

**SUPPLEMENTAL SUMMARY OF COMMENTS RECEIVED ON OR  
AFTER FEBRUARY 6, 2004**

**In Response to the Commission's Proposed Rules  
Relating to Security Holder Director Nominations**

**Exchange Act Release No. 34-48626  
Investment Company Act Release No. 26206  
File No. S7-19-03**

**Prepared by:**

**Division of Corporation  
Finance  
May 25, 2004**

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## **I. List of Commenters**

### **Academics**

1. John C. Coffee, Jr. (“Coffee”)
2. David C. Donald
3. Jill Fisch (“Fisch”)
4. Joseph A. Grundfest, joined by American Society of Corporate Secretaries and Barclay’s Global Investors, N.A., letter dated April 7, 2004 (“Grundfest/ASCS/Barclays”)
5. Thomas W. Joo
6. Roberta Karmel (“Karmel”)

### **Associations**

7. American Bar Association (“ABA”)
8. American Business Conference (“ABC”)
9. America’s Community Bankers (“ACB”)
10. American Society of Corporate Secretaries (“ASCS”)
11. Business Roundtable, letters dated April 27, 2004 and April 1, 2004 (“BRT”)
12. Corporations Committee of the Business Law Section of the State Bar of California, letters dated March 31, 2004 and February 27, 2004
13. Financial Services Forum (“FSF”)
14. National Association of Corporate Directors, letters dated March 26, 2004 and March 9, 2004 (“NACD”)
15. New York State Bar Association (“NYSBAR”)
16. North America Securities Administrators Association, Inc.
17. Washington Legal Foundation (“WLF”)

### **Corporations, Corporate Executives, and Corporate Directors**

18. Arch Coal, Inc. (“Arch Coal”)
19. Honeywell International Inc. (“Honeywell”)
20. Steve Odland, Chairman, President, and CEO, Autozone, Inc. (“Odland”)
21. Franklin D. Raines, Chairman and CEO, Fannie Mae (“Raines”)
22. RPM International (“RPM”)
23. United Technologies (“United Technologies”)

### **Form Letter Types**

24. Form Letter Type C, representing one individual that submitted comments after February 6, 2004 (“Letter Type C”)
25. Form Letter Type E, representing four individuals or entities that submitted comments after February 6, 2004 (“Letter Type E”)

- 26. Form Letter Type G, representing three individuals or entities that submitted comments after February 6, 2004 (“Letter Type G”)
- 27. Form Letter Type I, representing five individuals or entities that submitted comments after February 6, 2004 (“Letter Type I”)
- 28. Form Letter Type M, representing 388 individuals or entities that submitted comments after February 6, 2004 (“Letter Type M”)
- 29. Form Letter Type AA, representing fifty-five individuals or entities that submitted comments after February 6, 2004 (“Letter Type AA”)
- 30. Form Letter Type V, representing fifteen individuals or entities that submitted comments after February 6, 2004 (“Letter Type V”)
- 31. Form Letter Type W, representing ten individuals or entities that submitted comments after February 6, 2004 (“Letter Type W”)
- 32. Form Letter Type X, representing 1523 individuals or entities that submitted comments after February 6, 2004 (“Letter Type X”)
- 33. Form Letter Type Y, representing 360 individuals or entities that submitted comments after February 6, 2004 (“Letter Type Y”)
- 34. Form Letter Type Z, representing seven individuals or entities that submitted comments after February 6, 2004 (“Letter Type Z”)

**Individual**

- 35. Ann Aitken
- 36. Tom Aldrich
- 37. Gary Anderson
- 38. Anonymous Reviewer, letter submitted March 31, 2004
- 39. Anonymous Reviewer, letter submitted March 30, 2004
- 40. Anonymous Reviewer, letter submitted March 30, 2004
- 41. Anonymous Reviewer, letter submitted March 29, 2004
- 42. Anonymous Reviewer, letter submitted February 9, 2004
- 43. Phil Aramoonie
- 44. Michael Asato
- 45. Albert Austin (“Austin”)
- 46. Wayne E. Bartling
- 47. Ed Beltram

48. Lee Blasingame
49. Christopher H. Bock
50. Mark Brackenbusch (“Brackenbusch”)
51. Jimmy Briggs
52. Russ Bringe
53. Patrick Butcher
54. Christian Call
55. James F. Callow (“Callow”)
56. Robert Chaffin
57. Jonathan Clermont
58. Eliot Cohen
59. Dorothy Coleman (“Coleman”)
60. Brook Connery (“Connery”)
61. F. Dean Copeland
62. Peter Cram
63. Manley Cupstid, Jr.
64. Evelyn Y. Davis (“Davis”)
65. Ellison Dennis
66. Bob Djurdevic
67. [Dldebow@aol.com](mailto:Dldebow@aol.com)
68. Margaret Dower
69. William Edmondson (“Edmondson”)
70. Walter J. Ehmer
71. Dan Erlich
72. B. Chris Feher
73. Rick Finlinson (“Finlinson”)
74. Mark Flynn
75. David Fountain (“Fountain”)
76. Geno Gardner
77. Bill Garrison
78. Ken German
79. Beverly Gilbert (“Gilbert”)
80. Sushama Gokhale
81. Marc J. Goldberg
82. Michael Goldin
83. John R. Haaf
84. James A. Haigh
85. Donna Hamel (“Hamel”)
86. Peter Hanson (“Hanson”)
87. David G. Harding
88. Ed Harrell
89. Steven Harris (“Harris”)
90. Mark Harrison
91. Dayn Harum
92. Bjarne Hedegaard
93. Tim Hill (“Hill”)

94. Marcus Innis
95. Dave Jackson
96. James
97. Garvin Jabusch
98. Jacqueline Jenkins
99. Mark Kalagorgevich
100. David Keating (“Keating”)
101. Karl Kelcec
102. Abraham Keller
103. Paul A. Keller
104. Deborah Kozura (“Kozura”)
105. Elvis Krivicic
106. David Langtry
107. Kent Lion
108. James Little
109. Marion MacMahon
110. William and Paula Macy (“Macy”)
111. William A. Mahan (“Mahan”)
112. Ronald D. Markham (“Markham”)
113. Bob Mason
114. Joe Matchette
115. William McAllister
116. Joseph McCormack
117. Kara McMillan
118. Kendall Miles
119. Doug Millard (“Millard”)
120. Keith Miracle (“Miracle”)
121. Karen Moor (“Moor”)
122. Kevin Moorman
123. Charles Morris
124. Tony Mosich
125. Cody Nedved
126. Perry G. Noblett II
127. Dr. Vencil O’Block
128. Paul O’Rell
129. Anna Payne
130. Daniel Pensiero III
131. Steven W. Peterson
132. Nancy L. Pine
133. David Post
134. Steve Pratt
135. Keith Price
136. Eugene T. Quail (“Quail”)
137. Thomas Ramagli (“Ramagli”)
138. Oostur Raza
139. John K. Ritchie

- 140. Mike A. Rock
- 141. Steve Rode (“Rode”)
- 142. D. Floyd Russell
- 143. John Sanborn (“Sanborn”)
- 144. RW Schultz (“Schultz”)
- 145. Gary H. Schwartz
- 146. Richard Scotty
- 147. Troy Segler
- 148. Cerulean Skies
- 149. Bill Snodgrass
- 150. David Stadlin
- 151. Rosalie Steele
- 152. Alan Stephenson (“Stephenson”)
- 153. Wheeler Stewart
- 154. Aaron Stover (“Stover”)
- 155. Jack Swift
- 156. Glendon Thomas (“Thomas”)
- 157. Paul Tomasik
- 158. Mark Tucker
- 159. John D. Walker
- 160. [WOSTeward@aol.com](mailto:WOSTeward@aol.com)
- 161. Ken Wemhoff
- 162. Ron Wright
- 163. Milman Youngjohn
- 164. Lin Zicconi

**Law Firms and Attorneys**

- 165. Gibson, Dunn & Crutcher LLP, letters dated April 26, 2004, April 13, 2004 and March 19, 2004

**Security Holder Resource Providers**

- 166. Automatic Data Processing, Inc. (“ADP”)
- 167. Committee of Concerned Shareholders (“CCS”)
- 168. CorpGov.Net; James McRitchie, Editor (“McRitchie”)
- 169. Georgeson Shareholder Communications, Inc. (“Georgeson”)
- 170. Institutional Shareholder Services (“ISS”)
- 171. ProxyMatters.com, LLC
- 172. RestoreTheTrust.com

**Social, Environmental and Religious Funds and Related Service Providers**

- 173. Christian Brothers Investment Services (“CBIS”)
- 174. Nathan Cummings Foundation (“Cummings”)

**Unions, Pension Funds, Institutional Investors, Institutional Investor Associations, and Governmental Representatives**

- 175. American Federation of Labor and Congress of Industrial Organizations (“AFL-CIO”)

- 176. Council of Institutional Investors, letters dated May 3, 2004 and March 31, 2004 (“CII”)
- 177. Dianna DeGette, U.S. Representative (Colorado) (“DeGette”)
- 178. International Union of Bricklayers & Allied Craftworkers, Local No.1 of Washington
- 179. Lucent Retirees Organization (“Lucent Retirees”)
- 180. Richard H. Moore, Treasurer, State of Connecticut (“Moore”)
- 181. Denise Nappier, Connecticut State Treasurer (“Nappier”)
- 182. Shamrock Holdings, Inc. (“Shamrock Holdings”)
- 183. Sierra Club Mutual Funds (“Sierra Club”)
- 184. SPEEA/IFPTE
- 185. E. Norman Veasey, Chief Justice, Supreme Court of Delaware (“Veasey”)



## II. Overview

In Exchange Act Release No. 34-48626 (October 14, 2003), the Commission proposed rules that would, under certain circumstances, require companies to include in their proxy materials security holder nominees for election as director. On February 9, 2004, the Commission announced that it would host a roundtable on March 10, 2004, to discuss the proposed rules relating to security holder director nominations. On March 10, 2004, the Commission held the Security Holder Director Nominations Roundtable (Roundtable).<sup>1</sup> Following the Roundtable, the Commission solicited additional comment in connection with the proposed rules and the viewpoints expressed at the Roundtable. The commenters who responded were comprised of the following groups:<sup>2</sup>

- 5 academics;
- 11 associations;
- 6 corporations, corporate executives, and corporate directors;
- 11 Form Letter Types (representing approximately 1915 individuals or entities that submitted letters after February 6, 2004);
- 130 individuals;
- 1 law firm;
- 8 security holder resource providers;
- 2 social and religious funds; and
- 11 unions, pension funds, governmental representatives, institutional investors, and institutional investor associations.

The vast majority of commenters submitted brief statements that supported the proposed rules (“Supporting Commenters”).<sup>3</sup> While they viewed the proposed rules as a critical first step in reforming corporate governance, more than half the Supporting

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<sup>1</sup> Transcripts of the Roundtable are available at <http://www.sec.gov/spotlight/dir-nominations/transcript03102004.txt>. An archived webcast is available at <http://www.connectlive.com/events/secnominations/>. Prepared statements submitted by the participants are reflected in this Supplemental Comment Summary and are available at <http://www.sec.gov/spotlight/dir-nominations.htm#parts>. Publications or forthcoming publications submitted by the participants are not reflected in this Supplemental Comment Summary, but are available at <http://www.sec.gov/spotlight/dir-nominations.htm#parts>.

<sup>2</sup> The aggregate number of commenters and the numerical breakdowns of the commenters according to category are approximations and are current as of May 20, 2004. Comment letters continue to be submitted.

<sup>3</sup> See, e.g., Letter Type M; Letter Type W; Letter Type X; Letter Type Y; Letter Type Z; Letter Type AA.

Commenters desired a stronger rule.<sup>4</sup> Those in favor of a stronger rule, however, generally did not address how the proposed rules should be revised.<sup>5</sup>

The number of commenters that opposed the rules (“Opposing Commenters”) was very limited.<sup>6</sup> The Opposing Commenters generally recommended that the Commission not adopt or defer implementing the proposed rules until the Commission has had time to assess the impact of the Sarbanes-Oxley Act of 2002, the markets’ amendments to their listing standards, and the Commission’s own recent reforms.<sup>7</sup> Several of these commenters expressed concern that the proposed rules would apply to all public companies, contrary to the Commission’s stated goal of targeting only unresponsive companies.<sup>8</sup> A number of the commenters expressed further concern over purported adverse effects that the proposed rules would have on companies and their boards.<sup>9</sup> For example, commenters stated that the proposed rules, among other things, would facilitate special interest directors, disrupt and polarize boards, discourage qualified candidates from serving on boards, encourage costly election contests, result in director nominees who do not meet legal requirements, and diminish board accountability by bypassing companies’ nominating committees.<sup>10</sup>

The portions of the proposed rules and Roundtable discussions that generated the most extensive comment are addressed below. It should be noted that the vast majority of commenters did not address directly the discussions held at the Roundtable.

### **III. Authority**

Supporting Commenters did not address whether the Commission has the authority to adopt the proposed rules.

Several Opposing Commenters, on the other hand, addressed the question of authority and submitted that, if adopted, the proposed procedure would exceed the Commission’s statutory authority under Exchange Act Section 14(a) and the other statutory provisions cited as authority for the new rule.<sup>11</sup> The commenters indicated that neither Exchange Act Section 14(a) nor the other statutory provisions authorize the Commission to regulate corporate governance.<sup>12</sup> Three commenters stated that the proposed procedure—by creating a right in certain shareholders to solicit proxies for their

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<sup>4</sup> See, e.g., Letter Type X; Letter Type AA.

<sup>5</sup> See, e.g., Letter Type X.

<sup>6</sup> See, e.g., ABA; ACB; Arch Coal; ASCS; BRT; Coleman; FSF; Gilbert; Honeywell; Karmel; Kozura; Letter Type E; Letter Type V; Mahan; Millard; Moor; NACD; NYSBAR; Rode; RPM International; Sanborn; Schultz; Stover; United Technologies; Veasey; WLF. Two commenters that supported reforming the proxy process opposed the proposed rules, which they viewed generally as biased in favor of large institutional investors. See CCS; Davis.

<sup>7</sup> See, e.g., ABA; ACB; Arch Coal; ASCS; BRT; FSF; Honeywell; Letter Type V; NACD; NYSBAR; RPM; United; WLF.

<sup>8</sup> See, e.g., Arch Coal; ASCS; FSF; Letter Type V; Odland; Raines; United. See also ABA.

<sup>9</sup> See, e.g., ABA; Arch Coal; ASCS; BRT; FSF; Honeywell; Letter Type V; RPM; Schultz; United.

<sup>10</sup> See, e.g., ABA; Arch Coal; ASCS; BRT; FSF; Honeywell; Letter Type V; RPM; Schultz; United.

<sup>11</sup> See, e.g., ABA; BRT; WLF. See also Karmel (questioning the authority of the Commission).

<sup>12</sup> See, e.g., ABA; BRT; Karmel; WLF.

director nominees in the company’s proxy materials, at the company’s expense, under specified circumstances and conditions—constituted impermissible substantive regulation rather than regulation of disclosure and process.<sup>13</sup>

One Opposing Commenter provided a number of examples that it claimed demonstrated that the proposed rules involve matters of corporate governance typically regulated by the states.<sup>14</sup> The commenter indicated that state law, although it typically affords security holders a right to nominate directors, does not establish a right of access to a company’s proxy statement by security holders for nomination purposes.<sup>15</sup> The commenter then noted that the proposed nomination procedure would “independently confer authority with respect to access on certain shareholders and make access virtually an organic requirement through the biannual renewal mechanism.”<sup>16</sup> The commenter also stated that the proposal would establish, via federal action, special rights for certain security holders and not others, a development not authorized under state law.<sup>17</sup>

The commenter also noted that security holders, unlike directors, are not committed by law to act as fiduciaries on behalf of all security holders.<sup>18</sup> By permitting security holders that are not fiduciaries to use a company’s proxy materials to pursue their own interests, the commenter argues, the proposed rules would bypass the established corporate governance system.<sup>19</sup> The commenter further noted its view that the history of limited security holder access to company proxy materials for proposals under Exchange Act Rule 14a-8 “does not support treating the proposed rule as a mere additional procedural regulation.”<sup>20</sup> Finally, the commenter cautioned that if the purpose of the proposed rule is to provide security holders access in order to enhance their role in managing corporate affairs, such a purpose intrudes on the state statutory scheme and impedes—and in some respects eliminates—the ability of the directors to act as fiduciaries for the corporate interest.<sup>21</sup>

One commenter, who did not take a general supporting or opposing view of the proposed rules, believed that the nomination procedure is consistent with state and

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<sup>13</sup> See, e.g., ABA (identifying a number of reasons why the proposed rules involve substantive internal corporate law matters); BRT (“This radical transformation of corporate practice would occur not pursuant to the laws of the States—where such matters of corporate governance traditionally have been regulated—but through federal agency rulemaking.”); WLF (“[t]he proposed rules create a new substantive right above and beyond the Commission’s rulemaking power.”).

<sup>14</sup> ABA.

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> *Id.* State law provisions require shares of the same class to carry the same rights. State law does not permit different classes of security holders within a single class of shares (*i.e.*, classes of security holders with different rights regarding, among other things, director nominations and the use of company funds and resources).

<sup>18</sup> ABA. See also Karmel.

<sup>19</sup> ABA. See also Karmel (“[U]nless shareholders who gain access to management’s proxy are charged with new and additional duties to all shareholders, it is inappropriate for them to have access to management’s proxy when other shareholders do not.”).

<sup>20</sup> ABA. See also ABA letter dated January 7, 2004.

<sup>21</sup> ABA. See also Odland.

federal law and falls within the Commission’s rulemaking authority under Exchange Act Section 14(a).<sup>22</sup> Another commenter, who similarly chose to refrain from taking a general supporting or opposing view of the proposed rules, took no position on the Commission’s legal authority, but did express concern that the nomination procedure raised a federalism concern.<sup>23</sup> The commenter noted, “Th[e] concern is whether the Commission, as a matter of policy, should undertake to provide a substantive right in certain stockholders when the creation of that right by the Commission, intrudes upon and may be in conflict with corporate internal affairs that are the province of state law.”<sup>24</sup> Another commenter, who also refrained from taking a general supporting or opposing view of the proposed rules, cited similar federalism concerns and stated that “proposed Rule 14a-11 lives or dies on a ‘procedure versus substance’ distinction.”<sup>25</sup>

#### **IV. To Which Companies Would the Proposed Rules Apply**

Two commenters addressed this issue. Both commenters believed that the proposed rules should not apply to all companies subject to the proxy rules.<sup>26</sup> One of the commenters stated that the proposal would have a disproportionate impact on smaller companies and urged the Commission to restrict application of the proposed rules to accelerated filers.<sup>27</sup> The other commenter favored application of the proposed rules to a limited sample of sophisticated companies on a trial basis.<sup>28</sup> The commenter suggested the Commission focus initially on the largest 200 companies in terms of market capitalization.<sup>29</sup>

#### **V. Timing Regarding the Effectiveness of the Proposal**

Large numbers of Supporting Commenters urged the Commission to approve the proposed rules at the earliest possible opportunity.<sup>30</sup> Several Supporting Commenters specifically urged the Commission not to “table” the proposed rules to give companies and investors time to evaluate the numerous reforms mandated by the Sarbanes-Oxley Act of 2002, the markets’ amendments to their listing standards, and the Commission’s own recent reforms.<sup>31</sup> Two of these commenters were of the view that the recent governance reforms had not addressed the “critical issue” of the ability of security holders to exercise a meaningful vote on director elections.<sup>32</sup> The commenters indicated that currently many long-term security holders can only address director problems by running an expensive and complex proxy fight—a nonviable alternative for most security

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<sup>22</sup> Fisch.

<sup>23</sup> Veasey.

<sup>24</sup> *Id.*

<sup>25</sup> Coffee.

<sup>26</sup> ABC; ACB.

<sup>27</sup> ACB.

<sup>28</sup> ABC.

<sup>29</sup> *Id.*

<sup>30</sup> *See, e.g.*, CBIS; CII; Finlinson; Hill; Letter Type X; Miracle.

<sup>31</sup> *See, e.g.*, CBIS; CII; Moore.

<sup>32</sup> CII; Moore.

holders, particularly fiduciaries acting on behalf of employee benefit plans.<sup>33</sup> Accordingly, the commenters expressed the position that the recent governance reforms should not be considered a replacement for proposed proxy reforms.<sup>34</sup>

On the other hand, Opposing Commenters, as noted above, generally urged that the Commission not adopt or defer implementing the proposal until the Commission has had time to assess the impact of the Sarbanes-Oxley Act of 2002, the markets' amendments to their listing standards, and the Commission's own recent reforms.<sup>35</sup> Two of the commenters urged that, should the Commission determine to adopt the proposal, the final rules, including the triggering events, should not become effective immediately.<sup>36</sup> One commenter suggested that any final rules become operational no less than one full year following the date the final rules become effective.<sup>37</sup> Another commenter suggested that the final rules should be effective no earlier than the 2005 proxy season and that any such rules should not have triggers that are retroactive to votes taken at any annual meetings before the effective date of the new rules.<sup>38</sup>

## **VI. "Triggering Events" – What Events Must Occur Before the Company Would Be Required to Include a Security Holder Nominee in Its Proxy Materials**

### *"Triggering Events" Generally*

For the small number of Supporting Commenters that did identify unfavorable aspects of the proposed rules, the most commonly cited issue was the triggering events, either in general or as currently drafted. A number of Supporting Commenters opposed triggering events *on principle*; several of these commenters believed that any triggering events would undercut unfettered inclusion of security holder nominees in a company's proxy materials.<sup>39</sup> Supporting Commenters that opposed the triggering events *as drafted* believed that: (1) the high ownership thresholds would render the inclusion of security holder nominees in an issuer's proxy materials beyond the reach of most security holders, including even the largest pension funds and institutional investors; and (2) the two-step, two-year process required to elect a director under the proposed triggers is too lengthy.<sup>40</sup>

Opposing Commenters, to the extent they addressed the triggering events, believed that, if adopted, the rules should include revised triggering events that are objective and narrowly tailored to limit the rule's impact to only those companies that

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<sup>33</sup> CII; Moore.

<sup>34</sup> CII; Moore.

<sup>35</sup> See, e.g., ABA; Arch Coal; ASCS; BRT; FSF; Honeywell; Letter Type V; NACD; NYSBAR; Odland; Raines; RPM; United; WLF.

<sup>36</sup> ASCS; NYSBAR.

<sup>37</sup> ASCS.

<sup>38</sup> NYSBAR.

<sup>39</sup> See, e.g., Austin; Hanson; Harris; Keating; Letter Type C; Letter Type G; Lucent Retirees; Markham; McRitchie; Moore; Ramagli; Sierra Club; Thomas.

<sup>40</sup> See, e.g., Callow; CBIS; Edmondson; Hamel; Letter Type I; Letter Type Z; SPEEA/IFPTE; Stephenson. See also Lucent Retirees; McRitchie; Moore; Sierra Club (current triggers, if maintained, are too burdensome).

truly demonstrate a significant level of security holder dissatisfaction with the proxy process.<sup>41</sup>

### *Appropriate Thresholds*

In order to strengthen the proposed rules and enhance their effectiveness, a number of Supporting Commenters supported relaxation of some of the obstacles raised by the triggering events. In this regard, five commenters that addressed the proposed threshold requiring a withhold vote for one or more directors of more than 35% of the votes cast believed the threshold was too high.<sup>42</sup> Two of the commenters suggested a threshold requiring a withhold vote for one or more directors of more than 20% of the votes cast.<sup>43</sup> One commenter suggested a threshold of more than 25% of the votes cast.<sup>44</sup> The remaining two commenters did not provide an alternative threshold.<sup>45</sup>

Another Supporting Commenter stated that the withhold votes threshold should remain at no more than 35% of the votes cast.<sup>46</sup> The commenter noted that increasing the withhold vote trigger to 50% of the votes cast, even excluding broker votes, would be “a significant change” that would severely limit the impact of the proposed rules.<sup>47</sup> The commenter was concerned particularly that excluding broker votes from the tabulation of the withhold votes threshold would not justify increasing that threshold to 50% of votes cast from 35% of votes cast.<sup>48</sup>

To illustrate its concern, the commenter cited a “narrow analysis of 110 companies reporting majority votes on shareholder resolutions in 2003.”<sup>49</sup> The survey indicated: (1) fourteen companies reporting at least one director that received a withhold vote exceeding 35%, excluding broker votes; (2) nine companies reporting at least one director that received a withhold vote exceeding 40%, excluding broker votes; and one company—less than 1% of the survey sample—reporting at least one director that received a withhold vote exceeding 50%, excluding broker votes.<sup>50</sup> The survey further indicated that broker votes represented on average 15% of the aggregate votes cast for directors.<sup>51</sup> The commenter, assuming a 15% broker vote, made the following observations: (1) a 35% withhold vote including broker votes does not translate into a 50% withhold vote, excluding broker votes; (2) a 35% withhold vote including broker votes would increase to 41.2% excluding broker votes; and (3) a withhold vote exceeding

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<sup>41</sup> See, e.g., ABA; ASCS; FSF; Honeywell; United Technologies.

<sup>42</sup> DeGette; Edmondson; Letter Type Z; Moore; Stephenson.

<sup>43</sup> Letter Type Z; Moore.

<sup>44</sup> DeGette.

<sup>45</sup> Edmondson; Stephenson.

<sup>46</sup> CII.

<sup>47</sup> *Id.*

<sup>48</sup> *Id.*

<sup>49</sup> *Id.*

<sup>50</sup> *Id.*

<sup>51</sup> *Id.* The commenter noted, “This number varied significantly, as would be expected, with companies having a heavier weighting of individual investors generally reporting a higher percentage of broker votes than companies with a preponderance of institutional investors.”

42.5% including broker votes would be necessary to reach a 50% withhold vote, excluding broker votes.<sup>52</sup>

The above commenter also believed strongly that the withhold vote trigger, regardless of the ultimate threshold, should not include a provision that would enable companies to “cure” the triggering event.<sup>53</sup>

Five Supporting Commenters that addressed the 1% ownership threshold for the security holder “opt-in” proposal believed it, also, was too high.<sup>54</sup> Three of the commenters favored requiring security holders or security holder groups to meet an ownership threshold similar to that set forth in Exchange Act Rule 14a-8;<sup>55</sup> the other two commenters did not provide an alternative threshold.<sup>56</sup>

The Opposing Commenters that addressed the triggering events generally believed that the proposed thresholds would not accomplish the Commission’s stated objective.<sup>57</sup> Three commenters remarked that because the thresholds associated with the triggering events are too low, the Commission’s proposal is overbroad and likely will be triggered more frequently than the Commission anticipates; these commenters did not offer specific recommendations on how the triggering events and the thresholds should be revised to limit their impact.<sup>58</sup> Two other commenters agreed that the thresholds were too low.<sup>59</sup> Specifically, the two commenters believed that the “withhold votes trigger,” which one of the commenters stated was the only appropriate triggering event, should take effect only when a director has failed to receive at least 50% of the votes cast.<sup>60</sup> One of the commenters further believed that it was “vital” that a company’s board have the opportunity to address and provide “a prompt cure” to security holder concerns expressed via withhold votes.<sup>61</sup> Examples of “cures,” according to the commenter, include the board requesting the resignation of the director who received the 50% withhold vote or publicly announcing that the board will not renominate the director, or the adoption of a majority vote requirement for such director.<sup>62</sup> The commenter believed that security holders should have the opportunity to nominate a director only after a failure by the board to take some affirmative action.<sup>63</sup>

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<sup>52</sup> *Id.*

<sup>53</sup> *Id.*

<sup>54</sup> Hamel; Letter Type Z; Lucent Retirees; Moore; Nappier.

<sup>55</sup> Letter Type Z; Lucent Retirees; Nappier.

<sup>56</sup> Hamel; Moore.

<sup>57</sup> *See, e.g.*, ABA; Arch Coal; ASCS; BRT; FSF; Honeywell; Odland; Raines; United Technologies.

<sup>58</sup> Arch Coal; Honeywell; Raines (“In practice, the proposed rules would impact all public companies, because the ‘triggers’ in the rule are easily tripped.”).

<sup>59</sup> FSF; United Technologies.

<sup>60</sup> FSF (believing the withhold votes trigger to be the only appropriate and necessary trigger); United Technologies.

<sup>61</sup> FSF.

<sup>62</sup> *Id.*

<sup>63</sup> *Id.*

One Opposing Commenter urged the Commission to revise the triggers to add a clear link to unresponsiveness by the company.<sup>64</sup> The commenter favored triggering events only in regard to a clearly identified problem.<sup>65</sup> The commenter suggested:

[I]f the withhold vote trigger is included, then any shareholder/group that wishes to publicize or communicate in favor of a withhold vote campaign should be required to file a disclosure document indicating the specific dissatisfaction with that director's service on that company's board. Or if a proposal-for-access trigger is included, it should be required to include a statement about specific proxy process issues at that company and how adding a shareholder-nominated director to the board would relate to that proxy process issue.<sup>66</sup>

Another Opposing Commenter was critical generally of the withhold votes trigger.<sup>67</sup> The commenter believed that the withholding of votes for one or only a few directors does not necessarily indicate a level of dissatisfaction with management of the company or the director selection process that warrants imposing the proposed procedures.<sup>68</sup> The commenter believed that, at the very least, the board should be given the opportunity to respond to the withhold vote with respect to the director or directors at issue.<sup>69</sup> The commenter suggested, for example, that if the requisite percentage of votes was withheld from a director, the board should be able to negate the consequences of that withheld vote by taking responsive action, which might include obtaining that director's resignation or agreement to resign, or electing to treat that director as not being independent.<sup>70</sup>

#### *Votes Cast vs. Shares Outstanding*

One Supporting Commenter urged the Commission to disregard the suggestions of Opposing Commenters that sought to change the applicable thresholds.<sup>71</sup> The commenter stated that all voting on triggering events should be calculated based on the number of votes cast on a particular matter, not the number of outstanding shares.<sup>72</sup> In this regard, the commenter noted, "Companies currently are more than happy to conduct business with the approval of less than a majority of the outstanding shares."<sup>73</sup>

Two Opposing Commenters countered that all triggering events should be calculated based on the total number of a company's outstanding shares, not the number of shares voted on a particular matter.<sup>74</sup> In the view of one of the commenters, a trigger

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<sup>64</sup> ASCS.

<sup>65</sup> *Id.*

<sup>66</sup> *Id.*

<sup>67</sup> ABA.

<sup>68</sup> *Id.*

<sup>69</sup> *Id.*

<sup>70</sup> *Id.*

<sup>71</sup> CII.

<sup>72</sup> *Id.*

<sup>73</sup> *Id.*

<sup>74</sup> ABA; ASCS.



based on the number of shares voted, rather than the total number of shares outstanding, would not reflect the effectiveness (or ineffectiveness) of the proxy process in the view of *all* of the company's security holders and, thus, would not accomplish the Commission's goal of targeting companies with an ineffective proxy process.<sup>75</sup> The other commenter equated the potential impact of votes related to triggering events with an amendment to a corporation's governance documents.<sup>76</sup> Thus, the commenter believed that the vote required under such triggering events should be comparable and analogous to the voting requirements for charter amendments, which, in most cases, would require the affirmative vote of a majority of the outstanding shares.<sup>77</sup>

### *The "Third Triggering Event"*

Five Supporting Commenters that responded to the Commission's inquiries regarding a third triggering event believed that non-implementation of a security holder proposal clearly indicates the ineffectiveness of, or security holder dissatisfaction with, a company's proxy process.<sup>78</sup>

Two Opposing Commenters believed that a third triggering event was not appropriate and strongly urged the Commission to refrain from adopting a trigger based on non-implementation of a security holder proposal that receives more than 50% of the votes cast on that proposal.<sup>79</sup> One of the commenters explained that an automatic assumption that a failure to implement a precatory security holder proposal is indicative of security holder dissatisfaction or a failure of the proxy process is erroneous.<sup>80</sup> The commenter further stated that boards of directors have fiduciary obligations under state law to make an independent judgment whether security holder proposals are in the company's best interests and should not, and cannot, comply automatically with the results of a security holder vote, regardless of the level of support.<sup>81</sup>

### *Additional Triggers*

In light of the two-year process that results due to the triggering events, several Supporting Commenters supported revisions that would require more immediate security holder access to a company's proxy materials in circumstances outside those set forth in the proposed triggering events.<sup>82</sup> Specifically, the commenters supported revisions that would require more immediate security holder access to a company's proxy materials based on the occurrence of specific events related to poor performance and/or poor governance or solely on the share ownership of a security holder or security holder group.<sup>83</sup>

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<sup>75</sup> ASCS.

<sup>76</sup> ABA.

<sup>77</sup> *Id.*

<sup>78</sup> CBIS; DeGette; Lucent Retirees; Moore; Nappier.

<sup>79</sup> Arch Coal; United Technologies.

<sup>80</sup> United Technologies.

<sup>81</sup> *Id.*

<sup>82</sup> *See e.g.*, Brackenbush; Connery; Harris; Moore; Quail; Thomas.

<sup>83</sup> *See e.g.*, Brackenbush; Connery; Harris; Quail; Thomas.

Among the specific events suggested by one commenter as additional triggers were the following: Commission enforcement actions, indictment of any executive or director on criminal charges directly related to his or her corporate duties, delisting by a market, significant underperformance relative to an applicable peer group for an extended period of time, and material restatements of financial reports.<sup>84</sup> The level of ownership most commonly cited as appropriate to entitle a security holder or security holder group to, upon its own motion, submit director nominees was at least 5% of the voting shares.<sup>85</sup>

## **VII. Upon the Occurrence of a Triggering Event at a Subject Company, Which Security Holder’s Nominee(s) Must the Company Include in Its Proxy Materials**

Most of the Supporting Commenters that submitted substantive comments concerning this issue acknowledged that eligibility to submit a nominee should be based on long-term ownership by a large security holder or group of security holders.<sup>86</sup> Many of these commenters, nonetheless, believed that the proposed ownership thresholds were too high.<sup>87</sup> Of the commenters that offered alternative thresholds, the letters evidenced a range of opinion. Three commenters supported a minimum ownership threshold of 3%.<sup>88</sup> One commenter supported a minimum ownership threshold of 2.5%.<sup>89</sup> Three commenters supported a minimum threshold of 1%.<sup>90</sup>

One commenter suggested a two-tiered approach, based on the level of a nominating security holder’s ownership.<sup>91</sup> Under the first tier of this suggested approach, companies would be required to include nominees of nominating security holders owning between \$2000 worth of a company’s stock and 5% of the company’s stock; however, those nominating security holders would be limited in their soliciting activities and expenditures.<sup>92</sup> Under the second tier of this suggested approach, companies would be required to include nominees of nominating security holders owning more than 5% of the company’s stock and those nominating security holders would not be limited in their soliciting activities or expenditures.<sup>93</sup>

Another commenter did not offer an alternative threshold, but supported a lower ownership threshold “set on a sliding scale based on [a] company’s market capitalization.”<sup>94</sup>

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<sup>84</sup> Moore.

<sup>85</sup> See, e.g., Connery; Harris; Quail; Thomas.

<sup>86</sup> See, e.g., Cummings; DeGette; Moore.

<sup>87</sup> See e.g., CBIS; Letter Type Z; Lucent Retirees; McRitchie; Shamrock Holdings; Sierra Club.

<sup>88</sup> DeGette; Moore; Sierra Club.

<sup>89</sup> Letter Type Z.

<sup>90</sup> CBIS; Lucent Retirees; Nappier.

<sup>91</sup> McRitchie.

<sup>92</sup> *Id.*

<sup>93</sup> *Id.*

<sup>94</sup> Shamrock Holdings.

One Opposing Commenter favored an ownership threshold of 10% for individual security holders and a higher ownership requirement for security holder groups.<sup>95</sup>

### **VIII. Maximum Number of Security Holder Nominees**

A small number of Supporting Commenters believed that the proposed limitations on the number of security holder nominees required to be included in company proxy materials were set too low.<sup>96</sup> Beyond supporting a requirement to place additional nominees in the proxy materials, these commenters were not in agreement as to the appropriate number of security holder nominees to be so included. Two commenters urged that in no event should the number of security holder nominees be less than two.<sup>97</sup> One commenter believed that the number of security holder nominees required to be included by the proposed rules should be 35% of the board seats available in each given election.<sup>98</sup> One commenter believed that the number of security holder nominees should be the greater of two directors or 35% of the board.<sup>99</sup> Another commenter believed that the number of security holder nominees should be not less than 40% of the total number of the eligible board seats in any given election cycle.<sup>100</sup> One commenter believed that there should be no limitations on the number of security holder nominees.<sup>101</sup>

One Opposing Commenter believed that that the proposed limitations on the number of security holder nominees required to be included in the company's proxy materials were too generous.<sup>102</sup> The commenter believed that the company should be required to include only one nominee, regardless of the size of the board.<sup>103</sup>

### **IX. Which Security Holder Nominee(s) Must the Company Include in Its Proxy Materials**

The issue of which security holder nominees must be included in company proxy materials generated comment from several Supporting Commenters.<sup>104</sup> These commenters focused on whether the limitations regarding independence of the nominee from the nominating security holder, nominating security holder group, or company were appropriate.<sup>105</sup> At least five Supporting Commenters expressed serious concern and/or outright disagreement with the limitations regarding independence of the nominee from the nominating security holder, nominating security holder group, or company.<sup>106</sup> Two

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<sup>95</sup> FSF.

<sup>96</sup> *See, e.g.*, Fountain; Keating; Macy; McRitchie; Moore; Sierra Club.

<sup>97</sup> Fountain; Macy.

<sup>98</sup> Sierra Club.

<sup>99</sup> Moore.

<sup>100</sup> McRitchie. In earlier comments, McRitchie stated that the number of security holder nominees should be "one less than half" of the eligible board seats in any given election cycle. *See* McRitchie letter dated November 16, 2003.

<sup>101</sup> Keating.

<sup>102</sup> FSF.

<sup>103</sup> *Id.*

<sup>104</sup> *See, e.g.*, Lucent Retirees; McRitchie; Moore; Shamrock Holdings; Sierra Club.

<sup>105</sup> *See, e.g.*, Lucent Retirees; McRitchie; Moore; Shamrock Holdings; Sierra Club.

<sup>106</sup> Lucent Retirees; McRitchie; Moore; Shamrock Holdings; Sierra Club.

of these commenters noted that the proposed limitations would hold a candidate suggested by a security holder or security holder group to a different independence standard than board-nominated candidates.<sup>107</sup> Furthermore, the three other commenters noted that the proposed limitations would inhibit large security holders from seeking seats on boards as part of actively managed governance strategies.<sup>108</sup>

## **X. Alternatives to the Proposed Rules**

The Roundtable featured extensive discussions regarding several alternative proposals to the pending rules.<sup>109</sup>

Two alternatives, proposed by Ira Millstein and Professor Joseph Grundfest, respectively, received significant attention. Each alternative proposal would make it possible for security holder disfavor with a director nominee, expressed as a withhold vote, to impact immediately the election of directors, if a nominee fails to receive a majority (or some other percentage) of the votes cast.

Mr. Millstein proposed that the New York Stock Exchange and the Nasdaq National Market adopt a new corporate governance listing standard, generally to be complied with through adoption of a by-law amendment by listed companies.<sup>110</sup> Mr. Millstein proposed that in any uncontested election of directors of a listed company that is required to have a majority of independent directors under existing listing standards, a director nominee could be elected only after receiving the affirmative vote of a majority of the votes cast.<sup>111</sup> Votes that are “withheld” would be treated effectively as votes against a nominee, in contrast to the prevailing plurality voting system, under which the nominee who obtains the most affirmative votes is elected, regardless of the number of votes “withheld.”<sup>112</sup> A nominee who is already a director, but who is rejected as a result of a withhold vote, would remain until he or she resigned or, if he or she did not resign, until his or her successor is elected. A nominee who is not already a director and who is rejected, as a result of a withhold vote, would not become a director. According to Mr. Millstein:

If, as a result of the election, one or more nominees are rejected, but a majority of the board consists of directors who have not been rejected, the board could proceed to address the situation however it deems appropriate. Under this circumstance, there would be no additional regulatory requirements imposed. We

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<sup>107</sup> Lucent Retirees; Sierra Club.

<sup>108</sup> McRitchie; Moore; Shamrock Holdings.

<sup>109</sup> See, e.g., Charles M. Elson, Roundtable Transcript at 94-95; Professor Joseph A. Grundfest, Roundtable Transcript at 100-02; Professor Randall S. Kroszner, Roundtable Transcript at 20-21; Ira Millstein, Roundtable Transcript at 104-06.

<sup>110</sup> Millstein. Available at <http://www.sec.gov/spotlight/dir-nominations/milstein030304.htm>.

<sup>111</sup> Millstein. Specifically, no nominee of the board of directors would be considered elected who has not received votes in favor of his or her election representing at least a majority of the votes of all the shares voted in respect of his or her election (and assuming satisfaction of any applicable quorum requirement).

<sup>112</sup> Millstein. See also Karmel (discussing briefly an alternative mechanism whereby security holders might be given the right to vote “No” instead of merely abstaining on a vote for a particular director).

would expect that a responsible board would seek to negotiate a solution which the shareholders would support. It might seek the resignation of some or all rejected nominees who are directors and fill the resulting vacancies either by holding an additional election or by appointing new directors, all as the company's organizational documents may provide. While a board could choose to ignore the shareholders' rejection of its slate of nominees, doing so could leave a board open to severe public criticism, and a possible proxy contest.

If, as a result of the election, a majority of the board consists of directors who were rejected as a result of this rule, the company would have 120 days to hold another shareholders meeting to elect directors. A responsible board would presumably pursue a dialogue with relevant shareholders regarding the nominees it would present in the subsequent election.<sup>113</sup>

Professor Grundfest proposed an alternative based on the advice and consent procedure created by Article II Section 2 of the United States Constitution.<sup>114</sup> Under the alternative, any director who is elected under state law but receives a majority of withhold votes would be deemed “unratified” for purposes of the federal securities laws and, as such, would be subject to a variety of material disabilities imposed via expansive and burdensome disclosure requirements pursuant to new Commission regulations.<sup>115</sup> According to Professor Grundfest, neither the targeted directors nor the boards on which they serve likely would be enthusiastic about the continued service of such directors after the disabilities had attached.<sup>116</sup> As such, Professor Grundfest notes:

If this calculation is correct, then the imposition of this disclosure requirement, which is rationally related to the Commission’s well-established disclosure authority, would have the collateral effect of *de facto* requiring that every sitting director be elected by a majority (or some other percentage) of the shareholder body, or be nominated by directors who satisfy that condition.<sup>117</sup>

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<sup>113</sup> Millstein (emphasis in original).

<sup>114</sup> In a letter dated April 7, 2004, Professor Grundfest, joined by the ASCS and Barclay’s Global Investors, N.A. (Barclays), submitted comments that modified and described in more detail the “advice and consent” alternative originally proposed by Professor Grundfest in his letter dated October 22, 2003. Any further reference to the “advice and consent” proposal shall mean the proposal as set forth in this joint letter. The letter, hereinafter cited as “Grundfest/ASCS/Barclays,” is available at <http://www.sec.gov/rules/proposed/s71903/grundfestascsbgi040704.pdf>.

<sup>115</sup> Grundfest/ASCS/Barclays. Under the proposal the Commission would adopt expansive disclosure requirements applicable to unratified directors and boards that allow unratified directors to continue to serve. These new disclosure obligations would be incorporated into Exchange Act Form 8-K and would require that the registrant and any unratified director make extensive disclosures regarding the deliberations and decisions reached by the registrant’s board and by any committee of the registrant’s board on which one or more unratified directors serve. The disclosures would provide shareholders with far more detailed information than they currently obtain about board process and decision-making. The disclosures, according to Professor Grundfest, would facilitate more scrupulous monitoring of the conduct of directors who serve over the objection of a majority (or some other percentage) of the shareholder body.

<sup>116</sup> Grundfest/ASCS/Barclays.

<sup>117</sup> *Id.*

In short, Professor Grundfest believes that the consequences of a director or directors being identified as unratified would force negotiations between boards and security holders directed at identifying board members satisfactory both to security holders and to the surviving incumbent directors.<sup>118</sup>

Another commenter proposed two alternatives to the proposed nomination procedure.<sup>119</sup> Under the first alternative, the Commission would exempt from the operation of any final rules any company that required that a majority of the votes cast be necessary to elect a director.<sup>120</sup> The commenter noted that the requirement that a director must receive a majority of the votes cast could be imposed by a company's certificate of incorporation, state statute, or company bylaw, provided that such a bylaw is validly adopted under state law.<sup>121</sup> According to the commenter, "This concept would seem to be consistent with the goals of the Commission and is more consistent with principles of federalism than the imposition of the proposed rule would be without such a reference to state law or private ordering."<sup>122</sup> The second alternative was based on the model of "comply or disclose" that is in general use in the United Kingdom.<sup>123</sup> The alternative would set forth an "aspirational" standard.<sup>124</sup> If a company chose not to comply with the aspirational standard by itself establishing the right to propose a nominee in the company's proxy statement after the triggering events, it would have to disclose that fact and the reasons for noncompliance.<sup>125</sup>

One commenter expressed the view that, in an effort to push companies towards experimenting with different levels of security holder access, it might be desirable to facilitate greater state involvement in the regulation of the proxy process.<sup>126</sup> The commenter suggested that the Commission "encourage state or company-specific rules . . . to clarify that rules affording greater shareholder access are not pre-empted by proposed rule 14a-11."<sup>127</sup>

At least three Supporting Commenters addressed the alternative proposals that would impose prescribed penalties if a majority (or some other percentage) of shares cast were withheld from a director.<sup>128</sup> The three commenters urged that the proposed rules should be supplemented by, not replaced with, the alternative proposals and/or revised listing standards.<sup>129</sup> One commenter stated that the right to reject a nominee has little value if security holders are not empowered to also select the rejected nominee's

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<sup>118</sup> *Id.*

<sup>119</sup> Veasey.

<sup>120</sup> *Id.*

<sup>121</sup> *Id.*

<sup>122</sup> *Id.*

<sup>123</sup> *Id.*

<sup>124</sup> *Id.*

<sup>125</sup> *Id.*

<sup>126</sup> Fisch.

<sup>127</sup> *Id.*

<sup>128</sup> CBIS; CII; ISS.

<sup>129</sup> CBIS; CII; ISS.

replacement.<sup>130</sup> Another commenter noted that while the suggested reforms would restore significance to the election of directors, the inability under such reforms for security holders to efficiently and simply run alternative candidates for the board of directors made the suggested alternatives inadequate.<sup>131</sup> This commenter was further concerned that any rulemaking related to revised listing standards might become bogged down at the NYSE and the Nasdaq, respectively.<sup>132</sup> The third commenter, which believed that the advice and consent proposal provides “strong incentives for companies to seek majority-vote election of all directors,” suggested that if the Commission decides to adopt the proposed rules substantially as drafted it should consider separately adoption of the advice and consent proposal substantially as drafted by Professor Grundfest.<sup>133</sup>

Opposing Commenters differed from the Supporting Commenters in their reaction to the two alternatives addressed above. As noted above, two commenters indicated their support for Professor Grundfest’s “advice and consent” proposal by joining with Professor Grundfest in submitting comments that outline in detail how such an alternative would work.<sup>134</sup> These commenters remarked that their alternative represented a “less confrontational mechanism that constructively engages shareholders” in the nomination and election process.<sup>135</sup> The commenters further believed that their alternative was simpler than and superior to the proposed rules, noting:

It could [] operate in a single election cycle, thereby eliminating the need for an election as to whether to have an election that protracts the contest over a two-year period. Such a rule would eliminate many of the essentially arbitrary triggers and thresholds found in the pending proposal. It would also eliminate the need for investors to track their shareholdings over long time periods in order to determine their qualifications pursuant to the proposed rules, and would eliminate the prospect of expensive litigation over these complex holding requirements, as well as over many other provisions of the pending proposal.<sup>136</sup>

The commenters that submitted the advice and consent proposal urged the Commission to re-propose the pending rules along with their alternative, and variants thereof, to obtain public comment as to the preferable approach.<sup>137</sup> Several other Opposing Commenters noted the advice and consent proposal and/or Mr. Millstein’s revised listing standards proposal.<sup>138</sup> Although unwilling to endorse either of the alternative reforms, the commenters urged the Commission to consider carefully and/or allow public comment on each proposal.<sup>139</sup>

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<sup>130</sup> CBIS.

<sup>131</sup> CII.

<sup>132</sup> *Id.*

<sup>133</sup> ISS.

<sup>134</sup> Grundfest/ASCS/Barclays.

<sup>135</sup> *Id.*

<sup>136</sup> *Id.*

<sup>137</sup> *Id.*

<sup>138</sup> *See, e.g.*, BRT (the BRT actually noted at least four alternatives put forth at the Roundtable); FSF; NYSBAR.

<sup>139</sup> *Id.*

## XI. Proxy Voting Mechanics

Several Opposing Commenters and one commenter that declined to oppose or support generally the proposed rules expressed concern that the proposed rules would result in a dramatic increase in the number of contested elections and that, as such, mechanical issues surrounding proxy voting would take on a new significance.<sup>140</sup> The issues cited most commonly by the commenters included: (1) rules governing company communications with security holders;<sup>141</sup> (2) technological means to track the votes necessary to determine whether triggers have been met;<sup>142</sup> (3) design of the proxy card;<sup>143</sup> and (4) the applicability of broker discretionary voting authority under NYSE Rule 452.<sup>144</sup> Additional issues noted by one commenter include: (1) accuracy of share records; (2) customary procedures authorizing security holders to sign and vote proxies in blank; and (3) review and inspection rights.<sup>145</sup> In light of the projected increase in the number and significance of security holder communications and the difficulty and costs inherent in the current rules, the commenters strongly urged the Commission to review the rules related to the mechanics of proxy voting.<sup>146</sup>

One commenter, a vendor specializing in securities transaction processing and security holder communications, noted that the proposed rules would require extensive modifications of the technological systems that currently support the proxy process.<sup>147</sup> Specifically, the commenter noted:

Our view of the amount of programming hours that would be required to accommodate the systems changes is over 21,400 based on our current understanding and assumptions. We have 63 development resources that would be involved in the proposed Proxy Plus and related systems modifications. Program modifications of this nature cannot happen in complete parallel in a development environment and cannot begin in earnest until any proposed rules are finalized. If we view the development timeline for these proposed changes, plus the additional time that is required for form design and review, process changes, systems quality assurance and capacity testing, the attached Gantt view shows us six to seven calendar months from the time the proposed rules are finalized until the completed changes would be available in a production environment. In other words, to be ready for the 2005 proxy season with a

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<sup>140</sup> See, e.g., ASCS; BRT; Georgeson (expressing neither general support nor opposition); Honeywell; NYSBAR; Raines.

<sup>141</sup> See, e.g., ASCS; BRT; Georgeson; Raines.

<sup>142</sup> See, e.g., ASCS; BRT; Georgeson; NYSBAR.

<sup>143</sup> See, e.g., ASCS; Georgeson; Honeywell.

<sup>144</sup> See, e.g., Georgeson; Honeywell.

<sup>145</sup> Georgeson.

<sup>146</sup> See, e.g., Georgeson (Recommending that “(1) The Commission should undertake a comprehensive review of proxy procedures for the purpose of simplifying the system and increasing its transparency. (2) The Commission should promptly rescind the NOBO/OBO rules and establish a new direct access rule that will empower beneficial owners in street name to sign and vote proxies and entitle companies to communicate directly with beneficial owners.”).

<sup>147</sup> ADP.



margin of safety required for our normal volume testing process to occur we would need to begin working on the implementation of the changes by the beginning of June 2004.<sup>148</sup>

## **XII. Role of the Nominating Committee**

Several Opposing Commenters expressed concern that the proposed rules would permit certain security holders to bypass the independent nominating committee process.<sup>149</sup> One of the commenters stated, “This intrudes on the ability of the board of directors and its nominating committee to act in this crucial area of corporate governance and impairs the nominating committee process.”<sup>150</sup> Two commenters believed that the board nominating committee should remain a part of the process regarding security holder nominations, and that the nominating committee should have an opportunity to vet all candidates.<sup>151</sup>

## **XIII. Institutional Investor Voting Practices and Proxy Advisory Services**

Several Opposing Commenters stated that the proposed rules, particularly the thresholds related to the triggering events, do not adequately take into account the realities of the current proxy process, particularly the existence of inflexible voting guidelines and/or the influence of proxy advisory services, and the impact that the process will have on the highly concentrated institutional ownership in most large public companies.<sup>152</sup> Institutional investors, according to the commenters, might develop internal voting guidelines or follow voting guidelines provided by third-party vendors—which are not beneficial owners and often do not owe a fiduciary duty to the institutional clients—to vote automatically in favor of triggering the nomination procedure without any consideration of the underlying performance and/or responsiveness of the subject company.<sup>153</sup> As such, the commenters cautioned that the proposal would increase dangerously the power of proxy advisory firms and institutional investors.<sup>154</sup> One commenter noted, “While the actions of these institutional investors and proxy analysis organizations are often well-meaning, this nevertheless is a precarious foundation upon which to build a new corporate governance regime, as the proposed rule would tend to do.”<sup>155</sup>

Two Supporting Commenters dismissed the concerns noted above as “overblown” and “unwarranted,” respectively, and stated that the proposed rules would not give disproportionate or unreasonable power to proxy advisory firms.<sup>156</sup> In this regard, one of the commenters stated that: (1) the largest institutional money managers have their own

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<sup>148</sup> *Id.*

<sup>149</sup> *See, e.g.,* ABA; FSF; Odland. *See also* ASCS; Honeywell.

<sup>150</sup> ABA.

<sup>151</sup> ASCS; FSF.

<sup>152</sup> *See, e.g.,* ABA; BRT; Raines.

<sup>153</sup> ABA; BRT; Raines.

<sup>154</sup> ABA; BRT; Raines.

<sup>155</sup> ABA.

<sup>156</sup> CII; Moore.

voting guidelines and, contrary to the assertions of many companies, do not blindly follow the recommendations of proxy advisory services; (2) approximately 70% of the equity holdings of all institutional investors are held by corporate pension funds, mutual funds, bank trust funds and insurance companies, which tend generally to support management's voting recommendations; and (3) the number of institutional investors, particularly mutual funds, that will adopt voting based on their own guidelines likely will increase in the future as a consequence of the Commission's recent requirements addressing the transparency of proxy votes by mutual funds and money managers.<sup>157</sup>

#### **IVX. Costs**

Two Opposing Commenters believed that the Commission underestimated significantly not only the degree to which the proposed procedure will be triggered, but also the costs the proposed rules would impose on companies.<sup>158</sup> Two Opposing Commenters presented data from November 2003 surveys ("November 2003 Surveys") that collected data from 137 public companies regarding the proposal.<sup>159</sup> The November 2003 Surveys indicated that adoption of the proposed nomination procedure would result in an additional total burden of more than \$700,000 per "affected" company.<sup>160</sup>

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<sup>157</sup> CII.

<sup>158</sup> BRT; Raines.

<sup>159</sup> BRT; Raines. The November 2003 Surveys were conducted by the BRT and ASCS.

<sup>160</sup> BRT. *See* BRT letter dated December 22, 2003.