

votes cast on that proposal at that meeting.⁷⁵

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

In order to facilitate an informed security holder vote with regard to security holder proposals that could trigger the security holder nomination procedure set out in Exchange Act Rule 14a-11, we have proposed an amendment to Exchange Act Rule 14a-5 that would require the company, where a security holder proposal is submitted by a more than 1% security holder who has held their securities for at least one year, to advise security holders of this fact in the proxy statement relating to the meeting at which the security holder proposal will

be presented. We recommend that, pending final action on that proposal, companies make such an identification, both in their interest and in the interest of their security holders. Companies also should consider whether failure to make such an identification has any implications 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

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

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

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

⁷⁷ 17 CFR 240.14a-9.

⁷⁸ Sample data provided by Automated Data Processing, Inc.; sample data relate to companies traded on the New York Stock Exchange, the American Stock Exchange, and the Nasdaq Stock Market. For each election, the number of "yes" votes and withhold votes received are totaled across all candidates on the proxy and then are reported. Thus, the level of withhold votes received on average across all candidates in a given election can be calculated, but not the outcome candidate-by-candidate. The result is that the number of elections in which a specific candidate received a certain number of withhold votes may be larger than the data presented here. This is due to the dilution experienced in elections where one candidate receives substantially more withhold votes than others on the same proxy.

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