

A Monthly
Newsletter of
Federal Securities &
Corporate Law
Developments

SEC Proposes Disclosure Regarding Director Nominations

On August 8, 2003, the SEC proposed new rules that would require public companies to disclose in their proxy materials more information about how they select directors and how they deal with candidates nominated by shareholders. (<http://www.sec.gov/rules/proposed/34-48301.htm>) If adopted, a company would be required to disclose if it has a nominating committee, names of any members and, if it does not have one, reasons why it does not have such a committee. A company would also be required to disclose whether its nominating committee has a charter and if it has a policy in how it considers director candidates recommended by shareholders, and to provide a description of minimum qualifications for board nominees.

The proposal also states that companies would need to disclose any policy they may have with respect to director candidates who have been nominated by shareholders, as well as the procedures shareholders must follow in order to nominate director candidates. If shareholders who own more than 3 percent of the company's common stock for at least a year nominate a candidate who is rejected, the company must disclose the reasons why it found the candidate unacceptable. **Companies should be prepared for the possibility of greater disclosure if these proposals are adopted.**

■ MINORITY SHAREHOLDER MAY BE LIABLE FOR APPOINTED DIRECTORS' ACTIONS

A Massachusetts court recently ruled that a minority shareholder in a Delaware corporation

may be liable to the corporation for aiding and abetting an alleged breach of fiduciary duties by two directors that were appointed by the shareholder. *CCBN.com Inc. v. Thomson Financial, Inc.*, No. 02-11532-PBS (D.Mass. July 2, 2003)

The defendant Thomson made an equity investment in CCBN in exchange for a minority ownership position and the right to appoint two directors to CCBN's five-person board. CCBN alleged that while serving on the board, these two directors provided Thomson with confidential and proprietary information about CCBN's business in breach of their fiduciary duties owed to CCBN. Thomson then used the information to launch a competing business.

CCBN sued Thomson, alleging that Thomson was liable for the breach by the two Thomson-appointed directors in the same way that an employer is responsible for its employees' acts. The court rejected this argument because of established Delaware law that only majority and controlling shareholders owed fiduciary duties to a company. In contrast, Thomson was a minority shareholder with limited ability to appoint directors.

However, the court noted that Thomson might be liable under a different legal theory—for aiding and abetting the breach of fiduciary duty by the Thomson-appointed directors if Thomson knowingly participated in the alleged breach. **Financing parties who negotiate board representation rights in connection with their investment in a company should ensure that any confidential information received from the directors is not used against the company.**

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■ NEW TAX RULE BARS OPTION DEDUCTION FOLLOWING MERGER

Sometimes a company can lose tax deductions for its stock options even when it pays out on them. In mergers, an acquiring company may agree to honor the non-incentive stock options of the target company by having them converted to options of the acquiring company. However, if the merger was not structured as a tax-free deal to the shareholders of the target company—say, because it was an all-cash deal—and the target company is kept as a subsidiary, the acquiring company will not be able to take the tax deduction on those options even if it issues its own stock when exercised or cancels them with its own cash.

According to a recent IRS ruling, only the company that actually issued the options—i.e., the target company—can receive the deduction because that is the company that arguably received the services for which the options were issued. The only exception under these circumstances is if the target company, as a subsidiary, is liquidated into the acquiring company. (Revenue Ruling 2003-98) (<http://www.irs.gov/pub/irs-drop/rr-03-98.pdf>)

The acquiring company could still receive the benefit of the tax deduction if it files a consolidated tax return with the target company; however, that would require the acquiring company to assume all of the potential tax liabilities of the target company, including pre-merger years.

■ AMENDMENTS MADE TO DELAWARE CORPORATE LAW

Several changes were made to Delaware corporate law effective August 1, 2003. The changes amended several areas including filing of instruments, shareholder submissions, mergers, inspection rights and

conversions. Among the changes were the following:

- Clerical errors found during the Secretary of State's processing of a document should not cause that document to lose its filing time.
- Corporations that attempted to file during a declared extraordinary condition of war, natural disaster or another extraordinary event may still receive their intended filing time.
- Directors may properly authorize submission of a matter to a shareholder vote, even if the directors subsequently determine to recommend that the shareholders vote against the submitted matter.
- The provision under which directors are deemed to have consented to personal jurisdiction for civil lawsuits brought in Delaware courts has been expanded to include certain senior officers as well.

Kutak Rock LLP is a national law firm with more than 325 attorneys located in 16 offices throughout the United States practicing in the areas of corporate, banking and securities law, public and corporate finance and complex commercial litigation matters.

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