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

**BUSINESS LAW SECTION**

***20032004 Executive Committee***

**GRACE STERRETT**
Chair
HudsonCook U P
632 Plank Road, Suite 201
Clifton Park, NY 12065
518/383-9440
FAX 518/383-9401

**GREGORY J. BLASI**
First Vice-Chair
Nixon Peabody LLP
437 Madison Avenue
New York, NY 10022
212/940-3789
FAX 212/940-3111

**SAMUEL F. ABERNETHY**
Second Vice-Chair
and Fiscal Officer
Menaker & Herrmann LLP
10 East 40th Street
New York, NY 10016
212/545-1900
FAX 212/545-1656

**DAVID L. GLASS**
Secretary
Clifford Chance US LLP
200 Park Avenue
54th Floor
New York, NY 10166
212/878-3202
FAX 212/878-8375

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September 16, 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. S7-14-03
Proposed Rule: Disclosure Regarding Nominating Committee Functions and Communications between Security Holders and Boards of Directors Release Nos. 34-48301 and IC-26145

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. 34-48301 (the "Release") to comment on the proposed rule (the "Proposed Rule") regarding disclosure of nominating committee functions and shareholder communications with the board of directors.

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 goals to enhance the transparency of boards of directors, and also generally supports the Proposed Rule on disclosure requirements for nominating committees and disclosure concerning the means, if any, by which security holders

may communicate with members of the board of directors. However, we recommend that the Commission make certain changes in the Proposed Rule set forth in this letter, which we believe would make the disclosures more meaningful without compromising the Commission's goals.

The Proposed Rule would require certain disclosures to be made regarding the selection process for board of director nominees. Our primary concern is that some of these proposed disclosure requirements, particularly the reasons for rejecting a director nominee, relate to matters in the nominee selection process which are not precise in nature and would be impractical, if not impossible to disclose. To address this concern, we propose that the Commission require only that companies disclose a general description of the nominating process, which would include broad, general characteristics, qualities and experience standards for director nominees as well as the procedures for director nominee submissions by shareholders, but which does not require the disclosure of how final decisions on nominees are made, particularly with respect to rejected nominees. We would not require disclosure of nominating committee nominees who do not meet specified criteria, specific sources of committee nominees or reasons for rejection of shareholder nominees. We also believe that shareholders proposing nominees should be required to provide relevant information about the nominees. We also recommend that the most appropriate ownership threshold for security holder recommendations would be *5%*.

In addition, the Commission indicated in the Release that it is shortly going to consider proposals mandating direct shareholder access to a company's proxy statement. We believe that the Commission should allow time for experience with the present disclosure, the Self Regulatory Organization ("SRO") proposals, and the Proposed Rule before considering any direct access proposals. Should the Commission issue a direct access proposal, we may modify certain views expressed in this letter.

Finally, we believe that security holder proposals under Rule 14a-8 under the Exchange Act should be expressly excluded from any requirement to report action taken as a result of communications from security holders. We also recommend that it be left to the board's discretion to determine whether communications from security holders that are also employees or agents of the company should be disclosed and whether material actions takes as a result of security holder communications should be disclosed.

**B. The Committee Supports the Goals of the Proposed Rule Regarding Nominating Committee Procedures; the Final Rule Should Contain the Modifications Discussed Below**

Currently, Item 7 of Schedule 14A of the Exchange Act requires a company to disclose in its proxy statement whether it has a nominating committee and, if so, whether the committee will consider nominees recommended by security holders and the procedures to submit such recommendations. Proposed New York Stock Exchange ("NYSE") listing standards would require that there be an independent nominating committee with a written charter that must include the board's criteria for selecting new directors. The Nasdaq Stock Market, Inc.

("Nasdaq") has proposed that director nominations be made by either a nominating committee consisting only of independent directors or a majority of the company's independent directors.

The Committee suggested to the Commission that SROs consider also requiring nominating committees to consider director nominees submitted by eligible shareholders and to disclose the number of proposed nominees from eligible shareholders and whether any are included in the slate selected by the nominating committee. (June 13,2003 letter from the Committee to the Commission regarding possible changes to the Proxy Rules.)

We believe that the Commission's proposals on nominating committees are consistent in concept with the pending SRO requirements and the views previously expressed by the Committee. We recommend a number of modifications, however, that we believe are necessary to make the Proposed Rules workable and the disclosures meaningful in understanding the nominating process.

Although the Proposed Rules are stated as disclosure requirements, we believe that as a practical matter most companies will be compelled to enact the items to be disclosed in order to avoid the adverse implications of negative disclosure. Therefore, our comments assume that registrants will be implementing the matters on which disclosure is requested.

**1. Disclosure of Minimum Qualifications for Nominees Should Be Broad and General in Nature; Disclosure of Nominees who do Not Meet the Criteria is Not Meaningful and Should Not be Required**

The Commission in Item 7(d)(2)(ii)(H) of the Proposed Rules has proposed that companies with nominating committees disclose (1) any specific, minimum qualifications that the nominating committee believes must be met by a nominating committee-recommended nominee, (2) a description of any specific qualities or skills that the nominating committee believes are necessary for one or more of the company's directors to possess, and (3) a description of any specific standards for the overall structure and composition of the company's board of directors.

This proposed disclosure makes it appear the Commission is looking for something that resembles a checklist of the ideal qualities a director should possess. Such a goal would be admirable if it were feasible. Obviously, characteristics such as intelligence, integrity, knowledge of the industry and work ethic are desirable in any director nominee. Evaluation of such qualities and others, however, is not a precise process that can be reduced to a formula. Any one person may not have all the qualifications and skills a company is seeking. **A** board of directors must function as a group, with each director providing different input. As the composition of a board changes, so will the characteristics the nominating committee looks for in a nominee. Accordingly, any description of such criteria must be broad and general in nature.

It will be troublesome if the Commission adopts a final rule requiring a checklist type disclosure which could place companies in the position of having to justify their choices of shareholder nominees and explaining why one candidate is selected over another.

The Commission has requested comments as to whether a company should be required to disclose when it chooses candidates who do not meet the disclosed criteria. Because, as set forth above, we think the selection process does not follow precise criteria, we believe such disclosure would not be meaningful and is not warranted.

**2. The Proposed Disclosure of the Specific Source of Nominees Should be Replaced with a General Description of the Nominating Process Including the Information Resources Available**

The Commission has also proposed the disclosure of the specific source, such as the name of an executive officer, director, or other individual, of each nominee (other than nominees who are executive officers or directors standing for re-election) approved by the nominating committee for inclusion on the registrant's proxy card.

Except for nominees submitted by only one shareholder or one group of shareholders, it is frequently difficult to identify the specific source of a nominee. An individual may be mentioned by one or more persons, but not considered at that specific time, or there may be differing sources at different times. It is not necessarily clear which source has influenced which committee or board member. We suggest, if the Commission wishes to require this type of disclosure, a description of the nominating process including the types of information resources available would provide more relevant information.

**3. Shareholders Proposing a Nominee Should Be Required to Provide Relevant Information with Respect to such Nominee**

Although not currently included in the Proposed Rule, we suggest that a shareholder who proposes a candidate for director should supply certain relevant information to the company about such proposed nominee. For example, the shareholder should be required to state that the individual has been contacted, has agreed to have his or her name proposed, will serve the term if nominated and elected to the board and, if applicable, meets the basic criteria for a nominee as set forth in the Nominating Committee Charter. Furthermore, there should **be** disclosure whether the shareholder or recommended nominee has a specific agenda or matters which are the basis for the submission to the committee. In addition, all material relationships of the recommended nominee with the proposing shareholder or shareholder group, including financial interests, should be furnished when a name is submitted to the nominating committee.

### 4. Companies Should Not be Required to Disclose the Reason for Rejection of a Proposed Nominee

The Commission has proposed in Item 7(d)(2)(ii)(L)(2) of the Proposed Rules that if a nominating committee receives a recommended nominee from a holder or group of holders representing more than 3% of the issuer's stock and the nominating committee does not choose to nominate that candidate, the issuer must disclose the specific reason for the committee's determination not to nominate the candidate.

While ideally we might agree that providing the reason behind the nominating committee's rejection of a recommended nominee could be beneficial disclosure, as we have stated above, decisions with respect to nominees are not subject to a precise formula. Accordingly, such disclosure would be impractical to provide and will not be useful to investors. In addition, the requirement to disclose the reason for rejecting a nominee will often involve disclosing the results of comparisons between one candidate and another which would not benefit investors and could be embarrassing and damaging to the candidate. Rather it should be left to the discretion of the nominating committee whether or not to make any disclosure of the reasons for rejection.

In the Release, the Commission also asks for comments on whether privacy issues of the recommended candidate or the recommending shareholder would be raised by requiring disclosure of the reasons for a recommended candidate being rejected by a nominating committee. We strongly believe that requiring disclosure of the reason for rejection could raise significant privacy issues both with respect to the recommended nominee and the recommending shareholder even without explicit disclosure of the identity of the rejected nominee. Accordingly, requiring such disclosure could very well serve as an impediment to the willingness of qualified candidates to be submitted as nominees. In addition, we believe that the Commission should not mandate disclosure of the identity of a rejected nominee even if the nominee consents to such disclosure as such a requirement would not be helpful to investors and could in certain instances be harmful to the company. Instead, we believe that the interests of companies and their shareholders would be best served by leaving the decision as to whether to make such disclosure in the hands of the board.

### 5. Disclosure that the Nominating Committee Charter is Available on the Company's Website Should be Sufficient

If a company has a Nominating Committee Charter, the Proposed Rule requires a disclosure in the proxy statement of the material terms of the Nominating Committee Charter and where the Charter is available, which can be the company's website. The Release inquires as to whether alternatives should be considered.

We do not believe that requiring a description of the material terms of the Nominating Committee Charter in the proxy statement is necessary or desirable. In the case of the Audit

Committee Charter, for example, the requirement is that it be published in the proxy statement at least once every three years, and we see no reason why the standards for the Nominating Committee Charter should be any more rigorous. This would avoid expanding the proxy statement with a needless summary. In fact, we believe that if a company were to make its Nominating Committee Charter available on its website and disclose that fact in its proxy statement, that disclosure should be sufficient, provided such company provides shareholders with a copy of the Nominating Committee Charter upon request. Further, a description of the material elements of the charter might very well be far more expansive than any shareholder would require in evaluating the functioning of the committee. In the case of a NYSE-listed company, for example, the company will be required by the newly proposed listing standards to have a nominating/corporate governance committee having a written charter that addresses, among other things, the committee's purpose, goals and responsibilities, including corporate governance principles applicable to the company. Thus, we do not believe that imposing the burden of disclosing the material terms of the charter would serve any useful purpose so long as there is a convenient means of making the charter available to shareholders.

### *6*. The Ownership Threshold to Trigger Disclosures Regarding a Security Holder Recommendation Should Be 5%

The Release asks for comment on whether the threshold for requiring additional disclosures concerning recommendations of director candidates in proposed Item 7(d)(2)(ii)(L) should be higher or lower than the proposed 3%. While we oppose requiring disclosure of the source of a nominee and the reasons for rejection of shareholder recommended nominees, if such requirements are ultimately included in the final rule, we believe that such disclosures should be required only in cases of shareholders with a significant stake in the company. We suggest that a more appropriate threshold for such requirements would be where the recommending shareholder or shareholders own *5%* or more of the company's voting stock. We believe *5%* is a more appropriate threshold than 3% because *5%* is the level at which Congress decided in the Williams Act that an ownership interest is significant enough to require public disclosure of certain ownership information so that the public is aware of such ownership. If the Commission believes that a *5%* threshold is too high, then in no event should it be less than **3%.**

We also object to the proposal to explain why the **3%** or 5% shareholder's recommendation was not accepted. **As** noted above, the proposed disclosures imply a need to defend choosing otherwise. There is no basis for presuming that a committee should follow a 3% or 5% shareholder's recommendation.

## C. The Committee Supports the Goals of the Proposed Rule Regarding Shareholder Communications with the Board; the Final Rule Should Contain the Modifications Discussed Below

Proposed NYSE listing standards would require a method for interested parties to communicate directly and confidentially with the presiding director of non-management

directors or with the non-management directors as a group. Under Rule 1OA-3 of the Exchange Act, SROs will have to require that Audit Committees establish procedures for communications on accounting, controls and auditing matters to the committee. The Release proposes to require that companies disclose if they have a process for security holders to send communications to the board, and if so to describe the process, identify specific board members to whom communications can be sent, and describe any process for filtering communications to the board. In addition, disclosure is required of any material action taken by the board as a result of communications from security holders.

While it is our view that shareholders of many companies are already effectively communicating with directors through both formal and informal processes, we believe that the Commission's proposals on shareholder communications with the board are consistent in concept with the proposed NYSE listing standards. However, in certain instances we feel that the proposed disclosures are unnecessarily detailed and would not result in meaningful disclosure to investors. Accordingly, we recommend that the Commission make certain changes to the Proposed Rule that would further the Commission's goals without unduly burdening the board.

**1. No Disclosure of Material Actions Taken as a Result of Shareholder Communications Should Be Required**

The Commission has proposed in Item 7(h)(2)(iv) of the Proposed Rule that certain disclosure be made with respect to any material action taken by the board as a result of communications from security holders, We believe that this requirement as currently proposed is vague and will leave companies unsure as to what should or must be disclosed. Many companies receive large volumes of communications from security holders on many issues. These communications are but one of many sources of information received by directors, including information provided by other directors, management, auditors, and other advisors; information from the media, both general and industry specific; and information gleaned from personal experience. Accordingly, for most material decisions made by a board, it may have received some form of security holder input, likely both pro and con. Communications from security holders may frequently comprise one of many subjective factors in a given director's decision making process. Therefore, it will often be difficult to determine whether there is a sufficient connection between a particular security holder communication on a material action and the decision on the action itself to trigger the disclosure requirement. We believe that the Commission should not mandate disclosure; companies of course could choose to make such disclosure.

**2. Shareholder Proposals Under Exchange Act Rule 14a-8 Should Be Expressly Excluded from any Requirement to Report Action Taken as a Result Of Communications from Security Holders**

The Release requests comment on whether the rule should specifically address shareholder proposals under Rule 14a-8 and, if so, whether disclosure should be required for

such communications. As discussed in Section C.1 above, we believe that the proposed, required disclosure of any material action taken by the board as a result of communications from security holders is vague and unworkable. If the Commission nonetheless adopts the requirement, Rule 14a-8 communications should be expressly excluded. Both the shareholder proponent and the company are subject to specific, detailed requirements, conditions and deadlines, including regulation of the content of statements about the proposal. The rationale given in the Release is that requiring disclosure of such material actions is significant to security holders in evaluating the quality and responsiveness of the communications process. However, in the case of Rule 14a-8 proposals, if the shareholder satisfies the conditions of the Rule, the company is required to include the proposal in the proxy statement and report the results in a Form 10-Q. There is no need to impose another disclosure requirement on this process.

In addition, we believe that boards should and do seriously review and consider proposals, whether precatory or mandatory, voted for by a majority of shareholders, but we believe that no trigger such be imposed that would mandate direct access to a company's proxy statement should the Commission determine to adopt rules relating to direct access to a company's proxy statement. Boards should instead be given the discretion to act in a manner that they believe would be in the best interests of all shareholders.

**3. Disclosure of Names of Persons Involved in Receiving or Filtering Shareholder Communications Should Not be Required; Disclosure of Reasons for Filtering Communications Should Not be Required; a Description of the General Communication Process Should be Sufficient**

The Commission has proposed a requirement that companies disclose not only whether a process is in place to provide for shareholder communications with the board but that they also provide how any "filtering" of such communications will be conducted. We believe that this disclosure will unnecessarily burden companies without furthering the goals of the Commission or providing useful information to investors. For example, disclosure of the details of how and which communications will be relayed to the board is impractical to provide given that such matters are almost always based on subjective decisions by those who are responsible for screening communications. Shareholders merely need to know that a communication process exists and how it is to be accessed. Accordingly, we suggest that any disclosure obligation be limited to whether a process exists, whether communications will be filtered and how shareholders may utilize the process to better communicate with the board.

The Commission has requested comments about whether companies should be required to identify the persons involved in the filtering process. In addition, the Commission has asked whether disclosure of the role of management in the filtering process should be required. We believe that a general description of the communication process including the identification of

the group within the company or an outside organization involved in the filtering process and whether communications will go directly to the full board or a committee should be sufficient.

**4. The Final Rule Adopted Should Expressly Permit Companies to Exclude Communications from Management, Employees or Other Agents or Consultants of the Company Who Happen also to Be Security Holders**

The Release states that the Proposed Rule is not intended to cover communications with the board from management, employees or other agents of the company where such persons also happen to be security holders. We support that position for a number **of** reasons, and believe that it should be expressly included in the final rule. For example, many companies provide means for employees to make suggestions, ask questions of management or report wrongdoing. In addition, the SROs will be requiring procedures for employees to make anonymous complaints about questionable accounting or auditing matters. Including communications from employees could also negatively impact the company by interfering with its ordinary business operations. We believe that the most efficient way to provide for the exclusion of these communications would be for the final rule to provide that a company may exclude from the communications covered by the disclosures any communications from management, employees, or other agents or consultants of the company. This would leave it to each company to determine which of those communications it would exclude. For example, we would expect that some companies would exclude some but not all such communications.

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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
Richard E. Gutman
Richard R. Howe
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 Corporate Finance