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SEC Adopts New Rules for Internet Delivery of Proxy Materials

The U.S. Securities and Exchange Commission (SEC) recently adopted amendments to its proxy rules under the Securities Exchange Act of 1934 creating a new “notice and access model” for proxy solicitations for public companies.¹ The new model provides for two alternatives for delivering proxy materials: the “notice only option” and the “full set delivery option.” Under both alternatives, an issuer is required to post its proxy materials on an Internet Web site (other than the SEC’s EDGAR Web site) and provide shareholders a notice of such availability.

The “notice and access model” is now applicable to all issuers. In 2008, large accelerated filers² will be required to choose between the “notice only option” and the “full set delivery option.” In 2009, all other issuers (including registered investment companies) will be required to choose between the two alternatives. The two options are not mutually exclusive, however; an issuer may adopt a hybrid of the two — the “notice only option” with regard to some shareholders and the “full set delivery option” with regard to other shareholders. The new rules do not apply to the solicitation of proxies relating to business combinations.

The material differences between the “notice only option” and the “full set delivery option” are set forth below along with key advantages and disadvantages of each option.

Notice Only Option

Under the notice only option, the issuer must post its proxy materials on an Internet Web site (other than the SEC’s EDGAR Web site) and send a prescribed notice to shareholders clearly identifying the Web site address at which the proxy materials (including the proxy statement, annual report to shareholders, and proxy card) are available. The substantive requirements for inclusion in the notice are set forth in Exhibit A to this Legal News Alert. The issuer must send the notice at least 40 calendar days prior to the shareholder meeting date. Under the notice only option, an issuer must make paper or e-mail copies of the materials available at no charge upon

¹ The model was initially adopted as a voluntary model; see “Internet Availability of Proxy Materials,” Release Nos. 34-55146; IC-27671; File No. S7-10-05 (January 22, 2007) (<http://www.sec.gov/rules/final/2007/34-55146.pdf>). The SEC mandated the model in “Shareholder Choice Regarding Proxy Materials,” Release Nos. 34-56135; IC-27911; File No. S7-03-07 (July 26, 2007) (<http://www.sec.gov/rules/final/2007/34-56135.pdf>).

² A large accelerated filer is an issuer that had a public float of \$700 million or more as of the last business day of its most recently completed second quarter.

shareholder request. Furthermore, shareholders must be permitted to make a permanent election to receive paper or e-mail copies of future proxy materials. The issuer may not send a paper or e-mail proxy card to a shareholder until 10 or more calendar days after it has sent the notice to shareholders, although the issuer must provide a mechanism by which a shareholder can vote beginning as of the date of the notice (which may include telephone or Internet voting).

Advantages

- The issuer avoids the expense of printing and mailing a full set of proxy materials to each shareholder. Estimates vary widely on the percentage of shareholders who will request paper copies. The SEC's own estimate is that 19 percent of shareholders will request paper copies. Early reports from Broadridge (formerly known as ADP), a leader in the proxy processing and tabulating business, show that only three to four percent of shareholders have requested paper copies from issuers that have voluntarily adopted the notice only option.

Disadvantages

- The number of paper copies an issuer must print and the related expense may be difficult to predict. The expense will depend substantially on the demographics of the issuer's shareholders and the user-friendliness of the Web site containing the proxy materials.
- The issuer would be required to prepare a notice document and mail it to all shareholders, thereby incurring related preparation and mailing expenses.
- The issuer would be required to finalize its proxy materials at least 40 days in advance of the shareholder meeting date because the proxy materials must be posted to the issuer's Web site on or before the date the notice is mailed to shareholders. In practice, however, the proxy materials would need to be finalized at least 45 days in advance of the shareholder meeting date to provide sufficient time for

intermediaries to deliver the notice to shareholders whose shares are held in "street name."³

- The issuer would need to make available either a telephone⁴ or Internet voting mechanism because the notice may not be accompanied by any other documents (including a proxy card) and the shareholders must have a voting method available to them as of the date of the notice.⁵
- The issuer would be required to send a paper copy of the proxy materials by first-class mail to any shareholder who requests a copy within three days of the issuer's receipt of the request. The issuer must accept such requests by a toll-free telephone line, e-mail, and on the Web site. The issuer's obligation to provide paper copies upon request continues for one year from the date of the meeting; however, once the meeting has adjourned, the issuer is no longer required to use first-class mail or to mail within three days of receipt of the request.
- The issuer may experience a decline in shareholder voting. For example, those existing shareholders accustomed to opening hard-copy proxy mailings, completing the proxy card and returning it in a postage-paid envelope may choose not to navigate the Internet or wait to vote until the issuer sends a paper copy of the proxy card. An issuer must consider the proposals that will be on its agenda and the vote requirements for those proposals to determine the risk of such decline.

Full Set Delivery Option

The full set delivery option is identical to the notice only option in that the issuer must post its proxy materials on an Internet Web site and send a prescribed notice to shareholders informing them of the Internet availability of the proxy materials. Under this option, however, the issuer also would mail to shareholders a paper copy of the entire set of proxy materials (the proxy statement, annual report to shareholders, and a proxy card). The issuer would have the option to prepare a separate notice to be delivered with the proxy materials or to incorporate the required notice into the proxy materials. The substantive requirements for inclusion in the full set delivery option notice are set forth in Exhibit B to this Legal News Alert.

³ If an issuer instructs broker-dealers or other intermediaries to follow the notice and access model, then the intermediaries must comply. Broadridge estimates that a period of five days should provide sufficient time for delivery through most intermediaries.

⁴ The telephone number for voting may not be included in the notice but may be included on the Web site with the proxy materials.

⁵ The "Shareholder Choice Regarding Proxy Materials" release notes that an issuer may provide a proxy card on the Web site that can be printed and mailed to the company. If this were the sole means of voting, however, voter turnout may be very low.

Advantages

- The number of paper copies to print would be predictable.
- The issuer would have more time to prepare the proxy materials because the 40-day requirement described above does not apply.
- The issuer may include a proxy card with the initial mailing, and may send follow-up proxy cards at any time. Under the notice only option, an issuer must wait 10 days from the mailing of the notice before it may mail a proxy card to shareholders.
- The issuer would not be required to mail or e-mail copies of the proxy materials upon request.
- Some shareholders may prefer to receive a paper copy of the proxy materials.
- The initial mailing may include a toll-free telephone number for voting, which number may not accompany the notice under the notice only option.
- The issuer would not be required to provide shareholders with an electronic voting mechanism.
- The issuer would not risk the decline in shareholder voting that it may face under the notice only option.

Disadvantages

- The issuer would continue to incur the cost of printing and mailing proxy materials for each shareholder.
- The issuer would still need to include the notice in the proxy materials, so the cost of preparing it and printing the notice would not be completely eliminated.

Election Not Exclusive

Under both the notice only option and the full set delivery option, proxy materials will be available electronically on a Web site. As noted above, the two options are not mutually exclusive. An issuer may invoke the notice only option to provide proxy materials to some shareholders and may invoke the full set delivery option to provide proxy materials to other shareholders.

For example, an issuer may consider sending hard copy materials to shareholders with large holdings and the notice only materials to smaller shareholders to help mitigate the risk of voter decline. Alternatively, an issuer might consider sending only a notice to shareholders who have voted by telephone or the Internet in the past and sending a full set of proxy materials to shareholders who have historically voted by mail.

Web Site Requirements

The new rules require that the proxy materials be posted to a publicly accessible Web site, other than the SEC's own EDGAR Web site. The address for the Web site must contain prominent hyperlinks to each of the proxy-related disclosure documents. The online proxy materials must be available at least until the conclusion of the shareholder meeting. Proxy processing and tabulating firms and financial printers will offer platforms for issuers to post their proxy materials and tabulate votes.

If an issuer intends to undertake the development of its own Web platform, the issuer should begin the construction of the Web site sufficiently in advance of the proxy season to work out all of the logistics and to fully test the Web site. Even the conversion of an annual report to HTML format, for example, could be difficult. A recent survey of 215 large-cap U.S. companies reported that only 10 percent currently provide their annual report in HTML format. Also, subsequent additional soliciting materials must be posted to the Web site no later than the date that such materials are first sent to shareholders or made public. Issuers should be prepared to update their Web sites quickly in order to comply with the posting requirements.

Proxy materials posted on Web sites must be in formats convenient for both viewing and printing. Although not required, the SEC suggests that posting in two different formats may be advisable, taking into account that not all shareholders will have fast Internet connections. For example, an HTML file might be better for searching and reading and a PDF file may be the better format for printing. The Web site must offer shareholders the ability to execute a proxy card over the Internet, by telephone, or by printing and mailing a proxy card. For those sites with online voting capabilities, the Web site should be designed in a way that makes

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toggling between the online proxy card and the proxy materials easy. If the Web site is difficult to navigate, shareholders may choose not to vote and/or opt to receive all future proxy materials in paper form. If the Web site is designed poorly, it could increase the cost of the proxy solicitation significantly because all paper requests submitted prior to the meeting date must be sent by first-class postage rates, not bulk rates.

The Web site must be operated in a manner that does not compromise the anonymity of shareholders visiting the Web site. For example, the Web site may not track the identity of Web site visitors or use "cookies" or "spy-ware" that collect personal information about shareholders. Web site operators may track numerical IP addresses provided that the logs are not used to uncover the identity of shareholders. Additionally, issuers may not send unsolicited e-mail to shareholders who have provided their e-mail addresses in order to receive e-mail copies of proxy materials.

Proxy Contests

The new rules also apply to proxy solicitations other than by an issuer, which will reduce the cost of engaging in a proxy contest. Although the rules regulating solicitations by third parties are similar to the rules regulating issuers, other persons engaging in proxy solicitations may solicit less than all of the shareholders and the notice must be sent no later than 40 days prior the shareholder meeting or 10 days after the company sends out its proxy statement or notice to shareholders.

What Public Companies Should Be Doing Now

Issuers preparing for a notice and access proxy solicitation should evaluate the advantages and disadvantages of the two models. To do this, issuers may choose to survey shareholders in advance of the proxy season with an explanation of the notice and access model to determine anticipated demand for paper copies. As discussed above, if an issuer undertakes to develop its own Web site for posting proxy materials or Internet voting, it should begin this process sufficiently in advance of the date the site must be deployed.

Exhibit A – Notice Requirements for Notice Only Option

For the notice only option, the notice must contain the following text in bold-face type:

“Important Notice Regarding the Availability of Proxy Materials for the Shareholder Meeting to Be Held on [insert meeting date].

- **This communication presents only an overview of the more complete proxy materials that are available to you on the Internet. We encourage you to access and review all of the important information contained in the proxy materials before voting.**
- **The [proxy statement] [information statement] [annual report to security holders] [is/are] available at [Insert Web site address].**
- **If you want to receive a paper or email copy of these documents, you must request one. There is no charge to you for requesting a copy. Please make your request for a copy as instructed below on or before [Insert a date] to facilitate timely delivery.”**

In clear and understandable terms, the notice also must include:

- The date, time, and location of the meeting or, if corporate action is to be taken by written consent, the earliest date on which the corporate action may be effected;
- A clear and impartial identification of each separate matter intended to be acted on, and the issuer’s recommendations, if any, regarding those matters, but no supporting statements;
- A list of the materials being made available at the specified Web site;
- (1) A toll-free telephone number; (2) an e-mail address; and (3) an Internet Web site address where the shareholder can request a copy of the proxy materials, for all meetings and for the particular meeting to which the notice relates;
- Any control/identification numbers that the shareholder needs to access his or her proxy card;
- Instructions on how to access the proxy card, provided that such instructions do not enable a shareholder to execute a proxy without having access to the proxy statement; and
- Information about attending the shareholder meeting and voting in person.

Exhibit B – Notice Requirements for Full Set Delivery Option

For the full set delivery option, the notice must contain the following text in bold-face type:

“Important Notice Regarding the Availability of Proxy Materials for the Shareholder Meeting to Be Held on [insert meeting date]. The [proxy statement] [information statement] [annual report to security holders] [is/are] available at [Insert Web site address].”

In clear and understandable terms, the notice also must include:

- The date, time, and location of the meeting or, if corporate action is to be taken by written consent, the earliest date on which the corporate action may be effected;
- A clear and impartial identification of each separate matter intended to be acted on and the issuer’s recommendations, if any, regarding those matters, but no supporting statements;
- A list of the materials being made available at the specified Web site;
- Any control/identification numbers that the shareholder needs to access his or her proxy card; and
- Information about attending the shareholder meeting and voting in person.