117

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September 23, 2003

Via e-mail: rule-comments@sec.gov

Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Attention: Jonathan G. Katz, Secretary

Re: Disclosure Regarding Nominating Committee Functions and Communications Between Security Holders and Boards of Directors (Release No. 34-48301; IC-26145; File No. S7-14-03; RIN 3235-A190)

Ladies and Gentlemen:

This letter is submitted on behalf of the Committee on Federal Regulation of Securities of the American Bar Association's Section of Business Law (the "Committee")* in response to the Commission's request for comments on the above-identified Release issued August 8, 2003.

The comments expressed in this letter represent the views of **the** Committee only and have not been approved by the American Bar Association's House of Delegates or Board of Governors and therefore do not represent the official position of the **ABA.** In addition, they do not represent the official position of the ABA Section of Business Law, nor do they necessarily reflect the views of all members of the Committee.

* References herein to "we" and "our" refer to the Committee.

among directors and security holders can involve complex legal, regulatory and practical issues. The same justification requirement is being proposed for disclosures about nominating committees and the specific reasons why a candidate proposed by a greater-than-3% shareholder has not been nominated. We see no need for an SEC rule obligating a board to justify why it either has or does not follow a particular corporate governance practice or makes a business judgment. Disclosure of the existing practice or process or its non-existence would suffice to enable shareholders to make their investment or voting decisions.

There have been many constructive initiatives to improve corporate governance systems in an effort to remedy the much-publicized problems of some publicly-owned companies. The Commission has adopted many rules under the Sarbanes-Oxiey Act of 2002. The principal self-regulatory organizations have proposed a series of governance listing standards (which include a New York Stack Exchange standard requiring a policy on shareholder/board communications), which we trust will become effective in the near future. The ABA Task Force on Corporate Responsibility, The Business Roundtable, The Conference Board and other groups have recommended best practices, many of which have been adopted by publicly-owned companies. We recognize the Commission's constructive role in many of these initiatives and urge the Commission to take these recent developments into account in its final rulemaking.

The proposed governance listing standards focus significantly on the nominating process of listed companies. One such standard requires the establishment of a nominating committee comprised of independent directors (except in the case of controlled companies). The nominating committee would be required to have and to disclose a written charter that addresses the committee's purposes, its criteria for the selection of new directors and its process for making nominations. This new listing standard is a significant development. It should be given an opportunity to serve its intended purpose and thus should be considered by the Commission as it fashions disclosure requirements regarding director nominations.

Presumably, the nominating committee charter will establish procedures for consideration of candidates submitted by shareholder proponents, identify criteria applicable to all candidates and establish appropriate timetables. The charter of some nominating committees might require that in order to be eligible for consideration by the committee and the board, information concerning director

candidates must be submitted by shareholder proponents to the committee, except in the case of election contests to which the traditional proxy rules apply. This would encourage proponents to communicate with the nominating committee, which presumably would make its recommendations after diligence and due consideration. Communications of this nature should be encouraged. We believe that it would be appropriate for the Commission to adapt a requirement that companies, through their nominating committee, if they have one, disclose in a report, to be included in a proxy statement for the election of directors, its process for considering director candidates. (As we note below, however, it is important for such disclosure to be made without involving the identity or reputation of either incumbent directors or candidates). In short, we urge the Commission in its rulemaking to integrate its disclosure requirements with other measures that affect the nominating process.

We urge the Commission, in formulating disclosure rules regarding nominating committees, to keep in mind the corporate law principle that a nominating committee is appointed by the board of directors, acts through delegated authority and is subject to the ultimate authority of and monitoring by the board. Whatever role the governance listing standards provide for the nominating committee, listing standards are provisions in a contract between the issuer and the particular self-regulatory organization and do not supersede the legal obligations and duties of the directors. The Commission should avoid any implication, in requiring disclosure of nominating committee processes, that the board of directors has no role or authority in that process.

The proposed disclosure requirements apply to companies whose shares are listed as well as those companies, generally smaller, whose shares are not listed. Given the number of companies in the unlisted category and particularly those whose shares have not traded actively for a reasonable period of time, it is difficult to estimate the burden of compliance. It may be that most of the new governance disclosures would be more appropriately required of larger companies. The application of these measures to smaller companies should be customized to their ability to comply and the needs of their shareholders. We therefore urge the Commission to consider the adoption of disclosure rules on the nomination process only with respect to listed companies and defer application to other publicly-held companies pending further experience and consideration of the need for and burden of such requirements. However, to the extent smaller companies have established procedures applicable to shareholder nominations, disclosure of such procedures should be required and the Commission could

request unlisted companies to comply on a voluntary basis with the requirements applicable to larger companies. This would enable the Commission and its staff to evaluate the impact of those proposals before imposing them across the board. The line between listed and unlisted companies would in our view be an appropriate point of distinction for this disclosure, but we defer to the Cornmission **as** to another appropriate basis for distinction (such as market capitalization or S-3 eligibility), particularly since many listed companies are relatively small.

**A** more technical point warrants the Commission's attention throughout the proposed rules, which contain repeated references to "security holders." We suggest that, inasmuch as the proposed rules concern the voting process, the reference should **be** to "shareholders" and indeed only to those shareholders who are entitled to vote on the election of directors (at the upcoming election, as appropriate). The disclosure requirements should not apply for the benefit of holders of debt (convertible or otherwise), non-voting preferred stock or other financial instruments. Of course, when required to be disclosed, the information will be publicly available to the holders of non-voting securities and to the public generally.

This letter does not address the Cornmission's authority to adopt the proposed disclosure rules. Specifically, we urge the Cornmission to consider carefully when fashioning the disclosure rules whether a disclosure requirement as to the independence of nominating committee members of unlisted companies does not for practical purposes establish a governance requirement for such companies, thereby going beyond disclosure. Although a requirement of independence **for** certain directors, for example, may be a desirable governance practice, it generally is not mandated by state corporate law and, apart from specific separate legal provisions (such as Section 301 of the Sarbanes-Oxley Act and certain Internal Revenue Code requirements), is only applicable to companies as a result of existing or pending governance listing standards. Even the pending listing standards recognize that some listed companies' circumstances warrant additional flexibility regarding director independence (e.g., controlled companies). We believe the thousands of companies whose shares are not listed are entitled **to** use their **own** procedures and make their own determinations respecting independence of directors and board committees or other qualifications. Minimum standards may or may not **be** suitable for the circumstances of **a** particular company, In making this comment, we do not question the desirability of having independent directors or of informing

shareholders of qualification requirements already established by companies. Rather, our point is that there is a marked difference in operation and import between a material disclosure rule and a rule ostensibly dealing with disclosure but also implicating normative judgments that may have the intended or unintended consequence of affecting governance practices. We address the particular circumstances of investment companies below.

## SPECIFIC COMMENTS

### A. ENHANCED NOMINATING COMMITTEE DISCLOSURE

We concur with the Commission's view set forth in the Release that increased disclosure of nominating committee procedures and policies would, in general, be an effective means of increasing shareholder understanding of the nominating process. We also believe that many of the proposed proxy rule amendments would be appropriate in furtherance of these articulated goals.

However, as set forth below, we believe that a number of the proposed rule amendments would be ineffective, or worse, counterproductive, and should not be included in any final rule amendments because either the disclosures would result in boilerplate language or they would have unintended consequences that would undermine the enunciated policy goals sought to be advanced. The detailed requirements of the proposal would also increase the difficulty of compliance and overly complicate proxy statement disclosure. We also have certain technical comments that may enhance the clarity and efficacy of the proposed rule amendments.

**Disclosure of Nominating Committee Policy Regarding Candidates Nominated by Shareholders**

This proposed rule would require a "description of the material elements of the policy, which shall include, but not be limited to, a statement" regarding the committee's willingness to consider director candidates recommended by shareholders. The quoted language implies that the policy cannot simply be that the committee will consider such candidates. It is hard to understand why the proxy rules would mandate a more complicated policy if the nominating committee did not choose one. We recommend that the rule proposal be clarified to limit disclosure to the material terms of the nominating committee's policy and

procedures with regard to consideration of shareholder nominees.

**Disclosure of Nominating Committee Independence**

In the case of an unlisted company it is not clear how, under this proposed rule, the requisite determinations as to independence of the members of its nominating committee are to be made or what is to be disclosed about the determination. Under the new proposed listing standards, a determination of independence requires consideration by the entire board of all of the relevant facts and circumstances pertaining to each director, followed by a specific affirmative finding of independence applying the board's discretion to the circumstances. The procedure for making the determination is **part** of the independence standard. We do not believe that an unlisted company should **be** obligated to use the procedure or the definition of independence that is required of listed companies under applicable listing standards. An unlisted company should be entitled to define independence for its own purposes or for that matter not to require independence or not to have **a** nominating committee. The required disclosure should be limited to the nominating process at the unlisted company and **an** identification of the committee, if any, that makes decisions with respect to nominations, and the applicable independence criteria, if any.

If an independence disclosure requirement is retained in the final rule for unlisted companies, we urge that it be clarified in *two* respects to reflect the different circumstance of unlisted companies. First, the rule should specify that the company identify (in addition to the listing standard used by the company in defining independence for disclosure purposes only) the individuals or corporate body that has made the determination of independence. Second, except for the foregoing disclosure, only the conclusion **as** to independence or non-independence needs to be presented, and not the considerations that were taken into account in making the determination.

**Disclosure of Minimum Qualifications for Nominees**

This disclosure requirement should be simplified to call only for any preestablished criteria or qualifications for nominees. Any further elaboration will inevitably produce generalized boilerplate disclosure that is consciously intended to give the committee **as** much flexibility as possible, without illuminating the necessarily complicated and subjective judgments involved in the nomination process. While fashioning such boilerplate disclosures will not **be**

difficult, we submit that no purpose will be served by mandating their inclusion in every company's proxy materials.

**Disclosure of Source and of Process for Identifying and Evaluating Nominees**

We believe that identifying the "specific source" of a nominating committee's nominees is fraught with difficulties and unnecessary. There may be multiple "sources" which, over a period of a year or two, led to **a** candidate being considered at various stages in the nominating process and then selected by the nominating committee as a nominee. In response to the questions addressed *to* this disclosure item, we observe that more important and relevant to shareholders than the source is whether the nominee is "independent" by an identified standard. This, we believe, is more central and informative than trying to describe the source of a nominee or "connections" that may exist between nominees, on one hand, and the company and the nominating party, on the other hand. If the source of the nomination is the company or its management or directors, the articulated director independence standards of the proposed listing standards, where applicable, will address his or her pertinent connections. However, where the source is a shareholder, **we** believe that it is important for shareholders to know whether the nominee is independent not only of the company, but also of his or her shareholder proponent. Accordingly, we would revise this disclosure requirement to include the "independence" of the nominee from the company and, in the case of nominees who were proposed by shareholders, from the proponents of the candidacy. For this purpose the Commission should identify **the** relationships that would result in **a** candidate not being considered independent of a proponent. We note that the Commission has done so recently in addressing director independence in Rule 10A-3, through the provisions of section (e)(1) of that rule.

We also recommend that, in the adopting release, the Commission recognize that **a** nominee should be considered proposed by a shareholder proponent (or the shareholder considered the source of the nominee) only where there is clear identification and attribution. General expressions of support for a candidate by a shareholder should not constitute the proposal of the candidate (or the source of a nominee) for these purposes.

Finally, we agree with the Commission that any differences in the consideration of candidates based on the source of the candidacy would be material and should be disclosed. We believe, however, that the proposed rule

that would require the nominating committee to set forth its process for "evaluating" nominees, in addition to its process for identifying nominees, would produce meaningless boilerplate. **As** with disclosure of ideal nominee qualifications, the response would undou' tedly be broad and vague. Any attempt by the Commission to mandate otherwise is almost certain to fail because of the inherently subjective judgments involved in evaluating director candidates.

**3% Plus Shareholders — Expanded Disclosure**

We urge the Commission not to adopt the **proposal** requiring enhanced disclosure when a candidate proposed by any greater-than-3% shareholder is not nominated by the board. Naming such proponent and disclosing the specific reasons €or not nominating its candidate effectively requires the nominating committee to justify its actions publicly. **A** greater-than-3% shareholder would occupy a unique status in the operation of the proposed rule; **a** distinction would be established between a candidate of such a shareholder and all others. The greater-than-3% shareholder could use this process for its own purposes irrespective of control or intentions to influence or other (possibly undisclosed) special interests. Furthermore, there could be **a** significant number of such proponents, resulting in complex comparative disclosures and an excessively lengthy and perhaps confusing **proxy** statement. This form of disclosure may have a significant impact on the issuer and may not be in its best interests. We do not believe that this is **an** appropriate subject for an SEC disclosure rule. In any event, the subject matter is more appropriately considered in terms of shareholder access to issuers' proxy statements which the Commission will address separately in the near future. The elimination of this proposed disclosure requirement would not detract from the effectiveness of the other proposed disclosure rules.

**Disclosure of "'Specific Reasons" for Not Nominating a Shareholder Proposed Candidate**

We believe this proposal would produce problematic and counter-productive results. Although it may be intended to encourage careful consideration of shareholder candidates by nominating committees, it will likely have a contrary result. Whether or not rejected candidates are named, this proposed rule begs €or accusatory **or** speculative distinctions among candidates that could easily embarrass them and possibly damage their reputations. It could lead to a reluctance of qualified candidates to be considered. Public policy will not be served by forcing disclosure that candidate X (whether or not named) **was**

believed to be less able or less qualified than candidate ***Y*. A** nominating committee may believe a shareholder candidate has a stated, or more likely unstated, agenda that is not in the best interests of the corporation, is not particularly well-qualified, or had a disastrous interview or controversial background. No purpose is served by having these issues spread across a proxy statement.

We are also concerned that the drive for transparency explicit and implicit in the proxy rules may pressure **a** company to disclose the name of a rejected shareholder candidate absent a clear instruction to the contrary. Therefore, the Commission should ***make** clear* that the name of any shareholder candidate ***need*** not be disclosed.

Further unintended consequences may result from this proposed disclosure. If a shareholder candidate is rejected for what in the shareholder proponent's or candidate's view are "wrong" or "bad" reasons, can either or both sue the nominating committee, the board of directors or the issuer? If the **reason** for rejection has reputational connotations, can the committee, board or company be sued for libel? By the same token, the nominating committee may feel that it cannot be candid in its discussion of candidates or its explication of its reasons for rejecting a candidate out of fear of controversy or liability. Forcing nominating committees to abandon frank discourse and honest discussion in favor of "code" words and euphemism is not a prescription for advancing the quality and transparency of corporate governance.

For these reasons, as well as the "privacy" concerns acknowledged in the Release, **we** strongly urge deletion of this proposed disclosure in its entirety.

**Qualifications for Shareholder Proponents**

Our principal comment on the qualifications of shareholder proponents is that, in addition to whatever minimum holdings standard the Commission determines, shareholder candidates should be required to be independent both of the company and of the shareholder proponent. **As** indicated above, applicable independence standards should be specified for this purpose.

We believe it is inappropriate and unwise to allow shareholder proponents to trigger special disclosure obligations (if this concept is retained – see our comment under the heading "3% Plus Shareholders – **Expanded** Disclosure")

through the nomination of candidates who are not independent of the company and the proponent. That raises control and influence issues. In addition, the special disclosure obligation may create an incentive on the part of qualifying shareholders to complicate and perhaps disrupt the nominating and election process by triggering such special disclosure merely because a candidate who is affiliated in some meaningful sense with the proponent **was** rejected by the nominating committee.

On **a** more technical level, we suggest that the method of calculating the percentage ownership requirement be spelled out in more detail. The proposed rule seems to be premised on the percentage of outstanding shares owned by the proponent, but fails to specify the date on which the number of outstanding shares is to be calculated and the basis of calculation. An obvious choice would be the number and percentage of outstanding voting shares calculated as of the date of and based on the information contained in the company's most recent Form 10-K or Form 10-Q preceding the submission of the candidate to the nominating committee. Such a standard should be based on voting power, not number of shares owned, to take into account disparate voting power among different classes of equity securities. By the same token, options and other rights to acquire voting securities should be ignored in the computation in recognition that the proposed rule is dealing with the ability to elect directors through actual, not potential, voting power.

In the Release, the Commission also inquired whether there should be an additional holding period for large shareholder proponents of nominees. We believe that the shareholder proponent should be required to represent (i) that it has maintained minimum holdings for the requisite time period, and (ii) that it intends to maintain such minimum holdings for some period beyond the shareholders' meeting to which the **proxy** statement relates. If the shareholder proponent does not maintain minimum holdings for some period beyond the shareholders' meeting, the shareholder proponent and its affiliates should be banned from use of the rule for two years.

**Maintenance of Independence and Compliance with Governance Listing Standards**

There should be no requirement to disclose the failure to maintain independence of a director throughout the year. This is essentially an interpretive matter and often depends upon available facts. If the appropriate board committee is unaware of developments that could lead to a loss of independence, a company should not be penalized. The consequences would be too significant to impose a disclosure burden under these circumstances. If the Commission rule does require disclosure of a failure to maintain independence, it should be triggered only upon awareness of that fact by the committee or board and the passage of a reasonable period of time within which to remedy the situation.

**As a** general matter, it is standard practice for self-regulatory organizations to work with listed companies respecting compliance and to provide an opportunity to cure any failure to remain in compliance. This is an ordinary course event and is very much in the interests of investors. Disclosure of noncompliance may result in loss of the opportunity to cure and create other problems for the company. These matters are best left to the relationship between the self-regulatory organization and the listed company. The exception, of course, is the situation where in the annual proxy statement the identified directors would need to be characterized as independent for various purposes.

**Miscellaneous**

The following responds to specific questions in the Release which are not included in the foregoing discussion.

To require specific information concerning only large shareholders or groups of shareholders who submit candidates is inherently suspect from a disclosure perspective as either over- or under-inclusive. Determining when **a** large shareholder **or** a group of shareholders is involved in sponsoring **a** candidate could raise many issues, including what constitutes a "group," who or what is a "large shareholder," what is a "long-term shareholding" and what constitutes "support" of a candidate **by** a group. Would such a requirement **be** directed **at** institutional or other non-controlling shareholders only or would it include shareholders who control or may be part of a control group? The latter **are** relationships already required to be disclosed.

We suggest that the charter of the nominating committee should be set forth in the proxy statement initially and thereafter on a three-year cycle, or earlier when it is changed in any material respect, comparable to the disclosure required for audit committee charters. In those cases where the charter is not included in the proxy statement but the company discloses where the charter is available to shareholders (as proposed), we see no need for encumbering the proxy statement by mandating a summary of the charter as well.

We have no objection to disclosure as to the use of a search firm and the identity of the firm. However, disclosure should only be required as to those firms whose activities were pertinent to the selection of nominees or who were retained to assist the nominating committee in the search and/or selection process (as distinguished from incidental involvement with a committee, such as suggestion of a candidate who is not nominated).

**B. DISCLOSURE REGARDING THE ABILITY OF SECURITY HOLDERS TO COMMUNICATE WITH THE BOARD OF DIRECTORS**

Security holders already have the ability to communicate with directors through Rule 14a-8, by means of floor proposals or other statements at annual meetings, and through other formal and informal written and oral communications. Under current practice, security holders regularly send communications to directors at the Issuer's address and through other means, and we are not aware that any significant problems exist with this procedure. As the Release states, some security holders would like companies to tell them affirmatively that they may send communications to directors and *how* to do so (e.g., through email, toll free number, US mail, etc.). The Commission does not cite any evidence that this is a widespread concern, or that the current practices of issuers are causing significant problems. Nor does the Commission cite to commentary indicating that security holders desire detailed disclosure about the processes companies use to manage the communication process where they have established one. The nuts and bolts of how the company administers the process and how the board responds to security holder communications may be interesting to some security holders but would be largely irrelevant to most. Therefore, the proposals, if adopted in any form, should focus narrowly on requiring disclosure only of whether companies have established security holder/director communication procedures and, if they have, the material terms of those procedures.

It is **a** good governance practice for directors and security holders to have available lines of communication. However, such communications need to be managed with care in order to protect the interests of the corporation, investors and other constituents. **A** variety of legal and business considerations are applicable. The director needs to be concerned about prematurely disclosing material information, complying with Regulation FD, being sensitive to information which may provide a third party with competitive or other advantages and the management of proprietary or confidential information of the company. **As** a result, companies often channel communications through a designated spokesperson. The shareholder may be concerned with receiving inside information that may constrain it in trading in the company's securities. The mere receipt of security holder communications can become burdensome to directors, as there is no assurance that these communications will relate to the directors' oversight role. Therefore, each company, consistent with its own needs, should be free to establish whatever policy for the communication process it deems appropriate. There is no recognized best practice in this area for publicly-held companies. While the proposed listing standard of the **NYSE** mandates certain minimum practices for shareholder communication with directors, no such requirement has been proposed for Nasdaq-listed companies. This underscores our view that the Commission should limit its disclosure requirement to a description of the policy established by the company or the **fact** that there is no established policy. Many companies, and particularly those which are smaller and unlisted, may disclose that there is no formal policy but that any communication to **a** director can be directed to the company.

**Questions 1 and 2**. First, for the reasons discussed above, we question whether there is empirical evidence that additional disclosure in this area will enhance security holder interests. Second, we believe that detailed disclosure required about the process that a company adopts to facilitate **security** holder communication with directors **as** set forth in the proposal does not provide important information to security holders. Therefore, disclosure should be limited to a statement **as** to whether the company **has** such **a** process and how security holders may communicate with the directors. More detailed disclosure along the lines of the **proposed** rules would not further the Commission's objectives of promoting director accountability, responsiveness and improving corporate governance **policy, and** will simply burden proxy statements with additional disclosure of interest to few security holders.

**Question 3.** The Commission should consider encouraging companies to disclose on their websites whether and how security holders may communicate with directors. This can be accomplished by permitting website disclosure to substitute for **proxy** statement disclosure. Using the company website instead of the annual meeting proxy statement has advantages. Internet functionality would allow companies to provide a direct email link to a mailbox available to directors. In addition, if the contact information is on the company website, it would be available to security holders at all times. Security holders would not have to retain copies of the annual meeting proxy to know how to communicate with directors. This internet-based approach would also avoid additional disclosure in the proxy statement that does not relate directly to the matters to be voted upon, including the election of directors. Where possible, the Commission should try to avoid unnecessary "disclosure creep" in the proxy statement.

**Question 4**. Companies that establish a communications process should not be required to disclose why no director accepts communications individually because, as long as a process exists for the board to receive shareholder communications, this should not matter. Likewise, requiring companies to disclose the process they use to record and keep security holder communications does not directly bear on the company's process to facilitate communication with the directors. This type of detailed disclosure about the nuts and bolts of process administration only adds to the "disclosure creep" which is of concern to us and will not meaningfully benefit security holders. Nor does it encourage companies to establish **a** process or encourage directors to respond to security holder communications.

**Question 5**. We also do not **believe** that it would be helpful to security holders to require companies to disclose the company's process for determining which communications are relayed to the board. We believe that many, if not all, companies that establish a process for communicating with directors will (and should) include as **part** of the process a "filtering" function, This is a function the board itself may oversee. **As** part of this process a company would organize and prioritize communications so that the board may efficiently address issues raised. Through this process some security holder communications will not be relayed to the board because management in the **performance** of its duties determines that the communications are inappropriate or **that** sending the communication to the board will waste directors' time. Absent such **a** process, directors may find themselves inundated by the sheer number of communications or those that do not relate to their responsibilities, which may distract them from their most important

role of overseeing management and the effective and legally compliant operation of the company. Disclosure of the fact that the communications are screened and by whom would not enhance the directors' performance of their duties.

**Any** disclosure of the company's screening process would also likely be very general in nature and therefore of even less utility to security holders. The process of determining which communications will be reviewed by and/or discussed among board members requires management and the board to balance a number of competing considerations. Some objective criteria may be used, but ultimately what issues are relayed to the board will depend on subjective considerations and judgment. Disclosure that management uses its best judgment in deciding what communications to send to the board will not help security holders.

**Question 6.** We do not believe that requiring companies to disclose any material action taken by the board during the preceding fiscal year as a result of communications from security holders will meaningfully advance the cause of accountability, responsiveness or good corporate governance. There likely will be multiple considerations that lead companies to take a material action and shareholder communication may be only one of many factors considered. The source of a recommendation or idea is not **as** important as the fact that it is adopted, and many may claim "credit" for suggesting **an** action. The Commission should not create a separate disclosure requirement for material actions taken in response to security holder communication – a category which we believe in practice will usually defy clear description – and instead should rely upon existing line item disclosure requirements **and** Rule 14a-9/Rule 12b-20 disclosure standards to address such matters, where material to security holders. We do not believe that a disclosure system that encourages disclosure of and possible disagreement over who gets "credit" for **a** corporate action is sensible. Furthermore, it may be unclear as to the extent the company took **a** particular action because of **a** shareholder request. Rarely are events that simple.

Further, requiring the company to disclose when directors take material action in response to a security holder communication will not encourage the board to take the action in the first place and may inhibit communication with security holders. **In** the end, directors should be encouraged to take action in response to communications from **any** of the company's constituencies only where the board believes that it is in the best interests of the corporation and shareholders to do so.

**Question 7**. We observe that many companies have published procedures for security holders to communicate concerns to the board either because they believe it is good governance, they early-adopted the NYSE proposals on communications to non-management directors or they early-adopted the NYSE proposals regarding audit committees and extended the process to cover all concerns in addition to those related to accounting and auditing matters. Committee members who represent companies with established security holder/director communication processes inform us that disclosure of the process has not changed the level of accountability, responsiveness and corporate governance from that existing before the disclosure was made. Larger minority shareholders do find it easier to communicate with directors.

**Question 8.** Although a disclosure requirement alone may not assure that a non-NYSE listed company will establish a process facilitating shareholder communication, for reasons mentioned above, we believe that each company, consistent with its own needs, should be permitted to establish whatever policy it deems appropriate.

**Question 9.** The Commission should not decide whether communications should be limited *to* independent directors of the company or extend to the entire board. If the **NYSE** proposals are adopted, NYSE-listed companies will have to establish procedures for shareholder communication with non-management directors. But in the absence of **a** listing requirement, the board of directors and the company should decide whether to adopt **a** process, and if so, to whom the communications should be directed. The Commission does not need to decide this issue to achieve any of the perceived benefits of the proposals.

**Question 10**. It would be helpful for the Commission to memorialize, in an instruction to the rule or in the regulation text itself, that the term "communications" does not include communications from management, employees and agents of the company who are also security holders.

**Question 11.** The Commission should not provide guidance to companies or otherwise address what the Commission views as **appropriate** procedures for companies to implement because procedures will (and should) **vary** depending upon the company's circumstances. Large companies may adopt more robust processes whereas smaller companies may do the minimum necessary to comply. Best practices are readily available without Commission guidance. **As** a practical

matter, such "guidance" would be treated by registrants as regulation.

For those companies that have already established and disclosed a security holder/director communication process, the proposals would not have a disruptive effect and would not result in much, if any, additional costs. For those companies that **have** not adopted processes, the proposals will further burden company resources by requiring a person to administer the communication system. More fundamentally, the board may also be distracted from its primary duty of overseeing management and the business of the company while it attempts to deal with security holder communications.

## C. INVESTMENT COMPANIES

The Release contemplates that the proposed disclosure requirements regarding **board** nominating committees and security holders' communications with board members apply to proxy statements of investment companies ("funds"). **As a** general matter and subject to our comments in this letter, we believe that the proposals should apply to funds as it would apply to other companies.

The Commission specifically seeks comment on whether any of the proposed amendments should be modified in the case of funds. As noted above, we recommend that the requirement to disclose the source of the nominees be deleted in its entirety. If the Commission retains the concept in general, we note that a requirement to disclose **the** name of the specific source of a nomination for a fund director could operate as a disincentive **for** individuals, whether or not they are employed by fund affiliates, to nominate qualified candidates. For **example,** a prominent public figure may be reluctant to submit a nomination out of concern that the nomination would be rejected or because the failure to nominate another person could prove to be uncomfortable. Given the unique nature of funds and the relationship to their service providers, we believe that it would be sufficient to require funds to disclose the general nature of the source of the nomination, such **an** "an officer of **the** advisor" or "a director of a public company who is not an interested person of the fund."

The Commission also specifically seeks comment on whether the proposals should **apply** the "interested person" standard of Section 2(a)(19) of the Investment Company Act in requiring disclosure regarding the independence of

nominating committee members. We believe that the Commission should apply the Section 2(a)(19) standard because it is consistent with all other requirements of the Investment Company Act and is understood by funds, directors and their affiliates. Applying another standard could result in unnecessary complication or confusion.

Finally, the Commission specifically seeks comment on whether the proposals should apply a different standard to funds. We believe application of a more stringent disclosure standard to funds is unnecessary and unwarranted.

In addition, we suggest that the proposed rules should take into consideration the special nature and structure of funds. For example, the proposed rules would require issuers, including funds, to describe their "process for determining which communications would be related to board members, including identification of the department or other group within the registrant that is responsible for making this determination." We note that funds typically do not have employees or operating departments. Accordingly, we suggest that if the Commission retains its proposed detailed communication process disclosure, it should allow funds to delegate this function to an appropriate service provider.

We hope that these comments will be helpful to the Commission and its Staff. We would be pleased to discuss with the Commission or its Staff any aspect of this letter. Questions may be directed to Robert Todd Lang (212) 310-8200 or Charles Nathan (212) 906-1730.

Respectfully submitted,

Dixie Johnson, Chair,
Committee on Federal Regulation of Securities

R. Todd Lang /dj

Robert Todd Lang, Co-Chair,
Task Force on Shareholder Proposals

Charles Nathan /dj

Charles Nathan, Co-Chair,
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cc: Hon. William H. Donaldson
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