

SEC Gives Green Light to Electronic Shareholder Forums

Final Rules Encourage New Mode of Shareholder Communication

In an effort to promote electronic shareholder forums as a convenient and effective means of communication between shareholders and companies, the Securities and Exchange Commission (SEC) recently adopted amendments to the proxy rules under the Securities Exchange Act of 1934.¹

Under the new rules, statements made in an electronic shareholder forum may be exempt from most of the proxy rules. Additionally, the new rules provide liability protection for operators of the electronic forums. The SEC wants these forums used as an additional mode of communication. The forums are a supplement to, not a substitute for, the current shareholder proposal process under Rule 14a-8.

Exemption from Proxy Rules

One of the new amendments exempts from most of the proxy rules any communication made in an electronic forum by or on behalf of any person (1) who does not seek, directly or indirectly, the power to act as proxy for a shareholder and (2) who does not furnish or otherwise request a form of revocation, abstention, consent or authorization.² A shareholder or company which intends to act as proxy at a later shareholder meeting may participate in the forum as long as its communications are unrelated to its role as proxy.

The forums are a supplement to, not a substitute for, the current shareholder proposal process under Rule 14a-8.

Any communications on the forum must be made more than 60 days before the announced date of the company's next annual or special meeting. If a company announces the date of a shareholder meeting less than 60 days before the meeting, the forum communication must be made within two days after the announcement to be exempt. Any communications that do not satisfy the timing requirements may need to be filed with the SEC as soliciting materials.

Communications that constitute a solicitation and remain available on the forum after the 60-day cut-off must comply with the proxy rules. The SEC has recommended that companies either delete certain postings or have the forum "go dark" during the 60-day period before meetings.

The SEC noted that forum communications relating to acquiring, holding, voting or disposing of equity securities may result in the formation of a group under Regulation 13D and may impact Schedule 13G eligibility.

in this issue

- 1 SEC Gives Green Light to Electronic Shareholder Forums
- 3 Mandatory Electronic Filing of Form D Begins in 2009
- 4 SEC Denies Shareholder Attempts to Nominate Directors in Company Proxy Statements

Protection from Liability

The new rules provide liability protection to any shareholder, company or third party acting on behalf of a shareholder or company that establishes, maintains or operates an electronic shareholder forum.³ Pursuant to the new rules, these parties will not be held liable under federal securities laws for statements or information made by a forum participant. Only the forum operator receives this protection. Parties posting information on the forum remain liable for their communications.

Flexibility in Design

The SEC has not defined the term “electronic shareholder forum” in the final rules. Companies that elect to participate in, or sponsor, an electronic shareholder forum have the opportunity to be creative in their design. Companies could use the forum in many ways, including:

- as a symposium or “town hall” for shareholders and management to exchange questions and answers regarding the company’s policies
- as a message board for shareholders to voice their concerns
- as an online polling site for the company to gauge reaction to a new proposal
- as a blog for management to announce new initiatives and developments.

The SEC has not provided guidance on the technical aspects of the forums, which allows companies to develop their own standards for participant eligibility, identification and accountability.

For additional information, please contact the author or any member of Pepper Hamilton’s Corporate and Securities Practice Group.

Author:

Andrew J. Siegel
215.981.4043
siegela@pepperlaw.com

Endnotes

- 1 Electronic Shareholder Forums, SEC Release No. 34-57172, <http://www.sec.gov/rules/final/2008/34-57172.pdf> (Jan. 18, 2008).
- 2 See Exchange Act Rule 14a-(2)(b)(6). Such communications are not exempt from the proxy rules regarding shareholder list or antifraud provisions found in Rule 14a-7 and 14a-9, respectively.
- 3 See Exchange Act Rule 14a-17. The forum must be compliant with the applicable federal and state securities laws and the company’s bylaws.

RSS on www.pepperlaw.com

Subscribe to the latest Pepper articles via RSS feeds. Visit www.pepperlaw.com today and click on the RSS button to subscribe to our latest articles in your news reader.

Mandatory Electronic Filing of Form D Begins in 2009

The Securities and Exchange Commission (SEC) recently issued a release mandating the electronic filing of Form D in connection with private placements of securities, and adopting related revisions to Form D and Regulation D. Issuers may voluntarily file Form D electronically beginning September 15, 2008. Electronic filing becomes mandatory on March 16, 2009.

Adopted in the early 1980s, Regulation D promulgated under the Securities Act of 1933 was part of an initiative by the SEC to provide a coherent pattern of exemptive relief from the Securities Act, address the capital formation needs of small businesses and, through the data collected on Form D, serve as a tool for data collection and the enforcement of federal securities laws. The conversion to electronic filing and the revisions to the content contained on Form D are part of an effort by the SEC to fix the deficiencies in the current form as a data collection device and an enforcement tool.

Currently, Form D is filed in paper format. While the filed forms are accessible to the public on request or in person at the SEC's Public Reference Room, they are not readily reviewable on a comprehensive electronic database. Converting to an electronic filing system will, according to the SEC, make the information more accessible to the public and federal and state regulators. The SEC will post all electronically filed Form Ds on its Web site (www.sec.gov). To file a Form D electronically, the issuer must either already have EDGAR filing codes and a Central Index Key or obtain them from the SEC.

In conjunction with the availability of voluntary electronic filing, amendments to the disclosure requirements of the Form D which also become effective on September 15, 2008 include:

- permitting all issuers in a multi-issuer offering to be identified and to submit one collective Form D
- eliminating the requirement to reveal all owners of 10 percent or more of a class of the issuer's equity securities as "related persons"
- soliciting optional disclosure of revenue range information from the issuer, or aggregate net asset value range information in the case of hedge funds or other pooled

Issuers may voluntarily file Form D electronically beginning September 15, 2008. Electronic filing becomes mandatory on March 16, 2009.

investment funds other than private equity or venture funds

- requiring disclosure of the date of first sale and whether the offering is expected to last more than a year
- requiring disclosure of whether the offering is being made in connection with a business combination (including a tender offer, merger or acquisition)
- requiring the disclosure of CRD numbers for both individual recipients of sales compensation and associated broker-dealers who currently have a CRD number (CRD numbers are available at <http://brokercheck.finra.org> or through FINRA's hotline, 800.289.9999)
- limiting expense disclosure to include only amounts paid for sales commission and, separately stated, finders' fees
- limiting disclosure of use of proceeds to include only amounts paid to executive officers, directors and promoters
- requiring a certification that the issuer is not disqualified by rule from relying on the exemption claimed
- requiring the filing of an amendment to a previously filed Form D if there is a material change in information either about the offering or the issuer
- requiring annual amendments to be filed on or before the first anniversary of the previously filed Form D filing or amendment
- permitting a finite amount of free writing to clarify certain information provided.

The filing deadline for a Form D remains at 5:30 p.m. Eastern Standard Time 15 days after the first sale of securities. All filings deemed to be due on a holiday or a weekend will be due on the next business day.

In response to commentators' concerns that the electronically filed Form D could be viewed as a marketing document, and thus conflict with Regulation D's prohibition on general solicitation and general advertising, the SEC is revising Rule 502(c) of the Securities Act. As amended, Rule 502(c) includes a safe harbor from the general solici-

tation and general advertising prohibition for information provided in the Form D if the issuer provides the information in good faith and makes reasonable efforts to comply with the requirements of Form D.

Author:

Stephanie Pindyck Costantino
215.981.4406
costantinos@pepperlaw.com

SEC Denies Shareholder Attempts to Nominate Directors in Company Proxy Statements

The Securities and Exchange Commission (SEC) recently amended the proxy rules under the Securities and Exchange Act of 1934 to clarify that, for the time being, shareholders will continue to be denied direct access to the director nominating process in proxy statements. The SEC's longstanding interpretation of the proxy rules had been questioned by the U.S. Court of Appeals for the Second Circuit's decision in *AFSCME v. AIG* in 2006.

The federal regulatory framework governing proxy solicitations and the circumstances surrounding the *AFSCME* decision offer insight into the SEC's decision to amend the proxy rules.

Most SEC reporting companies that hold annual or special shareholder meetings solicit proxies from the shareholders who do not plan to attend the meetings in person, so their shares may be voted. The votes cast in connection with the proxy can decide many corporate issues, including the election of nominees to the board of directors. Shareholders also may submit proposals to the company to be included in the company's proxy materials. Rule 14a-8 of the Exchange Act explains how shareholders may submit proposals and what types of proposals may be included in proxy materials.

Even if a shareholder meets the threshold requirements for eligibility to submit a shareholder proposal, a company

Specifically, Rule 14a-8(i)(8) allows a company to exclude a shareholder proposal if it relates to an election for membership on the company's board of directors.

does not necessarily have to include the proposal in its proxy materials. Rule 14a-8(i) lists 13 bases a company may rely upon to exclude a shareholder proposal from its proxy materials. Specifically, Rule 14a-8(i)(8) allows a company to exclude a shareholder proposal if it relates to an election for membership on the company's board of directors. In the past several years, controversy arose regarding the interpretation of Rule 14a-8(i)(8), which led to litigation and ultimately to the SEC's amendment of the rule.

In December 2004, the American Federation of State, County and Municipal Employees (AFSCME) Employee Pension Plan, a shareholder of American International

Group, Inc. (AIG), submitted to AIG for inclusion in the company's 2005 proxy materials a shareholder proposal to amend AIG's bylaws. The proposed amendment would have required the company to include the names of shareholder-nominated candidates for AIG's board of directors in subsequent proxy statements.

AFSCME's shareholder proposal was an attempt to include shareholder nominees for the board on AIG's proxy statements, while evading the possibility of a 14a-8(i)(8) exclusion and associated disclosure requirements relating to shareholder nominations of director candidates.

A shareholder seeking to contest a company's board will ordinarily issue its own proxy solicitation – an expensive process that triggers numerous disclosure requirements on the shareholder's part. AFSCME calculated that a shareholder proposal to amend the procedures for board of directors elections could not be excluded under 14a-8(i)(8), and that once the bylaws were changed, shareholder nominees would have to be included in AIG's proxy materials at the company's expense, and no related disclosures would be needed.

Supported by a no-action letter issued by the SEC's Division of Corporation Finance, AIG excluded AFSCME's proposal from its 2005 proxy materials, arguing that the proposed amendments to the bylaws related to an election for membership on the company's board of directors and were thus excludable under Rule 14a-8(i)(8).¹ AFSCME promptly sued AIG, seeking a preliminary injunction. The U.S. District Court for the Southern District of New York agreed with the interpretation put forth by AIG and supported by the SEC, and held that the AFSCME proposal was excludable as it related to an election for a board seat.²

The U.S. Court of Appeals for the Second Circuit reversed the district court's ruling and held that 14a-8(i)(8) did *not* apply to AFSCME's proposal. The court of appeals relied upon canons of interpretation for administrative regulations and found that because a 1976 SEC release discussing Rule 14a-8(i)(8) "clearly reflects the view that the election exclusion is limited to shareholder proposals used to oppose solicitations dealing with an identified board seat in an upcoming election," Rule 14a-8(i)(8) could not be used to exclude AFSCME's proposal.³

Following the Second Circuit's surprise ruling, the SEC wanted to clarify Rule 14a-8(i)(8) by amending the rule. The amended rule states that an SEC reporting company

may exclude a shareholder proposal "if the proposal relates to a nomination or an election for membership on the company's board of directors or analogous governing body or a procedure for such nomination or election." The latter part of the rule regarding election procedures was inserted as a direct response to the AFSCME litigation, and to reverse the interpretation of the Second Circuit Court of Appeals.

The SEC further explained in the release accompanying the amendment that any shareholder proposal that could have the effect of any of the following may be excluded by the public company under Rule 14a-8(i)(8):

- disqualifying board nominees who are standing for election
- removing a director from office before his or her term expired
- questioning the competence or business judgment of one or more directors
- requiring companies to include shareholder nominees for director in the companies' proxy materials or otherwise resulting in a solicitation on behalf of shareholder nominees in opposition to management-chosen nominees.

On the other hand, proposals that relate to the following may not be excluded pursuant to Rule 14a-8(i)(8):

- qualifications of directors or board structure (as long as the proposal will not remove current directors or disqualify current nominees)
- voting procedures (such as majority or plurality voting standards or cumulative voting)
- nominating procedures (other than those that would result in the inclusion of a shareholder nominee in company proxy materials)
- reimbursement of shareholder expenses in contested elections.

The SEC emphasized that the above items are not exhaustive and are merely meant to illustrate the types of shareholder proposals that may or may not be excluded under Rule 14a-8(i)(8).

By reducing the uncertainty and ambiguity surrounding Rule 14a-8(i)(8), the SEC has likely decreased the prospect of future litigation on this topic, but it also has suspended the prospect of direct shareholder access to the director nominating process. Subsequent to the January 10, 2008

effective date of the amendment, the SEC has issued no-action letters to several public companies, including JPMorgan, Bear Stearns and E*Trade, confirming that public companies can exclude from their proxy statements shareholder proposals related to director nominating procedures without risking SEC enforcement action.⁴

Author:

Zachary I. Rentz
215.981.4180
rentzz@pepperlaw.com

Endnotes

- 1 See American International Group, Inc. SEC No-Action Letter, 2005 WL 372266 (Feb. 14, 2005).
- 2 See *Am. Fed'n of State, County & Mun. Employees Pension Plan v. Am. Int'l Group*, 361 F. Supp. 2d 344 (S.D.N.Y. 2005).
- 3 *Am. Fed'n of State, County & Mun. Employees Pension Plan v. Am. Int'l Group*, 462 F.3d 121, 128 (2d Cir. 2006).
- 4 See JPMorgan Chase & Co., SEC No-Action Letter, <http://www.sec.gov/divisions/corpfin/cf-noaction/2008/jpmorgan021108-14a8.htm> (Feb. 11, 2008); The Bear Stearns Companies Inc., SEC No-Action Letter, <http://www.sec.gov/divisions/corpfin/cf-noaction/2008/bearstearns021108-14a8.htm> (Feb. 11, 2008); E*TRADE Financial Corp., SEC No-Action Letter, <http://www.sec.gov/divisions/corpfin/cf-noaction/2008/etrade021108-14a8.htm> (Feb. 11, 2008).

Pepper Hamilton LLP

Attorneys at Law

The material in this publication is based on laws, court decisions, administrative rulings and congressional materials, and should not be construed as legal advice or legal opinions on specific facts. The information in this publication is not intended to create, and the transmission and receipt of it does not constitute, a lawyer-client relationship.

Please send address corrections to phinfo@pepperlaw.com.

www.pepperlaw.com

Berwyn | Boston | Detroit | Harrisburg | New York | Orange County | Philadelphia | Pittsburgh | Princeton | Washington, D.C. | Wilmington

© 2008 Pepper Hamilton LLP. All Rights Reserved.

This publication may contain attorney advertising.