

• The requirement would create a bias to accept marginal director candidates;<sup>74</sup>

• The requirements, specifically those regarding giving the reasons for rejecting nominees, would “chill” nominating committee discussions;<sup>75</sup>

• The disclosure would not be material to security holders;<sup>76</sup> and

• The disclosure would raise privacy issues for the nominating security holder and candidate.<sup>77</sup>

Conversely, this disclosure item also received strong support from security holders, many of whom recommended that we use a lower ownership percentage trigger or a trigger no more stringent than that proposed.<sup>78</sup>

With regard to the requirement that the reasons for not nominating a candidate be given, many commenters believed that this requirement would be difficult to satisfy, as:

• Nominating committee determinations are not always precise in nature;

• The disclosure would expose candidates to ridicule; and/or

• The disclosure would be an invasion of privacy for all parties involved in the process, including the nominating committee members, whose deliberations would be made public as a result of the disclosure requirement.<sup>79</sup>

Some commenters also expressed the view that this requirement would expose the company and nominating committee members to risk of litigation and would allow security holders to “second guess” the nominating committee’s determinations.<sup>80</sup> On the other hand, some commenters were of the view that we should retain the proposed disclosure standard and expand it to require companies to disclose the identity of rejected candidates, provided that the candidates consent to be so identified.<sup>81</sup>

After considering the comments, we continue to believe that disclosure of director recommendations made by large, long-term security holders would provide valuable information that would enable security holders to better

understand the nomination process. We have re-evaluated the 3% threshold to trigger the additional disclosure requirement, however, and have determined that ownership of more than 5% is a more appropriate threshold at which to require companies to provide additional disclosure.<sup>82</sup> In this regard, we agree with commenters that a more than 5% ownership threshold has a significant advantage over a lesser ownership threshold, in that recommending security holders would be subject to the beneficial ownership reporting requirements of Exchange Act Regulation 13D. We anticipate that a more than 5% ownership threshold will, in many cases, simplify the process by which a company and the recommending security holder determine that the recommending security holder satisfies the ownership threshold to trigger the additional disclosure requirement and, where a security holder or group has reported its beneficial ownership prior to making a recommendation, will help to ensure that the company and its security holders have basic information about the recommending security holder. This will benefit the company by providing the nominating committee with additional information regarding the recommending security holder and, possibly, the recommended candidate. Further, security holders will benefit through having additional information upon which they can evaluate the nominating committee’s response to the security holder recommendation.<sup>83</sup>

In addition, the new disclosure standard will require that companies make the specified disclosures, including identifying both the nominating security holder or security holder group and candidate, only in those instances where both parties have provided to the company their consent to be identified and, where the security holder or group members are not registered holders, the security holder or

group members have provided proof of the required ownership and holding period to the company. A security holder or group that seeks to require a company to provide disclosure related to a recommendation would provide their written consent and proof of ownership to the company at the time of the recommendation. The company would not be obligated to request such materials where a security holder or group does not otherwise provide their consent and proof of ownership.<sup>84</sup>

In consideration of the concerns expressed by commenters, including those with regard to boilerplate disclosure and privacy issues, the disclosure standard that we are adopting today does not include the proposed requirement that companies disclose the specific reasons for not nominating a candidate. The requirement will, however, require that companies identify the candidate in addition to the recommending security holder or group. While not required, a company could, of course, choose to explain why it did not nominate one or all of the security holder-recommended candidates.

We also have added language to the disclosure requirement to clarify the date by which a security holder must submit a recommended nominee in order to trigger the additional disclosure requirement by the company—a security holder’s recommendation would have to be received by a company’s nominating committee by a date not later than the 120th calendar day before the date the company’s proxy statement was released to security holders in connection with the previous year’s annual meeting.<sup>85</sup> We have added a new instruction clarifying that, where a company has changed its meeting date by more than 30 days, a security holder must make its recommendation by a date that is a reasonable time before the company begins to print and mail its proxy statement in order to trigger the additional disclosures.<sup>86</sup>

In addition, we have added a new instruction that responds to commenters’ suggestion that we address how the percentage of securities owned by a nominating security holder would

<sup>82</sup> On October 14, 2003, we proposed new rules regarding the inclusion of security holder nominees for director in company proxy materials. See Release No. 34–48626 (October 14, 2003). The issue of the appropriate ownership threshold, if any, for any such inclusion of security holder nominees for director is a separate issue from the appropriate ownership threshold for the disclosure we are adopting today and is not addressed in this release.

<sup>83</sup> In this regard, information available to our Office of Economic Analysis indicates that, of the companies listed on the New York Stock Exchange, Nasdaq Stock Market and American Stock Exchange as of December 31, 2002, 57% had at least one institutional security holder that beneficially owned 5% of the common equity or similar securities and 1.4% had five or more such security holders. This information was derived from filings on Exchange Act Form 13-F [17 CFR 249.325] that indicated that the filing security holder had held its securities for at least one year.

<sup>84</sup> See Instruction 4 to new Paragraph (d)(2)(ii)(L) of Item 7 of Exchange Act Schedule 14A.

<sup>85</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 120 calendar days.

<sup>86</sup> See Instruction 2 to new Paragraph (d)(2)(ii)(L) of Item 7 of Exchange Act Schedule 14A. The new instruction is modeled after the approach used with regard to Exchange Act Rule 14a–8 security holder proposals, as set forth in Exchange Act Rule 14a–8(e)(2) [17 CFR 240.14a–8(e)(2)].

<sup>74</sup> See Sullivan.

<sup>75</sup> See, e.g., *id.*

<sup>76</sup> See *id.*

<sup>77</sup> See *id.*

<sup>78</sup> See, e.g., American Federation of Labor and Congress of Industrial Organizations (“AFL–CIO”); CII; International Brotherhood of Teamsters (“IBT”); ISIS; McRitchie2; Nappier; SERS; Trillium Asset Management (“Trillium”); UBC. See also AFSCME; Association of the Bar of the City of New York’s Special Committee on Mergers, Acquisitions and Corporate Control Contests (“NYCBBAR”).

<sup>79</sup> See, e.g., ABA; BRT; Foley; Jenkins; NYSBAR; Sullivan; Valero.

<sup>80</sup> See, e.g., Compass; Foley; Jenkins.

<sup>81</sup> See CII; CIR; Cummings; SERS.