

5. Which Security Holders or Security Holder Groups May Submit a Nominee That the Company Would Be Required To Include in Its Proxy Materials?

a. Proposed Eligibility Standards

To be eligible to submit a nomination in accordance with proposed Exchange Act Rule 14a-11, a security holder or group of security holders would be required to:⁹³

- Beneficially own, either individually or in the aggregate, more than 5% of the company's securities that are eligible to vote for the election of directors at the next annual meeting of security holders (or, in lieu of such an annual meeting, a special meeting of security holders), with each of the securities used for purposes of calculating that ownership having been held continuously for at least two years as of the date of the nomination;⁹⁴
- Intend to continue to own those securities through the date of that annual or special meeting;⁹⁵
- Be eligible, as to the security holder or each member of the security holder group, to report beneficial ownership on Exchange Act Schedule 13G, rather than Exchange Act Schedule 13D,⁹⁶ in reliance on Exchange Act Rule 13d-1(b) or (c);⁹⁷ and

⁹³ The manner in which a nominating security holder or nominating security holder group would establish its eligibility to use the procedure in proposed Exchange Act Rule 14a-11 is discussed in Section II.8.a., below.

⁹⁴ See proposed Exchange Act Rule 14a-11(b)(1)-(2).

⁹⁵ The requirement regarding the nominating security holder's intent to continue to own the securities is set forth in proposed Exchange Act Rule 14a-11(b)(2). The nominating security holder would be required to include a representation regarding this intent in its notice to the company, pursuant to proposed Exchange Act Rule 14a-11(c)(2).

⁹⁶ 17 CFR 240.13d-101.

⁹⁷ 17 CFR 240.13d-1(b)-(c). This requirement is set forth in proposed Exchange Act Rule 14a-11(b)(3). The nominating security holder would be required to include a representation regarding this eligibility in its notice to the company, pursuant to proposed Exchange Act Rule 14a-11(c)(2). This requirement would not apply in the case of an open-end management investment company ("mutual fund") because security holders of mutual funds are not required to file Exchange Act Schedules 13D or 13G. See Exchange Act Rules 13d-1(a) and (i) [17 CFR 240.13d-1(a) and (i)] (requiring any person who is directly or indirectly the beneficial owner of more than 5% of a class of equity securities to file with the Commission a statement containing the information required by Exchange Act Schedule 13D, and defining "equity security" to mean any equity security of a class which is registered pursuant to Section 12 of the Exchange Act [15 U.S.C. 78l], or any equity security of any insurance company which would have been required to be so registered except for the exemption contained in Section 12(g)(2)(G) of the Exchange Act [15 U.S.C. 78l(g)(2)(7)], or any equity security issued by a closed-end investment company registered under the Investment Company Act).

• Have filed an Exchange Act Schedule 13G or an amendment to Exchange Act Schedule 13G reporting their beneficial ownership as a passive or institutional investor (or group) on such schedule before or on the date of the submission of the nomination to the company, which Schedule must include a certification that the security holder or security holder group has held more than 5% of the subject securities for at least two years.⁹⁸

The appropriate eligibility ownership threshold generated a great deal of comment in response to our solicitation of public input on the Division's review of the proxy rules.⁹⁹ While some commenters believed that all security holders should be able to access company proxy materials for the purpose of nominating directors, others advocated no ownership threshold or share ownership thresholds ranging from the \$2,000 threshold required to submit an Exchange Act Rule 14a-8 proposal to substantial share ownership percentages such as 3%, 5% or 10% of a company's outstanding common stock.¹⁰⁰ Those who advocated no threshold or a nominal dollar amount argued that the imposition of a threshold would discriminate against smaller investors or unfairly advantage larger security holders who already may have the resources to run their own slates using the existing rules for contested elections.¹⁰¹ Those who advocated a larger share ownership threshold contended that a nominating security holder should have a substantial, long-term stake in the company in order to require the use of company funds to nominate a candidate.¹⁰² In addition, advocates of a larger share ownership threshold pointed out that the composition of the board of directors is critical to a corporation's functions and, accordingly, security holders should have to evidence a significant financial interest by satisfying a substantial ownership threshold in order to use a security holder nomination procedure that may impact that composition.¹⁰³

We have proposed an ownership threshold of more than 5% in an effort to balance security holders' interest in

⁹⁸ This requirement is set forth in proposed Exchange Act Rule 14a-11(b)(4). A nominating security holder or group for a mutual fund would be required to file information reporting the security holder or group's beneficial ownership as part of the security holder's notice to the fund, pursuant to proposed Exchange Act Rule 14a-11(c)(11). See Section II.A.12., below.

⁹⁹ See 2003 Summary of Comments.

¹⁰⁰ See *id.*

¹⁰¹ See *id.*

¹⁰² See *id.*

¹⁰³ See *id.*

being able to access company proxy materials for the purpose of nominating directors against companies' concerns about the potential disruption that some contend may result from frequent use of the process by security holders who do not represent a significant ownership stake in the subject company. We believe that a threshold of more than 5% ownership for two years strikes an appropriate balance between these interests. Roughly 42% of filers have at least one security holder that can meet this threshold individually, while roughly 50% of filers have two or more security holders that each have held at least 2% of the shares outstanding for the appropriate period and, thus, could more easily aggregate their securities in order to meet the threshold ownership requirement.¹⁰⁴ A higher threshold amount would result in significantly fewer filers having even one security holder who could meet the required threshold. For example, using an ownership threshold of 10% would reduce the number of companies where a single security holder could make a nomination to 13% of the companies. Further, only 18% of filers have two or more security holders that have held at least 5% of the shares for the appropriate period. This data suggest that security holders may have significant difficulty in aggregating their shares to meet a 10% ownership threshold.

b. Questions

E.1. Are the proposed thresholds for use of the proposed procedure appropriate? If not, should there be any restrictions regarding which security holder nominees for director would be required to be disclosed in the company proxy materials under the proposed procedure? If so, should those restrictions be consistent with the ownership requirements of Exchange Act Rule 14a-8? Should those restrictions be more extensive than the minimum requirements in Exchange Act Rule 14a-8?

E.2. Is it appropriate to include a restriction on security holder eligibility that is based on percentage of securities owned? If so, is the more than 5% standard that we have proposed appropriate? Should the standard be lower (e.g., 2%, 3%, or 4%) or higher

¹⁰⁴ Based on 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.