

members of the board of directors is 20 or more.<sup>114</sup>

The proposed security holder nomination procedure would address situations where more than one security holder or group of security holders would be eligible to nominate a person or persons to a company's board of directors pursuant to the proposed rule. In those situations, the company would be required to include in its proxy statement and form of proxy the nominee or nominees of the security holder or security holder group with the largest beneficial ownership (as reported on Exchange Act Schedule 13G) at the time of the delivery of the nominating security holder's notice of intent to nominate a director pursuant to the rule, up to and including the total number required to be included by the company.<sup>115</sup> We believe this method of determining which security holder or security holder group's nominees are included in the company's proxy materials is appropriate, as it relates directly to the level of interest in the company of the nominating security holder or the nominating security holder group.

#### b. Questions

G.1. Is it appropriate to include such a limitation on the number of security holder nominees? If not, how would the proposed rules be consistent with our intention not to allow the proposed procedure to become a vehicle for changes in control?

G.2. If there should be a limitation, is the proposed limitation appropriate? Should the number of security holder nominees be higher or lower? Should the limitation instead be based on the total percentage of the board that the security holder nominees would comprise? Should the limitation be the greater or lesser of the number or a specified percentage, rather than a set number, as proposed? Is it appropriate to permit more than one security holder nominee regardless of the size of the company's board of directors?

G.3. Should the number increase during the second year of the proposed procedure? Should the number decrease during the second year of the proposed procedure?

G.4. The proposal contemplates taking into account incumbent directors in the

case of classified or "staggered" boards for purposes of determining the maximum number of security holder nominees. Is that appropriate? Should there be a different procedure to account for such incumbent directors? Also with regard to staggered boards, should the procedure address situations in which, due to a staggered board, fewer director positions are up for election than the maximum permitted number of security holder nominees? If so, how?

G.5. We have proposed a limitation that permits the security holder or security holder group with the largest beneficial ownership to include its nominee(s) where there is more than one eligible nominating security holder or nominating security holder group. Is this proposed procedure appropriate? If not, should there be different criteria for selecting the security holder nominees (e.g., length of security ownership, date of the nomination, random drawing, allocation among eligible nominating security holders or security holder groups, *etc.*)? Rather than using criteria such as that proposed, should the company's nominating committee have the ability to select among eligible nominating security holders or security holder groups?

G.6. Rather than a limitation on the maximum number of security holder nominees, should there be only a limitation on the number of security holder nominees that may be elected?

#### 8. What Notice Must the Nominating Security Holder or Nominating Security Holder Group Provide to the Company and File With the Commission?

##### a. Notice to the Company

To have a nominee included in the company's proxy statement and form of proxy, we propose that the nominating security holder or nominating security holder group be required to provide notice to the company of its intent to require that the company include that security holder's nominee on the company's proxy card no later than 80 days before the date that the company mails its proxy materials for the annual meeting.<sup>116</sup> This notice would be required to include:

<sup>116</sup> 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 the required number of calendar days. If the company did not hold an annual meeting during the prior year, or if the date of the meeting has changed more than 30 days from the prior year, then the nominating security holder would be required to provide notice a reasonable time before the company mails its proxy materials for the current year, as specified by the company in an Exchange Act Form 8-K filed pursuant to proposed Item 13.

- A representation that the nominating security holder is eligible to submit a nominee under the security holder nomination procedure;<sup>117</sup>

- A statement that, to the knowledge of the nominating security holder or group, the candidate's nomination or service on the board, if elected, would not violate controlling state law, federal law, or listing standards (other than a standard relating to independence);<sup>118</sup>

- A representation that the nominee meets the objective criteria for independence from the company that are set forth in applicable rules of a national securities exchange or national securities association;<sup>119</sup>

- Representations regarding the absence of a prohibited relationship between the nominee and the nominating security holder or nominating security holder group;<sup>120</sup>

- A representation that neither the nominee nor the nominating security holder (or any member of the nominating security holder group, if applicable) has a direct or indirect agreement with the company regarding the nomination of the nominee;<sup>121</sup>

- A copy of the nominating security holder's or nominating security holder group's filed Exchange Act Schedule 13G indicating ownership of more than 5% of the appropriate class of the company's securities;<sup>122</sup>

<sup>117</sup> The eligibility standards for nominating security holders are set forth in proposed Exchange Act Rule 14a-11(b). This representation would be included in the nominating security holder's notice pursuant to proposed Exchange Act Rule 14a-11(c)(2).

<sup>118</sup> Proposed Exchange Act Rule 14a-11(a)(3)(i) requires that the nomination not violate these standards. This representation would be included in the nominating security holder's notice pursuant to proposed Exchange Act Rule 14a-11(c)(1).

<sup>119</sup> This representation would be included in the nominating security holder's notice pursuant to proposed Exchange Act Rule 14a-11(c)(4). In the case of a fund, a nominating security holder or group would be required to represent that its nominee is not an "interested person" of the fund as defined in Section 2(a)(19) of the Investment Company Act. See Section II.A.12., below.

<sup>120</sup> This representation would be included in the nominating security holder's notice pursuant to proposed Exchange Act Rule 14a-11(c)(3).

<sup>121</sup> This representation would be included in the nominating security holder's notice pursuant to proposed Exchange Act Rule 14a-11(c)(5).

<sup>122</sup> Proposed Exchange Act Rule 14a-11(b)(4) would require that the nominating security holder or nominating security holder group to have filed this Exchange Act Schedule 13G. A copy of this Exchange Act Schedule 13G would be included in the nominating security holder's notice pursuant to proposed Exchange Act Rule 14a-11(c)(6). This requirement would not apply in the case of a company that is a mutual fund because security holders of mutual funds are not required to file Exchange Act Schedule 13G. See Exchange Act Rules 13d-1(a) and (i). 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

<sup>114</sup> Based on a sample of 1,439 public companies provided by IRRG to our Office of Economic Analysis, in 2002, the median board size was 9, with boards ranging in size from 4 to 24 members. Approximately 42% of the boards in the sample had 8 or fewer directors, approximately 58% had between 9 and 19 directors, and less than 1% had 20 or more directors.

<sup>115</sup> This requirement is set forth in proposed Exchange Act Rule 14a-11(d)(3).