

January 29, 2008

SEC Releases Final Rules on Electronic Shareholder Forums

On January 18, 2008, the Securities and Exchange Commission (SEC) released the full text of amendments to the proxy rules under the Securities Exchange Act of 1934, as amended, designed to promote the use of electronic shareholder forums as an effective means of communication among shareholders and between shareholders and management.¹ While the amendments do not require companies to implement electronic shareholder forums, the SEC has encouraged the development of such forums as a supplement to existing means of shareholder communication by removing two major impediments to their use.

How the Rules Work: Removing Barriers to Facilitate Use of Electronic Shareholder Forums

The SEC adopted the amendments to Rule 14a-2 and new Rule 14a-17 in substantially the same form as originally proposed.² The amendment and new rule, which become effective February 25, 2008, address the following two major concerns inhibiting the use and growth of electronic shareholder forums: (1) that statements made in an electronic shareholder forum may be construed as a solicitation under the proxy rules, and (2) that the parties who create or operate such forums will be held liable under the federal securities laws for statements made by forum participants.

In response to the first concern, the SEC has added a new exemption to Rule 14a-2, which exempts any solicitation in an electronic shareholder forum made by or on behalf of any person who does not seek directly or indirectly, either on its own or another's behalf, the power to act as proxy for a shareholder and does not otherwise request, or act on behalf of a person who furnishes or requests, a form of revocation, abstention, consent or authorization.³ Such a solicitation will be exempt so long as it is made more than

¹ Electronic Shareholder Forums, SEC Release No. 34-57172, <http://www.sec.gov/rules/final/2008/34-57172.pdf> (Jan. 18, 2008).

² See *Alston & Bird Securities Law Advisory*, "SEC Adopts Rules Related to Shareholder Access and Electronic Shareholder Forums," November 29, 2007, http://www.alston.com/securities_advisory_shareholder_forum_access.

³ See Exchange Act Rule 14a-2(b)(6).

60 days prior to the date announced by the company for its next annual or special meeting of shareholders. If a company announces the date of its annual or special meeting less than 60 days before the meeting date, then the solicitation may not be made more than two days following the announcement. Any person making solicitations under this exemption may continue to make solicitations after the exemption has expired, so long as any such solicitation is conducted in accordance with Regulation 14A. In addition, shareholders will continue to have the right under Rule 14a-8 to submit non-binding proposals to a company for inclusion in proxy materials; electronic shareholder forums are merely an additional option for shareholder communications, rather than a substitution for previously approved means of communication.

In responding to the second concern, the SEC added new Rule 14a-17, which clarifies that all shareholders, companies and third parties acting on behalf of a shareholder or company that establish, maintain, or operate an electronic shareholder forum will not be liable under federal securities laws for statements or information provided by another person to the forum.⁴ As originally proposed, the rule would not have extended this protection to forum sponsors or operators other than shareholders or companies. However, the SEC deemed it appropriate to extend such protection to sponsors or operators acting on behalf of a shareholder or company, such as Internet service providers.

What Are the Benefits to Companies?

The benefits of electronic shareholder forums for both shareholders and companies stem from the reduced communication costs of modern technologies. If shareholders are openly debating issues and presenting ideas in a virtual forum, a company can monitor shareholder concerns more frequently and more accurately than when working through the traditional annual meeting context. Online forums can be limited to just company shareholders, and electronic polling of shareholders based on ownership interest could produce real-time shareholder reaction to various suggested policies, allowing management to see which proposals are supported by a significant number of shareholders and which are backed by only a few shareholders. Electronic shareholder forums also present management with a means to disseminate information such as press releases and record dates, as well as the views of management and the board of directors on various topics. Companies can use the forums to address information pertinent to shareholder discussions at a minimum marginal cost.

What Are the Benefits to Shareholders?

For shareholders, use of the traditional proxy process for non-binding advisory matters appears on the verge of becoming archaic with the Internet and other telecommunications advances in recent decades. Electronic shareholder forums could be used to promote resolutions which typically have been proposed to management as non-binding shareholder proposals under Rule 14a-8. It is often questionable if the time and expense of such proposals is worth the sometimes marginal consideration given them through

⁴ See Exchange Act Rule 14a-17.

the proxy process, and an electronic forum would drastically reduce such costs. Another advantage of electronic shareholder forums is the ability of shareholders to easily communicate opinions to management throughout the year, rather than just during the limited time period prior to each annual shareholder meeting. Further, with such a relatively low-cost means of voicing shareholder opinion, a broader range of investors could be represented in electronic shareholder forums than in the traditional format of annual meetings, conferences or one-on-one meetings.

What Are the Drawbacks to Companies?

In addition to the expense of maintaining an electronic shareholder forum and monitoring shareholder initiatives on a continuous basis throughout the year, concerns have been raised regarding the length of the 60-day no-solicitation period contained in Rule 14a-2(b)(6). While the SEC believes this 60-day period will provide shareholders enough time to consider the information disseminated to them in connection with a shareholder meeting, commentators have expressed concern that the 60-day period is not enough time to protect companies from coordinated shareholder voting campaigns designed to impact voting results. Companies aiming to better gauge shareholder sentiment with an electronic forum should also realistically assess the expected amount and quality of shareholder input to be gained when shareholders are under no obligation to participate. Particularly, institutional investors with large portfolios cannot be expected to monitor hundreds of forums each day and become actively involved.

What Are the Drawbacks to Shareholders?

For shareholders participating in electronic forums, a level of skepticism should be maintained toward fellow participants, as full disclosure requirements will not likely apply to forum discussions. In addition to the risk of relying on information provided by other participants, shareholders face the potential for any misinformation disseminated through a forum to negatively affect stock prices. Another potential drawback for both shareholders and companies, and perhaps the greatest challenge electronic forums will face, is the risk that open forum discussions will diverge from pertinent issues to such an extent that the forum evolves into an Internet chat room with little or nothing to offer substantively related to the company, causing managers and serious shareholders to disregard the forum. If an electronic shareholder forum is established without some policy or controls guiding participation, its content could easily be susceptible to falling into this pattern.

Risks and Issues to Resolve

In the hopes of encouraging experimentation and innovation in the development of new shareholder communication technologies, the SEC provided little guidance as to the specific operation of electronic shareholder forums. A primary challenge throughout the process is maintaining accountability while providing enough privacy to encourage free expression. Several commentators have suggested that a company assign unique encrypted identifiers to each shareholder, such as a personal identification number, so that participants in the forum would not be able to see the identity of other participants. The only identifying information revealed to fellow participants on the forum would be the amount of votes held

by each participant, allowing shareholders to know the voting power backing varying opinions. Other commentators argue participants should be fully identified, increasing accountability for information provided on the forum. Since the overwhelming majority of stockholders of U.S. public companies hold their stock through brokers in “street name,” companies desiring to establish an electronic shareholder forum limited to company stockholders will first have to tackle the challenge of establishing a mechanism for efficiently and effectively assigning and maintaining access rights and identification information to its stockholders.

In spite of this freedom for innovation, both shareholders and companies should remain cognizant of the SEC’s rules and regulations not specifically addressed by the recent amendments. For example, communications on an electronic shareholder forum to acquire, hold, vote or dispose of the company’s stock may result in formation of a group under Regulation 13D-G.⁵ Shareholders should also be aware that any information posted on a forum which is not subsequently removed during the 60-day period prior to next meeting of shareholders will lose the exemption of Rule 14a-2 and possibly be construed as a solicitation. Companies may, but are not required to, prevent this problem from inadvertently arising for shareholders by implementing an automatic forum “black-out” during such 60-day periods.

Many companies have already begun using the Internet in various fashions to foster shareholder interaction, such as e-mail communications with directors and message boards on Web sites. With these recent amendments, the SEC seeks to further promote the free flow of information and opinions in an electronic shareholder forum while preventing such forums from being used to circumvent requirements of full and fair disclosure. It remains to be seen what market trends will emerge with the SEC broadly deferring the decisions relating to electronic shareholder forums to companies.

⁵ 17 CFR 240.13d-5.

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