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MEMORANDUM

To: Jeff Mahoney, General Counsel
Council of Institutional Investors
Re: SEC proposed disclosure requirements for proxy access proposals

This memorandum will summarize and analyze the mandatory disclosures proposed by the Securities and Exchange Commission (“SEC”) in its recent Notice of Proposed Rulemaking (the “Notice”) dealing with “proxy access” proposals. See *Shareholder Proposals*, Release No. 34-56160, 72 Fed. Reg. 43466 (Aug. 3, 2007).

Investors have expressed concern about detailed and burdensome disclosure requirements that may be imposed on shareowners seeking to form a group of 5% beneficial holders who seek to advance a proxy access bylaw. In particular, the SEC is proposing extensive disclosures of interests that these shareowners may have with a particular company, as well as detailed disclosures about the investors’ communications with a company, and the individuals involved in advancing the proposal.

Council members may wish to address these proposed disclosures – and the practical effect on their individual funds – in comments filed with the SEC, which are due on October 2, 2007 and may be sent via e-mail to rule-comments@sec.gov. Comments should include “Number S7-16-07” on the subject line.

Q. What exactly is the SEC proposing?

A. In a nutshell, the SEC is proposing to amend its rules to let shareowners submit a “proxy access” bylaw under which shareowners who have beneficially owned more than five percent of the company’s stock for at least one year may nominate candidates for the board of directors and have those candidates appear in the company-prepared proxy. The proposed rules would also apply to any shareowner nominations that are made after a company adopts a proxy access bylaw.

Q. Does the SEC proposal dictate what terms and conditions a proxy access bylaw would have to meet?

A. No. Unlike the SEC’s 2003 proposed rule, which was never adopted, the SEC is not mandating specific criteria that must be included in a proxy access proposal. Shareowners may write their own criteria in any proposed bylaw.

Q. Why is the SEC making this proposal?

A. The 2006 court ruling in *AFSCME Pension Plan v. AIG* held that shareowners may submit proxy access proposals under the SEC’s shareholder proposal rule (Rule 14a-8). The SEC is concerned that proxy access proposals submitted under that rule may not give shareowners the sort of information that they would receive in a contested director campaign with independently nominated board candidates. Thus, the Commission decided to rewrite its rules accordingly.

Q. What sort of disclosure is contemplated?

A. The starting point is Schedule 13G, which must be filed by investors (or a group of such investors) who beneficially own more than 5% of a company’s stock. A Schedule 13G filing sets out the identity of such shareowners and their interactions with the company. The SEC is proposing that a Schedule 13G be filed by an investor or a group of investors holding more than 5% of a company’s shares who files a proxy access proposal (let’s call them a “5% group”).

Q. Would such a 5% group have to disclose more than what's now required in a Schedule 13G?

A. Yes. The SEC is proposing four major categories of disclosures by shareowners in a 5% group who are proposing a proxy access bylaw. First, the 5% group would have to disclose in a Schedule 13G certain information about various relationships with the company, including:

(1) any “direct or indirect” interest in any contract with the company or an affiliate, including a collective bargaining agreement, consulting agreement, or employment agreement;

(2) any pending or threatened litigation in which one is a party or material participant that involves the company, any officer or director or corporate affiliate; and

(3) any other “material relationship” with the company and an affiliate, such as a past employment relationship.

Q. Would these disclosures have to be made regarding each investor in the 5% group? Or only regarding relationships involving the group as a whole?

A. On this issue, as with the other proposed disclosures, the focus appears to be on disclosure by each participant in the 5% group.

Q. What else does the SEC want disclosed?

A. The second major category would be information about the shareowners’ dealings with the company and the company’s competitors during (a) the 12 month period before plans were formed to submit the proposal and (b) the time that a proposal is pending. That would include:

(1) Any “material transaction” with the company or an affiliate;

(2) Any discussions about the proposal with a proxy advisor, such as ISS or Glass Lewis; and

(3) Any holdings of more than 5% of any competitor (*i.e.*, any company in the same “Standard Industrial Classification Code”), as well as any “material relationship” with a competitor, other than the relationship as shareowner.

Q. Do you mean that if our fund joins in proposing a proxy access bylaw at, say, Hewlett-Packard, then we'd have to research our holdings in every other computer company in the same SICC and disclose that data in a 13G?

A. So it would seem. Although the SEC proposal is drafted in terms of what is required of the 5% group, it would appear that every shareowner in the group would have to research its holdings in competitors; if the total regarding a competitor exceeds 5%, that fact would have to be reported.

Q. Doesn't the SEC proposal also require a fund to disclose meetings with a company?

A. Yes. The third major category would be disclosures about meetings or contacts with the management or directors of the company during the 12 months before the plan to submit a proposal was made, as well as while the proposal is pending.

Q. How much detail does the SEC want about meetings?

A. Each investor would have to set forth in "reasonable detail" the content of a communication with the company, a description of the action or actions the investor asked the company to take or not to take, the date of any communication, the person(s) to whom the communication was made, and the response.

Q. But suppose we contact a company at a time when we haven't even thought about filing or joining a proxy access proposal and we later decide to join such an effort. Would we have to make such a disclosure about the meeting?

A. If the contact came within 12 months before the bylaw proposal, yes.

Q. It sounds like our staff would have to keep pretty good records about communications with a company. Are there any exceptions?

A. Yes, if your fund holds regularly scheduled meetings or contacts with management or directors of a company, in which case you can describe the frequency of the meetings and the subjects covered at the meetings instead of providing details for each meeting. There is an exception to that exception, however, in that you would still have to make specific disclosure regarding any event or discussion that is material to your proxy access proposal.

Q. This sounds like a ton of paperwork. Did the SEC consider that?

A. Up to a point. The focus was on the cost of preparing and filing a Schedule 13G more than internal costs. However, the SEC is inviting comments on the cost issue, including how much time and money would be needed to comply with the rule, and whether certain requirements are too burdensome or impractical.

Q. All this for a shareowner proposal? It sounds like the SEC would require more data than is required for a Schedule 13D filing. And there's still a fourth category of disclosures?

A. You are correct. The fourth category would be disclosures of information about the individuals at a given fund or institutional investor who are "associated with" the plan to put forward a proxy access bylaw.

Q. Who exactly would that be?

A. The proposal isn't clear. It could mean the trustees. It could be the staff. It could be someone else. Regardless of who is identified, however, the SEC would also require disclosure of the selection process for that person or persons, whether the beneficiaries of a fund played a role in the selection of that person or persons, the qualifications of that individual, whether he or she has a fiduciary duty to beneficiaries, and his or her relationships with the company that might influence the decision by that person to submit a proposal.

Q. Why does the SEC want all this detail?

A. The Notice says that this is intended to provide "transparency" in the process by providing investors with material information about the proponents. The concern seems to be that proponents may have hidden or ulterior motives that should be publicly disclosed if they are going to propose a process that may produce contested elections. In fact, the Notice contemplates that a 5% shareowner group would have to make disclosures if the group decides *not* to offer a proxy access bylaw if a company agrees in return to take or not to take certain action.

Q. Isn't the SEC concerned that its proposal could inadvertently stymie routine dialogues between companies and shareowners?

A. There is no mention of that point in the Notice.

Q. Would each investor in a 5% group have to file its own Schedule 13G, or will one filing be sufficient for everyone in the group?

A. A single filing covering every participant should suffice.

Q. OK. Is there any potential liability for an investor if they file a Schedule 13G?

A. There may be. The disclosures that a 5% group would have to make in a Schedule 13G filing must be signed and certified as to accuracy. There could be liability if the Schedule 13G is not timely filed or if there are discrepancies or facts that the shareowners failed to disclose. Bear in mind that the SEC is also proposing that the company must make parallel disclosures in its proxy about the proponents' relationships, meetings and contacts with the company, so that information will be available as a cross-check.

Q. What is it that investors should be most concerned about?

A. Where to begin . . . The proposed disclosures would be so burdensome as to make any proxy access rule difficult to use. The SEC's proposal does not acknowledge the difficulty in getting 5% of a company's shareowners together on an issue, nor does it acknowledge the burdens that would be imposed if each investor in such a group had to make full disclosures reaching back a year in time. Some of the required disclosures seem like overkill, *e.g.*, the fourth category that would require identifying individuals behind an institutional investor's decision to sponsor a proxy access proposal. Others would require detailed recordkeeping, *e.g.*, a fund's contacts with a director of a targeted company, even if the contact had nothing to do with the company in question.

Q. What should investors do if they have concerns about the proposal?

A. The Council has filed an initial comment letter in response to the proposal and will be filing more detailed comments before the close of the comment period, which is October 2, 2007. Council members may wish to file their own comments. Comments that specifically discuss how the SEC's proposal would affect an individual fund are particularly useful, along with any discussion of alternatives, specific costs and benefits, comments on whether there are other items that would be more useful to investors, and comments on whether and why certain items being proposed are impractical or too burdensome to require.