of security holders would be higher than the percentage required of a single security holder. Also, the more widely held the stock then the smaller the ownership required, and the more closely held, the larger the percentage required.[413] This commenter, however, did not suggest any specific thresholds.[414] Another commenter, on the other hand, proposed a similar process for determining the minimum ownership threshold, but suggested specific ownership thresholds.[415] This commenter believed that it is appropriate to allow only a holder or group of holders with a substantial economic stake in the issuer to propose the nominee. As such, the commenter suggested that if one shareholder, acting alone, makes the nomination, that shareholder should hold 10% of outstanding shares. If a group of shareholders is to make the nomination, the group must hold 5% of outstanding shares.[416] Still another commenter supported a sliding percentage based on an issuer's market capitalization.[417] This commenter supported a threshold of 5% for "small-cap" issuers and a 2%-3% threshold for "large companies."[418]

At least twenty-one commenters believed the minimum ownership threshold was too low.[419] Generally, this belief was based on the view that higher thresholds will help avoid the election of a director who will serve the narrow interests of only one minority shareholder[420] and would demonstrate that a significant portion of shareholders are willing to bear the costs of a contested election.[421]

At least ten of the commenters that supported a higher threshold declined to quantify any alternative.[422] Five of the commenters urged that the minimum threshold be no less than 10%.[423] One commenter supported a minimum threshold of 15%.[424] One commenter favored a sliding threshold. This commenter offered two different proposals. If the proposed rules are applicable only to accelerated filers, this commenter suggested thresholds of at least 10% for individuals and least 15% for groups. If the Commission decides to eliminate the shareholder triggering events, this commenter urged thresholds of at least 15% for an individual and 25% when security holders aggregate shares.[425]

One of the commenters suggested a threshold of from 10% to 20% of issued and outstanding shares of the company.[426] Three of the commenters suggested a minimum threshold of 25%.[427]

E.3. Should there be a restriction on security holder eligibility that is based on the length of time securities have been held? If so, is two years the proper standard? Should the standard be shorter (e.g., 1 year) or longer (e.g., 3 years, 4 years, or 5 years)? Should the standard be measured by a different date (e.g., 2 years as of the date of the meeting, rather than the date of nomination)?

The above questions did not elicit nearly the number of responses generated by the Commission's inquiry into the appropriate ownership percentage.[428] Comments favored minimum holding periods, with the majority of commenters expressing support for the proposed two-year requirement.

Five commenters believed the proposed restriction on the length of ownership was too onerous and supported a restriction that required ownership for a period of one year.[429] Two commenters supported a minimum holding period, but did not indicate specifically any length of time and, instead, offered only a range of one to two years.[430]

Support for a two-year minimum holding period, as noted above, was strong. At least twelve commenters supported the proposed two-year minimum holding period.[431]

One commenter noted that, with regard to making a nomination under the proposed procedure, its internal policy supported a minimum holding period of three years.[432]

Five commenters believed that the minimum holding period set forth in the proposed rules was too short.[433] Only three of these commenters offered any alternative; all favored a minimum holding period of five years.[434]

One commenter's support for a minimum holding period of two years was contingent on the holder demonstrating "economic risk" with respect to their investment.[435] This commenter urged that security holders not be permitted "to be short the shares but be able to, in effect, `long' the vote."[436] The commenter further explained that security holders that are either the record or beneficial owners, but are not also at economic risk because their economic ownership is hedged are not the type of long-term security holders that should be given access to a company's proxy materials.[437] The commenter proposed revising proposed Exchange Act Rules 14a-11(b)(2) and 14a-11(c)(11)(ii) to address this issue.

E.4. As proposed, a nominating security holder would be required to represent its intent to hold the securities until the date of the election of directors. Is it appropriate to include such a requirement? Would it be appropriate to require the security holder to intend to hold the securities beyond the election of directors (e.g., for six months after the election, one year after the election, or two years after the election) and to so represent?

At least eighteen commenters responded to the above questions.[438] All but one of the commenters believed that a nominating security holder or group should be required to hold the securities at least until the date of the election of directors.[439] The lone holdout was concerned that any requirement that the nominating security holder must intend to continue to hold their securities through the meeting at which the election of the directors would be considered could conflict with an institutional investor's fiduciary duty to make investment decisions in the best interests of its clients.[440] According to this commenter, "This duty requires selling a security when it is prudent to do so."[441] As such, this commenter believed that the requirement be "eliminated or clarified to ensure that shareholders are not subject to onerous holding requirements."[442]

Eleven of the commenters believed that nominating security holders should be required to represent their intent to continue to satisfy the requisite ownership threshold for the duration of their nominee's service on the board.[443] One commenter compared the desired holding requirement to a shareholder's agreement under which a major security holder is given the contractual right to nominate one or more directors to a company's board.[444] The commenter noted that under shareholder's rights agreements rights are granted only for so long as the

major security holder maintains a minimum ownership level and any director nominated by the major security holder typically must step down when the security holder's percentage ownership falls below the minimum.[445] Accordingly, this commenter believed that "a nominating shareholder or group should represent their intent to hold their shares until the election, and thereafter for the duration of the nominee's term as a director should the nominee be elected."[446] In the event the nominee is elected and the nominating security holder or group falls below the ownership percentage eligibility threshold, this commenter believed that the director should step down from the board.[447]

Three commenters believed that the proposed rules were appropriate and supported a representation from the nominating security holder or group that it intended to hold the securities through the date of the election of directors.[448]

Another commenter urged that a nominating shareholder or group should be required to hold the shares for the shorter of: (1) one year or (2) the term of the director elected as its nominee.[449] This commenter believed that such a requirement would provide incentives to nominating shareholders to give careful consideration to their nominees and evidence a commitment to the company by the nominating security holder or group that "matches the level of influence in the company's proxy process they have been afforded by the rule."[450] This commenter further believed that a nominating security holder or group that fails to meet the proposed requirement should be denied eligibility to use Exchange Act Schedule 13G for any of the company's securities for the next three years.[451]

One commenter proposed a requirement that the nominating security holder or nominating security holder group represent that it intends to hold the securities for at least two years after the election.[452] Another commenter proposed a requirement that the nominating security holder represent that it intends to hold the securities for at least five years after the election.[453] This commenter also believed there should be a five-year disqualification period for participating in a triggering event for nominating security holders that fail to hold for the required period after the meeting.[454]

E.5. Is the eligibility requirement that a security holder or security holder group must file an Exchange Act Schedule 13G appropriate? Should there be a different mechanism for putting companies and other security holders on notice that a security holder or security holder group has ownership of more than 5% of the company's securities and intends to nominate a security holder? Is it appropriate to permit the filing to be on Exchange Act Schedule 13G rather than Exchange Act Schedule 13D? If not, why not?

At least thirteen commenters responded to the above questions.[455] The majority of the commenters supported the eligibility requirement that a security holder or group must file an Exchange Act Schedule 13G.[456] One of the commenters, however, believed that Exchange Act Rules 13d-1 and 16a-1(a)(1) should be "revised to clarify that nominating shareholders must comply with those provisions regardless of their participation in a nominating shareholder group, so that a Schedule 13D filer cannot become eligible to file a Schedule 13G simply by joining a nominating shareholder group."[457]

Two commenters expressed significant concern with the proposal's exclusion of Exchange Act Schedule 13D filers, which the commenters thought would have unintended adverse consequences for security holders that practiced an active, relational investment strategy that typically sought to *influence* portfolio companies, but not to effect a change in control.[458] One of the commenters noted that the exclusion of Exchange Act Schedule 13D filers, typically all active, relational investors that meet the requisite 5% ownership level, would: (1) motivate such holders to more frequently and prematurely seek proxy access before taking other less disruptive steps that currently are defined as *influence* of control triggers necessitating an Exchange Act Schedule 13D filing; and (2) preclude the use of the nomination procedure by such security holders that first chose other courses of action less disruptive to the portfolio companies but which trigger an Exchange Act Schedule 13D filing.[459] Because the proposed nomination procedure currently protects against a change in control by limiting the number of director nominees to less than a majority of the board, one of the commenters suggested there was no need to exclude Exchange Act 13D filers.[460] The second commenter expressed a similar sentiment and stated,

> I respectfully ask the SEC to focus on the distinction between seeking `control' and `value' now that the availability of the access rule makes the proper definition of control of key importance and not just a question of filing a Schedule 13G or Schedule 13D. Perhaps the answer will be to require major shareholders who are proponents of certain economically oriented proposals to continue filing on a Schedule 13D, but they would still be eligible to use the proposed access rule.[461]

Five of the commenters believed that any nominating security holder or group using the access mechanism should be subject to the expanded disclosure requirements required by Exchange Act Schedule 13D.[462] In support, one commenter stated:

> If a major shareholder or group is going to run an election contest, an act obviously designed to influence the management and control of the company, other shareholders are entitled to full disclosure as to the identity of the shareholder or group (including their controlling persons), the source of their funding, the purposes of their actions, agreements or understandings they have with others with respect to their shareholdings, etc.[463]

E.6. Should the procedure include a provision that would deny eligibility for any nominating security holder or nominating security holder group that has had a nominee included in the company materials where that nominee did not receive a sufficient number of votes (e.g., 5%, 15%, 25%, or 35%) within a specified period of time in the past? If there should be such an eligibility standard, how long should the prohibition last?

At least ten commenters responded to the above questions.[464] Two of the commenters did not believe it was appropriate to deny eligibility for any nominating security holder or nominating security holder group that has had a nominee included in the company materials where that nominee did not receive a sufficient number of votes (e.g., 5%, 15%, 25%, or 35%) within a specified period of time in the past.[465]

Eight of the commenters supported eligibility limitations for any nominating security holder or nominating security holder group where the nominee did not receive a designated level of support.[466] One commenter supported denying eligibility to a nominating security holder or group for one year where its nominee failed to receive at least 5% of the vote.[467] Another commenter supported denying eligibility to a nominating security holder or group for three years where its nominee failed to receive at least 35% of the "votes cast."[468] This commenter also supported revising the shareholder notice to "include a representation that the nominee whose name is proposed to be included in the company's proxy materials has not been submitted as a shareholder nominee under the rule in the past three years."[469]

One commenter supported denying eligibility to a nominating security holder or group for three years where its nominee failed to receive "sufficient votes" to be elected.[470] Two commenters supported denying eligibility to a nominating security holder or group for the next annual meeting where its nominee failed to receive at least 50% of the "votes outstanding."[471]

One commenter supported denying eligibility to a nominating security holder or group for five years unless the security holder nominee achieved a level of support of 20% of outstanding shares in the first year and 40% of outstanding shares in the second year.[472]

One commenter recommended that if a security holder or security holder group has a nominee included in an issuer's proxy statement, then whether or not that nominee is elected, the issuer should not be required to include another nominee of that proponent in the proxy in any of the following three years.[473]

E.7. Should security holders be allowed to aggregate their holdings in order to meet the ownership eligibility requirement to nominate directors? If so, is it appropriate to require that all members of a nominating security holder group individually meet the minimum holding period? Is it appropriate to require that all members of the group be eligible to file on Exchange Act Schedule 13G?

At least eight commenters addressed the question of whether security holders should be allowed to aggregate their holdings in order to meet the proposed ownership eligibility requirement. Seven of the commenters agreed that permitting security holders to aggregate their shares was appropriate.[474] One of these commenters, however, believed that there should be a limit on how many groups a security holder can enter.[475] This commenter stated, "[A] stockholder's ability to participate in group nominations should be limited to participation in that number of groups equal to the number of stockholder nominees permitted by the Proposed Rules."[476] One commenter believed it was not appropriate to permit security holders to aggregate their shares.[477] To the extent any final rules permit security holders to aggregate shares, this commenter believed that each security holder should "be required to state under oath its particular dissatisfaction with the issuer and the director(s) involved."[478]

Four commenters believed that the proposed two-year holding requirement should apply to all shareowners of any "group" formed for purposes of the access mechanism.[479] Three commenters believed it was appropriate to require that all members of a "group" be eligible to file an Exchange Act Schedule 13G.[480] One commenter disagreed with both of the aforementioned proposed requirements, but did not elaborate.[481]

E.8. As proposed, the beneficial ownership level of a nominating security holder or nominating security holder group would be established by the Exchange Act Schedule 13G filed by that security holder or security holder group, for companies other than open-end management investment companies ("mutual funds"). Is the filing of the Exchange Act Schedule 13G sufficient evidence of ownership? If not, what additional evidence would be appropriate? Should there be an additional procedure by which disputes regarding ownership levels are resolved?

At least one commenter responded to the above questions.[482] This commenter stated that Exchange Act Schedule 13G filings, and the proposed accompanying certifications of ownership, would provide adequate proof of ownership.[483] This commenter also believed that procedures for settling a dispute over ownership should be created by the Commission. The commenter stated:

> The procedures should provide for adequate means of cure, and should specify that as long as the group identified maintains the required thresholds, it will not be a violation of the rule resulting in the disqualification of the group or shareowner nominated candidate(s) if one or more members is found to have less shares than originally represented or a holding period that is different than originally represented.[484]

VIII. What are the eligibility requirements for a person whom a security holder or security holder group may nominate?

F.1. Should there be any other or additional limitations regarding nominee eligibility? Would any such limitations undercut the stated purposes of the proposed process? Are any such limitations necessary? If so, why?

At least twelve commenters stated that there should be additional limitations related to nominee eligibility.[485] These commenters urged that the Commision require prospective security holder nominees to meet additional objective director qualifications set forth in an issuer's organizational documents, so long as such qualifications apply equally to all board members and are administered in good faith by the board of directors.[486] One commenter noted that in light of the new nominating committee disclosure provisions adopted by the Commission that require disclosure of any specific, minimum qualifications that the nominating committee believes are required for board members, [487] it saw no reason why security holder nominees should not be required to meet the qualification standards adopted by the company which will be publicly disclosed and will apply to all director nominees.[488]

Several of the commenters also urged that the Commission require prospective security holder nominees to meet any additional objective director independence standards adopted by the company.[489] The commenters noted that many issuers have begun to adopt objective independence criteria in addition to those required by the recently revised listing standards.[490]

Accordingly, these commenters urged that the proposed rule should be revised to require a security holder nominee to meet not only the objective criteria of independence in the applicable listing standards, but also any additional objective director independence standards adopted by the issuer.[491]

At least one commenter stated that there should be no additional limitations regarding nominee eligibility.[492]

F.2. Is it appropriate to use compliance with state law, federal law, and listing standards as a condition for eligibility?

At least three commenters stated that although it may be appropriate for the Commission to use compliance with state law, federal law, and listing standards as an eligibility condition, they were concerned that states might be pressured to adopt laws giving companies flexibility to block or otherwise impose hurdles applicable to security holder candidates.[493]

At least three commenters stated that the Commission was correct in using compliance with state law, federal law, and listing standards as an eligibility condition.[494] According to two of these commenters, security holder nominees should be subject to the same laws and standards applicable to board nominees.[495] In voicing its support for the Commission's approach, the third commenter noted that without such a requirement, a security holder could nominate and successfully elect a director who is employed by the company's competitor, "potentially causing the company to violate Section 8 of the Clayton Act of 1914."[496]

One commenter was concerned that the nomination process would have an adverse or uncertain impact on highly regulated industries, such as banking.[497] In this regard, the commenter sought clarification on the applicability of the rule in cases where an established state or federal regulatory structure requires a regulated entity to get third party regulatory approval or file a notice before adding or replacing a member of the board.[498] Also, clarification would be needed on how to handle a situation where the applicable regulator denied the request to add the particular director.[499]

F.3. Should there be requirements regarding independence from the company? Should the fact that the nominee is being nominated by a security holder or security holder group, combined with the absence of any direct or indirect agreement with the company, be a sufficient independence requirement?

At least five commenters responded to the above questions.[500] Three commenters believed that, as they relate to independence between an issuer and any nominee and nominating security holder or nominating security holder group, the proposed rules are appropriate.[501] Two commenters, however, disagreed.[502] These commenters stated that all nominees should be independent under the applicable listing standards and any additional standards set forth in the issuer's corporate governance guidelines.[503]

F.4. How should any independence standards be applied? Should the nominee and the nominating security holder or nominating security holder group have the full burden of determining the effect of the nominee's election on the company's compliance with any independence requirements, even though those consequences may depend on the outcome of any election and may relate to the outcome of the election with regard to nominees other than security holder nominees?

At least three commenters responded to the questions noted above.[504] One commenter stated that if the nominee and the nominating shareholder comply with the independence requirements of the proposed rule any additional regulatory burdens are the responsibility of the company.[505]

One commenter stated that the nominee and nominating security holder or nominating security holder group should have the burden of determining the effect of the nominee's election on the company's compliance with any independence requirements.[506] Another commenter stated that the nominees and the nominating shareholders have "the responsibility of confirming that the nominee is independent."[507] However, this commenter, in addition to

believing that the nominee should be independent under the applicable listing standards and any additional standard set forth in the issuer's corporate governance guidelines, urged that the nominating security holder not be permitted to nominate a non-independent director, even if such a nomination technically was allowed because a majority of other directors would be independent.[508]

F.5. Are the proposed standards with regard to independence appropriate? If not, what standards would be appropriate? If these limitations generally are appropriate, are there instances where they should not apply?

Three commenters issued general statements of support for the proposed standards with regard to nominee independence.[509]

Four commenters believed the independence standards were not appropriate.[510] Three of these commenters' concerns were focused on proposed Exchange Act Rule 14a-11(a)(3)(i), which allows for the exclusion of nominees whose candidacy would violate the rules of a national securities exchange or national securities association (other than rules regarding director independence).[511] The three commenters strongly urged that the parenthetical clause be eliminated.[512] These commenters noted that an issuer subject to the aforementioned listing standards is required to have a majority of independent directors and, subject to the controlled company exception, to have only independent directors on its three major committees.[513] Permitting a security holder group to submit nominees without the requisite independence could, in certain instances, eliminate the majority of independent directors, thereby threatening compliance with applicable listing standards.[514] In addition, not requiring that security holder nominees be independent could burden the issuer with a director who is not available to serve on major committees and inhibit the issuer's ability to meet the requirements of the exchange or association that each of the foregoing three committees be composed entirely of independent directors.[515] At least two of the commenters stated that they did not anticipate that unaffiliated security holder groups would have any problem submitting independent nominees.[516]

Two commenters noted that the proposed independence standards do not address the audit committee independence and financial literacy requirements of the NYSE, Nasdaq and other stock exchange rules or the related requirement pursuant to the Sarbanes-Oxley Act of 2002 that the company must disclose if it has an audit committee financial expert.[517] The commenters were concerned that the election of a shareholder nominee, who is not required to meet these additional audit committee requirements, could result in a member of the audit committee not being elected, which potentially could have significant adverse consequences for an issuer.[518] As such, one commenter urged the Commission to address the interaction of the proposed nomination procedure with audit committee requirements, particularly the impact of an audit committee financial expert or any other member of the audit committee not being reelected as a result of the election of a security holder nominee under the rule, and with any other committee qualifications.[519] The second commenter recommended that in any situation where an issuer might lose an audit committee member in an election contest the Commission require any security holder or security holder group nominee satisfy the relevant audit committee requirements.[520]

F.6. Where a company is subject to an independence standard of a national securities exchange or national securities association that includes a subjective component (e.g., subjective determinations by a board of directors or a group or committee of the board of directors), should the security holder nominee be subject to those same requirements as a condition to nomination?

At least seven commenters recommended that security holder nominees be required to meet both the objective and subjective standards of independence established by a national securities exchange or national securities association.[521] One commenter was concerned that under the proposed rule, security holder nominees would not have to meet any subjective standards.[522] This commenter suggested a revision to the proposed rule, providing that:

> If (i) an applicable stock exchange has an independence standard with a subjective element; (ii) at least one management-supported candidate is

> independent; and (iii) a loss of one independent director will cause the company to fail to have sufficient independent directors under the applicable stock exchange's standards, then the company should not be required to include in its proxy statement any shareholder nominee who has any relationship whatsoever with the company (other than relationships that are deemed immaterial under any categorical standards for independence published by the company).[523]

At least three commenters, however, agreed with the requirement in the proposed rule that security holder nominees qualify as independent under relevant non-subjective stock exchange listing standards.[524]

F.7. As proposed, a nominating security holder or nominating security holder group would be required to represent that the security holder nominee satisfies applicable standards of a national securities exchange or national securities association regarding director independence, except where a rule imposes a standard regarding independence that requires a subjective determination by the board or a group or committee of the board. What independence requirements should be used if the company is listed on more than one market with such independence requirements? Should the nominating security holder or nominating security holder group have the discretion to choose the applicable standards? Should the company have discretion to choose the applicable standards? Should all the standards of all markets on which shares are traded apply? Should the more stringent standards apply?

At least six commenters responded to the above questions.[525] Two commenters stated that if an issuer lists on more than one market with applicable independence requirements, it would be acceptable if the Commission applied the more stringent standard.[526] Two commenters stated that in the case of multiple listings, any security holder nominee should meet all applicable standards.[527] Another commenter did not address what standard was appropriate in the case of multiple listings, rather it asked that the Commission require issuers to provide clear proxy statement disclosure of the applicable independence standard and any further qualifications required of security holder candidates.[528]

One commenter suggested that where an issuer is not listed on a national securities exchange or national securities association, the nominee should be subject to the same requirements of director independence as would be required under the Nasdaq rules then currently in effect. Alternatively, the issuer should be permitted to choose between the applicable listing standards, provided it used such consistently from year to year.[529]

F.8. Should there be requirements regarding independence of the nominee from the nominating security holder, nominating security holder group, or the company? If so, are the proposed limitations appropriate? What other or additional limitations would be appropriate? If these limitations generally are appropriate, are there instances where they should not apply?

At least twenty-nine commenters expressed substantial concern and/or disagreement with the proposed requirements regarding independence of the nominee from the nominating security holder, nominating security holder group, or company.[530] Commenters generally questioned the "fairness" and "wisdom" of the independence requirements.[531] Regarding "fairness," commenters expressed concern over holding a candidate suggested by a security holder to a different standard than board-nominated candidates.[532] One commenter noted, "Corporate boards are currently free to nominate candidates with a range of special interests, such as individuals from firms that provide investment banking, legal and other professional services, relatives of company executives and directors and other individuals with various links to the company and its executives."[533] The commenter further noted that it could see no reason why significant security holders were not afforded the same privileges.[534]

Regarding the "wisdom" of the proposed independence requirements, commenters believed that the proposed application of the requirements was "overinclusive" and would inhibit significant holders from seeking seats on boards as part of actively managed governance strategies.[535] Under these strategies, significant investors seek board representation in an effort to build long-term equity value in an issuer. In connection with such efforts, these parties often conduct substantial fundamental research and take significant equity positions. These individuals, according to many of the commenters, are among the "most desired type of director because they are independent, extremely well aligned with the owners, and very well

prepared with an in-depth understanding of the company that other directors typically do not possess."[536] In order to permit these active, relational investment strategies, at least two of the commenters supported an exception to the independence requirements.[537] The commenters suggested that the independence standards should provide that "any security holder nominee (not group) that holds of least 2% [of an issuers voting equity] would be exempted from the independence standards and would [be able] to nominate himself or herself."[538]

Many of the commenters noted above rejected the contention that any relaxation of the provisions requiring independence of the nominee from the nominating security holder or nominating security holder group and company would risk "special interests" inappropriately influencing the issuer.[539] These commenters pointed out that security holder nominees, among other things, would still need to garner enough support to get elected and that, if elected, the security holder nominees would still be subject to state law fiduciary duties.[540]

Five commenters favored the independence standards as set forth in the proposed rules.[541] Two commenters issued general statements of support.[542] Two commenters also expressed their support and added supporting reasons for their views. According to these commenters the proposed independence requirements were critical to: (1) ensure that the motivation of a nominating security holder is not solely to promote that security holder's individual interests; and (2) combat the perception that, if elected, the nominee would favor the interests of the nominating security holders over other shareholders.[543]

F.9. Should there be any standards regarding separateness of the nominee and the nominating security holder or nominating security holder group? Would such a limitation unnecessarily restrict access by security holders to the proxy process? If such standards are appropriate, are the proposed standards the proper standards? Should other standards be included? Should any of the proposed standards be eliminated?

At least three commenters responded to the above questions.[544] The three commenters stated that there should be additional standards regarding separateness of the nominee and the nominating security holder or nominating security holder group.[545] Two of the commenters stated that the parties must be totally independent of one another in order to combat the perception that, if elected, the nominee would favor the interests of the nominating security holders over other security holders.[546] The commenters warned that, as a practical matter, the perception of being a "special-interest director" likely would cripple the new director in his or her ability to influence the other directors.[547]

The third commenter recommended applying independence standards to nominating security holders or nominating security holder groups and their nominees similar to those set forth in the NYSE Listed Company Manual Section 303A(2)(b) (as applicable to directors and the corporation).[548] The commenter stated, "Such independence standards would be necessary to prevent the establishment of `boutique director houses' whose members organize (outside the Commission's radar) to exact subscription fees from special interest shareholders in exchange for service by the houses' employees as the shareholders' nominees for director."[549]

F.10. Should there be a prohibition, as is proposed, on any affiliation between nominees and nominating security holders or nominating security holder groups? If so, are the proposed rules appropriate? For example, we have proposed a definition of "immediate family" that is consistent with the existing disclosure requirement under Item 401(d) of Regulation S-K. Is this the appropriate definition for purposes of addressing relationships between the nominee and the nominating security holder or nominating security holder group? If not, what definition would be more appropriate?

Two commenters stated that generally they favored the security holder nominee eligibility requirements in the proposed rule, including the requirements regarding the lack of affiliation with the nominating security holder or group of security holders.[550] A third commenter addressed specifically the prohibition on any affiliation between nominees and nominating security holders or nominating security holder groups, and noted its approval.[551] A fourth commenter stated that a strict prohibition on any affiliation between nominees and nominating security holders or nominating security holder groups would clearly make it more difficult to induce high-quality candidates to accept nominations.[552]

F.11. Should there be exceptions to the prohibition on any affiliation between nominees and nominating security holders or nominating security holder groups? If so, what exceptions would be appropriate?

At least three commenters responded to the questions cited above.[553] Two commenters stated that there should be no exceptions.[554]

One commenter urged that the Commission reconsider the prohibition on affiliations between nominees and nominating security holders or nominating security holder groups.[555] As set forth below in "Question F.12," this commenter believed that in certain circumstances it might be appropriate to provide limited compensation to the nominee of a security holder or security holder group.[556]

F.12. Is the two-year prohibition on payments from nominating security holders to nominees appropriate? Should it be longer (e.g., 3 years, 4 years, or 5 years) or shorter (e.g., 1 year)? Should there be exceptions to this prohibition? If so, what exceptions would be appropriate?

One commenter, as noted above, strongly urged the Commission to reconsider the prohibition on payments from nominating security holders to nominees.[557] According to this commenter, "A prohibition on compensating nominees for the willingness to be candidates and the time spent on their candidacy would significantly and adversely narrow the pool of possible candidates."[558] Another commenter believed that a group should be permitted to pay on behalf of the nominee legal fees and expenses in connection with the proxy solicitation and indemnify the nominee for any related liabilities.[559]

F.13. Is the prohibition on direct or indirect agreements between companies and nominating security holders appropriate? Would such a prohibition inhibit desirable negotiations between security holders and boards or nominating committees regarding nominees for directors? Should the prohibition provide an exception to permit such negotiations? If so, what should the relevant limitations be?

At least five commenters responded to the above questions; all agreed that the proposed prohibition was generally appropriate.[560]

Three of the commenters, however, foresaw circumstances where an issuer should be able to discuss the nomination of a director candidate with a security holder proponent in the same way it can discuss and reach agreements regarding any other security holder proposal.[561] Two of these commenters urged that the Commission establish an exception in the proposed rules to permit negotiations and other communications between the nominating security holder or nominating security holder group and the issuer regarding the relevant nominees.[562] Such an exception, according to one of the commenters, "would permit companies to respond to nominating shareholder concerns and, possibly, prevent the costly and divisive proxy contests that would result from inclusion of [security holder] nominees in company proxy materials."[563] The third commenter expressed concern that any exception would be "difficult to conceptually define" and might "put at risk the integrity of the process by allowing a company to game the process."[564]

F.14. Should there be a nominee eligibility criterion that would exclude an otherwise eligible nominee or nominating security holder or nominating security holder group where that nominee (or a nominee of that security holder or security holder group) has been included in the company's proxy materials as a candidate for election as director but received a minimal percentage of the vote? If so, what would be the appropriate standard (e.g., 5%, 15%, 25%, or 35%)?

At least three commenters believed that nominee candidates should not be subject to resubmission standards, particularly in light of the substantial triggering events and the absence of similar resubmission standards applicable to management candidates.[565] In the event the Commission disagrees, one of the commenters recommended resubmission standards based on the criterion in Exchange Act Rule 14a-8.[566]

At least five commenters expressed support for subjecting security holder nominees to some

level of a resubmission standard.[567] One commenter supported a strict resubmission standard that would prohibit re-nomination at any point in the future if the nominee stood for election in the past and failed to gather enough support for election.[568] Another commenter supported denying eligibility to an otherwise eligible nominee or nominating security holder or group for three years where the nominee failed to receive "sufficient votes" to be elected.[569] One commenter supported denying eligibility to a nominee or nominating security holder or group for five years unless the security holder nominee achieved a level of support of 20% of outstanding shares in the first year and 40% of outstanding shares in the second year.[570] Another commenter recommended permitting a company to exclude a security holder nominee from the company proxy for two calendar years if that nominee does not receive votes from at least 10% of shares present and entitled to vote at the meeting the first time the nominee appears on the company's proxy statement.[571] The last commenter believed that a director nomination by a security holder should be treated like any other shareholder proposal under Exchange Act 14a-8.[572]

F.15. As proposed, the rule includes a safe harbor providing that nominating security holders will not be deemed "affiliates" solely as a result of using the security holder nomination procedure. This safe harbor would apply not only to the nomination of a candidate, but also where that candidate is elected, provided that the nominating security holder or nominating security holder group does not have an agreement or relationship with that director otherwise than relating to the nomination. Is it appropriate to provide such a safe harbor for security holder nominations? Should the safe harbor continue to apply where the nominee is elected?

Two commenters issued statements of general support for the proposed safe harbor.[573] Another commenter stated that, while it generally approved of the policy, the nominating security holder or nominating security holder group should not be deemed an affiliate of the issuer solely by reason of having nominated a candidate to the board of directors and making further efforts to support that nominee's election, it was concerned that the proposal does not clarify whether or not the nominator and the nominee would be considered affiliates of each other by reason of such nomination and support for election.[574] According to the commenter, "Such clarification may be desirable for other purposes under the Securities Act or the Exchange Act, as well as possible relevance to other circumstances in which they might be deemed to be acting in concert."[575]

Two commenters were concerned that the proposed safe harbor overlooked certain issues unique to investment companies.[576] In this regard, one of the commenters urged that any safe harbor adopted clarify that a nominating security holder "will not be deemed an `interested person' of an investment company under the Investment Company Act solely as a result of nominating a director or soliciting for the election of such a director nominee or against a company nominee pursuant to the security holder nomination procedure."[577]

Two commenters disagreed with the proposed safe harbor.[578] One commenter noted that most issuers treat their outside directors as affiliates because of their position of control in the company. This commenter stated that extending a safe harbor to security holder nominees solely on the distinction of how they became directors is "inconsistent with the objective of the proposed rule of having security holder nominees who are not special-interest directors and would suggest that the security holder nominees are in some way `second class' directors."[579] The commenter added that a determination of affiliate status is a legal judgment for the company and its counsel, not for the security holders.[580] The second commenter believed that the prohibitions on affiliation between the parties "should be continuous and not subject to any safe harbor."[581]

IX. What is the maximum number of security holder nominees that the company must include in its proxy materials?

G.1. Is it appropriate to include such a limitation on the number of security holder nominees? If not, how would the proposed rules be consistent with our intention not to allow the proposed procedure to become a vehicle for changes in control?

In recognition of the fact that the proposed rules are not intended to become a vehicle to effect changes in control, fifteen commenters unanimously approved of limiting in some manner the number of security holders nominees.[582] One commenter, however, questioned the

"intellectual underpinning" of the proposed limitation by pointing out that the Exchange Act Schedule 13G requirement already addresses the concern over the process being used as a vehicle for control.[583]

G.2. If there should be a limitation, is the proposed limitation appropriate? Should the number of security holder nominees be higher or lower? Should the limitation instead be based on the total percentage of the board that the security holder nominees would comprise? Should the limitation be the greater or lesser of the number or a specified percentage, rather than a set number, as proposed? Is it appropriate to permit more than one security holder nominee regardless of the size of the company's board of directors?

At least fifteen commenters, a significant majority of the commenters that responded to the above questions, believed that the proposed limitation was too low.[584] These commenters, primarily pension funds, persons or entities affiliated with pension funds and, to a lesser extent, individuals, were in agreement that in no event should the number of security holder nominees be less than two.[585] In supporting its belief, one commenter noted:

> At a company where the triggering events have occurred it would not be surprising if a single director elected under this rule was treated materially differently than management endorsed directors, e.g., executive committees may be formed and information may be withheld. While there is no guarantee that two candidates would not be similarly treated, allowing multiple candidates to serve at any company would minimize that risk and, at a minimum, make it more likely that candidates would serve, and continue to serve, in a hostile environment.[586]

Beyond supporting a right to place two nominees in the proxy materials, these commenters were not in agreement as to the appropriate number of security holder nominees. At least five commenters believed that the number of security holder nominees should be "one less than half" of the eligible board seats in any given election cycle.[587] At least four other commenters believed that the number of security holder nominees permitted by the proposed rules should be two directors or 35% of the board, whichever is greater.[588] Another commenter supported a standard that in all circumstances would entitle security holders to include nominees for 35% of the board.[589] Another commenter supported an approach permitting security holders to include nominees for 25% of the board, or in no event fewer than two directors.[590] One commenter believed that the number of security holder nominees permitted by the proposed rules should be two directors or 20% of the board, whichever is greater.[591] This commenter further believed that security holders "should be entitled to re-nominate any incumbent directors nominated by shareholders in prior elections and who are not included in the company's slate of director candidates.[592] Finally, at least six commenters favored a mechanism that would provide only the right to include at least two nominees.[593]

At least seven commenters believed that the proposed limitations were too generous.[594] Two of these commenters supported a limit of one nominee, regardless of the board's size.[595] In support, one commenter stated, "The election of just one shareholder-nominated candidate could lead to a fragmented board unable to function effectively as a team. Permitting dissident shareholders to include *more* than one Election Contest nominee in company proxy materials would only exacerbate these problems and result in voting blocs on boards."[596] Another commenter supported an approach permitting one security holder nominee for a board with twenty or fewer members and two security holder nominees for a board with more than twenty members.[597]

Two other commenters stated that the number of shareholder nominees that a company should be required to include in its proxy materials should be one for a company with a board of nine or fewer directors, two for a board of between 10 and 20 directors and three for a board of over 20 directors.[598] Changing the maximum board size that would require the inclusion of one nominee from eight to nine directors is, according to one of the commenters, supported by several factors.[599] First, a staggered board with three sets of three directors is a relatively common structure. Allowing two out of three directors elected in a given year to be security holder nominees would be, in the opinion of this commenter, "unnecessarily disruptive to the functioning of the board."[600] Second, the proposing release includes data demonstrating that the median public company board size is nine directors. This commenter urged that, in light of

the rule's significance, it "should not be geared to putting two nominees on the boards of what is likely to be a majority of public companies."[601]

One commenter supported revising the proposed rule to state that the number of shareholder nominees that a company should be required to include in its proxy materials should be one for a company with a board of nine or fewer directors, but the commenter did not address whether corresponding changes were appropriate for boards of between 10 and 20 directors and boards of over 20 directors.[602] Alternatively, this commenter suggested that the number of security holder nominees to be included in the proxy statement should be based not on the total size of the board, but rather on the number of directors who may be elected in any given year.[603] The commenter proposed that if three directors were up for election in a given year, one security holder nominee should be able to be elected.[604] The commenter did not address circumstances where more than three directors were up for election.[605]

Related Concerns

Three commenters expressed concern that, as it relates to the number of permissible security holder nominees, the current structure of the proposed rules may discourage an issuer and company security holders from opting for a course that foregoes the cost and distraction of a contested election process.[606] To illustrate the problem, two of the commenters outlined a scenario wherein a company is considering increasing the size of its board of directors in order to: (1) include a security holder candidate nominated under the rule without having a contested election; or (2) voluntarily include in management's slate a candidate of a 5% shareholder.[607]

Under the proposed rules, the commenters contend an issuer likely would not have any reason to agree to place a stockholder nominee on the management slate if such person does not qualify as a "security holder nominee" under Rule 14a-11(d).[608] For example, if a company has a board consisting of eight directors and increases the size of its board to nine directors in order to include voluntarily a shareholder nominee or a potential candidate of a 5% security holder, the company might still be required to include an additional shareholder nominee because its board size is now in the category permitting the inclusion of two shareholder nominees.

The two commenters believed that in such cases the rule should clarify that any security holder nominee elected to the board will not be counted for purposes of determining the number of nominees that security holders may nominate based on the size of the board of directors.[609] The clarification is necessary, according to one of the commenters, "to avoid a situation where increasing the board size in order to include a shareholder nominee results in the company having to potentially include an additional nominee."[610] The third commenter, on the other hand, recommended that no trigger event should occur, and no shareholder nomination process should be imposed, in any year in which the company voluntarily includes in its proxy a nominee of a security holder or group that would have been eligible to submit a direct access proposal.[611] This commenter further recommended that no triggering event should occur in any year in which any security holder nominees that were elected in previous years are being re-nominated by management.[612]

As it relates to the number of permissible security holder nominees, if only in a indirect fashion, the commenters believed two additional areas warranted the Commission's attention. First, one of the commenters stated that for purposes of proposed Exchange Act Rule 14a-11(d) a "security holder nominee" should continue to be counted as such for a minimum of three years, so long as the nominee continues to serve on the board during this period.[613] Second, for issuers where a class of security holders is entitled to elect one or more directors (but less than a majority), the other commenter contended that any such directors should not be counted for purposes of determining the board's size under paragraph (d) of proposed Exchange Act Rule 14a-11.[614]

G.3. Should the number increase during the second year of the proposed procedure? Should the number decrease during the second year of the proposed procedure?

Two commenters stated that no changes should be made during the second year of the

[615]

proposal.—

G.4. The proposal contemplates taking into account incumbent directors in the case of classified or "staggered" boards for purposes of determining the maximum number of security holder nominees. Is that appropriate? Should there be a different procedure to account for such incumbent directors? Also with regard to staggered boards, should the procedure address situations in which, due to a staggered board, fewer director positions are up for election than the maximum permitted number of security holder nominees? If so, how?

The above questions elicited a very limited number of responses. One commenter stated that because only one "mandatory" security holder nominee should be permitted to be included in the proxy materials regardless of the size of a company's board, "no special process would be required for classified boards."[616] Another commenter agreed generally with the provisions for staggered boards, but believed they did not go far enough.[617] In addition to the approach articulated by the Commission, this commenter thought the numerical process outlined by the Commission should be "applied to the number of directors eligible for election in a particular year rather than by reference to the total number of directors on the board."[618] An illustrative example provided by the commenter is as follows: if a company has a board comprised of twenty-one directors, seven of whom are to be elected in each year to a three-year term, then, according to this commenter, only one security holder nominee should be eligible for nomination in a particular year, rather than the three nominees suggested under the present wording of the proposal.[619]

Another commenter, while not wanting to encourage classified boards, recognized that it likely was appropriate to consider incumbent directors in the case of classified boards for purposes of determining the maximum number of holder nominees.[620] Nonetheless, this commenter believed that it should be permitted "to run the maximum number of seats allowed by the rule in any one year even if the number of seats up for election is less, unless the addition of the maximum number of additional seats would violate a company's articles of incorporation or state law." "In effect," according to this commenter, "shareowners could expand the size of the board by virtue of this rule unless such an action violates a company's articles of incorporation or state law."[621]

G.5. We have proposed a limitation that permits the security holder or security holder group with the largest beneficial ownership to include its nominee(s) where there is more than one eligible nominating security holder or nominating security holder group. Is this proposed procedure appropriate? If not, should there be different criteria for selecting the security holder nominees (e.g., length of security ownership, date of the nomination, random drawing, allocation among eligible nominating security holders or security holder groups, etc.)? Rather than using criteria such as that proposed, should the company's nominating committee have the ability to select among eligible nominating security holders or security holder groups?

Again, there were a limited number of responses to the above questions. Two commenters stated that the criterion for selecting one nominating group or holder from multiple eligible nominating groups or holders is appropriate.[622] These commenters did not believe it was appropriate for an issuer's nominating committee, in such instances, to select among nominating holders or groups.[623]

Another commenter agreed with the proposed criterion, but proposed a slight modification. According to this commenter, the nominating security holder or nominating security holder group "holding the largest number of voting shares in that company sixty (60) days prior to the deadline for submitting nominations should be the `Lead Shareholder', who should be the only shareholder authorized to submit board nominations."[624]

Three other commenters believed that the proposed criterion was not appropriate and that the nominating committee should select the nominating security holder or nominating security holder group if there were multiple nominating holders or groups.[625] Finally, one commenter urged that, at a minimum, all eligible nominating holders and groups "be required to hold a dialogue to attempt to agree."[626] Under this process, the Commission, in order to reduce to burden on the issuer, would be tasked with mediating any disputes between competing nominating holders or groups.[627]

G.6. Rather than a limitation on the maximum number of security holder nominees, should there be only a limitation on the number of security holder nominees that may be elected?

Six commenters responded to the above question. [628] Five commenters responded that a limitation based on the number of security holder nominees that could be included in the proxy materials was preferable to a limitation based on the number of security holder nominees that could be elected.[629] One commenter, however, did not support a limit on the number of security holder nominees that could be included in the proxy materials, but rather only on the number of shareholder nominees who may be elected in any given year.[630] This commenter stated, "If a shareholder or group with a sufficient ownership percentage puts forth a nominee, there is no rationale for excluding that nominee just because another shareholder or group put forth another nominee."[631]

X. What notice must the security holder or security holder group provide to the company and file with the commission?

H.1. Are the proposed content requirements of the notice appropriate? Are there matters included in the notice that should be eliminated? Are there additional matters that should be included? For example, is there additional information that should be included with regard to the nominating security holder or nominating security holder group (e.g., disclosure similar to that required from participants in solicitations in opposition with regard to contracts, arrangements or understandings relating to the company's securities), or with regard to the security holder nominee?

At least six commenters responded to the above questions.[632] Three of these commenters believed that the notice should require additional information that would serve to assist the issuer in determining whether a security holder nominee meets the applicable independence requirements.[633] These commenters identified as pertinent information "charitable, personal and other material relationships not covered by the objective independence standards."[634]

Another of the commenters believed that unless the contents of the notice included "the full disclosures required in other contested situations" security holders would be disadvantaged.[635]

One commenter stated that the notice content requirements are "appropriate."[636]

Finally, one commenter sought removal of certain information from the notice. This commenter believed that the statement in the notice that, to the shareholder's knowledge, the candidate's nomination or service would not violate controlling state law, federal law, or listing standards is not appropriate.[637] The commenter urged that the knowledge qualifier be eliminated. According to the commenter, "That change would encourage nominating shareholders to properly perform their due diligence and make clear that it is the nominating shareholder that should incur liability for violations if the statement is false."[638]

H.2. Are the required representations appropriate? Should there be additional representations? Should any of the proposed representations be eliminated?

At least eight commenters responded to the above questions.[639] Four of the commenters, including a significant pension fund and two large trade associations, agreed that the security holder nominee representations included in the notice should include some form of certification that the nominee was aware of his or her duties under state law to act in the best interests of the company and all of its shareholders.[640] The certification, thus, "would serve as a safeguard against board nominees who might seek to represent a limited group of shareholders or special interests."[641] One of the commenters supported extending this certification to management nominees as well.[642]

Three of the commenters stated that the notice representations should include an additional certification by the nominating security holder or group that their notice does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made not misleading.[643] According to the commenter, "Such a certification would permit the company to make the determination required by Proposed Rule 14a-11(a)(3) (requiring the company to determine an Election Contest nominee's eligibility based, in part,

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on the absence of false statements in the nominating shareholder's notice to the company)."—

To assist the company in making its determination of whether it must include a security holder nominee in its proxy materials and reduce the risk of a serious dispute following a decision not to include a candidate, one commenter sought additional representations by the nominating security holder or group that it would respond to requests for information by the company.[645]

One commenter believed that the proposed rules governing the contents of the notice should include a "carve-out" from the proposed representation disallowing agreements between company and nominator group.[646] This commenter noted, "Such an exception would permit companies to respond to nominating shareholder concerns and, possibly, prevent the costly and divisive proxy contests that would result from inclusion of Election Contest nominees in company proxy materials."[647]

Two of the commenters believed the representations are appropriate.[648]

H.3. Is it appropriate to require that the notice (other than the copy of the Exchange Act Schedule 13G included in that notice) be filed with the Commission? Should additional or lesser information be filed with the Commission and be made publicly available? Is the proposed filing requirement appropriate? For example, should the notice be filed as an exhibit to an amendment to the nominating security holder or nominating security holder group's Exchange Act Schedule 13G?

At least six commenters responded to the above questions.[649] All of the commenters agreed that the notice (other than the copy of the Exchange Act Schedule 13G included in that notice) should be filed with the Commission.[650]

One of these commenters was careful to note that the notice should be filed and publicly available and made an exhibit to the nominating group's Exchange Act Schedule 13G.[651] This commenter further believed that there should be penalties for inaccurate information, and suggested a bar from participating in a triggering event or nomination for five years.[652] Two other commenters believed the notice should not be filed as an exhibit to the nominating group's Exchange Act Schedule 13G.[653] These commenters also urged that "additional or lesser information" need not be filed with the Commission.[654]

H.4. When should the notice be required to be filed with the Commission? Should it be required to be filed at the time it is provided to the company? Should it be required to be filed within a specified period of time, such as two business days, after it is provided to the company, as is proposed? Should the information in the notice that is included in the company's proxy statement instead be filed on or about the date that the company releases its proxy statement to security holders?

At least five commenters responded to the above questions.[655] Two commenters supported the current approach and urged the Commission to retain the requirement that the notice be filed within two business days.[656] One commenter believed that the notice should be filed with the Commission not later than the next business day after it is provided to the company and suggested that proposed Rule 14a-6(q) be revised accordingly.[657] Another commenter supported filing the notice at the same time it is provided to the issuer.[658]

One commenter believed that the notice should be filed on or about the date the issuer notifies the security holder nominator that its nominee is to be included in the proxy materials.[659] This commenter noted that if a security holder's nominee is not selected for inclusion in the company's proxy statement, for whatever reason, it might cause "needless embarrassment to the nominee to have all of the required information already on file with the Commission and available to the public on the EDGAR site."[660]

H.5. What should be the consequence to the nominating security holder or nominating security holder group of submitting the notice to the company after the deadline? Should such a late submission render the nominating security holder or nominating security holder group ineligible to use the nomination procedure, as is currently proposed under the rule? What should be the consequence to the nominating security holder or nominating security holder

group of filing the notice with the Commission late? Should such late filing be viewed exclusively as a violation of Exchange Act Rule 14a-6 or should it affect eligibility to use the nomination procedure? Should the failure of a nominating security holder or nominating security holder group to file the notice with the Commission be viewed exclusively as a violation of Exchange Act Rule 14a-6 or should it affect eligibility to use the nomination procedure?

Five commenters responded to the above questions.[661] Three of the commenters believed that a company should not be required to include a security holder nominee in its proxy materials unless the nominating security holder or group has provided its notice, and has filed its notice with the Commission, by the required deadlines.[662] Two other commenters agreed that a late *submission* to the issuer should result in the ineligibility of the nominating security holder or group, however, these commenters believed that failure to *file* timely or at all with the Commission should be viewed exclusively as a violation of Exchange Act Rule 14a-6 and should not affect eligibility.[663] The latter two commenters supported granting nominating groups an opportunity to cure any defects in a timely filed notice with the Company or Commission.[664]

H.6. The proposed notice requirements address both regularly scheduled annual meetings and circumstances where a company may not have held an annual meeting in the prior year or has moved the date of the meeting more than 30 days from the prior year. Under these circumstances, what is the appropriate date by which a nominating security holder must submit their notice to the company? We have proposed a standard similar to that currently used in connection with the Exchange Act Rule 14a-8 security holder proposal process. Is such a standard appropriate? If not, what standard would be more appropriate?

Eight commenters responded directly to the above questions.[665] Five of the commenters believed that eighty days was too short a period.[666] The commenters, instead, were unanimous in their support for a submission deadline of 120 days, as currently required for shareholder proposals under Exchange Act Rule 14a-8.[667] Two of these commenters, however, qualified their beliefs regarding the 120-day submission deadline by stating that the deadline was appropriate only for companies without advance notice bylaw provisions that would necessitate earlier submission of the notice.[668]

Two commenters supported the standard set forth in the proposal.[669]

One commenter believed that the notice information is "fairly straightforward" and companies, therefore, "easily should be able to determine compliance with the Proposed Rule within 15 days, leave 15 days for a cure period, and 50 days if [Commission] intervention is needed."[670]

H.7. As proposed, Exchange Act Rule 14a-11 includes a number of notice and other timing requirements. Should these timing requirements incorporate or otherwise address any advance notice provisions under state law or a company's governing instruments? If so, should any advance notice provisions govern? Should they instead be provided as an alternative to the timing provisions set out in the rule?

Eight commenters responded to the above questions.[671] All but two of these commenters favored some form of deference to any existing advance notice bylaw provisions.[672]

One commenter stated that proposed Rule 14a-11 nominations should be required to conform with a company's applicable bylaw requirements, at least to the extent these requirements do not conflict with the express provisions of the proposed rules.[673] This commenter noted that "advance notice bylaws have worked to the benefit of all participants in the director nomination and election process" and urged that the proposed rules not supercede such advance notice bylaws any more than necessary.[674] Three other commenters believed it proper to defer to advance notice bylaws, if any are earlier and currently are in place.[675] One of these commenters remarked, "[W]e urge that the deadline for submission of proposals under the proposed rule should be no later than the first to occur of the last date for submission of proposals under Rule 14a-8 and the last date for valid shareholder nominations as established by advance notice bylaws or similar shareholder or board adopted policies."[676]

Another commenter believed that, notwithstanding the submission deadlines articulated in the proposed rules, advance notice provisions must be independently followed.[677] "Failure to comply with either of the proposed notice requirements or applicable advance notice requirements," according to the commenter, "should disqualify the shareholder from continuing with the nomination (they would need to start over with a new triggering event)."[678]

One commenter supported deference to validly adopted advance notice bylaw provisions, but for companies without such provisions believed that the submission deadline should be eighty days, rather than the 120-day period supported by the commenters noted above.[679]

In light of the strictures of Exchange Act Rule 14a-8, two commenters believed that state law should not allow an issuer to require additional procedural or notice requirements.[680]

XI. What must the company do after it receives such a notice?

I.1. Is it appropriate to require that the company include in its proxy statement a supporting statement by the nominating security holder or nominating security holder group? If so, is it appropriate to limit this requirement to instances where the company wishes to make a statement opposing the nominating security holder's nominee or nominees and/or supporting company nominees? Is it appropriate to limit the supporting statement to 500 words? If not, what limit, if any, is more appropriate? Is it appropriate to require filing of the statement on the date that the company releases its proxy statement to security holders? If not, what filing requirement would be appropriate?

At least eleven commenters responded to the above questions.[681] Eight of the commenters stated that it is appropriate to require that the company include in its proxy statement a supporting statement by the nominating security holder or group.[682] These commenters agreed that the supporting statement should be included irrespective of whether the issuer includes its own supporting statement or statement in opposition to the security holder nominee.[683] They also agreed that the nominating security holder or group should be provided with at least 500 words per candidate or equal space per candidate, whichever is greater.[684]

Three commenters voiced at least some level of objection to the requirement that a company include a supporting statement about the security holder or group nominee in its proxy material.[685] One commenter believed that if it included only statements supporting company nominees, but not a recommendation to vote in favor of the nominees, then it should not be required to include statements on behalf of any security holder nominees.[686] This commenter reasoned, "A statement from the nominating shareholder should be required only if the company says something in opposition to the shareholder's nominee other than a mere recommendation to withhold votes for the candidate."[687] Another commenter believed that the supporting statement should be included in the notice document, which would be an exhibit to the proxy materials, rather than in the proxy materials themselves.[688]

One commenter stated that the requirement to include the supporting statement was "unnecessary in light of the fact that a nominating shareholder is allowed under paragraph (f)(2) [of proposed Exchange Act Rule 14a-11] to conduct solicitations by any means, including through a website."[689] Accordingly, this commenter believed it will be satisfactory if the issuer merely provides in its proxy statement the website address at which a nominating shareholder conducts solicitations.[690] The commenter observed:

> It is likely that the company will be sensitive about what information is mailed on its behalf and that each side will dispute the accuracy of statements in support or opposition. Allowing the company to provide only the website at which a nominating shareholder or group conducts solicitations will avoid the waste of time and resources inherent in such disputes as well as the involvement of the Commission's staff in issues regarding the accuracy of supporting statements.[691]

One commenter asked that the nominating security holder or nominating security holder group's supporting statement be required to include certain information. Specifically, this commenter suggested that all supporting statements include "the name(s) of the nominee(s) of

the board who it recommends be replaced by its own candidate(s) (assuming the nominating shareholder group is making such a recommendation), i.e., specify from which nominee(s) of the board it recommends votes be withheld."[692]

In regard to supporting statements in favor of the security holder nominees, one commenter thought it would be "helpful" if the Commission permitted an issuer to use "an appropriate introduction, heading or lead in to the material submitted by the nominator in support of its nominees."[693] For instance, the commenter suggested that it might be appropriate for an issuer to indicate, "the following statement has been received from a security holder nominator in support of its nominees as required by the rules."[694]

Related Concerns

Several commenters expressed concern about including information in a proxy statement about the nominee of a security holder or security holder group that has been rejected by the issuer and, as such, will not be nominated as a director.[695]

Under the Proposed Rules, if the company makes a determination that it is permitted to exclude the nominating groups nominee, the company is required to so advise the nominating security holder or group and discuss the specific requirement or requirements that permit the company's board not to include the specific nominee and the specific basis for the belief that the company is permitted not to include the specific nominee. The company would then be required to include in its proxy statement for the meeting for which the nominee was submitted a statement that it has made such a determination and the bases for the nominee's exclusion. Several commenters oppose the requirement to include in the proxy statement disclosure regarding the specific bases for excluding a nominee.[696] Explaining the bases for such a position, one commenter noted:

> The specific grounds for excluding a nominee who has not complied with nomination requirements is not material information regarding the subject company or its included nominees on which security holders are voting. Nominees that are excluded for failing to meet nomination requirements should not be entitled to references in the proxy statement, let alone extended discussions.[697]

I.2. Is it appropriate for the company to make the specified determinations regarding the basis on which a nominee would not be included? By what means should a company's determination be subject to review? By the courts? Should there be an explicit statement by the Commission regarding this review? Should any determination by the company be subject to review by the Commission or its staff? Should there be an explicit provision for such review, as, for example, with security holder proposals under Exchange Act Rule 14a-8?

No commenters objected to an issuer making the specified determinations regarding the basis on which a nominee would not be included. Commenters either explicitly supported the ability of the issuer to make such a determination[698] or implicitly acknowledged that the determination appropriately rested with the issuer.[699] One commenter, however, urged that a decision by a committee of an issuer's board to exclude a nominee should be expressly permitted, as some of the grounds for exclusion likely would require only a ministerial decision.[700] Another commenter suggested that an issuer's determination to exclude a nominee should be entitled to a presumption of correctness, provided such decision was made by an issuer's non-management directors.[701]

At least eight commenters urged that the determination be subject to some type of review by the Commission or the Commission's staff.[702] Three commenters believed there should be a similar process for review and litigation as is available under Exchange Act 14a-8.[703] In favoring a Commission-supervised review mechanism over litigation in the court system, one commenter noted, "We think litigation of such a dispute would be costly and protracted, and therefore would vitiate various goals the Proposed Rules seek to achieve. Accordingly, we recommend that any such dispute be subject to expedited review and determination by the Staff, which has the expertise to resolve such disputes."[704] Five other commenters favored a review mechanism involving Commission oversight, but did not clarify whether such

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procedures should be modeled after Exchange Act Rule 14a-8.— One commenter, however, did suggest that any review should be done on a "expedited basis, perhaps three days."[706]

One commenter believed that an issuer should be entrusted with the determination, but, given the "potential burden that would be placed on Commission staff to police largely factual determinations as to nominee qualifications," did not support involving the Commission in any review of that determination.[707]

I.3. Proposed Exchange Act Rule 14a-11(a)(3) provides that a company is not required to include a security holder nominee where either: (a) the nominee's candidacy or, if elected, board membership, would violate controlling state law, federal law or rules of a national securities exchange or national securities association, (b) the nominating security holder's notice is not adequate, (c) any representation in the nominating security holder's notice is false in any material respect, or (d) the nominee is not required to be included in the company's proxy materials due to the proposed limitation on the number of nominees required to be included. Instruction 4 to proposed Exchange Act Rule 14a-11(a)(3) provides that the company shall determine whether any of these events have occurred. Should the nomination procedure include a procedure for a company to gather information additional to that included in the notice that is reasonably necessary for the company to make its determination in this regard? If so, please respond to the following additional questions (discussed separately below).

At least five commenters responded to the question noted above.[708] Three of the commenters prefaced their answers to the sub-questions set forth below by noting their trepidation with any procedure for a company to gather information additional to that included in the notice.[709] These commenters believed that all the information relevant to an issuer's determination whether to include a nominee already was available to the issuer via the proposed disclosure requirements. The commenters also were concerned that issuers might be inclined to spend significant company assets "to, in effect, litigate a nominee's adequacy."[710] As such, the commenters believed that any procedure should be "severely limited"[711] and "restricted to a very short period of time, and shareowners should be given a reasonable amount of time to respond to legitimate requests and to cure defective notices."[712]

Two commenters did not directly address the question at issue, but rather proposed an additional criterion by which an issuer validly could choose not to include a security holder nominee.[713] These commenters supported the ability of an issuer to challenge a nomination that does not meet certain standards of objectivity, independence or qualification.[714] One of the commenters stated, "A company should have an opportunity to challenge a nomination that it believes is frivolous, unqualified or otherwise not solely in the best interests of shareholders."[715] Under this procedure substantive challenges to the company's determination would be brought to the Commission. The nominating security holder or group would have an opportunity to counter the challenge, with the Commission making the final determination. According to the commenter, "[The] procedure would be similar to the procedure by which a company that receives a shareholder proposal can request a "no action" letter from the Commission's staff."[716]

a. Should the company be provided with a maximum amount of time to request specific information (e.g., three days, five days, one week, two weeks, or one month)?

One commenter believed that an issuer should be able to gather additional information "as needed."[717] Explaining its position, this commenter noted, "Meeting dates and agenda items sometimes change, which impact the schedules for preparing, printing and mailing proxy materials."[718] Another commenter proposed that a month is appropriate to accommodate the need for the company to conduct any independent investigation.[719] One commenter suggested a period of three days.[720]

b. Should nominating security holders and/or nominees be provided with a maximum amount of time to respond to such a request (e.g., three days, five days, one week, two weeks, or one month)?

Two commenters suggested a period of two weeks during which the nominating security [721]

holder must respond to issuer requests for additional information.— Another commenter stated that the nominating security holder should provide the requested data on the next business day, provided that the issuer shall provide additional time when practicable.[722] Another commenter suggested five days.[723]

c. Should the procedure prescribe the type of information that a company may request from a nominating security holder or nominee? Should the procedure specify those representations in the nominating security holder's notice to the company with regard to which the company may request information?

One commenter, fearing the potential for abuse by issuers, stated that the type of information that a company may request "should be severely restricted."[724] Another commenter believed that an issuer and its counsel must represent that the information is necessary and demonstrate why, but otherwise saw no need for additional constraints on the type of information sought.[725]

d. Should the procedure include a method for a company to obtain follow-up information after a nominating security holder or nominee submits an initial response? If so, should that follow-up method have similar time frames and informational standards to those related to the initial request and response?

Two commenters stated that a company should have an opportunity to obtain follow-up information after the initial response is submitted.[726] One of the commenters suggested a follow-up timeframe of two weeks.[727] The other commenter stated that the nominating security holder should provide the requested data on the next business day, provided that the issuer shall provide additional time when practicable.[728]

Two commenters again expressed their overriding concern that the process is open to abuse if not significantly restricted.[729]

e. Should the rule explicitly state that a nominee may be excluded from a company's proxy materials if the nominating security holder or nominee does not provide the requested information in the required timeframe, or if the information does not confirm the representations included in the notice to the company, or is it sufficient to rely on the proposed provision that permits the exclusion of nominees when a representation is false in any material respect? In order to facilitate reliance on this proposed provision if a nominating security holder or nominee fails to provide requested information, would it be appropriate to require that a nominating security holder represent that the nominating security holder or nominee will respond to a request by the company for information that is reasonably necessary to confirm the accuracy of representations of the nominating security holder?

Several commenters urged that the rule specifically provide that a nominee could be excluded from a company's proxy materials if the nominating shareholder does not provide the requested information in the required timeframe[730] or the information does not confirm the representations included in the shareholder's notice to the company.[731] The commenters also believed that the shareholder notice should include a representation by the security holder that, upon request by the company, it will provide any information that is reasonably necessary for the company to make its determination.[732]

f. Should this procedure be the same for operating companies, registered investment companies, and business development companies? Should there be unique procedures for different types of entities? If so, what is unique to a particular type of entity that would require a unique procedure?

One commenter responded that the procedures set forth above should not apply equally to operating companies, investment companies, and business development companies.[733] This commenter stated that the procedures "should be targeted to and made relevant for each of the types of entities []."[734]

I.4. As proposed, the company must provide the nominating security holder or nominating security holder group with notice of its determination whether to include in its proxy statement the security holder nominee by a date that will generally fall approximately 30 days prior to the date the company will mail its proxy statement. Does this requirement allow the

nominating security holder or nominating security holder group adequate time to contest a company's determination with regard to a potential security holder nominee? If not, what timing would be more appropriate? Is the timing requirement with regard to the nominating security holder's submission of its statement of support to the company appropriate? If not, what timing would be appropriate?

One commenter stated that the requirement that the company provide the nominating security holder or nominating security holder group with notice of its determination whether to include in its proxy statement the security holder nominee approximately 30 days prior to the company's mailing date would provide the nominating group with adequate time to contest an adverse determination.[735] Seven commenters, on the other hand, believed that 30 days would not provide adequate time to contest an adverse determination.[736]

Four of these commenters did not provide an alternative time frame.[737] One commenter suggested 45 days.[738] Another commenter favored notifying nominee proponents of any adverse decision "no later than 80 days prior to the proposed mailing date of the proxy materials."[739]

One commenter objected to the technical requirements of the proposed rules as they related to notifying the nominating group of the issuer's determination.[740] In particular, the commenter objected to the requirement that the issuer advise the nominating group of the "required form and timing of the proxy disclosure" that the nominating group must submit.[741] According to this commenter, "This is inconsistent with the Commission's intent that the nominating shareholder have full legal responsibility for the shareholder's proxy submission. If a company must guide each nominating shareholder in proper proxy procedures, then some measure of responsibility for the shareholder's compliance with the proxy rules is shifted to the company."[742]

Two commenters did not agree with the timing requirement with regard to the nominating group's submission of its supporting statement to the company.[743] The commenters believed that supporting statements should be provided to the company by the same deadline as the notice to the company.[744] One of the commenters stated, "There is no reason that a 5% shareholder group (which must have been working on the nomination for some time) could not provide its supporting statement at the same time that it submits the name of its candidates. Providing 120 days notice and requiring supporting statements by the same deadline would provide the proposed rule with a much more workable framework."[745]

I.5. As proposed, the rule would not provide a mechanism by which a nominating security holder or nominating security holder group could "cure" a defective notice. Would such a "cure" period, similar to that currently provided under Exchange Act Rule 14a-8, be appropriate? If so, how and by what date should a company be required to notify a nominating security holder or nominating security holder group of a defect in the notice? How long should the nominating security holder or nominating security holder group have to cure any defects? Are there any defects that would not require notice by the company, for example, where a defect could not be remedied?

Eight commenters responded to the above questions.[746] Six of the commenters supported a "cure period."[747] In support of such a "cure period," one commenter expressed concern that the notice and request for additional information process that is set forth above might result in "unforeseen issues and problems" and that companies might use such problems to exclude otherwise valid nominees.[748] The commenter, thus, suggested a notice and cure period if it is determined that a nominee did not provide the requested information on time, or if the information did not confirm the representations included in the notice.[749] The commenter suggested a no-action letter process should be followed if disputes were to arise.[750]

One commenter qualified its support for any "cure period."[751] This commenter stated, "We would favor the idea of permitting the nominator to cure a defect as is currently provided in Exchange Act Rule 14a-8, provided it has only one chance to do so after the company has advised the nominator of the specific problems with the nomination."[752]

Two commenters did not support a cure period.[753] In support of its belief, one of these

commenters noted, "The timetable for the proxy process is so tight that there is no `fat' in the schedule to give proponents a second chance. Given the holding and ownership requirements, it is unlikely that the proponents under Rule 14a-11 will be unsophisticated investors who might be confused."[754]

I.6. As proposed, inclusion of a security holder nominee in the company's proxy materials would not require the company to file a preliminary proxy statement provided that the company was otherwise qualified to file directly in definitive form. In this regard, the proposed rules make clear that inclusion of a security holder nominee would not be deemed a "solicitation in opposition." Is it appropriate to view the inclusion of a nominee in this manner or should the inclusion of a nominee instead be viewed as a solicitation in opposition that would require a company to file its proxy statement in preliminary form? Should we view inclusion of a security holder nominee as a solicitation in opposition for other purposes (e.g., expanded disclosure obligations)?

At least four commenters responded to the above questions.[755] All of the commenters believed that the proposed rule was appropriate and that the inclusion of a shareholder nominee under Exchange Act Rule 14a-11 should not result in the proxy statement being treated as involving a solicitation in opposition that requires filing of a preliminary proxy statement under Exchange Act Rule 14a-6.[756]

I.7. As proposed, the rule would prohibit companies from providing security holders the option of voting for the company's slate of nominees as a whole. Should we allow companies to provide that option to security holders? Are any other revisions to the form of proxy appropriate?

Five commenters supported the proposed prohibition on providing security holders the option of voting for the company's slate of nominees as a whole.[757] In support of this belief, one commenter noted:

> Allowing a shareholder to vote for an entire slate will have the potential effect of discouraging voters from taking the time and effort to identify whether any candidates are contested and to evaluate the qualifications of the competing nominees. Most importantly, many voters might mistakenly believe that the election is not contested.[758]

Instead, the commenters supported a form of proxy with separate votes on each candidate.[759]

One commenter did not express an opinion as to the wisdom of the prohibition against voting for the company's slate of directors as a whole.[760] Rather, this commenter was concerned with drawing a distinction on the form of proxy between issuer nominees and security holder nominees. To reduce confusion among those who vote, this commenter suggested that the proposed rules "expressly permit the company to identify on the proxy card which of the nominees are those of the company, the board or their nominating committee, and which are shareholder nominees under the new procedures."[761]

At least seven commenters opposed the prohibition on providing security holders the option of voting for the company's slate as a whole.[762] According to one commenter, "[B]arring shareholders from voting for a company's nominees as a group could cause confusion for the many shareholders who for decades have been permitted to vote for a company's slate of nominees."[763]

The anticipated general changes to the form of proxy were a significant concern of the majority of these commenters, as well.[764] The commenters stated that the use of a universal ballot containing both management and shareholder nominees, while not allowing a vote for management's nominees as a group, would create the potential for considerable shareholder confusion and disenfranchisement.[765] One commenter stated:

> It is not hard to imagine various scenarios in which a shareholder may, intentionally or by mistake, complete such a proxy card in a way as to ultimately disenfranchise himself or herself:

- It is likely that many shareholders, relying on common practice, will execute a blank proxy card without checking the boxes for any of the nominees, with the result most likely being an invalid proxy card.
- Other shareholders may mistakenly check all boxes, including the boxes for the shareholder nominees and the boxes for all management nominees.
- A shareholder may also check the box only for the shareholder nominees in an effort to underscore his or her support for them or check boxes for some management nominees but less than the number required for a full slate.[766]

To address the potential problems set forth above, the commenters strongly urged that the form of proxy be voted in essentially the same manner that shareholders are used to today.[767] However, several of the commenters recommended "a clear delineation of the management slate and the shareholder nominee(s)" as well as a statement on the face of the proxy card in bold face cautioning, "In order to vote for a shareholder nominee, you must check the box for that nominee and strike a candidate from the management slate."[768] "The more shareholders can rely on what has become customary," one commenter stated, "the lower the risk that a considerable number of invalid proxies will be returned in an election to which the access procedure applies."[769]

XII. How would the liability provisions of the federal securities laws apply to statements made by the company and the nominating security holder or nominating security holder group?

J.1. Is it appropriate to characterize the statements in the nominating security holder's notice as the nominating security holder's representations and not the company's? Does the proposal make clear that the nominating security holder would be responsible for the information submitted to the company? Should the proposal characterize these statements differently? If so, please explain in what manner.

The above questions elicited responses from at least eight commenters.[770] All of these commenters supported the Commission's approach in characterizing the statements in the nominating security holder's notice as the nominating security holder's representations and not the company's.[771]

Several of the commenters believed the proposed rules should contain more detailed assurances that the nominating security holder would be responsible for information submitted to the company.[772] One commenter stated that the rule should "affirmatively state that the company is not required or obligated to investigate the shareholder's statements further in order to reach any type of independent assessment of the veracity of the statements."[773] Another believed that a company should be permitted to make several statements in its proxy materials regarding the statements in the nominating security holder's notice, including: (1) information concerning the nominee was provided by the nominating security holder, not the company; (2) the company has no responsibility or liability for the information; and (3) the nominating shareholder has sole responsibility and liability for the information.[774] This commenter further stated that because the proposed rules state only that the company is not liable for any information provided by the nominating security holder, any final rule "should state clearly that responsibility and liability for any information provided by a nominating shareholder would be imposed solely upon the nominating shareholder."[775]

J.2. Does the proposal make clear the company's responsibilities when it includes such information in its proxy materials? Should the proposal include language otherwise addressing a company's responsibility for repeating statements that it knows are not accurate?

A limited number of commenters responded to these questions.[776] Two of the commenters believed the proposal is clear as it relates to the company's responsibilities when it includes information in its proxy materials.[777] One commenter believed that companies should have no liability for such information, "except when they expressly incorporate it by reference in other filings when they know it to be false."[778]

J.3. Should information provided by nominating security holders or nominating security holder groups be deemed incorporated by reference into Securities Act or Exchange Act filings? Why?

There was unanimous agreement that information provided by nominating security holders or nominating security holder groups should not be deemed incorporated by reference into Securities Act or Exchange Act filings.[779] One commenter sought assurance to this effect in the rule. This commenter stated,

> We believe that paragraph (e) of the rule, in addition to providing that the company is not responsible for any information in the notice from the nominating shareholder or otherwise provided by the nominating shareholder, should specifically confirm that information regarding a shareholder nominee furnished by a shareholder proponent and included in a company's proxy statement in accordance with Rule 14a-11 will not be deemed incorporated by reference in any other SEC filing.[780]

Related Concerns

One commenter believed the Commission should further address liability issues arising from the proposed rules.[781] This commenter suggested that any final rules should include a safe harbor from litigation for various actions taken by a company's board of directors.[782] For example, the commenter suggested that if the Commission moves forward with the possible third trigger related to non-implementation of a majority-vote shareholder proposal, it should include a safe harbor provision "stating that where a company's board has considered a majority-vote proposal and affirmatively determines that it cannot implement the proposal based on the board's fiduciary duty, then: (1) the [nomination procedure] would not be triggered; and (2) no suit or enforcement action could be brought under the rule.[783] The commenter also asked that the Commission provide safe harbors from "application of the proposed [nomination] procedure and from litigation relating to the procedure where the board has met specified obligations under the other proposed triggers."[784]

XIII. How do the other exchange act proxy rules apply to solicitations by the nominating security holder or nominating security holder group?

K.1. What requirements should apply to soliciting activities conducted by a nominating security holder? In particular, what filing requirements and specific parameters should apply to any such solicitations? For example, we have proposed that certain solicitations by security holders seeking to form a nominating security holder group be limited to no more than 30 security holders. Is this limitation appropriate? If not, what limitation would be appropriate, if any (e.g., fewer than 10 security holders, 10 security holders, 20 security holders, 40 security holders, more than 40 security holders)? In addition, is the alternate, content-based limitation appropriate? If not, what limitations would be more appropriate?

Four commenters supported the proposed limited exemptions to the proxy rules.[785] Three of these commenters issued brief, general statements of support for the new requirements.[786] "[I]t is appropriate for the Commission to permit more flexibility for nominating security holders in their soliciting activities, both to form nominating security holder groups and to solicit on behalf of nominees,"[787] according to one of the commenters. The fourth commenter believed the new limited exemptions should be revised to address verbal communications that may accompany the limited and permissible written soliciting materials filed with the Commission.[788] The commenter expressed concern that the verbal communications might go beyond the scope and content of the soliciting materials filed with the Commission. To remedy this perceived problem, the commenter suggested that the new exemptions not be available if a "written communication is accompanied, preceded or followed by verbal communications, formal or informal, which go further than the permitted material in the written communications."[789]

Three commenters urged reconsideration of the new limited exemptions.[790] These commenters believed the new exemptions, in certain instances, needlessly duplicate adequate existing exemptions, inappropriately expand certain existing exemptions, evidence inconsistency with existing exemptions, or require certain clarifications and/or modification.[791]

Two commenters drew attention to proposed Exchange Act Rule 14a-11(f), which creates an exemption for certain solicitations not involving more than 30 persons in connection with the

formation of a nominating security holder group.[792] The commenters believed the 30-person exemption might be used for undeclared control purposes.[793] These commenters believed there is no reason to replace the 10-person exemption set forth in Exchange Act Rule 14a-2(b)(2), which permits limited testing of the waters before application of the notice and filing requirements of the proxy rules.[794]

On the other hand, the commenter believed that eliminating the public filing requirement would open the door to possible abuse.[795] It stated:

> The Task Force believes that more than a majority of the outstanding voting securities of many issuers are controlled by fewer than 30 institutional or other shareholders. In the absence of a public filing requirement, Proposed Rule 14a-11(f)(1)(i) would permit completely undisclosed and unregulated solicitations of such holders to agree to join a nominating shareholder group. Since such an agreement, the Task Force believes, reasonably implies, at the least, a commitment to vote for the nominees of the group, a 30-holder exemption that requires no public disclosure would effectively allow a holder (or group) to secretly solicit support for, and perhaps ensure the election of, its nominee under the rubric of simply forming a nominating group. While this issue is to a degree also inherent in existing Rule 14a-2(b)(2) (solicitation of 10 holders or less), the Task Force believes that enlarging the permitted number of solicitees to 30 greatly increases the danger of turning group formation activities into electoral faits accomplis.[796]

Two of the commenters requested clarification regarding which security holders would be eligible to take advantage of the exemption set forth in proposed Exchange Act Rule 14a-11(f).[797] Given the exemption's purpose, both commenters urged that it should apply only to security holders or security holder groups meeting the nominating security holder eligibility requirements in proposed Exchange Act 14a-11(b)(2), which require the security holder or security holder group to maintain beneficial ownership of voting securities for at least two years before being able to avail itself of the exemption.[798] These commenters also urged that written communications by the soliciting security holder or security holder group under proposed Exchange Act Rule 14a-11(f)(1)(ii) state the number of shares beneficially owned continuously over two years by the security holder or group and advise other security holders that only similarly situated security holders are eligible to become part of the nominating group.[799]

In drawing attention to purported duplication of existing exemptions, one commenter noted Exchange Act Rule 14a-2(b)(1), which, according to this commenter, provides an exemption from the proxy rules "essentially as broad" as that contained in proposed Exchange Act Rule 14a-11(f) for solicitations by persons (other than issuers and certain other proscribed persons) who do not furnish or seek a form of proxy, provided they are not required to file a Exchange Act Schedule 13D.[800] This commenter noted:

> In light of the general requirement in Proposed Rule 14a-11 that any nominating shareholder (or group) that is a 5% holder be eligible to use Schedule 13G and the limitation on the availability of Proposed Rule 14a-11(f)(2) to persons who do not furnish or seek a form of proxy (a standard identical to that contained in Rule 14a-2(b)(1)), the Task Force believes that substantially all persons eligible to take advantage of the new proposed exemption for Rule 14a-11 situations, whether in soliciting others to form a nominating shareholder group or in conducting solicitation activities in support of a Proposed Rule 14a-11 nomination, would be equally eligible - and might well choose - to rely on Rule 14a-2(b)(1).[801]

Addressing purported inconsistencies with existing proxy rules, this commenter drew attention to the limitation on permissible content set forth in proposed Exchange Act Rule 14a-11(f)(1)(ii).[802] This commenter first noted that the exemption contemplated by proposed Exchange Act Rule 14a-11(f)(1) would establish either a numerical limit on solicitees or a severe limitation on content in written solicitation materials, together with a date of first use filing requirement.[803] The commenter, however, noted the fact that parties eligible for the exemption set forth in Exchange Act Rule 14a-2(b)(1), a class that arguably should include all persons intending and eligible to engage in a proposed Exchange Act Rule 14a-11 nomination, are permitted to conduct solicitations with persons without regard to the number

of persons and without limitation on the content of written materials, provided all written materials are furnished to the Commission within three days of first use, if the soliciting party owns more than $5 million of the securities.[804] The commenter concluded, "Since the class of persons eligible to take advantage of Rule 14a-2(b)(1) would appear, as noted above, to include substantially all persons intending and eligible to engage in a Proposed Rule 14a-11 nomination, we question whether the proposed new exemption serves a useful purpose."[805]

K.2. Should communications in connection with a direct access security holder proposal, for example by security holders seeking to form a more than 1% group to submit a security holder proposal, be included in the exemption provided for communications between security holders seeking to form a nominating security holder group? Would such an exemption be necessary and/or appropriate? If so, what parameters should apply?

At least three commenters responded to the questions posed above.[806] One of the commenters framed its response by first noting its general dissatisfaction with the proposed exemptions from the proxy rules for activities related to the formation of a nominating security holder group and solicitations conducted by such nominating group.[807] The commenter then stated that any further exemptions from the proxy rules for solicitations to form a group to submit an opt-in security holder proposal are neither necessary nor advisable.[808] This commenter believed the proxy rules and exemptions currently in force (as well as Exchange Act Regulations 13D-G) "provide a tested and adequate framework with minimal interference and appropriate safeguards for communications among shareholders."[809] Another commenter remarked briefly that the proposed rules should "ensure that the exemption be limited to solicitations solely for the limited purpose of forming a nominating security holder group and not for any other purpose."[810]

The third commenter stated that, in its opinion, the communications for the purpose of forming a group to submit an opt-in security holder proposal are likely already exempted.[811] In the event that such communications are not exempted, this commenter suggested that they should be included in the exemption.[812]

K.3. Should all soliciting materials be filed with the Commission on the date of first use? For example, as proposed, security holder communications that are limited to no more than 30 security holders would be filed with the Commission. Would such filing render the limitation unworkable in that the communication would be readily accessible to security holders on EDGAR?

One commenter believed that the solicitation material should be filed with the Commission within three days after first use.[813] Requiring disclosure of the materials at an earlier date, according to this commenter, "may provide for numerous inadvertent violations of the law without any corresponding benefit."[814]

Three commenters addressed the requirement in proposed Exchange Act Rule 14a-11(f)(1)(iii) to file on EDGAR all written materials used by a security holder on the date of first use.[815] The public filing requirement, according to the commenters, would render the 30-person limitation of proposed Exchange Act Rule 14a-11(f)(1)(i) "essentially meaningless" because, even if initially directed to fewer than 30 persons, the filing requirement would make the solicitation materials, and thus the intentions, identity, and activities of the soliciting security holder, available to an unlimited audience.[816] One of the commenters further noted that because there is no limitation on the content of written materials used (and filed) in reliance on proposed Exchange Act Rule 14a-11(f)(1)(i), public filing of such materials effectively would "gut" the content limitation in proposed Exchange Act Rule 14a-11(f)(1)(ii).[817]

K.4. We contemplate that solicitations in connection with elections involving Exchange Act Rule 14a-11 could involve electronic means. We have provided that, where requested, the company would include in its proxy materials the website address where solicitation materials related to a security holder nominee may be found. Are there other steps that we should take to provide for or encourage the use of electronic means for these elections?

Two commenters responded to the above question or to related issues.[818] One commenter asked that paragraph (f)(2) of proposed Exchange Act Rule 14a-11 "clarify that the word

`communication,' as used to refer to any soliciting communication, includes all materials posted on such website as well as all electronic communications."[819] This commenter reasoned that it is essential that the public have access to all information that is being used on behalf of a nominee.[820] Another commenter suggested that the Commission create and maintain a central, dedicated website that would facilitate and ease soliciting activities.[821] The dedicated website would, among other things, "capture data related to the company's nominating committee, nominating committee policies, track record of responding to shareholder concerns, number and type of contested elections, number of nominees proposed and elected and criteria for considering nominees."[822]

XIV. How would the proposed rule apply to investment companies?

This section of the Proposing Release elicited responses from a limited number of commenters. The commenters generally were comprised of investment advisers and the investment companies advised by such entities, the investment company trade association, and a legal association.

L.1. Should the proposed security holder nomination procedure apply to funds? If so, to which funds should it apply? Are there any aspects of the proposed nomination procedure that should be modified in the case of funds?

At least five commenters responded to the above questions and all such commenters were in agreement that the proposed rules should apply to investment companies.[823] One commenter, however, noted that the structure of investment companies warranted a slight modification or clarification in the proposed rules. This commenter pointed out that numerous open-end investment companies are structured as "series" funds. Series funds consist of one or more separately managed series portfolios, each with its own investment objective, policies, and restrictions. Portfolios generally are recognized as separate entities for many purposes, however they are not viewed as separate entities for purposes of electing a board of directors (or trustees, as the case may be). This commenter further noted that typically, the shareholders of all portfolios, in the aggregate, vote to elect a single board of directors, which oversees the functions of all portfolios of the series fund. The final rule, according to this commenter, "should clarify that it applies to the series fund in its entirety, and not to the individual portfolios that comprise the series fund."[824]

L.2. Should we apply the "interested person" standard of Section 2(a)(19) of the Investment Company Act with respect to the representation that a security holder nominee be independent from a company that is a fund? Should the "interested person" standard also apply to security holder nominees for election to the board of directors of a business development company? Should we instead apply a different independence standard to funds or business development companies, such as the definition of independence in Exchange Act Rule 10A-3?

In response to these questions, two commenters noted their support for the approach requiring any nominating security holder or security holder group to represent that its nominee to the board of a fund is not an "interested person" of the fund as defined in Section 2(a)(19) of the 1940 Act.[825] One commenter called the approach "critical," pointing out that if a security holder nominee was not required to satisfy the Section 2(a)(19) requirements and such a nominee was elected director, that investment company might be confronted with the responsibility of either removing a director who is an interested person or adding an independent director in order to assure that it continues to have a sufficient number of independent directors.[826] The second commenter also recognized the importance of nominees not being interested persons.[827] This commenter suggested that there be a requirement that each security holder nominee promptly complete a director's questionnaire provided by the fund's nominating committee (or board members serving a similar function).[828] The added layer of due diligence to assist in determining whether a nominee qualifies as a disinterested person, according to the second commenter, is "essential, especially in the case of funds with several sub-advisers, as the failure to qualify as a disinterested trustee could have serious consequences for an investment company and its shareholders."[829]

The second commenter also recommended that the rule address situations where a director has been elected based on a nominating security holder's representation that the individual is not an "interested person" of the fund, but that representation is later determined to be incorrect.[830]

The commenter suggested that the rule "should provide exemptive relief to the effect that all actions taken by the board in reliance on the nominator's representation shall be valid notwithstanding the 1940 Act provision that would treat the board as improperly constituted."[831] Finally, this commenter, in order to "further ensure the integrity of the shareholder nomination process, and to ensure the independence of director nominees," recommended that the Commission require in the case of investment companies that each director nominee not be an "interested person" (as defined by Section 2(a)(19)) of the nominating security holder or group of security holders.[832] According to this commenter, "This independence requirement would be consistent with the Commission's stated purpose of strengthening the independence of fund boards, while further ensuring that access is not abused to serve special interests."[833]

L.3. Is it appropriate to require a nominating security holder or group of security holders of a mutual fund to provide disclosure of its 5% beneficial ownership of the fund's securities in its notice to the fund of its intent to require its nominee on the fund's proxy card? If so, what requirements from Exchange Act Schedule 13G (or other information) should be required to be included in the notice? Should such a security holder or group instead be required to file on Exchange Act Schedule 13G upon reaching the 5% beneficial ownership threshold, in order to provide the fund with notice in advance that the security holder or group has reached this threshold? If so, are there any requirements of Exchange Act Schedule 13G that should be modified for this purpose?

Two commenters responded to the above questions. Both commenters believed that upon reaching the 5% beneficial ownership threshold, a security holder or group should be required to file on Exchange Act Schedule 13G.[834] In addition to requiring an Exchange Act Schedule 13G filing, one commenter suggested that each group formed to achieve the objectives permitted by the Commission's proposal should be required to amend the filings upon any material change in the percentage of beneficial ownership covered by the filing, and file a final amendment to Exchange Act Schedule 13G upon termination of the group.[835]

L.4. Are the triggering events proposed for use of the security holder nomination procedure appropriate for funds? Are there other nomination procedure triggering events that should be used?

At least two commenters addressed the above questions.[836] One commenter recommended a further modification of the proposed rules as they relate to investment companies.[837] According to this commenter mutual funds have "highly fragmented investor bases consisting overwhelmingly of individuals rather than institutions."[838] As such, this commenter recommended that the Commission "grant mutual fund shareholders holding at least 1⁄2% of the [fund shares] the right to place nominees in the mutual fund's proxy without any triggering event requirement."[839] Less restrictive access to the proxy of mutual funds was further warranted, according to this commenter, by the fact that the general industry practice of holding annual meetings only once every three years would create a six-year delay before security holders could nominate directors (or "elect directors").[840]

A second commenter believed the triggering events proposed were generally appropriate for investment companies.[841]

L.5. Should a fund be required to provide disclosure on Form N-CSR of whether it would be subject to the security holder nomination procedure as a result of a security holder vote with regard to any of the nomination procedure triggering events, and the required disclosure regarding such a nomination procedure triggering event? Will this disclosure allow sufficient time for a security holder to effectively exercise the nomination procedure? Should this disclosure instead be required on a different form?

Two commenters responded to the above questions.[842] Both commenters supported the proposed approach of tailoring the disclosure requirement for investment companies by requiring this disclosure to appear on Form N-CSR.[843]

L.6. We are proposing to delete as duplicative Item 77C of Form N-SAR, which currently requires disclosure regarding matters submitted to a vote of security holders similar to that required by Item 4 of Part II of Exchange Act Form 10-Q, and move this disclosure to Form N-

CSR. Should this disclosure remain in Form N-SAR?

One commenter responded to the above question.[844] This commenter supported the Commission's determination to delete as duplicative similar disclosure that currently appears on Form N-SAR.[845]

L.7. Should a fund be required to disclose on Exchange Act Form 8-K the date by which a security holder or security holder group must submit the notice to the fund of its intent to require its nominees on the fund's proxy card? Should funds instead be permitted to provide this disclosure in a different manner?

Two commenters responded to the above questions.[846] One commenter urged the Commission not to adopt the Exchange Act Form 8-K filing requirement for investment companies.[847] This commenter noted that investment companies typically are not required to file Exchange Act Forms 8-K. This commenter believed it is not necessary or appropriate to subject investment companies to Exchange Act Form 8-K reporting for the purpose of notifying their security holders of the date by which they must submit a notice of intent to nominate a director on the company's proxy statement.[848] Instead, this commenter recommended that the Commission require investment companies to inform security holders of this date through a different method (or combination of methods) of disclosure that is "reasonably designed to provide notice of the date to their security holders."[849] The commenter suggested that such methods could include, but would not be limited to, a press release or posting information on the company's website.[850]

A second commenter did not address explicitly the question of whether Exchange Act Form 8-K disclosure was necessary; instead, this commenter stated that the Commission should "create a web site [sic] specifically designed to facilitate this type of disclosure activity."[851]

XV. Beneficial Ownership Reporting Requirements - Rule Changes

M.1. The proposal would provide that a security holder or security holder group would not, solely by virtue of nominating a director under proposed Exchange Act Rule 14a-11, soliciting on behalf of that candidate, or having that candidate elected, be viewed as having acquired securities for the purpose or effect of changing or influencing the control of the company. This provision would then permit those holders or groups of holders to report their ownership on Exchange Act Schedule 13G, rather than Exchange Act Schedule 13D. Is this approach appropriate? Should other conditions be required to be satisfied? If so, what other conditions?

At least eight commenters agreed, either explicitly or implicitly, with the Commission's view that a security holder or group of security holders nominating a director under the proposed rules, should not be considered, merely as a result of such nomination, to be "controlling" the company in question.[852]

One of the commenters, however, urged that the proposed rules require security holders or groups making nominations under proposed Exchange Act Rule 14a-11 to retain this lack of a control purpose through the date of the relevant security holders meeting.[853] Another commenter went further and stated:

> The Commission should amend Schedule 13G to require that a nominating shareholder or group whose nominee has been elected to the board under proposed Rule 14a-11 must file amendments to its Schedule 13G if anything comes to the attention of the shareholder, following the submission of its notice under paragraph (c) of the proposed rule, that will not allow the shareholder or group to provide any of the representations required to be included in that notice. This would include a situation where the shareholder or any member of the shareholder group subsequently forms a relationships with the director elected as its nominee that would be disallowed by paragraph (c)(3) of the proposed rule. Clearly, the purpose of the paragraph (c)(3) representations will be undermined if the nominating shareholder develops any of the covered relationships with the director following his or her election to the board, such as if it subsequently employs the director or otherwise makes payments to him or her, particularly if it

> would allow the shareholder to influence the director's vote. Similarly, if the nominating shareholder subsequently discovers that any of its representations to the company were inaccurate (such as that the candidate does not meet the objective criteria for independence in applicable listing standards), the shareholder should be required to provide public notice. Furthermore, we suggest that if the nominating shareholder does develop any such relationships or discloses that any of the representations contained in the shareholder's notice under paragraph (c) of the proposed rule was not accurate, the shareholder or group should be prohibited from making a nomination under the access procedure for the subsequent three shareholder meetings.[854]

At least five commenters stated that nominating security holders or groups using the nomination procedure clearly are engaging in a control activity and, as such, those holders or groups should be required to file an Exchange Act Schedule 13D providing issuers and their security holders with the additional disclosures called for under Exchange Act Schedule 13D within the specified time periods.[855]

M.2. Should nominating security holders, including groups, be deemed to have a "control" purpose that would create additional filing and disclosure requirements under the Exchange Act beneficial ownership reporting standards?

At least three commenters explicitly addressed this question in the negative.[856] Another commenter that explicitly addressed the above question reached a different conclusion. This commenter stated, "[A]ttempting to influence or control the nomination and election of directors is clearly a control activity."[857] As noted elsewhere in this summary, a number of other commenters expressed the belief that that any nominating security holder or group using the access mechanism should be required to file a Schedule 13D.[858] One such commenter called the act of joining a nominating group "an act obviously designed to influence the management and control of the company."[859]

M.3. As proposed, security holders that intend to nominate a director pursuant to Exchange Act Rule 14a-11 would be required to disclose this intent on Exchange Act Schedule 13G. Those filers who originally filed an Exchange Act Schedule 13G without an Exchange Act Rule 14a-11 intent would be required to amend their Exchange Act Schedule 13G to disclose such intent if it exists. Is it appropriate to require such an amendment by existing filers? If not, how should such filers indicate their intent to make a nomination pursuant to Exchange Act Rule 14a-11? Are the security holder notice requirements of Exchange Act Rule 14a-11(c) sufficient for this purpose? Intent to use the nomination procedure would be evidenced in both new filings and amendments to already-filed Schedules by the beneficial owner checking the box on the cover page of the Schedule to identify the filing as having been made in connection with a nomination under the procedure and by making the proposed new certification regarding ownership of the required amount of company securities. Is this sufficient notice of the beneficial owner's intent to use the nomination procedure? Should we also require new disclosure related to such intent in a new item requirement to the Schedule? Would this be appropriate in light of the fact that Exchange Act Schedule 13G currently does not require such "purpose" disclosure?

Three commenters responded to the questions posed above.[860] All three of the commenters agreed that existing Exchange Act Schedule 13G filers should be required to amend the filing to notify the public of their new intent if they choose to nominate a director pursuant to proposed Exchange Act Rule 14a-11.[861] Two of the commenters did not address the adequacy of the proposed cover page "check-the-box" disclosure, but noted that the Commission "should facilitate the ease of compliance by amending all forms where helpful."[862] The third commenter noted the "check-the-box" disclosure, but suggested that the Exchange Act Schedule 13G filings or amendments disclosing a filer's intent to make a nomination also be "coded or tagged to easily distinguish those Schedule 13Gs on the Commission's web site from other Schedule 13Gs."[863]

Three commenters submitted comments that urged the Commission to require additional disclosures in the Exchange Act Schedule 13G filings of nominating security holders or nominating security holder groups wherein those parties noted their intent to form a nominating group.[864] These commenters believed that the limited disclosure called for by

Exchange Act Schedule 13G is "inadequate" and that filers should be required, in connection with the initial filing for proposed Exchange Act Rule 14a-11 purposes or an amendment to an existing filing to include such purpose, to provide more detailed information about the filer and its security ownership. One commenter noted that an expanded Exchange Act Schedule 13G "would assist the company in analyzing the nominee's eligibility and the accuracy of the nominating shareholder's notice."[865]

All three of the commenters supported inclusion of the information required by Item 6 of Exchange Act Schedule 13D.[866] Additional Exchange Act Schedule 13D disclosures sought were as follows: one commenter supported disclosure of the information required by Item 5,[867] another supported disclosure of the information required by clause (3) of Item 7,[868] and a third supported disclosure of the information required by Item 2.[869]

M.4. As proposed, nominating security holders and nominating security holder groups would be required to amend their Exchange Act Schedule 13G filings in accordance with the existing timing requirements for qualified institutional investors and passive investors. Should we instead require that such filers amend on a more expedited basis? For example, should such filers be required to report changes in the information reported previously promptly after such change or within another, specified period of time? Should amendments be limited to material changes in the information reported if such an expedited requirement is used? Should the election as director of a nominating security holder group's nominee be deemed the termination of that group (provided that the group does not have an agreement to act together for some other purpose)? Should such an election require an amendment to the nominating security holder or nominating security holder group's Exchange Act Schedule 13G?

Six commenters responded to the above questions.[870] One commenter believed the Exchange Act Schedule 13G requirements are adequate.[871] Four commenters, however, stated that the existing timing requirements for Exchange Act Schedule 13G filers are not adequate.[872] One of the commenters noted:

> [B]oth first time and existing filers should be required to file or amend promptly to disclose the intention to make the nomination. The Task Force believes that, in some cases, the fact that a significant stockholder or group has formed an intent to make a Proposed Rule 14a-11 nomination would be material information that could affect the trading of the company's stock.[873]

In regard to the question of filing an amendment to an Exchange Act Schedule 13G, one commenter stated that nominating security holders or groups should have to amend filings upon any material change in the percentage of beneficial ownership covered in the filing. This commenter did not address the timing requirements for any such amendment.[874]

Four commenters addressed whether the election of a security holder nominee should terminate a nominating group and whether that election requires an amendment to the nominating group's Exchange Act Schedule 13G.[875] Two commenters agreed that the election necessarily should terminate the nominating security holder group.[876] One commenter, however, believed that termination of that group should be reflected in an amendment to the security holder's Exchange Act Schedule 13G.[877] The second commenter, on the other hand, suggested that the rules "include an assumption (if true) that the holder or group's nomination intent only applies to the company's next annual meeting following the filing or amendment of the applicable Schedule 13G, thereby vitiating the need for a filing to terminate the group."[878] Two other commenters expressed concern with regard to "continuing actions in concert" by a security holder group formed exclusively for the nominating purpose under the proposed rules.[879] These commenters asked that the proposed rules clarify that once a nominee supported by the Exchange Act Schedule 13G group either has been elected or defeated the group should be dissolved immediately following the annual meeting at which its nominee was elected/defeated by the filing of a final amendment to its Exchange Act Schedule 13G.[880] According to one of the commenters, "This [clarification] will also be necessary to make sure that the proposed Instruction to paragraphs (b) and (c) of [Exchange Act] Rule 13d-1 will not be able to be used to mask continuing group activities beyond the scope of the original reason for forming the shareholder group."[881]

M.5. Are there any qualified institutional investors under Exchange Act Rule 13d-1(b) that would be qualified to file on Exchange Act Schedule 13G but should not be included in the category of filers who may nominate a director using the proposed procedure? If so, please explain why.

Two commenters responded to the questions posed above.[882] Neither commenter identified any institutional holders that per se should be excluded.[883] One of the commenters, however, did urge that security holders that disclaim beneficial ownership of shares should not be permitted to count such shares for purposes of determining whether the security holder owns a sufficient number of shares to make nominations under Proposed Rule 14a-11.[884]

M.6. A related issue with regard to beneficial ownership reporting is whether the withhold votes nomination procedure trigger may result in increased numbers of "vote no" campaigns by security holders who are attempting to trigger the nomination procedure. The possibility of triggering Exchange Act Schedule 13D reporting requirements currently may have a chilling effect on security holders who otherwise would organize such an effort. With regard to this concern, do the current rules under Exchange Act Regulation 13D have such a chilling effect? Are the current rules sufficient to determine when such activities should require additional security holder filings? Should security holders who organize such a campaign be deemed to have a control purpose or effect that would necessitate filing on Exchange Act Schedule 13D rather than Exchange Act Schedule 13G? Should we issue specific guidance with regard to these "vote no" campaigns and the beneficial ownership reporting requirements generally? Should any such guidance be limited to circumstances where the security holder engaging in the "vote no" campaign does so solely to trigger the security holder nomination procedure?

At least two commenters explicitly stated that the current rules are a deterrent to pursuing "vote no" campaigns.[885] One of these commenters noted that the current rules, and legal advice they have received regarding the application of such rules, have prevented them from pursuing a "more vigorous vote no campaign" against companies that fail to implement a majority-vote shareholder proposal.[886] The commenter urged the Commission to address the issues related to "vote no" campaigns by investors that do not want to control a company, but rather wish to communicate their dissatisfaction to unresponsive issuers and directors.[887]

The responses of at least five other commenters indicated that, as they related to "vote no" campaigns, the current rules were cause for a significant amount of uncertainty.[888] One of these commenters called on the Commission to establish a safe harbor for "short slate" campaigns that do not seek a board majority and "vote no" efforts in which security holders urge other security holders to simply withhold votes from directors.[889] Another commenter issued a broad appeal to the Commission for "specific guidance regarding `vote no' campaigns."[890]

The remaining commenters believed the withhold vote triggering event risked so-called "stealth withhold vote campaigns" because the proposed rules do not require sponsors of a withhold vote campaign to give notice to the issuer or to security holders of their campaign or their reasons for it, nor do they have to make any filings with the Commission so long as they do not solicit proxies (which are not needed for withholding votes) and do not form a 5% or greater group.[891] These commenters stated that, given the probable increase in the significance and number of "vote no" campaigns, the proposed rules should be revised to require such campaigns to be exposed to public light.[892] This could be done, according to the commenters, by establishing rules providing that any solicitations conducted by security holders to withhold the vote on any nominee would be deemed a "solicitation" as defined in Exchange Act Rule 14a-1(l) (subject to the exemptions contained in Rule Exchange Act 14a-2(b)).[893] According to one commenter:

> This would ensure that shareholders holding more than $5 million of market value of the company's shares would be required publicly to file any written materials used in connection with a `withhold the vote' campaign and reduce the prospects of an organized stealth campaign targeting incumbent directors. Making `withhold the vote' campaigns subject to a public filing requirement will serve the interests of all shareholders by disclosing who is actively seeking to cause the triggering event to occur. At the same time, shareholders engaged in such an activity could still take advantage of Rule 14a-1(l)(2)(iv), allowing public

statements of how a security holder intends to vote, and oral solicitations not covered by any filing requirements.[894]

XVI. Proposed amendments to rules under Exchange Act Section 16

N.1. Would the proposed Exchange Act Rule 16a-1(a)(1) amendments address nominating security holders and nominating security holder groups appropriately? Should the proposed exclusion be based on any additional or different conditions?

Commenters were in unanimous agreement that a group formed solely for the purpose of nominating a director pursuant to proposed Exchange Act Rule 14a-11, soliciting in connection with the election of that nominee, or having that nominee elected as director, would not be the type of group that should be viewed as being aggregated together for purposes of Exchange Act Section 16.[895] Such agreement extended to the belief that amendments are required to Exchange Act Rule 16a-1(a)(1) to exclude bona fide nominating shareholder groups from the definition of a 10% "beneficial owner" for Exchange Act Section 16 purposes.[896]

One commenter, while supportive of the proposed amendments, believed that the rule amendments should ensure that any nominating security holder group remain subject to the general condition of the proposed rules that they not have the purpose or effect of changing or influencing control of the issuer.[897] Security holder nominating groups, according to this commenter, should be protected from being subject to the requirements of Exchange Act Section 16 "only to the extent that they do not have a `control' purpose or effect."[898] This commenter expressed concern about the proposed rules and stated, "As drafted, the Proposed Rules appear to grant [] protection to all members of nominating groups that do not have a control purpose at the time of the nomination, even if that member, or the group as a whole, changes its purpose to a traditional `control' purpose after making the nomination." As such, the commenter proposed that new paragraph (a)(1)(ii)(K), which is part of the Commission's proposed amendment to Section 16a-1(a)(1), should be refined to address this potential oversight.[899] The commenter further believed that the accompanying Note should be revised to clarify the circumstances where solicitation against a director nominated by the company is deemed not to be a control purpose.[900]

N.2. If the Commission adopts a security holder nomination rule with an eligibility threshold of 10% or greater, would Exchange Act Section 16 reporting and short swing profit liability deter the formation of nominating security holder groups?

At least two commenters addressed the issue set forth above.[901] Both commenters noted briefly their belief that Exchange Act Section 16 reporting and short-swing profit liability might deter the formation of a nominating security holder group.[902]

XVII. Cost Benefit Analysis

O.1. We solicit quantitative data to assist our assessment of the benefits and costs of enhanced security holder access to company proxy materials when there has been a demonstrated failure in the proxy process. Will proposed Exchange Act Rule 14a-11 increase director accountability and responsiveness? If so, what costs would be incurred in instituting responsive policies and procedures? Will more accountability and responsiveness lead to better managed boards? What effects, if any, would increased accountability and responsiveness have on the board's time spent in its duties overseeing management?

Commenters did not provide quantifiable data responsive to the questions noted above.

O.2. We solicit quantitative data on the potential increases, if any, of security holder proposals under Exchange Act Rule 14a-8 as a result of these proposed rules. We also solicit quantitative data on how often the two triggering events that would activate proposed Exchange Act Rule 14a-11 would occur.

One commenter believed the Commission underestimated significantly the number of entities that would be affected by the proposal.[903] The commenter stated that 290 to 580 exchange-traded companies likely would face a "valid security holder nominee proposal" every year.[904]

The commenter did not quantify the number of entities listed on a national securities association that likely would be impacted.[905]

One commenter did not directly address the issues noted above, but took issue with the quantitative data used by the Commission to support the thresholds contained in the two triggering events.[906] The commenter believed that the Commission underestimated significantly the degree to which the nomination procedure will be triggered.[907]

In this regard, the commenter suggested that the Commission's analysis of the frequency with which the opt-in shareholder proposal event will be triggered is flawed because the data focuses primarily on the number of individual security holders with a greater than 1% stake, while the proposed rule provides that individual security holders and groups of security holders can file an opt-in proposal.[908] The commenter suggested the data presented in connection with the withhold votes trigger is similarly flawed because it measures withhold votes at the full board level, whereas the withhold votes trigger applies when any individual director receives greater than 35% withhold votes.[909] The commenter further suggested that the historical data provided in connection with each of the triggers does not recognize adequately the impact that institutional investor voting practices will have on the number of direct access proposals and withhold votes campaigns.[910]

O.3. We solicit quantitative date on the time and cost spent in preparing a no-action request to exclude a proposal under Exchange Act Rule 14a-8, the incremental cost spent to print and mail such a security holder proposal and to include a security holder nominee and his/her background information in the proxy materials, and the cost borne by both companies and security holders to solicit security holders regarding a direct access security holder proposal and election of a nominee or nominees to the board.

One commenter presented two vastly different analyses addressing the anticipated costs of the proposal, but cautioned that the final estimates likely represented the upper and lower boundaries, respectively, of the anticipated costs.[911] The first estimate borrowed data from a survey of proxy contests in the late 1980s that showed that insurgents spent an average of $1.8 million and incumbents an average of $4.4 million.[912] Using that data as a baseline, the commenter then assumed that issuers would face "contested elections" under proposed rule every three years and that the costs of the "contested elections" would be approximately one-third the cost of a full proxy contest.[913] Accordingly, this commenter stated that, based on the foregoing assumptions, each public corporation would face annualized costs of about $500,000.[914] The second analysis used the annual cost of Exchange Act Rule 14a-8 shareholder proposals as a baseline. The commenter used Commission data that placed the cost per company of including a shareholder proposal in the proxy statement at $87,000.[915] Next, the commenter noted that ISS had tracked 1,042 shareholder proposals at public corporations during the 2003 proxy season. The product of these two figures resulted in total annual corporate expenditures on shareholder proposals of $90,654,000.[916]

Two commenters presented data from November 2003 surveys ("November 2003 Surveys") that collected data from 137 public companies regarding the proposal.[917] As it related to the quantifiable costs of the proposal, one of the commenters stated that the November 2003 Surveys indicated that adoption of the proposed nomination procedure would result in an additional total burden of more than 500 hours and $700,000 per "affected" issuer.[918] In particular, the average burden and cost for each "affected" issuer in connection with opposing the occurrence of a trigger would be 192.3 hours and $162,299, and the average burden and cost in connection with opposing a security holder or security holder group nominee and supporting the company's nominees would be 323.9 hours and $580,321.[919] The commenters qualified the results by noting:

> Several important observations are pertinent to a full understanding of these results. First, the responses to the November 2003 Surveys in many cases required an element of interpretation. These compilations were performed in a conservative manner that, if anything, would understate the respondents' true projected costs. When the respondent provided a range of hours or cost, the midpoint of this range was used to calculate averages. When the respondent stated that hours or costs would be `at least' or `more than' a certain amount, the base amount was included

> in the average without upward adjustment, but when the respondent stated that hours or costs would be `at most' or `less than' a certain figure, the average was computed based on the midpoint between the given figure and zero. When the response reported time or cost `per person' and the number of relevant individuals could not be easily ascertained, the time or cost was applied to a minimal number of individuals, and in many cases to just one individual.[920]

Selected data from the survey is copied below, as presented by the two commenters in their remarks submitted to the Commission.

WHAT WILL BE THE AVERAGE HOURS REQUIRED AND ASSOCIATED COSTS FOR:	HOURS REQUIRED:	ASSOCIATED COSTS:
Preparing and submitting a no-action letter request to the SEC regarding a shareholder proposal?	**30.8 hours** (3360.5 hours/ 109 companies responding)	**$13,896** ($1,431,282/ 103 companies responding)
Printing and mailing one shareholder proposal in your proxy materials?	**34.0 hours** (3023.5 hours/ 89 companies)	**$15,324** ($1,547,762/ 101 companies)
In connection with opposing the occurrence of a trigger (*e.g.*, a shareholder access proposal from a greater than 1% holder or a 35% withhold vote for a director), please estimate the hours and associated costs:		
Company personnel (including executives)?	**89.5 hours** (8324.5 hours/ 93 companies responding)	**$39,363** ($3,109,700/ 79 companies responding)
Directors?	**13.4 hours** (1191.5 hours/ 89 companies)	**$11,971** ($706,300/ 59 companies)
Outside counsel?	**54.2 hours** (4391 hours/ 81 companies)	**$23,138** ($1,989,850/ 86 companies)
Proxy solicitor?	**105.2 hours** (6313 hours/ 60 companies)	**$77,864** ($6,151,250/ 79 companies)
Financial printer?	**9.9 hours** (426 hours/ 43 companies)	**$16,757** ($1,206,550/ 72 companies)
Mailing costs?	**10.7 hours** (171.5 hours/ 16 companies)	**$97,800** (5,867,980/ 60 companies)

Average total of specified hours and costs:	**192.3 hours** (192.3 hours/ 92 companies)	**$162,299** ($15,256,150/ 94 companies)
Other: Outside experts	(0 companies)	**$25,000-$100,000** (1 company)
Other: Follow-up mailings	(0 companies)	**$40,000** (1 company)
Other: NOBO list (non-objecting beneficial owners)	(0 companies)	**$20,000-$25,000** (1 company)
Other: Transfer agent tabulation services, inspector of election	**150 hours** (1 company)	**$100,000** (1 company)
Other: Independent tabulator extra charges for contested situations	(0 companies)	**$5,000-$10,000** (1 company)
Other: Transfer agent/ADP assistance	**5-10** (1 company)	(0 companies)
In connection with opposing a shareholder access nominee and supporting the company's nominees for director (once shareholder access is triggered), please estimate the hours and associated costs:[5]		
Company personnel (including executives)?	**182.7 hours** (15,527/ 85 companies responding)	**$69,497** ($5,212,260/ 75 companies responding)
Directors?	**21.6 hours** (1729/ 80 companies)	**$26,239** ($1,416,900/ 54 companies)
Outside counsel?	**59.4 hours** (4218.5/ 71 companies)	**$44,460** ($3,512,350/ 79 companies)
Proxy solicitor?	**126.8 hours** (6217.5/ 53 companies)	**$136,292** ($10,767,050/ 79 companies)
Financial printer?	**16.2 hours** (665/ 41 companies)	**$31,854** (2,420,900/ 76 companies)
Mailing costs?	**13.9 hours** (236/ 17 companies)	**$168,442** ($10,948,710/ 65 companies)
Average total of specified hours and costs:	**323.9 hours** (27208.5 hours/ 84 companies)	**$580,321** ($52,809,170/ 91 companies)
Other: Transfer agent/ADP assistance	**5-10 hours** (1 company)	(0 companies)

Other: Follow-up mailings	(0 companies)	**$40,000** (1 company)
Other: Second mailing to shareholders	**160 hours** (1 company)	**$1.5 million** (1 company)
Other: Investigation/ background check of shareholder nominee	**17.5 hours** (35 hours/ 2 companies)	**$42,500** ($85,000/ 2 companies)
Other: NOBO list	(0 companies)	**$20,000-$25,000** (1 company)
Other: Higher ADP proxy fees	(0 companies)	**$800,000** (1 company)
Other: Public relations firm	(0 companies)	**$100,000-$150,000** (1 company)
Other: Advertising (if circumstances warrant)	(0 companies)	**$283,333** ($850,000/ 3 companies)
Other: Independent tabulator	(0 companies)	**$10,000-$20,000** (1 company)
Other: Unspecified	(0 companies)	**$5,000 and $100,000-$1 million** (2 companies)

Another commenter also disagreed sharply with the Commission's estimate of the total annual incremental burden to prepare the required disclosure under the proposed rules.[921] The commenter believed the Commission underestimated severely both the number of entities that would be affected by the proposal and the cost of the proposal to such entities.[922] The commenter, as noted above, stated that 290 to 580 exchange-traded companies likely would face a "valid security holder nominee proposal" every year.[923] The commenter further stated that a more accurate cost for "handling" these proposals was approximately $50,000, not $4200.[924] Accordingly, the commenter suggested the appropriate annual incremental burden under the proposed rules would be $14.5 million to $29 million.[925] The commenter suggested that the affected companies would face additional burdens not addressed by the Commission. The aggregate costs would raise the estimated regulatory burden of the proposal from $89.4 million to $175.1 million. The aggregate costs are set forth in the table below as copied from the commenter's remarks submitted to the Commission.

Summary of Estimated Regulatory Burden of Proposed SEC Rule 14a-11		
Cost Element	**At least**	**To**
Read and comprehend the rule.	$12.1 million	$25.0 million
Review and investigate every proposal.	$29.0 million	$58.0 million
Create new data systems for director elections	$ 8.8 million	$13.1 million
Interaction with rule 14a-8	$25.0 million	$50.0 million
Handle valid nomination proposals	$14.5 million	$29.0 million
Total	**$89.4 million**	**$175.1 million**

XVIII. Related Suggestions

Alternatives to the Proposed Nomination Procedure

Advice and Consent Mechanism

One commenter, without reaching the general necessity or utility of the proposed nomination procedure, suggested a "potentially preferable" alternative based on the advice and consent procedure created by Article II Section 2 of the United States Constitution.[926] The alternative recognizes and attempts to take advantage of the purported comparative advantages of institutional security holders and incumbent boards of directors in the area of corporate governance. According to the commenter, institutional security holders have a comparative advantage in identifying suboptimal governance structures, while incumbent boards have a comparative advantage in addressing those shortcomings, provided that the incumbents concur that the shortcomings are material.[927] As such, the commenter favored a nomination procedure that would simultaneously allow each of the two groups to specialize in the area of their comparative advantage, while forcing boards to take shareholder criticism seriously.[928]

According to the commenter, the "advice and consent" procedures set forth in the Constitution can be adapted readily to the corporate context.[929] In this regard, the commenter proposed that any director that is elected under state law but also receives a majority of "withhold" votes would be subject to a variety of material disabilities imposed under Commission or SRO regulations.[930] The commenter, for example, notes that the relevant director might not be deemed independent for purposes of the markets' listing standards, or might be prohibited from voting on any matter required by the Commission or SRO rules.[931] The commenter further notes that the relevant director could also be subject to rules that would call into question an issuer's ability to insure or indemnify the corporation for violations of federal securities laws.[932]

The commenter believed that neither the targeted directors nor the boards on which they serve are likely to be "enthusiastic" about the continued service of such directors after the disabilities had attached.[933] The commenter stated, "By crafting a series of `cure' provisions that would attach to any such disabilities, the proposed advice and consent mechanism would effectively allow shareholders to use their existing authority to withhold approval as a means of denying consent to the election of directors."[934] According to the commenter, the interaction of the disabilities and the cure provisions would force negotiations directed at identifying board members satisfactory both to security holders and to the surviving incumbent directors.[935]

Moreover, according to the commenter, the advice and consent mechanism has several advantages over the proposed nomination procedure, including: (1) it reduces the danger that shareholders will resort to the proxy mechanism as a device for promoting special interest agendas; (2) it diminishes the dangers of "factionalization" that sometimes follow the election of dissident directors to a board; and (3) it eliminates the need for the Commission to adopt complex and potentially arbitrary rules defining triggering events and security holder eligibility, resulting in far less risk that the mechanism would be subject to a successful legal challenge.[936]

Enhanced Disclosure

One large pension fund objected to the proposed nomination procedure, stating that security holder access to the company proxy was not the "logical next step in the evolution of shareholder rights."[937] Rather, this commenter believed that enhanced proxy statement disclosure was a preferable alternative. The commenter stated, "The logical next step is to provide enhanced disclosure that will arm interested and committed long-term shareholders with information that will enable informed shareholder monitoring of corporations and encourage new broad-based, albeit less formal, participation in the director nomination and election processes."[938]

The commenter offered several suggestions regarding disclosure enhancements. The commenter sought revisions to the recent disclosure requirements regarding companies'
[939]

nominating committees.— The commenter urged that new disclosure requirement to provide the identification of the candidate and the security holder or security holder group that recommended the candidate and related disclosure concerning the processing of that candidate should apply to circumstances when the sponsoring shareholder or group holds 1% of the company's voting stock, not 5% as prescribed by recently adopted rules. In this regard, the commenter noted, "As one of the arguments raised against a proxy access right is the failure of shareholders to avail themselves of current nomination rights, shareholders are challenged to use this information and their organizational skills to regularly avail themselves of their rights in corporate nominating processes."

The commenter further suggested that there should be enhanced disclosure regarding the vote required for the election of directors.[940] The commenter believed that the current disclosure requirements, which require only identification of the level of vote necessary to pass any matter accepted for the meeting agenda, are inadequate.[941] The commenter urged that companies be required to "describe in detail" the standard for any nominee to be elected director.[942] In this regard, the commenter believed that companies should clarify whether the director election vote standard used is required or simply permitted by the law of the state of incorporation and what provisions of the company's articles or by-laws establish the vote standard.[943] The commenter also believed that additional disclosure is necessary in instances where the issuer employs plurality voting and only management-sponsored candidates are submitted for election.[944] The commenter suggested, for example, requiring disclosure noting that in an uncontested election: (1) directors can be elected or re-elected with as little as a single vote; and (2) no level of withhold votes would have any consequence if the candidate at issue receives a single vote.[945] The commenter further believed that the proxy statement should require publication of the level of withhold votes received by each director in the prior year's election.[946] Any directors that received a withhold vote in excess of 20% would be required to include in the proxy statement disclosure addressing the withhold vote, even if that director were not standing for re-election in the year following a qualifying withhold vote due to a classified board structure.[947] Finally, the commenter believed that large withhold votes are indicative of security holder dissatisfaction and, accordingly, directors that receive less than a majority of the votes cast by security holders should suffer some consequence.[948] The commenter did not suggest directly any potential consequences, but did reference the consequences set forth above in the "Advice and Consent Mechanism."[949]

Finally, the commenter suggested that there should be required proxy statement disclosure by the board of those board duties that security holders generally consider to be of critical importance.[950] The commenter cited director involvement in corporate strategy development and succession planning as two generally accepted areas of critical importance.[951] In this regard, the commenter stated,

> In order to provide security holders important information on these vitally important board roles, proxy material disclosure should include the following: (1) A statement of the important board duties identified by the board of directors; (2) A description of the board's role in the development and monitoring of the company's long-term strategic plan, including: (a) A description of the Company's corporate strategy development process and related timelines; (b) An outline of the specific tasks performed by the Board in the strategy development and the compliance monitoring processes, and (c) A description of the mechanisms in place to ensure director access to pertinent information for informed director participation in the strategy development and monitoring processes; and (3) A description of the processes and actions taken by the board or its committees concerning the issue of chief executive officer succession planning; and the identification of any third parties utilized by the board or its committees in performing its strategic planning and succession planning roles. [952]

The commenter indicated that, while it did not support the proposal, it did support continued reform efforts designed to enhance the activities of long-term shareholders interested in exercising their ownership rights and responsibilities. Finally, the commenter urged the Commission to "consider the formation of an advisory committee of shareholders and other governance experts to continue to explore means of enhancing the operations of corporate nomination and election processes."[953]

Proxy Mechanics and Communications With Security Holders

Several commenters expressed concern that the proposed rules would result in a dramatic increase in the number of contested elections.[954] As a consequence, these commenters believed that companies likely would face a corresponding increase in their need to communicate with their security holders.[955] The commenters, however, believed that the Commission's existing shareholder communication rules (set forth in Exchange Act Rules 14b-1, 14b-2, and 14a-13) make it difficult and expensive for companies to communicate with the beneficial owners of their securities held in street name.[956] This is especially problematic because, according to one commenter, approximately 70% to 80% of all outstanding public company shares were held in street name.[957]

The commenters generally described the "NOBO-OBO" rules, which currently govern communications between companies, beneficial owners, and the brokers and banks that are the registered owners of the securities at issue, as "cumbersome, circuitous, and often prohibitively expensive."[958] Furthermore, the commenters believed that the current system does not take advantage of recent technological advances.[959] In light of the projected increase in the number and significance of security holder communications and the difficulty and costs inherent in the current rules, the commenters strongly urged the Commission to review the rules related to communication with beneficial owners of shares held in "nominee" or "street" name.[960]

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1 In addition, the Commission and Division spoke with interested parties representing shareholders, the business community, and the legal community, including members from The Business Roundtable, Council of Institutional Investors, CalPERS, New York State Comptroller's Office, Commonwealth of Pennsylvania Treasurer's Office, New York State Common Retirement Fund, and North Carolina State Treasurer's Office. Public comments can be viewed in the Commission's Public Reference Room at 450 Fifth Street, NW, Washington, DC 20549, in File No. S7-19-03. Public comments also are available on the Commission's website, www.sec.gov.

2 The aggregate number of commenters and the numerical breakdowns of the commenters according to category are approximations and are current as of March 3, 2004. Comment letters continue to be submitted. The number of commenters that addressed specifically the questions raised in the Proposing Release is only a fraction of the number of commenters that responded generally to the proposed rules. Throughout this Summary of Comments the reported number of commenters that addressed each specific question raised in the Proposing Release represents an approximation.

3 Commenters urged that security holders be entitled to submit director nominees for the next shareholder meeting at which directors will be elected.

4 One commenter proposed that a security holder own at least 10% of the voting shares and a security holder group own at least 20% of the voting shares.

5 The substantial majority is a direct result of eleven Letter Types that in the aggregate expressed the support of 12,108 individuals or entities. *See* Letter Type A (representing the views of 24 individuals or entities); Letter Type B (representing the views of 136 individuals or entities); Letter Type C (representing the views of 4127 individuals or entities); Letter Type G (representing the views of 185 individuals or entities); Letter Type I (representing the views of 5853 individuals or entities);

Letter Type J (representing the views of 24 individuals or entities); Letter Type K (representing the views of 13 individuals or entities); Letter Type L (representing the views of 4 individuals or entities); Letter Type M (representing the views of 257 individuals or entities); Letter Type O (representing the views of 1470 individuals or entities); Letter Type R (representing the views of 5 individuals or entities).

6 *See, e.g.*, Bebchuk; CalPERS; CalSTRS; Capito; CII; CIR; Corporate Library; Aaron Rosenthal.

7 CII.

8 *Id.*

9 CalSTRS. *See also* Tannahill.

10 Corporate Library. *See also* Hevesi (calling the costs and logistics currently associated with a contested solicitation "exorbitant" and "burdensome," respectively).

11 Corporate Library.

12 *See* Lucian Arye Bebchuk, *The Case For Shareholder Access To The Ballot*, John M. Olin Center For Law, Economics, and Business, Harvard Law School, Discussion Paper No. 428 (Cambridge, MA: Harvard University, 2003), pp. 3-5.

13 Bebchuk. *See also* Harvard; Sen. Carl Levin.

14 Bebchuk.

15 *Id.*

16 *Id.*

17 *See, e.g.*, ConocoPhillips; Emerson; FSR; Ganske, Kelley & Profusek; ICBA; Letter Type D; Office Depot; Valero; Wachtell ("To the extent the threat of a proxy contest is necessary to keep a company's nominating committee and board `honest,' that threat is very real today.").

18 *See, e.g.*, Ganske, Kelley & Profusek; Morris.

19 *See, e.g.*, Delphi; Ganske, Kelley & Profusek; Pilcher; Valero.

20 Ganske, Kelley & Profusek; Morris.

21 *See e.g.*, Ganske, Kelley & Profusek.

22 *See e.g.*, Ashland; ICBA.

23 *See, e.g.*, CalPERS; CalSTRS; CII. *But see* CIR (citing significant compliance costs).

24 CalSTRS.

25 CalPERS; Thompson.

26 *See, e.g.*, CalPERS; CalSTRS; CII.

27 *See, e.g.*, CalPERS; CalSTRS; CII.

28 CalPERS.

29 *See, e.g.*, BRT; CC; ConocoPhillips; Intel.

30 *See, e.g.*, BRT; ConcoPhillips; Intel.

31 *See, e.g.*, BRT; Intel.

32 *See, e.g.*, BRT; Intel.

33 *See, e.g.*, BRT; Intel.

34 *See, e.g.*, ABA; ACB; Allstate; Ashland; Ayers; Callaway; Caterpillar; Cigna; ConocoPhillips; Cummins; Debevoise; Exelon; FirstEnergy; Ganske, Kelley & Profusek; General Mills; Howe; Hundt; International Paper; Letter Type D (representing 8 individuals or entities); Letter Type H (representing 7 individuals or entities); Letter Type N (representing 38 individuals or entities); Letter Type Q (representing 4 individuals or entities); McData; McKinnell; MDU; Morris; NACD; Office Depot; Pilcher; Progress; Tribune; Wachtell.

35 *See, e.g.*, ABA; ACB; Allstate; Ashland; Ayers; Callaway; Caterpillar; Cigna; ConocoPhillips; Cummins; Debevoise; Exelon; FirstEnergy; Ganske, Kelley & Profusek; General Mills; Howe; Hundt; International Paper; Letter Type D (representing 8 individuals or entities); Letter Type H (representing 7 individuals or entities); Letter Type N (representing 38 individuals or entities); Letter Type Q (representing 4 individuals or entities); McData; McKinnell; MDU; Morris; NACD; Office Depot; Pilcher; Progress; Tribune; Wachtell.

36 *See, e.g.*, CalPERS; CalSTRS; CBIS; CII; CIR; Iridian; ISIS; ISS; Johnson; Kiebler; Letter Type B; Letter Type C; Letter Type G; Letter Type K; Letter Type L; William Schaff; SDCERS; Thomas.

37 *See, e.g.*, Bebchuk; Domini; Harvard; SWIB; Szczur; TIAA-CREF.

38 *See, e.g.*, CalPERS; CalSTRS; CIR; ISS.

39 ISS ("Boards at more than two dozen firms have taken actions in recent months that respond, in full or in part, to mandates at 2003 annual meetings on shareholder proposals. This new trend contrasts markedly with the record of past years, when only a handful of boards typically took action in the year following the mandate.").

40 CalSTRS.

41 Corporate Library.

42 CalPERS. *See also* Hagberg.

43 *See, e.g.*, Accenture; Agilent; Allstate; Bain; Brazil; Butler; Callaway; Cigna; ConocoPhillips; Cummins; Eastman; Exelon; FedEx; Gantz; Gregory; Howe; Hundt; Kerr-McGee; Letter Type P; Letter Type Q; Liberty; McData; McNerney; Miller; Clauss & Wolf; Progress; Republic Services; Rural Metro; Sanger; Valero; Zeien.

44 *See, e.g.*, Accenture; Agilent; Allstate; Bain; Brazil; Butler; Callaway; Cigna; ConocoPhillips; Cummins; Eastman; Exelon; FedEx; Gantz; Gregory; Howe; Hundt; Kerr-McGee; Letter Type P; Letter Type Q; Liberty; McData; McNerney; Miller; Clauss & Wolf; Progress; Republic Services; Rural Metro; Sanger; Valero; Zeien.

45 ASCS.

46 *See, e.g.*, Accenture; Apache; Ayers; Debevoise; FedEx; Howe; McNerney; Pilcher; Tribune; Wachtell.

47 Blackwell Sanders.

48 Bainbridge; Blackwell Sanders.

49 ACB; California State Bar; Duberstein; ICBA; MAPI; Sidley Austin; Simpson Thacher; USSBA.

50 Sidley Austin; Simpson Thacher.

51 Sidley Austin; Simpson Thacher.

52 Duberstein.

53 *Id.*

54 AIMR; CalPERS; CalSTRS; Hartford; CC; Lawndale; Sen. Carl Levin; STRS Ohio; SDCERS; SIF; Gail H. Stone; Sullivan; Tannahill.

55 Lawndale.

56 Lawndale.

57 McNerney; Valero; Wachtell.

58 Valero.

59 Wachtell.

60 McNerney.

61 Debevoise; Nicholas

62 NYCBAR.

63 Clauss & Wolf.

64 ABA.

65 CalPERS; CalSTRS; CII; CIR; STRS Ohio; SDCERS; Tannahill; Valero.

66 CalPERS; CalSTRS; CII; CIR; STRS Ohio; SDCERS; Tannahill; Valero.

67 CalPERS.

68 ASCS; Microsoft; Sullivan.

69 Sullivan.

70 *Id.*

71 ASCS.

72 Bainbridge.

73 CC.

74 Wachtell.

75 Blackwell Sanders; Liberty; Melican. *See also* ACC.

76 ABA; Bebchuk; NYCBAR; Clauss & Wolf; Sullivan.

77 Sullivan.

78 *Id.*

79 *Id.*

80 *Id.*

81 ABA; Bebchuk; CC.

82 Sullivan.

83 Blackwell Sanders; NYCBAR; Clauss & Wolf.

84 Blackwell Sanders; NYCBAR; Clauss & Wolf; Sullivan.

85 Sullivan.

86 *Id.*

87 ASCS.

88 *Id. See also* ACC (supporting preconditions as set forth under the "town hall" meeting approach).

89 *Id.*

90 *Id.*

91 *Id.*

92 *Id.*

93 *Id.*

94 *Id.*

95 *Id.*

96 Clauss & Wolf.

97 *Id.*

98 *Id.*

99 *Id.*

100 ABA; BRT; CC; Emerson; Harley Smith; Intel; International Paper; NYSBAR; P&G; Sullivan; Wachtell; Wells Fargo.

101 ABA; BRT; CC; Emerson; Harley Smith; Intel; International Paper; NYSBAR; P&G; Sullivan; Wachtell; Wells Fargo.

102 ABA; BRT; CC; Emerson; Harley Smith; Intel; International Paper; NYSBAR; P&G; Sullivan; Wachtell; Wells Fargo.

103 CC.

104 CC; Sullivan.

105 ABA; BRT; Sullivan.

106 ABA; BRT; Sullivan.

107 Bainbridge; Bebchuk; ICDA.

108 *See, e.g.*, ABA; BRT; CC; Intel; NYCBAR; NYSBAR; Sullivan.

109 *See, e.g.*, ABA; BRT; CC; Intel; NYCBAR; NYSBAR; Sullivan.; *see also* Question C.8.

110 BRT.

111 BRT; Intel.

112 *See, e.g.*, California State Bar; ConocoPhillips; Emerson; Harley Smith; NYSBAR; Valero; Wachtell.

113 *See, e.g.*, Del. Code Ann. tit. 8, § 141 (2003).

114 ConocoPhillips; Emerson; Harley Smith; NYSBAR; Valero; Wachtell. *See also* Accenture.

115 ConocoPhillips; Emerson; Harley Smith; NYSBAR; Valero; Wachtell.

116 California State Bar.

117 Cal. Corp. Code § 185 (2003)

118 NYSBAR.

119 *Id.*

120 *Id.*

121 CalSTRS; CII; DCRB; SDCERS; Tannahill.

122 CalPERS. *See also* CIR.

123 Sullivan.

124 *Id.*

125 *Id.*

126 BRT; California State Bar; CC.

127 BRT.

128 CalPERS; CII; CIR; DCRB; SBDFla; ICDA; Ganske, Kelley & Profusek; SDCERS; SERS (PA State); SIF; State Retirement System of Maryland (SRSM).

129 *See, e.g.*, DCRB.

130 *See, e.g.*, CII; ICDA; Ganske, Kelley & Profusek; SDCERS; SERS; SIF; SRSM.

131 Ganske, Kelley & Profusek.

132 *See, e.g.*, CalSTRS; CII; SBDFla; SDCERS.

133 CalPERS.

134 *Id.*

135 AFL-CIO; Bebchuk; CalPERS; CalSTRS; Calvert; Clark; CII; CIR; KDP; Cohen; Colorado PERA; SBDFla; JPMorgan Fleming; Foreign Institutional Shareholders; Fortier; Mark Gardiner; Hermes; ICDA; ISIS; Lawndale;Lenz; McRitchie; Morley; Montagnon; NAPF; NCCR; Pelletier; Randall; Relational; Rembert; SDCERS; SERS; SIF; STRS Ohio; B. Stennettt; Tannahill; Thomas; Thompson; Trillium; Walden; Winters; Young; Zanglein.

136 AFL-CIO; Bebchuk; CalPERS; CalSTRS; Calvert; Clark; CII; CIR; KDP; Cohen; Colorado PERA; SBDFla; JPMorgan Fleming; Foreign Institutional Shareholders; Fortier; Mark Gardiner; Hermes; ICDA; ISIS; Lawndale;Lenz; McRitchie; Morley; Montagnon; NAPF; NCCR; Pelletier; Randall; Relational; Rembert; SDCERS; SERS; SIF; STRS Ohio; B. Stennettt; Tannahill; Thomas; Thompson; Trillium; Walden; Winters; Young; Zanglein.

137 Rev. Angelus; Bader; Barsetli@aol.com; Bebchuk; CalPERS; CalSTRS; Calvert; Caposel; Hartford; CBIS; CCS; Clark; CII; CIR; Clean Yield; Corbet; Collinge; KDP; Newground; Evans; Faber; Foreign Institutional

Shareholders; Fortier; Gardiner; Gorin; Hagberg; Hevesi; Heather Hipp; ICDA; Ignall; ISIS; Johnson; Kiebler; Kirk; Landishaw; Lawndale; Letter Type B (representing approximately 136 individuals or entities); Letter Type C (representing approximately 4127 individuals or entities); Letter Type G (representing approximately 185 individuals or entities); Letter Type I (representing approximately 5853 individuals or entities); Letter Type J (representing approximately 34 individuals or entities); Letter Type K (representing approximately 13 individuals or entities); Letter Type R (representing approximately 5 individuals or entities); Andrew N. Lenz; Maine Treasurer; Maine State Retirement System; James McRitchie; Morton; NAPF; NCCR; Chris Nelson; O'Dell; STRS Ohio; Partridge; Randall; Relational; Rembert; Responsible Wealth; SDCERS; SERS; S. Smith; Sprinker; B. Stennett; Gail H. Stone; Tannahill; Teamsters 728; Thomas; Thompson; Traugott; Wagner; Wagners; Winters; Wood; Young; Zehner; Zucker.

138 Baker; Eleanor Bloxham; Cohen; Cummings; DCRB; Fanning; Harvard; Hoban; Iridian; Killebrew; Letter Type L (representing approximately 4 individuals or entities); Sen. Carl Levin; Noyes Foundation; Pelletier; Shadow Reg. Comte.

139 *See, e.g.*, CalPERS; CII; Letter Type B; Letter Type I; Sen. Carl Levin; NCCR.

140 *See, e.g.*, CalPERS; CII; Letter Type B; Letter Type I; Sen. Carl Levin; NCCR.

141 Kristen Gilbertson; TIAA-CREF.

142 TIAA-CREF.

143 *See, e.g.*, ABA; Abbott; ACB; Aetna; Alltel; BRT; CC; Convergys; Delphi; FedEx; First Energy; FSR; Georgia-Pacific; Intel; Kellogg; Letter Type N; Letter Type Q; Letter Type U; McKinnell; McNerney; Microsoft; Praxair; Sprint; Sullivan.

144 *See, e.g.*, ABA; Abbott; ACB; Aetna; Alltel; BRT; CC; Convergys; Delphi; FedEx; First Energy; FSR; Georgia-Pacific; Intel; Kellogg; Letter Type N; Letter Type Q; Letter Type U; McKinnell; McNerney; Microsoft; Praxair; Sprint; Sullivan.

145 ABA.

146 Commenters expressing support for the withhold votes trigger included: Abbott; Aetna; Alltel; BRT; CC; Convergys; Delphi; FedEx; Georgia-Pacific; Intel; Kellogg; Letter Type Q; Letter Type U; Praxair; Sullivan. Commenters expressing support for the opt-in shareholder proposal trigger included: ABA; Microsoft.

147 *See, e.g.*, BRT; FedEx; Intel; Sullivan.

148 *See, e.g.*, BRT; CC; FedEx; Intel; Sullivan. *See also* Alltel; JP Morgan; Lilly; P&G; PPG; Sprint.

149 Sullivan.

150 *See, e.g.*, BRT; CC; FedEx; Intel; Sullivan.

151 *See, e.g.*, BRT; CC; FedEx; Intel; Sullivan.

152 *See, e.g.*, BRT; CC; FedEx; Intel; JPMorgan; Sullivan.

153 *See, e.g.*, BRT; CC; FedEx; Intel; JPMorgan; Sullivan.

154 *See, e.g.*, ASCS; BRT; FedEx; Intel; Melican.

155 Hall.

156 *See, e.g.*, ABA; ASCS; Microsoft.

157 *See, e.g.*, ABA; ASCS; Microsoft. S*ee also* Sprint; JPMorgan.

158 *See, e.g.*, ABA; ASCS; Microsoft.

159 *See, e.g.*, Microsoft. *See also* Abbott; Aetna; Agilent; Alltel; Convergys; Delphi; Georgia-Pacific; Kellogg; Letter Type N; Letter Type Q, Praxair; Sprint.

160 *See, e.g.*, ABA; *see also* Debevoise; Sullivan.

161 AFL-CIO; CalPERS; Calvert; CII; CIR; Colorado PERA; Domini; Duberstein; SBDFla; Hevesi; Long View; McRitchie; NCCR; Nicholas; ORS; SERS; SIF; Thompson; Walden; Wolf Haldenstein; 38 Retirement (representing 38 public employee retirement systems).

162 CalPERS. *See also* NCCR.

163 CalPERS; Calvert; CIR; Hevesi.

164 CalPERS; Calvert; CIR; Duberstein; Hevesi; Long View; NCCR; Walden.

165 AFL-CIO; CalPERS; Calvert; CIR; Duberstein; Hevesi; Long View; SIF; Wolf Haldenstein.

166 CalPERS; Calvert; CIR; Duberstein; Hevesi; NCCR; SIF.

167 CalPERS; Calvert; CIR; Duberstein; Hevesi; NCCR; SIF; Thompson.

168 CalPERS; Calvert; Duberstein; Hevesi; NCCR; SIF; Walden.

169 Calvert.

170 Calvert; Domini; SIF; Walden.

171 Calvert; Duberstein.

172 Calvert.

173 AFL-CIO; Bebchuk; Corporate Library; Foreign Institutional Shareholders; Hagberg; Harvard; ISIS; ISS; Lawndale; Sen. Carl Levin; LSV Asset; Maine Treasurer; Montagnon; Morley; Relational; SIF; Walden; Wolf Haldenstein.

174 ISS.

175 Wolf Haldenstein.

176 SIF.

177 ISIS; Montagnon; Morley.

178 AFL-CIO; Foreign Institutional Shareholders; Hagberg (contingent upon the security holder or security holder nominee having been rejected previously by the nominating committee of the relevant issuer); Lawndale; Relational; Maine State Retirement System; Walden.

179 Duberstein.

180 LSV Asset.

181 Bebchuk; Duberstein; Harvard; Sen. Carl Levin.

182 Corporate Library.

183 Melican.

184 CalPERS; CIR.

185 CalPERS; CIR.

186 AFL-CIO; Bebchuk; CalPERS; CIR; Foreign Institutional Investors; ISIS; Long View; Dale Maine Treasurer; Montagnon; Morley; NCCR; ORS; Railways; SERS; Thompson.

187 Foreign Institutional Investors; ISIS; Long View; Peter Montagnon; Morley.

188 AFL-CIO; Bebchuk; CalPERS; CIR; Maine Treasurer; NCCR; ORS; Railways; SERS; Thompson.

189 CIR.

190 Bebchuk; CalPERS.

191 ASCS; Blackwell Sanders; BRT; CC; FSR; Sullivan.

192 ASCS; Blackwell Sanders; BRT; CC; FSR; Sullivan.

193 Sullivan.

194 ABA; CC.

195 ABA; CC.

196 ABTR; AFL-CIO; AUSWR; Bader; Bebchuk; CalPERS; CBIS; CII; CIR; Colorado PERA; Cummings; DCRB; Duberstein; Hevesi; Hoban; ISIS; ISS (supporting a lower threshold unless, and until, the NYSE eliminates the use of broker-votes in director elections); Long View; Maine Treasurer; Morley; Montagnon; NCCR; STRS Ohio; ORS; Railways; Scott; SDCERS; SERS; SIF; Tannahill; Thompson; 38 Retirement (representing 38 public employee retirement systems).

197 CII; Hevesi; NCCR. CII conducted a statistical survey of 308 issuers; Hevesi and NCCR cited the survey in support of their objections to the 35% withhold threshold.

198 CII; Hevesi; NCCR.

199 CII; Hevesi; NCCR.

200 CII; Hevesi; NCCR.

201 CII; Hevesi; NCCR.

202 ABTR; AFL-CIO; AUSWR; CalPERS; CII; CIR; Colorado PERA; Cummings; Duberstein; Hevesi; ISIS; Long View; Maine Treasurer; Morley; Montagnon; NCCR; STRS Ohio; ORS; Railways; Scott; SDCERS; SERS; SIF; Thompson; 38 Retirement (representing 38 public employee retirement systems).

203 CII; Hevesi; NCCR.

204 CalPERS.

205 Tannahill.

206 Bader.

207 Bebchuk; Harvard; LSV Asset (supporting a lower threshold unless, and until, the NYSE eliminates the use of broker-votes in election for directors); ISS (supporting a lower threshold unless, and until, the NYSE eliminates the use of broker-votes in director elections).

208 CBIS; DCRB; Hoban.

209 ACC; Alliance Capital; ASCS; Blackwell Sanders; BRT; CC; Debevoise; DNP Select; FedEx; FSR; Intel; McNerney; NSTAR; NYSBAR; Clauss & Wolf; Sears; T. Rowe; Valero; Wachtell; Wells Fargo.

210 *See, e.g.*, BRT; FedEx; McNerney; Sears; Wachtell; Wells Fargo.

211 *See, e.g.*, BRT; FedEx; McNerney; Sears; Wachtell; Wells Fargo.

212 FedEx. *See also* BRT; McNerney; Wachtell; Wells Fargo.

213 *See, e.g.*, ABA; BRT; Sears; Sullivan; Wachtell.

214 ABA.

215 ABA; BRT; Intel; NYSBAR. At least thirteen commenters urged the Commission to exclude broker non-votes from any tabulation of votes related to the proposed triggering events. *See* AIMR; CII; Domini; Duberstein; ISS; LSV Asset; MAPI; STRS Ohio; Opportunity; Wyser-Pratte; SERS; SIF; Thompson.

216 NYSE Rule 452, the "10 day rule," governs the voting of shares held in street name by brokers. NYSE Rule 452 gives brokers discretionary authority to vote proxies for beneficial owners who have not given voting instructions by the tenth day before the meeting at which the votes are to be cast. This authority is limited, however, to voting on specified matters.

217 ABA; BRT; Intel; NYSBAR.

218 ABA; BRT; Intel; NYSBAR.

219 Alliance Capital; ASCS; Blackwell Sanders; BRT; CC; Debevoise; DNP Select; FedEx; FSR; Intel; NSTAR; NYSBAR; Clauss & Wolf; T. Rowe; Valero; Wachtell; Wells Fargo.

220 McNerney.

221 Alliance; T. Rowe; Wells Fargo.

222 ACC; DNP Select; NSTAR; Valero.

223 BRT; Intel.

224 CC.

225 Wachtell.

226 FedEx.

227 Capital Guardian; Compass; SBDFla.

228 ABA; ICI; Clauss & Wolf; Wyser-Pratte; Sullivan; Wolf Haldenstein.

229 Wyser-Pratte.

230 Wolf Haldenstein.

231 ABA; ICI; Clauss & Wolf; Sullivan.

232 ABA. *See also* Sullivan.

233 ABA; ICI; Clauss & Wolf; Sullivan.

234 ABA; Clauss & Wolf; Sullivan.

235 ABA (noting that even with a majority quorum requirement, a withhold vote of 35% of the votes cast could represent only 17.5% of an issuer's outstanding shares).

236 ABA.

237 Clauss & Wolf.

238 Sullivan.

239 *Id.*

240 *Id.*

241 *Id.*

242 *Id.*

243 *Id.*

244 NYSBAR. Should the Commission retain the votes cast standard, the commenter requested clarification regarding the meaning of votes cast. In this regard, the commenter noted that Instruction 2 to proposed Exchange Act 14a-11(a) only defines the "votes cast" for opt-in shareholder proposals.

245 ACB.

246 CalPERS; CIR.

247 ABA. *See also* NYSBAR.

248 ABA; NYSBAR.

249 *See, e.g.*, ABTR; AFL-CIO; AIMR; AUSWR; Bebchuk; CalPERS; CBIS; CERES; CII; CIR; ISS; Kane; Duberstein; IBT; Letter Type B; Letter Type K; Maine Treasurer; Montagnon; Morley; NCCR; Noyes Foundation; ORS; Railways; UNITE; SDCERS; SERS; Thompson; Trillium; Wolf Haldenstein; 38 Retirement (representing 38 public employee retirement systems). It should be noted, however, that one Letter Type, representing the views of approximately 5850 individuals or entities, objected to "certain barriers, including high ownership thresholds." *See* Letter Type I. Also, dozens of letters from individuals and entities contained similar general objections to "high ownership thresholds." *See, e.g.*, Collinge; Corbet; DCRB; Faber; Gorin; O'Dell, Sprinker. The Letter Type and the vast majority of the letters from the individuals did not offer alternative thresholds.

250 *See, e.g.*, CalPERS; CII; CIR; NCCR.

251 *See, e.g.*, CalPERS; CII; CIR; NCCR.

252 *See, e.g.*, AFL-CIO; Bebchuk; CalPERS; CBIS; CII; CIR; ISS; Kane; Letter Type B; Letter Type K; Maine Treasurer; Montagnon; Morley; NCCR; Noyes Foundation; ORS; SDCERS; SERS; Thompson.

253 Bebchuk; CERES; IBT; Letter Type B; Long View; Maine Treasurer;

Montagnon; Morley; NCCR; ORS; Railways; Thompson; 38 Retirement (representing 38 public employee retirement systems).

254 CBIS; ISIS.

255 Noyes Foundation.

256 ABTR; AFL-CIO; AUSWR; CalPERS; CII; CIR; Kane; Duberstein; Letter Type K; Long View; SDCERS; SERS.

257 CalPERS; CIR.

258 Wolf Haldenstein.

259 Capital Guardian; ICDA; Sullivan.

260 *See, e.g.*, ABA; ACC; Agilent; Alltel; ASCS; Blackwell Sanders; BRT; Callaway; CC; Cigna; Debevoise; FedEx; Intel; MAPI; Melican; Microsoft; Target; Valero; Wachtell. It should be noted, however, that two Letter Types, representing the views of approximately eleven individuals or entities, believed that "proposed thresholds" for submitting a direct access proposal were too low. *See* Letter Type H; Letter Type U. Also, two other Letter Types, representing the views of approximately eight individuals or entities, believed that "ownership thresholds" for submitting an opt-in shareholder proposal were too low. *See* Letter Type Q; Letter Type T. Finally, as it relates to submitting an opt-in shareholder proposal, dozens of letters from issuers and/or individuals affiliated with affected issuers contained similar general objections to inadequate "proposed thresholds" or "ownership thresholds." *See, e.g.*, Abbott; Aetna; Convergys; Delphi; International Paper; McNerney; Praxair.

261 *See, e.g.*, ABA; BRT; CC; Wachtell.

262 *See, e.g.*, ABA; Wachtell.

263 Agilent; Cigna; Melican.

264 Debevoise.

265 ASCS.

266 ABA; ACC; Blackwell Sanders; Callaway; CC; MAPI; Microsoft; Valero; Wachtell.

267 Compass.

268 BRT; FedEx; Intel.

269 *See, e.g.*, ABA; AFL-CIO; CalPERS; CII; CIR; Kane; ICDA; Letter K; SDCERS; SERS.

270 NAPF.

271 BRT; CC; Compass; FedEx; Intel; MAPI; Microsoft; Valero; Wachtell.

272 ASCS; Blackwell Sanders.

273 Debevoise.

274 Compass; Zeien.

275 Sullivan.

276 *Id; see also* ABA ("All calculations of percentages based on share ownership should be based on the voting power of the shares owned in

connection with the election of directors or other proposal for a triggering event, as the case may be. Class voting and variable voting rights should be taken into account in establishing voting power with respect to a particular triggering event.).

277 NYCBAR; Sullivan.

278 NYCBAR.

279 ASCS; CalPERS; CII; CIR.

280 CalPERS; CII; CIR.

281 ASCS.

282 *Id.*

283 *Id.*

284 DCRB.

285 *Id.*

286 CalPERS; Capital Guardian; CII; CIR.

287 CalPERS; Capital Guardian; CII; CIR.

288 CalPERS.

289 CII.

290 ABA; ACC; BRT; CC; Compass; FSR; Intel; Clauss & Wolf; Sullivan; T. Rowe; Valero; Wachtell.

291 *See, e.g.*, ABA; CC; Sullivan.

292 *Id.*

293 ABA**.** *See also* BRT; CC.

294 *See, e.g.*, ABA; CC; NYSBAR.

295 ABA.

296 *See, e.g.*, ABA.

297 ASCS.

298 Blackwell Sanders.

299 ICI ("This approach would be consistent with Section 2(a)(42) of the Investment Company Act, which provides that a vote of a majority of the outstanding voting securities occurs when 67% or more of the voting securities are present at such meeting, if the holders of more than 50% of the outstanding voting securities of such company are present or represented by proxy.").

300 NYSBAR.

301 *Id.*

302 *Id.*

303 ACB

304 CalPERS; CII; CIR; Tannahill.

305 ABA; ASCS; Blackwell Sanders; BRT; CC; Intel; Sullivan.

306 ASCS; Blackwell Sanders.

307 BRT.

308 ABA; Sullivan.

309 CC.

310 Intel.

311 ABA.

312 *Id.*

313 *Id.*

314 *See, e.g.*, ABA; ACC; Agilent; Allstate; ASCS; Ashland; Blackwell Sanders; BRT; CC; Debevoise; Eastman; Exelon; First Energy; Intel; International Paper; Letter H; Liberty; McData; NYCBAR; NYSBAR; NSTAR; Rural Metro; Sears; Sullivan; Valero.

315 *See, e.g.*, Agilent; Allstate; Ashland; Eastman; Exelon; First Energy; Intel; International Paper; Liberty; McData; Rural Metro; Sears; Valero.

316 *See, e.g.*, ABA; ASCS; Ashland; Blackwell Sanders; BRT; CC; Debevoise; First Energy; Intel; International Paper; NYCBAR; NYSBAR; NSTAR; Sullivan; Valero.

317 *See, e.g.*, ABA; ASCS; Ashland; Blackwell Sanders; BRT; CC; Debevoise; First Energy; Intel; International Paper; NYCBAR; NYSBAR; NSTAR; Sullivan; Valero.

318 *See, e.g.*, ABA; ASCS; Ashland; Blackwell Sanders; BRT; CC; Debevoise; First Energy; Intel; International Paper; NYCBAR; NYSBAR; NSTAR; Sullivan; Valero.

319 Current Exchange Act Rule 14a-8(i)(8) permits companies to exclude proposals that relate "to an election for membership on the...board of directors."

320 *See, e.g.*, ABA; CC; NYCBAR.

321 NYCBAR. *See also* ABA.

322 ABA; CC.

323 *Id.*

324 CII; Tannahill.

325 CalPERS; CIR.

326 *Id.*

327 CalPERS. *See also* CIR.

328 CalPERS. *See also* CIR.

329 CalPERS. *See also* CIR.

330 CalPERS. *See also* CIR.

331 CII.

332 *Id.*

333 *Id.*

334 *See, e.g.*, ABA; ASCS; BRT; Blackwell Sanders; Sullivan; Valero.

335 *See, e.g.*, ABA; ASCS; BRT; Blackwell Sanders; Sullivan; Valero.

336 *See, e.g.*, ABA; ASCS; BRT; Blackwell Sanders; Sullivan; Valero.

337 ABA; ASCS; Blackwell Sanders; CC; Clauss & Wolf; Sullivan.

338 ASCS.

339 ASCS.

340 CC; Sullivan.

341 Sullivan.

342 Sullivan.

343 Clauss & Wolf. *See also* ASCS (acknowledging the issue as problematic, but finding no "ready remedy").

344 Clauss & Wolf.

345 *Id.*

346 CalPERS; CIR.

347 ABA; ACB; ACC; Aetna; Agilent; Alltel; ASCS; Blackwell Sanders; BRT; Callaway; Capital Guardian; CC; Compass; Convergys; Corporate Library; Debevoise; Delphi; FedEx; FSR; Georgeson; Hall; ICI; Intel; International Paper; JPMorgan; Kellogg; Letter Type N (representing approximately 38 individuals or entities); Lilly; Microsoft; NYCBAR; NYSBAR; Clauss & Wolf; PPG; Praxair; Sprint; Software & Information; Sullivan; T. Rowe; UBC; Valero; Wachtell; Wells Fargo.

348 *See, e.g.*, ABA; Blackwell Sanders; BRT; CC; Georgeson; Intel; ISS; NYSBAR; Sullivan.

349 Georgeson. *See also* ABA.

350 *See, e.g.*, ABA; Sullivan.

351 *See, e.g.*, ABA; NYSBAR; Sullivan.

352 ABA.

353 *See, e.g.*, ABA; ACB; BRT; CC; Debevoise; FedEx; FSR; Georgeson; ICI; Intel; International Paper; NYCBAR; NYSBAR; Clauss & Wolf; Sullivan; Valero; Wachtell; Wells Fargo.

354 *See, e.g.*, ABA; BRT; CC; NYSBAR; Sullivan

355 Sullivan.

356 ABTR; AIMR; AUSWR; Hartford; Meghan P. Caposel; CBIS; CERES; CII; Colorado PERA; Cummings; Domini; Duberstein; JPMorgan Fleming; SBDFla; Foreign Institutional Shareholders; Hoban; ISIS; Sen. Carl Levin; Dale Maine Treasurer; Montagnon; Morley; NCCR; Nicholas; STRS Ohio; Railways; Wyser-Pratte; Scott; SDCERS; SIF; Walden.

357 CalPERS.

358 NCCR.

359 Domini.

360 CalPERS; CBIS; CII; CIR.

361 CalPERS.

362 NYCBAR; Software & Information.

363 CalPERS; CII; CIR.

364 BRT; Wachtell.

365 CalPERS; CIR.

366 CalPERS; CIR.

367 CalPERS; CIR.

368 CalPERS; CIR.

369 CalPERS; CIR.

370 CalPERS; CIR.

371 CalPERS; CIR.

372 CalPERS; CIR.

373 CalPERS.

374 NYSBAR; Valero.

375 ASCS; CalPERS; CII; CIR.

376 UBC.

377 *Id.*

378 *Id.*

379 ASCS; BRT; CalPERS; CII; CIR; Intel; ISS; LSV Asset; NYCBAR; SDCERS; STRS Ohio.

380 ASCS; BRT; CalPERS; CII; CIR; Intel; NYCBAR; SDCERS; STRS Ohio. *But see* ISS; LSV Asset (dissenting viewpoint).

381 CII; SDCERS.

382 BRT; Intel; NYCBAR.

383 BRT.

384 ISS; LSV Asset.

385 ISS; LSV Asset.

386 ISS; LSV Asset.

387 ISS; LSV Asset.

388 *See, e.g.,* ASCS; CalPERS; CII; CIR; ISS; SDCER; SIF.

389 *See, e.g.,* AFL-CIO; CalPERS; CalSTRS; CII; CIR; Letter Type B (representing approximately 136 individuals or entities); Letter Type J (representing approximately 34 individuals or entities); Letter Type K (representing approximately 13 individuals or entities); Letter Type I (representing approximately 5850 individuals or entities); Sen. Carl Levin; Longview Funds; LSV Asset; NCCR; ORS; UNITE.

390 Letter Type I.

391 *See, e.g.*, ASCS; BRT; CalPERS; NCCR; Sullivan.

392 *See, e.g.*, Alliance; Bebchuk; ASCS; BRT; CalPERS; ISIS; ISS; Lawndale; NCCR; SDCERS; Sullivan; T. Rowe Price.

393 BRT.

394 *Id.*

395 *Id.*

396 *Id.*

397 *See, e.g.*, ABTR; AIMR; AUSWR; CERES; Colorado PERA: CRPTF; IBT; JP Morgan Fleming; Letter Type B; Letter Type J; Letter Type K; Letter Type I; Long View; LSV Asset; UNITE; Shamrock; Trillium; Wolf Haldenstein; Zanglein; 38 Retirement (representing 38 public employee retirement systems).

398 Cohen; CCS.

399 ABTR; AUSWR; CERES; CBIS; Nicholas; Tannahill; Trillium; SIF; Zanglein.

400 SIF.

401 Wolf Haldenstein.

402 AFL-CIO; CalPERS; CalSTRS; CIR; Gardiner; Hevesi; IBT; International Brotherhood of Electrical Workers Local 428; Iridian; Letter Type B; Longview Funds; LSV Asset; Dale Maine Treasurer, NCCR; Office of the Treasurer of State; Sen. Carl Levin; UNITE; Shamrock; Teamsters 728;

403 *See, e.g.*, CalPERS; CalSTRS; CII; Hevesi; NCCR; Thompson.

404 NCCR.

405 Alliance; CII (noting, however, that some individual members of CII preferred 3%); Foreign Institutional Shareholders; Hagberg; SDCERS; STRS Ohio; Sullivan; T. Rowe; Walden.

406 Duberstein.

407 Sullivan.

408 *Id.*

409 *Id.*

410 *Id.*

411 Bebchuk.

412 Clauss & Wolf. The alternative ownership thresholds were based on the percentage of securities owned, not the dollar amount of securities owned.

413 *Id.*

414 *Id.*

415 ASCS.

416 *Id.*

417 Shamrock.

418 *Id.*

419 ACB; ACC; Aetna; Agilent; Alltel; BRT; Capital Guardian; CC; Exelon; FedEx; FSR; Intel; International Paper; Letter Type H (representing six individuals or entities); Letter Type Q (representing four individuals or entities); Letter Type T (representing four individuals or entities); Letter Type U (representing five individuals or entities); McNerney; Mestek; Valero; Wachtell.

420 *See, e.g.,* ACB.

421 *See, e.g.,* BRT.

422 Agilent; Alltel; Exelon; FSR; International Paper; Letter Type H; Letter Type Q; Letter Type T; Letter Type U; McNerney.

423 Aetna; Capital Guardian; CC; Valero; Wachtell.

424 ACC.

425 ACB.

426 Mestek.

427 BRT; FedEx; Intel.

428 This fact is due largely to the absence of any Letter Types that addressed specifically the length of time a nominating security holder or group must hold the securities.

429 CalPERS; CIR; Duberstein; Tannahill; Wolf Haldenstein.

430 Blackwell Sanders; Walden.

431 AFL-CIO; Alliance Capital; ASCS; BRT; CC; Hagberg; NYSBAR; STRS Ohio; Sullivan; T. Rowe; Valero; Wachtell.

432 CII.

433 CIEBA; Compass; FSR; Deegan; Zeien.

434 Compass; Deegan; Zeien.

435 NYSBAR.

436 *Id.*

437 *Id.*

438 ACB; Alliance Capital; ASCS; Blackwell Sanders; BRT; CalPERS; CC; CIR; Compass; FedEx; Intel; International Paper; Clauss & Wolf; Sullivan; Tannahill; Valero; Wachtell; Wells Fargo.

439 Alliance Capital (opposing view).

440 Alliance Capital.

441 *Id.*

442 *Id.*

443 ACB; BRT; CC; Compass; FedEx; Intel; International Paper; Clauss & Wolf; Valero; Wachtell; Wells Fargo.

444 Wachtell.

445 *Id.*

446 *Id. See also* ACB; BRT; Compass; FedEx; Intel; International Paper; Valero; Wells Fargo.

447 *Id. See also* ACB; BRT; Compass; FedEx; Intel; International Paper; Valero; Wells Fargo.

448 CalPERS; CIR; Tannahill.

449 Sullivan.

450 *Id.*

451 Sullivan.

452 Blackwell Sanders.

453 ASCS.

454 *Id.*

455 ASCS; Blackwell Sanders; BRT; CalPERS; CC; CII; CIR; Debevoise; Lawndale; SDCERS; STRS Ohio; Valero; Wachtell.

456 BRT; Blackwell Sanders; CalPERS; CII; CIR; SDCERS; STRS Ohio.

457 BRT.

458 Duberstein; Lawndale.

459 Lawndale.

460 *Id.*

461 Duberstein.

462 ASCS; CC; Debevoise; Valero; Wachtell.

463 Wachtell.

464 ASCS; Blackwell Sanders; BRT; CalPERS; CC; CIR; Intel; NYCBAR; Sullivan; Tannahill.

465 CalPERS; Tannahill.

466 ASCS; Blackwell Sanders; BRT; CC; CIR; Intel; NYCBAR; Sullivan.

467 CIR.

468 Sullivan.

469 *Id.*

470 NYCBAR.

471 BRT; Intel.

472 Blackwell Sanders.

473 CC.

474 ASCS; Blackwell Sanders; CalPERS; CII; CIR; NYCBAR; SDCERS; Tannahill.

475 NYCBAR.

476 *Id.*

477 ASCS.

478 *Id.*

479 Blackwell Sanders; CalPERS; CII; SDCERS.

480 Blackwell Sanders; CalPERS; T. Rowe.

481 CIR.

482 CalPERS.

483 *Id.*

484 *Id.*

485 ABA; Agilent; BRT; CC; Hall; ICI; Intel; NYCBAR; Software & Information; Sullivan, Valero; Wells Fargo.

486 ABA; Agilent; BRT; CC; Hall; ICI; Intel; NYCBAR; Software & Information; Sullivan, Valero; Wells Fargo.

487 Release No. 34-48825 (Nov. 24, 2003).

488 ABA.

489 *See, e.g.*, ABA; CC; Hall; NYCBAR; Sullivan.

490 *See, e.g.*, ABA; CC; Hall; NYCBAR; Sullivan.

491 *See, e.g.*, ABA; CC; Hall; NYCBAR; Sullivan.

492 CalPERS.

493 CalPERS; CII; CIR.

494 ASCS; Blackwell Sanders; BRT.

495 ASCS; Blackwell Sanders.

496 BRT.

497 ACB.

498 *Id.*

499 *Id.*

500 ASCS; BRT; CalPERS; CII; Sullivan.

501 BRT; CalPERS; CII.

502 ASCS; Blackwell Sanders.

503 ASCS; Blackwell Sanders.

504 ASCS; CalPERS; CIR.

505 CalPERS.

506 CIR.

507 ASCS.

508 *Id.*

509 CalPERS; CII; CIR.

510 ABA; ACB; NYSBAR; Sullivan.

511 ABA; ACB; NYSBAR (emphasis in original).

512 ABA; ACB; NYSBAR.

513 ABA; ACB; NYSBAR.

514 ABA; ACB; NYSBAR.

515 ABA; ACB; NYSBAR.

516 ABA; NYSBAR.

517 ABA; CC.

518 ABA; CC.

519 ABA.

520 CC. Similarly, CC believed that if any of the issuer-supported nominees satisfy the standards of Section 162(m) of the Internal Revenue Code or Exchange Act Rule 16b-3, then all shareholder nominees should be required to satisfy the same standards.

521 ABA; ACB; Agilent; ASCS; Blackwell Sanders; BRT; Intel.

522 CC.

523 *Id.*

524 CalPERS; CII; CIR.

525 CalPERS; CC; CII; CIR; Clauss & Wolf; Sullivan.

526 CalPERS; CIR.

527 CC; Sullivan.

528 CII.

529 Clauss & Wolf.

530 ABTR; AFL-CIO; AIMR; AUSWR; CalPERS; CalSTRS; CII; CIR; Corporate Library; Domini; Duberstein; SBDFla; Gardiner; Hermes; Hevesi; ISS; Lawndale; Long View; LSV Asset; McRitchie; SRPS of MD; NCCR; STRS Ohio; ORS; Relational; Schacht; SDCERS; SIF; Tannahill.

531 *See, e.g.*, CalPERS; CII; Hevesi; Lawndale; NCCR; Relational.

532 *See, e.g.*, CalPERS; CII; Hevesi; Lawndale; NCCR; Relational.

533 CII.

534 *Id.*

535 CalPERS; CII; Lawndale; McRitchie; NCCR; Relational.

536 NCCR. *See also*, CalPERS; CII; Lawndale; McRitchie; Relational.

537 CalPERS; NCCR.

538 CalPERS. *See also* NCCR ("The NCCR requests a narrow exception to the proposed independence standards that would permit holders of at least 2% to nominate principals of the fund.").

539 *See, e.g.*, CalPERS; NCCR.

540 *See, e.g.*, CalPERS; NCCR.

541 ABA; ASCS; Blackwell Sanders; Hall; Sullivan.

542 ABA; Sullivan.

543 ASCS; Blackwell Sanders.

544 ASCS; Blackwell Sanders; Valero.

545 ASCS; Blackwell Sanders; Valero.

546 ASCS; Blackwell Sanders.

547 ASCS; Blackwell Sanders.

548 Valero. *See also* ASCS (recommending that security holder nominees meet independence standards as set forth in applicable listing standards).

549 Valero.

550 ABA; Sullivan.

551 ASCS.

552 Bebchuk.

553 ASCS; Bebchuk; Blackwell Sanders.

554 ASCS; Blackwell Sanders.

555 Bebchuk.

556 *Id.*

557 *Id.*.

558 *Id.*

559 Duberstein.

560 BRT; CalPERS; CII; CIR; Wells Fargo.

561 BRT; CalPERS; Wells Fargo.

562 BRT; Wells Fargo.

563 BRT.

564 CalPERS.

565 CalPERS; CII; CIR.

566 CalPERS. *See also* Wells Fargo.

567 ASCS; Blackwell Sanders; ICI; NYCBAR; Wells Fargo.

568 ASCS.

569 NYCBAR.

570 Blackwell Sanders

571 ICI

572 Wells Fargo.

573 CalPERS; CIR.

574 Clauss & Wolf.

575 *Id.*

576 ICI; T. Rowe.

577 ICI. *See also* T. Rowe.

578 ASCS; Blackwell Sanders.

579 Blackwell Sanders.

580 *Id.*

581 ASCS.

582 *See, e.g.*, ABA; AFL-CIO; Blackwell Sanders; BRT; CalPERS; CC; CII; ICDA; Hevesi; Lawndale; NCCR; STRS Ohio; SIF; Sullivan; Thompson.

583 CalPERS.

584 *See, e.g.*, AFL-CIO; CalPERS; Calvert; CII; SBDFla; Gardiner; Hevesi; ICDA; Lawndale; ORS; NCCR; STRS Ohio; Thompson; Trillium; SIF.

585 *See, e.g.*, AFL-CIO; CalPERS; Calvert; CII; SBDFla; Gardiner; Hevesi; ICDA; Lawndale; ORS; NCCR; STRS Ohio; Thompson; Trillium; SIF.

586 CalPERS.

587 Calvert; Chevedden; SBFla; Gardiner; McRitchie.

588 CalPERS; CIR; NCCR; Thompson.

589 SIF.

590 Hevesi.

591 ICDA.

592 ICDA.

593 AFL-CIO; CII; Kane; Lawndale; ORS; STRS Ohio.

594 ABA; ACB; ASCS; Blackwell Sanders; BRT; CC; Sullivan.

595 ASCS; BRT.

596 BRT (emphasis in original).

597 ACB.

598 ABA; Sullivan.

599 Sullivan.

600 *Id.*

601 *Id.*

602 CC.

603 *Id.*

604 *Id.*

605 *Id.*

606 ABA; CC; Sullivan.

607 ABA; Sullivan.

608 ABA; Sullivan.

609 ABA; Sullivan.

610 Sullivan. *See also* ABA (voicing general agreement and further recommending that Instruction 1 to paragraph (d) of proposed rule Exchange Act Rule 14a-11 be amended to permit the inclusion of the nominee/candidate set forth above and that proposed Rule 14a-11(c)(5) be similarly clarified.)

611 CC.

612 *Id.*

613 ABA.

614 Sullivan.

615 CalPERS; CIR.

616 ASCS.

617 Clauss & Wolf.

618 *Id.*

619 *Id.*

620 CalPERS. *See also* CIR.

621 CalPERS. *See also* CIR.

622 CalPERS; CIR.

623 CalPERS; CIR.

624 ICDA.

625 BRT; CC (supporting involvement of the nominating committee if the Commission determines it appropriate to limit the number of security holder nominees required to be included in the proxy statement); Valero.

626 ASCS.

627 *Id.*

628 ACB; ASCS; Blackwell Sanders; CalPERS; CC; CIR.

629 ACB; ASCS; Blackwell Sanders; CalPERS; CIR.

630 CC.

631 *Id.*

632 ACB; ASCS; BRT; CalPERS; CIR; Intel.

633 BRT; CIR; Intel.

634 BRT. *See also* CIR; Intel.

635 ASCS.

636 CalPERS.

637 ACB.

638 *Id.*

639 ASCS; BRT; CalPERS; CIR; Corporate Library; Intel; Sullivan; TIAA-CREF.

640 ASCS; BRT; Corporate Library, TIAA-CREF (supporting certification from nominees and nominating security holders that each "understand[s] and subscribe[s] to the fundamental precepts of board responsibility").

641 TIAA-CREF.

642 Corporate Library.

643 ASCS; BRT; Intel.

644 BRT. *See also* ASCS; Intel.

645 Sullivan.

646 BRT.

647 *Id.*.

648 CalPERS; CIR.

649 ASCS; BRT; CalPERS; CC; CIR; Valero.

650 ASCS; BRT; CalPERS; CC; CIR; Valero.

651 ASCS.

652 ASCS. *See also* CC.

653 CalPERS; CIR.

654 CalPERS; CIR.

655 ASCS; CalPERS; CIR; Clauss & Wolf; Sullivan.

656 CalPERS; CIR.

657 Sullivan.

658 ASCS.

659 Clauss & Wolf.

660 *Id.*

661 ASCS; CalPERS; CC; CIR; Sullivan.

662 ASCS; CC; Sullivan.

663 CalPERS; CIR (emphasis added).

664 CalPERS; CIR.

665 ABA; ACB; ASCS; CalPERS; CIR; Duberstein; NYCBAR; Sullivan.

666 ABA; ACB; ASCS; NYCBAR; Sullivan.

667 ABA; ACB; ASCS; NYCBAR; Sullivan.

668 ABA; NYCBAR.

669 CalPERS; CIR.

670 Duberstein.

671 ABA; ASCS; CalPERS; CIR; Intel; NAREIT; NYCBAR; Sullivan.

672 CalPERS (opposing deference to advance notice bylaw provisions). *See also* CIR.

673 NYCBAR.

674 *Id.*

675 ABA; Intel; NAREIT.

676 ABA (emphasis in original).

677 ASCS.

678 *Id.*

679 BRT.

680 CalPERS; CIR.

681 ABTR; ACB; ASCS; AUSWR; CalPERS; CII; CIR; Duberstein; SIF; STRS Ohio; Sullivan.

682 ABTR; AUSWR; CalPERS; CII; CIR; Duberstein; SIF; STRS.

683 ABTR; AUSWR; CalPERS; CII; CIR; Duberstein; SIF; STRS.

684 ABTR; AUSWR; CalPERS; CII; CIR; Duberstein; SIF; STRS.

685 ACB; ASCS; Sullivan.

686 ACB.

687 *Id.*

688 ASCS.

689 Sullivan.

690 *Id.*

691 *Id.*

692 ABA.

693 Clauss & Wolf.

694 *Id.*

695 *See, e.g.*, ABA; BRT; ICI; Intel; NYCBAR.

696 *See, e.g.*, ABA (stating such disclosure in neither "necessary [nor] appropriate"); BRT (stating such disclosure is not "meaningful" and "could cause confusion"); ICI (stating such information would provide "little, if any, value to security holders"); Intel; NYCBAR.

697 NYCBAR (directing attention to Release No. 34-48825, "Disclosure Regarding Nominating Committee Functions and Communications Between Security Holders and Boards of Directors," wherein the Commission decided not to require companies to disclose their specific reasons for not nominating a candidate).

698 *See, e.g.*, ASCS; CalPERS; CII; CIR.

699 ABA; BRT; CII; ICI; NYCBAR; NYSBAR.

700 Wells Fargo.

701 Clauss & Wolf.

702 ASCS; CalPERS; CII; CIR; Clauss & Wolf; NYCBAR; NYSBAR; STRS Ohio.

703 CalPERS; CIR; NYCBAR.

704 NYCBAR.

705 ASCS; CII; Clauss & Wolf; NYSBAR; STRS Ohio.

706 ASCS.

707 ICI.

708 ASCS; CalPERS; CII; CIR; Sullivan.

709 CalPERS; CII; CIR.

710 CalPERS. *See also* CII; CIR.

711 CalPERS.

712 CII.

713 TIAA-CREF; Corporate Library.

714 TIAA-CREF; Corporate Library.

715 TIAA-CREF. *See also* Corporate Library.

716 TIAA-CREF; Corporate Library.

717 ASCS.

718 *Id.*

719 Sullivan.

720 CIR.

721 CIR; Sullivan.

722 ASCS.

723 CC.

724 CalPERS.

725 ASCS.

726 ASCS; Sullivan.

727 Sullivan.

728 ASCS.

729 CalPERS; CIR.

730 ASCS; CC; Sullivan.

731 ASCS; Sullivan.

732 ASCS; Sullivan. *See also* CC.

733 CIR.

734 *Id.*

735 ASCS.

736 CalPERS; CII; CIR; DCRB; SBDFla; NYCBAR; STRS Ohio.

737 CalPERS; CII; DCRB; STRS Ohio.

738 CIR.

739 NYCBAR. It should be noted that NYCBAR also stated that nominating groups should submit their notice to issuers 120 days before the date of the issuer's proxy statement released to security holders in connection with the previous year's annual meeting.

740 BRT.

741 *Id.*

742 *Id.*

743 NYSBAR; Wells Fargo.

744 NYSBAR; Wells Fargo.

745 NYSBAR.

746 ASCS; Blackwell Sanders; CalPERS; CII; CIR; Duberstein; Clauss & Wolf; STRS Ohio.

747 CalPERS; CII; CIR; Duberstein; Clauss & Wolf; STRS Ohio.

748 CalPERS.

749 *Id.*

750 *Id.*

751 Clauss & Wolf.

752 *Id.* (emphasis in original).

753 ASCS; Blackwell Sanders.

754 Blackwell Sanders.

755 ABA; ASCS; CalPERS; CIR.

756 ABA; ASCS; CalPERS; CIR.

757 ABTR; AUSWR; CalPERS; CII; CIR.

758 CalPERS.

759 CalPERS; CII; CIR.

760 Clauss & Wolf.

761 *Id.*

762 ABA; ACB; ASCS; BRT; Intel; NYSBAR; Sullivan.

763 BRT.

764 *See, e.g.*, ABA; BRT; Intel; NYSBAR; Sullivan.

765 *See, e.g.*, ABA; BRT; Intel; NYSBAR; Sullivan.

766 Sullivan.

767 ABA; BRT; Intel; NYSBAR; Sullivan

768 *See, e.g.*, ABA; Sullivan.

769 ABA.

770 ABA; Aetna; BRT; CalPERS; CIR; ICI; NYCBAR; Valero.

771 ABA; Aetna; BRT; CalPERS; CIR; ICI; NYCBAR; Valero.

772 Aetna; BRT; Valero.

773 Valero.

774 BRT.

775 *Id.* (emphasis added).

776 BRT; CalPERS; CIR.

777 CalPERS; CIR.

778 BRT.

779 *See, e.g.*, ABA; BRT; CalPERS; CIR; NYCBAR; Valero.

780 ABA.

781 BRT.

782 *Id.*

783 *Id.*

784 *Id.*

785 CalPERS; CIR; ICI; Clauss & Wolf.

786 CalPERS; CIR; ICI.

787 ICI.

788 Clauss & Wolf.

789 *Id.* (citing, as an example, conversations related to full or partial change in control of the issuer).

790 ABA; NYCBAR; Sullivan.

791 ABA; NYCBAR; Sullivan.

792 ABA; Sullivan.

793 ABA; Sullivan.

794 ABA; Sullivan.

795 *Id.*

796 *Id.*

797 ABA; Sullivan.

798 ABA; Sullivan.

799 ABA; Sullivan.

800 NYCBAR.

801 *Id.*

802 *Id.*

803 *Id.*

804 *Id.*

805 *Id.*

806 CalPERS; NYCBAR; Sullivan.

807 NYCBAR.

808 *Id.*

809 *Id.*

810 Sullivan.

811 CalPERS.

812 *Id.*

813 *Id.*

814 *Id.*

815 CC; Duberstein; NYCBAR.

816 CC; Duberstein; NYCBAR.

817 NYCBAR.

818 CIR; Sullivan.

819 Sullivan.

820 *Id.*

821 CIR.

822 *Id.*

823 ABA (finding "no substantive reasons for treating investment companies differently from operating companies); CII; CIR (agreeing that all investment companies should be covered, but suggesting the Commission might want to consider a market capitalization test); ICI (finding no reason to "distinguish investment companies from other companies" in the application of the proposed rules); T. Rowe.

824 ABA.

825 ABA; ICI.

826 ICI.

827 ABA.

828 *Id.*

829 *Id.*

830 *Id.*

831 *Id.*

832 *Id.*

833 *Id.*

834 ICI; T. Rowe.

835 ICI.

836 AFL-CIO; CIR.

837 AFL-CIO.

838 *Id.*

839 *Id.*

840 *Id.*

841 CIR.

842 CIR; ICI.

843 CIR; ICI.

844 ICI.

845 *Id.*

846 CIR; ICI.

847 ICI.

848 *Id.*

849 *Id.*

850 *Id.*

851 CIR.

852 BRT; CalPERS; CII; CIR; ICI; NYCBAR; NYSBAR; Sullivan.

853 NYCBAR.

854 Sullivan.

855 ASCS; Debevoise; Hall; Valero; Wachtell.

856 Blackwell Sanders; CalPERS; CIR.

857 ASCS.

858 ASCS; Debevoise; Valero; Wachtell.

859 Wachtell.

860 CalPERS; CIR; NYCBAR.

861 CalPERS; CIR; NYCBAR.

862 CalPERS; CIR.

863 NYCBAR.

864 BRT; NYCBAR; NYSBAR.

865 BRT.

866 BRT; NYCBAR; NYSBAR.

867 NYCBAR.

868 *Id.*

869 BRT.

870 ASCS; CalPERS; Debevoise; ICI; NYCBAR; NYSBAR.

871 CalPERS.

872 ASCS; Debevoise; NYCBAR; NYSBAR.

873 NYCBAR.

874 *Id.*

875 ABA; ICI; NYCBAR; Sullivan.

876 ICI; NYCBAR.

877 ICI.

878 NYCBAR.

879 ABA; Sullivan.

880 ABA; Sullivan.

881 Sullivan.

882 CalPERS; NYCBAR.

883 CalPERS; NYCBAR.

884 NYCBAR

885 CalPERS; CIR.

886 CalPERS.

887 *Id.*

888 ABA; CII; NYCBAR; Sullivan; Tomasik.

889 CII. *See also* Tomasik.

890 NYCBAR.

891 ABA; Sullivan.

892 ABA; Sullivan.

893 ABA; Sullivan.

894 Sullivan.

895 *See, e.g.*, CalPERS; CIR; ICI; NYCBAR; NYSBAR.

896 *See, e.g.*, CalPERS; CIR; ICI; NYCBAR; NYSBAR.

897 NYCBAR.

898 *Id.*

899 *Id.*

900 *Id.*

901 CalPERS; CIR.

902 CalPERS; CIR.

903 EPF.

904 *Id.*

905 *Id.*

906 BRT.

907 *Id.*

908 *Id.*

909 *Id.*

910 *Id.*

911 Bainbridge.

912 *See* Randall S. Thomas & Catherine T. Dixon, Aranow & Einhorn on Proxy Contests for Corporate Control § 21.01 (3d ed. 1998).

913 Bainbridge.

914 *Id.*

915 Release No. 34-40018 (May 21, 1998).

916 Bainbridge.

917 ASCS; BRT.

918 BRT.

919 *Id.*

920 ASCS; BRT.

921 EPF.

922 *Id.*

923 *Id.*

924 *Id.*

925 *Id.*

926 Grundfest.

927 *Id.*

928 *Id.*

929 *Id.*

930 *Id.*

931 *Id.*

932 *Id.*

933 *Id.*

934 *Id.*

935 *Id.*

936 *Id.*

937 UBC. UBC was the sole union pension fund that objected to the proposed rules.

938 UBC.

939 *See* Disclosure Regarding Nominating Committee Functions and Communications Between Security Holders and Boards of Directors, Release No.: 34-48825 (Nov. 24, 2003).

940 UBC.

941 *Id.*

942 *Id.*

943 *Id.*

944 *Id.*

945 *Id.*

946 *Id.*

947 *Id.*

948 *Id.*

949 *Id.*

950 *Id.*

951 *Id.*

952 *Id.*

953 *Id.*

954 *See, e.g.*, BRT; Georgeson; Intel.

955 *See, e.g.*, BRT; Georgeson; Intel.

956 *See, e.g.*, BRT; Georgeson; Intel.

957 BRT (citing Release No. 34-38406 (Mar. 14, 1997), at n.5).

958 BRT. *See also* Georgeson; Intel.

959 BRT; Georgeson; Intel.

960 BRT; Georgeson; Intel.

http://www.sec.gov/rules/extra/s71903summary.htm

Home | Previous Page

Modified: 03/10/2004

SUPPLEMENTAL SUMMARY OF COMMENTS RECEIVED ON OR AFTER FEBRUARY 6, 2004

In Response to the Commission's Proposed Rules Relating to Security Holder Director Nominations

Exchange Act Release No. 34-48626
Investment Company Act Release No. 26206
File No. S7-19-03

Prepared by:

Division of Corporation Finance
May 25, 2004

I. List of Commenters

Academics

1.	John C. Coffee, Jr.	("Coffee")
2.	David C. Donald	
3.	Jill Fisch	("Fisch")
4.	Joseph A. Grundfest, joined by American Society of Corporate Secretaries and Barclay's Global Investors, N.A., letter dated April 7, 2004	("Grundfest/ASCS/Barclays")
5.	Thomas W. Joo	
6.	Roberta Karmel	("Karmel")

Associations

7.	American Bar Association	("ABA")
8.	American Business Conference	("ABC")
9.	America's Community Bankers	("ACB")
10.	American Society of Corporate Secretaries	("ASCS")
11.	Business Roundtable, letters dated April 27, 2004 and April 1, 2004	("BRT")
12.	Corporations Committee of the Business Law Section of the State Bar of California, letters dated March 31, 2004 and February 27, 2004	
13.	Financial Services Forum	("FSF")
14.	National Association of Corporate Directors, letters dated March 26, 2004 and March 9, 2004	("NACD")
15.	New York State Bar Association	("NYSBAR")
16.	North America Securities Administrators Association, Inc.	
17.	Washington Legal Foundation	("WLF")

Corporations, Corporate Executives, and Corporate Directors

18.	Arch Coal, Inc.	("Arch Coal")
19.	Honeywell International Inc.	("Honeywell")
20.	Steve Odland, Chairman, President, and CEO, Autozone, Inc.	("Odland")
21.	Franklin D. Raines, Chairman and CEO, Fannie Mae	("Raines")
22.	RPM International	("RPM")
23.	United Technologies	("United Technologies")

Form Letter Types

24.	Form Letter Type C, representing one individual that submitted comments after February 6, 2004	("Letter Type C")
25.	Form Letter Type E, representing four individuals or entities that submitted comments after February 6, 2004	("Letter Type E")

26.	Form Letter Type G, representing three individuals or entities that submitted comments after February 6, 2004	("Letter Type G")
27.	Form Letter Type I, representing five individuals or entities that submitted comments after February 6, 2004	("Letter Type I")
28.	Form Letter Type M, representing 388 individuals or entities that submitted comments after February 6, 2004	("Letter Type M")
29.	Form Letter Type AA, representing fifty-five individuals or entities that submitted comments after February 6, 2004	("Letter Type AA")
30.	Form Letter Type V, representing fifteen individuals or entities that submitted comments after February 6, 2004	("Letter Type V")
31.	Form Letter Type W, representing ten individuals or entities that submitted comments after February 6, 2004	("Letter Type W")
32.	Form Letter Type X, representing 1523 individuals or entities that submitted comments after February 6, 2004	("Letter Type X")
33.	Form Letter Type Y, representing 360 individuals or entities that submitted comments after February 6, 2004	("Letter Type Y")
34.	Form Letter Type Z, representing seven individuals or entities that submitted comments after February 6, 2004	("Letter Type Z")

Individual

35.	Ann Aitken	
36.	Tom Aldrich	
37.	Gary Anderson	
38.	Anonymous Reviewer, letter submitted March 31, 2004	
39.	Anonymous Reviewer, letter submitted March 30, 2004	
40.	Anonymous Reviewer, letter submitted March 30, 2004	
41.	Anonymous Reviewer, letter submitted March 29, 2004	
42.	Anonymous Reviewer, letter submitted February 9, 2004	
43.	Phil Aramoonie	
44.	Michael Asato	
45.	Albert Austin	("Austin")
46.	Wayne E. Bartling	
47.	Ed Beltram	

48. Lee Blasingame
49. Christopher H. Bock
50. Mark Brackenbusch ("Brackenbusch")
51. Jimmy Briggs
52. Russ Bringe
53. Patrick Butcher
54. Christian Call
55. James F. Callow ("Callow")
56. Robert Chaffin
57. Jonathan Clermont
58. Eliot Cohen
59. Dorothy Coleman ("Coleman")
60. Brook Connery ("Connery")
61. F. Dean Copeland
62. Peter Cram
63. Manley Cupstid, Jr.
64. Evelyn Y. Davis ("Davis")
65. Ellison Dennis
66. Bob Djurdevic
67. Dldebow@aol.com
68. Margaret Dower
69. William Edmondson ("Edmondson")
70. Walter J. Ehmer
71. Dan Erlich
72. B. Chris Feher
73. Rick Finlinson ("Finlinson")
74. Mark Flynn
75. David Fountain ("Fountain")
76. Geno Gardner
77. Bill Garrison
78. Ken German
79. Beverly Gilbert ("Gilbert")
80. Sushama Gokhale
81. Marc J. Goldberg
82. Michael Goldin
83. John R. Haaf
84. James A. Haigh
85. Donna Hamel ("Hamel")
86. Peter Hanson ("Hanson")
87. David G. Harding
88. Ed Harrell
89. Steven Harris ("Harris")
90. Mark Harrison
91. Dayn Harum
92. Bjarne Hedegaard
93. Tim Hill ("Hill")

94. Marcus Innis
95. Dave Jackson
96. James
97. Garvin Jabusch
98. Jacqueline Jenkins
99. Mark Kalagorgevich
100. David Keating ("Keating")
101. Karl Kelcec
102. Abraham Keller
103. Paul A. Keller
104. Deborah Kozura ("Kozura")
105. Elvis Krivicic
106. David Langtry
107. Kent Lion
108. James Little
109. Marion MacMahon
110. William and Paula Macy ("Macy")
111. William A. Mahan ("Mahan")
112. Ronald D. Markham ("Markham")
113. Bob Mason
114. Joe Matchette
115. William McAllister
116. Joseph McCormack
117. Kara McMillan
118. Kendall Miles
119. Doug Millard ("Millard")
120. Keith Miracle ("Miracle")
121. Karen Moor ("Moor")
122. Kevin Moorman
123. Charles Morris
124. Tony Mosich
125. Cody Nedved
126. Perry G. Noblett II
127. Dr. Vencil O'Block
128. Paul O'Rell
129. Anna Payne
130. Daniel Pensiero III
131. Steven W. Peterson
132. Nancy L. Pine
133. David Post
134. Steve Pratt
135. Keith Price
136. Eugene T. Quail ("Quail")
137. Thomas Ramagli ("Ramagli")
138. Oostur Raza
139. John K. Ritchie

140. Mike A. Rock
141. Steve Rode ("Rode")
142. D. Floyd Russell
143. John Sanborn ("Sanborn")
144. RW Schultz ("Schultz")
145. Gary H. Schwartz
146. Richard Scotty
147. Troy Segler
148. Cerulean Skies
149. Bill Snodgrass
150. David Stadlin
151. Rosalie Steele
152. Alan Stephenson ("Stephenson")
153. Wheeler Stewart
154. Aaron Stover ("Stover")
155. Jack Swift
156. Glendon Thomas ("Thomas")
157. Paul Tomasik
158. Mark Tucker
159. John D. Walker
160. WOSteward@aol.com
161. Ken Wemhoff
162. Ron Wright
163. Milman Youngjohn
164. Lin Zicconi

Law Firms and Attorneys

165. Gibson, Dunn & Crutcher LLP, letters dated April 26, 2004, April 13, 2004 and March 19, 2004

Security Holder Resource Providers

166. Automatic Data Processing, Inc. ("ADP")
167. Committee of Concerned Shareholders ("CCS")
168. CorpGov.Net; James McRitchie, Editor ("McRitchie")
169. Georgeson Shareholder Communications, Inc. ("Georgeson")
170. Institutional Shareholder Services ("ISS")
171. ProxyMatters.com, LLC
172. RestoreTheTrust.com

Social, Environmental and Religious Funds and Related Service Providers

173. Christian Brothers Investment Services ("CBIS")
174. Nathan Cummings Foundation ("Cummings")

Unions, Pension Funds, Institutional Investors, Institutional Investor Associations, and Governmental Representatives

175. American Federation of Labor and Congress of Industrial Organizations ("AFL-CIO")

176.	Council of Institutional Investors, letters dated May 3, 2004 and March 31, 2004	("CII")
177.	Dianna DeGette, U.S. Representative (Colorado)	("DeGette")
178.	International Union of Bricklayers & Allied Craftworkers, Local No.1 of Washington	
179.	Lucent Retirees Organization	("Lucent Retirees")
180.	Richard H. Moore, Treasurer, State of Connecticut	("Moore")
181.	Denise Nappier, Connecticut State Treasurer	("Nappier")
182.	Shamrock Holdings, Inc.	("Shamrock Holdings")
183.	Sierra Club Mutual Funds	("Sierra Club")
184.	SPEEA/IFPTE	
185.	E. Norman Veasey, Chief Justice, Supreme Court of Delaware	("Veasey")

II. Overview

In Exchange Act Release No. 34-48626 (October 14, 2003), the Commission proposed rules that would, under certain circumstances, require companies to include in their proxy materials security holder nominees for election as director. On February 9, 2004, the Commission announced that it would host a roundtable on March 10, 2004, to discuss the proposed rules relating to security holder director nominations. On March 10, 2004, the Commission held the Security Holder Director Nominations Roundtable (Roundtable).[1] Following the Roundtable, the Commission solicited additional comment in connection with the proposed rules and the viewpoints expressed at the Roundtable. The commenters who responded were comprised of the following groups:[2]

- 5 academics;
- 11 associations;
- 6 corporations, corporate executives, and corporate directors;
- 11 Form Letter Types (representing approximately 1915 individuals or entities that submitted letters after February 6, 2004);
- 130 individuals;
- 1 law firm;
- 8 security holder resource providers;
- 2 social and religious funds; and
- 11 unions, pension funds, governmental representatives, institutional investors, and institutional investor associations.

The vast majority of commenters submitted brief statements that supported the proposed rules ("Supporting Commenters").[3] While they viewed the proposed rules as a critical first step in reforming corporate governance, more than half the Supporting

[1] Transcripts of the Roundtable are available at http://www.sec.gov/spotlight/dir-nominations/transcript03102004.txt. An archived webcast is available at http://www.connectlive.com/events/secnominations/. Prepared statements submitted by the participants are reflected in this Supplemental Comment Summary and are available at http://www.sec.gov/spotlight/dir-nominations.htm#parts. Publications or forthcoming publications submitted by the participants are not reflected in this Supplemental Comment Summary, but are available at http://www.sec.gov/spotlight/dir-nominations.htm#parts.

[2] The aggregate number of commenters and the numerical breakdowns of the commenters according to category are approximations and are current as of May 20, 2004. Comment letters continue to be submitted.

[3] *See, e.g.*, Letter Type M; Letter Type W; Letter Type X; Letter Type Y; Letter Type Z; Letter Type AA.

Commenters desired a stronger rule.[4] Those in favor of a stronger rule, however, generally did not address how the proposed rules should be revised.[5]

The number of commenters that opposed the rules ("Opposing Commenters") was very limited.[6] The Opposing Commenters generally recommended that the Commission not adopt or defer implementing the proposed rules until the Commission has had time to assess the impact of the Sarbanes-Oxley Act of 2002, the markets' amendments to their listing standards, and the Commission's own recent reforms.[7] Several of these commenters expressed concern that the proposed rules would apply to all public companies, contrary to the Commission's stated goal of targeting only unresponsive companies.[8] A number of the commenters expressed further concern over purported adverse effects that the proposed rules would have on companies and their boards.[9] For example, commenters stated that the proposed rules, among other things, would facilitate special interest directors, disrupt and polarize boards, discourage qualified candidates from serving on boards, encourage costly election contests, result in director nominees who do not meet legal requirements, and diminish board accountability by bypassing companies' nominating committees.[10]

The portions of the proposed rules and Roundtable discussions that generated the most extensive comment are addressed below. It should be noted that the vast majority of commenters did not address directly the discussions held at the Roundtable.

III. Authority

Supporting Commenters did not address whether the Commission has the authority to adopt the proposed rules.

Several Opposing Commenters, on the other hand, addressed the question of authority and submitted that, if adopted, the proposed procedure would exceed the Commission's statutory authority under Exchange Act Section 14(a) and the other statutory provisions cited as authority for the new rule.[11] The commenters indicated that neither Exchange Act Section 14(a) nor the other statutory provisions authorize the Commission to regulate corporate governance.[12] Three commenters stated that the proposed procedure—by creating a right in certain shareholders to solicit proxies for their

[4] *See, e.g.*, Letter Type X; Letter Type AA.
[5] *See, e.g.*, Letter Type X.
[6] *See, e.g.*, ABA; ACB; Arch Coal; ASCS; BRT; Coleman; FSF; Gilbert; Honeywell; Karmel; Kozura; Letter Type E; Letter Type V; Mahan; Millard; Moor; NACD; NYSBAR; Rode; RPM International; Sanborn; Schultz; Stover; United Technologies; Veasey; WLF. Two commenters that supported reforming the proxy process opposed the proposed rules, which they viewed generally as biased in favor of large institutional investors. *See* CCS; Davis.
[7] *See, e.g.*, ABA; ACB; Arch Coal; ASCS; BRT; FSF; Honeywell; Letter Type V; NACD; NYSBAR; RPM; United; WLF.
[8] *See, e.g.*, Arch Coal; ASCS; FSF; Letter Type V; Odland; Raines; United. *See also* ABA.
[9] *See, e.g.*, ABA; Arch Coal; ASCS; BRT; FSF; Honeywell; Letter Type V; RPM; Schultz; United.
[10] *See, e.g.*, ABA; Arch Coal; ASCS; BRT; FSF; Honeywell; Letter Type V; RPM; Schultz; United.
[11] *See, e.g.*, ABA; BRT; WLF. *See also* Karmel (questioning the authority of the Commission).
[12] *See, e.g.*, ABA; BRT; Karmel; WLF.

director nominees in the company's proxy materials, at the company's expense, under specified circumstances and conditions—constituted impermissible substantive regulation rather than regulation of disclosure and process.[13]

One Opposing Commenter provided a number of examples that it claimed demonstrated that the proposed rules involve matters of corporate governance typically regulated by the states.[14] The commenter indicated that state law, although it typically affords security holders a right to nominate directors, does not establish a right of access to a company's proxy statement by security holders for nomination purposes.[15] The commenter then noted that the proposed nomination procedure would "independently confer authority with respect to access on certain shareholders and make access virtually an organic requirement through the biannual renewal mechanism."[16] The commenter also stated that the proposal would establish, via federal action, special rights for certain security holders and not others, a development not authorized under state law.[17]

The commenter also noted that security holders, unlike directors, are not committed by law to act as fiduciaries on behalf of all security holders.[18] By permitting security holders that are not fiduciaries to use a company's proxy materials to pursue their own interests, the commenter argues, the proposed rules would bypass the established corporate governance system.[19] The commenter further noted its view that the history of limited security holder access to company proxy materials for proposals under Exchange Act Rule 14a-8 "does not support treating the proposed rule as a mere additional procedural regulation."[20] Finally, the commenter cautioned that if the purpose of the proposed rule is to provide security holders access in order to enhance their role in managing corporate affairs, such a purpose intrudes on the state statutory scheme and impedes—and in some respects eliminates—the ability of the directors to act as fiduciaries for the corporate interest.[21]

One commenter, who did not take a general supporting or opposing view of the proposed rules, believed that the nomination procedure is consistent with state and

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[13] *See, e.g.,* ABA (identifying a number of reasons why the proposed rules involve substantive internal corporate law matters); BRT ("This radical transformation of corporate practice would occur not pursuant to the laws of the States—where such matters of corporate governance traditionally have been regulated—but through federal agency rulemaking."); WLF ("[t]he proposed rules create a new substantive right above and beyond the Commission's rulemaking power.").
[14] ABA.
[15] *Id.*
[16] *Id.*
[17] *Id.* State law provisions require shares of the same class to carry the same rights. State law does not permit different classes of security holders within a single class of shares (*i.e.*, classes of security holders with different rights regarding, among other things, director nominations and the use of company funds and resources).
[18] ABA. *See also* Karmel.
[19] ABA. *See also* Karmel ("[U]nless shareholders who gain access to management's proxy are charged with new and additional duties to all shareholders, it is inappropriate for them to have access to management's proxy when other shareholders do not.").
[20] ABA. *See also* ABA letter dated January 7, 2004.
[21] ABA. *See also* Odland.

federal law and falls within the Commission's rulemaking authority under Exchange Act Section 14(a).[22] Another commenter, who similarly chose to refrain from taking a general supporting or opposing view of the proposed rules, took no position on the Commission's legal authority, but did express concern that the nomination procedure raised a federalism concern.[23] The commenter noted, "Th[e] concern is whether the Commission, as a matter of policy, should undertake to provide a substantive right in certain stockholders when the creation of that right by the Commission, intrudes upon and may be in conflict with corporate internal affairs that are the province of state law."[24] Another commenter, who also refrained from taking a general supporting or opposing view of the proposed rules, cited similar federalism concerns and stated that "proposed Rule 14a-11 lives or dies on a 'procedure versus substance' distinction."[25]

IV. To Which Companies Would the Proposed Rules Apply

Two commenters addressed this issue. Both commenters believed that the proposed rules should not apply to all companies subject to the proxy rules.[26] One of the commenters stated that the proposal would have a disproportionate impact on smaller companies and urged the Commission to restrict application of the proposed rules to accelerated filers.[27] The other commenter favored application of the proposed rules to a limited sample of sophisticated companies on a trial basis.[28] The commenter suggested the Commission focus initially on the largest 200 companies in terms of market capitalization.[29]

V. Timing Regarding the Effectiveness of the Proposal

Large numbers of Supporting Commenters urged the Commission to approve the proposed rules at the earliest possible opportunity.[30] Several Supporting Commenters specifically urged the Commission not to "table" the proposed rules to give companies and investors time to evaluate the numerous reforms mandated by the Sarbanes-Oxley Act of 2002, the markets' amendments to their listing standards, and the Commission's own recent reforms.[31] Two of these commenters were of the view that the recent governance reforms had not addressed the "critical issue" of the ability of security holders to exercise a meaningful vote on director elections.[32] The commenters indicated that currently many long-term security holders can only address director problems by running an expensive and complex proxy fight—a nonviable alternative for most security

[22] Fisch.
[23] Veasey.
[24] *Id.*
[25] Coffee.
[26] ABC; ACB.
[27] ACB.
[28] ABC.
[29] *Id.*
[30] *See, e.g.*, CBIS; CII; Finlinson; Hill; Letter Type X; Miracle.
[31] *See, e.g.*, CBIS; CII; Moore.
[32] CII; Moore.

holders, particularly fiduciaries acting on behalf of employee benefit plans.[33] Accordingly, the commenters expressed the position that the recent governance reforms should not be considered a replacement for proposed proxy reforms.[34]

On the other hand, Opposing Commenters, as noted above, generally urged that the Commission not adopt or defer implementing the proposal until the Commission has had time to assess the impact of the Sarbanes-Oxley Act of 2002, the markets' amendments to their listing standards, and the Commission's own recent reforms.[35] Two of the commenters urged that, should the Commission determine to adopt the proposal, the final rules, including the triggering events, should not become effective immediately.[36] One commenter suggested that any final rules become operational no less than one full year following the date the final rules become effective.[37] Another commenter suggested that the final rules should be effective no earlier than the 2005 proxy season and that any such rules should not have triggers that are retroactive to votes taken at any annual meetings before the effective date of the new rules.[38]

VI. "Triggering Events" – What Events Must Occur Before the Company Would Be Required to Include a Security Holder Nominee in Its Proxy Materials

"*Triggering Events" Generally*

For the small number of Supporting Commenters that did identify unfavorable aspects of the proposed rules, the most commonly cited issue was the triggering events, either in general or as currently drafted. A number of Supporting Commenters opposed triggering events *on principle;* several of these commenters believed that any triggering events would undercut unfettered inclusion of security holder nominees in a company's proxy materials.[39] Supporting Commenters that opposed the triggering events *as drafted* believed that: (1) the high ownership thresholds would render the inclusion of security holder nominees in an issuer's proxy materials beyond the reach of most security holders, including even the largest pension funds and institutional investors; and (2) the two-step, two-year process required to elect a director under the proposed triggers is too lengthy.[40]

Opposing Commenters, to the extent they addressed the triggering events, believed that, if adopted, the rules should include revised triggering events that are objective and narrowly tailored to limit the rule's impact to only those companies that

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[33] CII; Moore.
[34] CII; Moore.
[35] *See, e.g.,* ABA; Arch Coal; ASCS; BRT; FSF; Honeywell; Letter Type V; NACD; NYSBAR; Odland; Raines; RPM; United; WLF.
[36] ASCS; NYSBAR.
[37] ASCS.
[38] NYSBAR.
[39] *See, e.g.,* Austin; Hanson; Harris; Keating; Letter Type C; Letter Type G; Lucent Retirees; Markham; McRitchie; Moore; Ramagli; Sierra Club; Thomas.
[40] *See, e.g.,* Callow; CBIS; Edmondson; Hamel; Letter Type I; Letter Type Z; SPEEA/IFPTE; Stephenson. *See also* Lucent Retirees; McRitchie; Moore; Sierra Club (current triggers, if maintained, are too burdensome).

truly demonstrate a significant level of security holder dissatisfaction with the proxy process.[41]

Appropriate Thresholds

In order to strengthen the proposed rules and enhance their effectiveness, a number of Supporting Commenters supported relaxation of some of the obstacles raised by the triggering events. In this regard, five commenters that addressed the proposed threshold requiring a withhold vote for one or more directors of more than 35% of the votes cast believed the threshold was too high.[42] Two of the commenters suggested a threshold requiring a withhold vote for one or more directors of more than 20% of the votes cast.[43] One commenter suggested a threshold of more than 25% of the votes cast.[44] The remaining two commenters did not provide an alternative threshold.[45]

Another Supporting Commenter stated that the withhold votes threshold should remain at no more than 35% of the votes cast.[46] The commenter noted that increasing the withhold vote trigger to 50% of the votes cast, even excluding broker votes, would be "a significant change" that would severely limit the impact of the proposed rules.[47] The commenter was concerned particularly that excluding broker votes from the tabulation of the withhold votes threshold would not justify increasing that threshold to 50% of votes cast from 35% of votes cast.[48]

To illustrate its concern, the commenter cited a "narrow analysis of 110 companies reporting majority votes on shareholder resolutions in 2003."[49] The survey indicated: (1) fourteen companies reporting at least one director that received a withhold vote exceeding 35%, excluding broker votes; (2) nine companies reporting at least one director that received a withhold vote exceeding 40%, excluding broker votes; and one company—less than 1% of the survey sample— reporting at least one director that received a withhold vote exceeding 50%, excluding broker votes.[50] The survey further indicated that broker votes represented on average 15% of the aggregate votes cast for directors.[51] The commenter, assuming a 15% broker vote, made the following observations: (1) a 35% withhold vote including broker votes does not translate into a 50% withhold vote, excluding broker votes; (2) a 35% withhold vote including broker votes would increase to 41.2% excluding broker votes; and (3) a withhold vote exceeding

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[41] *See, e.g.*, ABA; ASCS; FSF; Honeywell; United Technologies.
[42] DeGette; Edmondson; Letter Type Z; Moore; Stephenson.
[43] Letter Type Z; Moore.
[44] DeGette.
[45] Edmondson; Stephenson.
[46] CII.
[47] *Id.*
[48] *Id.*
[49] *Id.*
[50] *Id.*
[51] *Id.* The commenter noted, "This number varied significantly, as would be expected, with companies having a heavier weighting of individual investors generally reporting a higher percentage of broker votes than companies with a preponderance of institutional investors."

42.5% including broker votes would be necessary to reach a 50% withhold vote, excluding broker votes.[52]

The above commenter also believed strongly that the withhold vote trigger, regardless of the ultimate threshold, should not include a provision that would enable companies to "cure" the triggering event.[53]

Five Supporting Commenters that addressed the 1% ownership threshold for the security holder "opt-in" proposal believed it, also, was too high.[54] Three of the commenters favored requiring security holders or security holder groups to meet an ownership threshold similar to that set forth in Exchange Act Rule 14a-8;[55] the other two commenters did not provide an alternative threshold.[56]

The Opposing Commenters that addressed the triggering events generally believed that the proposed thresholds would not accomplish the Commission's stated objective.[57] Three commenters remarked that because the thresholds associated with the triggering events are too low, the Commission's proposal is overbroad and likely will be triggered more frequently than the Commission anticipates; these commenters did not offer specific recommendations on how the triggering events and the thresholds should be revised to limit their impact.[58] Two other commenters agreed that the thresholds were too low.[59] Specifically, the two commenters believed that the "withhold votes trigger," which one of the commenters stated was the only appropriate triggering event, should take effect only when a director has failed to receive at least 50% of the votes cast.[60] One of the commenters further believed that it was "vital" that a company's board have the opportunity to address and provide "a prompt cure" to security holder concerns expressed via withhold votes.[61] Examples of "cures," according to the commenter, include the board requesting the resignation of the director who received the 50% withhold vote or publicly announcing that the board will not renominate the director, or the adoption of a majority vote requirement for such director.[62] The commenter believed that security holders should have the opportunity to nominate a director only after a failure by the board to take some affirmative action.[63]

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[52] *Id.*
[53] *Id.*
[54] Hamel; Letter Type Z; Lucent Retirees; Moore; Nappier.
[55] Letter Type Z; Lucent Retirees; Nappier.
[56] Hamel; Moore.
[57] *See, e.g.*, ABA; Arch Coal; ASCS; BRT; FSF; Honeywell; Odland; Raines; United Technologies.
[58] Arch Coal; Honeywell; Raines ("In practice, the proposed rules would impact all public companies, because the 'triggers' in the rule are easily tripped.").
[59] FSF; United Technologies.
[60] FSF (believing the withhold votes trigger to be the only appropriate and necessary trigger); United Technologies.
[61] FSF.
[62] *Id.*
[63] *Id.*

One Opposing Commenter urged the Commission to revise the triggers to add a clear link to unresponsiveness by the company.[64] The commenter favored triggering events only in regard to a clearly identified problem.[65] The commenter suggested:

> [I]f the withhold vote trigger is included, then any shareholder/group that wishes to publicize or communicate in favor of a withhold vote campaign should be required to file a disclosure document indicating the specific dissatisfaction with that director's service on that company's board. Or if a proposal-for-access trigger is included, it should be required to include a statement about specific proxy process issues at that company and how adding a shareholder-nominated director to the board would relate to that proxy process issue.[66]

Another Opposing Commenter was critical generally of the withhold votes trigger.[67] The commenter believed that the withholding of votes for one or only a few directors does not necessarily indicate a level of dissatisfaction with management of the company or the director selection process that warrants imposing the proposed procedures.[68] The commenter believed that, at the very least, the board should be given the opportunity to respond to the withhold vote with respect to the director or directors at issue.[69] The commenter suggested, for example, that if the requisite percentage of votes was withheld from a director, the board should be able to negate the consequences of that withheld vote by taking responsive action, which might include obtaining that director's resignation or agreement to resign, or electing to treat that director as not being independent.[70]

Votes Cast vs. Shares Outstanding

One Supporting Commenter urged the Commission to disregard the suggestions of Opposing Commenters that sought to change the applicable thresholds.[71] The commenter stated that all voting on triggering events should be calculated based on the number of votes cast on a particular matter, not the number of outstanding shares.[72] In this regard, the commenter noted, "Companies currently are more than happy to conduct business with the approval of less than a majority of the outstanding shares."[73]

Two Opposing Commenters countered that all triggering events should be calculated based on the total number of a company's outstanding shares, not the number of shares voted on a particular matter.[74] In the view of one of the commenters, a trigger

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[64] ASCS.
[65] *Id.*
[66] *Id.*
[67] ABA.
[68] *Id.*
[69] *Id.*
[70] *Id.*
[71] CII.
[72] *Id.*
[73] *Id.*
[74] ABA; ASCS.

based on the number of shares voted, rather than the total number of shares outstanding, would not reflect the effectiveness (or ineffectiveness) of the proxy process in the view of *all* of the company's security holders and, thus, would not accomplish the Commission's goal of targeting companies with an ineffective proxy process.[75] The other commenter equated the potential impact of votes related to triggering events with an amendment to a corporation's governance documents.[76] Thus, the commenter believed that the vote required under such triggering events should be comparable and analogous to the voting requirements for charter amendments, which, in most cases, would require the affirmative vote of a majority of the outstanding shares.[77]

The "Third Triggering Event"

Five Supporting Commenters that responded to the Commission's inquiries regarding a third triggering event believed that non-implementation of a security holder proposal clearly indicates the ineffectiveness of, or security holder dissatisfaction with, a company's proxy process.[78]

Two Opposing Commenters believed that a third triggering event was not appropriate and strongly urged the Commission to refrain from adopting a trigger based on non-implementation of a security holder proposal that receives more than 50% of the votes cast on that proposal.[79] One of the commenters explained that an automatic assumption that a failure to implement a precatory security holder proposal is indicative of security holder dissatisfaction or a failure of the proxy process is erroneous.[80] The commenter further stated that boards of directors have fiduciary obligations under state law to make an independent judgment whether security holder proposals are in the company's best interests and should not, and cannot, comply automatically with the results of a security holder vote, regardless of the level of support.[81]

Additional Triggers

In light of the two-year process that results due to the triggering events, several Supporting Commenters supported revisions that would require more immediate security holder access to a company's proxy materials in circumstances outside those set forth in the proposed triggering events.[82] Specifically, the commenters supported revisions that would require more immediate security holder access to a company's proxy materials based on the occurrence of specific events related to poor performance and/or poor governance or solely on the share ownership of a security holder or security holder group.[83]

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[75] ASCS.
[76] ABA.
[77] *Id.*
[78] CBIS; DeGette; Lucent Retirees; Moore; Nappier.
[79] Arch Coal; United Technologies.
[80] United Technologies.
[81] *Id.*
[82] *See e.g.*, Brackenbush; Connery; Harris; Moore; Quail; Thomas.
[83] *See e.g.*, Brackenbush; Connery; Harris; Quail; Thomas.

Among the specific events suggested by one commenter as additional triggers were the following: Commission enforcement actions, indictment of any executive or director on criminal charges directly related to his or her corporate duties, delisting by a market, significant underperformance relative to an applicable peer group for an extended period of time, and material restatements of financial reports.[84] The level of ownership most commonly cited as appropriate to entitle a security holder or security holder group to, upon its own motion, submit director nominees was at least 5% of the voting shares.[85]

VII. Upon the Occurrence of a Triggering Event at a Subject Company, Which Security Holder's Nominee(s) Must the Company Include in Its Proxy Materials

Most of the Supporting Commenters that submitted substantive comments concerning this issue acknowledged that eligibility to submit a nominee should be based on long-term ownership by a large security holder or group of security holders.[86] Many of these commenters, nonetheless, believed that the proposed ownership thresholds were too high.[87] Of the commenters that offered alternative thresholds, the letters evidenced a range of opinion. Three commenters supported a minimum ownership threshold of 3%.[88] One commenter supported a minimum ownership threshold of 2.5%.[89] Three commenters supported a minimum threshold of 1%.[90]

One commenter suggested a two-tiered approach, based on the level of a nominating security holder's ownership.[91] Under the first tier of this suggested approach, companies would be required to include nominees of nominating security holders owning between $2000 worth of a company's stock and 5% of the company's stock; however, those nominating security holders would be limited in their soliciting activities and expenditures.[92] Under the second tier of this suggested approach, companies would be required to include nominees of nominating security holders owning more than 5% of the company's stock and those nominating security holders would not be limited in their soliciting activities or expenditures.[93]

Another commenter did not offer an alternative threshold, but supported a lower ownership threshold "set on a sliding scale based on [a] company's market capitalization."[94]

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[84] Moore.
[85] *See, e.g.*, Connery; Harris; Quail; Thomas.
[86] *See, e.g.*, Cummings; DeGette; Moore.
[87] *See e.g.*, CBIS; Letter Type Z; Lucent Retirees; McRitchie; Shamrock Holdings; Sierra Club.
[88] DeGette; Moore; Sierra Club.
[89] Letter Type Z.
[90] CBIS; Lucent Retirees; Nappier.
[91] McRitchie.
[92] *Id.*
[93] *Id.*
[94] Shamrock Holdings.

One Opposing Commenter favored an ownership threshold of 10% for individual security holders and a higher ownership requirement for security holder groups.[95]

VIII. Maximum Number of Security Holder Nominees

A small number of Supporting Commenters believed that the proposed limitations on the number of security holder nominees required to be included in company proxy materials were set too low.[96] Beyond supporting a requirement to place additional nominees in the proxy materials, these commenters were not in agreement as to the appropriate number of security holder nominees to be so included. Two commenters urged that in no event should the number of security holder nominees be less than two.[97] One commenter believed that the number of security holder nominees required to be included by the proposed rules should be 35% of the board seats available in each given election.[98] One commenter believed that the number of security holder nominees should be the greater of two directors or 35% of the board.[99] Another commenter believed that the number of security holder nominees should be not less than 40% of the total number of the eligible board seats in any given election cycle.[100] One commenter believed that there should be no limitations on the number of security holder nominees.[101]

One Opposing Commenter believed that that the proposed limitations on the number of security holder nominees required to be included in the company's proxy materials were too generous.[102] The commenter believed that the company should be required to include only one nominee, regardless of the size of the board.[103]

IX. Which Security Holder Nominee(s) Must the Company Include in Its Proxy Materials

The issue of which security holder nominees must be included in company proxy materials generated comment from several Supporting Commenters.[104] These commenters focused on whether the limitations regarding independence of the nominee from the nominating security holder, nominating security holder group, or company were appropriate.[105] At least five Supporting Commenters expressed serious concern and/or outright disagreement with the limitations regarding independence of the nominee from the nominating security holder, nominating security holder group, or company.[106] Two

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[95] FSF.
[96] *See, e.g.*, Fountain; Keating; Macy; McRitchie; Moore; Sierra Club.
[97] Fountain; Macy.
[98] Sierra Club.
[99] Moore.
[100] McRitchie. In earlier comments, McRitchie stated that the number of security holder nominees should be "one less than half" of the eligible board seats in any given election cycle. *See* McRitchie letter dated November 16, 2003.
[101] Keating.
[102] FSF.
[103] *Id.*
[104] *See, e.g.*, Lucent Retirees; McRitchie; Moore; Shamrock Holdings; Sierra Club.
[105] *See, e.g.*, Lucent Retirees; McRitchie; Moore; Shamrock Holdings; Sierra Club.
[106] Lucent Retirees; McRitchie; Moore; Shamrock Holdings; Sierra Club.

of these commenters noted that the proposed limitations would hold a candidate suggested by a security holder or security holder group to a different independence standard than board-nominated candidates.[107] Furthermore, the three other commenters noted that the proposed limitations would inhibit large security holders from seeking seats on boards as part of actively managed governance strategies.[108]

X. Alternatives to the Proposed Rules

The Roundtable featured extensive discussions regarding several alternative proposals to the pending rules.[109]

Two alternatives, proposed by Ira Millstein and Professor Joseph Grundfest, respectively, received significant attention. Each alternative proposal would make it possible for security holder disfavor with a director nominee, expressed as a withhold vote, to impact immediately the election of directors, if a nominee fails to receive a majority (or some other percentage) of the votes cast.

Mr. Millstein proposed that the New York Stock Exchange and the Nasdaq National Market adopt a new corporate governance listing standard, generally to be complied with through adoption of a by-law amendment by listed companies.[110] Mr. Millstein proposed that in any uncontested election of directors of a listed company that is required to have a majority of independent directors under existing listing standards, a director nominee could be elected only after receiving the affirmative vote of a majority of the votes cast.[111] Votes that are "withheld" would be treated effectively as votes against a nominee, in contrast to the prevailing plurality voting system, under which the nominee who obtains the most affirmative votes is elected, regardless of the number of votes "withheld."[112] A nominee who is already a director, but who is rejected as a result of a withhold vote, would remain until he or she resigned or, if he or she did not resign, until his or her successor is elected. A nominee who is not already a director and who is rejected, as a result of a withhold vote, would not become a director. According to Mr. Millstein:

> If, as a result of the election, one or more nominees are rejected, but a majority of the board consists of directors who have not been rejected, the board could proceed to address the situation however it deems appropriate. Under this circumstance, there would be no additional regulatory requirements imposed. We

[107] Lucent Retirees; Sierra Club.
[108] McRitchie; Moore; Shamrock Holdings.
[109] *See, e.g.*, Charles M. Elson, Roundtable Transcript at 94-95; Professor Joseph A. Grundfest, Roundtable Transcript at 100-02; Professor Randall S. Kroszner, Roundtable Transcript at 20-21; Ira Millstein, Roundtable Transcript at 104-06.
[110] Millstein. Available at http://www.sec.gov/spotlight/dir-nominations/milstein030304.htm.
[111] Millstein. Specifically, no nominee of the board of directors would be considered elected who has not received votes in favor of his or her election representing at least a majority of the votes of all the shares voted in respect of his or her election (and assuming satisfaction of any applicable quorum requirement).
[112] Millstein. *See also* Karmel (discussing briefly an alternative mechanism whereby security holders might be given the right to vote "No" instead of merely abstaining on a vote for a particular director).

> would expect that a responsible board would seek to negotiate a solution which the shareholders would support. It might seek the resignation of some or all rejected nominees who are directors and fill the resulting vacancies either by holding an additional election or by appointing new directors, all as the company's organizational documents may provide. While a board could choose to ignore the shareholders' rejection of its slate of nominees, doing so could leave a board open to severe public criticism, and a possible proxy contest.
>
> If, as a result of the election, a majority of the board consists of directors who were rejected as a result of this rule, the company would have 120 days to hold another shareholders meeting to elect directors. A responsible board would presumably pursue a dialogue with relevant shareholders regarding the nominees it would present in the subsequent election.[113]

Professor Grundfest proposed an alternative based on the advice and consent procedure created by Article II Section 2 of the United States Constitution.[114] Under the alternative, any director who is elected under state law but receives a majority of withhold votes would be deemed "unratified" for purposes of the federal securities laws and, as such, would be subject to a variety of material disabilities imposed via expansive and burdensome disclosure requirements pursuant to new Commission regulations.[115] According to Professor Grundfest, neither the targeted directors nor the boards on which they serve likely would be enthusiastic about the continued service of such directors after the disabilities had attached.[116] As such, Professor Grundfest notes:

> If this calculation is correct, then the imposition of this disclosure requirement, which is rationally related to the Commission's well-established disclosure authority, would have the collateral effect of *de facto* requiring that every sitting director be elected by a majority (or some other percentage) of the shareholder body, or be nominated by directors who satisfy that condition.[117]

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[113] Millstein (emphasis in original).

[114] In a letter dated April 7, 2004, Professor Grundfest, joined by the ASCS and Barclay's Global Investors, N.A. (Barclays), submitted comments that modified and described in more detail the "advice and consent" alternative originally proposed by Professor Grundfest in his letter dated October 22, 2003. Any further reference to the "advice and consent" proposal shall mean the proposal as set forth in this joint letter. The letter, hereinafter cited as "Grundfest/ASCS/Barclays," is available at http://www.sec.gov/rules/proposed/s71903/grundfestascsbgi040704.pdf.

[115] Grundfest/ASCS/Barclays. Under the proposal the Commission would adopt expansive disclosure requirements applicable to unratified directors and boards that allow unratified directors to continue to serve. These new disclosure obligations would be incorporated into Exchange Act Form 8-K and would require that the registrant and any unratified director make extensive disclosures regarding the deliberations and decisions reached by the registrant's board and by any committee of the registrant's board on which one or more unratified directors serve. The disclosures would provide shareholders with far more detailed information than they currently obtain about board process and decision-making. The disclosures, according to Professor Grundfest, would facilitate more scrupulous monitoring of the conduct of directors who serve over the objection of a majority (or some other percentage) of the shareholder body.

[116] Grundfest/ASCS/Barclays.

[117] *Id.*

In short, Professor Grundfest believes that the consequences of a director or directors being identified as unratified would force negotiations between boards and security holders directed at identifying board members satisfactory both to security holders and to the surviving incumbent directors.[118]

Another commenter proposed two alternatives to the proposed nomination procedure.[119] Under the first alternative, the Commission would exempt from the operation of any final rules any company that required that a majority of the votes cast be necessary to elect a director.[120] The commenter noted that the requirement that a director must receive a majority of the votes cast could be imposed by a company's certificate of incorporation, state statute, or company bylaw, provided that such a bylaw is validly adopted under state law.[121] According to the commenter, "This concept would seem to be consistent with the goals of the Commission and is more consistent with principles of federalism than the imposition of the proposed rule would be without such a reference to state law or private ordering."[122] The second alternative was based on the model of "comply or disclose" that is in general use in the United Kingdom.[123] The alternative would set forth an "aspirational" standard.[124] If a company chose not to comply with the aspirational standard by itself establishing the right to propose a nominee in the company's proxy statement after the triggering events, it would have to disclose that fact and the reasons for noncompliance.[125]

One commenter expressed the view that, in an effort to push companies towards experimenting with different levels of security holder access, it might be desirable to facilitate greater state involvement in the regulation of the proxy process.[126] The commenter suggested that the Commission "encourage state or company-specific rules . . . to clarify that rules affording greater shareholder access are not pre-empted by proposed rule 14a-11."[127]

At least three Supporting Commenters addressed the alternative proposals that would impose prescribed penalties if a majority (or some other percentage) of shares cast were withheld from a director.[128] The three commenters urged that the proposed rules should be supplemented by, not replaced with, the alternative proposals and/or revised listing standards.[129] One commenter stated that the right to reject a nominee has little value if security holders are not empowered to also select the rejected nominee's

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[118] *Id.*
[119] Veasey.
[120] *Id.*
[121] *Id.*
[122] *Id.*
[123] *Id.*
[124] *Id.*
[125] *Id.*
[126] Fisch.
[127] *Id.*
[128] CBIS; CII; ISS.
[129] CBIS; CII; ISS.

replacement.[130] Another commenter noted that while the suggested reforms would restore significance to the election of directors, the inability under such reforms for security holders to efficiently and simply run alternative candidates for the board of directors made the suggested alternatives inadequate.[131] This commenter was further concerned that any rulemaking related to revised listing standards might become bogged down at the NYSE and the Nasdaq, respectively.[132] The third commenter, which believed that the advice and consent proposal provides "strong incentives for companies to seek majority-vote election of all directors," suggested that if the Commission decides to adopt the proposed rules substantially as drafted it should consider separately adoption of the advice and consent proposal substantially as drafted by Professor Grundfest.[133]

Opposing Commenters differed from the Supporting Commenters in their reaction to the two alternatives addressed above. As noted above, two commenters indicated their support for Professor Grundfest's "advice and consent" proposal by joining with Professor Grundfest in submitting comments that outline in detail how such an alternative would work.[134] These commenters remarked that their alternative represented a "less confrontational mechanism that constructively engages shareholders" in the nomination and election process.[135] The commenters further believed that their alternative was simpler than and superior to the proposed rules, noting:

> It could [] operate in a single election cycle, thereby eliminating the need for an election as to whether to have an election that protracts the contest over a two-year period. Such a rule would eliminate many of the essentially arbitrary triggers and thresholds found in the pending proposal. It would also eliminate the need for investors to track their shareholdings over long time periods in order to determine their qualifications pursuant to the proposed rules, and would eliminate the prospect of expensive litigation over these complex holding requirements, as well as over many other provisions of the pending proposal.[136]

The commenters that submitted the advice and consent proposal urged the Commission to re-propose the pending rules along with their alternative, and variants thereof, to obtain public comment as to the preferable approach.[137] Several other Opposing Commenters noted the advice and consent proposal and/or Mr. Millstein's revised listing standards proposal.[138] Although unwilling to endorse either of the alternative reforms, the commenters urged the Commission to consider carefully and/or allow public comment on each proposal.[139]

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[130] CBIS.
[131] CII.
[132] *Id.*
[133] ISS.
[134] Grundfest/ASCS/Barclays.
[135] *Id.*
[136] *Id.*
[137] *Id.*
[138] *See, e.g.*, BRT (the BRT actually noted at least four alternatives put forth at the Roundtable); FSF; NYSBAR.
[139] *Id.*

XI. Proxy Voting Mechanics

Several Opposing Commenters and one commenter that declined to oppose or support generally the proposed rules expressed concern that the proposed rules would result in a dramatic increase in the number of contested elections and that, as such, mechanical issues surrounding proxy voting would take on a new significance.[140] The issues cited most commonly by the commenters included: (1) rules governing company communications with security holders;[141] (2) technological means to track the votes necessary to determine whether triggers have been met;[142] (3) design of the proxy card;[143] and (4) the applicability of broker discretionary voting authority under NYSE Rule 452.[144] Additional issues noted by one commenter include: (1) accuracy of share records; (2) customary procedures authorizing security holders to sign and vote proxies in blank; and (3) review and inspection rights.[145] In light of the projected increase in the number and significance of security holder communications and the difficulty and costs inherent in the current rules, the commenters strongly urged the Commission to review the rules related to the mechanics of proxy voting.[146]

One commenter, a vendor specializing in securities transaction processing and security holder communications, noted that the proposed rules would require extensive modifications of the technological systems that currently support the proxy process.[147] Specifically, the commenter noted:

> Our view of the amount of programming hours that would be required to accommodate the systems changes is over 21,400 based on our current understanding and assumptions. We have 63 development resources that would be involved in the proposed Proxy Plus and related systems modifications. Program modifications of this nature cannot happen in complete parallel in a development environment and cannot begin in earnest until any proposed rules are finalized. If we view the development timeline for these proposed changes, plus the additional time that is required for form design and review, process changes, systems quality assurance and capacity testing, the attached Gantt view shows us six to seven calendar months from the time the proposed rules are finalized until the completed changes would be available in a production environment. In other words, to be ready for the 2005 proxy season with a

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[140] *See, e.g.*, ASCS; BRT; Georgeson (expressing neither general support nor opposition); Honeywell; NYSBAR; Raines.
[141] *See, e.g.*, ASCS; BRT; Georgeson; Raines.
[142] *See, e.g.*, ASCS; BRT; Georgeson; NYSBAR.
[143] *See, e.g.*, ASCS; Georgeson; Honeywell.
[144] *See, e.g.*, Georgeson; Honeywell.
[145] Georgeson.
[146] *See, e.g.*, Georgeson (Recommending that "(1) The Commission should undertake a comprehensive review of proxy procedures for the purpose of simplifying the system and increasing its transparency. (2) The Commission should promptly rescind the NOBO/OBO rules and establish a new direct access rule that will empower beneficial owners in street name to sign and vote proxies and entitle companies to communicate directly with beneficial owners.").
[147] ADP.

margin of safety required for our normal volume testing process to occur we would need to begin working on the implementation of the changes by the beginning of June 2004.[148]

XII. Role of the Nominating Committee

Several Opposing Commenters expressed concern that the proposed rules would permit certain security holders to bypass the independent nominating committee process.[149] One of the commenters stated, "This intrudes on the ability of the board of directors and its nominating committee to act in this crucial area of corporate governance and impairs the nominating committee process."[150] Two commenters believed that the board nominating committee should remain a part of the process regarding security holder nominations, and that the nominating committee should have an opportunity to vet all candidates.[151]

XIII. Institutional Investor Voting Practices and Proxy Advisory Services

Several Opposing Commenters stated that the proposed rules, particularly the thresholds related to the triggering events, do not adequately take into account the realities of the current proxy process, particularly the existence of inflexible voting guidelines and/or the influence of proxy advisory services, and the impact that the process will have on the highly concentrated institutional ownership in most large public companies.[152] Institutional investors, according to the commenters, might develop internal voting guidelines or follow voting guidelines provided by third-party vendors– which are not beneficial owners and often do not owe a fiduciary duty to the institutional clients–to vote automatically in favor of triggering the nomination procedure without any consideration of the underlying performance and/or responsiveness of the subject company.[153] As such, the commenters cautioned that the proposal would increase dangerously the power of proxy advisory firms and institutional investors.[154] One commenter noted, "While the actions of these institutional investors and proxy analysis organizations are often well-meaning, this nevertheless is a precarious foundation upon which to build a new corporate governance regime, as the proposed rule would tend to do."[155]

Two Supporting Commenters dismissed the concerns noted above as "overblown" and "unwarranted," respectively, and stated that the proposed rules would not give disproportionate or unreasonable power to proxy advisory firms.[156] In this regard, one of the commenters stated that: (1) the largest institutional money managers have their own

[148] *Id.*
[149] *See, e.g.,* ABA; FSF; Odland. *See also* ASCS; Honeywell.
[150] ABA.
[151] ASCS; FSF.
[152] *See, e.g.,* ABA; BRT; Raines.
[153] ABA; BRT; Raines.
[154] ABA; BRT; Raines.
[155] ABA.
[156] CII; Moore.

voting guidelines and, contrary to the assertions of many companies, do not blindly follow the recommendations of proxy advisory services; (2) approximately 70% of the equity holdings of all institutional investors are held by corporate pension funds, mutual funds, bank trust funds and insurance companies, which tend generally to support management's voting recommendations; and (3) the number of institutional investors, particularly mutual funds, that will adopt voting based on their own guidelines likely will increase in the future as a consequence of the Commission's recent requirements addressing the transparency of proxy votes by mutual funds and money managers.[157]

IVX. Costs

Two Opposing Commenters believed that the Commission underestimated significantly not only the degree to which the proposed procedure will be triggered, but also the costs the proposed rules would impose on companies.[158] Two Opposing Commenters presented data from November 2003 surveys ("November 2003 Surveys") that collected data from 137 public companies regarding the proposal.[159] The November 2003 Surveys indicated that adoption of the proposed nomination procedure would result in an additional total burden of more than $700,000 per "affected" company.[160]

[157] CII.
[158] BRT; Raines.
[159] BRT; Raines. The November 2003 Surveys were conducted by the BRT and ASCS.
[160] BRT. *See* BRT letter dated December 22, 2003.

