SEC ISSUES LEGAL BULLETIN ON SHAREHOLDER PROPOSALS RELATING TO STOCK-BASED COMPENSATION

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On July 12, 2002, the Division of Corporation Finance of the Securities and Exchange Commission (the "Staff") issued Staff Legal Bulletin No. 14A (the "Bulletin") regarding shareholder proposals relating to equity compensation. The Bulletin reflects a reinterpretation by the Staff of certain proxy rules that will make it more difficult for companies to omit shareholder proposals relating to stock-based compensation from future proxy statements.

The proxy rules generally provide that a shareholder can submit a proposal for inclusion in a company's proxy materials for presentation to a vote at a shareholders meeting unless the proposal fails to meet certain procedural requirements or the proposal falls within one of 13 substantive bases for exclusion set forth in Rule 14a-8. Rule 14a-8(i)(7), one of the substantive bases for exclusion of a shareholder proposal, allows the exclusion of a proposal if the proposal deals with a matter relating to the company's ordinary business operations.

In the past the Staff has applied a bright-line analysis to shareholder proposals concerning equity or cash compensation:

- Companies may exclude proposals that relate to general employee compensation matters in reliance on Rule 14a-8(i)(7); and

- Companies may not exclude proposals that concern only senior executive and director compensation in reliance on Rule 14a-8(i)(7).

At the same time, the Staff has taken the position that proposals relating to ordinary business operations may not be excluded in reliance on Rule 14a-8(i)(7) if the proposals focus on "sufficiently significant social policy issues… because the proposals would transcend the day-to-day business matters and raise policy issues so significant that it would be appropriate for a shareholder vote." One of the factors the Staff will consider in determining if proposals concerning an issue "transcend the day-to-day business matters" is the presence of widespread public debate regarding the issue.

In the Bulletin, the Staff indicates that it believes that the public debate regarding shareholder approval of equity compensation plans has become significant in recent months. In light of this development, the Staff is modifying its treatment of proposals relating to shareholder approval of equity compensation plans as follows:

- Proposals that focus on equity compensation plans that may be used to compensate only senior executive officers and directors:
    - Consistent with the Staff's past position, these proposals cannot be omitted from proxy materials in reliance on Rule 14a-8(i)(7).
- Proposals that focus on equity compensation plans that may be used to compensate senior executive officers, directors and the general workforce:
    - If the proposal seeks to obtain shareholder approval of all such equity compensation plans, without regard to their potential dilutive effect, a company may rely on Rule 14a-8(i)(7) to exclude the proposal from its proxy materials;
    - If the proposal seeks to obtain shareholder approval of all such equity compensation plans that potentially would result in material dilution[1] to existing shareholders, a company may not rely on Rule 14a-8(i)(7) to exclude the proposal from its proxy materials.
- Proposals that focus on equity compensation plans that may be used to compensate the general workforce only, with no senior executive officer or director participation:
    - If the proposal seeks to obtain shareholder approval of all such equity compensation plans, without regard to their potential dilutive effect, a company may rely on Rule 14a-8(i)(7) to exclude the proposal from its proxy materials;
    - If the proposal seeks to obtain shareholder approval of all such equity compensation plans that potentially would result in material dilution to existing shareholders, a company may not rely on Rule 14a-8(i)(7) to exclude the proposal from its proxy materials.

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[1] The Bulletin does not define the term "material dilution".

If you have any questions concerning the Bulletin, please contact Vincent Pagano (vpagano@stblaw.com), John Lobrano (jlobrano@stblaw.com) or Jessica Gross (jgross@stblaw.com) of our firm at (212) 455-2000.

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