

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.<sup>62</sup> 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.<sup>63</sup>

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,<sup>64</sup> and investment companies registered under Section 8 of the Investment Company Act.<sup>65</sup> Companies that fall within the definition of "accelerated filer" in Exchange Act Rule 12b-2<sup>66</sup> 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)<sup>67</sup> or 15(d)<sup>68</sup> 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

<sup>64</sup> 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.

<sup>65</sup> See Section II.A.12., below.

<sup>66</sup> 17 CFR 240.12b-2.

<sup>67</sup> 15 U.S.C. 78m(a).

<sup>68</sup> 15 U.S.C. 78o(d).

- The company is not eligible to use Exchange Act Forms 10-QSB and 10-KSB.<sup>69</sup>

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."<sup>70</sup> 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

<sup>69</sup> 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.

<sup>70</sup> Source: SEC and Compustat.

<sup>62</sup> 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.

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