MEMORANDUM

INVESTMENT COMPANY INSTITUTE

December 22, 2003

Mr. Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: *Proposed Rule Regarding Security Holder Director Nominations (File No. S7-19-03)*

Dear Mr. Katz:

The Investment Company Institute[1] appreciates the opportunity to express its views on the Securities and Exchange Commission's recent proposal that would, under certain circumstances, require companies to include in their proxy materials a security holder nominee for election as director.[2] The proposal applies to the proxy statements of all companies, including investment companies. Investment companies are both shareholders of the companies in which they invest and issuers with their own directors and shareholders. Accordingly, the Institute is interested in assuring that any requirements regarding a shareholder's access to a company' proxy statement strike an appropriate balance in advancing shareholder interests without unreasonably interfering with corporate management.

The Institute generally supports the Commission's proposal, including its application to investment companies. The Institute does not believe that there is any reason for the Commission to distinguish investment companies from other companies in the general application of the proposed requirements.

Notwithstanding our general support, we have several specific comments on the proposal. These comments are intended to assist the Commission in refining the proposed rules so that they more effectively meet the Commission's goal of providing long-term shareholders with significant holdings with access to the company's proxy statement in those instances where there is evidence regarding the ineffectiveness of, or security holder dissatisfaction with, a particular company's proxy process.

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[1] The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,672 open-end investment companies ("mutual funds"), 605 closed-end investment companies, 108 exchange-traded funds and 6 sponsors of unit investment trusts. Its mutual fund members have assets of about $7.149 trillion. These assets account for more than 95% of assets of all U.S. mutual funds. Individual owners represented by ICI member firms number 86.6 million as of mid 2003, representing 50.6 million households.

[2] SEC Release No. 34-48626 (October 14, 2003) [68 FR 60784 (October 23, 2003)] ("Proposing Release").

In summary, the Institute's comments are as follows.

- The Institute recommends revising the proposal to require that a company be subject to the proposed security holder nomination procedure if, in an election of directors, 35% of the votes cast are withheld from half of the company's nominees on any given proxy statement, as opposed to a single nominee.

- The Institute recommends that the Commission require that a direct access proposal receive more than two-thirds of the votes cast by shareholders on the proposal, provided that at least 50 % of shares outstanding have been voted on the proposal.

- The Institute strongly recommends that the Commission not adopt a third triggering event discussed in the Proposing Release relating to the failure to implement a proposal under Rule 14a-8.

- The Institute recommends that all security holder(s), including mutual fund security holders, be required to file on Schedule 13G upon reaching the more than 5% beneficial ownership threshold.

- The Institute supports requiring each person that is a security holder nominee not to be an "interested person" of an investment company under Section 2(a)(19) of the Investment Company Act of 1940.

- The Institute recommends that with respect to any security holder nominee that does not receive at least 10 % of votes present and eligible to vote at the security holder meeting the first time the nominee appears on the company's proxy statement, a company be permitted to exclude that nominee from the company's proxy statement for the next two calendar years.

- The Institute requests that the Commission include a statement in any adopting release that investment company by-laws, validly adopted under relevant state law, may continue to establish qualifications for director nominees, consistent with Commission rules.

- The Institute supports the aspect of the proposal that would require companies to examine the required information regarding the nominating security holder(s) and any nominees and determine whether they have complied with proposed Rule 14a-11 and whether the nominee satisfies each of the requirements of the proposed procedure.

- The Institute recommends not requiring companies to include information in proxy statements about a person that was put forward for nomination by a security holder(s) when that person is not eligible for nomination under proposed Rule 14a-11.

- The Institute supports requiring investment companies to provide disclosure on Form N-CSR regarding the occurrence of any nominating procedure triggering events.

- The Institute strongly urges the Commission to permit investment companies to use a method other than disclosure on Form 8-K to disclose the date by which a security holder(s) must submit notice of its intent to require the investment company to include that security holder's nominee on the investment company's proxy statement.

- The Institute supports providing limited exemptions from the proxy rules for nominating security holder(s) to enable them to communicate with other security holders for the purpose of: forming a nominating security holder group; and soliciting support for the security holder nominee placed on the company's proxy statement.

- The Institute supports the Commission's decision not to view a security holder as having acquired securities for the purpose of influencing the control of the company by virtue of nominating a director under proposed Rule 14a-11, soliciting on behalf of that candidate, or having that candidate elected.

- The Institute supports excluding from Rule 16a-1(a)(1)'s definition of 10% owner a nominating security holder group.

- The Institute strongly supports including both a provision in Rule 14a-11 and a statement in any adopting release making clear that the nominating security holder or group, not the company, would be liable for any false or misleading statements included in the notice to the company and any disclosure based thereon in the proxy statement.

Each of these comments is discussed more fully below.

I. Proposed Nomination Procedure Triggering Events

A. Withhold Votes in a Director Election

The Commission has proposed requiring companies, including investment companies, to provide a security holder or security holder group a "limited access right" to their proxy statements for the purpose of including security holder nominees for director.[3] A company would become subject to the proposed security holder nomination procedure if, in an election of directors, at least one of the director candidates nominated by the company receives "withhold" votes from more than 35% of the votes cast by shareholders. The Proposing Release explains

[3] The proposed nomination procedure, which is set forth in proposed Rule 14a-11 under the Securities Exchange Act of 1934, would involve a two-step process: first, the occurrence of a "triggering event" which, in the view of the Commission, would suggest that the company has been unresponsive to shareholder concerns as they relate to the proxy process; and second, inclusion in the company's proxy of a limited number of director candidates nominated by a security holder or security holder group satisfying certain share ownership requirements.

that the Commission views such a withhold vote as showing that the company's proxy process may be ineffective or indicating security holder dissatisfaction with such process.[4]

The Institute recommends revising the proposal to instead require that a company be subject to the proposed security holder nomination procedure if, in an election of directors, 35% of the votes cast are withheld from *half* of the company's nominees on any given proxy statement (or from all of the nominees, if there are two or fewer nominees). We do not believe that votes being withheld from simply one nominee evidences the ineffectiveness of, or security holder dissatisfaction with, a company's proxy process. Votes may be withheld from a nominee for a variety of reasons, including the age or outside activities of the candidate, or other reason unrelated to concerns regarding the company's proxy process. We believe that withhold votes being received for half, rather than one, of the nominees, better evidences dissatisfaction with the company's proxy process.[5]

B. <u>Direct Access Proposals</u>

The Commission has proposed making a company subject to the nomination procedure if a security holder proposal submitted pursuant to Rule 14a-8 under the Exchange Act providing that the company become subject to the security holder nomination procedure ("direct access proposal"): (a) was submitted for a vote of security holders at an annual meeting of security holders by a security holder or security holder group that held more than 1% of the company's securities entitled to vote on the proposal for one year as of the date the proposal was submitted and provided evidence of such holding to the company; and (b) that direct access proposal received more than 50% of the votes cast on that proposal at that meeting. The Proposing Release explains that the Commission views this sequence of events as showing that the company's proxy process may be ineffective or indicating security holder dissatisfaction with such process.[6]

With regard to the direct access proposal requirement, the Proposing Release requests comment on whether the standard should be based on votes cast for the proposal as a percentage of the outstanding securities that are eligible to vote on the proposal.[7] The Institute believes that the standard should be based on both votes cast and votes outstanding. We believe that a standard that takes into account both votes cast and votes outstanding would better reflect the views of a significant portion of a company's shareholders. In contrast, if only votes cast are measured, the vote of only a low percentage of the overall shareholder base could satisfy the Commission's proposed 50% threshold. When combined with the proposed 1%

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[4] Proposing Release at 60789.

[5] Thus, if two or three nominees appeared on the ballot (*e.g.*, in the case of staggered boards), at least 35% of the votes cast for two nominees would have to be withhold votes to constitute a triggering event. In the case of an odd number of nominees, we recommend that it constitute a triggering event if at least 35% of the votes cast for closest to but fewer than half of the nominees are withhold votes (i.e., calculate half of the nominees and round that number down to the closest whole number). Thus, for example, if five nominees appeared on the ballot and 35% of the votes cast for two of these nominees were withhold votes, under our recommended approach, this would constitute a triggering event.

[6] Proposing Release at 60789.

[7] Proposing Release at 60792.

threshold for submitting a direct access proposal, an objectively sound corporate governance structure and proxy process can be held hostage to an immaterial percentage of a company's security holder base. We are concerned that activist professional investors, particularly arbitrageurs whose interests do not coincide with those of long-term security holders, will have undue influence on a company's proxy process under the Commission's proposal. Accordingly, the Institute recommends that the Commission require that the proposal receive more than two-thirds of the votes cast on the proposal, provided that at least 50% of shares outstanding have been voted on the proposal.[8]

C. Non-implementation of a Security Holder Proposal

The Proposing Release requests comment on a third triggering event that would result in a company being subject to the nomination procedure if: (a) a security holder(s) holding more than 1% of the company's securities eligible to vote on the proposal for at least one year submits a proposal under Rule 14a-8 (other than a direct access proposal); (b) the proposal receives more than 50% of the votes cast by security holders on the proposal; and (c) the company's board of directors fails to implement the proposal by the 120th day prior to the date that the company mails its proxy materials for the next shareholder meeting (*i.e.*, the meeting following the one at which security holders voted in favor of the proposal).

The Proposing Release explains that an argument can be made that where a majority of votes cast by security holders favor a proposal and the board exercises its judgment not to implement it, there is an indication of ineffectiveness in the proxy process. The Proposing Release states the Commission's concern, however, that the link between the possible ineffectiveness of a company's proxy process and this possible nomination procedure triggering event is more indirect than in the case of the two nominating process triggering events proposed.[9]

The Proposing Release requests comment on whether this third triggering event should be included in the nomination procedure.[10] The Institute strongly recommends that the Commission not adopt this as a triggering event. A disagreement between a company's security holders and the board regarding the board's judgment on a security holder proposal does not necessarily indicate that the company's proxy process is ineffective, particularly given the variety of topics that may be addressed in security holder proposals that are unrelated to a company's proxy process.[11] For example, a board's decision not to implement a shareholder

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[8] This approach would be consistent with Section 2(a)(42) of the Investment Company Act, which provides that a vote of a majority of the outstanding voting securities occurs when 67% or more of the voting securities are present at such meeting, if the holders of more than 50% of the outstanding voting securities of such company are present or represented by proxy.

[9] Proposing Release at 60792.

[10] Proposing Release at 60793.

[11] Similarly, the Institute believes that the other events on which the Commission requests comment do not provide sufficient grounds for concluding that there is dissatisfaction with a company's proxy process. Therefore, we do not believe that they should qualify as triggering events. *See* Proposing Release at 60792 (requesting comment on whether the following should trigger the nomination procedure: lagging a peer index for a specified number of consecutive years; being delisted by a market; being sanctioned by the Commission; being indicted on criminal charges; or having to restate earnings once or restate earnings more than once in a specified period).

proposal that requires (or requests) an investment company not to invest in a particular type of portfolio company (*e.g.*, tobacco companies), which receives more than 50% of the votes cast on the proposal clearly does not evidence shareholder dissatisfaction with the company's proxy process.

Further, because the Commission's proposal already provides for security holder proposals that do evidence dissatisfaction with the company's proxy process – the direct access proposal – we believe that adoption of this third triggering event would be unnecessary and inappropriate. Moreover, the Institute is concerned that there is a great deal of potential for dispute regarding whether proposals are implemented, which will be burdensome and costly for companies to resolve (and the Commission, to the extent it chooses to be involved with such disputes).[12]

Finally, most state corporation laws provide that the directors, and not the security holders, "manage the corporation" and, accordingly, permit security holders to make only precatory proposals. The Institute believes that it would be inconsistent with the balance struck between directors and security holders in state corporation laws to infer dissatisfaction with the proxy process by the failure of a board to implement a proposal that is precatory. Indeed, making this a triggering event could result in a *de facto* override of state corporate law by "penalizing" corporations whose boards properly view such shareholder proposals as being precatory in nature.

II. Eligibility Standards for Nominating Security Holders

A. Filing of Schedule 13G By Nominating Security Holder

As proposed, the beneficial ownership level of a nominating security holder(s) would be established by the Exchange Act Schedule 13G filed by that security holder(s) on or before the date of the submission of the nomination to the company, for companies other than open-end management investment companies ("mutual funds"). The Proposing Release explains that this requirement would not apply in the case of mutual funds because security holders of mutual funds currently are not required to file Schedule 13Gs.[13] Instead, the Commission would require a nominating security holder(s) for a mutual fund to include certain selected information from Schedule 13G, as part of the notice to the mutual fund of the security holder(s) intent that its nominee be included on the company's proxy card.[14] The Proposing Release requests comment on whether there should be a different mechanism for putting companies and other security holders on notice that a security holder or security holder group has ownership of more than 5% of the company's securities and intends to nominate a director.[15] The Proposing Release also

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[12] *See* Proposing Release at 60791 (it would be necessary to provide guidance to companies and security holders regarding whether a proposal has been implemented). If the Commission determines to adopt this requirement, we recommend that it state in any adopting release that if a Rule 14a-8 proposal is a request for the board to consider a particular issue, the board's consideration of the issue would constitute implementation of the proposal and, therefore, would not be a triggering event.

[13] *See* Proposing Release at 60794.

[14] Under the proposal, a security holder(s) would be required to provide notice to any company, including an investment company, of its intention to submit a nominee(s) no later than 80 days before proxy materials are mailed.

[15] Proposing Release at 60795.

requests comment on whether a security holder or group should be required to file on Schedule 13G upon reaching the more than 5% beneficial ownership threshold.[16]

The Institute believes that there should be public disclosure that groups have been formed to achieve the objectives permitted by the Commission's proposal and, thus, that all such security holder groups should be required to file on Schedule 13G upon reaching the more than 5% beneficial ownership threshold, and to amend such filings upon any material change in the percentage of beneficial ownership covered by the filing. In addition, we recommend requiring a security holder group to file a final amendment to Schedule 13G upon termination of the group.[17]

III. Eligibility Standards for Security Holder Nominees

A. Use of Investment Company Act Section 2(a)(19) Definition of Interested Person

The Commission has proposed requiring nominating security holder(s) to represent that any nominee to the board of an operating company is "independent" under self-regulatory standards. In the case of an investment company, the required representation would be that the nominee is not an "interested person" of the investment company, as defined in Section 2(a)(19) of the Investment Company Act. The Proposing Release requests comment on whether the Commission should apply the "interested person" standard of Section 2(a)(19) with respect to the representation that a security holder nominee be independent from an investment company.[18] The Institute strongly supports this aspect of the proposal because, as noted in the Proposing Release, the Section 2(a)(19) test is tailored to the types of conflicts of interest faced by investment company directors. Consequently, it is more appropriate for investment company directors than the independence standard applied to directors of other companies.

In addition, such a provision is critical to an investment company being able to comply with requirements that a specified proportion of its directors not be interested persons under Section 2(a)(19) of the Investment Company Act. As a result of certain Commission rules, most investment companies are required to have at least a majority of independent directors.[19] These rules rely on fund directors that are not interested persons to approve and oversee arrangements or transactions that involve conflicts of interest and that would, in the absence of such rules, be prohibited by the Investment Company Act. In order to be able to rely on these rules, the investment company engaging in the particular arrangement or transaction must have at least a majority of independent directors, and these independent directors must approve and

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[16] Proposing Release at 60805.

[17] *See* Item 9 of Schedule 13G.

[18] Proposing Release at 60805.

[19] *See* Investment Company Act Release No. 24816 (January 2, 2001). Chairman Donaldson recently announced that the Commission would be considering a rule proposal to increase from a majority to three-fourths the proportion of investment company directors required to be independent. *See* Opening Statement at Open Securities and Exchange Commission Meeting (statement of William H. Donaldson, Chairman, U.S. Securities and Exchange Commission) (December 3, 2003). *See also Testimony Concerning Regulatory Reforms To Protect Our Nation's Mutual Fund Investors before the Senate Committee on Banking, Housing and Urban Affairs* (statement of William H. Donaldson, Chairman, U. S. Securities and Exchange Commission) (Nov. 18, 2003) (recommending that the percentage of investment company independent directors under Commission rules be increased from a majority to three-fourths).

oversee these arrangements or transactions. If a security holder nominee was not required to satisfy the Section 2(a)(19) requirements and such a nominee was elected director, that investment company might be burdened with the responsibility of either removing a director who is an interested person or adding an independent director in order to assure that it continues to have a sufficient number of independent directors.[20]

B. Prohibited Relationships Between the Nominee and the Nominating Security Holder

The Commission has proposed including an instruction in proposed Rule 14a-11(a) to make clear that a nominating security holder will not be deemed an "affiliate" of the company under the Securities Act of 1933 or the Securities Exchange Act solely as a result of nominating a director or soliciting for the election of such a director nominee or against a company nominee pursuant to the security holder nomination procedure.[21]

Consistent with the approach taken with respect to the Securities Act and the Securities Exchange Act, we believe that use of the nominating procedure should not, in of itself, be deemed to establish a relationship between a nominating security holder or nominating security holder group and an investment company. Accordingly, we request that any safe harbor adopted make clear that a nominating security holder will not be deemed an "interested person" of an investment company under the Investment Company Act solely as a result of nominating a director or soliciting for the election of such a director nominee or against a company nominee pursuant to the security holder nomination procedure.

C. Exclusion of a Nominee that Receives a Minimal Percentage of the Vote

The Proposing Release requests comment on whether there should be a nominee eligibility criterion that would exclude an otherwise eligible nominee where that nominee has been included in the company's proxy materials as a candidate for election as director but received a minimal percentage of the vote, and, if so, the appropriate standard for exclusion. The Institute recommends permitting a company to exclude a security holder nominee from the company proxy for two calendar years if that nominee does not receive votes from at least 10 percent of shares present and entitled to vote at the meeting the first time the nominee appears on the company's proxy statement.[22] If a nominee garners so little shareholder support (by receiving fewer than the recommended 10 percent of votes), this is a clear indication that security holders generally are not dissatisfied with the proxy process, and, therefore, it is unnecessary to continue including that nominee in the company's proxy statement.

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[20] Of course, the steps a company would be required to take would depend on how the newly-elected director would alter the relative percentages of independent and other directors.

[21] Instruction 3 to proposed Rule 14a-11(a).

[22] Our recommended approach would be consistent with Rule 14a-8 under the Exchange Act, which permits a company to omit a shareholder proposal from its proxy material if the proposal deals with substantially the same subject matter as a prior proposal submitted to shareholders where the proposal failed to receive a minimum percentage of votes in the prior submission. In choosing the 10% threshold, we assumed that nominating security holders (which would be required to own more than 5% of the company's securities eligible to vote for the election of directors) would vote in favor of their own nominee. We believe that it would be reasonable to require that holders of at least another approximately 5% of the company's voting securities vote in favor of that nominee.

D. Investment Company By-Laws

The Proposing Release states that if a company's by-laws prohibit security holder nominations, as permitted by relevant state law, the Commission's proposed nomination procedure would not be available to that company's security holders.[23] Investment company by-laws sometimes provide that director nominees must meet certain qualifications. The Institute requests that the Commission include a statement in any adopting release clarifying that investment company by-laws, validly adopted under relevant state law, may continue to establish qualifications for director nominees.

IV. Company Obligations Regarding Nominees and Nominating Security Holders

A. Determination of Eligibility under Rule 14a-11

The Commission has proposed requiring a company that receives a nominee to determine whether the nominating security holder(s) has complied with proposed Rule 14a-11 and whether the nominee satisfies each of the requirements of the proposed procedure.[24] The Proposing Release requests comment on whether it is appropriate for the company to make the specified determinations regarding the basis on which to exclude a nominee. The Institute believes that it is appropriate for companies to examine the required information regarding the nominating security holder(s) and any nominees and determine whether they meet applicable requirements.

The Proposing Release also requests comment as to the appropriate review for a company's determination (*e.g.*, judicial or Commission).[25] We do not believe that the Commission should be involved in such a review, given the potential burden that would be placed on Commission staff to police largely factual determinations as to nominee qualifications.[26]

If a company determines to exclude a nominee from its proxy statement, the Commission has proposed requiring it to include in its proxy statement, for the meeting for which the nominee was submitted, a statement that it has made the determination described above as well as disclosure of the information relating to that determination that the company included in the notice to the nominating security holder.[27] The Institute believes that it is sufficient for companies to determine eligibility under the objective criteria in the rule and provide notice to the nominating security holder(s). It is not necessary, and likely would be confusing to shareholders, to include information in a proxy statement about a person that is

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[23] Proposing Release at 60787-60788.

[24] Proposing Release at 60800.

[25] *Id*.

[26] Under Rule 14a-8, the Commission staff functions as an intermediary between security holder proponents and companies, reviewing the reasons offered by the company for its exclusion of a proposal and indicating whether it will recommend enforcement action if the company omits the proposal. Commission staff has indicated that this review takes a great deal of staff time.

[27] Proposing Release at 60801.

not being nominated as a director. To so require would clutter up proxy statements with information of little, if any, value to security holders.

B. Filing Obligations

The Commission has proposed requiring investment companies to provide disclosure on Form N-CSR regarding the occurrence of any nominating procedure triggering events. As proposed, operating companies would be required to make parallel disclosure on Form 10-Q. The Proposing Release explains that because the proposed security holder nomination procedure would operate only upon the occurrence of specified nomination procedure triggering events, it would be essential that the company make security holders aware when a nomination procedure triggering event has occurred.[28] The Institute supports the proposed approach of tailoring the disclosure requirement for investment companies by requiring this disclosure to appear on Form N-CSR. We also support the Commission's determination to delete as duplicative similar disclosure that currently appears on Form N-SAR.[29]

The Commission has proposed requiring any company that did not hold an annual meeting during the prior year, or that changed the date of its annual meeting by more than 30 days from the prior year, to disclose on Form 8-K the date by which a security holder(s) must submit notice of its intent to require that the company include that security holder(s)' nominee on the company's proxy statement. The proposal would apply the same Form 8-K filing obligations to investment companies. The Proposing Release explains that the reason for this requirement is to help to ensure that a company's security holders are made aware of the date by which they must submit a notice of intent to nominate a director on the company's proxy statement.

With regard to the Form 8-K filing requirement, the Proposing Release requests comment on whether investment companies should be permitted to provide this disclosure in a different manner.[30] The Institute strongly urges the Commission not to adopt the Form 8-K filing requirement for investment companies. As the Institute has pointed out previously,[31] investment companies typically are not required to file Form 8-K, and we do not believe it is necessary or appropriate to subject them to Form 8-K reporting for the purpose of notifying investment company security holders of the date by which they must submit a notice of intent to nominate a director on the company's proxy statement. Rather, we recommend that the Commission require investment companies to inform security holders of this date through another method (or combination of methods) of disclosure that is reasonably designed to provide notice of the date to their security holders. Such methods could include, but would not be limited to, a press release or posting information on the company's website.[32]

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[28] Proposing Release at 60793.

[29] *See* Item 77C of Form N-SAR.

[30] Proposing Release at 60804.

[31] *See, e.g.*, Letter to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, from Dorothy M. Donohue, Associate Counsel, Investment Company Institute, dated December 13, 2002 (Institute comment letter regarding proposed Regulation Blackout Trading Restriction).

[32] The recommended approach is similar to Regulation FD, which gives companies the choice of making public disclosure of certain information by filing a Form 8-K with the Commission or by disseminating "the information

V. Related Rule Changes Affecting Investment Companies as Investors

A. Solicitations by the Nominating Security Holder(s)

The Commission has proposed providing limited exemptions from the proxy rules to enable one or more security holders to communicate with other security holders for the limited purpose of forming a nominating security holder group without filing and disseminating a proxy statement.[33] The limited exemptions generally would be available if the total number of persons solicited is not more than 30 or each written communication is limited to certain information.[34] The proposal also would provide a new exemption from certain of the proxy rules[35] for solicitations by or on behalf of a nominating security holder(s) in support of a nominee placed on the company's proxy card in accordance with proposed Rule 14a-11. The Institute believes that it is appropriate for the Commission to permit more flexibility for nominating security holders in their soliciting activities, both to form nominating security holder groups and to solicit on behalf of nominees, than would exist under the current proxy rules. Accordingly, we support this aspect of the proposal.

B. Beneficial Ownership Requirements

Under the proposal, a security holder or security holder group would not be viewed as having acquired securities for the purpose or effect of changing or influencing the control of the company solely by virtue of nominating a director under proposed Rule 14a-11, soliciting on behalf of that candidate, or having that candidate elected. The proposal would also permit the nominating security holder(s) to report their ownership on Schedule 13G, rather than Schedule 13D. The Institute believes that a security holder or group of security holders that engages in the limited activities described above should not be viewed as having the purpose or effect of changing or influencing control of a company. Therefore, we support the proposed approach.

C. Section 16 under the Exchange Act

Under the proposal, Rule 16a-1(a)(1), which defines who is a 10% owner for Exchange Act Section 16 purposes, would be amended to exclude from that definition a Rule 14a-11 nominating security holder group.[36] As a result, that group would not be subject to Section 16's provisions regarding reporting or short swing profits. The Institute agrees that a group formed solely for the purpose of (1) nominating a director under proposed Rule 14a-11, (2) soliciting in connection with the election of that nominee, or (3) having that nominee elected as director should not be viewed as the type of group that should be aggregated together for purposes of Section 16. As the Proposing Release points out, the group's actions are fully disclosed, not for

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through another method (or combination of methods) of disclosure that is reasonably designed to provide broad, non-exclusionary distribution of information to the public." *See* Rule 101(e) under the Exchange Act.

[33] *See* Proposing Release at 60803.

[34] *Id.*

[35] An exemption would be provided from Rules 14a-3 to 14a-6(o), 14a-8, 14a-10, and 14a-12 under the Exchange Act.

[36] Proposing Release at 60805.

a "control" purpose, and they do not have presumed "insider" status. Accordingly, we support the proposed approach.[37]

VI. Liability Under the Federal Securities Laws

Proposed Rule 14a-11(e) would provide that a company would not be responsible for any false or misleading statements included in the nominating security holder(s)' notice to the company or otherwise provided by the nominating security holder(s). The Institute agrees that such a provision is necessary to make clear that a nominating security holder or group, not the company, would be liable for any false or misleading statements included in (1) the notice to the company and/or (2) the nominating security holder's statement of support for the security holder nominee that appears in the company's proxy statement.[38] Consistent with this approach, the Institute recommends modifying Rule 14a-11(e) to provide that a company would not be responsible for any disclosure in the company's proxy statement based on information provided by the nominating security holder.

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The Institute appreciates the opportunity to comment on this significant proposal. If you have any questions or need additional information, please contact me at (202) 326-5824 or Dorothy M. Donohue at (202) 218-3563.

Sincerely,

Amy B. R. Lancellotta
Senior Counsel

cc: Paul F. Roye, Director
John M. Faust,
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U.S. Securities and Exchange Commission

[37] Proposing Release at 60807.

[38] *See* Proposing Release at 60800 (if a company includes a statement supporting the company nominee or opposing the security holder nominee, the security holder nominee would be given the opportunity to include in the company's proxy statement a statement of support for the security holder nominee(s) of a length not to exceed 500 words).