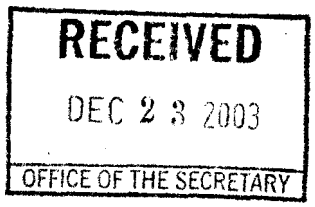
NYSBA

New York State Bar Association

One Elk Street, Albany, New York 12207 • 518/463-3200 • http://www.nysba.org

December 22,2003

Securities and Exchange Commission
450 Fifth Street, N.W.
Washington D.C. 20549
E-mail address: rule-comments@sec.gov



Attention: Jonathan G. Katz, Secretary

Re: File No. S7-19-03
Proposed Rule: Security Holder Director Nominations
Release Nos. 34-48626 and IC-26206

Ladies and Gentlemen:

The Committee on Securities Regulation (the "Committee") of the Business Law Section of the New York State Bar Association appreciates the Commission's invitation in Release No. 34-48626 (the "Release") to comment on the proposed rule (the "Proposed Rule") requiring companies, under certain circumstances, to include in their proxy material security holder director nominations.

The Committee is composed of members of the New York Bar, a principal part of whose practice is in securities regulation. The Committee includes lawyers in private practice and in corporation law departments. A draft of this letter was reviewed by certain members of the Committee, and the views expressed in this letter are generally consistent with those of the majority of members who reviewed and commented on the letter in draft form. The views set forth in this letter, however, are those of the Committee and do not necessarily reflect the views of the organizations with which its members are associated, the New York State Bar Association, or its Business Law Section.

A. Summary of Comments

The Committee supports the Commission's goal that security holders participate meaningfully in the proxy process. The Committee has generally supported the changes resulting from the Sarbanes-Oxley Act of 2002, recent Commission rule changes and recently approved listing standards of Self Regulatory Organizations, which have gone a long way

to create effective corporate governance structures and mechanisms that promote shareholder participation. Should the Commission adopt the Proposed Rule, or some variation thereof, providing for direct shareholder access, we recommend that the Commission make certain changes in the Proposed Rule set forth in this letter, which we believe are necessary to make the Proposed Rule more effective, minimize confusion and disruption, and permit practical and efficient implementation.

We believe that the trigger thresholds based on a percentage of votes cast (i.e., receipt of a 35% "withhold" vote for any director or a 50% vote in favor of an "opt-in" proposal) are too low and should be increased by requiring a percentage of outstanding shares as a trigger or, at a minimum, a percentage of votes represented at the meeting. In addition, we believe that any trigger based on "withhold" votes will not work for elections where cumulative voting is permitted. Also, there are implementation issues and questions raised by the Proposed Rule that should be addressed by the Commission in an amendment to the Proposed Rule including: (a) clarifying certain issues relating to the length of time that a nomination right will exist and to the application of such rights for companies with classified boards; (b) permitting companies to exclude a nominee if the election of the nominee would violate the rules of a national securities exchange or national securities association regarding director independence; (c) increasing the notice requirement for submission of a nominee from the current 80 days prior to the mailing date of the previous year's proxy materials in the Proposed Rule to 120 days as is provided in connection for Rule 14a-8 proposals; and (d) removing the prohibition in the Proposed Rule against security holders granting authority to vote for or to withhold votes from nominees as a group when a security holder nominee is included in the company's proxy.

We also believe that the Commission should provide a mechanism for resolving disputes relating to the interpretation and application of any final rule adopted by the Commission as well as a suitable remedy in the event of a failure on the part of a nominee or the security holder making the nomination to comply with the requirements of any final rule, which should include the possibility of requiring the cancellation of the vote for such nominee.

In order to further balance the goals of the Commission in issuing the Proposed Rule with the general desire to provide as much useful information as possible to the public about potential nominees and the security holders that make such nominations, all security holders nominating directors should be required to make certain of the disclosures contained in Schedule 13D and the rules under Section 13 and Section 16 and related rules should be amended to make clear that the security holder nomination process will not create an affiliate relationship when one would not otherwise exist. Also, the requirements for amending Schedule 13D filings should be made to apply to any Schedule 13G filed by a group of security holders nominating a candidate.

Furthermore, the Commission's intention that security holders nominating directors demonstrate a significant ownership stake in the company would be furthered by providing that only security holders that certify that they bear the economic risk of the investment in the company, as well as record or beneficial ownership. be afforded the right to make a nomination.

In the Release, the Commission asked for comments on a possible third trigger event based on a company's non-implementation of a Rule 14a-8 proposal. We believe that a trigger based on a company's failure to implement a Rule 14a-8 proposal would not be beneficial because in most cases a failure to implement a Rule 14a-8 proposal is not indicative of a board being unresponsive to its security holders. In addition, adopting such a trigger would be impractical and would distort and confuse security holder voting on such proposals.

With respect to the timing of the implementation of the Proposed Rule, the Proposed Rule provides that the "opt-in" and "withhold" triggers for the right of security holders to nominate directors in a company's proxy are to be applicable even though a final rule on security holders nominations has not yet been adopted. We believe that making such triggers applicable prior to the Commission adopting a final rule on this subject is inappropriate and quite possibly contrary to existing statutes and Commission procedural requirements.

Finally, we believe that adoption of the Proposed Rule would raise serious issues about the Commission's authority under the Exchange Act and inconsistency of the Rule with applicable state corporate law.

B. The Final Rule, If Adopted, Should Contain the Modifications Discussed Below

1. The Voting Thresholds For The Triggering Events Should Be Increased And The Method Of Calculation Clarified; The "Withhold" Vote Triggering Event Will Not Work Where Cumulative Voting Is Permitted

- **35% "Withhold" Vote**

The 35% "withhold" trigger would require that at least one of a company's nominees for the board receive "withhold" votes from more than 35% of the "votes cast" at the meeting. We believe that this threshold is far tod low for a matter of this importance – access to the nominating procedure by shareholders. Historical information regarding "withhold" votes is not necessarily indicative of the voting practices that would occur if there were "withhold vote" campaigns based on the new rules. In addition, financial intermediaries might view the triggering event as the equivalent of an election contest as to which brokers would withhold votes without instructions from the beneficial owners, whether or not SRO rules allowed brokers to vote without instructions. In either case, the number of votes cast would not constitute a representative base of shareholders of the company. The actual percentage of "withhold" votes cast could be minimal in relation to the outstanding voting power.

Further, basing the test on any single directorship without regard to the rest of the board, as the Proposed Rule provides, also is inappropriate. We, therefore, recommend that the required number of "withhold" votes should be a percentage of the outstanding stock or, at a minimum, a

percentage of the votes present and entitled to vote at the meeting, as compared with the number of "votes cast."

If the Commission, nonetheless, adopts a standard based on votes cast, the final rule should make clear what is meant by "votes cast" in this context. For this purpose, the instructions to the rule should state that in determining the votes cast, both the number of votes cast "for" and the number of "withhold" votes applicable to a director constitute the "votes cast." Instruction 2 of paragraph 14a-11(a) of the proposed rule only defines the term for shareholder proposals.

In addition, we believe that this trigger would be meaningless where a company's shareholders are entitled to cumulative voting for the election of directors. If shareholders cumulate votes for one director, the number of shares voted for other candidates would be significantly less and therefore any trigger based on such votes would likely not be meaningful. Also, in theory, it may be possible for shareholders to cumulate all of their votes as "withhold" votes for one director. It follows then that the votes "withheld" from such director could exceed 35% of the votes cast without necessarily indicating that a significant percentage of shareholders are dissatisfied with the director. Accordingly, should the Commission adopt this trigger, we suggest that it not be applicable in circumstances where cumulative voting is permitted.

- **50% Vote on an Opt-In Proposal**

Similarly, we believe that the threshold for determining the percentage of votes cast for a direct access shareholder proposal should be based upon the number of shares outstanding or, at a minimum, a percentage of the votes present and entitled to vote at the meeting, and not solely upon the number of votes cast. Here, too, because of the large number of broker non-votes that are likely on this issue, relying solely on votes cast would not reflect the views of a representative body of shareholders, thereby effectively disenfranchising many smaller shareholders in favor of institutions. An issue of this magnitude should require the support of a very significant number of shareholders in relation to the total number of shares outstanding. In our view, the calculation based solely upon votes cast will not achieve that result.

2. Implementation Issues Raised By The Proposed Rule Should Be Clarified

The Commission should provide further clarity on how the Proposed Rule is to be implemented. The following are situations and issues that need to be addressed.

- **Non-Classified Boards**

We assume that, in a case of a company with an **8** director non-classified board in which all directors are elected annually, a nominee submitted by a 5% shareholder group and elected by the shareholders would serve one year. Thereafter. the board or a 5% shareholder group could nominate the same director again. However, if neither one did this, the director's term would

expire and he or she would no longer be on the board. Conversely, if the 5% shareholder group re-nominated the same director for a new one-year term, there could be no additional nominees submitted by that or any other 5% shareholder group in the second year.

In the case of a board of 9 to 19 directors, we assume that one or more 5% shareholder groups could submit two nominees for the annual election of directors for a given year. Thereafter the re-nomination procedures described above for the one director on the smaller board should apply for the two directors on the larger board. We also assume that the Proposed Rule would operate in the same manner where shareholders have the right to nominate ***3*** directors.

The Proposed Rule would allow a 5% shareholder group to submit nominations for two successive annual meetings after shareholder access becomes available. We assume that if two candidates were submitted and elected at the first such annual meeting, the 5% shareholder group or groups could submit two candidates at the next annual meeting who could be the same individuals or different individuals. Thereafter the shareholder access process would have to be renewed for future elections.

- **Classified Boards**

Consider also boards of 12 directors with staggered terms. That is, four directors are elected each year for three-year terms. In that case, will one or more 5% shareholders groups be entitled to submit nominees for two directors in the first year or must they submit only one nominee for each of two different classes of directors? If they are entitled to submit two nominees for the first year's election for three-year terms, does that mean they are not entitled to submit candidates for the second and third years (assuming there is a new trigger that would apply to the third year)? We believe that should be the case since otherwise at the end of the third election, that group may have submitted six candidates elected to the board of 12 directors, which does not appear to be the intent of the proposal.

- **Two Or More Classes Of Stock**

Where two or more classes of stock vote together to elect directors, we assume that the Proposed Rule only allows the submission of nominees by holders of 5% of the aggregate total votes of all classes entitled to vote on the election of such directors. If two or more classes of stock vote for separate classes of directors, can one group holding 5% of the shares of the one class submit one or nominees for that class of directors while another shareholder group holding 5% of the shares of another class submits one or more nominees for another class of directors?

- **Removal of Directors**

Certain state laws currently provide for the removal of directors with or without cause in certain circumstances. It is our understanding that in most states (e.g., Delaware, Florida, Illinois, Maryland, Michigan, New Jersey. New York, Pennsylvania and South Dakota) and

under the Model Business Corporation Act, shareholders usually may remove directors with or without cause. In some jurisdictions, the board may do so only if such powers have been expressly delegated to the board by the company's charter or by statute. We assume that any existing right to remove a director under state law would continue to apply and ask that the Commission indicate that the Proposed Rule is not intended to affect those state laws.

- **Independence of Nominees**

Under the Proposed Rule, a company could exclude from a proxy statement a submitted nominee if the nominee's election to the board would violate controlling state law and federal law or rules of a national securities exchange or a national securities association applicable to the registrant. However, carved out of the foregoing exclusion are rules of a national securities exchange or national securities association regarding director independence. See proposed clause (3)(i) of Rule 14a-11(a). We believe that parenthetical clause should be eliminated. Independent directors are important under the governance provisions of those rules. The majority of the board must be independent and all members of the audit, compensation and nominating committees must be independent directors. Allowing a shareholder group to submit nominees without requiring independence could, in particular cases, eliminate the majority of independent directors, which would create a significant problem. In addition, not requiring that shareholder nominees be independent could saddle the Company with a board member who isn't available for major committees and inhibit the company's ability to meet the requirements of the exchange or association that each of the foregoing three committees be composed entirely of independent members. Furthermore, we do not anticipate that unaffiliated shareholder groups would have any problem submitting independent nominees.

We do not believe that the representation by a security holder required under proposed Rule 14a-11(c)(4) (and the related instruction) that the nominee meets the "objective criteria for independence" of the exchange or association rules applicable to the company cures the difficulties discussed above.

- **Filing Date**

We believe that the time period is too short between the point when the shareholder group must submit the name of its nominees and any supporting statement and the time when the registrant must complete preparation of its proxy statement. The shareholder group may submit its nominees as late as 80 days before the date that the registrant mailed its proxy materials for the prior year's annual meeting. Even then, it need not submit its supporting statement for its candidates until notified by the registrant that its candidates will be included in the proxy material. The registrant's notice must provide at least ten business days for the shareholder group's response. That essentially eliminates another two weeks from the period the registrant has for proxy statement preparation.

Rule 14a-8 provides an analogous system for submitting proxy material and has a tested and workable timeframe. Under Rule 14a-8, shareholder proposals must be submitted at least

120 calendar days before the date the registrant's proxy statement was released to shareholders for the prior year's annual meeting. Proponents submit their supporting statements at the same time. There is no reason that a *5%* shareholder group (which must have been working on the nomination for some time) could not provide its supporting statement at the same time that it submits the name of its candidates. Providing 120 days notice and requiring supporting statements by the same deadline would provide the proposed rule with a much more workable framework.

- **Voting For Nominees As A Group**

We are also concerned about the proposal to prohibit the grant of authority to vote for any nominees as a group or to withhold such authority when one or more security holder nominees are included in the proxy material. That provision will undoubtedly confuse many shareholders familiar with a proxy process that has worked differently for many decades. It is crucial to insuring an effective voting process that shareholders understand that certain nominees are being proposed by management. and that they know who the management nominees are. For shareholders who decide to vote for all of the management nominees, i.e., to vote for the management nominees as a group, we can think of no valid reason to prohibit the ability of shareholders to vote for those directors as a group. We are not aware of problems with the present provision of Rule 14a-4 that specifically permits such voting as a group if shareholders can similarly withhold votes for such directors as a group. The change proposed to Rule 14a-4 would increase the possibility of shareholders making mistakes in voting, resulting in their votes not being counted or their intentions not being reflected in the vote tally. This could occur where shareholders intended to vote for all of management's nominees, and neglected to check one or more of those nominees. It could also result from shareholders checking all of the nominees, including shareholder nominees. In such a case, would the shareholders' votes not be counted at all? We see no alternative in those cases to disqualifying all of the selections by the shareholders. Also, we would expect that new systems and procedures would need to be implemented in order to identify proxy cards where shareholders have voted for too many directors.

It is common practice for a substantial number of shareholders to sign and return proxy cards without checking "for" or "against" or "vote withheld" boxes. They know that under existing practice that means that they have agreed to vote in accordance with the board's recommendations. We believe that shareholders who do this each year are doing so with the intent that their shares will be counted for each voting matter. We note that such a practice would continue to be permitted under Rule 14a-4(b)(1).

In sum, we do not know what is gained by including this prohibition against voting for nominees as a group. The proxy rules already require that shareholders be given the opportunity to withhold votes from one or more or a group of nominees while voting by one check mark for the rest of the group. Conversely, if all of the board nominees and one or more *5%* shareholder group nominees are individually listed on the proxy card, we are not convinced that all shareholders will have a better understanding of the new voting system than the present system,

and be less prone to making errors in voting that would disenfranchise them. There will be more nominees than there will be places on the board to be filled. Undoubtedly, some shareholders will check the wrong number of boxes. As discussed above, we would expect that the proposed prohibition will lead to more errors in voting and disenfranchisement of greater numbers of shareholders.

3. A Mechanism Should Be Adopted To Insure That A Security Holder Nominee Elected To The Board Not Be Entitled To Serve When The Nominating Security Holder Or The Nominee Do Not Meet Stated Requirements

Under the Proposed Rule. Rule 14a-11(b) very appropriately lays out the requirements for a nominating security holder including representations by the nominators with respect to the nominee's independence from the nominators. However, the Commission in the Proposed Rule has not provided any mechanism or procedural remedy for non-compliance with the requirements of any final rule. We believe that any final rule adopted by the Commission should contain a mechanism to allow a company to challenge the right of a director to serve on its board if the nominee or the security holder that made the nomination failed to comply with the requirements of the final rule. The final rule should expand the scope of the certification currently proposed to encompass this point. Furthermore, the mechanism adopted by the Commission should address the resolution of any dispute over interpretation and application of the final rule on a timely basis to permit distribution of the proxy statement on schedule. An expeditious mechanism is necessary. particularly where, in almost every instance, the determination will be a question of ascertainable fact.

4. Additional Information Should Be Required To Be Provided By Nominating Security Holders; Existing Rules Should Be Amended To Expressly Exclude From Schedule 13D, Section 16 And The Definition Of Affiliate, Groups Formed Solely For The Purpose Of The Proposed Rules

We agree with the Commission's view as expressed in the Proposed Rule that a group of security holders nominating a director under the Proposed Rule, should not be considered, merely as a result of such nomination, to be "controlling" the company in question. However, we believe that the disclosure required by Item 6 of Schedule 13D regarding "Contracts, Arrangements, Understandings or Relationships With Respect to Securities of the Issuer" and clause (3) of Item 7 regarding filing copies of written agreements for such arrangements would be beneficial to a nominating committee and to all shareholders, and that the same disclosure should be required by such groups under the Proposed Rule. In addition, we believe that the final rule should apply the stricter standards for amending an existing Schedule 13D to the Schedule 13G to be filed by the nominating security holder group pursuant to the final rule. Applying this more stringent amendment standard would help the company and shareholders track any important changes being made to the group or to its intentions during proxy solicitation.

Finally, we recommend that the Commission adopt amendments to explicitly provide in existing rules that merely joining together as a group for the purpose of nominating directors under the Proposed Rule would not by itself make the group an affiliate of the company under the securities acts, including Section 16 of the Exchange Act, Rule 144 of the Securities Act, and the definitions of "control" and "affiliate" and related definitions.

5. The Ownership Threshold To Nominate Directors Should Require Full Economic Risk And Not Merely A Hedging Position; Nominating Shareholders Should Be Required To Certify To That Ownership Interest

In order to gain access to the ballot, the Proposed Rule requires that a security holder, or group of security holders: must "beneficially own" more than 5% of the registrant's securities that are eligible to vote for the election of directors "continuously for at least two years," intending to continue to hold the securities through the date of the shareholder meeting to elect directors.

The Release states that the minimum percentage that must be held and the duration of the holding is designed to insure that the access process is not used by securities holders "who do not represent a significant ownership stake in the subject company."

The Commission's emphasis on the need to demonstrate a significant ownership stake or, as stated elsewhere in the Release, the need to demonstrate a "substantial, long-term stake in one company" is appropriate. This being the case. the final rule should clearly require that the security holder or group of security holders actually be at economic risk with respect to their investment. They should not be able to be short the shares but be able to in effect "long" the vote.

However, as drafted, there is, in fact, no need to show economic investment. The definition of beneficial ownership, found in Rule 13d-3, which the Proposed Rule provides as the test of economic ownership, was fashioned to deal with an earlier era of hostile takeovers in which sole or shared power to vote or direct the vote or the sole or shared power to direct the disposition of shares of a company was crucial to a change in control: economic interest was taken as a given. Therefore, relying on the Rule 13d-3 definition of beneficial ownership does nothing to insure that security holders wishing access to the ballot have a "significant ownership interest" in a company.

The Commission's emphasis on an economic stake in the context of shareholder participation is not new. As early as 1976, Rule 14a-8 was amended to require that a proponent be a record or beneficial owner of a security entitled to vote at the meeting on the proposal and "continue to own" such security through the meeting date.

In the Securities Exchange Act Release No. 12999 giving notice of the amendment, the Commission said the purpose of requiring continuous ownership "is to assure that the proponent

will maintain an investment interest in the issuer through the meeting date." Some years later when Rule 14a-8 was further amended to require that in order to be eligible to use the rule, a proponent had to be the record or beneficial owner of at least 1% or $1,000 in market value and have held such securities at least one year, continuing to own them through the date of the meeting, the Commission again stated that the purpose of the holding period was to require that the proponent "have some measured economic stake or investment in the corporation."

In other words, an economic interest is fundamental. Shareholders that are either the record or beneficial owners, but are not also at economic risk because their economic ownership is hedged should not be given access to a registrant's ballot.

Access should not be granted to investors, be they pension funds, investment companies, family trusts or any other individual or entity that seeks access to the ballot, unless the ultimate investor is long the shares and can truly state in the common meaning sense, that they are long term shareholders.

We believe that proposed Rule 14a-11(b)(2) should be amended to read:

> (b)(2) "The security holder or each member of the security holder group must have held the securities used for purposes of determining the more than 5% ownership threshold required by paragraph (b)(1) of this section themselves, or on behalf of others who have the right to receive dividends or proceeds from the sale of securities, continuously and at full economic risk for at least two years and intend to continue to hold those securities at full economic risk through the date of the subject election of directors."

The certification language of proposed Rule 14a-11(c)(11)(ii) should be similarly revised.

6. Non-Implementation Of A Security Holder Proposal (Other than A Direct Access Security Holder Proposal) That Receives A Majority Vote Should Not Be A Nomination Procedure Triggering Event

The Release asks for comment on whether there should be a third triggering event -- failure of the company to implement a Rule 14a-8 security holder proposal (other than a direct access security holder proposal) that receives a majority vote. Assuming that the Commission adopts the presently proposed two triggers, or variations thereof, there would be no valid reason to also adopt an additional triggering event. Such an additional trigger would, in any event, tend to distort and confuse the voting on the underlying security holder proposal, would not be a reliable indicator of ineffectiveness or dissatisfaction with the proxy process, and would introduce possible controversies with no apparent satisfactory mechanism for resolution, all to the detriment of issuers and their shareholders.

- **Failure To Implement A Rule 14a-8 Proposal Is Not An Indication That The Company Is Unresponsive To Security Holders**

The Commission states in the Release that the proposed two triggers would limit use of the security holder nomination process to companies where there is evidence indicating ineffectiveness of or dissatisfaction with the proxy process. In addition, the Release states that those two triggering events may serve to make boards more responsive to security holder concerns and dissatisfactions with directors where the company wants to avoid triggering the nomination procedure. The possible third trigger based on Rule 14a-8 proposals other than an "opt-in" to the security holder nomination process, however, would not be so limited.

We understand that currently a number of companies regularly negotiate with large, responsible shareholders over proposed shareholder proposals, and often are able to reach compromises that result in the withdrawal of proposals or proposals not being made. This, as stated above, is one of the objectives of the security holder nominating process. Moreover, it follows that in a number of cases, where Rule 14a-8 shareholder proposals are made, it may be more of an indication that the shareholder proponent is inflexible and is unwilling to negotiate and compromise, than the company is unresponsive to shareholders.

In addition, using Rule 14a-8 proposals as a trigger in effect is a determination that a board's decision to oppose, and not to implement, a proposal is being unresponsive to shareholders. It also would blur the distinction between "mandatory" and "precatory" proposals, and tend to pressure boards into agreeing with every Rule 14a-8 proposal. In sum, it would be unreasonable to equate, as the possible third trigger would, a judgment by a board in the exercise of its fiduciary obligations under governing state law with being unresponsive to the company's shareholders and imposing the remedy for unresponsiveness.

- **Difficulties In Determining Whether Rule 14a-8 Proposals Have Been Implemented Make Such Proposals Impracticable As A Trigger**

The discussion and questions in the Release about the difficulties that would arise in the event that failure to implement a Rule 14a-8 proposal receiving a majority vote is used as a trigger demonstrate the impracticality of using such a trigger. For example, although we do not agree that there should be liability, the Release even discusses the issue of possible liability of a company that determines it has implemented a proposal, where security holders may disagree, and whether shareholders would have a private right of action. There is no need for a third trigger and all the resulting implementation difficulties since, if the Commission decides to adopt its security holder access proposal, there will be two triggers available for shareholders.

- **Tying Shareholder Proposals Under Rule 14a-8 to Direct Shareholder Access Would Distort And Confuse Voting On The Proposals**

Adding a third trigger based on Rule 14a-8 proposals would create a voting dilemma. What the shareholders are voting for or against would not be clear -- would shareholders be

voting for direct shareholder access or for the substantive proposal? The Commission recognizes this type of dilemma in the Release, and proposes an amendment to Rule 14a-5 that would require an issuer with an "opt-in" proposal that the company become subject to the shareholder nomination procedure by a 1% shareholder, to disclose that the vote on that proposal may determine whether the issue will become subject to the shareholder nomination procedure. At least in that case, the proposal has some nexus to the election of directors. For these other shareholder proposals under consideration, there usually is no nexus to the election of directors. In these cases, disclosure of the voting dilemma would do nothing to ameliorate the dilemma.

Furthermore, such a third trigger would permit a single-issue or agenda shareholder group to "game" or take advantage of the process. For example, a shareholder group could propose a facially attractive or appealing sounding proposal at a company that is well-managed and responsive to shareholders, for the purpose of triggering direct shareholder access. Conversely, where the proposal is the proponent's main objective but the proposal may not be attractive or appealing on a general basis, the shareholder group may be able to use the threat of triggering direct shareholder access to pressure the company to agree to a proposal it otherwise would not agree to, and which may not be in the best interest of the company.

7. The Proposed Application Of Triggering Events Prior To Adoption Of Final Rule Is Unwarranted And Contrary To The Rules Of The Commission

The Commission has proposed in the Release that the triggering events relating to shareholder proposals and the 35% "withhold" votes for directors would be applicable to annual meetings held in early 2004 before the adoption of a final rule. Thus, a shareholder proposal under Rule 14a-8 to "opt-in" to the director nomination procedure would require disclosure in the proxy statement and could be applicable to the annual meeting at a time when the details of the final rule are unknown and accurate disclosure virtually impossible, thus violating the current requirements of Rule 14a-8. Further, since the shareholder proposal would relate to a board election, the requirements of Rule 14a-8 also would be violated because they do not permit shareholder proposals on that subject. Effectively, if the Proposed Rule is adopted as proposed the Commission would be amending its rules contrary to the notice and comment requirements of the Administrative Procedure Act. The application of this triggering event prior to the adoption of a final rule is unwarranted – a triggering event should not become effective until a reasonable period of time following adoption. Similarly, applying the 35% "withhold" votes triggering event to procedures that are not yet finalized also would be unwarranted and would create disclosure issues comparable to those raised by the "opt-in" proposal. As to both of these issues, we agree with the analyses and conclusions set forth in the comment letter of the American Bar Association dated November 3, 2003.

8. There Are Serious Issues About The Authority Of The Commission To Adopt The Proposed Rule

Issues about the Commission's authority to adopt the mandatory shareholder access provisions of the Proposed Rule center around the extent of the Commission's authority under the Exchange Act, and whether the Proposed Rule would be inconsistent with state corporate law.

The Commission in the Release bases its authority on Section 14(a) of the Exchange Act, which grants authority to prescribe rules regulating the solicitation of proxies "as necessary or appropriate in the public interest or for the protection of investors." Under that Section, the Commission has authority to regulate the process of proxy solicitation and the related disclosures in soliciting materials. Although in most states shareholders already have the right to make nominations for director in accordance with applicable company procedures and procedures in the governing state corporate law, the Proposed Rule would create a right in certain shareholders to solicit proxies for their director nominees in the company's proxy statement under specified conditions and circumstances. We believe that this right to access the company's proxy statement to conduct a proxy solicitation for one or more directors, which inevitably involves a contested election, creates a federal substantive right in a small group of shareholders which goes beyond the proxy procedures and disclosures contemplated by Section 14(a).

The decision in Business Roundtable v. SEC is probably the most definitive judicial interpretation of the Commission's authority over shareholder voting rights. We recognize that case involved a different aspect of shareholder voting rights -- prohibiting the listing of certain dual classes of stock with different voting rights -- and a different Exchange Act section -- Section 19(c) authorizing regulation of the rules of self-regulatory organizations in furtherance of the purposes of the Exchange Act. However, we believe that the rationale of that decision with respect to the limitation of the Commission's authority over shareholder voting is applicable here.

Finally, we also believe that adoption of the Proposed Rule would raise significant issues involving inconsistency with applicable state corporate law. The rights the Proposed Rule would give to a certain group of shareholders in connection with the election of directors appear to discriminate among shareholders and interfere with the duty and responsibility of directors to manage the affairs of the corporation.

* *

We hope the Commission and the Staff find these views and suggestions helpful. We would be happy to meet with the Staff to discuss these matters further.

Respectfully submitted,

COMMITTEE ON SECURITIES REGULATION

By: Michael J. Holliday
MICHAEL J. HOLLIDAY
CHAIR OF THE COMMITTEE

Drafting Committee:

Louis Goldberg, Chair
Gerald S. Backman
Margaret Bancroft
Richard E. Gutman
Michael J. Holliday
Richard R. Howe
Jeffrey Rosenbloom
Kathleen A. Warwick

Copy to:

The Honorable William H. Donaldson, Chairman
The Honorable Paul S. Atkins, Commissioner
The Honorable Roel C. Campos, Commissioner
The Honorable Cynthia A. Glassman, Commissioner
The Honorable Harvey J. Goldschmid, Commissioner
Alan L. Beller, Esq., Director of Division of Corporation Finance