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Part II

**Securities and
Exchange
Commission**

**17 CFR Parts 240, 249 and 274
Security Holder Director Nominations;
Proposed Rule**

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240, 249 and 274

[Release Nos. 34-48626; IC-26206; File No. S7-19-03]

RIN 3235-A193

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 should be received on or before 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 Web site (<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-11¹ 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-11⁹ and 16a-1,¹⁰ Schedules 13G¹¹ and 14A,¹² and Forms 8-K,¹³ 10-Q,¹⁴ 10-QSB,¹⁵ 10-K¹⁶ and 10-KSB¹⁷ under the Securities Exchange Act of 1934,¹⁸ and Forms N-CSR¹⁹ and N-SAR²⁰ under the Securities Exchange Act of 1934 and the Investment Company Act of 1940.²¹ Although we are not proposing amendment to Schedule 14C²² 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

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 Web site, (<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.*

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

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).

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

³⁰ See *Securities 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 *Securities 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).

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 Act⁴⁴ prohibits any person from soliciting proxies with respect to a Section 12⁴⁵-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

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.

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.2b. 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.

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

⁴⁴ 15 U.S.C. 78n(a).

⁴⁵ 15 U.S.C. 78l.

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

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

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).

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.

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-2⁶⁶ 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

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).

- 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

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.

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)].

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

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

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” votes⁷² 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

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).

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

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.

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 under Exchange Act Rule 14a-9.⁷⁷

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

⁷⁷ 17 CFR 240.14a-9.

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

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.

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 2003⁸⁴ 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.

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.

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

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.

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.*

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

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.

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

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

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-KSB⁸⁹

Because the proposed security holder nomination procedure would operate only upon the occurrence of specified nomination procedure triggering events,

⁸⁹In 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.

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?

⁹⁰In 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.

⁹¹Item 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.

⁹²See 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.

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

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. 78l], 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).

- 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

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.*

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

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.

(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

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.

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:

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.

- 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

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 228401(d)].

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

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)

- 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 1933¹¹¹ 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

of the Investment Company Act. See Section II.A.12., below.

¹¹¹ 15 USC 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.

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

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

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:

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.

- 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

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

¹¹⁴ Based on a sample of 1,439 public companies provided by IRRG 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).

- 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

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

- 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 Web site 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

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).

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

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.

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 Web site 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 Web site, 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

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.

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.

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

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).

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(I)(2),¹³⁸ providing that the company would not be responsible for that disclosure.¹³⁹

¹³⁸ 17 CFR 240.14a-8(I)(2).

¹³⁹ See proposed Exchange Act Rule 14a-11(e). Exchange Act Rule 14a-8(I)(2) applies with respect to proposals and supporting statements that are submitted by shareholders and then required to be

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?

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.

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, 14a-10, and 14a-12 to 14a-15¹⁴³ 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 Web site 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, 14a-10, and 14a-12 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 Web site; 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

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).

provided that, where requested, the company would include in its proxy materials the Web site 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

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,

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

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].

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

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).

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

¹⁶² See Section IIA2a, 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.

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,

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.

“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 to the issuer.¹⁷⁸

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

¹⁸⁰ 44 U.S.C. 3501 *et seq.*

¹⁸¹ 44 U.S.C. 3507(d) and 5 CFR 1320.11.

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.

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.

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

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.

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

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.

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

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

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

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.

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

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

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

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 11% 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 375% 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: IRR.

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

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

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

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.

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

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

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

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.

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

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.

TABLE 1.—CALCULATION OF INCREMENTAL PRA BURDEN ESTIMATES²⁰⁴

	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 *	¹ 23,743	83	0.9	75	56	19	\$5,700
FORM 8-K	² 333,915	3	5	15	11	4	\$1,200
FORM N-CSR	³ 6,658	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	49306	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.

¹ 7,914 respondents.

² 13,200 respondents.

³ 3,829 respondents.

⁴ 4,653 respondents.

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 directors²⁰⁵ 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

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).

²⁰⁴ The incremental burden estimate for Form N-CSR includes 140.5 hours (281 responses X 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.

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:

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.

- 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

²⁰⁸ See *id.*

²⁰⁹ See Release No 34-48301 (August 14, 2003).

²¹⁰ See 2003 Summary of Comments.

²¹¹ See *id.*

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 2003 request for public input, one commenter noted that

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 1405 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].

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

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.*

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

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 Act 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.

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 data 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 Act²²⁶ 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 Act²²⁷ and Section 2(c) of the Investment Company Act²²⁸ 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

²²⁷ 15 U.S.C. 78c(f).

²²⁸ 15 U.S.C. 80a-2(c).

²²⁶ 15 U.S.C. 78w(a)(2).

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 directors²²⁹ 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.

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.

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).

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

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."

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:

²³⁸ Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996).

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

1. The authority citations 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 citations 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): 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.

(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).

§ 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 § 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 Web site 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 Web site; 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) and add "Note to Paragraph (a)(1)(ii)(K)" 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

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Part II—Other Information

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

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(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

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Part I

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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

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Part I

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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

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Instructions to Specific Items

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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.

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Dated: October 14, 2003.

By the Commission.

Margaret H. McFarland, Deputy Secretary.

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