E-Proxy Rules: Update

I. Overview

Under the e-proxy rules adopted by the Securities and Exchange Commission in 2007,[1] issuers are provided with two primary options for conducting their proxy solicitations: the notice and access option and the full set delivery option. Commencing on January 1, 2009, Internet posting will be a requirement for all issuers under both options.[2] The e-proxy rules were adopted in an attempt to enable shareholders to take advantage of technological developments and the growth of the Internet while also allowing issuers to lower the costs of their proxy solicitations significantly.[3] The following discussion summarizes the solicitation options available to issuers and provides information regarding recent e-proxy experience and the practical considerations that issuers face in complying with the e-proxy rules.

A. Notice and Access

Under the notice and access option, the issuer or issuer's intermediary sends a notice to shareholders containing specified information at least 40 days before the scheduled meeting informing them that proxy materials are available on the Internet.[4] The notice is sent in lieu of a traditional mailing and the full set of proxy materials must be made available online on or before the date the notice is mailed.[5] The notice itself may not be accompanied by a proxy card or any other information.[6] The online proxy materials must also provide shareholders with a means to vote, either electronically, by telephone, or by printing and mailing a proxy card. Further, shareholders must be given the option to request a hard copy of the proxy materials from the issuer.[7]

B. Full Set Delivery

Under the full set delivery option, the issuer still must post a full set of proxy materials on the Internet, but will also continue to deliver hard copies of proxy materials to shareholders. The issuer must still provide the specified information required in the notice, but a separate mailing is not necessary if the required information is included in the proxy materials.[8] Moreover, issuers using the full set delivery option do not need to comply with

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1 *Shareholder Choice Regarding Proxy Materials*, Release No. 34-56135; IC-27911; File No. S7-03-07 RIN 3235-AJ79 (July 26,2007), *available at* http://sec.gov/rules/final/2007-34-56135.pdf, codified at 17 C.F.R. § 240 (2007). For notice and access see Rule 14a-16(a)(1). For full set delivery see Rule 14a-16(n).

2 For notice and access see Rule 14a-16(a)(1). For full set delivery see Rule 14a-16(n). The majority of issuers use an intermediary's website to host their proxy materials. It should be noted, however, that the web address relied upon for compliance with the new rules can not be the SEC website. Rule 14a-16(b)(3).

3 *See Internet Availability of Proxy Materials*, Release Nos. 34-55146; IC-27671; File No. S7-10-05 (January 29, 2007), codified at 17 C.F.R. § 240.

4 Rule 14a-16(a)(1). See Rule 14a-16(l) for requirements of intermediaries.

5 Rule 14a-16(b)(1). A full set of proxy materials includes a copy of the proxy statement, a copy of the issuer's annual report and a form of proxy. Rule 14a-16(n)(1).

6 Rule 14a-16(e), (f)(2). See Rule 14a-16(d) for required language and contents of the notice.

7 Rule 14a-16(d)(3). If requested, the issuer must send paper or e-copy of materials to the shareholder within 3 business days. Paper copies must be sent by first class mail only. Rule 14a-16(j)(1).

8 Rule 14a-16(n)(2), (3). The rules are satisfied if either the notice accompanies the full set of proxy materials or if the notice does not accompany the full set, but all of the information required to be in the notice pursuant to Rule 14a-16(d) is incorporated in the proxy statement and the form of proxy. *Id.*

the 40 day notice period because the shareholder will already have the proxy materials and will not need extra time to request copies.[9] Generally, this approach does not change existing practice other than the requirement that proxy materials must be made available on the Internet.

C. Hybrid

The notice and access option and the full set delivery option are not mutually exclusive. Issuers may choose a hybrid, or "stratified," approach where the full set delivery option is used for some shareholders and the notice and access option for others for the same proxy solicitation. For example, an issuer may choose to send full paper sets of proxy materials to retail holders who actually voted in the prior year or who own in excess of a certain number of shares (e.g., more than 10,000) while the balance of such issuer's shareholders receive notice and access. Similarly, issuers can use the notice and access option for some meetings, like those with only routine proposals, while reserving the full set delivery method for others, like those where potentially controversial proposals will be voted on.

II. Recent E-Proxy Experience

According to a recent joint survey of 519 of their members, the National Investor Relations Institute and the Society for Corporate Secretaries and Governance Professionals (the "Joint Study") found that most issuers used the notice and access option or the hybrid option while only 15% used the full set delivery option for their 2008 proxy solicitations.[10] As expected, there appears to be a correlation between the issuers' use of the notice and access or hybrid methods, and the size of their shareholder base. Broadridge Financial Solutions, Inc. ("Broadridge") reported that of the 653 issuers utilizing their services to implement the notice and access option between July 1, 2007 and June 30, 2008, 68% had shareholder distribution sizes greater than 10,000, while only 3% had shareholder distribution sizes of less than 1,000.[11] Further, Broadridge found that a majority of issuers that used the notice and access option had only routine proposals on their agenda.

III. Practical Considerations

Issuers face three primary considerations in determining whether to implement the notice and access option, the full set delivery option or a hybrid: the impact on retail shareholder vote, issuer cost savings and the impact on timing and technology.

A. Impact on Retail Shareholder Vote

Research conducted by Broadridge has indicated that issuers soliciting through the notice and access option have seen a significant negative impact on responsiveness of retail shareholders.[12] In a year-to-year

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9 Rule 14a-16(n)(3)(i).

10 Jeffrey D. Morgan, Executive Alert: *Notice and Access Implementation Proceeded Smoothly for Many but Showed Modest Cost Savings Overall*, National Investor Relations Institute (September 15, 2008) (hereinafter the "Joint Study").

11 *Notice & Access: Statistical Overview of Use with Beneficial Shareholders*, Broadridge Financial Solutions, Inc. (June 30, 2008), *available at* http://www.broadridge.com/notice-and-access/index.asp (hereinafter the "Broadridge Report"). The Joint Study reported a similar trend. Sixty-eight percent of the issuers surveyed reported distribution sizes of 10,000 or greater.

12 *Id.* at 3. The Joint Study also reports that 44% of participants saw a decline in retail voting. Not surprisingly, quorums have been met at an unchanged rate, likely due to the responsiveness of the institutional franchise. Broadridge Report at 3.

comparison, the percentage of retail shares voted dropped from 34% to 17% with retail voter response rates experiencing a similar decline, dropping from 21% to 6%.[13] Data in the Broadridge Report suggests that a higher retail response rate may be achievable by sending a full set of proxy materials to targeted retail investors using a hybrid or stratified approach. This data suggests that some retail voters may not be willing or able to take additional steps necessary to vote after receiving notice only and thus may be a significant consideration for issuers that rely heavily on the vote of their retail holders. In such cases, a pure notice and access approach may not be optimal.

B. Issuer Cost Savings

Cost savings has been cited as a key factor for issuers choosing the notice and access option.[14] In the last year, Broadridge estimates that this option has saved issuers approximately $143 million in printing and postage fees.[15] Further, Broadridge estimates that an issuer with 75,000 beneficial positions could save an estimated $175,000 and an issuer with 600,000 beneficial positions could save an estimated $780,000 when switching from the traditional practice of full set delivery to a notice and access approach.[16] It is noted, however, that according to the Joint Study, some issuers may not have optimized the savings potential afforded by the notice and access option. Of the 519 issuers surveyed in the Joint Study that used either the notice and access or hybrid option, approximately 25% spent more than their previous print budget this year; 30% spent between 76-100% of their previous print budget; 23% spent between 50-74% of their previous print budget; 15% spent between 25-49% of their previous print budget; and 7% spent less than 25% of their previous print budget. This is likely because any anticipated cost savings must be reduced by the cost of printing and mailing full sets of proxy materials to shareholders that request them after receiving notice (and, if using a hybrid approach, printing and mailing costs associated with the targeted shareholders). Although on average only 1% of shareholders actually made this request,[17] issuers should consider this incremental cost and compare it to the cost of printing and sending full sets to all shareholders.[18] In doing so, issuers may more closely estimate their potential cost savings which should assist them in determining what process to use -- taking into account also the possible effect on the retail vote, as discussed above.[19] Issuers may conclude that the hybrid option may provide an optimal balance from the perspective of both a cost savings and preserving participation by retail investors.

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13 Broadridge Report at 3.

14 Chuck Callan, *Take Note, E-proxy Is On Its Way*, Corporate Secretary (April 2008), *available at* http://www.corporatesecretary.com. Executives at Sara Lee, Pharmos and Microsoft each cited potential cost savings as the main driver behind implementing the notice and access option. *Id.*

15 Broadridge Report at 5.

16 *Notice and Access Beneficial Pricing*, Broadridge Financial Solutions, Inc. (2008), *available at* http://www.broadridge.com/notice-and-access/75k.asp and http://www.broadridge.com/notice-and-access/600k.asp.

17 Broadridge Report at 4.

18 Any print savings may also be offset by an increase in fees paid to third party service providers. Fifty-eight percent of companies surveyed in the Joint Study reported increased fees. Issuers should contact their financial printers and/or distributors to estimate the incremental cost of printing and distributing full sets for shareholders requesting them. Often, a flat fee is charged for a set number of materials.

19 According to the Joint Study, 67% of companies saved roughly what they expected to save, 23% saved less than expected and only 10% saved more.

C. Impact on Timing and Technology

Issuers considering the notice and access or hybrid options also must consider the effect the 40 day time requirement for posting the materials may have on the company's ability to finalize its proxy materials and annual report on an expedited timeline. Proxy materials may have to be prepared even sooner if an intermediary is used to distribute them.[20] As discussed above, an issuer using the full set delivery option does not have to comply with the 40 day requirement and therefore will not face this time constraint.[21]

Issuers posting their proxy materials to their own websites must also consider the implications the new rules will have on their IT departments. For example, the time needed to generate a user-friendly interface and to comply with anonymity requirements.[22] Issuers should work with their IT departments sooner rather than later to make sure they have a plan in place for complying with the technical requirements of the new rules and for providing training to legal, investor relations and trouble shooting personnel. Alternatively, an issuer can use a third party provider to host its proxy materials.

IV. Conclusion

In light of the new rules, issuers should analyze the comparative costs and timing requirements of each option and seek to optimize the balance between preserving the retail vote and taking advantage of the potential cost savings. Based on the reported experience to date, it appears that issuers can maximize potential cost savings without compromising a significant portion of the retail vote by using the hybrid option for soliciting their shareholders, especially for routine proposals.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com; or Stephen Gruberg at 212.701.3312 or sgruberg@cahill.com.

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20 Intermediaries also must comply with the 40 day requirement, and intermediaries may request that the materials required to be posted online be delivered to the intermediary up to 5 days prior to the commencement of the 40 day period.

21 Rule 14a-16(n)(3)(i).

22 Rule 14a-16(k)(1). The issuer must maintain the website on which it posts its proxy materials in a manner that it does not compromise the anonymity of the person accessing the site. *Id.*