

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.

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

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.*

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.

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.