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# Client Alert

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## SECURITIES LAW

### SEC Expands Shareholder Power to Propose Votes on Equity Compensation Plans

Mintz Levin would like to alert its clients and friends to a recent Staff Legal Bulletin issued by the Securities and Exchange Commission's Division of Corporation Finance (the "Division") which many may have overlooked in the excitement surrounding the recent passage of the Sarbanes-Oxley Act. Staff Legal Bulletin No. 14A announces a change in the Division's policy regarding shareholders' opportunity to propose votes on public company equity compensation plans. Pursuant to Rule 14a-8 under the Securities Exchange Act of 1934, as amended, a shareholder owning even a relatively small amount of a company's stock may submit a proposal to be placed in the company's proxy materials alongside management's proposals in connection with annual or special meetings of stockholders. The company must generally include the proposal in its proxy statement unless the proposal falls within one of Rule 14a-8's enunciated exclusions.

Public companies are increasingly being faced with shareholder proposals that seek to limit or eliminate altogether equity compensation plans that have been implemented by companies for the benefit of their employees, officers and/or directors. Historically, companies have used the exception under Rule 14a-8(i)(7), which permits companies to exclude proposals that relate to their ordinary business matters, to exclude most shareholder proposals regarding equity compensation plans.<sup>1</sup>

**Expanded Shareholder Power.** The Bulletin clarifies and changes the Division's previous position that allowed a public company to rely on the "ordinary business matters exception" to exclude from its proxy statement proposals relating to broad-based equity compensation plans. The Division states that its reason for the change is that it believes that the public debate regarding shareholder approval of equity compensation plans has become significant in recent months and that the presence of widespread public debate is a factor in determining that such shareholder proposals "transcend day-to-day business matters." The Bulletin states that a public company may not rely on the "ordinary business matters exception" to

<sup>1</sup> Proposals that relate to ordinary business matters but that focus on "sufficiently significant social policy issues" are often held not excludable because, according to the SEC, these proposals would transcend the day-to-day business matter or raise a policy issue that is so significant that it would be appropriate for a shareholder vote.

omit from its proxy statement the following types of proposals:

- *Plans that are Exclusive to Officers and Directors.* Any proposal regarding equity compensation plans that may be used to compensate only senior executive officers and directors may not be excluded under the ordinary business matters exception.
- *Plans that Result in Material Dilution.* Any proposal regarding equity compensation plans that may result in “material” dilution to existing shareholders, regardless of who may participate in the plan, may not be excluded under the ordinary business matters exception. The Division indicates in the Bulletin that it is making this change from existing policy in response to widespread shareholder concerns about dilution resulting from companies’ use of stock options as compensation.

The Division provides no guidance in the Bulletin on what will constitute “material” dilution, leaving that determination up to the company and to shareholder proponents, based on the company’s facts and circumstances. The Division, however, has indicated in a telephone inquiry, that if a shareholder proposal is submitted regarding an equity compensation plan, and the proposal is silent on whether the plan will result in material dilution to existing shareholders, the company will bear the burden of asserting that the plan will not result in material dilution and that therefore the proposal may be excluded based on the ordinary business matters exception.

The Division notes in the Bulletin that shareholder proposals relating to plans that may be used to compensate a company’s general workforce only, or plans in which both

the general workforce and management may participate if the plan does not involve material dilution, may continue to be excluded under the ordinary business matters exception.

***Applicable to All Public Companies.*** The Division’s interpretation set forth in the Bulletin applies to all public companies. This change is unrelated to the well-publicized rules recently proposed by the New York Stock Exchange and The Nasdaq Stock Market relating to shareholder approval of equity compensation plans for companies that are listed or quoted on those markets.

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***Please contact the Mintz Levin attorney who handles your corporate and securities law matters if you have any questions regarding this information.***