

**MEMO# 21424**

August 2, 2007

## **SEC Issues Two Releases Regarding Shareholder Proposals Relating to the Election of Directors; August 22nd Conference Call**

[21424]

August 2, 2007

TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 26-07  
SEC RULES COMMITTEE No. 61-07  
SMALL FUNDS COMMITTEE No. 31-07 RE: SEC ISSUES TWO RELEASES REGARDING  
SHAREHOLDER PROPOSALS RELATING TO THE ELECTION OF DIRECTORS; AUGUST 22ND  
CONFERENCE CALL

The Securities and Exchange Commission recently published for comment two releases relating to Rule 14a-8 under the Securities Exchange Act of 1934. In the first release, the SEC proposed amending Rule 14a-8 to permit shareholders to include in company proxy materials their proposals for bylaw amendments regarding the procedures for nominating candidates to the board of directors. [\[1\]](#) The SEC also proposed two new rules in this release. New Rule 14a-17 would require disclosure about any shareholder nominee for director and nominating shareholders when shareholder nominees are included in a company's proxy materials. New Rule 14a-18 would make clear that both companies and shareholders may establish and maintain electronic shareholder forums under the federal securities laws.

In the second release, the SEC proposed clarifying the meaning of the exclusion for shareholder proposals related to the election of directors in current Rule 14a-8. [\[2\]](#) The SEC issued the second release to eliminate uncertainty arising from a recent court decision of the United States Court of Appeals for the Second Circuit. [\[3\]](#) The releases are summarized below.

Comments on the releases are due to the SEC 60 days after publication in the Federal Register. The Institute will hold a conference call to discuss the releases and the Institute's comments thereon on Wednesday, August 22nd at 2:00 EST. If you plan on participating in the call, please let Kathy Craft know via email ([tlegal@ici.org](mailto:tlegal@ici.org)) as soon as possible but no

later than August 21st . If you are unable to participate on the call but have comments on the releases, please provide them prior to the call to Dorothy Donohue by phone at (202) 218-3563 or email ([ddonohue@ici.org](mailto:ddonohue@ici.org)). The dial-in number for the call is 888-889-4951 and the pass code is 58542.

## **Release I**

### **Eligibility and Disclosure Regarding Proponents of Bylaw Amendments**

The SEC proposed amendments that would establish a new procedure by which shareholders could use Rule 14a-8 to propose bylaw amendments establishing procedures that would permit eligible shareholders to nominate candidates for the board of directors in the company's proxy materials. To be included, the bylaw amendments would have to be submitted by a shareholder (or group of shareholders) who is eligible to file, and has filed, a Schedule 13G [4] including all required disclosures and has continuously held more than five percent of the company's securities entitled to be voted on the proposal for at least one year by the date the shareholder submits the proposal.

The SEC also proposed requiring disclosure in the proponent's Schedule 13G and the company's proxy statement regarding the proponent's background and relationships with the company. For example, any pending litigation involving the company in which the shareholder proponent is a party would have to be disclosed. In addition, disclosure regarding any communication between the shareholder proponent and the company that occurred during the twelve-month period prior to the formation of any plans or proposals, or during the pendency of a proposal, would have to be disclosed.

The company's charter and bylaws (or state law if the charter or bylaws are silent) would determine the voting threshold required for the company to adopt the bylaw amendment.

### **Disclosure by Nominating Shareholders**

The SEC also proposed Rule 14a-17 to require disclosure about any shareholder nominee for director and nominating shareholders when shareholder nominees are included in the company's proxy materials. The disclosure required would be the same as that required today for director elections involving solicitations in opposition to the company's nominees. For example, proposed Rule 14a-17 would require nominating shareholders to provide the company with information regarding each director nominee and the background of the nominating shareholder and its relationships with the company. The disclosures would be required to appear in the company's proxy statement. In the Internet version of its proxy statement, the company would be permitted to provide a link to a website address containing the disclosures.

The only substantive limitations on nomination procedures would be those imposed by state law or the company's charter. The SEC provides, as an example, that the company's nomination procedure could specify a minimum level of share ownership for those nominating a director for inclusion in the company's proxy materials or specify the number of director slots subject to the procedure – so long as the form and substance of any such requirements were consistent with applicable state law and the company's charter and bylaws.

Proposed Rule 14a-17 provides that the company is not responsible for the content of the shareholder proponent's proposal or supporting statement. Rather, a shareholder

proponent would be liable for any materially false or misleading statements in the disclosure provided to the company and included in the company's proxy statement.

## **Electronic Shareholder Forums**

The SEC proposed Rule 14a-18 to make clear that both companies and shareholders may establish and maintain an electronic shareholder forum under the federal securities laws. The proposed rule does not prescribe any specific approach to online shareholder forums. Rather, it is designed to remove any possible impediments to using the Internet for communication among shareholders and between shareholders and the company. For example, the proposed rule would clarify that participating in an electronic shareholder forum would be exempt from the proxy rules (and thus not constitute a solicitation) so long as the forum occurs more than sixty days prior to the date announced by the company for its annual or special meeting of shareholders. The proposed rule also would clarify that the company is not liable for independent statements by shareholders on a company's forum.

### **Request for Comment Regarding Non-Binding Shareholder Proposals**

The SEC requested comment as to whether it should adopt rules that would permit a company or shareholder to be able to propose and adopt bylaws to establish the procedures that a company will follow for including non-binding proposals in the company's proxy materials (in lieu of Rule 14a-8's procedures). The SEC also requests comment on any additional changes that should be made to Rule 14a-8, such as amending the threshold requirements, and whether additional disclosure regarding the voting results for non-binding shareholder proposals should be required.

## **Release II**

The Second Circuit recently held that a shareholder proposal calling for a company to amend its bylaws to establish a process for permitting shareholder-nominated directorial candidates to appear on the company's proxy cannot be excluded from the company's proxy materials on the basis that the proposal "relates to an election of directors" under Rule 14a-8(i)(8). [5] In reaching that decision, the Second Circuit reversed the decision of the district court and the SEC's determination that the company could exclude the proposal. In response to the court decision, the SEC proposed amending Rule 14a-8 to make clear that a shareholder proposal calling for a company to amend its bylaws to establish procedures for permitting shareholder-nominated directorial candidates to appear on the company's proxy can be excluded from the company's proxy materials on the basis that the proposal "relates to an election of directors" under current Rule 14a-8(i)(8). The SEC explained that without such clarification, shareholders and companies may be uncertain as to the range of shareholder proposals that are required to be included in company proxy materials.

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### **endnotes**

[1] See SEC Release Nos. 34-56160, IC-27913 (July 27, 2007), ("Release I"). The Release is available on the SEC's website at <http://www.sec.gov/rules/proposed/2007/34-56160.pdf>.

[2] See SEC Release Nos. 34-56161, IC-27914 (July 27, 2007), ("Release II"). The Release is available on the SEC's website at <http://www.sec.gov/rules/proposed/2007/34-56161.pdf>.

[3] See Institute [Memorandum](#) to SEC Rules Members No. 82-06, Closed-End Investment Company Members No. 44-06, and Small Funds Members No. 67-06 [20408], dated September 26, 2006 (discussing *American Federation of State, County & Municipal Employees, Employee Pension Plan v. American International Group, Inc.* No. 05-2825-cv, 2006, WL 2557941 (2d Cir. Sept. 5, 2006)).

[4] Shareholders eligible to file on Form 13G must not have acquired or held their securities for the purpose of or with the effect of changing or influencing the control of the company. The SEC noted that proposing a bylaw amendment would not on its own eliminate the ability to file a Schedule 13G. The SEC further noted that determination of whether a shareholder is eligible to file a Schedule 13G will be based, as it is today, on the specific facts and circumstances accompanying the activities of the proposing shareholder.

[5] See note 3, *supra*.

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