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Office of Thrift Supervision  
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September 22, 2010

**Transmittal**  
**TR-461**

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Federal Register, Vol. 75, No. 179, pp. 56668-56716

**Number TR-461**

On September 16, 2010, the Securities and Exchange Commission issued a final rule adopting changes to the Federal proxy rules to facilitate the effective exercise of shareholders' traditional State law rights to nominate and elect directors to company boards of directors.



# Federal Register

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**Thursday,  
September 16, 2010**

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**Part II**

## **Securities and Exchange Commission**

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**17 CFR Parts 200, 232, 240 and 249  
Facilitating Shareholder Director  
Nominations; Final Rule**

**SECURITIES AND EXCHANGE COMMISSION****17 CFR PARTS 200, 232, 240 and 249**

[Release Nos. 33-9136; 34-62764; IC-29384; File No. S7-10-09]

RIN 3235-AK27

**Facilitating Shareholder Director Nominations****AGENCY:** Securities and Exchange Commission.**ACTION:** Final rule.

**SUMMARY:** We are adopting changes to the Federal proxy rules to facilitate the effective exercise of shareholders' traditional State law rights to nominate and elect directors to company boards of directors. The new rules will require, under certain circumstances, a company's proxy materials to provide shareholders with information about, and the ability to vote for, a shareholder's, or group of shareholders', nominees for director. We believe that these rules will benefit shareholders by improving corporate suffrage, the disclosure provided in connection with corporate proxy solicitations, and communication between shareholders in the proxy process. The new rules apply only where, among other things, relevant state or foreign law does not prohibit shareholders from nominating directors. The new rules will require that specified disclosures be made concerning nominating shareholders or groups and their nominees. In addition, the new rules provide that companies must include in their proxy materials, under certain circumstances, shareholder proposals that seek to establish a procedure in the company's governing documents for the inclusion of one or more shareholder director nominees in the company's proxy materials. We also are adopting related changes to certain of our other rules and regulations, including the existing solicitation exemptions from our proxy rules and the beneficial ownership reporting requirements.

**DATES:** *Effective Date:* November 15, 2010.

*Compliance Dates:* November 15, 2010, except that companies that qualify as "smaller reporting companies" (as defined in 17 CFR 240.12b-2) as of the effective date of the rule amendments will not be subject to Rule 14a-11 until three years after the effective date.

**FOR FURTHER INFORMATION CONTACT:** Lillian Brown, Tamara Brightwell, or Ted Yu, Division of Corporation Finance, at (202) 551-3200, or, with regard to investment companies, Kieran

G. Brown, Division of Investment Management, at (202) 551-6784, U.S. Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549.

**SUPPLEMENTARY INFORMATION:** We are adding new Rule 82a of Part 200 Subpart D—Information and Requests,<sup>1</sup> and new Rules 14a-11,<sup>2</sup> and 14a-18,<sup>3</sup> and new Regulation 14N<sup>4</sup> and Schedule 14N,<sup>5</sup> and amending Rule 13<sup>6</sup> of Regulation S-T,<sup>7</sup> Rules 13a-11,<sup>8</sup> 13d-1,<sup>9</sup> 14a-2,<sup>10</sup> 14a-4,<sup>11</sup> 14a-5,<sup>12</sup> 14a-6,<sup>13</sup> 14a-8,<sup>14</sup> 14a-9,<sup>15</sup> 14a-12,<sup>16</sup> and 15d-11,<sup>17</sup> Schedule 13G,<sup>18</sup> Schedule 14A,<sup>19</sup> and Form 8-K,<sup>20</sup> under the Securities Exchange Act of 1934.<sup>21</sup> Although we are not amending Schedule 14C<sup>22</sup> under the Exchange Act, the amendments will affect the disclosure provided in Schedule 14C, as Schedule 14C requires disclosure of some items contained in Schedule 14A.

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<sup>21</sup> 15 U.S.C. 78a *et seq.* (the "Exchange Act"). Part 200 Subpart D—Information and Requests and Regulation S-T are also promulgated under the Securities Act of 1933 [15 U.S.C. 77a *et seq.*] (the "Securities Act").

<sup>22</sup> 17 CFR 240.14c-101.

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## I. Background and Overview of Amendments

### A. Background

On June 10, 2009, we proposed a number of changes to the Federal proxy rules designed to facilitate shareholders' traditional State law rights to nominate and elect directors. Our proposals sought to accomplish this goal in two ways: (1) By facilitating the ability of shareholders with a significant, long-term stake in a company to exercise their rights to nominate and elect directors by establishing a minimum standard for including disclosure concerning, and enabling shareholders to vote for, shareholder director nominees in company proxy materials; and (2) by narrowing the scope of the Commission rule that permitted companies to exclude shareholder proposals that sought to establish a procedure for the inclusion of shareholder nominees in company proxy materials.<sup>23</sup> We recognized at that time that the financial crisis that the nation and markets had experienced heightened the serious concerns of many shareholders about the accountability and responsiveness of some companies and boards of directors to shareholder interests, and that these concerns had resulted in a loss of investor confidence. These concerns also led to questions about whether boards were exercising appropriate oversight of management, whether boards were appropriately focused on shareholder interests, and whether boards need to be more accountable for their decisions regarding issues such as compensation structures and risk management.

A principal way that shareholders can hold boards accountable and influence matters of corporate policy is through the nomination and election of directors. The ability of shareholders to effectively use their power to nominate and elect directors is significantly

<sup>23</sup> See *Facilitating Shareholder Director Nominations*, Release No. 33–9046, 34–60089 (June 10, 2009) [74 FR 29024] (“Proposal” or “Proposing Release”). The Proposing Release was published for comment in the Federal Register on June 18, 2009, and the initial comment period closed on August 17, 2009. The Commission re-opened the comment period as of December 18, 2009 for thirty days to provide interested persons the opportunity to comment on additional data and related analyses that were included in the public comment file at or following the close of the original comment period. In total, the Commission received approximately 600 comment letters on the proposal. The public comments we received are available on our Web site at <http://www.sec.gov/comments/s7-10-09/s71009.shtml>. Comments also are available for Web site viewing and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m.

affected by our proxy regulations because, as has long been recognized, a federally-regulated corporate proxy solicitation is the primary way for public company shareholders to learn about the matters to be decided by the shareholders and to make their views known to company management.<sup>24</sup> As discussed in detail below, in light of these concerns, we reviewed our proxy regulations to determine whether they should be revised to facilitate shareholders' ability to nominate and elect directors. We have taken into consideration the comments received on the proposed amendments as well as subsequent congressional action<sup>25</sup> and are adopting final rules that will, for the first time, require company proxy materials, under certain circumstances, to provide shareholders with information about, and the ability to vote for a shareholder's, or group of shareholders', nominees for director. We also are amending our proxy rules to provide shareholders the ability to include in company proxy materials, under certain circumstances, shareholder proposals that seek to establish a procedure in the company's governing documents for the inclusion of one or more shareholder director

<sup>24</sup> See, e.g., *Securit[ies] and Exchange Commission Proxy Rules: Hearings on H.R. 1493, H.R. 1821, and H.R. 2019 Before the House Comm. on Interstate and Foreign Commerce, 78th Cong., 1st Sess., at 17–19 (1943)* (Statement of the Honorable Ganson Purcell, Chairman, Securities and Exchange Commission) (explaining the initial Commission rules requiring the inclusion of shareholder proposals in company proxy materials: “We give [a stockholder] the right in the rules to put his proposal before all of his fellow stockholders along with all other proposals \* \* \* so that they can see then what they are and vote accordingly. \* \* \* The rights that we are endeavoring to assure to the stockholders are those rights that he has traditionally had under State law, to appear at the meeting; to make a proposal; to speak on that proposal at appropriate length; and to have his proposal voted on. But those rights have been rendered largely meaningless through the process of dispersion of security ownership through[out] the country. \* \* \* [T]he assurance of these fundamental rights under State laws which have been, as I say, completely ineffective \* \* \* because of the very dispersion of the stockholders' interests throughout the country[;] whereas formerly \* \* \* a stockholder might appear at the meeting and address his fellow stockholders[, t]oday he can only address the assembled proxies which are lying at the head of the table. The only opportunity that the stockholder has today of expressing his judgment comes at the time he considers the execution of his proxy form, and we believe \* \* \* that this is the time when he should have the full information before him and ability to take action as he sees fit.”); see also *S. Rep. 792, 73d Cong., 2d Sess., 12 (1934)* (“[I]t is essential that [the stockholder] be enlightened not only as to the financial condition of the corporation, but also as to the major questions of policy, which are decided at stockholders' meetings.”).

<sup>25</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, § 971, 124 Stat. 1376 (2010) (“Dodd-Frank Act”).

nominees in the company's proxy materials.

Regulation of the proxy process was one of the original responsibilities that Congress assigned to the Commission as part of its core functions in 1934. The Commission has actively monitored the proxy process since receiving this authority and has considered changes when it appeared that the process was not functioning in a manner that adequately protected the interests of investors.<sup>26</sup> One of the key tenets of the Federal proxy rules on which the Commission has consistently focused is whether the proxy process functions, as nearly as possible, as a replacement for an actual in-person meeting of shareholders.<sup>27</sup> This is important because the proxy process represents shareholders' principal means of participating effectively at an annual or special meeting of shareholders.<sup>28</sup> In our Proposal we noted our concern that the Federal proxy rules may not be facilitating the exercise of shareholders' State law rights to nominate and elect directors. Without the ability to effectively utilize the proxy process, shareholder nominees do not have a realistic prospect of being elected because most, if not all, shareholders return their proxy cards in advance of the shareholder meeting and thus, in essence, cast their votes before the

<sup>26</sup> For example, the Commission has considered changes to the proxy rules related to the election of directors in recent years. See *Security Holder Director Nominations*, Release No. 34-48626 (October 14, 2003) [68 FR 60784] ("2003 Proposal"); *Shareholder Proposals*, Release No. 34-56160 (July 27, 2007) [72 FR 43466] ("Shareholder Proposals Proposing Release"); *Shareholder Proposals Relating to the Election of Directors*, Release No. 34-56161 (July 27, 2007) [72 FR 43488] ("Election of Directors Proposing Release"); and *Shareholder Proposals Relating to the Election of Directors*, Release No. 34-56914 (December 6, 2007) [72 FR 70450] ("Election of Directors Adopting Release"). When we refer to the "2007 Proposals" and the comments received in 2007, we are referring to the Shareholder Proposals Proposing Release and the Election of Directors Proposing Release and the comments received on those proposals, unless otherwise specified.

<sup>27</sup> Professor Karmel has described the Commission's proxy rules as having the purpose "to make the proxy device the closest practicable substitute for attendance at the [shareholder] meeting." Roberta S. Karmel, *The New Shareholder and Corporate Governance: Voting Power Without Responsibility or Risk: How Should Proxy Reform Address the De-Coupling of Economic and Voting Rights?*, 55 Vill. L. Rev. 93, 104 (2010).

<sup>28</sup> Historically, a shareholder's voting rights generally were exercised at a shareholder meeting. As discussed in the Proposing Release, in passing the Exchange Act, Congress understood that the securities of many companies were held through dispersed ownership, at least in part facilitated by stock exchange listing of shares. Although voting rights in public companies technically continued to be exercised at a meeting, the votes cast at the meeting were by proxy and the voting decision was made during the proxy solicitation process. This structure continues to this day.

meeting at which they may nominate directors. Recognizing that this failure of the proxy process to facilitate shareholder nomination rights has a practical effect on the right to elect directors, the new rules will enable the proxy process to more closely approximate the conditions of the shareholder meeting. In addition, because companies will be required to include shareholder-nominated candidates for director in company proxy materials, shareholders will receive additional information upon which to base their voting decisions. Finally, we believe these changes will significantly enhance the confidence of shareholders who link the recent financial crisis to a lack of responsiveness of some boards to shareholder interests.<sup>29</sup>

The Commission has, on a number of prior occasions, considered whether its proxy rules needed to be amended to facilitate shareholders' ability to nominate directors by having their nominees included in company proxy materials.<sup>30</sup> Most recently, in June 2009, we proposed amendments to the proxy rules that included both a new proxy rule, Exchange Act Rule 14a-11, that would require a company's proxy materials to provide shareholders with information about, and the ability to vote for, candidates for director nominated by long-term shareholders or groups of long-term shareholders with significant holdings, and amendments to Rule 14a-8(i)(8) to prohibit exclusion of certain shareholder proposals seeking to establish a procedure in the company's governing documents for the inclusion of one or more shareholder director nominees in the company's proxy materials. We received significant comment on the proposed amendments. Overall, commenters were sharply

<sup>29</sup> See letters from American Federation of Labor and Congress of Industrial Organizations ("AFL-CIO"); California Public Employees' Retirement System ("CalPERS"); Council of Institutional Investors ("CII"); Lynne L. Dallas ("L. Dallas"); Los Angeles County Employees Retirement Association ("LACERA"); Laborers' International Union of North America ("LIUNA"); The Nathan Cummings Foundation ("Nathan Cummings Foundation"); Pax World Management Corp. ("Pax World"); Pershing Square Capital Management, L.P. ("Pershing Square"); Relational Investors, LLC ("Relational"); RiskMetrics Group, Inc. ("RiskMetrics"); Shareowner Education Network and Shareowners.org ("Shareowners.org"); Social Investment Forum ("Social Investment Forum"); State of Wisconsin Investment Board ("SWIB"); International Brotherhood of Teamsters ("Teamsters"); Trillium Asset Management Corporation ("Trillium"); Universities Superannuation Scheme—UK ("Universities Superannuation"); Washington State Investment Board ("WSIB").

<sup>30</sup> For a discussion of the Commission's previous actions in this area, see the Proposing Release and the 2003 Proposal.

divided on the necessity for, and the workability of, the proposed amendments. Supporters of the amendments generally believed that, if adopted, they would facilitate shareholders' ability to exercise their State law right to nominate directors and provide meaningful opportunities to effect changes in the composition of the board.<sup>31</sup> These commenters predicted that the amendments would lead to more accountable, responsive, and effective boards.<sup>32</sup> Many commenters saw a link between the recent economic crisis and shareholders' inability to have nominees included in a company's proxy materials.<sup>33</sup>

Commenters opposed to our Proposal believed that recent corporate governance developments, including increased use of a majority voting standard for the election of directors and certain State law changes, already provide shareholders with meaningful opportunities to participate in director elections.<sup>34</sup> These commenters viewed

<sup>31</sup> See letters from CII; Colorado Public Employees' Retirement Association ("COPERA"); CitW Investment Group ("CitW Investment Group"); L. Dallas; Thomas P. DiNapoli ("T. DiNapoli"); Florida State Board of Administration ("Florida State Board of Administration"); International Corporate Governance Network ("ICGN"); Denise L. Nappier ("D. Nappier"); Ohio Public Employees Retirement System ("OPERS"); Pax World; Teamsters.

<sup>32</sup> *Id.*

<sup>33</sup> See letters from AFL-CIO; CalPERS; California State Teachers' Retirement System ("CalSTRS"); CII; L. Dallas; LACERA; LIUNA; Nathan Cummings Foundation; Pax World; Pershing Square; Relational; RiskMetrics; Shareowners.org; Social Investment Forum; SWIB; Teamsters; Trillium; Universities Superannuation; WSIB.

<sup>34</sup> See letters from Group of 26 Corporate Secretaries and Governance Professionals ("26 Corporate Secretaries"); 3M Company ("3M"); Advance Auto Parts, Inc. ("Advance Auto Parts"); The Allstate Corporation ("Allstate"); Avis Budget Group, Inc. ("Avis Budget"); American Express Company ("American Express"); Anadarko Petroleum Corporation ("Anadarko"); Association of Corporate Counsel ("Association of Corporate Counsel"); AT&T Inc. ("AT&T"); Lawrence Behr ("L. Behr"); Best Buy Co., Inc. ("Best Buy"); The Boeing Company ("Boeing"); Business Roundtable ("BRT"); Robert N. Burt ("R. Burt"); State Bar of California, Corporations Committee of Business Law Section ("California Bar"); Sean F. Campbell ("S. Campbell"); Carlson ("Carlson"); Caterpillar Inc. ("Caterpillar"); U.S. Chamber of Commerce Center for Capital Markets Competitiveness ("Chamber of Commerce/CMCC"); Chevron Corporation ("Chevron"); CIGNA Corporation ("CIGNA"); W. Don Cornwell ("W. Cornwell"); CSX Corporation ("CSX"); Cummins Inc. ("Cummins"); Davis Polk & Wardwell LLP ("Davis Polk"); Dewey & LeBoeuf ("Dewey"); E.I. du Pont de Nemours and Company ("DuPont"); Eaton Corporation ("Eaton"); Michael Eng ("M. Eng"); FedEx Corporation ("FedEx"); FMC Corporation ("FMC Corp."); FPL Group, Inc. ("FPL Group"); Frontier Communications Corporation ("Frontier"); General Electric Company ("GE"); General Mills, Inc. ("General Mills"); Charles O. Holliday, Jr. ("C. Holliday"); Honeywell International Inc. ("Honeywell"); Constance J.

the amendments as inappropriately intruding into matters traditionally governed by State law or imposing a “one size fits all” rule for all companies and expressed concerns about “special interest” directors, forcing companies to focus on the short-term rather than the creation of long-term shareholder value, and other perceived negative effects of the amendments, if adopted, on boards and companies.<sup>35</sup> Finally, commenters

Horner (“C. Horner”); International Business Machines Corporation (“IBM”); Jones Day (“Jones Day”); Keating Muething & Klekamp PLL (“Keating Muething”); James M. Kilts (“J. Kilts”); Reatha Clark King, Ph.D. (“R. Clark King”); Ned C. Lautenbach (“N. Lautenbach”); MeadWestvaco Corporation (“MeadWestvaco”); MetLife, Inc. (“MetLife”); Motorola, Inc. (“Motorola”); O’Melveny & Myers LLP (“O’Melveny & Myers”); Office Depot, Inc. (“Office Depot”); Pfizer Inc. (“Pfizer”); Protective Life Corporation (“Protective”); Sullivan & Cromwell LLP (“S&C”); Safeway Inc. (“Safeway”); Sara Lee Corporation (“Sara Lee”); Shearman & Sterling LLP (“Shearman & Sterling”); The Sherwin-Williams Company (“Sherwin-Williams”); Sidley Austin LLP (“Sidley Austin”); Simpson Thacher & Bartlett LLP (“Simpson Thacher”); Tesoro Corporation (“Tesoro”); Textron Inc. (“Textron”); Texas Instruments Corporation (“TI”); Gary L. Tooker (“G. Tooker”); UnitedHealth Group Incorporated (“UnitedHealth”); Unitrin, Inc. (“Unitrin”); U.S. Bancorp (“U.S. Bancorp”); Wachtell, Lipton, Rosen & Katz (“Wachtell”); Wells Fargo & Company (“Wells Fargo”); West Chicago Chamber of Commerce & Industry (“West Chicago Chamber”); Weyerhaeuser Company (“Weyerhaeuser”); Xerox Corporation (“Xerox”); Yahoo! (“Yahoo”).

<sup>35</sup> See letters from 26 Corporate Secretaries; American Bar Association (“ABA”); ACE Limited (“ACE”); Advance Auto Parts; AGL Resources (“AGL”); Aetna Inc. (“Aetna”); Allstate; Alston & Bird LLP (“Alston & Bird”); American Bankers Association (“American Bankers Association”); The American Business Conference (“American Business Conference”); American Electric Power Company, Inc. (“American Electric Power”); Anadarko; Applied Materials, Inc. (“Applied Materials”); Artistic Land Designs LLC (“Artistic Land Designs”); Association of Corporate Counsel; Avis Budget; Atlantic Bingo Supply, Inc. (“Atlantic Bingo”); L. Behr; Best Buy; Biogen Idec Inc. (“Biogen”); James H. Blanchard (“J. Blanchard”); Boeing; Tammy Bonkowski (“T. Bonkowski”); BorgWarner Inc. (“BorgWarner”); Boston Scientific Corporation (“Boston Scientific”); The Brink’s Company (“Brink’s”); BRT; Burlington Northern Santa Fe Corporation (“Burlington Northern”); R. Burt; California Bar; Callaway Golf Company (“Callaway”); S. Campbell; Carlson; Carolina Mills (“Carolina Mills”); Caterpillar; Chamber of Commerce/CMCC; Chevron; Rebecca Chicko (“R. Chicko”); CIGNA; Comcast Corporation (“Comcast”); Competitive Enterprise Institute’s Center for Investors and Entrepreneurs (“Competitive Enterprise Institute”); W. Cornwell; CSX; Edwin Culwell (“E. Culwell”); Cummins; Darden Restaurants, Inc. (“Darden Restaurants”); Daniels Manufacturing Corporation (“Daniels Manufacturing”); Davis Polk; Delaware State Bar Association (“Delaware Bar”); Tom Dermody (“T. Dermody”); Devon Energy Corporation (“Devon”); DTE Energy Company (“DTE Energy”); Eaton; The Edison Electric Institute (“Edison Electric Institute”); Eli Lilly and Company (“Eli Lilly”); Emerson Electric Co. (“Emerson Electric”); M. Eng; Erickson Retirement Communities, LLC (“Erickson”); ExxonMobil Corporation (“ExxonMobil”); FedEx; Financial Services Roundtable (“Financial Services Roundtable”);

worried about the impact of the proposed amendments on small businesses.<sup>36</sup>

Flutterby Kissed Unique Treasures (“Flutterby”); FPL Group; Frontier; GE; Allen C. Goolsby (“A. Goolsby”); C. Holliday; IBM; Investment Company Institute (“ICI”); Intellect Corporation (“Intellect”); JPMorgan Chase & Co. (“JPMorgan Chase”); Jones Day; R. Clark King; Leggett & Platt Incorporated (“Leggett”); Teresa Liddell (“T. Liddell”); Little Diversified Architectural Consulting (“Little”); McDonald’s Corporation (“McDonald’s”); MeadWestvaco; MedFax, Inc. (“MedFax”); Medical Insurance Services (“Medical Insurance”); MetLife; Mary S. Metz (“M. Metz”); Microsoft Corporation (“Microsoft”); John R. Miller (“J. Miller”); Marcelo Moretti (“M. Moretti”); Motorola; National Association of Corporate Directors (“NACD”); National Association of Manufacturers (“NAM”); National Investor Relations Institute (“NIRI”); O’Melveny & Myers; Office Depot; Omaha Door & Window (“Omaha Door”); The Procter & Gamble Company (“P&G”); PepsiCo, Inc. (“PepsiCo”); Pfizer; Realogy Corporation (“Realogy”); Jared Robert (“J. Robert”); Marissa Robert (“M. Robert”); RPM International Inc. (“RPM”); Ryder System, Inc. (“Ryder”); Safeway; Ralph S. Saul (“R. Saul”); Shearman & Sterling; Sherwin-Williams; Raymond F. Simoneau (“R. Simoneau”); Society of Corporate Secretaries and Governance Professionals, Inc. (“Society of Corporate Secretaries”); The Southern Company (“Southern Company”); Southland Properties, Inc. (“Southland”); The Steele Group (“Steele Group”); Style Crest Enterprises, Inc. (“Style Crest”); Tesoro; Textron; Theragenics Corporation (“Theragenics”); TI; Richard Trummel (“R. Trummel”); Terry Trummel (“T. Trummel”); Viola Trummel (“V. Trummel”); tw telecom inc. (“tw telecom”); Laura D’Andrea Tyson (“L. Tyson”); United Brotherhood of Carpenters and Joiners of America (“United Brotherhood of Carpenters”); UnitedHealth; U.S. Bancorp; VCG Holding Corporation (“VCG”); Wachtell; The Way to Wellness (“Wellness”); Wells Fargo; Whirlpool Corporation (“Whirlpool”); Xerox; Yahoo; Jeff Young (“J. Young”).

<sup>36</sup> See letters from ABA; American Mailing Service (“American Mailing”); All Cast, Inc. (“All Cast”); Always N Bloom (“Always N Bloom”); American Carpets (“American Carpets”); John Arquilla (“J. Arquilla”); Beth Armbrust (“B. Armbrust”); Artistic Land Designs; Charles Atkins (“C. Atkins”); Book Celler (“Book Celler”); Kathleen G. Bostwick (“K. Bostwick”); Brighter Day Painting (“Brighter Day Painting”); Colletti and Associates (“Colletti”); Commercial Concepts (“Commercial Concepts”); Complete Home Inspection (“Complete Home Inspection”); Debbie Courtney (“D. Courtney”); Sue Crawford (“S. Crawford”); Crespin’s Cleaning, Inc. (“Crespin”); Don’s Tractor Repair (“Don’s”); Theresa Ebreo (“T. Ebreo”); M. Eng; eWareness, Inc. (“eWareness”); Evans Real Estate Investments, LLC (“Evans”); Fluharty Antiques (“Fluharty”); Flutterby; Fortuna Italian Restaurant & Pizza (“Fortuna Italian Restaurant”); Future Form Inc. (“Future Form Inc.”); Glaspell Goals (“Glaspell”); Cheryl Gregory (“C. Gregory”); Healthcare Practice Management, Inc. (“Healthcare Practice”); Brian Henderson (“B. Henderson”); Sheri Henning (“S. Henning”); Jaynee Herren (“J. Herren”); Ami Iriarte (“A. Iriarte”); Jeremy J. Jones (“J. Jones”); Juz Kidz Nursery and Preschool (“Juz Kidz”); Kernan Chiropractic Center (“Kernan”); LMS Wine Creators (“LMS Wine”); Tabitha Luna (“T. Luna”); Mansfield Children’s Center, Inc. (“Mansfield Children’s Center”); Denise McDonald (“D. McDonald”); Meister’s Landscaping (“Meister”); Merchants Terminal Corporation (“Merchants Terminal”); Middendorf Bros. Auctioneers and Real Estate (“Middendorf”); Mingo Custom Woods (“Mingo”); Moore Brothers Auto Truck Repair (“Moore Brothers”); Mouton’s Salon (“Mouton”); Doug Mozack (“D. Mozack”); Ms. Dee’s Lil Darlins

After considering the comments and weighing the competing interests of facilitating shareholders’ ability to exercise their State law rights to nominate and elect directors against potential disruption and cost to companies, we are convinced that adopting the proposed amendments to the proxy rules serves our purpose to regulate the proxy process in the public interest and on behalf of investors. We are not persuaded by the arguments of some commenters that the provisions of Rule 14a–11 are unnecessary.<sup>37</sup> Those commenters argued that changes in corporate governance over the past six years have obviated the need for a Federal rule to allow shareholders to place their nominees in company proxy materials and that shareholders should be left to determine whether, on a company-by-company basis, such a rule is necessary at any particular company.

While we recognize that some states, such as Delaware,<sup>38</sup> have amended their state corporate law to enable companies to adopt procedures for the inclusion of shareholder director nominees in company proxy materials,<sup>39</sup> as was

Daycare (“Ms. Dee”); Gavin Napolitano (“G. Napolitano”); NK Enterprises (“NK”); Hugh S. Olson (“H. Olson”); Parts and Equipment Supply Co. (“PESC”); Pioneer Heating & Air Conditioning (“Pioneer Heating & Air Conditioning”); RC Furniture Restoration (“RC”); RTW Enterprises Inc. (“RTW”); Debbie Sapp (“D. Sapp”); Southwest Business Brokers (“SBB”); Security Guard IT&T Alarms, Inc. (“SGIA”); Peggy Sicilia (“P. Sicilia”); Slycers Sandwich Shop (“Slycers”); Southern Services (“Southern Services”); Steele Group; Sylvron Travels (“Sylvron”); Theragenics; Erin White Tremaine (“E. Tremaine”); Wagner Health Center (“Wagner”); Wagner Industries (“Wagner Industries”); Wellness; West End Auto Paint & Body (“West End”); Y.M. Inc. (“Y.M.”); J. Young.

<sup>37</sup> See, e.g., letters from 26 Corporate Secretaries; 3M; Advance Auto Parts; Allstate; Avis Budget; American Express; Anadarko; Association of Corporate Counsel; AT&T; L. Behr; Best Buy; Boeing; BRT; R. Burt; California Bar; S. Campbell; Carlson; Caterpillar; Chamber of Commerce/CMCC; Chevron; CIGNA; W. Cornwell; CSX; Cummins; Davis Polk; Dewey; DuPont; Eaton; M. Eng; FedEx; FMC Corp.; FPL Group; Frontier; GE; General Mills; Joseph A. Grundfest, Stanford Law School (July 24, 2009) (“Grundfest”); C. Holliday; Honeywell; C. Horner; IBM; Jones Day; Keating Muething; J. Kilts; R. Clark King; N. Lautenbach; MeadWestvaco; MetLife; Motorola; O’Melveny & Myers; Office Depot; Pfizer; Protective; S&C; Safeway; Sara Lee; Shearman & Sterling; Sherwin-Williams; Sidley Austin; Simpson Thacher; Tesoro; Textron; TI; G. Tooker; UnitedHealth; Unitrin; U.S. Bancorp; Wachtell; Wells Fargo; West Chicago Chamber; Weyerhaeuser; Xerox; Yahoo.

<sup>38</sup> We refer to Delaware law frequently because of the large percentage of public companies incorporated under that law. The Delaware Division of Corporations reports that over 50% of U.S. public companies are incorporated in Delaware. See <http://www.corp.delaware.gov>.

<sup>39</sup> Del. Code Ann. tit. 8, § 112. In December 2009, the Committee on Corporate Laws of the American Bar Association Section of Business Law Committee adopted amendments to the Model Act that explicitly authorize bylaws that prescribe

Continued

highlighted by a number of commenters, other states have not.<sup>40</sup> These commenters noted that, as a result, companies not incorporated in Delaware could frustrate shareholder efforts to establish procedures for shareholders to place board nominees in the company's proxy materials by litigating the validity of a shareholder proposal establishing such procedures, or possibly repealing shareholder-adopted bylaws establishing such procedures. In addition, due to the difficulty that shareholders could have in establishing such procedures, we believe that it would be inappropriate to rely solely on an enabling approach to facilitate shareholders' ability to exercise their State law rights to nominate and elect directors. Even if bylaw amendments to permit shareholders to include nominees in company proxy materials were permissible in every state, shareholder proposals to so amend company bylaws could face significant obstacles.

We also considered whether the move by many companies away from plurality voting to a general policy of majority voting in uncontested director elections should lead to a conclusion that our actions are unnecessary or whether we should premise our actions on the failure of a company to adopt majority

shareholder access to company proxy materials or reimbursement of proxy solicitation expenses. See ABA Press Release, "Corporate Laws Committee Adopts New Model Business Corporation Act Amendments to Provide For Proxy Access And Expense Reimbursement," December 17, 2009, available at [http://www.abanet.org/abanet/media/release/news\\_release.cfm?releaseid=848](http://www.abanet.org/abanet/media/release/news_release.cfm?releaseid=848).

In addition, in 2007, North Dakota amended its corporate code to permit 5% shareholders to provide a company notice of intent to nominate directors and require the company to include each such shareholder nominee in its proxy statement and form of proxy. N.D. Cent. Code § 10-35-08 (2009); see North Dakota Publicly Traded Corporations Act, N.D. Cent. Code § 10-35 et al. (2007).

<sup>40</sup> See letters from American Federation of State, County and Municipal Employees ("AFSCME"); AllianceBernstein L.P. ("AllianceBernstein"); Amalgamated Bank LongView Funds ("Amalgamated Bank"); Association of British Insurers ("British Insurers"); CalPERS; CII; The Corporate Library ("Corporate Library"); L. Dallas; Florida State Board of Administration; ICGN; LIUNA; D. Nappier; Paul M. Neuhauser ("P. Neuhauser"); Comment Letter of Nine Securities and Governance Law Firms ("Nine Law Firms"); Pax World; Pershing Square; *theRacetotheBottom.org* ("RacetotheBottom"); RiskMetrics; Schulte Roth & Zabel LLP ("Schulte Roth & Zabel"); Sodali ("Sodali"); Teachers Insurance and Annuity Association of America and College Retirement Equities Fund ("TIAA-CREF"); United States Proxy Exchange ("USPE"); ValueAct Capital, LLC ("ValueAct Capital").

voting.<sup>41</sup> We agree with commenters<sup>42</sup> who argued that a majority voting standard in director elections does not address the need for a rule to facilitate the inclusion of shareholder nominees for director in company proxy materials. While majority voting impacts shareholders' ability to elect candidates put forth by management, it does not affect shareholders' ability to exercise their right to nominate candidates for director.

We also do not believe that the recent amendments to New York Stock Exchange (NYSE) Rule 452, which eliminated brokers' discretionary voting authority in director elections, negate the need for the rule. Certain commenters specifically noted their concurrence with us on this point.<sup>43</sup> The amendments to NYSE Rule 452 address who exercises the right to vote rather than shareholders' ability to have their nominees put forth for a vote. While these and other changes have been important events, they bolster shareholders' ability to elect directors who are already on the company's proxy card, not their ability to affect who appears on that card. We therefore are convinced that the Federal proxy rules should be amended to better facilitate the exercise of shareholders' rights under State law to nominate directors.

We also considered whether we should amend Rule 14a-8 to narrow the "election exclusion," without also adopting Rule 14a-11. We note that a significant number of commenters supported the proposed amendments to Rule 14a-8(i)(8).<sup>44</sup> We concluded, however, as certain commenters pointed out, that adopting only the proposed amendments to Rule 14a-8(i)(8), without Rule 14a-11, would not achieve the Commission's stated objectives.<sup>45</sup> We believe that the amendments to Rule 14a-8(i)(8) will provide shareholders with an important mechanism for including in company proxy materials proposals that would address the inclusion of shareholder director nominees in the company's proxy materials in ways that supplement Rule

14a-11, such as with a lower ownership threshold, a shorter holding period, or to allow for a greater number of nominees if shareholders of a company support such standards.

We recognize that many commenters advocated that shareholders' ability to include nominees in company proxy materials should be determined *exclusively* by what individual companies or their shareholders affirmatively choose to provide, or that companies or their shareholders should be able to opt out of Rule 14a-11 or otherwise alter its terms for individual companies (the "private ordering" arguments).<sup>46</sup> After careful consideration of the numerous comments advocating this perspective,<sup>47</sup> we believe that the arguments in favor of this perspective are flawed for several reasons.

First, corporate governance is not merely a matter of private ordering. Rights, including shareholder rights, are artifacts of law, and in the realm of corporate governance some rights cannot be bargained away but rather are imposed by statute. There is nothing novel about mandated limitations on private ordering in corporate governance.<sup>48</sup>

<sup>46</sup> See letters from 26 Corporate Secretaries; ABA; ACE; Advance Auto Parts; AGL; Aetna; Allstate; Alston & Bird; American Bankers Association; American Business Conference; American Electric Power; Anadarko; Applied Materials; Artistic Land Designs; Association of Corporate Counsel; Avis Budget; Atlantic Bingo; L. Behr; Best Buy; Biogen; J. Blanchard; Boeing; T. Bonkowski; BorgWarner; Boston Scientific; Brink's; BRT; Burlington Northern; R. Burt; California Bar; Callaway; S. Campbell; Carlson; Carolina Mills; Caterpillar; Chamber of Commerce/CMCC; Chevron; R. Chicker; CIGNA; Comcast; Competitive Enterprise Institute; W. Cornwell; CSX; E. Culwell; Cummins; Darden Restaurants; Daniels Manufacturing; Davis Polk; Delaware Bar; T. Dermody; Devon; DTE Energy; Eaton; Edison Electric Institute; Eli Lilly; Emerson Electric; M. Eng; Erickson; ExxonMobil; FedEx; Financial Services Roundtable; Flutterby; FPL Group; Frontier; GE; A. Goolsby; Grundfest; C. Holliday; IBM; ICI; Intellect; JPMorgan Chase; Jones Day; R. Clark King; Leggett; T. Liddell; Little; McDonald's; MeadWestvaco; MedFarr; Medical Insurance; MetLife; M. Metz; Microsoft; J. Miller; M. Moretti; Motorola; NACD; NAM; NIRI; O'Melveny & Myers; Office Depot; Omaha Door; P&G; PepsiCo; Pfizer; Realogy; J. Robert; M. Robert; RPM; Ryder; Safeway; R. Saul; Shearman & Sterling; Sherwin-Williams; R. Simoneau; Society of Corporate Secretaries; Southern Company; Southland; Steele Group; Style Crest; Tesoro; Textron; Theragenics; TI; R. Trummel; T. Trummel; V. Trummel; tw telecom; L. Tyson; United Brotherhood of Carpenters; UnitedHealth; U.S. Bancorp; VCG; Wachtell; Wellness; Wells Fargo; Whirlpool; Xerox; Yahoo; J. Young.

<sup>47</sup> See *id.*

<sup>48</sup> For example, quite a few aspects of Delaware corporation law are mandatory (*i.e.*, not capable of modification by agreement or provision in the certificate of incorporation or bylaws), including: (i) The requirement to hold an annual election of directors (Del. Code Ann., tit. 8, § 211(b)); *Jones Apparel Group v. Maxwell Shoe Co.*, 883 A.2d 837,

<sup>41</sup> Despite the rate of adoption of a majority voting standard for director elections by companies in the S&P 500, only a small minority of firms in the Russell 3000 index have adopted them. See discussion in footnote 69 in the Proposing Release.

<sup>42</sup> See letters from AFSCME; AllianceBernstein; CalPERS; CII; L. Dallas; D. Nappier; P. Neuhauser; RiskMetrics; TIAA-CREF. One commenter characterized a majority voting standard as a mechanism for "registering negative sentiment" about an incumbent board nominee, not a mechanism to ensure board accountability. See letter from AFSCME.

<sup>43</sup> See letters from CII; Sodali; USPE.

<sup>44</sup> For a list of these commenters, see footnotes 677, 678, and 679 below.

<sup>45</sup> See letters from CII; USPE.

Second, the argument that there is an inconsistency between mandating inclusion of shareholder nominees in company proxy materials and our concern for the rights of shareholders under the Federal securities laws<sup>49</sup> mistakenly assumes that basic protections of, and rights of, particular shareholders provided under the Federal proxy rules should be able to be abrogated by “the shareholders” of a particular corporation, acting in the aggregate. The rules we adopt today provide individual shareholders the ability to have director nominees included in the corporate proxy materials if State law<sup>50</sup> and governing corporate documents permit a shareholder to nominate directors at the shareholder meeting and the requirements of Rule 14a–11 are satisfied. Those rules similarly facilitate the right of individual shareholders to vote for those nominated, whether by management or another shareholder, if the shareholder has voting rights under State law and the company’s governing documents. The rules we adopt today reflect our judgment that the proxy rules should better facilitate shareholders’ effective exercise of their traditional State law rights to nominate directors and cast their votes for nominees. When the Federal securities laws establish protections or create rights for security holders, they do so individually, not in some aggregated capacity. No provision

848–849 (Del. Ch. 2004) *citing Rohe v. Reliance Training Network, Inc.*, 2000 Del. Ch. LEXIS 108 at \*10–\*11 (Del. Ch. July 21, 2000)); (ii) the limitation against dividing the board of directors into more than three classes (Del. Code Ann., tit. 8, § 141(d); *see also Jones Apparel*); (iii) the entitlement of stockholders to inspect the list of stockholders and other corporate books and records (Del. Code Ann., tit. 8, §§ 219(a) and 220(b); *Loew’s Theatres, Inc. v. Commercial Credit Co.*, 243 A.2d 78, 81 (Del. Ch. 1968)); (iv) the right of stockholders to vote as a class on certain amendments to the certificate of incorporation (Del. Code Ann., tit. 8, § 242(b)(2)); (v) appraisal rights (Del. Code Ann., tit. 8, § 262(b)); and (vi) fiduciary duties of corporate directors (*Siegan v. Tri-Star Pictures, Inc.*, C.A. No. 9477 (Del. Ch. May 5, 1989, revised May 30, 1989), reported at 15 Del. J. Corp. L. 218, 236 (1990); *cf.* Del. Code Ann., tit. 8, § 102(b)(7), permitting elimination of director liability for monetary damages for breach of the duty of care). *See also* Edward P. Welch and Robert S. Saunders, *What We Can Learn From Other Statutory Schemes: Freedom And Its Limits In The Delaware General Corporation Law*, 33 Del. J. Corp. L. 845, 857–859 (2008); Jeffrey N. Gordon, *Contractual Freedom In Corporate Law: Articles & Comments; The Mandatory Structure Of Corporate Law*, 89 Colum. L. Rev. 1549, 1554 n.16 (1989) (identifying several of these and other mandatory aspects of Delaware corporation law).

<sup>49</sup> *See* letters from Grundfest; Form Letter Type A. Cf. letter from Nine Law Firms.

<sup>50</sup> In the case of a non-U.S. domiciled issuer that does not qualify as a foreign private issuer (as defined in Exchange Act Rule 3b–4), we will look to the underlying law of the jurisdiction of organization. *See* Rule 14a–11(a).

of the Federal securities laws can be waived by referendum. A rule that would permit some shareholders (even a majority) to restrict the Federal securities law rights of other shareholders would be without precedent and, we believe, a fundamental misreading of basic premises of the Federal securities laws. In addition, allowing some shareholders to impair the ability of other shareholders to have their director nominees included in company proxy materials cannot be reconciled with the purpose of the rules we are adopting today. In our view, it would be no more appropriate to subject a Federal proxy rule that provides the ability to include nominees in the company proxy statement to a shareholder vote than it would be to subject any other aspect of the proxy rules—including the other required disclosures—to abrogation by shareholder vote.

Third, the net effect of our rules will be to expand shareholder choice, not limit it. Our rules will result in a greater number of nominees appearing on a proxy card. Shareholders will continue to have the opportunity to vote solely for management candidates, but our rules will also give shareholders the opportunity to vote for director candidates who otherwise might not have been included in company proxy materials.

In addition to these basic conclusions, we note that there are other significant concerns raised by a private ordering approach. A company-by-company shareholder vote on the applicability of Rule 14a–11 would involve substantial direct and indirect, market-wide costs, and it is possible that boards of directors, or shareholders acting with their explicit or implicit encouragement, might seek such shareholder votes, perhaps repeatedly, at no financial cost to themselves but at considerable cost to the company and its shareholders. Another concern relates to the nature of the shareholder vote on whether to opt out of Rule 14a–11: Specifically, in that context management can draw on the full resources of the corporation to promote the adoption of an opt-out, while disaggregated shareholders have no similarly effective platform from which to advocate against an opt-out.

In addition, the path to shareholder adoption of a procedure to include nominees in company proxy materials is by no means free of obstructions. While shareholders may ordinarily have the State law right to adopt bylaws providing for inclusion of shareholder nominees in company proxy materials even in the absence of an explicit authorizing statute like Delaware’s, the

existence of that right in the absence of such a statute may be challenged. Moreover, we understand that under Delaware law, the board of directors is ordinarily free, subject to its fiduciary duties, to amend or repeal any shareholder-adopted bylaw.<sup>51</sup> In addition, not all state statutes confer upon shareholders the power to adopt and amend bylaws, and even where shareholders have that power it is frequently limited by requirements in the company’s governing documents that bylaw amendments be approved by a supermajority shareholder vote.<sup>52</sup>

After careful consideration of the options that commenters have suggested, we have determined that the most effective way to facilitate shareholders’ exercise of their traditional State law rights to nominate and elect directors would be through Rule 14a–11 and the related amendments to the proxy rules that we proposed in June 2009. We have concluded that the ability to include shareholder nominees in company proxy materials pursuant to Rule 14a–11<sup>53</sup> must be available to shareholders who are entitled under State law to nominate and elect directors, regardless of any provision of State law or a company’s governing documents that purports to waive or prohibit the use of Rule 14a–11. In this regard, we note that although the rules we are adopting do not permit a company or its shareholders to opt out of or alter the application of Rule 14a–11, the amendments do contemplate that any additional ability to include shareholder nominees in the company’s proxy materials that may be established in a company’s governing documents will be permissible under our rules. Moreover, our amendments to Rule 14a–8 will facilitate the presentation of proposals by shareholders to adopt company-

<sup>51</sup> It has been argued to us, as a basis for excluding a shareholder proposal under Rule 14a–8, that Delaware law does not permit a bylaw to deprive the board of directors of the power to amend or repeal it, where the corporation’s certificate of incorporation confers upon the board the power to adopt, amend and repeal bylaws. *See, e.g., CVS Caremark Corp.*, No-Action Letter (March 9, 2010). *See also* Del. Code Ann., tit. 8, § 109(b) and *Centaur Partners, IV v. National Intergroup, Inc.*, 582 A.2d 923, 929 (Del. 1990).

<sup>52</sup> *See* Beth Young, The Corporate Library, “The Limits of Private Ordering: Restrictions on Shareholders’ Ability to Initiate Governance Change and Distortions of the Shareholder Voting Process” (November 2009), available at <http://www.sec.gov/comments/s7-10-09/s71009-568.pdf>. *See, e.g.,* Ind. Code § 23–1–39–1; Okla. Stat., tit. 18, § 18–1013.

<sup>53</sup> Throughout this release, when we refer to “a nomination pursuant to Rule 14a–11,” a “Rule 14a–11 nomination,” or other similar statement, we are referring to a nomination submitted for inclusion in a company’s proxy materials pursuant to Rule 14a–11.



specific procedures for including shareholder nominees for director in company proxy materials, and our adoption of new Exchange Act Rule 14a-18 (which requires disclosure concerning the nominating shareholder or group and the nominee or nominees that generally is consistent with that currently required in an election contest) will help assure that investors are adequately informed about shareholder nominations made through such procedures.

In contrast, if State law<sup>54</sup> or a provision of the company's governing documents were ever to prohibit a shareholder from making a nomination (as opposed to including a validly nominated individual in the company's proxy materials), Rule 14a-11 would not require the company to include in its proxy materials information about, and the ability to vote for, any such nominee. The rule defers entirely to State law as to whether shareholders have the right to nominate directors and what voting rights shareholders have in the election of directors.

While we have concluded that we should provide shareholders the means to have nominees included in proxy materials in certain circumstances, we also are mindful that to accomplish this goal the regulatory structure must arrive at a solution that ultimately is workable. Accordingly, we are adopting a number of significant changes to the rules we proposed in order to address the many thoughtful and constructive comments we received on the specifics of our proposed amendments. The changes that we are making to the amendments are described in detail throughout this release. There also were a number of suggested changes that we considered and decided not to adopt, as detailed below.

### B. Our Role in the Proxy Process

Several commenters challenged our authority to adopt Rule 14a-11.<sup>55</sup> We considered those comments carefully but continue to believe that we have the authority to adopt Rule 14a-11 under Section 14(a) as originally enacted.<sup>56</sup> In

<sup>54</sup> In the case of a non-U.S. domiciled issuer that does not qualify as a foreign private issuer, we will look to the underlying law of the jurisdiction of organization. See footnote 50 above.

<sup>55</sup> See letters from Ameriprise; AT&T; L. Behr; BRT; Burlington Northern; CMCC; Dewey; M. Eng; FedEx; Grundfest; Keating Muething; OPLP; Sidley Austin.

<sup>56</sup> When it adopted Section 14(a) of the Exchange Act, Congress determined that the exercise of shareholder voting rights via the corporate proxy is a matter of Federal concern, and the statute's grant of authority is not limited to regulating disclosure. *Roosevelt v. E.I. DuPont de Nemours & Co.*, 958 F.2d 416, 421-422 (D.C. Cir. 1992) (Congress "did

any event, Congress confirmed our authority in this area and removed any doubt that we have authority to adopt a rule such as Rule 14a-11.<sup>57</sup> As described more fully below, Rule 14a-11 is necessary and appropriate in the public interest and for the protection of investors.<sup>58</sup> Additionally, as explained below, the terms and conditions of Rule 14a-11 are also in the interests of shareholders and for the protection of investors.<sup>59</sup> Therefore, this challenge is now moot.

Although our statutory authority to adopt Rule 14a-11 is no longer at issue, the constitutionality of Rule 14a-11 also has been challenged by commenters. We disagree with their arguments.<sup>60</sup> Proxy regulations do not infringe on corporate First Amendment rights both because "management has no interest in corporate property except such interest as derives from the shareholders," and because such regulations "govern speech by a corporation *to itself*" and therefore "do not limit the range of information that the corporation may contribute to the public debate."<sup>61</sup> Even if statements in proxy materials are viewed as more than merely internal communications, this communication is of a commercial—not political—nature, and regulation of such statements through Rule 14a-11 is consistent with applicable First Amendment standards.<sup>62</sup>

### C. Summary of the Final Rules

As noted above, we carefully considered the comments and have decided to adopt new Exchange Act

not narrowly train [S]ection 14(a) on the interest of stockholders in receiving information necessary to the intelligent exercise of their" State law rights; Section 14(a) also "shelters use of the proxy solicitation process as a means by which stockholders \* \* \* may communicate with each other."); see also, e.g., *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 n.10 (1976) (Section 14(a) is a grant of "broad statutory authority"). The adoption of Rule 14a-11 reflects our continuing purpose to ensure that proxies are used as a means to enhance the ability of shareholders to make informed choices, especially on the critical subject of who sits on the board of directors.

<sup>57</sup> Dodd-Frank Act § 971(a) and (b). These provisions expressly provide that the Commission may issue rules permitting shareholders to use an issuer's proxy solicitation materials for the purpose of nominating individuals to membership on the board of directors of the issuer.

<sup>58</sup> Exchange Act § 14(a) and Investment Company Act § 20(a).

<sup>59</sup> Dodd-Frank Act § 971(b).

<sup>60</sup> See letter from BRT.

<sup>61</sup> *Pacific Gas and Electric Company v. Public Utilities Comm'n of California*, 475 U.S. 1, 14 n.10 (1986) (emphasis in original).

<sup>62</sup> Nor does Rule 14a-11 violate the Fifth Amendment, as it does not constitute a regulatory taking. See, e.g., *Lingle v. Chevron U.S.A.*, 544 U.S. 528, 546-47 (2005); *Penn Central Transp. Co. v. City of New York*, 438 U.S. 104 (1978).

Rule 14a-11 with significant modifications in response to the comments. We believe that the new rule will benefit shareholders and protect investors by improving corporate suffrage, the disclosure provided in connection with corporate proxy solicitations, and communication between shareholders in the proxy process. Consistent with the Proposal, Rule 14a-11 will apply only when applicable State law or a company's governing documents do not prohibit shareholders from nominating a candidate for election as a director. In addition, as adopted, the rule will apply to a foreign issuer that is otherwise subject to our proxy rules only when applicable foreign law does not prohibit shareholders from making such nominations. Also consistent with the Proposal, companies may not "opt out" of the rule—either in favor of a different framework for inclusion of shareholder director nominees in company proxy materials or no framework. In addition, as was proposed, the rule will apply regardless of whether any specified event has occurred to trigger the rule and will apply regardless of whether the company is subject to a concurrent proxy contest.<sup>63</sup> Also as proposed, the final rule will apply to companies that are subject to the Exchange Act proxy rules, including investment companies and controlled companies, but will not apply to "debt-only" companies. The rule will apply to smaller reporting companies, but we have decided to delay the rule's application to these companies for three years. We believe that a delayed effective date for smaller reporting companies should allow those companies to observe how the rule operates for other companies and should allow them to better prepare for implementation of the rules. Delayed implementation for these companies also will allow us to evaluate the implementation of Rule 14a-11 by larger companies and provide us with the additional opportunity to consider whether adjustments to the rule would be appropriate for smaller reporting companies before the rule becomes applicable to them. To use Rule 14a-11, a nominating shareholder or group will be required to satisfy an ownership threshold of at least 3% of the voting power of the company's securities entitled to be voted at the meeting. Shareholders will be able to aggregate their shares to meet the threshold. The

<sup>63</sup> Throughout this release, the terms "proxy contest," "election contest," and "contested election" refer to any election of directors in which another party commences a solicitation in opposition subject to Exchange Act Rule 14a-12(c).

required ownership threshold has been modified from the Proposal, which would have required that a nominating shareholder or group hold 1%, 3%, or 5% of the company's securities entitled to be voted on the election of directors, depending on accelerated filer status or, in the case of registered investment companies, depending on the net assets of the company. The final rule requires that a nominating shareholder or group must hold both investment and voting power, either directly or through any person acting on their behalf, of the securities. In calculating the ownership percentage held, under certain conditions, a nominating shareholder or member of the nominating shareholder group would be able to include securities loaned to a third party in the calculation of ownership. In determining the total voting power held by the nominating shareholder or any member of the nominating shareholder group, securities sold short (as well as securities borrowed that are not otherwise excludable) must be deducted from the amount of securities that may be counted towards the required ownership threshold. In addition, a nominating shareholder (or in the case of a group, each member of the group) will be required to have held the qualifying amount of securities continuously for at least three years as of the date the nominating shareholder or group submits notice of its intent to use Rule 14a-11 (on a filed Schedule 14N), rather than for one year, as was proposed. Consistent with the proposed amendments, we are adopting a requirement that the nominating shareholder or members of the group must continue to own the qualifying amount of securities through the date of the meeting at which directors are elected and provide disclosure concerning their intent with regard to continued ownership of the securities after the election of directors. In addition, the nominating shareholder (or where there is a nominating shareholder group, any member of the nominating shareholder group) may not be holding the company's securities with the purpose, or with the effect, of changing control of the company or to gain a number of seats on the board of directors that exceeds the maximum number of nominees that the company could be required to include under Rule 14a-11, and may not have a direct or indirect agreement with the company regarding the nomination of the nominee or nominees prior to filing the Schedule 14N.

The nominating shareholder or group must provide notice to the company of

its intent to use Rule 14a-11 no earlier than 150 days prior to the anniversary of the mailing of the prior year's proxy statement and no later than 120 days prior to this date. The final rule differs from the Proposal, which would have required the nominating shareholder or group to provide notice to the company no later than 120 days prior to the anniversary of the mailing of the prior year's proxy statement or in accordance with the company's advance notice provision, if applicable. As was proposed, under the final rule the nominating shareholder or group will be required to file on EDGAR and transmit to the company its notice on Schedule 14N on the same date.

The rule also includes certain requirements applicable to the shareholder nominee. Consistent with the Proposal, the final rule provides that the company will not be required to include any nominee whose candidacy or, if elected, board membership would violate controlling state or Federal law, or the applicable standards of a national securities exchange or national securities association, except with regard to director independence requirements that rely on a subjective determination by the board, and such violation could not be cured during the provided time period.<sup>64</sup> In addition, the rule we are adopting provides that a company will not be required to include any nominee whose candidacy or, if elected, board membership would violate controlling foreign law. As we proposed, the rule does not include any restrictions on the relationships between the nominee and the nominating shareholder or group.

As was proposed, under Rule 14a-11, a company will not be required to include more than one shareholder nominee, or a number of nominees that represents up to 25% of the company's board of directors, whichever is greater. Where there are multiple eligible nominating shareholders, the nominating shareholder or group with the highest percentage of the company's voting power would have its nominees included in the company's proxy materials, rather than the nominating shareholder or group that is first to submit a notice on Schedule 14N, as we had proposed. We also have clarified in the final rule that when a company has a classified (staggered) board, the 25% calculation would still be based on the

<sup>64</sup> In the case of an investment company, the nominee may not be an "interested person" of the company as defined in Section 2(a)(19) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(19)). See Section II.B.3.b. for a more detailed discussion of the applicability of Rule 14a-11 to registered investment companies.

total number of board seats. In addition, in response to public comment, we have added a provision to the rule designed to prevent the potential unintended consequences of discouraging dialogue and negotiation between company management and nominating shareholders. Under this provision, shareholder nominees of an eligible nominating shareholder or group with the highest qualifying voting power percentage that a company agrees to include as company nominees after the filing of the Schedule 14N would count toward the 25%.

The notice on Schedule 14N will be required to include:

- Disclosure concerning:
  - The amount and percentage of voting power of the company's securities entitled to be voted by the nominating shareholder or group and the length of ownership of those securities;
  - Biographical and other information about the nominating shareholder or group and the shareholder nominee or nominees, similar to the disclosure currently required in a contested election;
  - Whether or not the nominee or nominees satisfy the company's director qualifications, if any (as provided in the company's governing documents);
- Certifications that, after reasonable inquiry and based on the nominating shareholder's or group's knowledge, the:
  - Nominating shareholder (or where there is a nominating shareholder group, each member of the nominating shareholder group) is not holding any of the company's securities with the purpose, or with the effect, of changing control of the company or to gain a number of seats on the board of directors that exceeds the maximum number of nominees that the company could be required to include under Rule 14a-11;
  - Nominating shareholder or group otherwise satisfies the requirements of Rule 14a-11, as applicable; and
  - Nominee or nominees satisfy the requirements of Rule 14a-11, as applicable;
- A statement that the nominating shareholder or group members will continue to hold the qualifying amount of securities through the date of the meeting and a statement with regard to the nominating shareholder's or group member's intended ownership of the securities following the election of directors (which may be contingent on the

results of the election of directors); and

- A statement in support of each shareholder nominee, not to exceed 500 words per nominee (the statement would be at the option of the nominating shareholder or group).

These requirements for Schedule 14N are largely consistent with the Proposal, with some modifications made in response to comments. Among the modifications is the new disclosure requirement concerning whether, to the best of the nominating shareholder's or group's knowledge, the nominee or nominees satisfy the company's director qualifications, if any (as provided in the company's governing documents). We also have revised the certifications to require certification not only with regard to control intent, but also with regard to the other nominating shareholder and nominee eligibility requirements.

A company that receives a notice on Schedule 14N from an eligible nominating shareholder or group will be required to include in its proxy statement disclosure concerning the nominating shareholder or group and the shareholder nominee or nominees, and include on its proxy card the names of the shareholder nominees. The nominating shareholder or group will be liable for any statement in the notice on Schedule 14N which, at the time and in light of the circumstances under which it is made, is false or misleading with respect to any material fact or that omits to state any material fact necessary to make the statements therein not false or misleading, including when that information is subsequently included in the company's proxy statement. The company will not be responsible for this information. These liability provisions are included in the final rules largely as proposed, but with two changes in response to comments. Final Rule 14a-9(c) makes clear that the nominating shareholder or group will be liable for any statement in the Schedule 14N or any other related communication that is false or misleading with respect to any material fact, or that omits to state any material fact necessary to make the statements therein not false or misleading, regardless of whether that information is ultimately included in the company's proxy statement. In addition, consistent with the existing approach in Rule 14a-8, under Rule 14a-11 as adopted, a company will not be responsible for any information provided by the nominating shareholder or group and included in the company's proxy statement. Under the Proposal, a company would not have been

responsible for any information provided by the nominating shareholder or group except where the company knows or has reason to know that the information is false or misleading.

A company will not be required to include a nominee or nominees if the nominating shareholder or group or the nominee fails to satisfy the eligibility requirements of Rule 14a-11. A company that determines it may exclude a nominee or nominees must provide a notice to the Commission regarding its intent to exclude the nominee or nominees. The company also may submit a request for the staff's informal view with respect to the company's determination that it may exclude the nominee or nominees (commonly referred to as "no-action" requests). In addition, a company could exclude a nominating shareholder's or group's statement of support if the statement exceeds 500 words per nominee and could seek a no-action letter from the staff with regard to this determination if it so desired. In the event that a nominating shareholder or group or nominee withdraws or is disqualified prior to the time the company commences printing the proxy materials, under certain circumstances companies will be required to include a substitute nominee if there are other eligible nominees. Therefore, companies seeking a no-action letter from the staff with respect to their decision to exclude any Rule 14a-11 nominee or nominees would need to seek a no-action letter on all nominees that they believe they can exclude at the outset.

We also have adopted two new exemptions, slightly modified from the Proposal, to the proxy rules for solicitations in connection with a Rule 14a-11 nomination. The first exemption applies to written and oral solicitations by shareholders who are seeking to form a nominating shareholder group. Reliance on this new exemption will require:

- That the shareholder not be holding the company's securities with the purpose, or with the effect, of changing control of the company or to gain a number of seats on the board of directors that exceeds the maximum number of nominees that the registrant could be required to include under Rule 14a-11;
- Limiting the content of written communications to certain information specified in the rule;
- Filing all written soliciting materials sent to shareholders in reliance on the exemption with the Commission or, in the case of oral communications, a filing under cover of Schedule 14N with the appropriate box

checked before or at the same time as the first solicitation in reliance on the new exemption; and

- No solicitations in connection with the subject election of directors other than pursuant to the provisions of Rule 14a-11 and the new exemption described below.

Shareholders that do not want to rely on this new exemption could opt to rely on other exemptions from the proxy rules (e.g., Rule 14a-2(b)(2), which is limited to solicitations of not more than 10 persons).

The second new exemption applies to written and oral solicitations by or on behalf of a nominating shareholder or group whose nominee or nominees are or will be included in the company's proxy materials pursuant to Rule 14a-11 in favor of shareholder nominees or for or against company nominees. Reliance on this new exemption will require:

- That the nominating shareholder or group does not seek the power to act as a proxy for another shareholder;
- Disclosing certain information (including the identity of the nominating shareholder or group, and a prominent legend about availability of the proxy materials) in all written communications;
- Filing all written soliciting materials sent to shareholders in reliance on the exemption with the Commission under cover of Schedule 14N with the appropriate box checked; and

- No solicitations in connection with the subject election of directors other than pursuant to the provisions of Rule 14a-11 and this new exemption.

Consistent with the Proposal, we also are amending our beneficial ownership reporting rules so that shareholders relying on Rule 14a-11 would not become ineligible to file a Schedule 13G, in lieu of filing a Schedule 13D, solely as a result of activities in connection with inclusion of a nominee under Rule 14a-11. Also consistent with the proposed amendments, we are not adopting an exclusion from Exchange Act Section 16 for activities in connection with a nomination under Rule 14a-11 that may trigger a filing requirement by nominating shareholders. In addition, after considering the comments, we are not adopting a specific exclusion from the definition of affiliate for nominating shareholders.

Finally, consistent with the Proposal, we are narrowing the scope of the exclusion in Rule 14a-8(i)(8) relating to the election of directors. The revised rule will provide that companies must include in their proxy materials, under

certain circumstances, shareholder proposals that seek to establish a procedure in the company's governing documents for the inclusion of one or more shareholder director nominees in a company's proxy materials.

As we proposed, the final rules provide that a nominating shareholder that is relying on a procedure under State law or a company's governing documents to include a nominee in a company's proxy materials would be required to provide disclosure concerning the nominating shareholder and nominee or nominees to the company on Schedule 14N and file the Schedule 14N on EDGAR. In response to comment, we have clarified that the disclosure also would be required for nominations made pursuant to foreign law.<sup>65</sup> The disclosure requirements on Schedule 14N for nominations made pursuant to a procedure under state or foreign law, or a company's governing documents largely mirror those for a Rule 14a-11 nomination. As with Rule 14a-11 nominees, a company would include in its proxy materials disclosure concerning the nominating shareholder or group and shareholder nominee similar to the disclosure currently required in a contested election. The nominating shareholder or group would have liability for any statement in the notice on Schedule 14N or in information otherwise provided to the company and included in the company's proxy materials which, at the time and in light of the circumstances under which it is made, is false or misleading with respect to any material fact or that omits to state any material fact necessary to make the statements therein not false or misleading. The company would not be responsible for the information provided to the company and required to be included in the company proxy statement.

## II. Changes to the Proxy Rules

### A. Introduction

After careful consideration of the comments received on the Proposal, we are adopting amendments to the proxy rules to facilitate the effective exercise of shareholders' traditional State law rights to nominate and elect directors to company boards of directors. Under the new rules, shareholders meeting certain requirements will have two ways to more fully exercise their right to nominate directors. First, we are adopting a new proxy rule, Rule 14a-11, which will, under certain circumstances, require companies to provide shareholders with information

about, and the ability to vote for, a shareholder's, or group of shareholders', nominees for director in the companies' proxy materials. This requirement will apply unless State law, foreign law,<sup>66</sup> or a company's governing documents<sup>67</sup> prohibits shareholders from nominating directors.<sup>68</sup> In addition to the standards provided in new Rule 14a-11, provisions under State law, foreign law, or a company's governing documents<sup>69</sup> could provide an additional avenue for shareholders to submit nominees for inclusion in company proxy materials, but would not act as a substitute for Rule 14a-11. Thus, Rule 14a-11 will continue to be available to shareholders regardless of whether they also can avail themselves of a provision under State law, foreign law, or a company's governing documents.

Second, we are amending Rule 14a-8(i)(8) to preclude companies from relying on Rule 14a-8(i)(8) to exclude from their proxy materials shareholder proposals by qualifying shareholders that seek to establish a procedure under a company's governing documents for the inclusion of one or more shareholder director nominees in the company's proxy materials. A company must include such a shareholder proposal under the final rules as long as the procedural requirements of Rule 14a-8 are met and the proposal is not subject to exclusion under one of the other substantive bases. In this regard, a shareholder proposal seeking to limit or remove the availability of Rule 14a-11 would be subject to exclusion under Rule 14a-8.<sup>70</sup>

As described throughout this release, we have made many changes to the final rules in response to comments received. We believe the final rules reflect a careful balancing of the policy, workability, and other comments we received on the Proposal.

<sup>65</sup> See discussion in footnote 50 above.

<sup>66</sup> Under State law, a company's governing documents may have various names. When we refer to governing documents throughout the release and rule text, we generally are referring to a company's charter, articles of incorporation, certificate of incorporation, declaration of trust, and/or bylaws, as applicable.

<sup>67</sup> We are not aware of any law in any state or in the District of Columbia or in any country that currently prohibits shareholders from nominating directors. Nonetheless, should any such law be enacted in the future, Rule 14a-11 will not apply.

<sup>68</sup> See discussion in Section II.C.5. below.

<sup>69</sup> As would currently be the case if a State law permitted a company to prohibit shareholders from nominating candidates for director, a shareholder proposal seeking to prohibit shareholder nominations for director generally or, conversely, to allow shareholder nominations for director, would not be excludable pursuant to Rule 14a-8(i)(8).

### B. Exchange Act Rule 14a-11

#### 1. Overview

Based on the comments received in response to our solicitation of public input on the Proposal and on prior releases and in roundtables,<sup>71</sup> we understand that shareholders face significant obstacles to effectively exercising their rights to nominate and elect directors to corporate boards. We have received significant public comment supporting the view that including shareholder nominees for director in company proxy materials would be the most direct and effective method of facilitating shareholders' rights in connection with the nomination and election of directors.<sup>72</sup>

On the other hand, many commenters have expressed concern that mandating shareholder access to company proxy materials would lead to more proxy contests or "politicized elections,"<sup>73</sup> which would be distracting, expensive, time-consuming, and inefficient for companies, boards, and management.<sup>74</sup>

<sup>71</sup> See the Proposing Release; the 2003 Proposal; the Election of Directors Proposing Release; and the Shareholder Proposals Proposing Release. See also the Roundtable on the Federal Proxy Rules and State Corporation Law and the Roundtable on Proposals of Shareholders available at <http://www.sec.gov/spotlight/proxyprocess.htm>.

<sup>72</sup> See letters from CII; COPERA; C/W Investment Group; L. Dallas; T. DiNapoli; Florida State Board of Administration; ICGN; D. Nappier; OPERS; Pax World; Teamsters.

<sup>73</sup> See letters from ABA; Advance Auto Parts; Atlas Industries, Inc. ("Atlas"); J. Blanchard; Samuel W. Bodman ("S. Bodman"); Boeing; Brink's; BRT; Burlington Northern; Callaway; Cargill ("Cargill"); Carlson; Carolina Mills; Chamber of Commerce/CMCC; Jaime Chico ("J. Chico"); Consolidated Edison, Inc. ("Con Edison"); Anthony Conte ("A. Conte"); W. Cornwell; Crown Battery Manufacturing Co. ("Crown Battery"); CSX; Darden Restaurants; Eaton; FedEx; FPL Group; Frontier; Hickory Furniture Mart ("Hickory Furniture"); IBM; Keating Muething; Little; Louisiana Agencies LLC ("Louisiana Agencies"); Massey Services, Inc. ("Massey Services"); John B. McCoy ("J. McCoy"); D. McDonald; MedFarr; MetLife; M. Metz; Norfolk Southern Corporation ("Norfolk Southern"); O3 Strategies, Inc. ("O3 Strategies"); Office Depot; Victor Pelson ("V. Pelson"); PepsiCo; Pfizer; Ryder; Sidley Austin; Southland; Style Crest; Tenet Healthcare Corporation ("Tenet"); TI; tw telecom; L. Tyson; United Brotherhood of Carpenters; T. White.

<sup>74</sup> See letters from ABA; Anonymous letter dated June 26, 2009 ("Anonymous #2"); Atlas; AT&T; Book Celler; Carlson; Carolina Mills; Chamber of Commerce/CMCC; Chevron; Crespin; M. Eng; Erickson; ExxonMobil; Fenwick & West LLP ("Fenwick"); GE; General Mills; Glass, Lewis & Co., LLC ("Glass Lewis"); Glaspell Goals ("Glaspell"); Intellect; R. Clark King; Koppers Inc. ("Koppers"); MCO Transport, Inc. ("MCO"); MeadWestvaco; MedFarr; Medical Insurance; Merchants Terminal; Dana Merilatt ("D. Merilatt"); NAM; NRI; NK; O3 Strategies; Roppe Holding Company ("Roppe"); Rosen Hotels and Resorts ("Rosen"); Safeway; Sara Lee; Schneider National, Inc. ("Schneider"); Southland; Style Crest; Tenet; TI; tw telecom; Rick VanEngelenhoven ("R. VanEngelenhoven"); Wachtell; Wells Fargo; Weyerhaeuser; Yahoo.

<sup>65</sup> See Section II.C.5. below.

Commenters also opined that the increased likelihood of a contested election could discourage experienced and capable individuals from serving on boards, making it more difficult for companies to recruit qualified directors or create boards with the proper mix of experience, skills, and characteristics.<sup>75</sup> The current filing and other requirements applicable to shareholders who wish to propose an alternate slate are, in the view of these commenters, more appropriate than including shareholder nominees for director in company proxy materials.<sup>76</sup>

As we also noted in the Proposing Release, we recognize that there are long-held and deeply felt views on every side of these issues. To the extent shareholders have the right to nominate directors at meetings of shareholders, the Federal proxy rules should facilitate the exercise of this right. We believe the rules we are adopting today will better accomplish this goal and will further our mission of investor protection.

New Rule 14a–11 will require companies to include information about shareholder nominees for director in company proxy statements, and the names of the nominee or nominees as choices on company proxy cards, under specified conditions.<sup>77</sup> The rule will permit companies to exclude a nominee or nominees from the company's proxy materials under certain circumstances, such as when a nominating shareholder or group fails to satisfy the eligibility requirements of the rule. In the following sections we describe, in detail, the final rules, comments received on the Proposal, and changes made in response to the comments.

## 2. When Rule 14a–11 Will Apply

In this section, we address the rule's application, including when there are conflicting or overlapping provisions under state or foreign law or a company's governing documents, during concurrent proxy contests, and in the absence of any specific triggering

events. We also address the reasons why neither an opt-in nor opt-out provision is necessary or appropriate.

### a. Interaction With State or Foreign Law

While we are not aware of any law in any state or in the District of Columbia that prohibits shareholders from nominating directors, consistent with the Proposal, a company to which the rule would otherwise apply will not be subject to Rule 14a–11 if applicable State law or the company's governing documents prohibit shareholders from nominating candidates for the board of directors. The final rule also clarifies that, in the case of a non-U.S. domiciled issuer that does not meet the definition of foreign private issuer under the Federal securities laws, the rule will not apply if applicable foreign law prohibits shareholders from nominating a candidate for election as a director.<sup>78</sup> If a company's governing documents prohibit shareholder nominations, shareholders could seek to amend the provision by submitting a shareholder proposal under Rule 14a–8.<sup>79</sup>

Consistent with the Proposal, Rule 14a–11 will apply regardless of whether state or foreign law or a company's governing documents prohibit inclusion of shareholder director nominees in company proxy materials or set share ownership or other terms that are more restrictive than Rule 14a–11 under which shareholder director nominees will be included in company proxy materials. For example, if applicable state or foreign law or a company's governing documents were to require that shareholder nominees be included in company proxy materials only if submitted by a 10% shareholder of the company, a shareholder who does not meet the 10% threshold but does meet the requirements of Rule 14a–11, including the 3% ownership threshold described below, would be able to submit their nominee or nominees for inclusion in the company's proxy materials pursuant to Rule 14a–11. If, on the other hand, applicable state or foreign law or a company's governing documents sets the ownership threshold lower than the 3% ownership threshold required under Rule 14a–11, then Rule 14a–11 would not be available to holders with ownership below the Rule 14a–11 threshold. Those shareholders meeting the lower ownership threshold would have the ability to have their nominees included in the company's proxy materials to whatever extent is provided under applicable state or

foreign law or the company's governing documents. In this instance, new Exchange Act Rule 14a–18, discussed in Section II.C.5. below, would require specified disclosures concerning the nominating shareholder or group and the shareholder nominee or nominees.

There also may be situations where applicable state or foreign law or a company's governing documents are more permissive in certain respects, and more restrictive in other respects, than Rule 14a–11. For example, applicable state or foreign law or a company's governing documents could require 10% ownership to have a nominee or nominees included in a company's proxy materials, but allow a shareholder that owns 10% to have nominees up to the full number of board seats included in a company's proxy materials or to otherwise have a change in control intent. While Rule 14a–11 would continue to be available in that case for a shareholder that is eligible to use it, a shareholder could choose to proceed under the alternate procedure and standards. In this instance, a shareholder would be required to clearly evidence its intent to rely either on Rule 14a–11 or on the applicable state or foreign law or company's governing documents, and then meet all of the requirements of whichever procedure it selects.<sup>80</sup> A shareholder could not “pick and choose” different aspects of different procedures. If a shareholder chooses to rely on a provision under applicable state or foreign law or a company's governing documents to include a nominee in a company's proxy materials, it would be required to satisfy the disclosure requirements of new Rule 14a–18.

### b. Opt-In Not Required

In the Proposing Release, we requested comment on whether Rule 14a–11 should apply only if shareholders of a company elect to have it apply at their company. While commenters did not specifically address the possibility of shareholders opting into Rule 14a–11, many commenters opposed the Commission's Proposal on the basis that it would create a “one size fits all” Federal rule that intrudes into matters that traditionally have been the province of state or local law.<sup>81</sup> Those

<sup>80</sup> New Schedule 14N, which is described further in Section II.B.8. below, includes check boxes where a nominating shareholder or group must specify whether it is seeking to include the nominee or nominees in the company's proxy materials under Rule 14a–11 or pursuant to a provision in State law, foreign law, or a company's governing documents.

<sup>81</sup> See letters from 26 Corporate Secretaries; ABA; ACE; Advance Auto Parts; AGL; Aetna; Allstate; Alston & Bird; American Bankers Association;

<sup>75</sup> See letters from 3M; ABA; American Electric Power; Atlantic Bingo; AT&T; Avis Budget; Biogen; Boeing; BRT; Burlington Northern; Callaway; Carlson; Chamber of Commerce/CMCC; CIGNA; Columbine Health Plan (“Columbine”); Cummins; CSX; John T. Dillon (“J. Dillon”); Emerson Electric; Erickson; ExxonMobil; FedEx; Headwaters Incorporated (“Headwaters”); C. Holliday; IBM; Intellect; R. Clark King; Lange Transport (“Lange”); Louisiana Agencies; MetLife; NIRI; O3 Strategies; V. Pelson; PepsiCo; Pfizer; Roppe; Rosen; Ryder; Sara Lee; Sidley Austin; tw telecom; Wachtell; Wells Fargo; Weyerhaeuser; Yahoo.

<sup>76</sup> See letters from Ameriprise; Anonymous #2; Artistic Land Designs; Chamber of Commerce/CMCC; Crown Battery; Evelyn Y. Davis (“E. Davis”); Kernan; Medical Insurance; Mouton; Unitrin; R. VanEngelenhoven; Wells Fargo.

<sup>77</sup> See new Exchange Act Rule 14a–11.

<sup>78</sup> See letters from S&C; Curtis, Mallet-Prevost, Colt & Mosle LLP (“Curtis”).

<sup>79</sup> See footnote 70 above.

commenters asked the Commission to permit private ordering so that companies and shareholders could devise, if they chose to, a process for the inclusion of shareholder director nominees in company proxy materials that best suits their particular circumstances. Commenters also expressed fears that the Commission's Proposal, if adopted, would stifle future innovations relating to inclusion of shareholder director nominees in company proxy materials and corporate governance in general.<sup>82</sup> On the other hand, some commenters expressed general support for uniform applicability of proposed Rule 14a-11, unless State law or the company's governing documents prohibit shareholders from nominating candidates to the board.<sup>83</sup>

Though we considered commenters' views concerning a private ordering approach, as discussed in Section I.A. above, we have concluded that our rules should provide shareholders the ability to include director nominees in company proxy materials without the need for shareholders to bear the burdens of overcoming the substantial obstacles to creating that ability on a company-by-company basis. Rule 14a-11 is designed to facilitate the effective exercise of shareholder director nomination and election rights.

American Business Conference; American Electric Power; Anadarko; Applied Materials; Artistic Land Designs; Association of Corporate Counsel; Avis Budget; Atlantic Bingo; L. Behr; Best Buy; Biogen; J. Blanchard; Boeing; T. Bonkowski; BorgWarner; Boston Scientific; Brink's; BRT; Burlington Northern; R. Burt; California Bar; Callaway; S. Campbell; Carlson; Carolina Mills; Caterpillar; Chamber of Commerce/CMCC; Chevron; R. Chicks; CIGNA; Comcast; Competitive Enterprise Institute; W. Cornwell; CSX; E. Culwell; Cummins; Darden Restaurants; Daniels Manufacturing; Davis Polk; Delaware Bar; T. Dermody; Devon; DTE Energy; Eaton; Edison Electric Institute; Eli Lilly; Emerson Electric; M. Eng; Erickson; ExxonMobil; FedEx; Financial Services Roundtable; Flutterby; FPL Group; Frontier; GE; A. Goolsby; Grundfest; C. Holliday; IBM; ICI; Intellect; JPMorgan Chase; Jones Day; R. Clark King; Leggett; T. Liddell; Little; McDonald's; MeadWestvaco; MedFarrx; Medical Insurance; MetLife; M. Metz; Microsoft; J. Miller; M. Moretti; Motorola; NACD; NAM; NIIRI; O'Melveny & Myers; Office Depot; Omaha Door; P&G; PepsiCo; Pfizer; Realogy; J. Robert; M. Robert; RPM; Ryder; Safeway; R. Saul; Shearman & Sterling; Sherwin-Williams; R. Simoneau; Society of Corporate Secretaries; Southern Company; Southland; Steele Group; Style Crest; Tesoro; Textron; Theragenics; TI; R. Trummel; T. Trummel; V. Trummel; tw telecom; L. Tyson; United Brotherhood of Carpenters; UnitedHealth; U.S. Bancorp; VCG; Wachtell; Wellness; Wells Fargo; Whirlpool; Xerox; Yahoo; J. Young.

<sup>82</sup> See letters from ABA; BRT; Davis Polk; Delaware Bar; Frontier; IBM; Protective.

<sup>83</sup> See letters from 13D Monitor ("13D Monitor"); AFL-CIO; CalPERS; CFA Institute Centre for Market Integrity ("CFA Institute"); CII; Florida State Board of Administration; ICGN; LIUNA; D. Nappier; P. Neuhauser; OPERS; Pax World; RiskMetrics; SWIB; Teamsters; USPE.

Requiring shareholders to persuade other shareholders to opt into a system that better facilitates such State law rights would frustrate the benefits that our new rule seeks to promote.

### c. No Opt-Out

In the Proposing Release, we sought comment on whether Rule 14a-11 should be inapplicable where a company has or adopts a provision in its governing documents that provides for, or prohibits, the inclusion of shareholder director nominees in the company's proxy materials. We also sought comment on whether Rule 14a-11 should apply in various circumstances, such as where shareholders approve provisions in the governing documents that are more or less restrictive than Rule 14a-11.

Commenters were divided on whether companies and shareholders should be permitted to adopt alternative requirements for shareholder director nominations, or to completely opt out of Rule 14a-11. Many commenters generally supported a provision that would permit companies and shareholders to adopt alternative requirements for shareholder director nominations that could be either more restrictive or less restrictive than those of Rule 14a-11.<sup>84</sup> Among these commenters, some argued that creating a "one-size-fits-all" rule that cannot be altered by companies and shareholders conflicts with the traditional enabling approach of state corporation laws and denies shareholder choice.<sup>85</sup> Some commenters advocated allowing companies to opt out of Rule 14a-11 through a shareholder-approved bylaw (including through a Rule 14a-8 shareholder proposal), with some suggesting that Rule 14a-11 apply initially only to companies that have not opted out through a shareholder-approved process by the time of the first

<sup>84</sup> See letters from ABA; Advance Auto Parts; Aetna; American Bankers Association; American Electric Power; American Express; Applied Materials; Association of Corporate Counsel; Best Buy; BRT; California Bar; Carlson; J. Chico; Cleary Gottlieb Steen & Hamilton LLP ("Cleary"); Comcast; Con Edison; CSX; Cummins; L. Dallas; Davis Polk; Devon; Dupont; ExxonMobil; Financial Services Roundtable; FPL Group; IBM; JPMorgan Chase; Keating Muething; Koppers; Alexander Krakovsky ("A. Krakovsky"); Group of 10 Harvard Business School and Harvard Law School Professors ("Lorsch *et al.*"); Brett H. McDonnell ("B. McDonnell"); Motorola; O'Melveny & Myers; P&G; Pfizer; S&C; Sara Lee; Group of Seven Law Firms ("Seven Law Firms"); Shearman & Sterling; Securities Industry and Financial Markets Association ("SIFMA"); Society of Corporate Secretaries; Southern Company; U.S. Bancorp; Wachtell.

<sup>85</sup> See letters from ABA; BRT; Delaware Bar.

annual meeting held after the adoption of the proposed rules.<sup>86</sup>

On the other hand, several commenters expressed support for the uniform applicability of Rule 14a-11.<sup>87</sup> These commenters expressed general support for the Commission's Proposal that Rule 14a-11 apply to all companies subject to the Federal proxy rules unless State law or the company's governing documents prohibit shareholders from nominating candidates to the board.<sup>88</sup> Several commenters stated they oppose a provision that would permit companies to opt out of Rule 14a-11.<sup>89</sup> Some commenters expressed a general concern that if companies are allowed to opt out of the rule, boards would adopt provisions in a company's governing documents that are so restrictive that it would be impossible for shareholders to have their candidates included in company proxy materials,<sup>90</sup> with one commenter noting that the laws of most states would allow a board to adopt such provisions in a company's bylaws without a shareholder vote.<sup>91</sup> Further, a commenter warned that boards would use corporate funds to defeat shareholders' attempts to change such board-adopted provisions through shareholder proposals.<sup>92</sup> One commenter argued that the "idea that individual corporations should be given the right to 'opt out' of the proposed regulations through bylaws or otherwise is contrary to the Commission's entire regulatory scheme" and referred to Section 14 of the Securities Act,<sup>93</sup> which voids "[a]ny condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this

<sup>86</sup> See letters from DTE Energy (endorsing the opt-out approach described in the letter submitted by the Society of Corporate Secretaries); JPMorgan Chase; P&G; Seven Law Firms; Society of Corporate Secretaries; U.S. Bancorp.

<sup>87</sup> See letters from 13D Monitor; AFL-CIO; CalPERS; CFA Institute; CII; Florida State Board of Administration; ICGN; LIUNA; D. Nappier; P. Neuhauser; Pax World; OPERS; RiskMetrics; SWIB; Teamsters; USPE.

<sup>88</sup> See letters from 13D Monitor; AFL-CIO; CalPERS; CFA Institute; CII; Florida State Board of Administration; ICGN; LIUNA; D. Nappier; P. Neuhauser; Pax World; OPERS; RiskMetrics; SWIB; Teamsters; USPE.

<sup>89</sup> See letters from AFL-CIO; Amalgamated Bank; William Baker ("W. Baker"); Florida State Board of Administration; International Association of Machinists and Aerospace Workers ("IAM"); The Marco Consulting Group ("Marco Consulting"); P. Neuhauser; Nine Law Firms; Norges Bank Investment Management ("Norges Bank"); Relational; Shamrock Capital Advisors, Inc. ("Shamrock"); TIAA-CREF; USPE; ValueAct Capital.

<sup>90</sup> See letters from Florida State Board of Administration; P. Neuhauser; Shamrock.

<sup>91</sup> See letter from Shamrock.

<sup>92</sup> See letter from P. Neuhauser.

<sup>93</sup> Letter from Nine Law Firms.

title or of the rules and regulations of the Commission\* \* \*.”<sup>94</sup>

After carefully considering the comments, we have determined that Rule 14a–11 should not provide an exemption for companies that have or adopt a provision in their governing documents that provides for or prohibits the inclusion of shareholder director nominees in the company’s proxy materials. Thus, regardless of whether a company has a provision for the inclusion of shareholder nominees in its proxy materials, Rule 14a–11 will apply. As noted, the only exception is if state or foreign law or a company’s governing documents prohibits shareholders from making director nominations.

We believe the rights to nominate and elect directors are traditional State law rights of all shareholders and we believe the current proxy rules could better facilitate the effective exercise of these State law rights. We do not believe that it is appropriate for our rules to permit a company’s board or a majority of shareholders to elect to opt out of Rule 14a–11 and thus deprive other shareholders of an effective means to exercise their State law right to nominate directors and to freely exercise their franchise rights. Thus, allowing a vote to opt out of the rule would contravene a fundamental rationale of Rule 14a–11—improving the degree to which shareholders participating through the proxy process are able “to control the corporation as effectively as they might have by attending a shareholder meeting.”<sup>95</sup>

When shareholders have the right to nominate candidates for director at a shareholder meeting, we believe shareholder choice is enhanced if our rules facilitate the ability of shareholders to nominate candidates for director through the proxy process. Allowing a company or a majority of its shareholders to opt out of the rule would diminish the rights of shareholders who participate by proxy by preventing shareholder nominees from being included in company proxy materials, thus reducing shareholder choice in the critical area of director elections. Similarly, allowing a company or a majority of its shareholders to opt out of the rule would diminish the ability of shareholders to vote for nominees put forth by other shareholders.

In addition, companies and their shareholders do not have the option to elect to opt out of other Federal proxy rules and we do not believe they should

have the ability to do so with this rule. In our view, shareholders’ electoral rights through the proxy process should not be impaired by a unilateral act of the board of directors, or even by a shareholder vote supported by management. Further, as we describe above, allowing some portion of shareholders to alter the application of Rule 14a–11 would effectively reduce choices for shareholders who do not favor that decision.<sup>96</sup>

Finally, we considered the objections of some commenters to a “one-size-fits-all” rule and concerns that for some companies with various capital structures the rule may raise more complex issues.<sup>97</sup> As we have noted, no Federal proxy rule allows shareholders or boards to alter how the rules apply

<sup>96</sup> Our view in this regard has been sharply criticized. E.g., Joseph A. Grundfest, *The SEC’s Proposed Proxy Access Rules: Politics, Economics, and the Law*, 65 Bus. Law. 361, 370 (2010) (this article also was included as an attachment to the January 18, 2010 letter from Joseph A. Grundfest (“Grundfest II”)) (“there is no intellectually credible argument that shareholders are \* \* \* competent to elect directors but incompetent to determine the rules governing the election of directors. There is also no support for the proposition that shareholders can be trusted to relax the mandatory minimum standards established by the Commission, but not to strengthen them.”). In our view, these assertions are flawed. This is not an issue of shareholder competence. It is, instead, a recognition that permitting a company or a group of shareholders to prevent shareholders from effectively participating in governing the corporation through participation in the proxy process is fundamentally inconsistent with the goal of Federal proxy regulation. See *Business Roundtable*, 905 F.2d at 410.

<sup>97</sup> See letters from 26 Corporate Secretaries; ABA; ACE; Advance Auto Parts; AGL; Aetna; Allstate; Alston & Bird; American Bankers Association; American Business Conference; American Electric Power; Anadarko; Applied Materials; Artistic Land Designs; Association of Corporate Counsel; Avis Budget; Atlantic Bingo; L. Behr; Best Buy; Biogen; J. Blanchard; Boeing; T. Bonkowski; BorgWarner; Boston Scientific; Brink’s; BRT; Burlington Northern; R. Burt; California Bar; Callaway; S. Campbell; Carlson; Carolina Mills; Caterpillar; Chamber of Commerce/CMCC; Chevron; R. Chicko; CIGNA; Comcast; Competitive Enterprise Institute; W. Cornwell; CSX; E. Culwell; Cummins; Darden Restaurants; Daniels Manufacturing; Davis Polk; Delaware Bar; T. Dermody; Devon; DTE Energy; Eaton; Edison Electric Institute; Eli Lilly; Emerson Electric; M. Eng; Erickson; ExxonMobil; FedEx; Financial Services Roundtable; Flutterby; FPL Group; Frontier; GE; A. Goolsby; C. Holliday; IBM; ICI; Intellect; JPMorgan Chase; Jones Day; R. Clark King; Leggett; T. Liddell; Little; McDonald’s; MeadWestvaco; MedFaxx; Medical Insurance; MetLife; M. Metz; Microsoft; J. Miller; M. Moretti; Motorola; NACD; NAM; NIRI; O’Melveny & Myers; Office Depot; Omaha Door; P&G; PepsiCo; Pfizer; Realogy; J. Robert; M. Robert; RPM; Ryder; Safeway; R. Saul; Shearman & Sterling; Sherwin-Williams; R. Simoneau; Society of Corporate Secretaries; Southern Company; Southland; Steele Group; Style Crest; Tesoro; Textron; Theragenics; TI;. R. Trummel; T. Trummel; V. Trummel; tw telecom; L. Tyson; United Brotherhood of Carpenters; UnitedHealth; U.S. Bancorp; VCG; Wachtell; Wellness; Wells Fargo; Whirlpool; Xerox; Yahoo; J. Young.

to companies. The concept that our rules are not subject to company-by-company variation is entirely consistent with our mandate to protect all investors. In this regard, we are not persuaded that we should allow our rules to be altered by shareholders or boards to the potential detriment of other shareholders. We believe that having a uniform standard that applies to all companies subject to the rule will simplify use of the rule for shareholders and allowing different procedures and requirements to be adopted by each company could add significant complexity and cost for shareholders and undermine the purposes of our new rule. While other procedures and standards could be adopted by companies or shareholders to supplement Rule 14a–11, shareholders would benefit from the predictability of the uniform application of Rule 14a–11 at all companies.

It is important to note that while Rule 14a–11 facilitates the existing rights of shareholders and we do not believe the rule should be altered, it is not the exclusive way by which a candidate other than a management nominee may be put to a shareholder vote. Shareholders may continue to choose to conduct traditional proxy contests. Regardless of whether a shareholder uses Rule 14a–11 or conducts a traditional proxy contest to nominate a candidate for director, a company concerned about how such a shareholder nominee fits into its particular capital structure or other unique fact patterns presumably would address that concern in its proxy materials.

#### d. No Triggering Events

Under the Commission’s 2003 Proposal, a company would have been subject to the shareholder director nomination requirements after the occurrence of one or both of two possible triggering events. The first triggering event was that at least one of the company’s nominees for the board of directors for whom the company solicited proxies received withhold votes from more than 35% of the votes cast at an annual meeting of shareholders at which directors were elected.<sup>98</sup> The second triggering event was that a shareholder proposal submitted under Rule 14a–8 providing that a company become subject to the proposed shareholder nomination procedure was submitted for a vote of

<sup>98</sup> This triggering event could not occur in a contested election to which Rule 14a–12(c) would apply or an election to which the proposed shareholder nomination procedure would have applied.

<sup>94</sup> 15 U.S.C. 77n.

<sup>95</sup> *Business Roundtable v. SEC*, 905 F.2d 406, 410 (D.C. Cir. 1990).

shareholders at an annual meeting by a shareholder or group of shareholders that held more than 1% of the company's securities entitled to vote on the proposal and the shareholder or group of shareholders held those securities for one year as of the date the proposal was submitted, and the proposal received more than 50% of the votes cast on that proposal at the meeting.<sup>99</sup> In 2003, these triggering events were included because they were believed to be indications that a company had a demonstrated corporate governance issue, such that shareholders should have the opportunity to include director nominees in the company's proxy materials.

Unlike the 2003 Proposal, our current proposal did not include a triggering event requirement in Rule 14a-11. As noted in the Proposing Release, we did not include such a requirement because we were concerned that the Federal proxy rules may be impeding the exercise of shareholders' ability under State law to nominate and elect directors at all companies, not just those with demonstrated governance issues. In addition, we noted our concern, and the concern expressed by commenters on the 2003 Proposal, that the inclusion of triggering events would result in unnecessary complexity and would delay the operation of the rule. However, we solicited comment about whether triggers for the application of Rule 14a-11 would be appropriate.

Many commenters opposed the inclusion of a triggering event requirement,<sup>100</sup> with some commenters expressing concern that triggering events would cause significant delays and introduce undue complexity into the rule.<sup>101</sup> On the other hand, other commenters supported the inclusion of a triggering event requirement, believing that such a requirement would serve as a useful indicator of the companies with demonstrated governance issues (e.g., companies that do not act within a certain time period on a shareholder proposal that received majority support).<sup>102</sup>

<sup>99</sup> Only votes for and against a proposal would have been included in the calculation of the shareholder vote.

<sup>100</sup> See letters from AFSCME; CalSTRS; CFA Institute; CII; COPERA; T. DiNapoli; Florida State Board of Administration; ICGN; N. Lautenbach; LIUNA; D. Nappier; Nathan Cummings Foundation; OPERS; Pax World; Relational; Sodali; SWIB; TIAA-CREF; G. Tooker; USPE; ValueAct Capital.

<sup>101</sup> See letters from AFSCME; CFA Institute; CII; T. DiNapoli; LIUNA.

<sup>102</sup> See letters from Automatic Data Processing, Inc. ("ADP"); Alaska Air Group, Inc. ("Alaska Air"); Allstate; American Electric Power; Anadarko; AT&T; Avis Budget; Barclays Global Investors

We remain concerned that the Federal proxy rules may not be facilitating the exercise of shareholders' ability under State law to nominate and elect directors and this concern is not limited to shareholders' ability to nominate directors at companies with demonstrated governance issues. Indeed, allowing shareholders to include nominees in company proxy materials before there are demonstrated governance failures could have the benefit of increasing director responsiveness and avoiding future governance failures. In addition, we share the concerns of some commenters that inclusion of triggering events would introduce undue complexity to the rule. Therefore, we are adopting the rule as proposed, without a triggering event requirement.

#### e. Concurrent Proxy Contests

As proposed, Rule 14a-11 would apply regardless of whether a company is engaged in, or anticipates being engaged in, a concurrent proxy contest; however, we requested comment on whether a company should be exempted from complying with Rule 14a-11 if another party commences or evidences its intent to commence a solicitation in opposition subject to Rule 14a-12(c). Of the commenters that responded, a few stated that shareholders of a company that is the subject of a traditional proxy contest should be allowed to use Rule 14a-11 to have nominees included in the company's proxy materials,<sup>103</sup> and others stated that shareholders of a company engaged in a traditional proxy contest should not be allowed to use Rule 14a-11 to have nominees included in the company's proxy materials.<sup>104</sup>

In support of enabling shareholders to use Rule 14a-11 during a traditional proxy contest, one commenter argued that exempting companies subject to a traditional proxy contest from Rule 14a-11 would be inconsistent with the Commission's objective of changing the

("Barclays"); Biogen; Boeing; BRT; Burlington Northern; R. Burt; Callaway; Chevron; CIGNA; CNH Global N.V. ("CNH Global"); Comcast; Cummins; Deere & Company ("Deere"); Eaton; ExxonMobil; FedEx; FMC Corp.; FPL Group; Frontier; General Mills; C. Holliday; IBM; ITT Corporation ("ITT"); J. Kilts; Ellen J. Kullman ("E.J. Kullman"); N. Lautenbach; McDonald's; J. Miller; Motorola; Office Depot; O'Melveny & Myers; P&G; PepsiCo; Pfizer; Protective; Ryder; Sara Lee; Sherwin-Williams; Theragenics; TI; tw telecom; G. Tooker; UnitedHealth; Xerox.

<sup>103</sup> See letters from CII; Florida State Board of Administration; Sodali; USPE.

<sup>104</sup> See letters from ABA; American Express; Biogen; BorgWarner; BRT; Davis Polk; Dewey; Eli Lilly; Fenwick; Honeywell; JPMorgan Chase; Leggett; PepsiCo; Seven Law Firms; Society of Corporate Secretaries; Tenet; U.S. Bancorp; Verizon; Wachtell.

proxy process to better reflect the rights shareholders would have at a shareholder meeting, and that dissatisfied shareholders who are not seeking a change in control and who otherwise meet the eligibility criteria under Rule 14a-11 would be disenfranchised.<sup>105</sup> The commenter stated that dissatisfied shareholders should not be forced to make a choice between a change in control or "business as usual." Another commenter stated that contested elections have been conducted successfully with more than two slates.<sup>106</sup>

On the other hand, commenters that sought a limitation on use of Rule 14a-11 during a traditional proxy contest were concerned that Rule 14a-11 could have the effect of facilitating a change in control of the company.<sup>107</sup> Commenters noted that under certain staff positions,<sup>108</sup> as well as the Commission's discussion of Rule 14a-4(d)(4), as set forth in the *Proxy Disclosure and Solicitation Enhancements* proposing release,<sup>109</sup> a dissident shareholder could "round out" its short-slate proxy card by seeking authority to vote for Rule 14a-11 shareholder nominees, thereby facilitating a change in control.<sup>110</sup> Further, commenters believed that under the Proposal shareholders that submit nominees in reliance on Rule 14a-11 would not be barred from actively soliciting for the nominees of a shareholder using a traditional proxy contest and, conversely, a shareholder using a traditional proxy contest could actively engage in soliciting activities for Rule 14a-11 shareholder nominees.<sup>111</sup> Commenters also worried that multiple groups of shareholders who simultaneously propose different directors for different purposes could lead to substantial confusion for other shareholders.<sup>112</sup> Commenters warned that shareholder confusion would increase if there are two or more proxy cards with more than twice the number

<sup>105</sup> See letter from CII.

<sup>106</sup> See letter from Florida State Board of Administration.

<sup>107</sup> See letters from ABA; BRT; Davis Polk; Eli Lilly; Seven Law Firms; Society of Corporate Secretaries.

<sup>108</sup> See *Eastbourne Capital LLC* No-Action Letter (March 30, 2009) and *Iahn Associates Corp.* No-Action Letter (March 30, 2009).

<sup>109</sup> Release No. 33-9052, 34-60280 (July 10, 2009) [74 FR 35076].

<sup>110</sup> See letters from ABA; Eli Lilly; JPMorgan Chase; Society of Corporate Secretaries.

<sup>111</sup> See letters from ABA; Society of Corporate Secretaries.

<sup>112</sup> See letters from ABA; BRT; Davis Polk; Eli Lilly; PepsiCo; Seven Law Firms; Society of Corporate Secretaries.



of nominees than available slots.<sup>113</sup> According to these commenters, further confusion would result from any assumption by shareholders that the Rule 14a–11 slate is allied with the insurgent slate, despite the Rule 14a–11 representation regarding the lack of control intent.<sup>114</sup> One commenter also argued that, despite the Rule 14a–11 representation regarding the lack of control intent, it is “easy to imagine that in some contested elections, a [R]ule 14a–11 nominee would be the swing vote, tipping the majority of the board and thus control of the company.”<sup>115</sup> Citing these same concerns, another commenter recommended that when a company’s board receives notice of a traditional proxy contest, the company should be permitted to exclude Rule 14a–11 nominees from the company’s proxy materials (and, if the proxy materials have already been distributed, to issue supplemental proxy materials eliminating these nominees from the company’s materials).<sup>116</sup>

Finally, some commenters argued that Rule 14a–11 is unnecessary when a company is engaged in a traditional proxy contest because the company’s shareholders are already effectively exercising their rights under State law to nominate and elect directors.<sup>117</sup> One commenter stated that if the Commission decides not to prohibit a concurrent vote on Rule 14a–11 nominees and nominees presented through a traditional proxy contest, it should at least provide that the nominees presented through the traditional proxy contest be counted against the number of permissible Rule 14a–11 nominees to reduce the likelihood of a change in control.<sup>118</sup> The commenter stated that if Rule 14a–11 could be used concurrently with a traditional proxy contest, the nominating shareholder should not be allowed to be a “participant” (as defined under Schedule 14A) in the traditional proxy contest or to engage in any soliciting activity for a nominee of another shareholder. The commenter also suggested that dissidents in a traditional proxy contest be precluded from including Rule 14a–11 nominees on their proxy card. Acknowledging the possibility of collusion, shareholder confusion, and change in control, one commenter expressed support for

reasonable limitations on a Rule 14a–11 nomination if there is a simultaneous proxy contest.<sup>119</sup>

While we appreciate commenters’ concerns, we do not believe that our efforts to facilitate the exercise of shareholders’ State law right to nominate directors should be limited by the activities of other persons engaged in a traditional proxy contest. We also believe that, as described below, Rule 14a–11 and the related rule amendments, together with our staff review process, can adequately address concerns about investor confusion and potential abuse of the process by those seeking a change in control. Therefore, we are adopting the rule as proposed, without an exception for companies that are subject to or anticipate being subject to a concurrent proxy contest. In this regard, we agree with those commenters that opposed including a limitation because to do so would be inconsistent with the goals of our rulemaking, which are not limited by the nomination activities of other persons. In addition, we note that there is no current limitation in the Federal proxy rules on the number of proxy contests that can take place simultaneously and we do not believe that there is sufficient reason to provide such a limitation in this circumstance. Companies and shareholders have been able, to date, to successfully navigate multiple slates on those occasions when more than one person undertakes a proxy contest. In addition, we believe that a company can address commenters’ concerns through disclosure in its proxy materials. For example, the company may disclose in its proxy statement potential effects of electing non-management nominees (whether those nominees are included in the company’s materials or in other soliciting persons’ materials), such as the potential to cause the company to violate law or the independence requirements of the exchange listing standards, and allow shareholders to consider that information when making their voting decisions. Similarly, we believe that appropriate disclosure in the company’s proxy materials, as well as the dissident’s proxy materials, could serve to potentially avoid shareholder confusion about how many nominees a shareholder may vote for and how to mark the card.

We also have not revised Rule 14a–11, as suggested by commenters, to count nominees put forth by persons outside of Rule 14a–11 for purposes of the calculation of the maximum number of nominees required to be included in the company’s proxy materials pursuant to

Rule 14a–11. We believe that to do so would, like an outright exception, be inconsistent with the goal of our rulemaking—to change the proxy process to better reflect the rights shareholders would have at a shareholder meeting, which are not limited by the nomination activities of other persons.

While we are not adopting an exception from the rule for companies that are, or anticipate being, subject to a concurrent proxy contest, we do understand concerns about the possibility of confusion and abuse in this area absent clear guidance.<sup>120</sup> Accordingly, we have made clear in our discussion, in Section II.B.10. below, that a nominating shareholder or group relying on new Rule 14a–2(b)(7) or (8) to engage in an exempt solicitation to form a nominating shareholder group or in connection with a nomination included in the company’s proxy materials pursuant to Rule 14a–11 would lose the exemption if they engage in a non-Rule 14a–11 solicitation for directors or another person’s solicitation with regard to the election of directors. In addition, we are adopting an instruction to Rule 14a–11<sup>121</sup> to make clear that, in order to rely on Rule 14a–11 to have a nominee or nominees included in a company’s proxy materials, a nominating shareholder or group or any member of the nominating shareholder or group may not be a member of any other group with persons engaged in solicitations or other nominating activities in connection with the subject election of directors; may not separately conduct a solicitation in connection with the subject election of directors other than a Rule 14a–2(b)(8) exempt solicitation in relation to those nominees it has nominated pursuant to Rule 14a–11 or for or against the company’s nominees; and may not act as a participant in another person’s solicitation in connection with the subject election of directors.

### 3. Which Companies Are Subject to Rule 14a–11

#### a. General

In this section, we discuss which companies will be subject to new Rule 14a–11, including the rule’s application to investment companies, controlled companies, “debt-only” companies, voluntary registrants, and smaller reporting companies.

New Rule 14a–11 will apply to companies that are subject to the Exchange Act proxy rules, including

<sup>113</sup> See letters from ABA; Davis Polk.

<sup>114</sup> See Section II.B.4. below for a further discussion of change in control intent and the certifications required by the new rules.

<sup>115</sup> Letter from Davis Polk.

<sup>116</sup> See letter from Society of Corporate Secretaries.

<sup>117</sup> See letters from BRT; Verizon.

<sup>118</sup> See letter from ABA.

<sup>119</sup> See letter from P. Neuhauser.

<sup>120</sup> See, e.g., letters from ABA; Seven Law Firms.

<sup>121</sup> See Instruction to Rule 14a–11(b).

investment companies registered under Section 8 of the Investment Company Act of 1940.<sup>122</sup> The rule also will apply to controlled companies and those companies that choose to voluntarily register a class of securities under Section 12(g). Smaller reporting companies will be subject to the rule, but on a delayed basis. Consistent with the Proposal, we have excepted from the rule's application companies that are subject to the proxy rules solely because they have a class of debt registered under Section 12 of the Exchange Act. In addition, foreign private issuers are exempt from the Commission's proxy rules with respect to solicitations of their shareholders, so the rule will not apply to these issuers.<sup>123</sup>

#### b. Investment Companies

Under the Proposal, Rule 14a-11 would apply to registered investment companies. We sought comment on whether Rule 14a-11 should apply to these companies.<sup>124</sup>

Several commenters supported including registered investment companies in the rule.<sup>125</sup> Commenters noted that investment company boards, like other boards, must be responsive and accountable to their shareholders;<sup>126</sup> that some investment company boards are "too cozy" with the company's investment adviser;<sup>127</sup> and that the proposed rule will add competition to the board nomination process, which may create some traction in board negotiations with the company's investment adviser.<sup>128</sup> A number of commenters did not believe that the rule would result in unreasonable cost or an excessive number of contested elections.<sup>129</sup> One commenter suggested that investment company shareholders would use the rule infrequently and then only if the

<sup>122</sup> 15 U.S.C. 80a *et seq.* Registered investment companies currently are required to comply with the proxy rules under the Exchange Act when soliciting proxies, including proxies relating to the election of directors. *See* Investment Company Act Rule 20a-1 [17 CFR 270.20a-1] (requiring registered investment companies to comply with regulations adopted pursuant to Section 14(a) of the Exchange Act that would be applicable to a proxy solicitation if it were made in respect of a security registered pursuant to Section 12 of the Exchange Act).

<sup>123</sup> Exchange Act Rule 3a12-3 [17 CFR 240.3a12-3] exempts securities of certain foreign issuers from Section 14(a) of the Exchange Act.

<sup>124</sup> The Commission has considered the impact of this issue on investment companies on prior occasions. *See, e.g.*, 2003 Proposal.

<sup>125</sup> *See, e.g.*, letters from AFSCME; CalPERS; CII; Mutual Fund Directors Forum ("MFDF"); Julian Reid ("J. Reid"); Jennifer S. Taub ("J. Taub"); TIAA-CREF.

<sup>126</sup> *See* letter from MFDF.

<sup>127</sup> Letter from J. Reid.

<sup>128</sup> *See* letter from J. Taub.

<sup>129</sup> *See, e.g.*, letters from AFSCME; J. Taub.

investment company is experiencing a real governance or other failure.<sup>130</sup>

On the other hand, a number of commenters, largely from the investment company industry, opposed the inclusion of registered investment companies in the rule.<sup>131</sup> Commenters asserted that the Commission had not presented any empirical evidence of governance problems with respect to investment companies that would support extending the rule to them and that the trend for investment company boards is to have strong governance practices.<sup>132</sup> Commenters also argued that investment companies are subject to a unique regulatory regime under the Investment Company Act that provides additional protection to investors, such as the requirement to obtain shareholder approval to engage in certain transactions or activities,<sup>133</sup> and that investment companies and their boards

<sup>130</sup> *See* letter from J. Taub.

<sup>131</sup> *See, e.g.*, letters from ABA; American Bar Association (September 18, 2009) ("ABA II"); Barclays; ICI; Investment Company Institute and Independent Directors Counsel ("ICI/IDC"); Independent Directors Council ("IDC"); S&C; T. Rowe Price Associates, Inc. ("T. Rowe Price"); The Vanguard Group, Inc. ("Vanguard"). One commenter opposed the inclusion of business development companies in the rule for the same reasons that it opposed including registered investment companies in the rule. *See* letter from ICI. Business development companies are a category of closed-end investment companies that are not registered under the Investment Company Act, but are subject to certain provisions of that Act. *See* Sections 2(a)(48) and 54-65 of the Investment Company Act [15 U.S.C. 80a-2(a)(48) and 80a-53-64]. We are including business development companies in the rule for the same reasons provided below with respect to registered investment companies.

<sup>132</sup> *See* letters from ICI; ICI/IDC; IDC; T. Rowe Price; S&C. Among other things, commenters noted that 90% of fund complexes have boards that are 75% or more comprised of independent directors and the vast majority of fund boards have an independent director serving as chairman or as lead independent director. *See* letters from ICI/IDC; IDC. Two letters also cited a 1992 report by Commission staff that observed that the governance model embodied by the Investment Company Act is sound and should be retained with limited modifications. *See* letters from ICI; ICI/IDC.

<sup>133</sup> One joint comment letter noted that the Investment Company Act requires investment companies to obtain shareholder approval of contracts with the company's investment adviser and distributor and to change from an open-end, closed-end, or diversified company; to borrow money; to issue senior securities; to underwrite securities issued by other persons; to purchase or sell real estate or commodities; to make loans to other persons, except in accordance with the policy in the company's registration statement; to change the nature of its business so as to cease to be an investment company; or to deviate from a stated policy with respect to concentration of investments in an industry or industries, from any investment policy which is changeable only by shareholder vote, or from any stated fundamental policy. The commenters also noted that investment company shareholders have the right to bring an action against the company's investment adviser for breach of fiduciary duty with respect to receipt of compensation. *See* letter from ICI/IDC.

have very different functions from non-investment companies and their boards.<sup>134</sup> One commenter noted that the Proposal would be inappropriate and not particularly useful for most open-end management investment companies, because open-end management investment company shares are held on a short-term basis and open-end management investment companies are not typically required to hold annual meetings under State law.<sup>135</sup>

Commenters also were concerned about the costs of the Proposal, particularly for fund complexes that utilize a "unitary" board consisting of one group of individuals who serve on the board of every fund in the complex, or "cluster" boards consisting of two or more groups of individuals that each oversee a different set of funds in the complex.<sup>136</sup> Commenters noted that if a

<sup>134</sup> *See* letters from ABA; Barclays; ICI; ICI/IDC; IDC; T. Rowe Price; S&C; Vanguard. However, we note that, in response to the 2003 Proposal, ABA and ICI indicated that there were no reasons to treat investment companies differently from non-investment companies. *See* letter from Investment Company Institute (December 22, 2003) on File No. S7-19-03; letter from American Bar Association (January 7, 2004) on File No. S7-19-03.

<sup>135</sup> *See* letter from ABA. *See also* letter from S&C (urging that at a minimum Rule 14a-11 should not apply to open-end investment companies, "which do not generally hold regular meetings and for which compliance would be particularly burdensome"). An open-end management investment company is an investment company, other than a unit investment trust or face-amount certificate company, that offers for sale or has outstanding any redeemable security of which it is the issuer. *See* Sections 4 and 5(a)(1) of the Investment Company Act [15 U.S.C. 80a-4 and 80a-5(a)(1)].

<sup>136</sup> *See* letters from ABA; ICI; ICI/IDC; IDC; MFDF; S&C; T. Rowe Price; Vanguard. Commenters noted that a recent survey of fund complexes representing 93% of the industry's total net assets indicated that 83% of fund complexes had a unitary board structure and 17% of fund complexes had a cluster board structure. *See* letters from ICI/IDC; IDC. However, one comment letter included materials noting that, while the average number of registered investment companies per fund complex is five, the median number of registered investment companies per fund complex is one. *See* letter from ICI/IDC. In cases where the fund complex consists of only one company, commenters' concerns about the loss of the unitary board would not be present.

Commenters also noted that among fund complexes that use unitary or cluster boards there are other aspects of board organization that vary from complex to complex. *See* letter from ICI/IDC. For example, one board may oversee all of the open-end funds in the complex and all but three of its closed-end funds, while a second board oversees the other closed-end funds. Alternatively, one board may oversee the open-end and closed-end fixed income funds advised by one particular adviser, while a second board oversees the open-end and closed-end equity and international funds advised by a second adviser, etc. However, the commenters did not note any specific issues that would be raised by the use of different structures among fund complexes using unitary or cluster boards if the Proposal were to be adopted.

shareholder-nominated director were to be elected to a unitary or cluster board, the investment companies in the fund complex would incur significant additional administrative costs and burdens (e.g., the shareholder-nominated director would have to leave during discussions that pertain to the other investment companies in the complex, board materials would have to be customized for the director, and the fund complex would face challenges in preserving the status of privileged information) and the benefits of the unitary or cluster board that result in the increased effectiveness of such boards would be lost.<sup>137</sup> One commenter also stated that if a shareholder nomination causes an election to be “contested” under rules of the New York Stock Exchange, brokers would not be able to vote client shares on a discretionary basis, making it difficult and more expensive for investment companies to achieve a quorum for a meeting.<sup>138</sup>

After considering these comments, we agree with the commenters who believe that Rule 14a–11 should apply to registered investment companies, as was proposed. The purpose of Rule 14a–11 is to facilitate the exercise of shareholders’ traditional State law rights to nominate and elect directors to boards of directors and thereby enable shareholders to participate more meaningfully in the nomination and election of directors at the companies in which they invest. These State law rights apply to the shareholders of investment companies, including each investment company in a fund complex, regardless of whether or not the fund complex utilizes a unitary or cluster board.<sup>139</sup> Moreover, although investment companies and their boards may have different functions from non-investment companies and their boards, investment company boards, like the

boards of other companies, have significant responsibilities in protecting shareholder interests, such as the approval of advisory contracts and fees.<sup>140</sup> Therefore, we are not persuaded that exempting registered investment companies would be consistent with our goals. We also do not believe that the regulatory protections offered by the Investment Company Act (including requirements to obtain shareholder approval to engage in certain transactions and activities), the trend asserted by commenters for investment companies to have good governance practices, or the fact that open-end management investment companies are not required by State law to hold annual meetings serves to decrease the importance of the rights that are granted to shareholders under State law.<sup>141</sup> In fact, the separate regulatory regime to which investment companies are subject emphasizes the importance of investment company directors in dealing with the conflicts of interest created by the external management structure of most investment companies.<sup>142</sup> We also note that some

<sup>140</sup> See *Jones v. Harris Assocs.*, 130 S.Ct. 1418, 1423, 176 L. Ed. 2d 265, 273–274 (2010). See also S. Rep. No. 91–184; 91st Congress 1st Session; S. 2224 (1969) (“This section is not intended to authorize a court to substitute its business judgment for that of the mutual fund’s board of directors in the area of management fees. \* \* \* The directors of a mutual fund, like directors of any other corporation will continue to have \* \* \* overall fiduciary duties as directors for the supervision of all of the affairs of the fund.”); letter from ICI/IDC (“The Investment Company Act of 1940 and the rules under it impose significant responsibilities on fund directors in addition to the duties of loyalty and care to which directors are typically bound under State law.”).

<sup>141</sup> In the 1992 report cited by two comment letters in footnote 132 above, the Commission staff also observed that the Investment Company Act “establishes a comprehensive regulatory framework predicated upon principles of corporate democracy” and was intended to provide an additional safeguard for investors by according “voting powers to investment company shareholders beyond those required by State corporate law.” Division of Investment Management, U.S. Securities and Exchange Commission, *Protecting Investors: A Half Century of Investment Company Regulation*, at pp. 251–52, 260 (May 1992) (emphasis added).

<sup>142</sup> See, e.g., Commission Guidance Regarding the Duties and Responsibilities of Investment Company Boards of Directors with Respect to Investment Adviser Portfolio Trading Practices, Release No. IC–28345 (July 30, 2008) [73 FR 45646, 45649 (August 6, 2008)] (“In addition to statutory and common law obligations, fund directors are also subject to specific fiduciary obligations relating to the special nature of funds under the Investment Company Act. \* \* \* A fund board has the responsibility, among other duties, to monitor the conflicts of interest facing the fund’s investment adviser and determine how the conflicts should be managed to help ensure that the fund is being operated in the best interest of the fund’s shareholders.”) (footnotes omitted); Interpretive Matters Concerning Independent Directors of Investment Companies, Release No. IC–24083 (October 14, 1999) [64 FR 59877, 59877–78 (November 3, 1999)] (listing various duties and

commenters have raised governance concerns regarding the relationship between boards and investment advisers.<sup>143</sup>

We are cognizant of the fact that the rule will impose some costs on investment companies. We believe, however, that policy goals and the benefits of the rule justify these costs. As discussed above, we believe that facilitating the exercise of traditional State law rights to nominate and elect directors is as much of a concern for investment company shareholders as it is for shareholders of non-investment companies. We continue to believe that parts of the proxy process may frustrate the exercise of shareholders’ rights to nominate and elect directors arising under State law, and thereby fail to provide fair corporate suffrage. The new rules seek to facilitate shareholders’ effective exercise of their rights under State law to both nominate and elect directors. In this regard, we note that commenters have stated that interest in mutual fund governance has increased in recent years.<sup>144</sup>

We recognize that it may be more costly for investment companies to achieve a quorum at shareholder meetings if a shareholder director nomination causes an election to be “contested” under rules of the New York Stock Exchange and brokers cannot vote customer shares on a discretionary basis. Furthermore, for fund complexes that utilize unitary or cluster boards, the election of a shareholder director nominee may, in some circumstances, increase costs and potentially decrease the efficiency of the boards.

We note, however, that these costs are associated with the State law right to nominate and elect directors, and are not costs incurred for including shareholder nominees in the company’s proxy statement. With respect to fund complexes utilizing unitary or cluster boards, we note that any increased costs and decreased efficiency of an investment company’s board as a result of the fund complex no longer having a unitary or cluster board would occur, if at all, only in the event that investment company shareholders elect the shareholder nominee. Investment companies may include information in the proxy materials making investors aware of the company’s views on the perceived benefits of a unitary or cluster board and the potential for increased

responsibilities of the independent directors of an investment company and noting that “Each of these duties and responsibilities is vital to the proper functioning of fund operations and, ultimately, the protection of fund shareholders.”)

<sup>143</sup> See letters from J. Reid; J. Taub.

<sup>144</sup> See letters from AFSCME; J. Taub.

<sup>137</sup> Commenters noted that unitary and cluster boards can result in enhanced board efficiency and greater board knowledge of the many aspects of fund operations that are complex-wide in nature. See, e.g., letters from ABA; ICI; ICI/IDC; IDC; MFDF; S&C; T. Rowe Price; Vanguard. For instance, commenters noted that many of the same regulatory, valuation, compliance, disclosure, accounting, and business issues may arise for all of the funds that the unitary or cluster board oversees and that consistency among funds in the complex greatly enhances both board efficiency and shareholder protection. See, e.g., letter from ICI/IDC. One joint comment letter also suggested that “[b]ecause they are negotiating on behalf of multiple funds, unitary and cluster boards have a greater ability than single fund boards to negotiate with management over matters such as fund expenses; the level of resources devoted to technology; and compliance and audit functions.” See *id.*

<sup>138</sup> See letter from S&C.

<sup>139</sup> We note that “unitary” or “cluster” boards are not required by State law.

costs and decreased efficiency if the shareholder nominees are elected. Moreover, we note that a fund complex can take steps to minimize the cost and burden of a shareholder-nominated director by, for example, entering into a confidentiality agreement in order to preserve the status of confidential information regarding the fund complex.<sup>145</sup>

We believe that the costs imposed on investment companies will be less significant than the costs imposed on other companies for three reasons. First, to the extent investment companies do not hold annual meetings as permitted by State law, investment company shareholders will have less opportunity to use the rule.<sup>146</sup> Second, even when investment company shareholders do have the opportunity to use the rule, the disproportionately large and generally passive retail shareholder base of investment companies will probably mean that the rule will be used less frequently than will be the case with non-investment companies.<sup>147</sup> Third, because we have sought to limit the cost and burden on all companies, including investment companies, by limiting use of Rule 14a-11 to shareholders who have maintained significant continuous holdings in the company for at least three years, and because many funds, such as money market funds, are held by shareholders on a short-term basis,<sup>148</sup> we believe that the situations where shareholders will meet the eligibility requirements will be limited.

Although commenters argued that the election of a shareholder-nominated director to a unitary or cluster board will necessarily result in decreased effectiveness of the board, we disagree. In this regard, one commenter argued that competition in the board nomination process may improve efficiency by providing additional leverage for boards in negotiations with the investment adviser.<sup>149</sup> In any event,

<sup>145</sup> Two commenters argued in a joint comment letter that there are a number of practical and legal issues that prevent confidentiality agreements from being sufficient to address the issues that arise when a shareholder-nominated director is elected to the board of an investment company in a fund complex using a unitary or cluster board. *See* letter from ICI/IDC. We emphasize that entering into a confidentiality agreement is only one method of preserving the confidentiality of information revealed in board meetings attended by the shareholder-nominated director. The fund complex can have separate meetings and board materials for the board with the shareholder-nominated director, especially if particularly sensitive legal or other matters will be discussed or to protect attorney-client privilege. For a further discussion of this comment, *see* Section IV.E.1.

<sup>146</sup> *See* letters from ABA; MFDF.

<sup>147</sup> *See* letter from J. Taub.

<sup>148</sup> *See* letter from ABA.

<sup>149</sup> *See* letter from J. Taub.

we believe that investment company shareholders should have a more meaningful opportunity to exercise their traditional State law rights to elect a non-unitary or non-cluster board if they so choose.

### c. Controlled Companies

As proposed, Rule 14a-11 would allow eligible shareholders to submit director nominees at all companies subject to the Exchange Act proxy rules other than companies that are subject to the proxy rules solely because they have a class of debt registered under Section 12 of the Exchange Act. We sought comment on whether Rule 14a-11 also should provide an exception for controlled companies.

In response to our request for comment, one commenter argued that controlled companies should not be excluded from Rule 14a-11,<sup>150</sup> acknowledging that while there may be no mathematical possibility of a shareholder nominee submitted pursuant to Rule 14a-11 being elected at a controlled company, in a controlled company there could be an even greater need for non-controlling shareholders to express their concerns. The commenter noted that a large—even if not a majority—vote by non-controlling shareholders could send an important message to the board. Other commenters noted that controlled companies are commonly structured with dual classes of stock, which allows shareholders of the non-controlling class of stock to elect a set number of directors that is less than the full board.<sup>151</sup> Another commenter noted that dual-class companies with supervoting stock often can benefit the most from having the interests of non-controlling shareholders better represented in the boardroom.<sup>152</sup> This commenter encouraged the Commission to include some means by which minority shareholders of dual-class and parent-controlled companies could meaningfully avail themselves of the rule, even if a different set of eligibility or disclosure requirements is determined to be more appropriate in these cases.

On the other hand, several commenters argued that controlled companies should be excluded from Rule 14a-11.<sup>153</sup> According to these commenters, providing shareholders the ability to include nominees in company

proxy materials in this context would be ineffective and needlessly disruptive and costly because there is no prospect that a shareholder nominee would be elected.<sup>154</sup> Two of these commenters also noted that subjecting these companies to Rule 14a-11 would possibly cause investor confusion.<sup>155</sup> These commenters remarked that shareholders would continue to have other avenues to express their views to the company, such as through the Rule 14a-8 process. Commenters who supported an exclusion for controlled companies suggested that for purposes of the exclusion the definition of “controlled company” should be similar to the definition used by the national securities exchanges in connection with director independence requirements.<sup>156</sup> Some commenters suggested that if Rule 14a-11 excluded controlled companies using the same definition as the national securities exchanges in connection with director independence requirements, then the rule should contain an instruction providing that whether more than 50% of the voting power of a company is held by an individual, group, or other company would be determined by any schedules filed under Section 13(d) of the Exchange Act.<sup>157</sup>

After considering the issue further, we are persuaded that Rule 14a-11 should apply to controlled companies, as we proposed. As commenters noted, it is common for companies structured with dual classes of stock to allow shareholders of the non-controlling class to elect a set number of directors that is less than the full board. In that situation, it may be useful for non-controlling shareholders to be able to include shareholder nominations in company proxy materials with respect to the directors the non-controlling class is entitled to elect. In addition, though applying Rule 14a-11 to controlled companies would be unlikely to result in the election of shareholder-nominated directors in cases in which these are not directors elected exclusively by the non-controlling shareholders, we appreciate that shareholders at controlled companies

<sup>154</sup> *See* letters from ABA; AllianceBernstein; Cleary; Seven Law Firms; Duane Morris; Sidley Austin.

<sup>155</sup> *See* letters from ABA; Seven Law Firms.

<sup>156</sup> *See* letters from ABA; AllianceBernstein; Cleary; Seven Law Firms; Duane Morris; Sidley Austin. *See, e.g.,* New York Stock Exchange Rule 303A.00 and NASDAQ Stock Market LLC Rule 5615(c) (defining “controlled companies” as a company of which more than 50% of the voting power for the election of directors is held by an individual, group or another company).

<sup>157</sup> *See* letters from AllianceBernstein; Duane Morris.

<sup>150</sup> *See* letter from P. Neuhauser.

<sup>151</sup> *See* letters from ABA; Duane Morris; Media General, Inc. (“Media General”); The New York Times Company (“New York Times”).

<sup>152</sup> *See* letter from T. Rowe Price.

<sup>153</sup> *See* letters from ABA; AllianceBernstein; Cleary; Seven Law Firms; Duane Morris LLP (“Duane Morris”); Sidley Austin.

may have other reasons for nominating candidates for director.<sup>158</sup>

#### d. "Debt Only" Companies

As proposed, Rule 14a-11 would allow eligible shareholders to submit director nominees at all companies subject to the Exchange Act proxy rules other than companies that are subject to the proxy rules solely because they have a class of debt securities registered under Section 12 of the Exchange Act. We sought comment on whether this exclusion from Rule 14a-11 was appropriate.

Commenters that specifically addressed this question agreed with our approach and stated generally that Rule 14a-11 should not apply to companies subject to the Federal proxy rules solely because they have a class of debt securities registered under Exchange Act Section 12.<sup>159</sup> Most of these commenters stated that the ability to submit nominees for inclusion in a company's proxy materials should be limited to holders of equity securities registered under the Exchange Act.<sup>160</sup> One commenter warned that subjecting companies with a registered class of debt securities to Rule 14a-11 would deter private companies from accessing the public debt market and, in any case, private companies typically have shareholder agreements and other arrangements in place that address the election of directors.<sup>161</sup>

We are adopting this exclusion as proposed. We note that this approach was supported by investor and corporate commenters. We believe that Rule 14a-11 should not apply to companies that are subject to the Federal proxy rules solely because they have a class of debt securities registered under Section 12 of the Exchange Act.

<sup>158</sup> We note that controlled companies are not excluded from Rule 14a-8 despite the same improbability that a shareholder proposal will receive the approval of the majority of the votes cast at a controlled company. Shareholders may use Rule 14a-8 to submit a proposal to the board even though controlling shareholders may vote against the proposal and prevent it from being approved.

<sup>159</sup> See letters from ABA; CII; Cleary; S&C.

<sup>160</sup> See letters from ABA; Cleary; S&C.

<sup>161</sup> See letter from S&C. This commenter also stated that Rule 14a-11 should not apply to those reporting companies who voluntarily continue to file Exchange Act reports while they are not required to do so under Exchange Act Section 13(a) or Section 15(d). It argued that these voluntary filers should be treated the same as companies with Exchange Act reporting obligations relating solely to debt securities. We note that Rule 14a-11 will not apply to a company filing Exchange Act reports when neither Exchange Act Section 13(a) nor Section 15(d) requires that it do so (for example, to comply with a covenant contained in an indenture relating to outstanding debt securities).

e. Application of Exchange Act Rule 14a-11 to Companies That Voluntarily Register a Class of Securities Under Exchange Act Section 12(g)

In the Proposing Release, we noted that Rule 14a-11 would apply to companies that have voluntarily registered a class of equity securities pursuant to Exchange Act Section 12(g); however, we solicited comment on whether Rule 14a-11 should apply to these companies.<sup>162</sup> We also asked whether nominating shareholders of these companies should be subject to the same ownership eligibility thresholds as those shareholders of companies that were required to register a class of equity securities pursuant to Section 12, or whether we should adjust any other aspects of Rule 14a-11 for these companies.

Three commenters stated that Rule 14a-11 should apply to companies that voluntarily register a class of equity securities under Exchange Act Section 12(g).<sup>163</sup> One explained that investors in securities registered under Section 12 should be provided some assurance that the company is subject to various rules safeguarding their interests, such as the proposed rule, and expressed concern that less than uniform application could lead to investor confusion.<sup>164</sup> One commenter stated that nominating shareholders of voluntarily-registered companies should be subject to the same ownership thresholds as shareholders of companies that were required to register a class of securities under Exchange Act Section 12.<sup>165</sup>

We agree with the commenters that Rule 14a-11 generally should apply to those companies that choose to avail themselves of the obligations and benefits of Section 12(g) registration. As Section 12 registrants, these companies are subject to the full panoply of the Exchange Act, including Section 14(a), and their shareholders receive proxy materials in connection with annual and special meetings of shareholders in accordance with the proxy rules. We believe disparate treatment among these Section 12 registrants is unwarranted and shareholders of these companies

<sup>162</sup> A company must register a class of equity securities under Section 12(g) if, on the last day of its fiscal year, the class of equity securities is held by 500 or more record holders and the company has total assets of more than \$10 million. An issuer may, however, register any class of equity securities under Section 12(g) even if these thresholds have not been met. Reporting after this form of voluntary registration is distinguished from a company that continues to file Exchange Act reports when neither Exchange Act Section 13(a) nor Section 15(d) requires that it do so. See footnote 161 above.

<sup>163</sup> See letters from ABA; CII; USPE.

<sup>164</sup> See letter from USPE.

<sup>165</sup> See letter from ABA.

should enjoy the same protections generally available to shareholders of other companies with a class of equity securities registered pursuant to Section 12. Accordingly, Rule 14a-11 will apply to companies that have voluntarily registered a class of equity securities pursuant to Exchange Act Section 12(g), with the same ownership eligibility thresholds as those of companies that were required to register a class of equity securities pursuant to Section 12.

#### f. Smaller Reporting Companies

Under the Proposal, Rule 14a-11 would apply to all companies subject to the proxy rules, other than companies that are subject to the proxy rules solely because they have a class of debt securities registered under Exchange Act Section 12. Thus, Rule 14a-11, as proposed, would apply to smaller reporting companies. We sought comment in the Proposal on what effect, if any, the application of Rule 14a-11 would have on any particular group of companies, and in particular, smaller reporting companies.<sup>166</sup>

A number of commenters stated generally that Rule 14a-11 should not apply to small businesses.<sup>167</sup> One commenter argued that Rule 14a-11 should be limited to accelerated filers and that there should possibly be a transition period where the rule was only applicable to large accelerated filers.<sup>168</sup> That commenter believed that

<sup>166</sup> The Commission has considered this issue on prior occasions. See, e.g., 2003 Proposal; Division of Corporation Finance, Briefing Paper for Roundtable Discussion on the Proposed Security Holder Director Nominations Rules, February 25, 2004, available at <http://www.sec.gov/spotlight/dir-nominations/dir-nom-briefing.htm>.

<sup>167</sup> See letters from ABA; American Mailing; All Cast; Always N Bloom; American Carpets; J. Arquilla; B. Armbrust; Artistic Land Designs; C. Atkins; Book Celler; K. Bostwick; Brighter Day Painting; Colletti; Commercial Concepts; Complete Home Inspection; D. Courtney; S. Crawford; Crespin; Don's; T. Ebreo; M. Eng; eWareness; Evans; Fluharty; Flutterby; Fortuna Italian Restaurant; Future Form; Glaspell; C. Gregory; Healthcare Practice; B. Henderson; S. Henning; J. Herren; A. Iriarte; J. Jones; Juz Kidz; Kernan; LMS Wine; T. Luna; Mansfield Children's Center; D. McDonald; Meister; Merchants Terminal; Middendorf; Mingo; Moore Brothers; Mouton; D. Mozack; Ms. Dee; G. Napolitano; NK; H. Olson; PESC; Pioneer Heating & Air Conditioning; RC; RTW; D. Sapp; SBB; SGLA; P. Sicilia; Slycers Sandwich Shop; Southern Services; Steele Group; Sylvron; Theragenics; E. Tremaine; Wagner; Wagner Industries; Wellness; West End; Y.M.; J. Young.

<sup>168</sup> See letter from ABA. A large accelerated filer is an issuer that, as of the end of its fiscal year, had an aggregate worldwide market value of voting and non-voting common equity held by its non-affiliates of \$700 million or more, as of the last business day of the issuer's most recently completed second fiscal quarter; has been subject to the reporting requirements of Section 13(a) or 15(d) of the Exchange Act for at least 12 calendar months; has filed at least one annual report pursuant to Section 13(a) or 15(d) of the Act; and is not eligible to use

smaller companies would have trouble recruiting directors because the pool of qualified directors is already small for smaller companies, and directors would not want to risk the exposure to a proxy contest. Another commenter argued that we should implement Rule 14a-11 on a pilot basis for large accelerated filers for two years and then revisit whether application of the rule would be appropriate for smaller companies.<sup>169</sup>

Other commenters stated that smaller reporting companies should not be excluded from the application of Rule 14a-11.<sup>170</sup> One commenter agreed with the Commission that exempting small entities would be inconsistent with the stated goals of the Proposal and the costs and burden for such entities would be minimal.<sup>171</sup> Other commenters believed that small companies are “just as likely” to have poorly functioning boards as their larger counterparts.<sup>172</sup> Another commenter argued that Rule 14a-11 would not impose a material burden on any company subject to the proxy rules because companies already have to distribute proxy cards and it would not be an imposition if they were required to add additional nominees to those cards.<sup>173</sup>

In the recently enacted Dodd-Frank Act, Congress confirmed our authority to require inclusion of shareholder nominees for director in company proxy materials.<sup>174</sup> In addition, in Section 971(c) of the Dodd-Frank Act Congress specifically provided the Commission with the authority to exempt an issuer or class of issuers from requirements adopted for the inclusion of shareholder director nominations in company proxy materials. In doing so, this provision instructs the Commission to take into account whether such requirement for the inclusion of shareholder nominees for director in company proxy materials

the requirements for smaller reporting companies for its annual and quarterly reports. See Exchange Act Rule 12b-2(2).

<sup>169</sup> See letter from Theragenics. See also letter from Alston & Bird, recommending that we consider adopting a phase-in approach, whereby companies would be permitted to follow a phase-in schedule for mandatory compliance based on their size, similar to the Commission’s rules regarding internal controls reporting and XBRL. See *Management’s Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports*, Release No. 33-8238; 34-47968 [69 FR 9722] (June 5, 2003) and *Interactive Data to Improve Financial Reporting*, Release No. 33-9002; 34-59324 [74 FR 6776] (Jan. 30, 2009).

<sup>170</sup> See letters from AFSCME; CII; D. Nappier.

<sup>171</sup> See letter from CII.

<sup>172</sup> See letters from AFSCME; D. Nappier.

<sup>173</sup> See letter from USPE.

<sup>174</sup> Dodd-Frank Act §§ 971(a) and (b).

disproportionately burdens small issuers.<sup>175</sup>

After considering the comments, amended Section 14(a), and Section 971(c) of the Dodd-Frank Act, we continue to believe that Rule 14a-11 should apply regardless of company size, as was proposed. As noted above, the purpose of Rule 14a-11 is to facilitate the exercise of shareholders’ traditional State law rights to nominate and elect directors to company boards of directors and thereby enable shareholders to participate more meaningfully in the nomination and election of directors at the companies in which they invest. We are not persuaded that exempting smaller reporting companies would be consistent with these goals. As stated above, we expect the rule changes will further investor protection by facilitating shareholder rights to nominate and elect directors and providing shareholders a greater voice in the governance of the companies in which they invest. We believe shareholders of smaller reporting companies should be afforded these same protections.

Nonetheless, we recognize that smaller reporting companies may have had less experience with existing forms of shareholder involvement in the proxy process (e.g., Rule 14a-8 proposals), and thus may have less developed infrastructures for managing these matters. We believe that a delayed effective date for smaller reporting companies should allow those companies to observe how the rule operates for other companies and should allow them to better prepare for implementation of the rules. We also believe that delayed implementation for these companies will allow us to evaluate the implementation of Rule 14a-11 by larger companies and provide us with the additional opportunity to consider whether adjustments to the

<sup>175</sup> Dodd-Frank Act § 971(c). A comment letter on July 28, 2010 from the Society of Corporate Secretaries & Governance Professionals invoked this new legislation in support of a request to re-open the period for comment on the Proposal as it relates to small companies. As noted, we did specifically request comment in the Proposal on the rule’s effect on smaller reporting companies, and we received and have considered numerous comments on this topic. Accordingly, we believe we have substantially achieved the objective stated in that letter, namely to identify and evaluate any “unique and significant challenges that access to the proxy will create for small and mid-sized companies.” Moreover, our determination to delay implementation of Rule 14a-11 in respect of smaller companies will further allow us to evaluate the implementation of Rule 14a-11 by larger companies and provide us with the additional opportunity to consider whether adjustments to the rule would be appropriate for smaller reporting companies.

rule would be appropriate for smaller reporting companies before the rule becomes applicable to them. Therefore, we are delaying implementation for companies that meet the definition of smaller reporting company in Exchange Act Rule 12b-2.<sup>176</sup> New Rule 14a-11 will become effective for these companies three years after the date that the rules become effective for companies other than smaller reporting companies. In addition, as discussed below, in an effort to limit the cost and burden on all companies subject to the rule, including smaller reporting companies, we have limited use of Rule 14a-11 to nominations by shareholders who have maintained significant continuous holdings in the company for an extended period of time. As discussed further below, we have extended the required holding period to at least three years at the time the notice of nomination is filed with the Commission and transmitted to the company. In addition, we have made modifications to the ownership threshold that, in combination with the three-year holding period, we believe should facilitate shareholders’ ability to exercise their State law rights to nominate and elect directors without unduly burdening companies, including smaller reporting companies. We proposed a tiered ownership threshold that included a 5% ownership threshold for non-accelerated filers; however, we are adopting a 3% ownership threshold for all companies subject to the rule. In adopting the uniform 3% ownership threshold, we carefully considered, among other factors, the potential that

<sup>176</sup> See Exchange Act Rule 12b-2. A smaller reporting company is defined as “an issuer that is not an investment company, an asset-backed issuer, or a majority-owned subsidiary of a parent that is not a smaller reporting company and that: had a public float of less than \$75 million as of the last business day of its most recently completed second fiscal quarter, computed by multiplying the aggregate worldwide number of shares of its voting and non-voting common equity held by non-affiliates by the price at which the common equity was last sold, or the average of the bid and asked prices of common equity, in the principal market for the common equity; or in the case of an initial registration statement under the Securities Act or Exchange Act for shares of its common equity, had a public float of less than \$75 million as of a date within 30 days of the date of the filing of the registration statement, computed by multiplying the aggregate worldwide number of such shares held by non-affiliates before the registration plus, in the case of a Securities Act registration statement, the number of such shares included in the registration statement by the estimated public offering price of the shares; or in the case of an issuer whose public float as calculated under paragraph (1) or (2) of this definition was zero, had annual revenues of less than \$50 million during the most recently completed fiscal year for which audited financial statements are available.” Whether or not an issuer is a smaller reporting company is determined on an annual basis.

the rule would have a disproportionate impact on small issuers. Despite identifying that concern in the Proposal, however, the comments we received did not substantiate that concern, and comments from companies overwhelmingly supported uniform ownership thresholds for all public companies. Moreover, the data we examined did not indicate any substantial difference in share ownership concentrations between large accelerated filers and non-accelerated filers. Thus, we expect that the eligibility requirements will help achieve the stated objectives of the rule without disproportionately burdening any particular group of companies.

#### 4. Who Can Use Exchange Act Rule 14a-11

##### a. General

In an effort to facilitate fair corporate suffrage, we could have proposed and adopted a rule pursuant to which the ability to use Rule 14a-11 would be conditioned solely on whether the shareholder lawfully could nominate a director, and not include any ownership thresholds or holding period. However, we believe it is appropriate to take a measured approach that balances competing interests and seeks to ensure investor protection. Accordingly, Rule 14a-11 will be available to shareholders that hold a significant, long-term interest in the company, have provided timely notice of their intent to include a nominee in the company's proxy materials, and provide specified disclosure concerning themselves and their nominees. More specifically, as described in detail in this section, a company will be required to include a shareholder nominee or nominees if the nominating shareholder or group:<sup>177</sup>

- Holds, as of the date of the shareholder notice on Schedule 14N,<sup>178</sup> either individually or in the aggregate,<sup>179</sup> at least 3% of the voting

power (calculated as required under the rule)<sup>180</sup> of the company's securities that are entitled to be voted on the election of directors at the annual meeting of shareholders (or, in lieu of such an annual meeting, a special meeting of shareholders) or on a written consent in lieu of a meeting;<sup>181</sup>

- Has held the qualifying amount of securities used to satisfy the minimum ownership threshold continuously for at least three years as of the date of the shareholder notice on Schedule 14N (in the case of a shareholder group, each member of the group must have held the amount of securities that are used to satisfy the ownership threshold continuously for at least three years as of the date of the shareholder notice on Schedule 14N);<sup>182</sup>

- Continues to hold the required amount of securities used to satisfy the ownership threshold through the date of the shareholder meeting;<sup>183</sup>

- Is not holding any of the company's securities with the purpose, or with the effect, of changing control of the company or to gain a number of seats on the board of directors that exceeds the maximum number of nominees that the company could be required to include under Rule 14a-11;<sup>184</sup>

- Does not have an agreement with the company regarding the nomination;<sup>185</sup>

- Provides a notice to the company on Schedule 14N, and files the notice with the Commission,<sup>186</sup> of the nominating shareholder's or group's intent to require that the company include that nominating shareholder's or group's nominee in the company's proxy materials no earlier than 150 calendar days, and no later than 120 calendar days, before the anniversary of the date that the company mailed its proxy materials for the prior year's annual meeting;<sup>187</sup> and

- Includes the certifications required in the shareholder notice on Schedule 14N.<sup>188</sup>

##### b. Ownership Threshold

As proposed, a nominating shareholder or group would have been required to beneficially own 1%, 3%, or 5% of the company's securities entitled to be voted on the election of directors at the shareholder meeting, depending on the company's accelerated filer status or, in the case of registered investment companies, depending on the net assets of the company. We received significant comment on this topic, which we discuss further below, and have made alterations to the final rule to reflect the concerns expressed by commenters.

As adopted, to rely on Rule 14a-11, a nominating shareholder or group will be required to hold, as of the date of the shareholder notice on Schedule 14N, either individually or in the aggregate, at least 3% of the voting power of the company's securities that are entitled to be voted on the election of directors at the annual (or a special meeting in lieu of the annual) meeting of shareholders or on a written consent in lieu of a meeting. The nominating shareholder or group or member of a nominating shareholder group will be required to hold both the power to dispose of and the power to vote the securities, as discussed below. The nominating shareholder or member of a nominating shareholder group also will be required to have held the qualifying amount of securities for at least three years as of the date of the notice on Schedule 14N, and to hold that amount through the date of the election of directors. Each aspect of the ownership requirement is discussed further below.

proxy statement, increasing the year by one, and counting back 150 calendar days and 120 calendar days for the beginning and end of the window period, respectively. In this regard, we note that the deadline could fall on a Saturday, Sunday or holiday. In such cases, the deadline should be treated as the first business day following the Saturday, Sunday or holiday, similar to the treatment filing deadlines receive under Exchange Act Rule 0-3. See Instruction 1 to Rule 14a-11(b)(10). If the company did not hold an annual meeting during the prior year, or if the date of the meeting has changed by more than 30 days from the prior year, then the nominating shareholder or group must provide notice pursuant to new Item 5.08 a reasonable time before the company mails its proxy materials, as specified by the company in a Form 8-K filed within four business days after the company determines the anticipated meeting date. See new Rule 14a-11(b)(10) and Instruction 2 to that paragraph. See further discussion in Section II.B.8.c.ii.

<sup>188</sup> See new Rule 14a-11(b)(11) and Item 8 of new Schedule 14N. Pursuant to new Schedule 14N, the nominating shareholder or group would be required to include in its notice to the company a certification that the nominating shareholder or group satisfies the requirements in Rule 14a-11.

<sup>177</sup> In some circumstances, the requirements of Rule 14a-11 applicable to a nominating shareholder group must be satisfied by each member of the group individually (e.g., no member of the group may be holding the company's securities with the purpose of, or with the effect, of changing control of the company or to gain more than the maximum number of nominees that the registrant would be required to include under the rule). See also Section II.B.4.

<sup>178</sup> Throughout this release, when we say "as of the date of the notice on Schedule 14N" we mean the date the nominating shareholder or group files the Schedule 14N with the Commission and transmits the notice to the company. See Section II.B.8.c.ii. below for a further discussion of the timing requirements for filing a Schedule 14N.

<sup>179</sup> The manner in which a nominating shareholder or group would establish its eligibility to use new Rule 14a-11 is discussed further in Section II.B.4.b.iv. below.

<sup>180</sup> See Instruction 3 to new Rule 14a-11(b)(1).

<sup>181</sup> See new Rule 14a-11(b)(1).

<sup>182</sup> See new Rule 14a-11(b)(2). The three-year holding period requirement applies only to the amount of securities that are used for purposes of determining the ownership threshold.

<sup>183</sup> See new Rule 14a-11(b)(2).

<sup>184</sup> See new Rule 14a-11(b)(6).

<sup>185</sup> See new Rule 14a-11(b)(7).

<sup>186</sup> See Section II.B.8. for a discussion of new Schedule 14N and the disclosures required to be filed. The Schedule 14N may be filed by an individual shareholder that meets the ownership threshold, an individual shareholder that is a member of a nominating shareholder group that is aggregating the individual members' securities to meet the ownership threshold but is choosing to file the notice on Schedule 14N individually, or a nominating shareholder group through their authorized representative, as provided for in Rule 14n-1(b)(1).

<sup>187</sup> The dates would be calculated by determining the release date disclosed in the previous year's

## i. Percentage of Securities

We proposed tiered ownership thresholds for large accelerated, accelerated, and non-accelerated filers in an effort to address the possibility that certain companies could be affected disproportionately based on their size.<sup>189</sup> Many commenters criticized the proposed ownership thresholds or recommended generally higher thresholds.<sup>190</sup> Of these, most commenters criticized the tiered ownership thresholds and recommended a uniform ownership threshold generally higher than the proposed thresholds.<sup>191</sup> Many of these

<sup>189</sup> Similarly, we proposed tiered ownership thresholds for registered investment companies with the tiers based on net assets.

<sup>190</sup> See letters from 26 Corporate Secretaries; ABA; Australian Council of Superannuation Investors (“ACSI”); ADP; Advance Auto Parts; Aetna; Alaska Air; Alcoa Inc. (“Alcoa”); Allstate; American Express; Anadarko; Applied Materials; Association of Corporate Counsel; AT&T; Avis Budget; Barclays; Best Buy; J. Blanchard; Boeing; BorgWarner; BRT; Burlington Northern; R. Burt; Calvert Group, Ltd. (“Calvert”); Caterpillar; CFA Institute; Chevron; J. Chico; Committee on Investment of Employee Benefit Assets (“CIEBA”); CIGNA; Peter Clapman (“P. Clapman”); Cleary; CNH Global; Comcast; Con Edison; Capital Research and Management Company (“CRMC”); CSX; Cummins; Darden Restaurants; Davis Polk; Deere; Dewey; W. Brinkley Dickerson, Jr. (“W. B. Dickerson”); J. Dillon; DTE Energy; DuPont; Craig Dwight (“C. Dwight”); Eaton; Edison Electric Institute; Eli Lilly; Emerson Electric; eWareness; ExxonMobil; FedEx; Financial Services Roundtable; FMC Corp.; FPL Group; GE; General Mills; A. Goolsby; Home Depot; Honeywell; IBM; ICI; Intel; ITT; JPMorgan Chase; J. Kiltz; Koppers; E.J. Kullman; N. Lautenbach; Leggett; Lionbridge Technologies, Inc. (“Lionbridge Technologies”); Lorsch *et al.*; M. Metz; McDonald’s; MeadWestvaco; J. Miller; Motorola; Norfolk Southern; Northrop Grumman Corporation (“Northrop”); Office Depot; PepsiCo; Pfizer; P&G; Praxair, Inc. (“Praxair”); Protective; Stephen Lange Ranzini (“S. Ranzini”); Rosen; Ryder; Sara Lee; S&C; Seven Law Firms; Shearman & Sterling; Sherwin-Williams; SIFMA; Society of Corporate Secretaries; Southern Company; Tenet; Tesoro; Textron; TI; TIAA-CREF; Tidewater Inc. (“Tidewater”); Tompkins Financial Corporation (“Tompkins”); G. Tooker; T. Rowe Price; tw telecom; L. Tyson; UnitedHealth; U.S. Bancorp; ValueAct Capital; Vanguard; Verizon Communications Inc. (“Verizon”); Bruno de la Villarmois (“B. Villarmois”); Wachtell; Wells Fargo; Weyerhaeuser; Xerox.

<sup>191</sup> See letters from ACSI; ADP; Advance Auto Parts; Allstate; American Express; Applied Materials; Association of Corporate Counsel; AT&T; Avis Budget; Barclays; Best Buy; J. Blanchard; Boeing; BRT; Burlington Northern; R. Burt; Calvert; Caterpillar; CFA Institute; J. Chico; CIGNA; CNH Global; Comcast; Con Edison; CSX; Darden Restaurants; Davis Polk; Deere; Dewey; W. B. Dickerson; J. Dillon; DTE Energy; DuPont; Eaton; Edison Electric Institute; Eli Lilly; Emerson Electric; ExxonMobil; FedEx; Financial Services Roundtable; FMC Corp.; FPL Group; General Mills; Home Depot; IBM; Intel; ITT; JPMorgan Chase; J. Kiltz; E.J. Kullman; Lorsch *et al.*; McDonald’s; M. Metz; Motorola; N. Lautenbach; Office Depot; PepsiCo; Praxair; Protective; S. Ranzini; Sara Lee; S&C; Seven Law Firms; Shearman & Sterling; Sherwin-Williams; Society of Corporate Secretaries; Southern Company; Tesoro; Textron; TI; TIAA-CREF; Tompkins; G. Tooker; T. Rowe Price; tw

commenters questioned whether the data on shareholdings discussed in the Proposal in relation to the proposed thresholds took into account the fact that shareholders could aggregate their holdings in order to use Rule 14a-11.<sup>192</sup> One of these commenters described formation of a nominating group as “the most likely scenario” to qualify for use of Rule 14a-11,<sup>193</sup> and another commenter submitted that with a significant ownership threshold an “inability to aggregate shareholders to reach the ownership threshold is unreasonable.”<sup>194</sup>

A few commenters criticized generally the proposed thresholds as too high and recommended lower thresholds.<sup>195</sup> One commenter opposed the tiered ownership thresholds because a number of companies regularly move from one category of filer to another as the aggregate worldwide market value of their voting and non-voting common equity changes from fiscal year to fiscal year, which the commenter believed would lead to uncertainty under the Commission’s tiered approach.<sup>196</sup> Commenters from the investment company industry noted that the proposed eligibility thresholds were based on data for non-investment companies and were not supported by empirical data analysis for investment companies.<sup>197</sup>

On the other hand, we also received comment generally supporting the proposed tiered ownership thresholds.<sup>198</sup> One commenter expressed general support for the proposed thresholds and stated that the proposed thresholds would achieve the Commission’s and commenter’s shared objective of facilitating the exercise of shareholders’ nomination rights.<sup>199</sup> Another commenter explained that the thresholds would “ensure [ ] that only those long-term shareholders who are

telecom; L. Tyson; UnitedHealth; U.S. Bancorp; ValueAct Capital; Vanguard; Verizon; Weyerhaeuser; Xerox.

<sup>192</sup> See letters from ABA; ABA II; BRT; Business Roundtable (January 19, 2010) (“BRT II”); Cleary; Davis Polk; Honeywell; SIFMA.

<sup>193</sup> Letter from BRT II.

<sup>194</sup> Letter from California State Teachers’ Retirement System (Nov. 18, 2009) (“CalSTRS II”).

<sup>195</sup> See letters from Committee of Concerned Shareholders (“Concerned Shareholders”); L. Dallas; USPE.

<sup>196</sup> See letter from Shearman & Sterling.

<sup>197</sup> See, e.g., letters from ICI; S&C; T. Rowe Price.

<sup>198</sup> See letters from AFL-CIO; AFSCME; British Insurers; CalPERS; CalSTRS; COPERA; CRMC; Florida State Board of Administration; Glass Lewis; IAM; ICGN; LACERA; Marco Consulting; D. Nappier; Nathan Cummings Foundation; P. Neuhauser; Norges Bank; OPERS; Pax World; RiskMetrics; David E. Romine (“D. Romine”); Shamrock; Sodali; Teamsters; WSIB.

<sup>199</sup> See letter from CII.

seriously concerned about the governance of portfolio companies will have a seat at the table.”<sup>200</sup>

With regard to an appropriate uniform ownership threshold, commenters recommended a number of different possibilities, including:

- At least 1% of the company’s outstanding shares for an individual shareholder and 5% for a group of shareholders;<sup>201</sup>
- At least 2% of a company’s voting securities;<sup>202</sup>
- 3% of a company’s shares;<sup>203</sup>
- 5% of the company’s voting securities for an individual shareholder and 10% for a group of shareholders;<sup>204</sup>
- 5% of a company’s outstanding shares;<sup>205</sup>
- 5% of a company’s outstanding shares for an individual shareholder and a higher but unspecified threshold for a group of shareholders;<sup>206</sup>
- With regard to investment companies, a 5% threshold;<sup>207</sup>
- From 5% to 10% of a company’s shares;<sup>208</sup>
- 10% of the company’s shares;<sup>209</sup>
- 10% of the company’s outstanding shares for an individual shareholder and 15% of the outstanding shares for a group of shareholders;<sup>210</sup>
- 5% to 15% of the company’s outstanding shares;<sup>211</sup>

<sup>200</sup> Letter from AFL-CIO.

<sup>201</sup> See letter from Deere.

<sup>202</sup> See letter from ADP.

<sup>203</sup> See letters from CSI; Calvert; CFA Institute; Labour Union Co-operative Retirement Fund (“LUCRF”); S. Ranzini.

<sup>204</sup> See letters from Advance Auto Parts; Alaska Air; American Express; Association of Corporate Counsel; Avis Budget; Best Buy; J. Blanchard; Boeing; BRT; Burlington Northern; Callaway; CIGNA; CNH Global; Comcast; Con Edison; Darden Restaurants; Dewey; J. Dillon; DTE Energy; DuPont; Eaton; Edison Electric Institute; Eli Lilly; Emerson Electric; ExxonMobil; FedEx; FMC Corp.; FPL Group; General Mills; Home Depot; Intel Corporation (“Intel”); JPMorgan Chase; E.J. Kullman; McDonald’s; N. Lautenbach; PepsiCo; Praxair; Protective (recommending this threshold if its proposed 35% withhold vote triggering event is not included; if included, it recommended a 3% threshold); Sara Lee; Seven Law Firms; Sherwin-Williams; Society of Corporate Secretaries; Textron; Tompkins; G. Tooker; Weyerhaeuser; Xerox.

<sup>205</sup> See letters from Applied Materials; R. Burt; CSX; Financial Services Roundtable; IBM (recommending 5% as one of the two acceptable thresholds); ITT; J. Kiltz; Shearman & Sterling; Southern Company; Tesoro; TIAA-CREF; T. Rowe Price; tw telecom; UnitedHealth; U.S. Bancorp; Verizon.

<sup>206</sup> See letters from Applied Materials; U.S. Bancorp.

<sup>207</sup> See letters from S&C; TIAA-CREF.

<sup>208</sup> See letters from Davis Polk; Lorsch *et al.*

<sup>209</sup> See letters from Allstate; Caterpillar; J. Chico; W. B. Dickerson; IBM (recommending 10% as one of the two acceptable thresholds); ICI; M. Metz; Office Depot; L. Tyson; ValueAct Capital; Vanguard.

<sup>210</sup> See letter from Motorola.

<sup>211</sup> See letter from Barclays.



- 15% of the company's shares;<sup>212</sup> and

- 20% of a company's shares.<sup>213</sup>

Two of the commenters that criticized the proposed threshold as too high recommended that Rule 14a-11 have the same ownership threshold as Rule 14a-8,<sup>214</sup> with one of these commenters expressing the belief that the proposal, with its ownership thresholds, would enable only institutional shareholders to access the corporate ballot.<sup>215</sup> Another of the commenters opposing the proposed thresholds asserted that the threshold for non-accelerated filers is too high and cited figures indicating that a significant number of such filers do not have any shareholders that would satisfy the proposed threshold.<sup>216</sup> This commenter suggested that for an individual shareholder or a group of shareholders, the threshold should be based on the dollar value of the shares held (e.g., \$250,000) or a lower percentage of shares (e.g., 0.25%).

After considering the comments, we believe that it is appropriate to apply a uniform 3% ownership threshold to all companies subject to the rule, regardless of whether they are classified as large accelerated, accelerated, or non-accelerated filers under the Federal securities laws. As an initial matter, as we did at the time we issued the Proposing Release, we considered whether and why Rule 14a-11 should include any ownership threshold. Because the Commission's proxy rules seek to enable the corporate proxy process to function, as nearly as possible, as a replacement for in-person participation at a meeting of shareholders, some may argue that once a shareholder has satisfied any procedural requirements to a director nomination that a company is allowed to impose under State law, then that nomination should be included in the company's proxy materials. Each time we consider and adopt amendments to our rules, however, we balance competing interests.

Based on our consideration of these competing interests, including balancing and facilitating shareholders' ability to participate more fully in the nomination and election process against the potential cost and disruption of the amendments, we have determined that

requiring a significant ownership threshold is appropriate to use Rule 14a-11. Indeed, we believe that the 3% ownership threshold—combined with the other requirements of the rule—properly addresses the potential practical difficulties of requiring inclusion of shareholder director nominations in a company's proxy materials, and some concerns that both company management and other shareholders may have about the application of Rule 14a-11. Providing this balanced, practical, and measured limitation in Rule 14a-11 is consistent with the approach we have taken in many of our other proxy rules<sup>217</sup> and reflects our desire to proceed cautiously with these new amendments to our rules.

We also considered whether the ownership threshold we adopt for Rule 14a-11 should be tiered based on the size and related filing status (or net assets) of the company, or uniform for all companies, and what percentage of ownership would be most appropriate. We have decided to adopt a uniform standard for all companies for several reasons. First, we determined that a uniform standard would reduce the complexities of Rule 14a-11. As noted by one commenter,<sup>218</sup> the potential for the filing status of a company to change would result in uncertainty about the availability of the provisions of Rule 14a-11 as a result of market fluctuations in share prices, acquisitions, or divestitures. A uniform standard avoids that uncertainty and the resulting potential for the costs and burdens of disputes over the selection of the appropriate tier. Elimination of that uncertainty, moreover, would make the availability of Rule 14a-11 more predictable and therefore more useful for shareholders in planning nominations in reliance on the rule. A uniform standard also will avoid any ability on the part of management to structure corporate actions to modify the impact of Rule 14a-11 by placing the company in a different tier. The

<sup>217</sup> See, e.g., Exchange Act Rule 14a-8(b) (requiring shareholders to have "continuously held at least \$2,000 in market value, or 1%, of the company's securities entitled to be voted on the proposal at the meeting for at least one year by the date" they submit a shareholder proposal); Exchange Act Rule 14a-6(g) (requiring a soliciting person that "owns beneficially securities of the class which is the subject of the solicitation with a market value of over \$5 million" to file a notice with the Commission); Regulation S-K, Item 404(a) (requiring disclosure of transactions with related parties that exceed \$120,000).

<sup>218</sup> See letter from Shearman & Sterling.

concern we expressed in the Proposal—that companies could be disproportionately affected by adoption of the rule based on their size—was not supported by comments of potentially affected companies; to the contrary, comments from companies overwhelmingly supported uniform ownership thresholds.<sup>219</sup> In addition, as discussed below, we are deferring implementation of Rule 14a-11 for smaller reporting companies.<sup>220</sup>

A comparison of the share ownership concentrations in large accelerated filers and non-accelerated filers produced relatively minor observable difference. The results, adjusted to give effect to a three-year holding period requirement, are summarized in the table below:<sup>221</sup>

<sup>219</sup> See letters from General Mills; Tesoro; T. Rowe Price; ValueAct Capital; Verizon (explicitly opposing variation in percentage ownership requirement based on issuer size); and letters identified in footnotes 199-211 above (commenters supporting various uniform ownership thresholds).

<sup>220</sup> As noted in Section II.B.3.f., we have adopted a three-year delay in implementation for smaller reporting companies.

<sup>221</sup> The percentages in the table are derived from the data set described in the Proposing Release involving companies that have held meetings between January 1, 2008 and April 15, 2009 (the "Proposing Release data"). See Section III.B.3. of the Proposing Release. The percentages have been adjusted, however, because the Proposing Release data did not give effect to any holding period requirement, and we have attempted to estimate what those percentages would have been had they given effect to the three-year holding period we are adopting. By the calculation described below, we have estimated a reasonable adjustment to the reported percentages in the Proposing Release data by using the data presented in a November 24, 2009 memorandum based on the analysis of Schedule 13F filings, data which did give effect to holding period requirements. See Memorandum from the Division of Risk, Strategy, and Financial Innovation regarding the Share Ownership and Holding Period Patterns in 13F data (November 24, 2009), available at <http://www.sec.gov/comments/s7-10-09/s71009-576.pdf> (the "November 2009 Memorandum"). The two data sets have overlapping statistics that can be used for comparison and adjustment: Both sets report percentages of a broad sample of public companies and identify percentages of companies having (i) at least one shareholder with holdings of 3% or more, (ii) at least two shareholders with holdings of 3% or more, (iii) at least one shareholder with holdings of 1% or more, and (iv) at least two shareholders with holdings of 1% or more. Comparing the percentages reflected in the November 2009 Memorandum (giving effect to a three-year holding period requirement) with the percentages in the Proposing Release data (not reflecting any holding period requirement), we observe that the percentages reported in the Proposing Release data exceed the percentages reported in the November 2009 memorandum by amounts ranging from 56% to 69%. In order to derive the approximate percentages in the table, we adjusted downward by 62.5% the percentages reported in the Proposing Release data, to account at least approximately for the application of the three-year holding period requirement.

<sup>212</sup> See letter from TI.

<sup>213</sup> See letter from AT&T.

<sup>214</sup> See letters from Concerned Shareholders; USPE.

<sup>215</sup> See letter from Concerned Shareholders.

<sup>216</sup> See letter from L. Dallas.

	Non-accelerated filers (approximate percentages)	Large accelerated filers (approximate percentages)
Companies with at least one 1% shareholder .....	37	37
Companies with at least one 3% shareholder .....	33	32
Companies with at least one 5% shareholder .....	22	16
Companies with at least two 1% shareholders .....	36	37
Companies with at least two 1.5% shareholders .....	33	33
Companies with at least two 2.5% shareholders .....	27	25

Our further review of relevant data has persuaded us that applying different ownership thresholds to large accelerated filers and non-accelerated filers is not justified.<sup>222</sup>

As noted above, we have decided to adopt a uniform ownership threshold for all categories of public companies. We determined that a 3% ownership threshold is an appropriate standard for all such companies—not just accelerated filers. We believe that the 3% threshold, while higher for many companies and lower for others than the thresholds advanced in the Proposal, properly balances our belief that Rule 14a–11 should facilitate shareholders’ traditional State law rights to nominate and elect directors with the potential costs and impact of the amendments on companies. The ownership threshold we are establishing should not expose issuers to excessively frequent and costly election contests conducted through use of Rule 14a–11, but it is also not so high as to make use of the rule unduly inaccessible as a practical matter.

We selected the uniform 3% threshold based upon comments received, our analysis of the data available to us, and the fact that the rule allows for shareholders to form groups to aggregate their holdings to meet the threshold. We also considered that our amendments to Rule 14a–8 remove barriers to the ability of shareholders to have proposals included in company proxy materials to establish a procedure under a company’s governing documents for the inclusion of one or more nominees in the company’s proxy materials. Because of these amendments, shareholders who believe the 3% threshold is too high can take steps to seek to establish a lower ownership threshold.<sup>223</sup>

<sup>222</sup> See letter from P. Neuhauser (suggesting only two ownership eligibility tiers because data show “almost no difference in ownership characteristics between smaller accelerated filers and non-accelerated filers.”).

<sup>223</sup> As noted in Section II.C., we are adopting an amendment to Rule 14a–8(i)(8) to preclude companies from relying on that basis to exclude from their proxy materials shareholder proposals that seek to establish a procedure under a

We note that we considered a lower threshold, such as 1%, and a higher threshold, such as 5%, both of which were thresholds in the proposed tiers. Quite a few commenters, including a number who generally supported the adoption of Rule 14a–11, advocated for an ownership threshold higher than the 1% level we proposed for large accelerated filers.<sup>224</sup> One large institutional investor, for example, “strongly urg[ed] the adoption of proposed Rule 14a–11” and argued that “existing reforms are incomplete as long as boards retain the exclusive control of the proxy card and sole discretion over the mechanisms that govern their own elections,” but also stated the belief that “in order to use company resources to nominate a director, a significant amount of capital must be represented and 5% is an acceptable threshold.”<sup>225</sup> Similarly, the manager of a large family of investment companies stated its “support [for] the Commission’s intent to facilitate shareholders’ rights to participate in the governance process,” yet commented that “a 1% threshold is too low, in our opinion, to maintain the critical balance between serving the interests of eligible nominating shareholders and serving the interests of a company’s shareholder base at large.”<sup>226</sup> That commenter recommended a “flat 5% threshold for all companies” because it “represents significant economic stake.” Other commenters recommended a uniform 3% ownership threshold in the interest of avoiding “frivolous or vexatious nominations,”<sup>227</sup> or because it “is not so small that it would allow a board nomination for only a de minimis investment in [a non-accelerated filer],”

company’s governing documents for the inclusion of one or more shareholder director nominees in the company’s proxy materials. Such a shareholder proposal would, of course, have to satisfy the other requirements of the rule, like other Rule 14a–8 shareholder proposals.

<sup>224</sup> See letters from ACSI (advocating a uniform 3% threshold); Calvert (same); LUCRF (same); S. Ranzini (same); TIAA–CREF (advocating a uniform 5% threshold); T. Rowe Price (same).

<sup>225</sup> Letter from TIAA–CREF.

<sup>226</sup> Letter from T. Rowe Price.

<sup>227</sup> Letters from SCSI and LUCRF.

but “would not be so large as to prevent all but the largest institutional shareowners to submit nominees for [large accelerated filers].”<sup>228</sup>

In light of such comments we have determined not to adopt the 1% threshold we had proposed with respect to large accelerated filers. We also have determined not to adopt, as the uniform standard, the 5% threshold we had proposed for non-accelerated filers. Several commenters from the investor community explicitly opposed a 5% uniform threshold, maintaining that it would as a practical matter exclude all but the largest institutional investors.<sup>229</sup> On the other hand, although some companies supported a uniform 5% threshold,<sup>230</sup> most other companies urged the adoption of a substantially higher threshold, either for individual shareholders or for shareholder groups, or both. For example, companies and their counsel generally believed a higher threshold should apply to group nominations and overwhelmingly recommended a 10% minimum ownership requirement for nominations by shareholder groups.<sup>231</sup> We note, however, that at a 10% threshold for groups, the likelihood of forming a group sufficient to meet the minimum ownership requirement would likely be significantly reduced compared to a 3% threshold. Given a three-year holding period, the data in the November 2009 Memorandum identify combinations

<sup>228</sup> Letter from CFA Institute.

<sup>229</sup> See letters from CFA Institute; P. Neuhauser; RiskMetrics.

<sup>230</sup> See letters from CSX; IIT; Southern Company; Tesoro; tw telecom; UnitedHealth; Verizon.

<sup>231</sup> See letters from Advance Auto Parts; Alaska Air; American Express; Association of Corporate Counsel; Avis Budget; Best Buy; J. Blanchard; Boeing; BRT; Burlington Northern; Callaway; CIGNA; CNH Global; Comcast; Con Edison; Darden Restaurants; Dewey; J. Dillon; DTE Energy; DuPont; Eaton; Edison Electric Institute; Eli Lilly; Emerson Electric; ExxonMobil; FedEx; FMC Corp.; FPL Group; General Mills; Home Depot; Intel; JPMorgan Chase; E.J. Kullman; McDonald’s; N. Lautenbach; PepsiCo; Praxair; Protective (recommending this threshold if its proposed 35% withhold vote triggering event is not included; if included, it recommended a 3% threshold); Sara Lee; Seven Law Firms; Sherwin-Williams; Society of Corporate Secretaries; Textron; Tompkins; G. Tooker; Weyerhaeuser; Xerox.

totaling 10% or more but involving five or fewer shareholders as achievable in as little as 7% of public companies, compared to at least 21% of public companies at a 5% threshold and at least 31% of public companies at a 3% threshold. In addition, the data suggest that it would be even more unlikely that a company would have an individual shareholder that would meet a 10% ownership threshold.<sup>232</sup> While some commenters suggested a 5% threshold was appropriate because that amount is consistent with other filing requirements such as Schedule 13D and 13G,<sup>233</sup> we ultimately were not persuaded because the underlying principles of such filing requirements<sup>234</sup> are quite different from those underlying the ownership condition to Rule 14a–11. After considering the comments and available data, we have decided that a 3% ownership threshold—including where shareholders form groups to satisfy the threshold—is an appropriate and workable approach for the rule.

In adopting a uniform 3% threshold for all companies, as opposed to a lower ownership threshold for all companies, we are mindful that the rule will allow shareholders to form a group by aggregating their holdings to meet the ownership threshold.<sup>235</sup> Indeed, as we assumed in the Proposing Release and as some commenters told us, in many cases shareholders will need to form groups to meet the ownership threshold

<sup>232</sup> The data in the November 2009 Memorandum suggest that just 4% of companies would have at least one shareholder with 10%.

<sup>233</sup> See, e.g., letters from CSX; ITT; Shearman & Sterling; Tesoro; T. Rowe Price; tw telecom.

<sup>234</sup> See, e.g., Release No. 34–26598, Reporting of Beneficial Ownership in Publicly-Held Companies (March 6, 1989) (“The beneficial ownership reporting requirements embodied in Sections 13(d) and 13(g) of the [Exchange Act] and the regulations adopted thereunder are intended to provide to investors and to the subject issuer information about accumulations of securities that may have the ability to change or influence control of the issuer.”). See also Release No. 34–50699 (proposing to require disclosure of persons holding 5% of an ownership interest in a securities exchange because the principles underlying such disclosure were similar to those underlying other filing requirements: “The 5% reporting threshold and the information proposed to be required to be disclosed about such ownership is modeled on the beneficial ownership reporting requirements of the Williams Act, embodied in Sections 13(d) and 13(g) of the Exchange Act and the rules and regulations thereunder. These Exchange Act provisions are intended to provide information to the issuer and the marketplace about accumulations of securities that may have the potential to change or influence control of an issuer.” (footnotes omitted)).

<sup>235</sup> Some commenters suggested that the data on share ownership dispersion referred to in the Proposing Release were insufficient because we did not focus on the possibility that shareholders could form groups to satisfy the minimum ownership requirement. See letters from American Bar Association (January 19, 2010) (“ABA III”); BRT II.

for the purpose of submitting director nominations pursuant to Rule 14a–11.<sup>236</sup> Commenters also pointed to instances of coordinated shareholder activity in recent “vote no” campaigns as support for the ability of shareholders to form groups.<sup>237</sup> We have adopted a number of amendments to our rules that will facilitate the formation of groups for this purpose.<sup>238</sup> We understand the result of our ownership threshold determination may be that shareholders will need to convince other shareholders to support their attempt to use Rule 14a–11. We believe this outcome reduces the potential for excessive costs to be incurred by companies and their shareholders.

The data available to us also suggest that reaching the 3% ownership threshold we are adopting is possible for a significant number of shareholders either individually or by a number of shareholders aggregating their holdings in order to satisfy the ownership requirement. In particular, the data presented in the November 2009 Memorandum indicate that a sizeable percentage (33%) of public companies have at least one institutional investor owning at least 3% of their securities for at least three years, and thus potentially qualified to meet the Rule 14a–11 ownership threshold individually. As noted, however, the data are based on Form 13F filings, which include holders that are custodians and may not be likely users of the rule. The data in the November 2009 Memorandum also suggest that forming nominating shareholder groups with holdings aggregating 3% is achievable at many companies by a relatively small number of shareholders. Even factoring in the requirement of continuous ownership for three years, 31% of public companies have three or more holders with at least 1% share ownership each; and 29% have two or more holders with at least 2% share ownership each.<sup>239</sup> Moreover, neither of these categories includes companies with one holder of 2% and another holder of at least 1%, and none of these percentages includes companies having a relatively small number (e.g. four to ten) of holders

<sup>236</sup> See letters from AFL–CIO (“[I]t will be necessary to permit aggregation of holdings to prevent the Proposed Access Rule from being usable only by hedge funds.”); Florida Board of Administration (“Public funds would need to form a nominating group in order to meet the hurdle in nearly all cases.”).

<sup>237</sup> See letter from BRT II.

<sup>238</sup> See, e.g., Rule 14a–2(b)(7).

<sup>239</sup> We note that it is unlikely that the ownership test used in calculating the data tracks the definition that we are adopting for Rule 14a–11. As a result, the percentages in the data may be over- or under-inclusive.

whose aggregate holdings exceed 3% but whose individual holdings do not bring the company within any of the categories identified in the data.

We are concerned, however, that use of Rule 14a–11 may not be consistently and realistically viable, even by shareholder groups, if the uniform ownership threshold were set at 5% or higher. At the 5% minimum ownership requirement for individuals as advocated by many of those same commenters, only 20% of public companies had even one shareholder satisfying that requirement. Finally, even applying a 5% threshold for shareholder groups, the data identify combinations involving five or fewer shareholders that add up to 5% or more as theoretically achievable in as few as 21% of public companies—at least 25% fewer than with a 3% threshold.<sup>240</sup>

All of these data thus suggest that a uniform 5% ownership requirement would be substantially more difficult to satisfy than the 3% requirement we are adopting. Moreover, our resulting concern about the viability of a 5% ownership threshold is exacerbated by several limitations on the data reported in the November 2009 Memorandum. While those data do account for the application of a three-year holding period requirement, they may overstate in several ways the potential to meet the ownership threshold. First, they may include controlling shareholders that may be unlikely to rely on Rule 14a–11. Second, the data are based on filings on Form 13F, in which ownership is defined differently than under Rule 14a–11, and thus may yield a higher number of larger shareholdings. Finally, the data include large shareholdings by institutions which report aggregated holdings of securities held for multiple beneficial owners.<sup>241</sup>

Nevertheless, and principally because they give effect to holding period requirements, we considered the data in

<sup>240</sup> At the 10% threshold for groups urged by many commenters, for example, the likelihood of forming a group sufficient to meet the minimum ownership requirement would be more sharply constrained: the data in the November 2009 Memorandum identify combinations totaling 10% or more but involving five or fewer shareholders as theoretically achievable in as little as 7% of public companies.

<sup>241</sup> On the other hand, the data in the November 2009 Memorandum may understate the number of large shareholdings, because the data may exclude smaller holdings in multiple institutions that are subject to common voting control, and in any event, do not include holdings of less than 1% at all, even though such holdings could contribute to the formation of a group eligible to use Rule 14a–11. Likewise, those data do not include securities held by institutions holding less than \$100 million in securities because Exchange Act Section 13(f) does not require such institutions to report their holdings. See letters from ABA III; BRT II.

the November 2009 Memorandum to be the most pertinent to our selection of a uniform minimum ownership percentage. We received additional data relating to large companies, however, that offer some additional indication about the number of shareholders potentially available to form a group to meet the 3% ownership threshold. One study indicated that in the top 50 companies by market capitalization as of March 31, 2009, the five largest institutional investors held from 9.1% to 33.5% of the shares, and an average of 18.4% of the shares.<sup>242</sup> That same study found that among a sample of 50 large accelerated filers, the median number of shareholders holding at least 1% of the shares for at least one year was 10.5, with 45 of the 50 companies in the sample having at least seven such shareholders.<sup>243</sup> Another study that was reported to us<sup>244</sup> similarly suggests relatively high concentration of share ownership. According to that analysis of S&P 500 companies, 14 institutional investors could satisfy a 1% threshold at more than 100 companies, eight could meet that threshold at over 200 companies, five could meet it at over 300 companies, and three could meet it at 499 of the 500. Information from specific large issuers likewise suggests the achievability of shareholder groups aggregating 3%.<sup>245</sup>

We realize these data likely overstate the number of eligible shareholders or shareholders whose holdings could be grouped to meet the ownership threshold, as these data generally do not appear to reflect any continuous holding requirement.

In any event, our assessment of the percentage of companies with various share ownership concentrations cannot be taken as an assurance that

<sup>242</sup> See "Report on Effects of Proposed SEC Rule 14a-11 on Efficiency, Competitiveness and Capital Formation, in Support of Comments by Business Roundtable" by NERA Economic Consulting ("NERA Report"), Appendix Table 1, submitted with the letter from BRT.

<sup>243</sup> *Id.* at 13-14, Figure 2.

<sup>244</sup> See letter from JPMorgan Chase.

<sup>245</sup> See letters from AT&T (eight shareholders owning 1% or more, although holding periods not identified); AGL Resources (same); CIGNA (20 1%+ shareholders, although holding periods not identified); Cummins (36 1%+ shareholders, although holding periods not identified); General Mills (one 5%+ shareholder holding for at least 6 years, over 12 1%+ shareholders, and over 25 0.5%+ shareholders, although holding periods not identified); ITT (14 1%+ shareholders, although holding periods not identified); McDonald's (10 holders owning 1% or more, one shareholder owning 5%, although holding periods not identified); UnitedHealth (four 3%+ shareholders, six 2%+ shareholders, nine 1%+ shareholders, 20 0.5%+ shareholders, 32 0.25% shareholders, applying a 2-year holding period); Weyerhaeuser (three 5%+ shareholders, 20 1%+ shareholders, although holding periods not identified).

shareholder nominating groups will or will not be formed at any particular combination of percentage ownership and holding period requirements or of the likelihood that persons with large securities holdings would be inclined or disinclined to use Rule 14a-11.<sup>246</sup>

Taking all of this information into account, overall we believe that our selection of a 3% ownership threshold strikes an appropriate balance between the benefits of facilitating shareholder participation in the process of electing directors of public companies and the costs and disruption associated with contested elections of directors conducted pursuant to new Rule 14a-11. We also believe, and as noted, many commenters supported, that a threshold tied to a significant commitment to the company is an important feature of our amendments. Of course, to the extent that shareholders believe the 3% threshold is too high our amendments to Rule 14a-8 will facilitate their ability to adopt a lower ownership percentage.<sup>247</sup>

We proposed to apply the same thresholds for registered investment companies and business development companies as for non-investment companies, except that the applicability of the particular thresholds for registered investment companies would have depended on the net assets of the company, rather than the company's accelerated filer status. No commenters recommended a higher threshold for investment companies than for non-investment companies. While some commenters noted the absence of data specifically relating to the impact of various ownership thresholds on investment companies,<sup>248</sup> no commenter supplied any data suggesting the need for an ownership threshold for investment companies different from that applicable to non-investment companies.<sup>249</sup> Although two

<sup>246</sup> See letter from Council of Institutional Investors (January 14, 2010) ("CII II"). This comment refers to research indicating that in a small sample of accelerated and non-accelerated filers, the holdings of the ten largest public pension funds, if aggregated, would not exceed 5% and would also be unlikely to meet a 3% threshold, while a 1% threshold could be met. Apart from the sample size, however, this research itself appears limited in that it apparently does not include other types of shareholders and is not adjusted for any holding period.

<sup>247</sup> See footnote 223 above.

<sup>248</sup> See, e.g., letters from ICI; S&C; T. Rowe Price.

<sup>249</sup> One joint comment letter provided data regarding the net assets of investment companies and the dollar value of the shares that would be necessary to meet the proposed 1%, 3%, or 5% thresholds. See letter from ICI/IDC. The data provided by the commenters suggest that there are a limited number of small investment companies with net assets ranging from \$50,000 to \$351,000, where the 3% threshold could be met by an investment ranging from \$1,500 to \$10,530.

commenters suggested a 5% ownership threshold for investment companies, both of these commenters also suggested a 5% threshold for non-investment companies.<sup>250</sup>

We believe that it is appropriate to apply to registered investment companies and business development companies the same 3% ownership threshold that we are applying to other companies. We also believe that, similar to non-investment companies, our selection of a 3% ownership threshold strikes an appropriate balance between the benefits of facilitating shareholder participation in the process of electing directors of investment companies and the costs and disruption associated with contested elections of directors conducted pursuant to Rule 14a-11.

We are not adopting the suggestion of commenters that the eligibility thresholds for investment companies be based on the holdings for the fund complex in the case of unitary boards or the cluster in the case of cluster boards.<sup>251</sup> We believe that eligibility should be based on holdings for the investment company, not the entire fund complex or cluster, because under State law, shareholder voting is determined based on the holdings in the investment company. Fund complexes have flexibility to organize their funds into one or more investment companies. Thereafter, State law governs which shareholders vote as a group for directors. Because Rule 14a-11 is intended to facilitate the exercise of traditional State law rights to nominate and elect directors, we believe that the rule should follow State law.

However, the data also indicate that the vast majority of funds are significantly larger, and would therefore require a significantly larger investment to meet the 3% threshold (e.g., 90% of long-term mutual funds, money market funds, and closed-end funds have total net assets greater than \$19 million, \$100 million, and \$57 million, respectively; the median long-term mutual fund, money market fund, and closed-end fund have total net assets of \$216 million, \$844 million, and \$216 million, respectively).

<sup>250</sup> See letters from S&C (recommending "with respect to the ownership thresholds applicable to shareholders of [registered investment companies], a minimum percentage of no less than the 5% threshold recommended in the Seven Law Firm Letter" (to which Sullivan & Cromwell was a party and which recommended that ownership thresholds of non-investment companies be adjusted upwards to 5% for individual shareholders and higher for groups of shareholders)); TIAA-CREF (recommending "that the Commission adopt a 5% ownership requirement across the board regardless of the company's size" and "[w]ith respect to investment companies, \* \* \* that the 5% requirement be applied at the fund complex level rather than at the individual fund level").

<sup>251</sup> See letters from Barclays; T. Rowe Price; TIAA-CREF.

## ii. Voting Power

We proposed that the ownership threshold be determined as a percentage of the securities entitled to be voted on the election of directors. Some commenters sought clarification of how the ownership threshold would be calculated where companies have multiple classes of stock with varying voting rights.<sup>252</sup> These commenters observed that the proposed rule did not adequately address voting regimes where the voting rights have been separated from the economic rights of ownership.<sup>253</sup> One commenter explained that in situations where ownership of securities does not correlate with voting power,<sup>254</sup> shares will have voting rights disproportionate to the number of shares held, and that creates a disparity between the two classes in terms of the economic value of a single vote.<sup>255</sup> One commenter advised that further clarification was needed for companies with two or more outstanding classes of voting securities with disparate voting rights, including those companies with classes of voting securities and non-voting securities, so that those companies would be treated in a manner consistent with companies that have one class of voting securities.<sup>256</sup>

In proposing that the ownership threshold be determined as a percentage of securities entitled to be voted on the election of directors, our goal was to have the requirement tie to the percentage of votes that could be cast for the director nominees. In response to these commenters, we have revised the rule text to clarify that the ownership threshold will be determined as a percentage of *voting power* of the securities entitled to be voted on the election of directors at the meeting, rather than as a percentage of *securities* entitled to be voted on the election of directors, as was proposed. Accordingly, where a company has multiple classes of stock with unequal voting rights and the classes vote together on the election of directors, then voting power would be calculated based on the collective

voting power.<sup>257</sup> If a company has multiple classes of stock that do not vote together in the election of all directors (where, for example, each class elects a subset of directors), then voting power would be determined only on the basis of the voting power of the class or classes of stock that would be voting together on the election of the person or persons sought to be nominated by the nominating shareholder or group, rather than the voting power of all classes of stock.<sup>258</sup> We believe this approach properly bases the availability of Rule 14a–11 on the right to vote for the nominees that may be included in the company's proxy materials, which is both consistent with the intent of the provisions of a company's governing documents and in accord with the principle that class directors are elected by the votes of the holders of the class.

## iii. Ownership Position

In the Proposing Release, we solicited comment about whether beneficial ownership is the appropriate standard of ownership to use for purposes of the minimum ownership threshold in the rule or whether another standard would be more appropriate. In this regard, we requested comment about whether a net long requirement should be used and, if so, what other modifications would be required. We received a number of comments addressing the appropriate standard of ownership and supporting the inclusion of a net long requirement.<sup>259</sup> Commenters suggested that we adopt an "ultimate" beneficial owner definition that included, among other things, a requirement that the nominating shareholder or group hold the entire bundle of voting and economic rights to any securities used to determine eligibility under the rule.<sup>260</sup> At least one of these commenters thought the ownership definition should be adopted this way in order to remove the possibility that multiple parties may count the same securities toward their individual securities ownership totals.<sup>261</sup> Moreover, many commenters were

concerned that without requiring net long ownership, shareholders could engage in hedging strategies to obtain the requisite amount of ownership while eliminating or reducing their economic exposure.<sup>262</sup> Some commenters expressed the view that shares loaned to a third party should be taken into account when determining whether the nominating shareholder or group satisfies the relevant ownership threshold.<sup>263</sup> Commenters explained that institutional investors who hold shares for the long-term may lend their shares to others periodically while retaining the right to recall those shares to cast votes.<sup>264</sup> Commenters suggested several conditions for counting these shares: the shareholder has a legal right to recall the shares and cast votes;<sup>265</sup> the shareholder discloses in the Schedule 14N an intention to vote the shares;<sup>266</sup> the shareholder holds the shares through the date of the meeting;<sup>267</sup> and the shares are held past the date of the election.<sup>268</sup>

After considering the comments, we have modified in several respects the ownership requirement of Rule 14a–11 so that it is consistent with our intent to limit use of Rule 14a–11 to long-term shareholders with significant ownership interests. First, in order to satisfy the ownership requirement, the nominating shareholder or member of the nominating shareholder group must hold a class of securities subject to the proxy solicitation rules.<sup>269</sup> Limiting Rule 14a–11 nominations to holders of securities that are subject to the proxy rules appropriately excludes from the calculation private classes of voting securities held by persons that would have no expectation that our proxy rules would be available to facilitate their State law nomination rights. Further, if we included securities not covered by

<sup>262</sup> See letters from 26 Corporate Secretaries; ABA; Advance Auto Parts; Alaska Air; Allstate; Applied Materials; Association of Corporate Counsel; AT&T; J. Blanchard; Biogen; BRT; CIEBA; Cleary; Devon; Dewey; Headwaters; IBM; JPMorgan Chase; PepsiCo; Sara Lee; Seven Law Firms; Shearman & Sterling; Sidley Austin; Society of Corporate Secretaries; Verizon.

<sup>263</sup> See letters from AFL–CIO; CalPERS; CII; COPERA; IAM, LIUNA; Marco Consulting; P. Neuhauser; D. Nappier; Sheet Metal Workers National Pension Fund ("Sheet Metal Workers"); SWIB.

<sup>264</sup> See letters from AFL–CIO; Marco Consulting; Sheet Metal Workers; SWIB.

<sup>265</sup> See letters from CalPERS; CII; COPERA; IAM; LIUNA; D. Nappier.

<sup>266</sup> See letters from AFL–CIO; CalPERS; CII; IAM; D. Nappier.

<sup>267</sup> See letters from CalPERS; CII; IAM; D. Nappier.

<sup>268</sup> See letters from COPERA.

<sup>269</sup> This would include securities registered pursuant to Section 12 of the Exchange Act or subject to Investment Company Act Rule 20a–1.

<sup>252</sup> See letters from ABA; Duane Morris; Media General; P. Neuhauser; New York Times. These letters illustrated a scenario where one publicly-issued class of stock is entitled to one vote per share, while the privately-held controlling class of stock is entitled to 10 votes per share and both classes vote together on the election of directors.

<sup>253</sup> See letters from ABA; P. Neuhauser; Duane Morris; Media General.

<sup>254</sup> See, e.g., discussion in footnote 252 of common ten-to-one voting provisions of a structure with Class A and Class B securities.

<sup>255</sup> See letter from ABA.

<sup>256</sup> See letter from Duane Morris.

<sup>257</sup> See Rule 14a–11(b)(1) and Instruction 3 and the discussion below.

<sup>258</sup> See Instruction 3 to Rule 14a–11(b)(1).

<sup>259</sup> See letters from 26 Corporate Secretaries; Advance Auto Parts; Aetna; Alaska Air; Alcoa; Alston & Bird; American Express; BorgWarner; BRT; Burlington Northern; CSX; L. Dallas; Dewey; DuPont; FPL Group; Florida State Board of Administration; GE; Honeywell; ICI; JPMorgan Chase; Kirkland & Ellis LLP ("Kirkland & Ellis"); Leggett; P. Neuhauser; PepsiCo; Protective; Seven Law Firms; SIFMA; Society of Corporate Secretaries; T. Rowe Price; tw telecom; UnitedHealth; ValueAct Capital; Xerox.

<sup>260</sup> See letters from BRT; Devon; IBM; P. Neuhauser; Society of Corporate Secretaries.

<sup>261</sup> See letter from ABA.

the proxy rules in the calculation, those securities could dilute the relative holdings of shareholders holding securities that our rules are designed to protect. Second, the nominating shareholder or member of the nominating shareholder group must hold both investment and voting power, either directly or through any person acting on their behalf, of the securities. By requiring that a nominating shareholder or member of a nominating shareholder group hold investment and voting power of the securities that are used for purposes of determining whether the ownership requirement has been met, we are addressing the concerns raised by certain commenters that the provisions of Rule 14a-11 should only be available to shareholders that possess ultimate ownership rights over the shares.

Similar to the provisions in Exchange Act Rule 13d-3,<sup>270</sup> the definition of voting power for purposes of Rule 14a-11 includes the power to vote, or to direct the voting of, such securities and investment power for purposes of Rule 14a-11 includes the power to dispose, or to direct the disposition of, such securities.<sup>271</sup> Unlike the provisions in Rule 13d-3, however, the ownership requirement of Rule 14a-11 includes both voting and investment power—as opposed to just one or the other—and voting and investment power for purposes of Rule 14a-11 does not exist over securities that a nominating shareholder or member of a nominating shareholder group merely has the right to acquire. For example, a nominating shareholder or member of a nominating shareholder group will not be able to count securities that could be acquired, such as securities underlying options that are currently exercisable but have not yet been exercised.

For purposes of meeting the ownership threshold in Rule 14a-11, a nominating shareholder or group will include investment and voting power of the company's securities that is held "either directly or through any person acting on their behalf." We are adopting the ownership provisions with this language to account for the common situation when financial intermediaries, such as banks or brokers, hold securities on behalf of their clients.<sup>272</sup> This

<sup>270</sup> 17 CFR § 240.13d-3. Like the approach under Rule 13d-3, we are including and excluding certain securities from the determination of who has voting power for policy reasons. Those inclusions and exceptions and the policy reasons underlying them are discussed throughout this section.

<sup>271</sup> See Instruction 3.c. to Rule 14a-11(b)(1).

<sup>272</sup> The rule also clarifies that financial intermediaries, such as banks or brokers, that may hold securities on behalf of their clients could not

additional language also covers relationships, such as parent and subsidiary, when for organizational or tax reasons, among others, investment and voting power is held by an entity that is controlled by another entity. This provision, however, would not include securities that are held in a pooled investment vehicle in which the nominating shareholder or member of a nominating shareholder group does not have voting and investment power over the securities held in the pooled investment vehicle.

Third, we have adopted a provision in the ownership requirement in Rule 14a-11 that, subject to specific conditions, allows for securities that have been loaned to a third party by or on behalf of the nominating shareholder or member of a nominating shareholder group to be considered in the calculation. We recognize that share lending is a common practice, and we believe that loaning securities to a third party is not inconsistent with a long-term investment in a company.<sup>273</sup> To capture only securities where voting power can ultimately be exercised by the nominating shareholder or member of a nominating shareholder group in the election of directors, however, securities that have been loaned by or on behalf of the nominating shareholder or any member of the nominating shareholder group to another person may be counted toward the ownership requirement only if the nominating shareholder or member of the nominating shareholder group:

- Has the right to recall the loaned securities; and
- Will recall the loaned securities upon being notified that any of the nominees will be included in the company's proxy materials.

Absent satisfaction of these conditions—in addition to holding the requisite investment power over the loaned securities—we believe it is appropriate to exclude securities that have been loaned to another person from the calculation of voting power because, generally, the person to whom the securities have been loaned has the ability to vote those securities.<sup>274</sup> If the rule were to allow loaned securities that either will not or cannot be recalled to be included for purposes of the ownership calculation, then the voting power of a nominating shareholder or member of a nominating shareholder

use the provisions of Rule 14a-11. See Instruction 3.c. to Rule 14a-11(b)(1).

<sup>273</sup> See letters from AFL-CIO; CalPERS; CII; COPERA; IAM; LIUNA; Marco Consulting; P. Neuhauser; D. Nappier; Sheet Metal Workers; SWIB.

<sup>274</sup> See letter from P. Neuhauser.

group may potentially be inflated because the calculation could include votes that the nominating shareholder or member of a nominating shareholder group cannot actually cast.

In determining the total voting power of the company's securities held by or on behalf of the nominating shareholder or any member of the nominating shareholder group, the voting power would be reduced by the voting power of any of the company's securities that the nominating shareholder or any member of a nominating shareholder group has sold in a short sale during the relevant periods.<sup>275</sup> In addition, the rule text explicitly excludes borrowed shares because the rule is intended to be used by holders with a significant long-term commitment to the company, and including shares that are merely borrowed is inconsistent with that purpose. The instruction makes clear that to the extent borrowed securities are not already excluded through the subtraction of securities sold short, borrowed securities would be subtracted in computing the relevant amount. We recognize that by requiring the voting power of securities sold short or borrowed for purposes other than a short sale to be subtracted from the ownership calculation, we are potentially reducing the eligibility of certain shareholders to rely on Rule 14a-11.<sup>276</sup> Nevertheless, as noted above,

<sup>275</sup> See Instruction 3.b.3 to Rule 14a-11(b)(1). We note that in a typical short sale the person selling the securities short would not have the power to vote the securities subject to the short sale. Nevertheless, the provisions of Rule 14a-11 require that the voting power of the securities subject to the short sale be deducted from the voting power held directly or on behalf of the nominating shareholder or member of the nominating shareholder group to address our concerns about limiting the application of Rule 14a-11 to shareholders that retain significant ownership interests in a company. Likewise, a person whose ownership of shares arises solely from borrowing them for purposes of short sale would be deemed to have no share ownership for purposes of the ownership requirement of Rule 14a-11(b)(1).

<sup>276</sup> The ownership provisions related to short sales do not apply to securities that have been sold in a short sale where the nominating shareholder or member of the nominating shareholder group had no control over such transactions. See Instruction 3.b.3. to Rule 14a-11(b)(1) (covering short sales by "the nominating shareholder or any member of the nominating shareholder group, as the case may be, or any person acting on their behalf \* \* \*"). For example, a nominating shareholder would not be required to exclude securities that have been sold short by a pooled investment vehicle in which the nominating shareholder or member of a nominating shareholder group has invested as long as the shareholder does not have the ability to direct the investments held in the pooled investment vehicle. Similarly, securities held by the pooled investment vehicle with respect to which the shareholder does not have the ability to direct the investments held in the pooled investment vehicle would not be

we believe that eligibility for Rule 14a-11 should be limited to those shareholders that have a significant interest in the company.<sup>277</sup> We agree with commenters who suggested that selling a company's securities short may divest that shareholder of the economic risks of ownership.<sup>278</sup>

For purposes of determining whether the nominating shareholder or any member of a nominating shareholder group has sold a company's securities short, the term "short sale" will have the meaning provided in Exchange Act Rule 200(a).<sup>279</sup> Under that rule, a short sale is "any sale of a security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller."

In calculating the voting power required to satisfy the 3% voting power eligibility requirement described above, nominating shareholders or members of a nominating shareholder group must first determine the total number of votes that can be derived from their holdings of securities that are subject to the proxy rules. This determination is made as of the date the Schedule 14N is filed. The total number of votes can be increased by the number of votes attributable to securities which have been loaned

included in the amount of holdings of the shareholder.

<sup>277</sup> We recognize that selling a company's securities short is only one of a number of ways that a shareholder can hedge the economic risk of its investment. Indeed, a number of commenters suggested that we adopt a beneficial ownership definition for purposes of Rule 14a-11 that netted all hedging arrangements (derivatives, swaps, etc.). We believe, however, that it is appropriate at this time to adopt the ownership threshold for Rule 14a-11 with the provision only relating to short sales as it contributes significantly towards the goal of excluding votes from the ownership calculation securities where the voting and economic interests are separated and does not unduly complicate the rule. Further, by excluding securities that the holder merely has the right to acquire (such as securities underlying options) and securities that have been loaned and cannot be recalled, we have further narrowed the application of the rule to address concerns about separating economic interest and voting power.

<sup>278</sup> See letters from 26 Corporate Secretaries; ABA; Advance Auto Parts; Alaska Air; Allstate; Applied Materials; Association of Corporate Counsel; AT&T; J. Blanchard; Biogen; BRT; CIEBA; Cleary; Devon; Dewey; Headwaters; IBM; JPMorgan Chase; PepsiCo; Sara Lee; Seven Law Firms; Shearman & Sterling; Sidley Austin; Society of Corporate Secretaries; Verizon.

<sup>279</sup> 17 CFR 242.200(a). We note that certain of the provisions in Exchange Act Rule 200, including when a "person shall be deemed to own a security" as defined in Rule 200(b), differ from the provisions we have adopted for purposes of Rule 14a-11. For instance, Rule 200(b) extends ownership of a security to options that have been exercised. As noted above, however, we have not extended ownership for purposes of Rule 14a-11 to options. We believe that these different, but not conflicting, approaches are appropriate and reflect the policy objectives for adopting each rule.

(subject to the conditions previously noted) and must be reduced by the number of votes attributable to any securities that have been sold in a short sale that is not closed out as of that date or borrowed for purposes other than a short sale. This adjusted number of votes is the qualifying number of votes eligible to be used as the numerator in calculating the percentage held of the company's total voting power. The number of securities to which these qualifying votes are attributable is the amount of securities that must be used for evaluating compliance with the continuous holding period requirements specified in Rule 14a-11(b)(2), and discussed below.

In determining the total voting power of the company's securities, nominating shareholders and members of a nominating shareholder group will be entitled to rely on the most recent quarterly, annual or current report filed by the company unless the nominating shareholder or member of a nominating shareholder group knows or has reason to know that the information in the reports is inaccurate.<sup>280</sup> We believe that a nominating shareholder or member of a nominating shareholder group should be able to rely on the filings made by the company in making the calculation of voting power for purposes of Rule 14a-11 even if the number of securities outstanding has changed since the last report so that a nominating shareholder or member of a nominating shareholder group can easily make a determination about the percentage of voting power that they hold.

#### iv. Demonstrating Ownership

Under the Proposal, a nominating shareholder or member of a nominating shareholder group would be able to demonstrate ownership in several ways.<sup>281</sup> If the nominating shareholder or member of the nominating shareholder group is the registered holder of the shares, he or she could state as much. In this instance, the

<sup>280</sup> See Instruction 1 to Rule 14a-11(b)(1). In the case of a registered investment company, in determining the total voting power of the securities that are entitled to be voted on the election of directors for purposes of establishing whether the 3% voting power threshold has been met, the nominating shareholder or group may rely on information set forth in the following documents, unless the nominating shareholder or group knows or has reason to know that the information contained therein is inaccurate: (1) In the case of a series company, a Form 8-K that will be required to be filed in connection with the meeting where directors are to be elected; or (2) in the case of other registered investment companies, the company's most recent annual or semi-annual report filed with the Commission on Form N-CSR. See Instruction 2 to Rule 14a-11(b)(1).

<sup>281</sup> See Item 5 of proposed Schedule 14N.

company would have the ability to independently verify the shareholder's ownership. Where the nominating shareholder or member of the nominating shareholder group is not the registered holder of the securities, the nominating shareholder or member of the nominating shareholder group would be required to demonstrate ownership by attaching to the Schedule 14N a written statement from the "record" holder of the nominating shareholder's shares (usually a broker or bank) verifying that, at the time of submitting the shareholder notice to the company on Schedule 14N, the nominating shareholder or member of the nominating shareholder group continuously held the securities being used to satisfy the applicable ownership threshold for a period of at least one year.<sup>282</sup> In the alternative, if the nominating shareholder or member of the nominating shareholder group has filed a Schedule 13D, Schedule 13G, Form 3, Form 4, and/or Form 5, or amendments to those documents, the shareholder or group member may so state and attach a copy or incorporate that filing or amendment by reference.

Commenters generally did not object to the proposed methods of demonstrating ownership; however, they did suggest some revisions to the rule. Two commenters believed that the nominating shareholder or group, if requested by the company, should be required to provide evidence from its broker-dealer or custodian certifying that its ownership position meets the requisite threshold through a date that is within five days of the shareholders' meeting.<sup>283</sup> Another commenter recommended a revision to the proposed rule to allow the written statement to be dated no more than seven days prior to the date of submission of the nomination to the company.<sup>284</sup> The commenter explained that it may be difficult for a group of nominating shareholders to obtain letters from the "record" holders on the exact same date they submit the nomination to the company and file a Schedule 14N and cited similar problems in the context of the Rule 14a-8 process as an example. Another commenter recommended more generally that the written statement be dated a short period before the filing of the Schedule 14N.<sup>285</sup> Other commenters submitted various suggestions as to who

<sup>282</sup> See the discussion below regarding the holding period we are adopting.

<sup>283</sup> See letters from BorgWarner; Society of Corporate Secretaries.

<sup>284</sup> See letter from CII.

<sup>285</sup> See letter from P. Neuhauser.

should provide the required written statement.<sup>286</sup>

While we are adopting the requirements to demonstrate ownership as proposed, we agree with the commenters that additional clarity is needed with regard to how far in advance of the notice date the statement of the broker or bank may be dated, as well as what type of bank or broker may provide the written statement on behalf of the shareholder. We believe the date should be as close as practicable to the notice date, and believe that seven calendar days should provide a workable time frame that is still close in time to the notice date. Accordingly, we have revised the rule to clarify that the statement from the registered holder, broker, or bank may be dated within seven calendar days prior to the date the nominating shareholder or group submits the notice on Schedule 14N.<sup>287</sup>

Also, to provide additional clarity about these requirements, the final rule includes an example of a form of written statement verifying share ownership that may be used if the nominating shareholder or any member of the nominating shareholder group (i) is not the registered holder of the shares, (ii) is not proving ownership by providing previously filed Schedules 13D or 13G or Forms 3, 4, or 5, and (iii) holds the shares in an account with a broker or bank that is a participant in the Depository Trust Company (“DTC”) or a similar clearing agency acting as a securities depository.<sup>288</sup> An instruction

<sup>286</sup> See letters from ABA; CII; ICI; P. Neuhauser; Schulte Roth & Zabel; Seven Law Firms; S&C. Litigation subsequent to the Proposal has underscored the utility of clarifying the source of verification of ownership by shareholders who are not themselves registered owners of the shares. See *Apache Corp. v. Chevedden*, 696 F.Supp.2d 723 (S.D.Tex. Mar. 10, 2010) (interpreting the proof of ownership requirement in Rule 14a–8(b)(2)).

<sup>287</sup> We note that a nominating shareholder may have changed brokers or banks during the time period in which it has held the shares it is using to meet the ownership threshold. In such cases, the nominating shareholder would need to obtain a written statement from each broker or bank with respect to the shares held and specify the time period in which the shares were held.

<sup>288</sup> This form of written statement from a bank or broker is a modification to the Proposal, and is provided as a non-exclusive example of an acceptable method of satisfying the requirement in Rule 14a–11(b)(3). See Instruction to Item 4 of new Schedule 14N. We note that the written statements would not reflect all aspects of the ownership requirement, such as the percentage of voting power held, and thus, would not be dispositive with regard to whether the nominating shareholder or group satisfied the ownership threshold. For purposes of complying with Rule 14a–11(b)(3), loaned securities may be included in the amount of securities set forth in the written statements. Consistent with the Proposal, a nominating shareholder or group proving ownership by using a previously filed Schedule 13D or 13G or Form 3, 4, or 5 could attach a copy of the filing to the

to Schedule 14N describes more fully what information should be provided if a nominating shareholder or any member of the nominating shareholder group holds the securities through a broker or bank (e.g., in an omnibus account) that is not a participant in DTC or a similar clearing agency.<sup>289</sup>

We note that satisfying the requirement in Rule 14a–11(b)(3) to demonstrate ownership is different from satisfying the requirement in Rules 14a–11(b)(1) and 14a–11(b)(2) that a shareholder or shareholder group hold the requisite amount of the company’s securities that are entitled to be voted on the election of directors for three years, as calculated pursuant to the Instruction to paragraph (b)(2). It is possible for a shareholder to be able to demonstrate ownership pursuant to Rule 14a–11(b)(3), and yet not satisfy the total voting power and holding period requirements in Rules 14a–11(b)(1) and (b)(2).

#### c. Holding Period

With respect to duration of ownership, we proposed a one-year holding requirement for each nominating shareholder or member of a nominating shareholder group. Although many commenters supported the proposed one-year holding period,<sup>290</sup> the majority of commenters suggested a holding period longer than the proposed one-year period, with many recommending alternative holding periods ranging from 18 months to four years.<sup>291</sup> Some commenters, for

example, expressed a belief that increasing the duration of the minimum holding period would ensure that use of Rule 14a–11 is limited to holders of a significant, long-term interest and would dissuade shareholders from using the rule to nominate and elect directors to make short-term gains at the expense of long-term shareholders.<sup>292</sup> A small number of commenters believed that Rule 14a–11 should not include a holding period requirement.<sup>293</sup> One commenter believed that all holders of the same securities should have the same rights under Rule 14a–11 regardless of how long the securities have been held.<sup>294</sup> Another commenter stated that a short-term shareholder has the same risk as long-term shareholders; thus their rights under Rule 14a–11 should be equal.<sup>295</sup>

After considering the comments, we have decided to adopt a three-year holding requirement, rather than the proposed one-year requirement. This decision is based on our belief that holding securities for at least a three-year period better demonstrates a shareholder’s long-term commitment and interest in the company.<sup>296</sup> We also based our decision to have a holding period longer than one year on the strong support of a variety of commenters. For instance, we received

Avis Budget; Biogen; J. Blanchard; Boeing; BorgWarner; BRT; Burlington Northern; Caterpillar; Chevron; CIEBA; CIGNA; CNH Global; P. Clapman; Comcast; Con Edison; CSX; C&W Investment Group; Cummins; L. Dallas; Darden Restaurants; E. Davis; Deere; Devon; Dewey; DTE Energy; DuPont; Eaton; Eli Lilly; ExxonMobil; FedEx; Fenwick; FMC Corp.; FPL Group; General Mills; Headwaters; Home Depot; Honeywell; IAM; IBM; ICI; Intel; ITT; JPMorgan Chase; Lionbridge Technologies; LIUNA; Marco Consulting; McDonald’s; M. Metz; J. Miller; NACD; D. Nappier (expressing a willingness to accept a two-year holding period instead of the proposed one-year holding period); Northrop; Office Depot; OPERS; Pfizer; P&G; Praxair; Protective; RiskMetrics (accepting a two-year holding period as alternative to the proposed one-year holding period); Sara Lee; S&C; Sheet Metal Workers; Sidley Austin; SIFMA; Society of Corporate Secretaries; Southern Company; Teamsters; Tesoro; Tectron; Theragenics; TI; TIAA-CREF; Tidewater; Time Warner Cable Inc. (“Time Warner Cable”); tw telecom; L. Tyson; UnitedHealth; U.S. Bancorp; Wells Fargo; Weyerhaeuser; Xerox; Vanguard; Verizon; B. Villiarmais.

<sup>292</sup> See letters from BRT; CIEBA; IBM; McDonald’s; Society of Corporate Secretaries.

<sup>293</sup> See letters from 13D Monitor; ACSI; British Insurers; Ironfire Capital LLC (“Ironfire”); LUCRF.

<sup>294</sup> See letter from British Insurers.

<sup>295</sup> See letter from 13D Monitor.

<sup>296</sup> One commenter pointed to the Aspen Principles, available at [http://www.aspeninstitute.org/sites/default/files/content/docs/pubs/Aspen\\_Principles\\_with\\_signers\\_April\\_09.pdf](http://www.aspeninstitute.org/sites/default/files/content/docs/pubs/Aspen_Principles_with_signers_April_09.pdf), suggesting that companies that are often forced to react to short-term investors are constrained from creating valuable goods and services, investing in innovations, and creating jobs. See also letter from AFL-CIO.

Schedule 14N or incorporate it by reference into the Schedule. We note that the calculation of voting power of a company’s securities for purposes of Rule 14a–11 differs from the determination of beneficial ownership for purposes of those schedules and forms. In addition, as adopted, we are clarifying that the schedules or forms used to provide proof of ownership must reflect ownership of the securities as of or before the date on which the three-year eligibility period begins.

<sup>289</sup> See the Instruction to Item 4 of new Schedule 14N.

<sup>290</sup> See letters from ADP; AFSCME; Callaway; CalPERS; CalSTRS; Calvert; CFA Institute; J. Chico; CII; Corporate Library; Dominican Sisters of Hope (“Dominican Sisters of Hope”); GovernanceMetrics International (“GovernanceMetrics”); ICGN; Lorsch *et al.*; LUCRF; Mercy Investment Program (“Mercy Investment Program”); Motorola; D. Nappier; Nathan Cummings Foundation; P. Neuhauser; Norges Bank; Pax World; RiskMetrics; Shamrock; Shearman & Sterling; Sisters of Mercy Regional Community of Detroit Charitable Trust (“Sisters of Mercy”); Social Investment Forum; Sodali; Tri-State Coalition for Responsible Investment (“Tri-State Coalition”); Trillium; T. Rowe Price; Ursuline Sisters of Tildonk (“Ursuline Sisters of Tildonk”); USPE; ValueAct Capital; Walden Asset Management (“Walden”).

<sup>291</sup> See letters from 26 Corporate Secretaries; ABA; Advance Auto Parts; Aetna; AFL-CIO; Alaska Air; Alcoa; Allstate; Alston & Bird; Amalgamated Bank; American Express; Anadarko; Applied Materials; Association of Corporate Counsel; AT&T;

example, expressed a belief that increasing the duration of the minimum holding period would ensure that use of Rule 14a–11 is limited to holders of a significant, long-term interest and would dissuade shareholders from using the rule to nominate and elect directors to make short-term gains at the expense of long-term shareholders.<sup>292</sup> A small number of commenters believed that Rule 14a–11 should not include a holding period requirement.<sup>293</sup> One commenter believed that all holders of the same securities should have the same rights under Rule 14a–11 regardless of how long the securities have been held.<sup>294</sup> Another commenter stated that a short-term shareholder has the same risk as long-term shareholders; thus their rights under Rule 14a–11 should be equal.<sup>295</sup>

After considering the comments, we have decided to adopt a three-year holding requirement, rather than the proposed one-year requirement. This decision is based on our belief that holding securities for at least a three-year period better demonstrates a shareholder’s long-term commitment and interest in the company.<sup>296</sup> We also based our decision to have a holding period longer than one year on the strong support of a variety of commenters. For instance, we received

Avis Budget; Biogen; J. Blanchard; Boeing; BorgWarner; BRT; Burlington Northern; Caterpillar; Chevron; CIEBA; CIGNA; CNH Global; P. Clapman; Comcast; Con Edison; CSX; C&W Investment Group; Cummins; L. Dallas; Darden Restaurants; E. Davis; Deere; Devon; Dewey; DTE Energy; DuPont; Eaton; Eli Lilly; ExxonMobil; FedEx; Fenwick; FMC Corp.; FPL Group; General Mills; Headwaters; Home Depot; Honeywell; IAM; IBM; ICI; Intel; ITT; JPMorgan Chase; Lionbridge Technologies; LIUNA; Marco Consulting; McDonald’s; M. Metz; J. Miller; NACD; D. Nappier (expressing a willingness to accept a two-year holding period instead of the proposed one-year holding period); Northrop; Office Depot; OPERS; Pfizer; P&G; Praxair; Protective; RiskMetrics (accepting a two-year holding period as alternative to the proposed one-year holding period); Sara Lee; S&C; Sheet Metal Workers; Sidley Austin; SIFMA; Society of Corporate Secretaries; Southern Company; Teamsters; Tesoro; Tectron; Theragenics; TI; TIAA-CREF; Tidewater; Time Warner Cable Inc. (“Time Warner Cable”); tw telecom; L. Tyson; UnitedHealth; U.S. Bancorp; Wells Fargo; Weyerhaeuser; Xerox; Vanguard; Verizon; B. Villiarmais.

<sup>292</sup> See letters from BRT; CIEBA; IBM; McDonald’s; Society of Corporate Secretaries.

<sup>293</sup> See letters from 13D Monitor; ACSI; British Insurers; Ironfire Capital LLC (“Ironfire”); LUCRF.

<sup>294</sup> See letter from British Insurers.

<sup>295</sup> See letter from 13D Monitor.

<sup>296</sup> One commenter pointed to the Aspen Principles, available at [http://www.aspeninstitute.org/sites/default/files/content/docs/pubs/Aspen\\_Principles\\_with\\_signers\\_April\\_09.pdf](http://www.aspeninstitute.org/sites/default/files/content/docs/pubs/Aspen_Principles_with_signers_April_09.pdf), suggesting that companies that are often forced to react to short-term investors are constrained from creating valuable goods and services, investing in innovations, and creating jobs. See also letter from AFL-CIO.



comments that advised that we should “adopt a more reasonable holding period of at least two years,”<sup>297</sup> and “a minimum holding period of at least two years is appropriate” because a “shorter holding period would allow shareholders with a short-term focus to nominate directors who, if elected, would be responsible for dealing with a company’s long-term issues.”<sup>298</sup> Another commenter stated that “three years would be a more reasonable test with respect to longevity of stock ownership.”<sup>299</sup> Although two commenters suggested even longer holding periods,<sup>300</sup> we believe that a three year holding period reflects our goal of limiting use of the rule to significant, long-term holders and appropriately responds to commenters’ suggestions regarding the length of the holding period. In this regard, as noted previously, some commenters suggested a two year holding period, but others stated it should be “at least” two years. Given the support expressed for a significant holding period, we believe a three year holding period, rather than one or two years, strikes the appropriate balance in providing shareholders with a significant, long-term interest with the ability to have their nominees included in a company’s proxy materials while limiting the possibility of shareholders attempting to use Rule 14a–11 inappropriately, as discussed further below.

We also factored our desire to limit the use of Rule 14a–11 to shareholders who do not possess a change in control intent with regard to the company into our decision to extend the holding period. Although we have, as noted below, adopted specific requirements in Rule 14a–11 to address the control issue, we believe that a longer holding period is another safeguard against shareholders that may attempt to inappropriately use Rule 14a–11 as a means to quickly gain control of a company. Finally, we note that if shareholders believe that the three-year period should be shorter, the amendment that we decided to adopt to Rule 14a–8 will remove barriers to proposals that seek to establish a different procedure with a lesser (or no) holding period condition.

The requirement we are adopting is that shareholders seeking to use Rule 14a–11 to have a nominee or nominees included in a company’s proxy materials must have held the minimum amount of securities used to satisfy the

3% ownership threshold continuously for at least three years.<sup>301</sup> Similar to the calculation of voting power discussed above, in order to satisfy the three-year holding requirement, the nominating shareholder or member of the nominating shareholder group must have investment and voting power over the amount of securities, and the amount of securities held during the period will have to be reduced by the amount of securities of the same class that are the subject of short positions or are borrowed for purposes other than a short sale during the period.<sup>302</sup> The rule also allows securities loaned to a third party to be considered held during the period, provided that the nominating shareholder or group has the right to recall the loaned securities during the period.<sup>303</sup> As discussed above, we do not believe that the common practice of lending securities is inconsistent with a long-term investment. While we believe it is important to include both of the recall provisions for purposes of allowing loaned securities to be used in the 3% ownership threshold calculation in Rule 14a–11(b)(1), we believe it is only necessary for the nominating shareholder or member of a nominating shareholder group to have the right to recall the loaned securities to satisfy the three-year holding period requirement.<sup>304</sup> Finally, the rule

<sup>301</sup> As proposed, a nominating shareholder or group would have been required to hold “the securities that are used for purposes of determining the applicable ownership threshold” and intend to continue to hold “those securities” through the date of the meeting. See proposed Rule 14a–11(b)(2). The Proposal also would have required the nominating shareholder or group to provide a statement that the nominating shareholder or group intends to continue to own the “requisite shares” through the date of the meeting. See proposed Rule 14a–18(f). As adopted, we are modifying Rule 14a–11 to require the nominating shareholder or each member of the nominating shareholder group to have held the “amount of securities” that are used for satisfying the ownership requirement and to continue to hold that amount of securities through the date of the meeting, rather than referring to the “requisite securities.” In addition, even though the ownership requirement is based on the percentage of voting power held, the requirement refers to “amount” rather than “percentage” so that satisfaction of the ownership requirement can be accurately determined. We believe it would be unduly burdensome to require that a nominating shareholder or group determine whether its holdings exceeded 3% of the company’s voting power continuously for a three-year period prior to the filing of the Schedule 14N.

<sup>302</sup> See the Instruction to Rule 14a–11(b)(2). For purposes of this calculation, the amount of the short position or borrowed securities at any point in time during the three year holding period would be deducted from the amount of securities otherwise held at that point in time.

<sup>303</sup> *Id.*

<sup>304</sup> *Id.* The recall provisions are discussed in Section II.B.4.b.iii. above. We note that at the time the nominating shareholder or group calculates its ownership and submits a nominee or nominees, it

requires the amount of securities to be adjusted for stock splits, reclassifications or other similar adjustments made by the company during the period.<sup>305</sup>

A commenter suggested that we clarify that a nominating shareholder or each member of the group must have continuously held only the minimum number of shares used to satisfy the ownership requirement.<sup>306</sup> We agree that a nominating shareholder or member of a nominating shareholder group is not required to have continuously held shares in excess of the amount used to attain eligibility for purposes of Rule 14a–11. For example, under Rule 14a–11(b)(2), which requires continuous holding of “the amount of securities that are used for purposes of satisfying the *minimum* ownership required of paragraph (b)(1) \* \* \*,” if a nominating shareholder owns 400,000 shares and those shares comprise 4% of the issuer’s voting power as of the date of filing of the Schedule 14N, that shareholder is not required to have held 400,000 shares continuously during the preceding three years and through the date of election of directors. Rather, the nominating shareholder would be required to continuously hold the minimum amount of shares required to satisfy the 3% ownership threshold in paragraph (b)(1), assuming no adjustments (in this example, at least 300,000 shares).

We also believe that it is important that any shareholder or member of a nominating shareholder group that intends to submit a nominee to a company for inclusion in the company’s proxy materials continue to maintain the qualified minimum amount of securities in the company needed to satisfy the ownership provisions in the rule through the date of the meeting at which the shareholder’s or group’s nominee is presented to a vote of shareholders. To meet the eligibility criteria in proposed Rule 14a–11(b)(2), a nominating shareholder or member of a nominating shareholder group would have been required to “intend to continue to hold” the securities used to meet the ownership threshold through the date of the meeting. Commenters on the Proposing Release generally supported a holding requirement

may not be certain that its nominee or nominees will be included in the company’s proxy materials. We do not believe it is necessary to require a nominating shareholder or group to recall loaned shares that it has the right to recall and vote prior to the time that the nominating shareholder or group is notified that its nominee or nominees will be included in the company’s proxy materials.

<sup>305</sup> See the Instruction to Rule 14a–11(b)(2).

<sup>306</sup> See letter from AFSCME.

<sup>297</sup> Letter from Teamsters.

<sup>298</sup> Letter from BRT.

<sup>299</sup> Letter from Tesoro.

<sup>300</sup> See letters from E. Davis; Fenwick.

through the date of the meeting,<sup>307</sup> and one commenter suggested that we clarify that shareholders would be required to hold the securities used for determining ownership through the election of directors.<sup>308</sup> We agree with the suggestion and are modifying the language in Rule 14a–11(b)(2) to clarify that a nominating shareholder or member of a nominating shareholder group “must continue to hold” the requisite amount of securities through the date of the meeting.<sup>309</sup> If a nominating shareholder or member of a nominating shareholder group fails to continue to hold the requisite amount of securities as required by the rule, a company could exclude the nominee or nominees submitted by the nominating shareholder or group.<sup>310</sup>

We also are adopting, as proposed, the requirement that a nominating shareholder or member of a nominating shareholder group provide a statement as to the nominating shareholder’s or group member’s intent to continue to hold the qualifying minimum amount of securities through the date of the

<sup>307</sup> See letters from ABA; Advance Auto Parts; Alston & Bird; American Express; Association of Corporate Counsel; J. Blanchard; BorgWarner; CalPERS; CII; Cleary; Comcast; CSX; Dewey; W. B. Dickerson; Florida State Board of Administration; General Mills; Headwaters; JPMorgan Chase; Nathan Cummings Foundation; Protective; Schulte Roth & Zabel; Seven Law Firms; Shearman & Sterling; Society of Corporate Secretaries; tw telecom; ValueAct Capital.

<sup>308</sup> See letter from ABA.

<sup>309</sup> For purposes of determining whether the requirement to hold the specified amount of securities from the date of the filing of the Schedule 14N through the date of the election of directors is satisfied, a nominating shareholder or group must hold (as determined pursuant to the instruction to the rule) the qualifying minimum amount of securities, which can include securities that are loaned to a third party if the nominating shareholder or group has the right to recall the securities, and will recall them upon being notified that any of the nominees will be included in the company’s proxy materials. Of course, between the date of the filing of the Schedule 14N and the date of the election of directors previously loaned securities may be returned. Likewise, the amount of securities held during the period from the filing of the Schedule 14N through the date of the election of directors must be reduced by the amount of securities of the same class that are sold in a short sale.

<sup>310</sup> See new Rule 14a–11(b)(2) and Rule 14a–11(g). The company would be required to provide notice to the staff in accordance with Rule 14a–11(g) and could seek a no-action letter from the staff with regard to the determination to exclude the nominee at that time if the company so wished. In the event that the nominating shareholder’s or group’s failure to continue to hold the securities comes to light after the company has printed its proxy materials, the company would be permitted to exclude the nominee or nominees and send a revised proxy card to its shareholders. For additional information about a company’s obligations in the event a nominee withdraws or is disqualified, see Section II.B.7.b. below.

meeting.<sup>311</sup> In addition, we proposed that nominating shareholders or members of a nominating shareholder group disclose their intent with regard to continued ownership of their shares after the election (which may be contingent on the election’s outcome). As noted above, commenters generally supported the requirement for the nominating shareholder or group to hold the requisite amount of securities through the date of the meeting, although some commenters expressed opposition to the proposed disclosure requirement or any requirement for the nominating shareholder or group to disclose their intent to hold the company’s shares after the date of the election.<sup>312</sup> One commenter explained that the nominating shareholder or group may not know its intent at the time the Schedule 14N is filed and, depending on the outcome of the director election, the nominating shareholder or group may, in fact, purchase more stock or sell some stock.<sup>313</sup> Another commenter observed that it is impractical for shareholders to represent that they would hold their position beyond the election and instead favored disclosure in an amended Schedule 14N of any change in the ownership of more than 1% of the voting shares or net economic position during a period after the election (*e.g.*, 60 days).<sup>314</sup> Other commenters supported the proposed disclosure requirement regarding the nominating shareholder’s or group’s intent to hold shares after the meeting, or recommended that the Commission require instead that the nominating shareholder or group hold the requisite amount of shares for a specific period after the date of the meeting.<sup>315</sup>

We believe that a requirement to hold the securities through the date of the election of directors is appropriate to demonstrate the nominating shareholder’s or group member’s

<sup>311</sup> See new Rule 14a–11(b)(4) and proposed Rule 14a–18(f).

<sup>312</sup> See letters from Alston & Bird; Amalgamated Bank; Calvert; CII; Florida State Board of Administration; P. Neuhauser; Norges Bank; Schulte Roth & Zabel; TIAA–CREF; USPE; ValueAct Capital.

<sup>313</sup> See letter from CII.

<sup>314</sup> See letter from Cleary.

<sup>315</sup> See letters from 26 Corporate Secretaries; ABA; Aetna; AGL; Alaska Air; Alcoa; Anadarko; Applied Materials; Association of Corporate Counsel; Avis Budget; BRT; Burlington Northern; Callaway; Caterpillar; Comcast; L. Dallas; Darden Restaurants; Devon; W. B. Dickerson; Dupont; Eli Lilly; FPL Group; General Mills; Home Depot; Honeywell; Intel; Lionbridge Technologies; Lorsch *et al.*; Keating Muething; Office Depot; PepsiCo; Pfizer; Protective; Sara Lee; SIFMA; Tesoro; Tectron; TI; UnitedHealth; U.S. Bancorp; Verizon; Xerox.

commitment to the director nominee and the election process. In addition, we are adopting the disclosure requirement, as proposed, concerning the nominating shareholder’s or group member’s intent with respect to continued ownership of their shares after the election.<sup>316</sup> We are not, however, adopting a requirement for a nominating shareholder or member of a nominating shareholder group to continue to hold their shares for a certain period of time after the date of the election. We believe that disclosure of a nominating shareholder’s or group member’s intent with respect to continued ownership in a Schedule 14N or amended Schedule 14N will provide investors with the information they need for this purpose.

#### d. No Change in Control Intent

Under the Proposal, to rely on Rule 14a–11, a nominating shareholder or member of a nominating shareholder group would have been required to provide a certification in the filed Schedule 14N that it did not hold the securities with the purpose, or with the effect, of changing the control of the company or gaining more than a limited number of seats on the board.<sup>317</sup> We noted that this certification, along with the other required disclosures, would assist shareholders in making an informed decision with regard to any nominee or nominees put forth by the nominating shareholder or group, in that the information would enable shareholders to gauge the nominating shareholder’s or group’s interest in the company, longevity of ownership, and intent with regard to continued ownership in the company.

Most commenters on this aspect of the Proposal agreed generally that Rule 14a–11 should not be available to shareholders seeking to effect a change in control of a company (or to obtain more than a specified number of board seats) and supported a certification requirement regarding the lack of change in control intent.<sup>318</sup> Some

<sup>316</sup> See new Rule 14a–11(b)(5) and new Item 4(b) of Schedule 14N.

<sup>317</sup> See Item 8 of proposed Schedule 14N.

<sup>318</sup> See letters from ABA; Advance Auto Parts; American Bankers Association; American Express; Americans for Financial Reform (“Americans for Financial Reform”); BRT; CalSTRS; CII; Cleary; COPERA; Corporate Library; Dewey; Dominican Sisters of Hope; Eli Lilly; Emerson Electric; Florida State Board of Administration; A. Goolsby; GovernanceMetrics; ICI; JPMorgan Chase; Sen. Carl Levin (“C. Levin”); Mercy Investment Program; Metlife; Nathan Cummings Foundation; P. Neuhauser; Protective; RiskMetrics; Seven Law Firms; SIFMA; Sisters of Mercy; Social Investment Forum; Society of Corporate Secretaries; Sodali; SWIB; TIAA–CREF; Trillium; Tri-State Coalition; T. Rowe Price; tw telecom; Ursuline Sisters of Tildonk; Wachtell; Walden; B. Villiarmino.

commenters, however, expressed concern about the lack of a remedy when a certification regarding control intent proves to be false or when a nominating shareholder or group changes its intent.<sup>319</sup> Suggested remedies included excluding the nominee of any nominating shareholder or group that changes intent and barring the nominating shareholder or group from using the rule for the following two annual meetings,<sup>320</sup> requiring disclosure of a change of intent and resignation of the Rule 14a–11 director,<sup>321</sup> and imposing liability under Rule 14a–9.<sup>322</sup>

We are adopting this requirement with some modifications from the Proposal. To rely on Rule 14a–11, the nominating shareholder (or where there is a nominating shareholder group, any member of the nominating shareholder group) must not be holding any of the company's securities with the purpose, or with the effect, of changing control of the company<sup>323</sup> or to gain a number of seats on the board of directors that exceeds the maximum number of nominees that the registrant could be required to include under Rule 14a–11 and must provide a certification to this effect in its filed Schedule 14N.<sup>324</sup>

The final requirement differs from the Proposal in three respects. First, in addition to requiring the certification to address the absence of change in control intent or intent to gain more than the maximum number of seats provided under the rule, we also have added this condition as an explicit requirement to the rule.<sup>325</sup> We believe that this more directly achieves our intent—that the rule not be used by shareholders that have an intent to change the control of the company or gain more than the maximum number of seats specified in the rule.

Second, we have clarified the language of the requirements so that it

provides that the rule is available only if the nominating shareholder or group members do not have an intent to change control of the company<sup>326</sup> or gain more seats on the board than the maximum provided for under Rule 14a–11. We slightly revised the language of the requirement to clarify our intended meaning. The Proposal used the language “gain more than a limited number of seats on the board,” which was intended to refer to the limitations within the rule on the maximum number of nominees required to be included in the company's proxy materials. The final rule states this more explicitly.

Finally, we have added an instruction to clarify that in order to rely on Rule 14a–11 to include a nominee or nominees in a company's proxy materials, a nominating shareholder or a member of a nominating shareholder group may not be a member of any other group with persons engaged in solicitations or other nominating activities in connection with the subject election of directors; may not separately conduct a solicitation in connection with the subject election of directors other than a Rule 14a–2(b)(8) exempt solicitation in relation to those nominees it has nominated pursuant to Rule 14a–11 or for or against the company's nominees; and may not act as a participant in another person's solicitation in connection with the subject election of directors.<sup>327</sup>

We understand that companies have concerns that shareholders using Rule 14a–11 may inaccurately assert that they do not have a change in control intent, and that this can be a difficult factual issue. If a company determines that it can exclude a nominee based on this eligibility condition, it will be required to notify the nominating shareholder, members of the nominating shareholder group, or, where applicable, the nominating shareholder group's authorized representative, of a deficiency in its notice on Schedule 14N and provide the nominating shareholder or group the opportunity to respond. The company also would be required to submit a notice to the Commission stating its intent to exclude a nominee from its proxy materials (which would be required to include a description of the company's basis for exclusion) and, if it wished to, it could seek the staff's informal view with regard to its determination to exclude the nominee (commonly referred to as a “no-action”

request).<sup>328</sup> In addition, a nominating shareholder and each member of a nominating shareholder group will have liability under Rule 14a–9 for a materially false or misleading certification in the Schedule 14N. Questions concerning the nomination also may be resolved by the parties outside the staff process provided in Rule 14a–11(g), including through private litigation where necessary, similar to the way they resolve issues arising in traditional proxy contests.<sup>329</sup> Finally, we note that the Commission also could take enforcement action with respect to companies that inappropriately exclude nominees under Rule 14a–11 or shareholders that provide false certifications in their Schedule 14N. We believe these measures should provide sufficient means to address situations in which a nominating shareholder or member of a nominating shareholder group provides a false certification regarding change in control intent.

#### e. Agreements With the Company

In the Proposing Release, we noted that a shareholder nomination process that includes limits on the number of nominees that a company is required to include in its proxy materials presents the potential risk of nominating shareholders or groups acting merely as a surrogate for the company or its management in order to block usage of the rule by another nominating shareholder or group. We proposed to address this concern by providing that a nominating shareholder or group using Rule 14a–11 would be required to represent that no agreement between the nominating shareholder or group and the company and its management exists.<sup>330</sup> To avoid any uncertainty about the breadth of this requirement, the Proposal included an instruction noting that prohibited agreements would not include unsuccessful negotiations with the company to have the nominee included in the company's proxy materials as a management nominee, or negotiations that are limited to whether the company is required to include the shareholder

<sup>319</sup> See letters from American Bankers Association; Dewey; Emerson Electric; A. Goolsby; Metlife; Protective; Seven Law Firms; SIFMA.

<sup>320</sup> See letter from Seven Law Firms.

<sup>321</sup> See letter from Protective.

<sup>322</sup> See letter from P. Neuhauser.

<sup>323</sup> Although Rule 14a–11 does not contain a requirement that the shareholder nominee or nominees do not have an intent to change the control of the company, a nominating shareholder's or group's ability to meet the requirement and certify that it does not have such an intent will be impacted by the intentions and actions of its nominee or nominees. For example, a nominating shareholder would not be able to certify that it does not hold the company's securities for the purpose, or with the effect, of changing the control of the company if its nominee is engaged in its own proxy contest or tender offer while the Rule 14a–11 nomination is pending.

<sup>324</sup> See certifications in Item 8 of new Schedule 14N.

<sup>325</sup> See Rule 14a–11(b)(6).

<sup>326</sup> A change in control includes, but is not limited to, an extraordinary corporate action, such as a merger or tender offer.

<sup>327</sup> See new Instruction to Rule 14a–11(b).

<sup>328</sup> See Section II.B.9.b. below for further discussion of determinations to exclude a nominee or nominees.

<sup>329</sup> See Sections II.B.8. and II.B.9. for an explanation of the disclosure requirements applicable to a nomination made pursuant to Rule 14a–11 and the process for excluding a nominee.

<sup>330</sup> In this regard, we also proposed to require a nominating shareholder or group to represent that no relationships or agreements between the nominee and the company and its management exist. This aspect of the rule is discussed in Section II.B.5.c. below.

nominee in the company's proxy materials under Rule 14a-11.

Commenters generally supported the proposed requirement, including the clarifying instruction regarding certain negotiations with the company.<sup>331</sup> One commenter specifically supported the portion of the proposed rule providing that unsuccessful negotiations or negotiations that were limited to whether the company is required to include a shareholder nominee under Rule 14a-11 would not be deemed to be a direct or indirect agreement.<sup>332</sup> One commenter was concerned about possible manipulation by companies and supported a prohibition on agreements.<sup>333</sup> According to that commenter, negotiations that resulted in a nomination being included in the proxy statement should be treated as a company nominee and not a shareholder nominee under Rule 14a-11.

Some commenters encouraged us to allow negotiations that resulted in inclusion of shareholder nominees as management nominees and cautioned that the proposal could discourage constructive dialogue between companies and shareholders.<sup>334</sup> Three commenters opposed limits on some or all relationships between the company and the nominating shareholder, group, or shareholder nominee.<sup>335</sup> These commenters believed that the Commission should not prohibit agreements between a company and a nominating shareholder or group. They warned that restricting the ability of companies to reach agreements with a nominating shareholder or group would limit the dialogue between companies and investors. One commenter suggested that proposed Rule 14a-18(d) be revised to permit a company to agree not to contest the eligibility of a shareholder nominee.<sup>336</sup> The commenter also suggested that if a company settled a threatened election contest by placing a shareholder nominee on the board, additional shareholder nominees should not be permitted for a specified period of time.

After careful review of the comments, we continue to believe that it is appropriate to provide that a nominating shareholder or group will not be eligible to have a nominee or nominees included in a company's

proxy materials under Rule 14a-11 if the nominating shareholder, group, or any member of the nominating shareholder group, has any agreement with the company with respect to the nomination. We have revised the rule to make it clearer that this is an eligibility condition by listing it as a condition in the rule, rather than only a representation required in Schedule 14N.<sup>337</sup> We have incorporated, as proposed, the instruction with respect to unsuccessful negotiations (*i.e.* negotiations that do not result in an agreement) regarding whether a company is required to include a nominee in order to make clear that those negotiations would not be disqualifying.

As described above, a nominating shareholder or group will not be eligible to use Rule 14a-11 if there is an agreement with the company regarding the nomination of the nominee.<sup>338</sup> When a nominating shareholder or group files its Schedule 14N, this requirement will apply, and the certification required by Schedule 14N will have the effect of confirming that there are no agreements. We believe this is an important safeguard to prevent actions that could undermine the purpose of the rule. If, after the Schedule 14N is filed, a nominating shareholder or group reached an agreement with the company for the nominee to be included in the company's proxy materials as a management nominee, the nominating shareholder or group would no longer be proceeding under Rule 14a-11. Consequently, there is no need to revise the "no agreements" requirement in Rule 14a-11 to address that fact pattern.

Although we are adopting the "no agreements" requirement largely as proposed, we are persuaded by commenters that we should revise our final rules so that they do not unnecessarily discourage constructive dialogue between shareholders and

companies. However, we believe this concern is more appropriately addressed in the method of calculation of the maximum number of permissible nominees, and the question of whether that number should include management nominees that were originally put forward as shareholder nominees under Rule 14a-11. Our revisions to that provision are discussed in Section II.B.6. below.

#### f. No Requirement To Attend the Annual or Special Meeting

Under Rule 14a-11 as proposed, a nominating shareholder or group would have no obligation to attend the annual or special meeting at which its nominee or nominees is being presented to shareholders for a vote. We received comment on the Proposal, however, suggesting that we require a nominating shareholder or group, or a qualified representative of the nominating shareholder or group, to attend the company's shareholder meeting and nominate its director candidate(s) in person.<sup>339</sup> One commenter explained that this requirement would be consistent with State law requirements for nominations and many companies' advance notice bylaws.<sup>340</sup> Another commenter suggested that, as required under Rule 14a-8(h)(3) for shareholder proposals, if the nominating shareholder or group (or its qualified representative) fails, without good cause, to appear and nominate the candidate, the company should be permitted to exclude from its proxy materials for the following two years all nominees submitted by that nominating shareholder or members of the nominating group.<sup>341</sup>

We have decided not to include a requirement that the nominating shareholder or qualified representative appear at the meeting and present the nominee because we believe that shareholders will have sufficient incentive to take steps to assure that their nominees are voted on at the meeting, whether through attending the meeting or sending a qualified representative, or through other arrangements with the company, and we do not want to add unnecessary complexities and burdens to the rule. We note that State law will control what happens if a candidate is not nominated at the meeting because the person supporting the candidate does not

<sup>331</sup> See letters from ADP; BRT; Calvert; CFA Institute; CII; Seven Law Firms; TIAA-CREF; USPE.

<sup>332</sup> See letter from CII.

<sup>333</sup> See letter from USPE.

<sup>334</sup> See letters from BRT; Seven Law Firms; Society of Corporate Secretaries.

<sup>335</sup> See letters from ABA; Steve Quinlivan ("S. Quinlivan"); Verizon.

<sup>336</sup> See letter from S. Quinlivan.

<sup>337</sup> We note that a nominating shareholder or members of a nominating shareholder group will be required to provide a certification in the Schedule 14N that the requirements of Rule 14a-11 are satisfied, which will include the "no agreements" requirement. A nominating shareholder or member of a nominating shareholder group will be liable, pursuant to Rule 14a-9(c), for a false or misleading certification provided in Schedule 14N.

<sup>338</sup> See Rule 14a-11(b)(7). See also Rule 14a-11(d)(7) which clarifies that if a nominee, nominating shareholder or any member of a nominating group has an agreement with the company or an affiliate of the company regarding the nomination of a candidate for election, other than as specified in Rule 14a-11(d)(5) or (6), any nominee or nominees from such shareholder or group shall not be counted in calculating the number of shareholder nominees for purposes of Rule 14a-11(d).

<sup>339</sup> See letters from ABA; BRT.

<sup>340</sup> See letter from ABA.

<sup>341</sup> See letter from BRT.

attend the meeting or make other arrangements.<sup>342</sup>

#### g. No Limit on Resubmission

Under the Proposal, a nominating shareholder's or group's ability to use Rule 14a-11 would not be impacted by prior unsuccessful use of the rule. In response to our request for comment, a number of commenters supported a provision that would render a nominating shareholder or group ineligible to use Rule 14a-11 for a period of time (e.g., one, two, or three years) if the nominating shareholder or group presented a nominee who failed to receive significant shareholder support in a previous election (e.g., 10%, 15%, 25%, or 30%).<sup>343</sup> One commenter indicated that this resubmission threshold would have a dual purpose: (i) when the nominee failed to garner significant support from shareholders, it would be inappropriate to require the company to expend resources repeatedly to include the unsuccessful nominee;<sup>344</sup> and (ii) other shareholders would have an opportunity to submit their own nominations.<sup>345</sup> On the other hand, some commenters opposed a provision that would render a nominating shareholder or group ineligible to use Rule 14a-11 for a period of time if the nominating shareholder or group presented a nominee who failed to receive a specified percentage of shareholder votes at a previous

<sup>342</sup> While state statutes are largely silent on the subject of presentation of nominations, motions or other business at meetings of shareholders, the chairman of the meeting typically has broad discretionary authority over its conduct (see, e.g., Model Business Corporation Act § 7.08(b)). As we understand, it is prevailing practice for the chairman to invite nominations of directors from the meeting floor. See David A. Drexler, *et al.*, Delaware Corporation Law and Practice, ¶ 24.05[3] (2009 supp.); Carroll R. Wetzel, *Conduct of a Stockholders' Meeting*, 22 Bus. Law. 303, 313-314 (1967); American Bar Association Corporate Laws Committee and Corporate Governance Committee, Business Law Section, Handbook for the Conduct of Shareholders' Meetings (2d ed. 2010) at 151.

<sup>343</sup> See letters from 26 Corporate Secretaries; ABA; ADP; Advance Auto Parts; Aetna; Alcoa; AllianceBernstein; Anadarko; Applied Materials; Avis Budget; Boeing; BorgWarner; BRT; Burlington Northern; Caterpillar; Chevron; CIGNA; Cleary; Comcast; CSX; Darden Restaurants; Deere; Dewey; DTE Energy; Dupont; Eaton; FedEx; Florida State Board of Administration; FMC Corp.; FPL Group; General Mills; Headwaters; Intel; ITT; JPMorgan Chase; Kirkland & Ellis; E.J. Kullman; Leggett; P. Neuhauser; Northrop; PepsiCo; Pfizer; Protective; RiskMetrics; Sara Lee; Seven Law Firms; SIFMA; Society of Corporate Secretaries; Southern Company; T. Rowe Price; tw telecom; U.S. Bancorp; Wells Fargo; Weyerhaeuser; Whirlpool; Xerox.

<sup>344</sup> See discussion in Section II.B.5.e. below with regard to resubmission of unsuccessful shareholder nominees.

<sup>345</sup> See letter from Society of Corporate Secretaries.

election.<sup>346</sup> One commenter pointed out that management nominees are not subject to similar limits.<sup>347</sup> After consideration of the comments we do not believe it is necessary or appropriate to include a limitation on use of Rule 14a-11 by nominating shareholders or groups that have previously used the rule. We continue to believe that such a limitation would not facilitate shareholders' traditional State law rights and would add unnecessary complexity to the rule's operation.

#### 5. Nominee Eligibility Under Exchange Act Rule 14a-11

##### a. Consistent With Applicable Law and Regulation

Under the Proposal, a company would have been able to exclude a nominee where the nominee's candidacy or, if elected, board membership would violate controlling State law, Federal law, or rules of a national securities exchange or national securities association (other than rules of a national securities exchange or national securities association that set forth requirements regarding the independence of directors, which the rule addresses separately) and such violation could not be cured.<sup>348</sup>

Commenters generally supported this requirement.<sup>349</sup> These commenters suggested that the rule require the nominating shareholder or group to provide any information necessary to ensure compliance with these laws or regulations. Some of these commenters noted that there are various Federal and State laws that govern or affect the ability of a person to serve as a director, such as the Federal Power Act and related FERC regulations, Federal maritime laws and regulations, Department of Defense security clearance requirements, Department of State export licensing requirements, bank holding company laws, FCC licensing requirements, state gaming licensing requirements, Federal Reserve regulations, FDIC regulations, U.S. government procurement regulations, Section 8 of the Clayton Act, Section 1 of the Sherman Act, and Section 5 of the

<sup>346</sup> See letters from CII; Norges Bank; Solutions; USPE; Walden.

<sup>347</sup> See letter from CII.

<sup>348</sup> In the Proposing Release, we described an exception from the provision if the violation could be cured. We inadvertently did not include language for this provision in the proposed regulatory text.

<sup>349</sup> See letters from 26 Corporate Secretaries; American Bankers Association; Association of Corporate Counsel; BRT; Dewey; Emerson Electric; Financial Services Roundtable; GE; Intel; JPMorgan Chase; O'Melveny & Myers; Protective; Sidley Austin; Tenet; Xerox.

Federal Trade Commission Act.<sup>350</sup> One commenter, for example, explained that banking laws and regulations impose their own eligibility standards for directors.<sup>351</sup> One commenter stated more generally that it does not oppose the proposed requirement that a company would not have to include a shareholder nominee in its proxy materials if the nominee's candidacy or election would violate Federal law or State law and such violation could not be cured.<sup>352</sup> It noted, however, that "there is not a lot of law" that disqualifies a person from serving as a director and described concerns about State law barriers as a "red herring."

On the other hand, one commenter stated that a company should not be allowed to exclude a shareholder nominee from its proxy materials because the election of the nominee would result in the violation of State law or Federal law.<sup>353</sup> The commenter explained that allowing such exclusion "would make it prohibitively expensive for most shareowners to submit nominations under the proposed rule. It would lead to many shareowner nominees being disqualified based on technicalities or invented legal theories."

After considering the comments, we continue to believe that Rule 14a-11 should address Federal law, State law, and applicable exchange requirements (other than the requirements related to objective independence standards, which are addressed separately under the rule). Requiring compliance with basic legal requirements regarding nominees should encourage nominating shareholders to bring forward candidates that may be more likely to be able to be elected and serve as directors, and should reduce disruption and expense for companies of opposing a candidate who could not serve on the board if elected because their service would violate law.<sup>354</sup> Thus, under Rule 14a-11, a nominee will not be eligible to be included in a company's proxy materials if the nominee's candidacy, or if elected, board membership will violate Federal law, State law, or applicable exchange requirements, if any,<sup>355</sup> other than those related to

<sup>350</sup> See letters from American Bankers Association; BRT; Emerson Electric; GE; O'Melveny & Myers; Sidley Austin; Tenet.

<sup>351</sup> See letter from American Bankers Association.

<sup>352</sup> See letter from CII.

<sup>353</sup> See letter from USPE.

<sup>354</sup> We note that this condition would not disqualify a nominee unless the violation could not be cured during the time period in which a nominating shareholder or group has to respond to a company's notice of deficiency.

<sup>355</sup> We are not aware of other exchange requirements related to director qualifications, but

independence standards, and such violation could not be cured during the time period provided in the rule.<sup>356</sup>

#### b. Independence Requirements and Other Director Qualifications

Under the Proposal, the nominating shareholder or each member of the nominating shareholder group would have been required to provide a representation that the shareholder nominee meets the *objective criteria* for “independence” of the national securities exchange or national securities association rules applicable to the company, if any, or, in the case of a registrant that is an investment company, a representation that the nominee is not an “interested person” of the registrant, as defined in Section 2(a)(19) of the Investment Company Act.<sup>357</sup> For registrants other than investment companies, the representation would not have been required in instances where a company is not subject to the requirements of a national securities exchange or a national securities association. We also noted that exchange rules regarding director independence generally include some standards that depend on an objective determination of facts and other standards that depend on subjective determinations.<sup>358</sup> Under our

should an exchange adopt new requirements, this provision would apply.

<sup>356</sup> As discussed in Section II.B.9.b., a company that intends to exclude a shareholder nominee or nominees will be required to notify the nominating shareholder or group of the basis on which the company plans to exclude the nominee or nominees and the nominating shareholder or group will have 14 calendar days to cure the deficiency (where curable).

<sup>357</sup> Pursuant to proposed Rule 14a–18(c), a nominating shareholder or group would include a representation in its notice to the company that the nominee satisfies the existing independence or “interested person” standards.

<sup>358</sup> See proposed Rule 14a–18(c) and the Instruction to paragraph (c). For example, the NYSE listing standards include both subjective and objective components in defining an “independent director.” As an example of a subjective determination, Section 303A.02(a) of the NYSE Listed Company Manual provides that no director will qualify as “independent” unless the board of directors “affirmatively determines that the director has no material relationship with the listed company (either directly or as a partner, shareholder or officer of an organization that has a relationship with the company).” On the other hand, Section 303A.02(b) provides that a director is not independent if he or she has any of several specified relationships with the company that can be determined by a “bright-line” objective test. For example, a director is not independent if “the director has received, or has an immediate family member who has received, during any twelve-month period within the last three years, more than \$120,000 in direct compensation from the listed company, other than director and committee fees and pension or other forms of deferred compensation for prior service (provided such compensation is not contingent in any way on continued service).” Similar to the NYSE rules, the

Proposal, the representation would not cover subjective determinations. Also, the representation would not cover additional independence or director qualification requirements imposed by a board on its independent members, although we requested comment on whether it should.

Commenters generally supported the requirement regarding the objective independence standards.<sup>359</sup> Institutional and other investors agreed that nominating shareholders should not be required to represent that nominees satisfy the subjective independence standards of the relevant exchange or national securities association, and also agreed that they should not be subject to any director independence or qualification standards set by the board or the nominating committee.<sup>360</sup> One of these commenters expressed agreement with the Proposal that where a company is not subject to the independence standards of an exchange or national securities association, the nominating shareholder or group should not be required to provide disclosure concerning whether nominees would be independent.<sup>361</sup> To the extent that a company has independence standards that are more stringent than those of an exchange, then the commenter would not oppose the application of those standards to the shareholder nominee as long as the standards are objective. Two commenters expressed the view that the

NASDAQ Listing Rules require a company’s board to make an affirmative determination that individuals serving as independent directors do not have a relationship with the company that would impair their independence. The NASDAQ rules include certain objective criteria, similar to those provided in NYSE Section 303A.02(b), for making such a determination. See NASDAQ Rule 5605(a)(2) and IM–5605.

<sup>359</sup> See letters from ABA; ACSI; Advance Auto Parts; Aetna; Alaska Air; Alcoa; Anadarko; Avis Budget; Biogen; The Board Institute (“Board Institute”); BorgWarner; BRT; Burlington Northern; Callaway; CalSTRS; Caterpillar; CIGNA; Cleary; Comcast; Con Edison; CII; COPERA; CSX; Cummins; Darden Restaurants; Deere; Dewey; DTE Energy; Eaton; Edison Electric Institute; Einstein Noah Restaurant Group, Inc. (“Einstein Noah”); Emerson Electric; ExxonMobil; FedEx; FMC Corp.; FPL Group; General Mills; A. Goolsby; Headwaters; Home Depot; Honeywell; Horizon Lines, Inc. (“Horizon”); C. Horner; IBM; Intel; JPMorgan Chase; Keating Muething; E.J. Kullman; LUCRF; McDonald’s; Merchants Terminal; MetLife; P. Neuhauser; Norfolk Southern; Northrop; Office Depot; O’Melveny & Myers; P&G; PepsiCo; Pfizer; Protective; S&C; Seven Law Firms; Sidley Austin; SIFMA; Society of Corporate Secretaries; Southern Company; Tenet; Tesoro; Theragenics; TI; TIAA–CREF; Tompkins; tw telecom; UnitedHealth; U.S. Bancorp; ValueAct Capital; Verizon; Wells Fargo; Weyerhaeuser.

<sup>360</sup> See letters from ACSI; CalSTRS; CII; COPERA; LUCRF; P. Neuhauser; TIAA–CREF; ValueAct Capital.

<sup>361</sup> See letter from CII.

Section 2(a)(19) test is more appropriate for investment company directors than the independence standard applied to non-investment company directors,<sup>362</sup> with one noting that the Section 2(a)(19) test is tailored to the types of conflicts of interest faced by investment company directors and that the Section 2(a)(19) provision is critical given that investment companies must have a specified percentage of independent directors to be able to comply with certain statutory and regulatory requirements.<sup>363</sup>

A significant number of commenters from the corporate community stated generally that shareholder nominees should satisfy not just the objective director independence standards of the relevant exchange or national securities associations, but all of the company’s director qualifications and independence standards (including, if applicable, more stringent objective independence standards imposed by the board, subjective director independence standards, director qualification standards, board service guidelines, and code of conduct in the company’s governance principles and committee charters) applicable to all directors and director nominees.<sup>364</sup> Many commenters warned that exempting shareholder nominees from a company’s director independence and qualification standards could cause the company to be exposed to legal issues, lower the quality and diversity of the board, and create difficulties in recruiting qualified directors.<sup>365</sup> Other commenters also believed that exempting shareholder nominees from the subjective director independence standards of the relevant exchange or national securities association would put companies at risk of noncompliance with the exchange’s

<sup>362</sup> See letters from ABA II; ICI.

<sup>363</sup> See letter from ICI. One commenter stated that the application of the “interested person” standard of Section 2(a)(19) is unnecessary. See letter from Norges Bank.

<sup>364</sup> See letters from ABA; Advance Auto Parts; Aetna; Alaska Air; Alcoa; Anadarko; Avis Budget; Biogen; Board Institute; BorgWarner; BRT; Burlington Northern; Callaway; Caterpillar; CIGNA; Cleary; Comcast; Con Edison; CSX; Cummins; Darden Restaurants; Deere; Dewey; DTE Energy; Eaton; Edison Electric Institute; Einstein Noah; Emerson Electric; ExxonMobil; FedEx; FMC Corp.; FPL Group; General Mills; A. Goolsby; Headwaters; Home Depot; Honeywell; Horizon; C. Horner; IBM; Intel; JPMorgan Chase; Keating Muething; E.J. Kullman; McDonald’s; Merchants Terminal; MetLife; Norfolk Southern; Northrop; Office Depot; O’Melveny & Myers; P&G; PepsiCo; Pfizer; Protective; S&C; Seven Law Firms; Sidley Austin; SIFMA; Society of Corporate Secretaries; Southern Company; Tenet; Tesoro; Theragenics; TI; Tompkins; tw telecom; UnitedHealth; U.S. Bancorp; Verizon; Wells Fargo; Weyerhaeuser.

<sup>365</sup> See letters from Board Institute; BRT; Con Edison; C. Horner; TI; Verizon.

or association's rules regarding independent directors, burden the remaining independent directors with additional duties by forcing them to serve on more board committees, make it more difficult for companies to recruit the independent directors needed for the board committees, and force companies to increase the size of the board and conduct additional searches for directors qualifying as independent.<sup>366</sup>

After carefully considering the comments, we are adopting the requirement largely as proposed. We believe that the Rule 14a-11 process should be limited to nominations of board candidates who meet any objective independence standards of the relevant securities exchange. While we understand the concerns expressed by many commenters from the corporate community, particularly with respect to the risk of noncompliance with listing standards, we continue to believe that the rule should not extend to subjective independence standards. We note that Rule 14a-11 only addresses when a company must include a nominee in its proxy materials—it does not preclude a nominee from ultimately being subject to any subjective determination of independence for board committee positions. We believe the concerns regarding independent directors being forced to take on additional duties, companies needing to increase the size of the board or conducting additional searches for independent directors are best addressed through disclosure. A company could include disclosure in its proxy materials advising shareholders that the shareholder nominee would not meet the company's subjective criteria, as appropriate. This would provide shareholders with the opportunity to make an informed choice with regard to the candidates for director.

We believe that it is in both the company's and shareholders' interest for the company to continue to meet any applicable listing standards, and requiring that Rule 14a-11 nominees meet the objective independence standards will further that interest. It also should help reduce disruption and expense for companies opposing a candidate it believes would cause it to violate applicable listing standards. To clarify that this is an affirmative requirement for Rule 14a-11 nominees, we have revised the rule to include this provision as an eligibility requirement rather than a representation.<sup>367</sup>

<sup>366</sup> See letters from Metlife; O'Melveny & Myers; Seven Law Firms; Wells Fargo.

<sup>367</sup> See Rule 14a-11(b)(9).

A nominating shareholder or group also will be required to provide a statement in Schedule 14N that the nominee or nominees meets the objective independence standards of the applicable exchange rules.<sup>368</sup> For this purpose, the nominee would be required to meet the definition of "independent" that is applicable to directors of the company generally and not any particular definition of independence applicable to members of the audit committee of the company's board of directors.<sup>369</sup> To the extent a rule imposes a standard regarding independence that requires a subjective determination by the board or a group or committee of the board (for example, requiring that the board of directors or any group or committee of the board of directors make a determination that the nominee has no material relationship with the listed company), this element of an independence standard would not have to be satisfied.<sup>370</sup> Where a company (other than an investment company) is not subject to the standards of a national securities exchange or national securities association, the requirement would not apply.

While we acknowledge commenters' concerns about nominees not being subject to subjective independence requirements, we believe that including such requirements would create undue uncertainty for shareholders seeking to nominate directors and make it difficult to evaluate the board's conclusion regarding independence. In addition, if a board believes a nominee would not be considered independent under its subjective independence evaluation, it could describe its reasons for that view in its proxy statement. In this regard, we note that in a traditional proxy contest an insurgent's nominee or nominees do not have to comply with any requirements, including the independence requirements applicable to the company.<sup>371</sup> We also agree with

<sup>368</sup> See Item 5(f) of new Schedule 14N.

<sup>369</sup> See new instruction to paragraph (b)(9) in Rule 14a-11.

<sup>370</sup> The rule addresses only the requirements under Rule 14a-11 to be included in a company's proxy materials—it would not preclude a nominee from ultimately being subject to the subjective determination test of independence for board committee positions. A company could include disclosure in its proxy materials advising shareholders that the shareholder nominee for director would not meet the company's subjective criteria, as appropriate. If a shareholder nominee is elected and the board determines that the nominee is not independent, the board member presumably would be included in the group of non-independent directors for purposes of applicable listing standards.

<sup>371</sup> If a shareholder nominee did not meet the independence requirements of a listed market, that listed market may provide for a cure period during

the commenter who noted that the "interested person" test under Section 2(a)(19) is tailored to the types of conflicts of interest faced by investment company directors and that the Section 2(a)(19) provision is critical given that investment companies must have a specified percentage of independent directors to be able to comply with certain statutory and regulatory requirements.<sup>372</sup> Accordingly, under the final rule, a company will be required to include a shareholder nominee in its proxy materials if the shareholder nominee meets the objective criteria for "independence" of the national securities exchange or national securities association rules applicable to the company, if any, or, in the case of a company that is an investment company, the nominee is not an "interested person" of the registrant, as defined in Section 2(a)(19) of the Investment Company Act.<sup>373</sup>

As noted above, we did not propose to require a shareholder nominee submitted pursuant to Rule 14a-11 to be subject to the company's director qualification standards. With regard to these standards, we believe that a nominee's compliance with a company's director qualifications is best addressed through disclosure. Under State law, shareholders generally are free to nominate and elect any person to the board of directors, regardless of whether the candidate satisfies a company's qualification requirement at the time of nomination and election.<sup>374</sup> Many commenters recommended a requirement that the shareholder nominee complete the company's standard director questionnaire or otherwise provide information required of other nominees.<sup>375</sup> While we do not

which time the company may resolve this deficiency. See, e.g., NASDAQ Rule 5810(c)(3)(E) ("If a Company fails to meet the majority board independence requirement in Rule 5605(b)(1) due to one vacancy, or because one director ceases to be independent for reasons beyond his/her reasonable control, the Listing Qualifications Department will promptly notify the Company and inform it has until the earlier of its next annual shareholders meeting or one year from the event that caused the deficiency to cure the deficiency.").

<sup>372</sup> See letter from ICI.

<sup>373</sup> See new Rule 14a-11(b)(9).

<sup>374</sup> See, e.g., *Triplex Shoe Co. v. Rice & Hutchins, Inc.*, 152 A. 342, 375 (Del. 1930). See also 1-13 David A. Drexler et al., *Delaware Corporation Law and Practice* § 13.01 n. 42 (citing *Triplex* for the proposition that "a bylaw requiring a director to be a stockholder required a director to own stock prior to entering into the office of director, not prior to election").

<sup>375</sup> See letters from 26 Corporate Secretaries; Advance Auto Parts; Alaska Air; Anadarko; Aetna; American Express; Association of Corporate Counsel; BorgWarner; BRT; Callaway; Caterpillar; Dewey; DTE Energy; Dupont; Emerson Electric; eWaresness; ExxonMobil; Financial Services Roundtable; IBM; ICI; McDonald's; O'Melveny &

believe nominees submitted pursuant to Rule 14a-11 should be required to complete a company's director questionnaire, we are persuaded that information should be provided regarding whether the nominee meets the company's director qualifications, if any. Accordingly, although we have not revised the rule to allow exclusion of nominees who do not meet any director qualification requirements, we have adopted a requirement that a nominating shareholder or group disclose under Item 5 of Schedule 14N whether, to the best of their knowledge, the nominating shareholder's or group's nominee meets the company's director qualifications, if any, as set forth in the company's governing documents.<sup>376</sup> The company also may choose to provide disclosure in its proxy statement about whether it believes a nominee satisfies the company's director qualifications, as is currently done in a traditional proxy contest. Where a company's governing documents establish certain qualifications for director nominees that, consistent with State law, would preclude the company from seating a director who does not meet these qualifications, we believe this would be important disclosure for shareholders.

#### c. Agreements With the Company

As discussed above with regard to the eligibility requirements for a nominating shareholder or group, we recognize that certain limitations of the rule create the potential risk of nominating shareholders or groups acting merely as a surrogate for the company or its management in order to block usage of the rule by another nominating shareholder or group.<sup>377</sup> Under the Proposal as it relates to nominee eligibility, a nominating shareholder or group would have been required to represent that no agreements between the nominee and the company and its management exist regarding the nomination of the nominee.<sup>378</sup> The Proposal included an instruction clarifying that negotiations between a nominating shareholder or group, nominee, and nominating committee or

Myers; PepsiCo; Praxair; Seven Law Firms; Society of Corporate Secretaries; Theragenics; UnitedHealth; U.S. Bancorp; Xerox.

<sup>376</sup> See Item 5(e) of new Schedule 14N.

<sup>377</sup> See the discussion in Section II.B.4.e. above regarding relationships or agreements between the nominating shareholder or group and the company and its management.

<sup>378</sup> In this regard, we also proposed to require a nominating shareholder or group to represent that no relationships or agreements between the nominee and the company and its management exist. This aspect of the rule is discussed in Section II.B.5.d. below.

board of a company to have the nominee included in the company's proxy materials, where the negotiations were unsuccessful or were limited to whether the company was required to include the nominee in accordance with Rule 14a-11, would not represent a direct or indirect agreement with the company.<sup>379</sup>

Commenters generally supported this proposed requirement.<sup>380</sup> Most of the comments addressed negotiations or agreements between the nominating shareholder or group and the company rather than the relationship or agreements between a nominee and the company.<sup>381</sup>

Consistent with our approach to agreements with nominating shareholders, we are adopting the requirement that there not be any agreements between the nominee and the company and its management regarding the nomination of the nominee largely as proposed. In this regard, we believe it would undermine the purpose of the rule to allow nominees under Rule 14a-11 to have such agreements with the company because of the potential risk of a nominating shareholder or group acting merely as a surrogate for a company. In order to clarify that this is an affirmative requirement of Rule 14a-11, we have revised the rule to make clear that this is an eligibility condition by listing it as a condition in the rule, rather than only in a representation required in Schedule 14N.

#### d. Relationship Between the Nominating Shareholder or Group and the Nominee

We did not propose a requirement that the nominee must be independent or unaffiliated with the nominating shareholder or group, but we requested comment on whether we should include such a requirement.<sup>382</sup> A large number of commenters supported generally an independence requirement that would limit some or all relationships between the nominating shareholder or group and its nominee.<sup>383</sup> Commenters

<sup>379</sup> See instruction to proposed Rule 14a-18(d).

<sup>380</sup> See letters from ADP; BRT; Calvert; CFA Institute; CII; Seven Law Firms; TIAA-CREF; USPE.

<sup>381</sup> See Section II.B.4.e. above for a further discussion of the comments.

<sup>382</sup> The 2003 Proposal included such a requirement. For a discussion of this aspect of the 2003 Proposal and the comments received, see the Proposing Release.

<sup>383</sup> See letters from ABA; Advance Auto Parts; Aetna; Alaska Air; Association of Corporate Counsel; Avis Budget; Biogen; Boeing; BorgWarner; Brink's; BRT; Callaway; Caterpillar; CIGNA; Comcast; Cummins; Darden Restaurants; Deere; Dewey; Dupont; Eaton; Eli Lilly; ExxonMobil; FedEx; Financial Services Roundtable; FMC Corp.; FPL Group; General Mills; Headwaters; Honeywell; JPMorgan Chase; E.J. Kullman; Leggett; Norfolk

explained that an independence requirement would reduce the risk that a successful shareholder nominee would represent only the nominating shareholder or group, avoid potential disruptions and divisiveness from having "special interest" directors, ameliorate the issue of preserving confidentiality within the boardroom and avoiding misuse of material non-public information, and lessen the likelihood that Rule 14a-11 would be used for change in control attempts.<sup>384</sup>

With regard to the degree of independence needed and types of relationships that should be prohibited, numerous commenters recommended a prohibition on any affiliation between the nominating shareholder or group and the shareholder nominee.<sup>385</sup> Some commenters recommended that Rule 14a-11 prohibit a shareholder nominee from being (1) a nominating shareholder, (2) a member of the immediate family of any nominating shareholder, or (3) a partner, officer, director or employee of a nominating shareholder or any of its affiliates.<sup>386</sup> They noted that a similar limitation was included in the 2003 Proposal. Two commenters recommended that the Commission impose the same restrictions and disclosure requirements that were included in the 2003 Proposal.<sup>387</sup>

One commenter noted the Commission's assertion in the Proposing Release that "such limitations may not be appropriate or necessary" because, if elected, a director would be subject to State law fiduciary duties owed to the company.<sup>388</sup> The commenter, however, expressed skepticism that fiduciary obligations would adequately resolve the issue of "special interest" directors. One commenter would not require independence between the nominating shareholder or group and the nominee if the nominating shareholder or group could use Rule 14a-11 to nominate only one candidate; however, if the nominating shareholder or group is allowed to nominate more than one

Southern; Office Depot; O'Melveny & Myers; Pax World; Protective; Sara Lee; Seven Law Firms; SIFMA; Society of Corporate Secretaries; Southern Company; Tenet; U.S. Bancorp; Vinson & Elkins LLP ("Vinson & Elkins"); Wells Fargo; Weyerhaeuser.

<sup>384</sup> See letters from ABA; Alaska Air; Eli Lilly; Leggett.

<sup>385</sup> See letters from Advance Auto Parts; Aetna; Association of Corporate Counsel; Avis Budget; Boeing; Brink's; CIGNA; Cummins; Deere; Eaton; FedEx; FMC Corp.; FPL Group; General Mills; E.J. Kullman; Pax World; Protective; Sara Lee.

<sup>386</sup> See letters from Alaska Air; BorgWarner; Caterpillar; JPMorgan Chase; O'Melveny & Myers; Society of Corporate Secretaries.

<sup>387</sup> See letters from BRT; Intel.

<sup>388</sup> Letter from BRT.



candidate using Rule 14a-11, then the commenter believed independence between the nominating shareholder or group and the nominees is needed.<sup>389</sup> The commenter asserted that a lack of an independence requirement between multiple nominees and the nominating shareholder could give rise to control issues because the nominees, if elected, could be beholden to a single nominating shareholder or group. In addition, the commenter claimed that a lack of independence could give rise to “single issue” or “special interest” directors, thereby causing balkanization of boards. According to this commenter, if independence is not required, then Schedule 14N should require detailed disclosure about the nature of relationships between the nominating shareholder or group and the nominees.<sup>390</sup>

A few commenters recommended requiring disclosure in the Schedule 14N of any direct or indirect relationships between the nominating shareholder or group and the nominee, including family or employment relationships, ownership interests, commercial relationships and any other arrangements or agreements.<sup>391</sup> One commenter recommended that a nominating shareholder or group provide “[d]isclosure about any agreements or relationships with the Rule 14a-11 nominee other than those relating to the nomination of the nominee.”<sup>392</sup>

Other commenters opposed generally any requirement that the nominating shareholder or group be independent from the shareholder nominee.<sup>393</sup> Of these, some commenters recommended the Commission require full disclosure of any affiliations and business relationships instead of an outright prohibition.<sup>394</sup> One commenter noted

<sup>389</sup> See letter from Seven Law Firms.

<sup>390</sup> *Id.* The recommended disclosures included: familial relationships with a nominating shareholder or group member; ownership interests (or other participation) in a nominating shareholder, group member, or affiliates; employment history with a nominating shareholder, group member, or affiliates; prior advisory, consulting or other compensatory relationships with a nominating shareholder, group member, or affiliates; and agreements with a nominating shareholder, group member, or affiliates (other than relating to the nomination).

<sup>391</sup> See letters from O’Melveny & Myers; SIFMA; UnitedHealth. See also letter from CII.

<sup>392</sup> Letter from IBM.

<sup>393</sup> See letters from Amalgamated Bank; CalSTRS; CFA Institute; CII; COPERA; Nathan Cummings Foundation; P. Neuhouser; Norges Bank; Pershing Square; Relational; RiskMetrics; Solutions by Design (“Solutions”); TIAA-CREF; USPE; B. Villiarmino.

<sup>394</sup> See letters from CFA Institute; CII; COPERA; P. Neuhouser; Pershing Square; Relational; USPE; B. Villiarmino.

that no such restriction or prohibition applies to current director candidates, some of whom have various personal and professional links to the company and its executives.<sup>395</sup> Another commenter noted that the NYSE recognized the issue of share ownership when crafting its director independence rules and determined that even significant share ownership should not be dispositive as to a determination of a director’s independence.<sup>396</sup> Two commenters opposed a prohibition on any affiliation between the nominating shareholder and its nominee because they believed that fears regarding the election of “special interest” directors are unfounded or exaggerated, as any nominee would have to gain the support of a broad array of shareholders to be elected.<sup>397</sup> One commenter asserted that existing fiduciary duties are an adequate safeguard against “special interest” directors.<sup>398</sup>

We continue to believe that such limitations are not appropriate or necessary. Rather, we believe that Rule 14a-11 should facilitate the exercise of shareholders’ traditional State law rights and afford a shareholder or group meeting the requirements of the rule the ability to propose a nominee for director that, in the nominating shareholder’s view, better represents the interests of shareholders than those put forward by the nominating committee or board. We note that once a nominee is elected to the board of directors, that director will be subject to State law fiduciary duties and owe the same duty to the corporation as any other director on the board.<sup>399</sup> To the extent a company board is concerned that a director nominee will not represent the views of shareholders, the board could address those points in the company’s proxy materials opposing the candidate’s election. In addition, we believe the disclosure requirements about the relationships between a nominating shareholder or group and the nominee that we are adopting, combined with the fact that any nominee elected will be subject to fiduciary duties, should help address any “special interest” concerns.

#### e. No Limit on Resubmission of Shareholder Director Nominees

Under the Proposal, an individual would not be limited in their ability to

<sup>395</sup> See letter from CII.

<sup>396</sup> See letter from Relational.

<sup>397</sup> See letters from CII; Nathan Cummings Foundation.

<sup>398</sup> See letter from TIAA-CREF.

<sup>399</sup> See E. Norman Veasey & Christine T. DiGuglielmo, *How Many Masters Can a Director Serve? A Look at the Tensions Facing Constituency Directors*, 63 Bus. Law. 761 (2008).

stand as a nominee under the rule based on prior unsuccessful nominations under the rule. A number of commenters supported a provision under which a shareholder nominee who failed to receive a specified threshold (e.g., 10%, 15%, 25%, or 30%) of support at a previous election would be ineligible to be nominated again pursuant to Rule 14a-11 for a specified period (e.g., one, two, or three years).<sup>400</sup> One commenter reasoned that “[t]his would allow more shareholders to participate in the process and would motivate them to propose high quality candidates.”<sup>401</sup> On the other hand, other commenters opposed a provision under which a shareholder nominee who failed to receive significant support at a previous election would be ineligible to be nominated again pursuant to Rule 14a-11 for a specified period.<sup>402</sup> One commenter reasoned that “[s]imilar resubmission requirements aren’t applicable to management’s candidates, so they shouldn’t apply to candidates suggested by shareowners.”<sup>403</sup> We agree with those commenters who opposed a provision that would limit the ability of a shareholder nominee to be nominated based on the level of support received in a prior election. We do not believe that such a limitation would facilitate shareholders’ traditional State law rights and would add undue complexity to the rule’s operation.

#### 6. Maximum Number of Shareholder Nominees To Be Included in Company Proxy Materials

##### a. General

Under the Proposal, a company would be required to include no more than one shareholder nominee or the number of nominees that represents 25% of the company’s board of directors, whichever is greater.<sup>404</sup> Where the term of a director that was nominated

<sup>400</sup> See letters from 26 Corporate Secretaries; ABA; Aetna; Anadarko; BorgWarner; BRT; Burlington Northern; Caterpillar; Cummins; Dewey; Headwaters; JPMorgan Chase; Kirkland & Ellis; Leggett; P. Neuhouser; Northrop; PepsiCo; Pfizer; Protective; Sara Lee; SIFMA; Society of Corporate Secretaries; TIAA-CREF; T. Rowe Price; Xerox.

<sup>401</sup> Letter from Northrop.

<sup>402</sup> See letters from CII; Corporate Library; Dominican Sisters of Hope; First Affirmative Financial Network LLC (“First Affirmative”); Mercy Investment Program; Sisters of Mercy; Social Investment Forum; Tri-State Coalition; Trillium; Ursuline Sisters of Tildonk; USPE.

<sup>403</sup> Letter from CII.

<sup>404</sup> See proposed Rule 14a-11(d)(1). According to information from RiskMetrics, based on a sample of 1,431 public companies, in 2007, the median board size was 9, with boards ranging in size from 4 to 23 members. Approximately 40% of the boards in the sample had 8 or fewer directors, approximately 60% had between 9 and 19 directors, and less than 1% had 20 or more directors.

pursuant to Rule 14a–11 continues past the meeting date, that director would continue to count for purposes of the 25% maximum.

As noted in the Proposing Release, we do not intend for Rule 14a–11 to be available for any shareholder or group that is seeking to change the control of the company or to gain more than a limited number of seats on the board.<sup>405</sup> The existing procedures regarding contested elections of directors are intended to continue to fulfill that purpose.<sup>406</sup> We also noted that by allowing shareholder nominees to be included in a company's proxy materials, part of the cost of the solicitation is essentially shifted from the individual shareholder or group to the company and thus, all of the shareholders.<sup>407</sup> We do not believe that we should require that an election contest conducted by a shareholder to change the control of the company or to gain a number of seats on the board of directors that exceeds the maximum number of nominees that the registrant could be required to include under Rule 14a–11 be funded out of corporate assets.

Some commenters supported generally the proposed limit on the number of shareholder nominees.<sup>408</sup> While agreeing that the Commission's proposed limit on the number of shareholder nominees is needed to ensure a more measured approach towards inclusion of shareholder nominees in company proxy materials, one commenter supported the general principle that shareholders should be entitled to nominate as many directors as necessary to focus the board's attention on optimizing company performance, profitability and sustainable returns.<sup>409</sup> On the other hand, many commenters disagreed with the proposed limit or recommended different limits.<sup>410</sup> Some commenters

<sup>405</sup> The final rule clarifies the second part of this requirement by specifying that a nominating shareholder or group may not be seeking to gain a number of seats on the board of directors that exceeds the maximum number of nominees that the registrant could be required to include under Rule 14a–11.

<sup>406</sup> See, e.g., Exchange Act Rule 14a–12(c).

<sup>407</sup> In this regard, we anticipate that shareholders seeking election of nominees included in the company's proxy materials may need to engage in solicitation efforts for which they will incur expenses.

<sup>408</sup> See letters from CalPERS; CalSTRS; CFA Institute; ICGN; Nathan Cummings Foundation; P. Neuhauer; Norges Bank; Protective; RiskMetrics; TIAA-CREF; T. Rowe Price; WSIB.

<sup>409</sup> See letter from CalPERS.

<sup>410</sup> See letters from 13D Monitor; ABA; ACSI; Advance Auto Parts; Aetna; Alcoa; Allstate; American Express; Americans for Financial Reform; Association of Corporate Counsel; Avis Budget; Best

expressed a general concern that the proposed limit would affect a significant portion of the board, disrupt the board, facilitate a change in control of the company, and possibly require companies to integrate numerous new directors into their boards each year.<sup>411</sup> Other commenters wanted more shareholder nominees to be allowed because they feared that a single shareholder-nominated director would be ineffective due to the lack of a second for motions at board meetings, hostile board members, possible exclusion from key committees, and being effectively cut out of key discussions.<sup>412</sup> Commenters' suggestions as to the appropriate limitation on the number of shareholder nominees ranged from a limit of one shareholder nominee, regardless of the size of the board,<sup>413</sup> to at least two nominees, but less than a majority of the board.<sup>414</sup> Other commenters recommended various limits ranging from 10% to 15% of the board.<sup>415</sup>

We carefully considered commenters' concerns regarding the limitation on the number of Rule 14a–11 nominees;

Buy; J. Blanchard; Boeing; BorgWarner; BRT; Burlington Northern; R. Burt; Callaway; CalPERS; Caterpillar; CIGNA; CII; Cleary; CNH Global; Comcast; Concerned Shareholders; COPERA; Cummins; L. Dallas; Darden Restaurants; Deere; Dupont; Eaton; Eli Lilly; Dale C. Eshelman ("D. Eshelman"); ExxonMobil; FedEx; FMC Corp.; FPL Group; Frontier; GE; General Mills; Headwaters; C. Holliday; Honeywell; IBM; ICI; ITT; JPMorgan Chase; J. Kilts; E. J. Kullman; N. Lautenbach; Leggett; C. Levin; Lionbridge Technologies; LUCRF; McDonald's; Motorola; Office Depot; O'Melveny & Myers; OPERS; P&G; Nathan Cummings Foundation; Northrop; Pax World; PepsiCo; Sara Lee; S&C; Schulte Roth & Zabel; Sherwin-Williams; Sidley Austin; SIFMA; Society of Corporate Secretaries; Solutions; SWIB; Teamsters; TI; G. Tooker; tw telecom; Universities Superannuation; U.S. Bancorp; Verizon; USPE; B. Villiarmois; Wachtell; Wells Fargo; Weyerhaeuser; WSIB.

<sup>411</sup> See letters from BRT (citing a July 2009 survey showing many companies would have to integrate multiple new directors); CII; Eaton; N. Lautenbach; McDonald's; Sherwin-Williams; Sidley Austin; Society of Corporate Secretaries; G. Tooker; WSIB.

<sup>412</sup> See letters from CII; L. Dallas; C. Levin; Nathan Cummings Foundation; Universities Superannuation.

<sup>413</sup> See letters from Advance Auto Parts; Avis Budget; BRT; Caterpillar; CIGNA; CNH Global; Comcast; Cummins; Darden Restaurants; Deere; Eaton; Eli Lilly; FedEx; FMC Corp.; FPL Group; Frontier; General Mills; ICI; ITT; E. J. Kullman; N. Lautenbach; Leggett; McDonald's; Office Depot; O'Melveny & Myers; PepsiCo; Sherwin-Williams; TI; G. Tooker; tw telecom; Verizon; Wachtell; Weyerhaeuser.

<sup>414</sup> See letters from ACSI; Americans for Financial Reform; CalPERS; CII (stating that while it supports the Commission's proposed limit, shareholders should be allowed to nominate two candidates in all cases); COPERA; C. Levin; LUCRF; Nathan Cummings Foundation; SWIB; Teamsters.

<sup>415</sup> See, e.g., Aetna; Association of Corporate Counsel; Barclays; J. Blanchard; BorgWarner; Dewey; ExxonMobil; Headwaters; Honeywell; Lionbridge Technologies; Northrop; Sidley Austin; Society of Corporate Secretaries; U.S. Bancorp.

however, we are adopting the limitation largely as proposed. We believe the rule we are adopting strikes the appropriate balance in allowing shareholders to more effectively exercise their rights to nominate and elect directors, but does not provide nominating shareholders or groups using the rule with the ability to change control of the company. The limitation on the number of Rule 14a–11 nominees that a company is required to include should also limit costs and disruption as compared to a rule without such a limit. We also believe that a lower threshold, such as 10% or 15%, may result in only one shareholder-nominated director at many companies. In addition, we note that our rule only addresses the inclusion of nominees in the company's proxy materials. After reviewing all of the disclosures provided by the company and the nominating shareholder or group, shareholders will be able to make an informed decision as to whether to vote for and elect a shareholder nominee. We believe that the modifications we are making to the rule, as described below, help to alleviate concerns that the election of shareholder nominees would unduly disrupt the board. As to concerns about the possibility that a single shareholder-nominated director would be ineffective due to actions of other members of the board, the rule is not intended to address the interactions of board members after the election of directors. In this respect, we note that any shareholder-nominated directors and board-nominated directors would be subject to fiduciary duties under State law.

As adopted, Rule 14a–11(d) will not require a company to include more than one shareholder nominee or the number of nominees that represents 25% of the company's board of directors, whichever is greater.<sup>416</sup> Consistent with the Proposal, where a company has a director (or directors) currently serving on its board of directors who was elected as a shareholder nominee pursuant to Rule 14a–11, and the term of that director extends past the date of the meeting of shareholders for which the company is soliciting proxies for the election of directors, the company will not be required to include in its proxy materials more shareholder nominees than could result in the total number of directors serving on the board that were elected as shareholder nominees being greater than one shareholder nominee or 25% of the company's board of

<sup>416</sup> See new Rule 14a–11(d)(1).

directors, whichever is greater.<sup>417</sup> We believe this limitation is appropriate to reduce the possibility of a nominating shareholder or group using Rule 14a–11 as a means to gain a number of seats on the board of directors that exceeds the maximum number of nominees that the company could be required to include under Rule 14a–11 or to effect a change in control of the company by repeatedly nominating additional candidates for director. One commenter requested that we explain how Rule 14a–11 would apply to different board structures, and in particular, classified boards.<sup>418</sup> In the case of a staggered board, the rule provides that the 25% limit will be calculated based on the total number of board seats,<sup>419</sup> not the lesser number that are being voted on because it is the size of the full board, not the number up for election, that would be relevant for considering the effect on control.

We note that in the 2003 Proposal, the Commission proposed to require companies to include a set number of nominees, rather than a percentage of the board.<sup>420</sup> We believe that using a percentage in the rule will promote ease of use and alleviate any concerns that a company may increase its board size in an effort to reduce the effect of a shareholder nominee elected to the board.

We understand the concerns addressed by some commenters that this limitation could result in shareholder-nominated directors being less influential,<sup>421</sup> as well as the concerns of other commenters that the possibility of 25% of the board changing through the Rule 14a–11 process could present significant changes to the board.<sup>422</sup> For the reasons discussed above, we believe the limitation as adopted strikes an

appropriate balance and is an appropriate safeguard to assure that the Rule 14a–11 process is not used as a means to effect a change in control.

Though we are adopting this requirement largely as proposed, we have added certain clarifications, which are described below, to address situations at companies where shareholders are able to elect only a subset of the board, revised the standard for determining which nominating shareholder or group will have their nominee or nominees included in the company's proxy materials where there is more than one eligible nominating shareholder or group, and made other modifications designed to facilitate negotiations between companies and nominating shareholders.

#### b. Different Voting Rights With Regard to Election of Directors

Several commenters responded to the Commission's request for comment about how to calculate the maximum number of candidates a nominating shareholder or group could nominate under Rule 14a–11 when certain directors are not elected by all shareholders. Some commenters noted that controlled companies are commonly structured with dual classes of stock which allow shareholders of the non-controlling class of stock to elect a set number of directors that is less than the full board.<sup>423</sup>

In the context of a company where shareholders are only entitled to elect a subset of the total number of directors, the rule as proposed potentially would have allowed shareholders to nominate more candidates than may be elected by the nominating shareholders. Two commenters argued that Rule 14a–11 should be modified so that the maximum number of shareholder nominees is based on the number of directors that may be elected by the class of securities held by the shareholders making the nomination, as opposed to the number of total directors.<sup>424</sup> Another commenter urged us to revise Rule 14a–11 so that it would be limited to a percentage of the number of directors that are elected by the public shareholders (rather than a percentage of all directors) and would not apply to directors that are elected by shareholders of a class of stock having a right to nominate and elect a specified number or percentage of directors, or preferred shareholders having such right as a result of the company's failure to

pay dividends.<sup>425</sup> Another commenter argued that, as proposed, Rule 14a–11 would not allow companies with multiple classes of voting shares the ability to make choices about how to best implement access to the company's proxy to fit their capital structure.<sup>426</sup> One commenter suggested that Rule 14a–11 address how it would apply to companies with multiple classes of stock to prevent shareholders from using the rule to change control of the class of directors those shareholders have the right to elect.<sup>427</sup> Other commenters, by contrast, believed that the maximum number of nominees that companies should be required to include should be based on the total number of director seats, regardless of whether a class of shares only gets to elect a subset of the board.<sup>428</sup>

We also sought comment on how to calculate the maximum number of nominees where the company is contractually obligated to permit a certain shareholder or group to elect a set number of directors to the board. Commenters' views differed on how to calculate the maximum number of nominees a shareholder or shareholder group may nominate in that case. Some commenters believed that the maximum number of nominees should be based on the total board size, regardless of whether a company has granted rights to nominate.<sup>429</sup> One such commenter noted that if Rule 14a–11 contained an exception for board seats subject to contractual rights, companies would have an incentive to enter into contractual agreements in order to evade its application.<sup>430</sup> Other commenters, however, asserted that the maximum number of nominees that shareholders should be permitted to nominate under Rule 14a–11 should be limited to 25% of the "free" seats on the board—that is, only those board seats that are not subject to a contractual nomination right that existed as of the date of the submission and filing of a Schedule 14N.<sup>431</sup> These commenters suggested taking board seats subject to contractual nomination rights "off the table" and basing the 25% calculation on the number of nominees that the nominating committee is free to name. One such commenter remarked that unless board seats subject to contractual nomination rights are excluded,

<sup>417</sup> See new Rule 14a–11(d)(2). This requirement is adopted as it was proposed in Rule 14a–11(d)(2). Depending on board size, 25% of the board may not result in a whole number. In those instances, the maximum number of shareholder nominees for director that a registrant will be required to include in its proxy materials will be the closest whole number below 25%. See the Instruction to paragraph (d)(1).

<sup>418</sup> See letter from ABA.

<sup>419</sup> See Rule 14a–11(d)(2).

<sup>420</sup> Comments on the 2003 Proposal provided a range of views regarding the appropriate number of shareholder nominees. Commenters that supported the use of a percentage, or combination of a set number and a percentage, to determine the number of shareholder nominees suggested percentages ranging from 20% to 35%. See Comment File No. S7–19–03, available at <http://www.sec.gov/rules/proposed/s71903.shtml>.

<sup>421</sup> See letters from CII; L. Dallas; C. Levin; Nathan Cummins Foundation; Universities Superannuation.

<sup>422</sup> See letters from BRT (citing a July 2009 survey showing many companies would have to integrate multiple new directors); CII; Eaton; N. Lautenbach; McDonald's; Sherwin-Williams; Sidley Austin; Society of Corporate Secretaries; G. Tooker; WSIB.

<sup>423</sup> See letters from ABA; Duane Morris; Media General; New York Times.

<sup>424</sup> See letters from Media General; New York Times.

<sup>425</sup> See letter from Sidley Austin.

<sup>426</sup> See letter from BRT.

<sup>427</sup> See letter from Media General.

<sup>428</sup> See letters from CII; P. Neuhauser.

<sup>429</sup> *Id.*

<sup>430</sup> See letter from P. Neuhauser.

<sup>431</sup> See letters from Seven Law Firms; Sidley Austin; ValueAct Capital.

companies may be limited in their ability to offer contractual nominating rights to shareholders without running a heightened risk of change of control, which could result in increased costs of capital and a decrease in the number of strategic alternatives.<sup>432</sup>

We believe that the maximum number of candidates a shareholder can nominate using Rule 14a-11 at companies with multiple classes of stock should be based on the total board size, as is the case at other companies. Thus, we are adopting this requirement as proposed. We believe the changes we are adopting with regard to calculating ownership and voting power, as discussed above, should address concerns about the possibility that the rule could be used to change control of the company or to affect the rights of shareholders as established by a particular company's capital structure.<sup>433</sup> Where shareholders have the right to elect a subset of the full board, however, we believe it is appropriate to provide that the maximum number of nominees a company may be required to include under Rule 14a-11 may not exceed the number of director seats the class of shares held by the nominating shareholder is entitled to elect.<sup>434</sup> We believe the right to nominate is an integral part of the right to elect, therefore we are linking the ability under Rule 14a-11 for a shareholder to nominate directors to instances in which the shareholder can elect directors. Limiting the number of nominations to the number of director seats the class of shares held by the nominating shareholder is entitled to elect presumably would allow to be fully expressed the views of the shareholder about who should sit in the director seats in respect of which the shareholder has nomination rights.

The shareholder nomination provisions in Rule 14a-11 are available only for holders of classes of securities that are subject to the Exchange Act proxy rules, provided that a company is otherwise subject to the rule. If a company subject to Rule 14a-11 has multiple classes of eligible securities, however, the maximum number of candidates a shareholder can nominate will be determined based on the number of director seats the class of shares held by the nominating shareholder is entitled to elect.<sup>435</sup>

c. Inclusion of Shareholder Nominees in Company Proxy Materials as Company Nominees

As discussed in Section II.B.4.e. above, commenters expressed concern that the rule, as proposed, might discourage constructive dialogue between shareholders and companies.<sup>436</sup> These commenters noted that companies would be discouraged from discussing potential board candidates with shareholders planning to use Rule 14a-11 and including them as management nominees because such nominees would not reduce the maximum number of shareholder nominees that the company would be required to include under Rule 14a-11. Subject to certain safeguards, we believe our rule should not discourage dialogue between nominating shareholders and companies and agree that the rule, as proposed, could have the effect of discouraging constructive dialogue if shareholder nominees nominated by a company as a result of that dialogue do not count toward the maximum number of shareholder nominees a company is required to include in its proxy materials. Consequently, under our final rule, where a company negotiates with the nominating shareholder or group that has filed a Schedule 14N before beginning any discussion with the company about the nomination and that otherwise would be eligible to have its nominees included in the company's proxy materials, and the company agrees to include the nominating shareholder's or group's nominees on the company's proxy card as company nominees, those nominees will count toward the 25% maximum set forth in the rule.<sup>437</sup> As noted, this would only apply where the nominating shareholder or group has filed its notice on Schedule 14N before beginning discussions with the company. Although this limitation may reduce somewhat the utility of this provision, we believe limiting the treatment to situations in which the nominating shareholder or group has filed a Schedule 14N will reduce the possibility that this exception is used by a company to avoid having to include shareholder director nominees submitted by shareholders or groups of

shareholders that are not affiliated with or not working on behalf of the company.

In the Proposing Release, we requested comment as to whether it would be appropriate for the rule to take into account incumbent directors who were nominated pursuant to Rule 14a-11 for purposes of determining the maximum number of shareholder nominees, or whether there should be a different means to account for such incumbent directors. One commenter argued that incumbent Rule 14a-11 directors should not count towards the 25% limit.<sup>438</sup> It reasoned that, once elected, the Rule 14a-11 director represents all shareholders and that future use of

Rule 14a-11 by other shareholders should not be restricted. A number of commenters stated that incumbent Rule 14a-11 directors should count towards the maximum number of shareholder nominees allowed under the rule,<sup>439</sup> with some suggesting that this should be the case in limited circumstances, such as when a Rule 14a-11 director is re-nominated by the board or as long as the director continues on the board.<sup>440</sup> Commenters expressed concerns that the method of calculating the maximum number of directors subject to Rule 14a-11 nominations—which as proposed would not include directors previously elected following a Rule 14a-11 nomination unless they are nominated again by a shareholder using Rule 14a-11—would not encourage boards to integrate these directors.<sup>441</sup> Some commenters asserted that failing to count such a director toward the 25% limit would cause boards to be disinclined to include these directors as company nominees in future elections.<sup>442</sup> They viewed this as counterproductive to efficient board integration and functioning.

While we appreciate commenters' views, we are not persuaded that it is appropriate to provide an exception to the general method of calculating the maximum number of Rule 14a-11 nominees in the case of a shareholder-nominated incumbent director that is re-nominated by the company. As noted

<sup>438</sup> See letter from Florida State Board of Administration.

<sup>439</sup> See letters from ABA; Aetna; American Express; BorgWarner; BRT; Chevron; Cleary; Davis Polk; DTE Energy; Dupont; Edison Electric Institute; Eli Lilly; ExxonMobil; FPL Group; Home Depot; ICI; JPMorgan Chase; MetLife; P. Neuhouser; Pfizer; Protective; RiskMetrics; S&C; Seven Law Firms; Sidley Austin; SIFMA; Society of Corporate Secretaries; Verizon; Vinson & Elkins; Wells Fargo.

<sup>440</sup> See letters from P. Neuhouser; RiskMetrics.

<sup>441</sup> See letters from ABA; BRT; Seven Law Firms.

<sup>442</sup> See letters from Davis Polk; Society of Corporate Secretaries.

<sup>436</sup> See letters from BRT; Seven Law Firms; Society of Corporate Secretaries.

<sup>437</sup> See new Rule 14a-11(d)(4). In this regard, we note that we would view such an agreement as a termination of a Rule 14a-11 nomination. Thus, the nominating shareholder or group would be required to file an amendment to Schedule 14N to disclose the termination of the nomination as a result of the agreement with the company regarding the inclusion of the nominee or nominees. See Item 7 of Schedule 14N and Rule 14n-2.

<sup>432</sup> See letter from Seven Law Firms.

<sup>433</sup> See Section II.B.4.b. above.

<sup>434</sup> See new Rule 14a-11(d)(3).

<sup>435</sup> See new Rule 14a-11(d)(3).

previously, by adopting Rule 14a–11 we are seeking to facilitate shareholders' ability under State law to nominate and elect directors, not necessarily to enhance shareholder representation on the board. We do not believe that a Commission rule is needed to facilitate the working relationship between the shareholder-nominated director and the company-nominated directors, or to provide an incentive for the board to integrate the shareholder-nominated director into its activities. To the extent that a shareholder nominee is elected to the board, the company-nominated directors and the shareholder-nominated director will have a fiduciary duty to act in the best interests of the company and its shareholders.

#### 7. Priority of Nominations Received by a Company

##### a. Priority When Multiple Shareholders Submit Nominees

Proposed Rule 14a–11(d)(3) addressed situations where more than one shareholder or group would be eligible to have its nominees included in the company's form of proxy and disclosed in its proxy statement pursuant to the proposed rule. In those situations, the company would have been required to include in its proxy materials the nominee or nominees of the first nominating shareholder or group from which it receives timely notice of intent to nominate a director pursuant to the rule, up to and including the total number of shareholder nominees required to be included by the company. We proposed this standard because we believed that there would be a benefit to enabling companies to begin preparing their proxy materials and coordinating with the nominating shareholder or group immediately upon receiving an eligible nomination rather than requiring companies to wait to see whether another nomination from a larger nominating shareholder or group was submitted before the notice deadline.

Commenters were almost uniformly opposed to the proposed "first-in" standard. A large number of commenters expressed general opposition to the proposed first-in approach, with many presenting their own recommendations.<sup>443</sup> Commenters

expressed concern that the first-in approach would rush shareholders to submit nominations.<sup>444</sup> One commenter worried that even if the Commission included a window period for submission of shareholder nominees in the final rule, the first-in approach would encourage a race to file, discourage constructive dialogue between shareholders and management, and encourage a "gamesmanship" attitude among possible nominating shareholders or groups.<sup>445</sup> Another commenter argued that the first-in approach would undercut the Commission's stated objectives in proposing Rule 14a–11.<sup>446</sup> One commenter worried that the "first in" approach would favor large shareholders, who have greater resources to prepare their submission materials, over small shareholders who must aggregate to reach the ownership threshold and need to pool resources to prepare their submission materials.<sup>447</sup>

Some commenters expressed general concern about how companies should handle multiple nominations received on the same date.<sup>448</sup> Two commenters worried that it would be difficult for companies to determine which nomination was received first because nominations could be submitted by various methods (e.g., fax transmission, mail, hand delivery) or arrive on the same date.<sup>449</sup> Another commenter feared that a company that receives several nominations on the same date could choose the nomination submitted

by shareholders friendly to management.<sup>450</sup>

Many commenters that opposed the first-in approach suggested alternatives. Of these, the majority preferred to give priority to the largest shareholder or group that submits a nomination.<sup>451</sup> Noting that the 2003 Proposal included this standard and that it received the most support, one commenter argued that what matters most is not who is the fastest to nominate but which shareholder or group has the "greatest stake in the director election and, ultimately, the long-term performance of the company" (with the added benefits of avoiding "gamesmanship" and "administrative challenges").<sup>452</sup> Further, commenters believed that an approach based on the largest holdings would provide sufficient certainty because the number of shares of the largest shareholder or group could be determined from the Schedule 14N filing.<sup>453</sup>

Commenters presented a wide range of views or recommendations for determining priority. Some commenters suggested that when the largest shareholder or group nominates fewer than the maximum number of nominees allowed under Rule 14a–11, then the second largest shareholder or group should have the right to have its nominees included (up to the maximum

<sup>450</sup> See letter from USPE.

<sup>451</sup> See letters from 13D Monitor; 26 Corporate Secretaries; ABA (recommending this approach as one of several recommendations); ACSI; Advance Auto Parts; Aetna; AFL–CIO; AFSCME; Allstate; Amalgamated Bank; Anadarko; Applied Materials; Avis Budget; BCI/A; Best Buy; Boeing; BorgWarner; Burlington Northern; CalPERS; CalSTRS; Caterpillar; CFA Institute; Chevron; CIGNA (recommending this approach as an alternative to another recommendation that the shareholder that held the shares the longest be given priority); CII; Cleary; Con Edison; COPERA; Corporate Library; Cummins; Darden Restaurants; Deere; Devon; Dominican Sisters of Hope; DuPont; Eaton; Emerson Electric; ExxonMobil; FedEx; Financial Services Roundtable; First Affirmative; Florida State Board of Administration (supporting this approach as an alternative to the first-in approach); FMC Corp.; Frontier; A. Goolsby; IAM; ICI; JPMorgan Chase; Kirkland & Ellis; C. Levin; Leggett; LIUNA; LUCRF; Marco Consulting; J. McCoy; McDonald's; J. McTague; Mercy Investment Program; Metlife; D. Nappier; Nathan Cummings Foundation; P. Neuhauser; Norfolk Southern; Norges Bank; Office Depot; OPERS; PACCAR Inc. ("PACCAR"); Pershing Square; PepsiCo; Pfizer; S. Quinlivan; RacetotheBottom; RiskMetrics; Ryder; Sara Lee; Social Investment Forum; Seven Law Firms; Shearman & Sterling; Sheet Metal Workers; Sidley Austin; SIFMA; Sisters of Mercy; Society of Corporate Secretaries; Sodali; Southern Company; SWIB; Teamsters; Tenet; TI; TIAA–CREF; Tri-State Coalition; Trillium; T. Rowe Price; Tectron; tw telecom; Universities Superannuation; Ursuline Sisters of Tildonk; U.S. Bancorp; USPE; ValueAct Capital; Verizon; Wachtell; Walden; Wells Fargo; Weyerhaeuser; Whirlpool; WSIB; Xerox.

<sup>443</sup> See letters from 13D Monitor; 26 Corporate Secretaries; ABA; ACSI; Advance Auto Parts; Aetna; AFL–CIO; AFSCME; Allstate; Alston & Bird; Amalgamated Bank; American Bankers Association; Anadarko; Applied Materials; Avis Budget; Blue Collar Investment Advisors ("BCIA"); Best Buy; Boeing; BorgWarner; Brink's; BRT; Burlington Northern; CalPERS; CalSTRS; Caterpillar; CFA Institute; Chevron; CIGNA; CII; Cleary; Con Edison; COPERA; Corporate Library; CSX; Cummins;

<sup>444</sup> See letters from ABA; BRT; Con Edison; First Affirmative; C. Levin; Verizon.

<sup>445</sup> Letter from ABA.

<sup>446</sup> See letter from BRT.

<sup>447</sup> See letter from Con Edison.

<sup>448</sup> See letters from IBM; S. Quinlivan; USPE; Verizon; Xerox.

<sup>449</sup> See letters from IBM; Verizon.

<sup>452</sup> Letter from CII.

<sup>453</sup> See letters from CII; Society of Corporate Secretaries.

number allowable), and so on.<sup>454</sup> Commenters also suggested that a nominating shareholder or group be required to “rank” their nominees in the order of preference to facilitate any necessary “cutbacks.”<sup>455</sup>

A few commenters stated that in the case of competing nominations submitted by shareholders with equally-sized holdings, the shareholder that held the shares for the longest period of time should be allowed to include its nominees.<sup>456</sup> Two commenters recommended that when determining the order of priority, an individual shareholder should have priority over a nominating group.<sup>457</sup>

One commenter recommended that nominees be ordered in accordance with the largest qualifying shareholdings, but subject to the qualification that the Commission impose a cap on either the permitted number of members in a nominating group or on the aggregate holdings of a nominating group and limit each nominating shareholder or group to only one Rule 14a–11 nomination at an annual meeting.<sup>458</sup> If shareholders are not limited to one nomination, then companies should be allowed to order the nominees based on the largest holdings. Alternatively, the commenter recommended awarding Rule 14a–11 nomination slots first to the nominating shareholder or group with the largest holdings, next to the nominating shareholder or group with the longest holding period, then to the next largest holder, and so on.

One commenter stated that priority should be given to the largest nominating shareholder or group based on the number of voting securities over which such shareholder or group has voting control (as opposed to beneficial ownership).<sup>459</sup> Another commenter stated that in the case of nominating groups, the determination of the largest holder should be based on the largest shareholder within the nominating group.<sup>460</sup>

Other commenters recommended that the shareholder or group holding a company’s shares for the longest period be permitted to submit nominees under Rule 14a–11.<sup>461</sup> These commenters

argued that this approach would be more consistent with the Commission’s stated goal of making Rule 14a–11 available to shareholders with a long-term interest.

Some commenters preferred to give priority based on a combination of factors, such as length of ownership and size of ownership stake.<sup>462</sup> Several commenters preferred to let companies (e.g., the nominating committee) choose either the shareholder nominees or the method for deciding which shareholder nominees are included in the proxy materials when there are multiple nominations.<sup>463</sup> Under this approach, companies would disclose the method in the previous year’s proxy statement or in a Form 8–K.

A small number of commenters supported the proposed first-in approach.<sup>464</sup> While understanding the concern about “a rush to the courthouse,” one commenter indicated that this concern may not necessarily be justified because the “‘first’ proponent may have sufficiently prepared beforehand for the nomination process.”<sup>465</sup> Further, the commenter believed that “[a]llowing the largest shareholder group to essentially trump the first smaller, but no less committed or relevant, shareholder submission is not good governance.” Another commenter believed that the first-in approach would best give effect to the proposed rule.<sup>466</sup> If the standard was based on the amount of securities held instead, the commenter would be concerned that long-term owners of companies with index-tracking portfolios might be frozen out of the process. One commenter believed the first-in approach would provide certainty, but companies should be required to set the dates in calendar form and announce the dates in Form 8–K filings at least 30 days prior to the date of effectiveness.<sup>467</sup>

After considering the comments, we have revised the manner in which the rule addresses multiple qualifying nominations. Rather than a first-in standard, as was proposed, a company

given priority); Cummins; Darden Restaurants; FPL Group; General Mills; IBM (recommending this approach as an alternative to its recommendation that the largest shareholder be given priority); Motorola; TIAA–CREF; Xerox.

<sup>462</sup> See letters from L. Dallas; T. DiNapoli; Nathan Cummings Foundation; OPERS; Southern Company.

<sup>463</sup> See letters from Alston & Bird; CSX; Textron.

<sup>464</sup> See letters from Calvert; Florida State Board of Administration; Hermes Equity Ownership Services Ltd. (“Hermes”); Protective.

<sup>465</sup> Letter from Calvert.

<sup>466</sup> See letter from Hermes.

<sup>467</sup> See letter from Florida State Board of Administration.

will be required to include in its proxy materials the nominee or nominees of the nominating shareholder or group with the highest qualifying voting power percentage.<sup>468</sup> In this regard, in light of the comments received, we are concerned that a first-in standard would result in shareholders rushing to submit nominations, discourage constructive dialogue between shareholders and management, and encourage gamesmanship among possible nominating shareholders or groups. When there are multiple qualifying nominations, giving priority to the shareholder or group with the highest voting power percentage is consistent with our overall approach to facilitate director nominations by shareholders with significant commitments to companies. Finally, we seek to avoid the confusion that could result if multiple nominating shareholders or groups submitted their notices on the same day.

We believe that the standard we are adopting, under which the nominating shareholder or group with the highest qualifying voting power percentage will have its nominees included in the company’s proxy materials, up to the maximum of 25% of the board, addresses these concerns. We are persuaded that this standard is more consistent with the other limitations of Rule 14a–11 that seek to balance facilitating shareholder rights to nominate directors with practical considerations.

As adopted, Rule 14a–11 addresses situations where more than one shareholder or group would be eligible to have its nominees included on the company’s proxy card and disclosed in its proxy statement pursuant to the rule. Given that we are adopting a highest qualifying voting power percentage standard rather than a first-in standard, the company will determine which shareholders’ nominees it must include in its proxy statement and on its proxy card by considering which eligible nominating shareholder or group has the highest qualifying voting power percentage, as opposed to which eligible nominating shareholder or group submitted a timely notice first. A company will be required to include in its proxy statement and on its proxy card the nominee or nominees of the nominating shareholder or group with

<sup>468</sup> See Rule 14a–11(e). Rule 14a–11(e)(4) prescribes a limited variation on this principle where the company has more than one class of voting shares subject to the proxy rules and eligible nominating shareholders or shareholder groups from more than one of those classes submit nominations that exceed the 25% maximum. In this circumstance, priority of nominations will be determined by reference to the relative voting power of the classes in question.

<sup>454</sup> See letters from Amalgamated Bank; CII; COPERA; P. Neuhauser; Protective; T. Rowe Price.

<sup>455</sup> See letters from Amalgamated Bank; CFA Institute; CII; COPERA; P. Neuhauser; Protective; T. Rowe Price.

<sup>456</sup> See letters from Allstate; Boeing; Pfizer.

<sup>457</sup> See letters from Honeywell; Sara Lee.

<sup>458</sup> See letter from ABA.

<sup>459</sup> See letter from Kirkland & Ellis.

<sup>460</sup> See letter from Seven Law Firms.

<sup>461</sup> See letters from BRT; CIGNA (recommending this approach as an alternative to its recommendation that the largest shareholder be

the highest qualifying voting power percentage in the company's securities as of the date of filing the Schedule 14N, up to and including the total number of shareholder nominees required to be included by the company.<sup>469</sup> Where the nominating shareholder or group with highest qualifying voting power percentage that is otherwise eligible to use the rule and that filed a timely notice does not nominate the maximum number of directors allowed under the rule, the nominee or nominees of the nominating shareholder or group with the next highest qualifying voting power percentage that is otherwise eligible to use the rule and that filed a timely notice of intent to nominate a director pursuant to the rule would be included in the company's proxy materials, up to and including the total number of shareholder nominees required to be included by the company. This process would continue until the company included the maximum number of nominees it is required to include in its proxy statement and on its proxy card or the company exhausts the list of eligible nominees. If the number of eligible nominees exceeds the maximum number required under Rule 14a-11 and the shareholder or group with the next highest qualifying voting power percentage submitted more nominees than there are remaining available director slots, the nominating shareholder would have the option to specify which of its nominees are to be included in the company's proxy materials.<sup>470</sup>

#### b. Priority When a Nominating Shareholder or Group or a Nominee Withdraws or Is Disqualified

Under the Proposal, we did not address what would be expected of a company if a nominating shareholder or group or nominee withdraws or is disqualified after the company has provided notice to the nominating shareholder or group of its intent to include the nominee in the company's proxy materials. One commenter asked for guidance on how to handle such situations.<sup>471</sup> Another commenter stated that it opposed allowing a nominating shareholder group to change its composition to correct an identified deficiency, such as a failure of the group to meet the requisite ownership threshold.<sup>472</sup> Two commenters believed that if any member of a nominating shareholder group becomes ineligible

due to a failure to own the requisite number of shares, then the entire group and its nominee also should be ineligible to use Rule 14a-11.<sup>473</sup> On the other hand, one commenter recommended that a nominating shareholder group should be allowed to change its composition to correct an identified deficiency, such as the failure of the group to meet the requisite threshold.<sup>474</sup> The commenter also addressed a situation in which a nominating shareholder group qualifies to use Rule 14a-11, provides the necessary notice, submits its nominees, but then becomes disqualified before the meeting at which its nominees would have been put to a shareholder vote. The commenter stated that while it "generally believe[s] that the nominating shareowner should have a short window within which to add a shareowner who would meet all eligibility requirements, a lapse that cannot be cured in that fashion should be remedied by going to the 'second' candidate(s)."

Consistent with the Proposal, under our final rules, neither the composition of the nominating shareholder group nor the shareholder nominee may be changed as a means to correct a deficiency identified in the company's notice to the nominating shareholder or nominating shareholder group—those matters must remain as they were described in the notice to the company.<sup>475</sup> We believe that to allow otherwise could serve to undermine the purpose of the notice deadline provided for in the rule. Thus, a nominating shareholder or group should be sure that it and its nominees meet the requirements of the rule—including the ownership and holding period requirements—before it files its Schedule 14N, as a nominating shareholder or group will not be permitted to add or substitute another shareholder or nominee in order to satisfy the requirements.<sup>476</sup>

<sup>473</sup> See letters from CFA Institute; Verizon.

<sup>474</sup> See letter from CII.

<sup>475</sup> See Instruction 2 to Rule 14a-11(g) and proposed Rule 14a-11(f)(6).

<sup>476</sup> In this regard, we note that if a member of a nominating shareholder group withdraws, the nominating shareholder group and its nominee or nominees would continue to be eligible so long as the group continues to meet the requirements of the rule. If the withdrawal of a member of the nominating shareholder group would result in the group failing to meet the ownership threshold, a company would no longer be required to include any nominees submitted by the nominating shareholder group. As another example, if after a nominating shareholder or group submits one nominee for inclusion in a company's proxy materials and the nominee subsequently withdraws or is disqualified, a company will not be required to include a substitute nominee from that nominating shareholder or group.

In the Proposing Release, we solicited comment on how we should address situations where a nomination is submitted and the nominating shareholder subsequently becomes ineligible under the rule. We also sought comment as to the circumstances under which a second shareholder or group should be able to have its nominees included in a company's proxy materials. Some commenters stated that if a nominating shareholder or group does not remain eligible, the company should be allowed to withdraw the nominating shareholder's or group's candidate from its proxy materials.<sup>477</sup> Some commenters believed that a company should not be required to include a substitute shareholder nominee if the original shareholder nominee is excluded by a company after receiving a no-action letter from the Commission staff regarding the nomination, is withdrawn by the nominating shareholder or group, or otherwise becomes ineligible.<sup>478</sup> These commenters generally argued that a company would not have enough time to seek the exclusion of such a substitute nominee. Still other commenters argued that a nominating shareholder or group should be allowed to submit a new nominee if its original nominee is determined to be ineligible,<sup>479</sup> especially if the company sought and obtained a no-action letter from the staff concerning the company's determination to exclude the nominee.<sup>480</sup> One commenter worried that a prohibition on substitute shareholder nominees would encourage an unduly adversarial approach by both sides.<sup>481</sup> Another commenter recommended that if the first nominating shareholder or group becomes ineligible, then the nominating shareholder or group with the second-largest holdings should be allowed to submit their own nominees.<sup>482</sup>

Our final rule provides that if a nominating shareholder or group withdraws or is disqualified (e.g., because the nominating shareholder or a member of the group<sup>483</sup> failed to

<sup>477</sup> See letters from BorgWarner; Society of Corporate Secretaries.

<sup>478</sup> See letters from 26 Corporate Secretaries; ABA; Allstate; American Express; BorgWarner; DTE Energy; Dupont; FPL Group; Honeywell; IBM; Pfizer; RiskMetrics; Seven Law Firms; Society of Corporate Secretaries; Xerox.

<sup>479</sup> See letters from AFL-CIO; P. Neuhauser; USPE.

<sup>480</sup> See letter from P. Neuhauser.

<sup>481</sup> See letter from Universities Superannuation.

<sup>482</sup> See letter from CFA Institute.

<sup>483</sup> If one member of a group becomes ineligible to use the rule but the group continues to qualify to use the rule without that member, the group would remain eligible overall.

<sup>469</sup> See new Rule 14a-11(e) and proposed Rule 14a-11(d)(3).

<sup>470</sup> See Instruction 2 to new Rule 14a-11(e).

<sup>471</sup> See letter from Best Buy.

<sup>472</sup> See letter from ABA.

continue to hold the qualifying amount of securities) after the company provides notice to the nominating shareholder or group of the company's intent to include the nominee or nominees in its proxy materials, the company will be required to include in its proxy statement and form of proxy the nominee or nominees of the nominating shareholder or group with the next highest voting power percentage that is otherwise eligible to use the rule and that filed a timely notice in accordance with the rule, if any.<sup>484</sup> This process would continue until the company included the maximum number of nominees it is required to include in its proxy materials or the company exhausts the list of eligible nominees.

If a nominee withdraws or is disqualified after the company provides notice to the nominating shareholder or group of the company's intent to include the nominee in its proxy materials, the company will be required to include in its proxy materials any other eligible nominee submitted by that nominating shareholder or group.<sup>485</sup> If that nominating shareholder or group did not include any other nominees in its notice filed on Schedule 14N, then the company will be required to include the nominee or nominees of the nominating shareholder or group with the next highest voting power percentage that is otherwise eligible to use the rule and that filed a timely notice in accordance with the rule, if any, until the maximum number of nominees is included in the company's proxy materials or the list of eligible nominees is exhausted.

We believe that these requirements are appropriate in order to give effect to the intent of our rule—to facilitate shareholders' ability to nominate and elect directors. If the nominating shareholder or group with the highest voting power percentage used all available Rule 14a–11 nominations in a company's proxy materials and the nominating shareholder or group with the second highest voting power percentage had its nominees excluded even after one or more nominees from the nominating shareholder or group with the highest voting power percentage withdrew or was disqualified, we believe the purpose of our rule would be undermined. However, in order to address practical considerations, Rule 14a–11(e)(2) provides that once a company has commenced printing its proxy materials it will not be required to include a

substitute nominee or nominees. We believe that at that point in the process it would be too difficult and costly for a company to change course to include a new nominee or nominees. If a nominating shareholder or group or nominee withdraws or is disqualified after the company has commenced printing its proxy materials, the company may determine whether it wishes to print (and furnish) additional materials and a proxy card, delete the disqualified or withdrawn nominee, or instead provide disclosure through additional soliciting materials informing shareholders about the change.<sup>486</sup>

#### 8. Notice on Schedule 14N

##### a. Proposed Notice Requirements

As proposed, in order to submit a nominee for inclusion in the company's proxy statement and form of proxy, Rule 14a–11 would require that the nominating shareholder or group provide a notice on Schedule 14N to the company of its intent to require that the company include that shareholder's or group's nominee or nominees in the company's proxy materials.<sup>487</sup> The shareholder notice on Schedule 14N also would be required to be filed with the Commission on the date it is first sent to the company.

We proposed to require the notice to be provided to the company and filed with the Commission by the date specified in the company's advance notice bylaw provision, or where no such provision is in place, no later than 120 calendar days before the date the company mailed its proxy materials for the prior year's annual meeting. If the company did not hold an annual meeting during the prior year, or if the date of the meeting changes by more than 30 calendar days from the prior year, the nominating shareholder must provide notice a reasonable time before the company mails its proxy materials. The company would be required to disclose the date by which the shareholder must submit the required notice in a Form 8–K filed pursuant to proposed Item 5.07 within four business days after the company determines the anticipated meeting date.<sup>488</sup>

As proposed, the notice on Schedule 14N would include disclosures relating to the nominating shareholder's or

group's interest in the company, length of ownership, and eligibility to use Rule 14a–11. The notice on Schedule 14N also would include disclosure required by proposed Rule 14a–18 about the nominating shareholder or group and the nominee for director, as well as disclosure regarding the nature and extent of relationships between the nominating shareholder or group and nominee or nominees and the company. The disclosure provided by the nominating shareholder or group would be similar to the disclosure currently required in a contested election and would be included by the company in its proxy materials.

In addition, as proposed, the notice on Schedule 14N also would include the following representations by the nominating shareholder or group:

- The nominee's candidacy or, if elected, board membership, would not violate controlling State or Federal law, or rules of a national securities exchange or national securities association other than rules relating to director independence;<sup>489</sup>
- The nominating shareholder or group satisfies the eligibility conditions in Rule 14a–11;<sup>490</sup>
- In the case of a company other than an investment company, the nominee meets the objective criteria for “independence” of the national securities exchange or national securities association rules applicable to the company, if any, or, in the case of a company that is an investment company, the nominee is not an “interested person” of the company as defined in Section 2(a)(19) of the Investment Company Act of 1940;<sup>491</sup> and
- Neither the nominee nor the nominating shareholder (or any member of a nominating shareholder group) has an agreement with the company regarding the nomination of the nominee.<sup>492</sup>

Proposed Item 8 of Schedule 14N would have required a certification from the nominating shareholder or each member of the nominating shareholder

<sup>489</sup> See proposed Rule 14a–18(a). Proposed Rule 14a–11 also included this provision as a direct requirement. Thus, a company would not be required to include a shareholder nominee in its proxy materials if the nominee's candidacy or, if elected, board membership would violate controlling State law, Federal law, or rules of a national securities exchange or national securities association (other than rules of a national securities exchange or national securities association that set forth requirements regarding the independence of directors).

<sup>490</sup> See proposed Rule 14a–18(b) (which referred to the requirements in proposed Rule 14a–11(b)).

<sup>491</sup> See proposed Rule 14a–18(c).

<sup>492</sup> See proposed Rule 14a–18(d).

<sup>484</sup> See new Rule 14a–11(e)(2).

<sup>485</sup> See new Rule 14a–11(e)(3).

<sup>486</sup> We note that pursuant to Exchange Act Rule 14a–4(c)(5) a completed proxy card containing a disqualified or withdrawn nominee or nominees could, under certain circumstances, confer discretionary authority to vote on the election of a substitute director or directors.

<sup>487</sup> See proposed Rule 14a–11(c), Rule 14a–18 and Rule 14n–1.

<sup>488</sup> See proposed Instruction 2 to Rule 14a–11(a) and proposed Rule 14a–18.



group that the securities used for purposes of meeting the ownership threshold in Rule 14a-11 are not held for the purpose, or with the effect, of changing control of the company or to gain more than a limited number of seats on the board.

#### b. Comments on the Proposed Notice Requirements

Commenters generally supported the proposed content requirements of Schedule 14N on the general principle that the Commission should impose disclosure requirements on nominating shareholders and their nominees.<sup>493</sup> Two of these commenters also stated that additional disclosures or representations are not needed.<sup>494</sup> In addition, some commenters recommended that all nominees be subject to any new disclosure rules adopted by the Commission as part of its proxy disclosure and solicitation enhancements rulemaking.<sup>495</sup> Four commenters asked that companies be allowed to require additional disclosure from a nominating shareholder or group through, for example, the advance notice bylaws, as long as such requirements are consistent with State law.<sup>496</sup> One commenter argued that the nominating shareholder, group, or nominee should provide any disclosure required under a company's governing documents as long as such disclosure is required of all nominees.<sup>497</sup> One commenter asked that all content requirements be set forth in Schedule 14N itself, as it found the structure of the Schedule and the references to disclosure requirements to be unnecessarily complicated.<sup>498</sup> The commenter recommended that we include a requirement that the nominating shareholder or group disclose information about the nature and extent of the relationships between the nominating shareholder, group and the nominee and the company or its affiliates.<sup>499</sup> Another commenter recommended the rules include a representation that the nominee is not

controlled by the nominating shareholder or group.<sup>500</sup>

We also sought comment on the proposed representations to be provided by the nominating shareholder or group in Schedule 14N. One commenter stated that the proposed representations are appropriate and no additional representations are needed.<sup>501</sup> This commenter opposed a requirement for a shareholder nominee to make any representation either in addition to, or instead of, those made by the nominating shareholder or group. One commenter stated simply that none of the proposed representations in Schedule 14N should be eliminated.<sup>502</sup> It also observed generally that the shareholder nominee should be required to make the representations (*e.g.*, regarding independence) because he or she would know the facts relating to the representations and therefore should accept responsibility. One commenter opposed the requirement for a representation that a shareholder nomination (or election of the shareholder nominee) would not violate State law, Federal law, or listing standards.<sup>503</sup> The commenter also believed it would be inappropriate to require a representation that the nomination complies with any independence requirement under Federal law, State law, or listing standards.

#### c. Adopted Notice Requirements

We are adopting the notice requirements substantially as proposed, with differences noted below. In addition, we agree that the rules as proposed could be streamlined to reduce complexity. As adopted, Schedule 14N will contain the disclosure items that were included in the Schedule as proposed, as well as the disclosures proposed in Rule 14a-11, Rule 14a-18 and Rule 14a-19. We believe that the disclosure requirements we are adopting will provide transparency and facilitate shareholders' ability to make an informed voting decision on a shareholder director nominee or nominees without being unnecessarily burdensome on nominating shareholders or groups.

#### i. Disclosure

Schedule 14N will require a nominating shareholder or group to provide the following information about

the nominating shareholder or group and the nominee:<sup>504</sup>

- The name and address of the nominating shareholder or each member of the nominating shareholder group;
- Information regarding the amount and percentage of securities held and entitled to vote on the election of directors at the meeting and the voting power derived from securities that have been loaned or sold in a short sale that remains open, as specified in Instruction 3 to Rule 14a-11(b)(1);<sup>505</sup>
  - A written statement from the registered holder of the shares held by the nominating shareholder or each member of the nominating shareholder group, or the brokers or banks through which such shares are held, verifying that, within seven calendar days prior to submitting the notice on Schedule 14N to the company, the shareholder continuously held the qualifying amount of securities for at least three years;<sup>506</sup>
    - A written statement of the nominating shareholder's or group's intent to continue to hold the qualifying amount of securities through the shareholder meeting at which directors are elected. Additionally, the nominating shareholder or group would provide a written statement regarding the nominating shareholder's or group's intent with respect to continued ownership after the election;<sup>507</sup>
      - A statement that the nominee consents to be named in the company's proxy statement and form of proxy and, if elected, to serve on the board of directors;<sup>508</sup>
        - Disclosure about the nominee as would be provided in response to the disclosure requirements of Items 4(b), 5(b), 7(a), (b), and (c) and, for investment companies, Item 22(b) of Schedule 14A, as applicable;<sup>509</sup>
          - Disclosure about the nominating shareholder or each member of a nominating shareholder group as would be required in response to the disclosure

<sup>504</sup> The disclosure requirements proposed in Rule 14a-18(e)-(f) are now contained in new Item 4(b) and new Item 5 of Schedule 14N.

<sup>505</sup> See Item 3 of new Schedule 14N.

<sup>506</sup> See Item 4(a) of new Schedule 14N. A nominating shareholder would not be required to provide this statement if the nominating shareholder is the registered holder of the shares or is attaching or incorporating by reference a previously filed Schedule 13D, Schedule 13G, Form 3, Form 4, and/or Form 5, or amendments to those documents to prove ownership.

<sup>507</sup> See Item 4(b) of new Schedule 14N. These requirements were proposed in Rule 14a-18(f) and Item 5(b) of Schedule 14N.

<sup>508</sup> See Item 5(a) of new Schedule 14N and proposed Rule 14a-18(e).

<sup>509</sup> See Item 5(b) of new Schedule 14N and proposed Rule 14a-18(g).

<sup>493</sup> See letters from ABA; Alston & Bird; Americans for Financial Reform; CalSTRS; CFA Institute; CII; Corporate Library; Dominican Sisters of Hope; Florida State Board of Administration; GovernanceMetrics; ICI; Mercy Investment Program; Protective; RiskMetrics; Sisters of Mercy; Tri-State Coalition; Ursuline Sisters of Tildonk; USPE; Walden.

<sup>494</sup> See letters from CII; USPE.

<sup>495</sup> See letters from ABA; Alaska Air; Robert A. Bassett ("R. Bassett"); BorgWarner; Eli Lilly; NACD; O'Melveny & Myers; Pfizer; Society of Corporate Secretaries; UnitedHealth.

<sup>496</sup> See letters from ABA; Chevron; Sidley Austin; SIFMA.

<sup>497</sup> See letter from Cleary.

<sup>498</sup> See letter from ABA.

<sup>499</sup> *Id.*

<sup>500</sup> See letter from IBM.

<sup>501</sup> See letter from CII.

<sup>502</sup> See letter from ABA.

<sup>503</sup> See letter from USPE.

requirements of Items 4(b) and 5(b) of Schedule 14A, as applicable;<sup>510</sup>

- Disclosure about whether the nominating shareholder or any member of a nominating shareholder group has been involved in any legal proceeding during the past ten years, as specified in Item 401(f) of Regulation S-K;<sup>511</sup>

- Disclosure about whether, to the best of the nominating shareholder's or group's knowledge, the nominee meets the director qualifications set forth in the company's governing documents, if any;<sup>512</sup>

- A statement that, to the best of the nominating shareholder's or group's knowledge, in the case of a company other than an investment company, the nominee meets the objective criteria for "independence" of the national securities exchange or national securities association rules applicable to the company, if any, or, in the case of a company that is an investment company, the nominee is not an "interested person" of the company as defined in Section 2(a)(19) of the Investment Company Act of 1940;<sup>513</sup>

- Disclosure about the nature and extent of the relationships between the nominating shareholder or group, the nominee, and/or the company or any affiliate of the company,<sup>514</sup> such as:

- Any direct or indirect material interest in any contract or agreement between the nominating shareholder or any member of the nominating shareholder group, the nominee, and/or the company or any affiliate of the company (including any employment agreement, collective bargaining agreement, or consulting agreement);
- Any material pending or threatened litigation in which the nominating

shareholder or any member of the nominating shareholder group and/or the nominee is a party or a material participant, and that involves the company, any of its officers or directors, or any affiliate of the company; and

- Any other material relationship between the nominating shareholder or any member of the nominating shareholder group, the nominee, and/or the company or any affiliate of the company not otherwise disclosed;<sup>515</sup>

- Disclosure of any Web site address on which the nominating shareholder or group may publish soliciting materials;<sup>516</sup> and

- If desired to be included in the company's proxy statement, a statement in support of the shareholder nominee or nominees, which may not exceed 500 words per nominee.<sup>517</sup>

The disclosure provided by the nominating shareholder or group in Item 5 of Schedule 14N would be included by the company in its proxy materials,<sup>518</sup> along with the company's disclosure in response to Items 4(b) and 5(b) of Schedule 14A.<sup>519</sup>

In a traditional proxy contest, shareholders receive the disclosure

<sup>510</sup> See Item 5(g) of new Schedule 14N and proposed Rule 14a-18(j).

<sup>516</sup> See Item 5(h) of new Schedule 14N and proposed Rule 14a-18(k).

<sup>517</sup> See Item 5(i) of new Schedule 14N and proposed Rule 14a-18(l). This requirement is discussed in more detail in this section. If a nominating shareholder or group submits a statement in support that exceeds 500 words per nominee, a company will be required to include the nominee or nominees, provided that the eligibility requirements are met, but may exclude the statement in support from its proxy materials pursuant to Rule 14a-11(g). In this instance, the company would provide notice to the staff and could, if desired, seek a no-action letter from the staff. See new Rule 14a-11(c) and Rule 14a-11(g). The 500 words would be counted in the same manner as words are counted under Rule 14a-8. Any statements that are, in effect, arguments in support of the nomination would constitute part of the supporting statement. Accordingly, any "title" or "heading" that meets this test would be counted toward the 500-word limitation. Inclusion of a Web site address in the supporting statement would not violate the 500-word limitation; rather, the Web site address would be counted as one word for purposes of the 500-word limitation.

<sup>518</sup> See Item 7(e) of Schedule 14A. Similarly, if a company receives a nominee for inclusion in its proxy materials pursuant to a procedure set forth under applicable state or foreign law, or the company's governing documents providing for the inclusion of shareholder director nominees in the company's proxy materials, the disclosure provided by the nominating shareholder or group in response to Item 6 of Schedule 14N would be included in the company's proxy materials. See Item 7(f) of Schedule 14A.

<sup>519</sup> Instruction 3 to Rule 14a-12(c) clarifies that though inclusion of a nominee pursuant to Rule 14a-11 or solicitations by a nominating shareholder or nominating shareholder group that are made in connection with that nomination would constitute solicitations in opposition subject to Rule 14a-12(c), they would not be treated as such for purposes of Exchange Act Rule 14a-6(a).

required by Items 4(b), 5(b), 7, and 22, as applicable, of Schedule 14A from both the company and the insurgent when the contest relates to an annual election of directors. The new Schedule 14N disclosure requirements are somewhat more expansive in that they also include the disclosures concerning ownership amount, length of ownership, intent to continue to hold the shares through the date of the meeting and with respect to continued ownership after the meeting, and disclosure regarding the nature and extent of the relationships between the nominating shareholder or group and nominee and the company or any affiliate of the company. We believe that these disclosures will assist shareholders in making an informed voting decision with regard to any nominee or nominees put forth by the nominating shareholder or group using Rule 14a-11, in that the disclosures will enable shareholders to gauge the nominating shareholder's or group's interest in the company, longevity of ownership, and intent with regard to continued ownership in the company. These disclosures also will be important to the company in determining whether the nominating shareholder or group is eligible to rely on Rule 14a-11 to require the company to include a nominee or nominees in the company's proxy materials.

In some cases, the requirements in new Schedule 14N are slightly different than we proposed. We have clarified that the nominating shareholder or group will be required to include disclosure in the Schedule 14N concerning specified relationships between the nominating shareholder or group and the nominee or nominees. As discussed in Section II.B.5.d. above, we received comment suggesting that, in the absence of a limitation on relationships between the nominating shareholder or group and their nominee or nominees, we should adopt a disclosure requirement concerning relationships between the parties.<sup>520</sup> Similarly, and as discussed in Section II.B.5.b., we have added a requirement that a nominating shareholder or group disclose whether, to the best of their knowledge, the nominating shareholder's or group's nominee meets the company's director qualifications, if any, as set forth in the company's governing documents.<sup>521</sup> We added this requirement because we believe that this information will be useful to shareholders in making a voting

<sup>520</sup> See letters from CII; IBM; O'Melveny & Myers; SIFMA; UnitedHealth.

<sup>521</sup> See Item 5(e) of new Schedule 14N.

<sup>510</sup> See Item 5(c) of new Schedule 14N and proposed Rule 14a-18(h). If a nominating shareholder is organized in a form other than a corporation or partnership, comparable disclosure with respect to persons in similar capacities would be required.

<sup>511</sup> See Item 5(d) of new Schedule 14N and proposed Rule 14a-18(i). As proposed, the rule would have required disclosure regarding a nominating shareholder's involvement in any legal proceedings during the past five years. Recently, the Commission amended Item 401(f) of Regulation S-K to require disclosure regarding involvement in legal proceedings for the prior ten years. See *Proxy Disclosure Enhancements*, Release No. 33-9089; 34-61175 (Dec. 16, 2009) [74 FR 68334] ("Proxy Disclosure Enhancements Adopting Release"). Accordingly, as adopted, Item 5(d) will require disclosure about a nominating shareholder's involvement in legal proceedings during the past ten years.

<sup>512</sup> See Item 5(e) of new Schedule 14N.

<sup>513</sup> See Item 5(f) of new Schedule 14N.

<sup>514</sup> We note that this disclosure requirement would apply to relationships between the nominating shareholder or group and the nominee, as well as the relationships between the nominating shareholder or group and the nominee and the company or its affiliates. See Item 5(g) of new Schedule 14N.

decision by enabling them to consider whether shareholder nominees would meet a company's director qualifications. Shareholders will provide this disclosure "to the best of their knowledge" to address the fact that the standards will be company standards and thus could be subject to interpretation.

We also have added an instruction to Item 4 of Schedule 14N to provide a form of written statement that may be used for verifying the amount of securities held by the nominating shareholder, and that the qualifying amount of securities has been held continuously for at least three years.<sup>522</sup> A statement will be required from a nominating shareholder that is not the registered holder of the securities and is not proving ownership by providing previously filed Schedules 13D or 13G, or Forms 3, 4, or 5. We believe that providing a form of written statement will make it easier for nominating shareholders and the persons through which they hold their securities to comply with the requirement and reduce complexity for shareholders and companies in determining whether satisfactory proof of ownership has been provided.<sup>523</sup> In addition, as noted above, Item 5(d) will require disclosure about each nominating shareholder's involvement in legal proceedings during the past ten years rather than the past five years as proposed, consistent with the changes recently adopted by the Commission for board nominees in general.

In connection with our revisions to the rule concerning calculation of ownership, we also have added new Items 3(c) and (d) to the Schedule 14N to require disclosure of the voting power attributable to securities that have been loaned or sold in a short sale that is not closed out, or that have been borrowed for purposes other than a short sale, as specified in Instruction 3 to Rule 14a-11(b)(1).

Finally, as proposed, a nominating shareholder or group could provide a statement in support of a shareholder nominee or nominees, which could not exceed 500 words if the nominating shareholder or group elects to have such a statement included in the company's

proxy materials. Two commenters stated that a limit of 500 words would be appropriate,<sup>524</sup> five commenters recommended that a nominating shareholder or group be permitted to include a supporting statement of more than 500 words,<sup>525</sup> and four commenters proposed a limit of either 750 or 1000 words.<sup>526</sup> We believe it is appropriate to allow a nominating shareholder or group to provide a statement in support of the shareholder nominee or nominees which may not exceed 500 words for each nominee, rather than 500 words for all nominees in total,<sup>527</sup> if the nominating shareholder or group elects to have such a statement included in the company's proxy materials. We believe that a limitation of 500 words per nominee is sufficient for a nominating shareholder or group to express their support for a nominee. In this regard, we note that shareholders and companies are familiar with the 500 word limitation, as it is the limit on the number of words that may be used to support a shareholder proposal submitted under Rule 14a-8. While we believe it is appropriate to limit the length of the supporting statement that the company is required to include, we note that if a nominating shareholder or group wishes to provide additional information, it is free to do so in supplemental materials, provided it complies with the requirements of Rule 14a-2(b)(8). If a nominating shareholder or group submits a statement in support that exceeds 500 words per nominee, a company will be required to include the nominee or nominees, provided that the eligibility requirements are met, but the company may exclude the statement in support from its proxy materials provided it provides notice to the staff of its intent to do so.<sup>528</sup>

As noted above, we proposed to require certain representations to be provided in the Schedule 14N, either in the form of representations or as certifications. As adopted, we are including the proposed representations and certifications as direct requirements in Rule 14a-11.<sup>529</sup> Consequently, we have simplified the requirements so that under the final rules a nominating shareholder or group will be required to

certify, in its notice on Schedule 14N filed with the Commission, that it does not have a change in control intent or an intent to gain more than the maximum number of board seats provided for under Rule 14a-11 and that the nominating shareholder and the nominee satisfies the applicable requirements of Rule 14a-11.<sup>530</sup> We have retained the certification with regard to no change in control intent or intent to gain more than the maximum number of board seats provided for under Rule 14a-11, even though this is also a direct requirement in Rule 14a-11 as adopted, because we believe it is important to highlight this requirement for nominating shareholders or groups signing the certification. As was proposed, the nominating shareholder or each member of the nominating shareholder group (or authorized representative) will be required to certify when signing the Schedule 14N that, "after reasonable inquiry and to the best of my knowledge and belief," the information in the statement is "true, complete and correct." Though all disclosure in the Schedule 14N would be covered by this representation, we have specifically included it in the certifications concerning compliance with the requirements of Rule 14a-11 as well.

We have revised the rule to delete the provision that had the effect of allowing exclusion of a nominee if any required representation or certification was materially false or misleading.<sup>531</sup> Rather than allowing companies to exclude Rule 14a-11 nominees on that basis, we believe companies should address any concerns regarding false or misleading disclosures through their own disclosures, as in traditional proxy contests. This change will limit the bases on which a company may exclude a nominee,<sup>532</sup> but we emphasize that the nominating shareholder or group will

<sup>530</sup> See new Rule 14a-11(b)(11) and Item 8(a) of new Schedule 14N. We note that in some cases, an authorized representative may file a Schedule 14N for each member of a nominating shareholder group and would provide the required disclosures and certifications. In such cases, each member of the nominating shareholder group represented by the authorized representative will be deemed to have provided the certifications.

<sup>531</sup> See proposed Rule 14a-11(a)(5).

<sup>532</sup> See Section II.B.9. below for a discussion of the requirements for a company receiving a nomination submitted pursuant to Rule 14a-11 and the process for seeking a staff no-action letter with respect to a company's decision to exclude a nominee. As noted below, assertions that a certification or disclosure provided by a nominating shareholder or group is false or misleading will not be a basis for excluding a nominee or nominees. A company seeking a no-action letter from the staff with regard to a determination to exclude a nominee or nominees would need to assert that a requirement of the rule has not been met.

<sup>522</sup> See the Instruction to Item 4 of new Schedule 14N.

<sup>523</sup> In this regard, we note that providing proper proof of ownership has proved to be an area of confusion for some shareholder proponents using Rule 14a-8 who must obtain a written statement from the "record" holder of the proponent's securities. Thus, we believe that providing a form of written statement that may be used to provide proof of ownership for purposes of Rule 14a-11(b)(3) will alleviate any potential confusion that could arise in this context.

<sup>524</sup> See letters from CII; Florida State Board of Administration.

<sup>525</sup> See letters from ACSI; AFSCME; Hermes; Pax World; USPE.

<sup>526</sup> See letters from AFSCME; L. Dallas; P. Neuhauser; USPE.

<sup>527</sup> We are adopting this modification in Item 5(i) of Schedule 14N.

<sup>528</sup> See new Rule 14a-11(c) and Rule 14a-11(g).

<sup>529</sup> See also Section II.B.4. and Section II.B.5. above, regarding nominating shareholder and nominee eligibility.