

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

⁵⁶ See *id.*

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

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

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

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

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