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SPECIAL COMMITTEE ON
MERGERS, ACQUISITIONS AND CORPORATE CONTROL CONTESTS

September 15, 2003

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

Attention: Jonathan G. Katz, Secretary

File No. S7-14-03; Release No. 34-48301
Proposed Rule: Disclosure Regarding Nominating Committee Functions and Communications between Security Holders and Boards of Directors

Ladies and Gentlemen:

This letter is submitted on behalf of the Association of the Bar of the City of New York's Special Committee on Mergers, Acquisitions and Corporate Control Contests (the "Committee") in response to the Commission's request in the above identified Release (the "Release") for comments to the Division of Corporation Finance concerning enhanced disclosure related to issuers' nominating committees and security holder communication procedures. The Committee previously responded to the Commission's solicitation of public views concerning possible changes to the proxy rules.[1]

We are generally supportive of the Commission's proposed enhanced nominating committee disclosure obligations and the proposed rules regarding the ability of shareholders to

[1] See letter of Task Force on Potential Changes to the Proxy Rules of the Association of the Bar of the City of New York, comprised of members of the Committee and the Association's Committee on Corporations and Committee on Federal Regulation of Securities, dated June 13, 2003.

communicate with boards of directors, although we make specific suggestions with respect to each. However, we have serious reservations, for reasons described below, concerning the proposed requirements that (a) nominating committees disclose reasons for not selecting a particular candidate or for selecting one candidate over another and (b) boards isolate and disclose any actions taken "as a result of communications with shareholders," and believe that such requirements should not be adopted.

Our comments and concerns reflect our underlying belief that any enhanced disclosure requirements with respect to the process of nominations of directors and communications between shareholders and boards of directors should meet the following standards:

- The requirements on all parties involved (issuers, nominating committees, shareholders, candidates, etc.) should be spelled out clearly and comprehensively.

- The requirements should be carefully tailored to elicit meaningful disclosure. Additional disclosure requirements will not be helpful if they result only in bland, generic language that merely extends the length of proxy statements at a significant cost (lawyer's fees, printing and mailing expenses) to the issuer without providing meaningful information to shareholders.

- The requirements should be consistent with other issuer requirements, such as the proposed NYSE and Nasdaq listing standards. Separate compliance obligations will be an unnecessary burden for issuers.

- The requirements should be designed so that they do not have the unintended effect of chilling shareholder communications or effective operations of nominating committees or boards, or of discouraging qualified candidates from being willing to be publicly considered for nomination to boards of directors.

Enhanced Nominating Committee Disclosures

Candidate Recommendations from Large, Long-Term Shareholders

Minimum Ownership Thresholds. As a means of providing large shareholders with a mechanism through which they may have input on the composition of the board of directors, the Commission has proposed requiring that issuers make certain disclosures with respect to nominations made by shareholders that have held at least 3% of the outstanding common stock of the company for at least one year. We believe that the application of the rule should be clarified in the following respects:

- The disclosure requirement should be triggered in the event of any nomination made by any one shareholder that meets these eligibility criteria, or by any group of not more than 10 shareholders, each of which meets the holding period requirement, and which in the aggregate, meets the 3% ownership requirement. We note that a 10 person limit to the formation of a group for this purpose would be consistent with the exemption under Rule 14a-2 for solicitations of less than 10 persons, as well as remaining consistent with what we perceive as the Commission's intent to facilitate recommendations by shareholders with a *significant* long-term investment in a company.

- Irrespective of whether the Commission chooses to place an upper limit on the number of shareholders that can be gathered together to endorse a recommendation so as to make it a disclosable event, we believe the Commission should clarify that any solicitation of shareholders for the purpose of jointly recommending a candidate remains subject to the proxy rules (subject, of course, to the Rule 14a-2 exemption). Such clarification is necessary in order to avoid the issue of "stealth solicitations" previously raised by commentators, in response to the Commission's solicitation of comments on proposed Regulation M-A, with respect to adopting a broad "test the waters" approach to proxy solicitations.[2]

Schedule 13G "Safe Harbor". Some commentators have proposed that the Commission establish a Schedule 13G "safe harbor," such that a shareholder's recommendation to the nominating committee of a director candidate will not, in and of itself, disqualify the shareholder from continuing to report beneficial ownership on Schedule 13G pursuant to Rule 13d-1(b). We respectfully disagree.

Under current rules, persons are not eligible to file a Schedule 13G if they hold, and must file a Schedule 13D within 10 days of the time they have determined to hold, securities "with a purpose *or effect* of changing *or influencing* control of the issuer, or in connection with or as a participant in any transaction having that purpose or effect" (emphasis added)[3]. We believe that the new rules should be neutral on this point and that a determination as to whether recommendation of a candidate to a board falls within such broad, inclusive language (triggering the disclosures and other protections provided to the investing public by Rule 13d-1(e)) should continue to be made on a case by case basis by the proposing shareholder or shareholder group in accordance with existing case law and rule interpretations. We note that if a shareholder and its counsel conclude that under their particular facts and circumstances the shareholder would be required to file a Schedule 13D if it made a disclosable recommendation to a nominating

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2 See Release No. 33-7760, p. 33.

3 Rule 13d-1(e)(1)(i).

committee, the shareholder would still have the alternative of conducting informal discussions with the issuer in a manner that was consistent with the standard established for Schedule 13G eligibility.

Additional Requirements. We believe that other eligibility and procedural requirements are necessary and appropriate before disclosure of a recommendation is mandated. The Release contemplates that an issuer or nominating committee would adopt (and would be obligated to disclose) "procedures to be followed by security holders in submitting such recommendations." We believe that the rules should contain the following basic requirements that provide both shareholder access and issuer certainty and would act as a default rule so that issuers need not adopt an individualized process:

- The proof of share ownership and timing requirements of Rule 14a-8.

- The requirement that the following documentation, at a minimum, be submitted by a shareholder proponent regarding its recommended candidate, which documentation we believe is necessary, particularly under the enhanced corporate governance provisions adopted or being considered by the Commission, to enable nominating committees to fulfill their role:

    - a statement signed by the candidate that he or she (i) is willing to serve as a director, if nominated and elected, and (ii) will cooperate with the company in its conduct of any due diligence on the candidate that the company considers appropriate, including the candidate's agreement to be subject to a background check and to be available for personal interviews;

    - background information on the candidate, comprising all information concerning board nominees required by Schedule 14A to be disclosed in the issuer's proxy statement; and

    - a statement by the candidate and the shareholder making the recommendation as to whether the candidate meets all of the issuer's and any applicable listing standards' requirements of an "Independent Director" and, if not, why not.

- As contemplated by the Release, issuers could adopt alternative procedures, such as making the timing of shareholder recommendations consistent with an issuer's advance notice bylaw requirements for shareholder proposals or nominations, or other eligibility requirements, such as maximum age or number of public boards on which a director may serve. Such issuer-specific requirements would be required to be disclosed in the issuer's proxy statement or, if our suggestions with respect to disclosure below are adopted, contained in its publicly available

nominating committee charter or corporate governance guidelines. Issuers would also be free to adopt company-specific informational requirements and disclose such in their proxy statements (or, as noted, in their nominating committee charters or corporate governance guidelines).

Annual Report of the Nominating Committee

We believe that the SEC should, as with the proposed NYSE rules, encourage issuers to adopt and post on their websites nominating committee charters and corporate governance guidelines setting forth such qualifications for director candidates as their nominating committees adopt. For companies that have publicly disclosed their nominating committee charter and corporate governance guidelines, the Committee favors a short-form nominating committee report that includes disclosure in the following areas:

- the existence and identity of a nominating committee and the independence of its members;
- the existence of a nominating committee charter and corporate governance guidelines relating to the qualification of the directors, if any, and a statement of where or how a shareholder may obtain a copy of the charter;
- a discussion of the general process undertaken by the nominating committee in its search for qualified candidates, including use of third party search firms or advisors, where material; and
- a report on:
  - the number of candidate recommendations received from shareholders and the names of the candidate and the recommending shareholder, and
  - the number of candidates nominated for election to the board of directors.

Only if the issuer does not have a publicly available nominating committee charter and corporate governance guidelines should the report also be required to include disclosure as to a summary of the nominating committee charter and any qualification requirements of directors and the process of determining nominees. In addition, if the Commission adopts our suggestion of providing "default" provisions in the rule and a company adopts requirements for shareholder recommendations beyond such provisions, the company-specific requirements should be spelled out (either in the proxy statement or in the same place where the nominating committee charter and corporate governance guidelines are publicly disclosed). Otherwise, we would suggest only a reference to the rule itself.

We believe that requiring any other information in the proxy statement regarding director qualifications or the process of determining nominees will be detrimental to full and frank discussions among members of nominating committees, or will only result in the inclusion of information that is already available to shareholders or bland, generic language that will not provide additional meaningful disclosure.

In particular, we have very serious concerns as to requiring a discussion of the reasons for not selecting a particular candidate or for selecting one candidate over another. We believe that mandating disclosure of personal information concerning candidates or a discussion of the reasons for not selecting a particular candidate will discourage many qualified candidates from being willing to agree to be recommended by shareholders for nomination to serve on the boards of public companies and exacerbate the current director retention and recruitment problem, resulting in an even smaller pool of well-qualified individuals willing to serve on corporate boards.

Finally, we believe that for the sake of clarity, the rule should specifically state that the issuer's disclosure requirements should not apply to any recommendation that has been withdrawn by the recommending shareholder prior to the date of the issuer's proxy statement.

Disclosure Regarding Shareholder Communications

Procedures for Shareholder Communications with the Board of Directors

To provide meaningful access while avoiding overly-broad or inconsistent requirements, we believe that any requirements mandated by the rule should be consistent with, and not more extensive than, the final listing standards as adopted by the New York Stock Exchange regarding procedures through which shareholders may communicate with the Lead Independent Director.

Disclosure of Actions taken by the Issuer in Response to Shareholder Communications

Our Committee believes that the proposed rule mandating disclosure of actions taken by an issuer in response to shareholder communications will be detrimental to both corporations and shareholders and will inadvertently result in the "chilling" of the communications that the proposed rule is designed to enhance. Our concern is based on the following:

- We are concerned that a requirement that shareholder communications be disclosed will cause such discussions to no longer occur between management and shareholders, but between such parties and the lawyers for each, in order to avoid any issues that may arise later as to whether disclosure was required.

- To the extent that the subject matter of proposed communications involves sensitive or confidential information, companies may decline to have conversations out of concern that the disclosure requirement could result in significant liability exposure, given the Commission's view that the existence of a confidentiality agreement is an insufficient basis for not providing mandated disclosure.

- Frequently, a number of factors, and not solely a communication with one or more shareholders, lead to a board decision. Thus, it may not be clear that a particular action was taken "in response" to a shareholder communication. We are concerned that boards will be more reluctant to discuss a variety of matters with shareholders, particularly matters relating to their oversight of the "ordinary business" of the corporation, out of concern that they will thereby significantly expand disclosure and liability to the detriment of full and frank discussions at the board level.

More importantly, we believe that mandating such disclosure will adversely affect the on-going dialogue that has developed between corporations and their larger shareholders, and the positive results to improving corporate governance that often result. Corporations frequently consult informally with larger shareholders regarding contemplated courses of action (for example, consideration of new stock options or other management incentive plans), as well as entertaining suggestions from such shareholders, including on matters which the board may already be considering and wishes to continue to consider in a non-public manner (for example, consideration of greater board independence or business restructuring initiatives). Institutional shareholders have indicated to us that some of their greatest successes have come as a result of such confidential discussions with companies, and they strongly believe that private, confidential discussions should continue to be permitted without disclosure considerations beyond those currently required under present law and regulation. Disclosure of material actions by an issuer is already required. We believe that any requirement for issuers to attribute the motives for such action will be counter-productive and we would suggest that the Commission leave it to the interested parties to determine how much to disclose with respect to the impetus for any particular action. And, we note that any shareholder who wishes to publicly disclose its part in a company's action or decision is free to do so at any time.

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.

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Respectfully submitted,

Special Committee on Mergers, Acquisitions and Corporate Control Contests

Erica H. Steinberger, Chair