

PROLOGIS
Form 424B3
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PROSPECTUS

1999 Dividend Reinvestment and Share Purchase Plan

ProLogis previously established the 1999 Dividend Reinvestment and Share Purchase Plan. This prospectus amends and restates the plan.

The ProLogis Dividend Reinvestment and Share Purchase Plan is designed to promote long-term investing in ProLogis common shares. Current shareholders can conveniently and economically purchase ProLogis common shares of beneficial interest by reinvesting all or a portion of their cash distributions and submitting optional cash payments. In addition, persons who are not already shareholders of ProLogis can purchase their first common shares through the plan. The plan will be administered by an agent, Computershare Trust Company, N.A., or any successor bank or trust company as may from time to time be designated by ProLogis.

At ProLogis' discretion, the agent will purchase common shares in one of the following manners:

- directly from ProLogis;
- in the open market; or
- in negotiated transactions with third parties.

ProLogis common shares purchased directly from ProLogis under the plan may be priced at a discount from market prices at the time of the investment, as described in Question 16 under Description of the Plan.

ProLogis common shares are listed on the New York Stock Exchange under the symbol PLD.

These securities have not been approved or disapproved by the Securities and Exchange Commission or any State Securities Commission nor has the Securities and Exchange Commission or any State Securities Commission passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

The date of this Prospectus is January 4, 2007

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PROLOGIS

We are a real estate investment trust that operates a global network of real estate properties, primarily industrial distribution properties. Our business strategy is designed to achieve long-term sustainable growth in cash flow and sustain a high level of return for our shareholders. We manage our business by utilizing the ProLogis Operating System[®], an organizational structure and service delivery system that we built around our customers. When combined with our international network of distribution properties, the ProLogis Operating System enables us to meet our customers' distribution space needs on a global basis. We believe that by integrating international scope and expertise with a strong local presence in our markets, we have become an attractive choice for our targeted customer base, the largest global users of distribution space.

We are organized under Maryland law and have elected to be taxed as a REIT under the Internal Revenue Code of 1986, as amended. Our world headquarters are located in Denver, Colorado. Our European headquarters are located in the Grand Duchy of Luxembourg with our European customer service headquarters located in Amsterdam, the Netherlands. Our regional offices in Asia are located in Tokyo, Japan and Shanghai, China. Our common shares were first listed on the New York Stock Exchange in March 1994 and now trade under the ticker symbol **PLD**. Our Series F cumulative redeemable preferred shares of beneficial interest and Series G cumulative redeemable preferred shares of beneficial interest, are listed on the New York Stock Exchange under the symbols **PLD-PRF** and **PLD-PRG**, respectively.

DESCRIPTION OF THE PLAN

The following questions and answers describe the plan.

Purposes and advantages

1. What is the purpose of the plan?

The purpose of the plan is to provide current shareholders and interested investors with a convenient and economical method to invest in common shares of ProLogis and to build their investment over time.

2. How may shareholders purchase common shares under the plan?

Shareholders may purchase common shares under the plan by:

- (1) having cash distributions on some or all of their common shares (up to a maximum of 300,000 common shares) automatically reinvested in additional common shares; or
- (2) making optional cash payments of not less than \$200 per payment nor more than \$10,000 per month.

The minimum and maximum dollar amounts for optional cash payments may be changed at any time at ProLogis' sole discretion.

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3. *What are the advantages and disadvantages of participation in the plan?*

The advantages of participation in the plan include:

full investment of distributions and optional cash payments because participants are not required to pay brokerage commissions, except with respect to common shares purchased in the open market with optional cash payments, or other expenses, except with respect to initial cash payments, in connection with the purchase of common shares under the plan;

the plan permits fractional common shares as well as whole common shares to be purchased;

common shares purchased directly from ProLogis under the plan may be purchased at a discount from market prices at the time of the investment, as described in Question 16;

distributions on all whole and fractional dividend reinvestment plan shares are automatically reinvested in additional common shares;

participants avoid the necessity for safekeeping certificates representing the common shares purchased pursuant to the plan;

certificates for underlying common shares may be deposited for safekeeping in order to protect against loss, theft or destruction of those certificates as described in Question 23; and

statements provide participants with a record of each transaction.

The plan, however, has some disadvantages as compared to purchases of common shares through brokers or otherwise. They include the following:

no interest is paid by ProLogis or the agent on any distributions or optional cash payments held pending investment;

the agent, not the participant, determines the timing of investments, as described in Question 15, and, as a result, the purchase price for the common shares may vary from that which would otherwise have been obtained by directing a purchase through a broker or in a negotiated transaction;

the actual number of shares acquired by the participant will not be known until after the common shares are purchased by the agent, as described in Question 17;

optional cash payments of less than the minimum amount will be returned to the participant without interest, as will the portion of any optional cash payment which exceeds the maximum monthly amount;

participants can not be assured of the availability or the amount of the discount as it may range between 0% and 2% at ProLogis' sole discretion, as described in Question 16;

any discount from market prices at the time of the investment on common shares purchased under the plan, as described in Question 16, may create additional taxable income to the participant, as described under *Federal Income Tax Considerations Relating to the Plan* ; and

commissions paid by ProLogis in connection with the reinvestment of distributions, if the common shares are purchased in the open market, will be taxable income to the participant, as described under Federal Income Tax Considerations Relating to the Plan.

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Eligibility and participation

4. Who is eligible to become a participant?

Any person who has reached the age of majority in his or her state of residence, whether he, she or it (in the case of an entity) is currently a shareholder of ProLogis, is eligible to participate in the plan.

Persons who are citizens or residents of a country other than the United States, its territories and possessions and are interested in becoming participants in the plan should make certain that their participation would not violate local laws governing such things as taxes, currency and exchange controls, share registration, foreign investments and related matters.

5. How does an eligible person become a participant?

After reading this prospectus, an eligible person may become a participant in the plan by following the appropriate procedures set forth below.

Registered Holder:

A registered holder (a shareholder whose common shares are registered on the share transfer books of ProLogis in his, her or its name) may elect to become a participant in the plan at any time, subject to ProLogis' right to modify, suspend, terminate or refuse participation in the plan. In order to become a participant, a registered holder can enroll online at www.computershare.com, over the telephone at (800) 956-3378 or through the mail by completing a shareholder enrollment form and returning it to the agent at Computershare Trust Company, N.A., P.O. Box 43078, Providence, RI 02940-3078.

If the shares are registered in more than one name (e.g., joint tenants, trustees, etc.) all registered holders of such shares must sign the shareholder enrollment form exactly as their names appear on the account registration. Shareholder enrollment forms can be obtained by contacting the agent.

Beneficial Owner:

A beneficial owner (a shareholder whose common shares are registered in a name other than the name of such person; for example, in the name of a broker, bank or other nominee) may elect to become a participant in the plan only after instructing his, her or its financial intermediary to re-register all or a portion of the shares into his, her or its own name. Any costs associated with that re-registration will be borne solely by the beneficial owner. Once such shares have been re-registered, the shareholder can follow the instructions listed above for a registered holder in order to become a participant in the plan.

Alternatively, beneficial owners may enroll in the plan in the same manner as someone who is not currently a shareholder as described below.

Only shares registered on the share transfer books of ProLogis in a shareholder's name (not that of a bank, broker or other nominee) are eligible for participation. Distributions on common shares that remain registered in a name other than that of the shareholder will not be reinvested under the plan.

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Interested Investors who do not currently own ProLogis common shares:

A person who is not already a shareholder of ProLogis may purchase common shares under the plan in either of the following ways:

(1) Going to *www.computershare.com* and following the instructions provided for opening an account online. The investor will be asked to complete an online enrollment form and to submit an initial investment of not less than \$200 nor more than \$10,000. To make an initial investment, the person may

authorize a one-time deduction from his, her or its U.S. bank account or

establish an automatic monthly investment from a qualified financial institution, as described in Question 10.

(2) Submitting a completed initial enrollment form to the agent along with his, her or its initial investment of not less than \$200 nor more than \$10,000. To make an initial investment, the person may

enclose a check payable in U.S. dollars, drawn against a U.S. bank and made payable to Computershare ProLogis or

authorize an automatic monthly deduction from a qualified financial institution by completing the direct debit authorization form enclosed with the initial enrollment form and enclosing a voided blank check (if a checking account) or deposit slip (if a savings account), as described in Question 10.

Interested investors choosing to make their initial investment through the automatic monthly investment feature should note that automatic monthly deductions will continue indefinitely, beyond the initial investment, until the agent is notified to discontinue such deductions. In addition, the minimum and maximum dollar amounts for initial investments may be changed at any time at ProLogis' sole discretion.

For an initial investment, investors should include an additional \$10.00 for the initial enrollment fee.

6. What do the shareholder enrollment and initial enrollment forms provide?

The shareholder enrollment and initial enrollment forms authorize the agent to apply all or a portion of the distributions received for an account registered on the share transfer books of ProLogis in a shareholder's name to the purchase of additional common shares. Shareholders may choose their desired level of participation by selecting one of the three distribution reinvestment elections offered under the plan. Prior to selecting an election, however, shareholders should note the following share types and how they function under the distribution reinvestment portion of the plan.

(a) ***CERTIFICATE SHARES:*** Shares held by the shareholder in certificate form. Participants can choose to reinvest or receive distributions on these shares.

(b) ***BOOK SHARES:*** Shares held electronically by the agent. Like certificate shares, participants can choose to reinvest or receive distributions on these shares.

(c) ***DIVIDEND REINVESTMENT PLAN SHARES:*** Shares purchased under the plan or deposited into the plan through its safekeeping feature. Like book shares, dividend reinvestment plan shares

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are held electronically by the agent; however, distributions on all dividend reinvestment plan shares will automatically be reinvested.

As outlined in the shareholder enrollment and initial enrollment forms, the plan offers the following distribution reinvestment elections:

FULL DISTRIBUTION REINVESTMENT: Under this election, cash distributions on all common shares held in certificate and book form and distributions on all dividend reinvestment plan shares (up to an aggregate total of 300,000 certificate, book and dividend reinvestment plan shares) will automatically be reinvested to purchase additional common shares. Participants enrolled in this investment election may also make optional cash payments of not less than \$200 per payment, nor more than an aggregate maximum monthly amount of \$10,000.

PARTIAL DISTRIBUTION REINVESTMENT: Under this election, cash distributions on a specified number of shares will be paid to the participant by check or direct deposit. The specified number of shares must be less than the combined total of the participant's certificate and book shares. Cash distributions on the remaining common shares held in certificate and book form and distributions on all dividend reinvestment plan shares (up to an aggregate total of 300,000 certificate, book and dividend reinvestment plan shares) will automatically be reinvested to purchase additional common shares. Participants enrolled in this investment election may also make optional cash payments of not less than \$200 per payment, nor more than an aggregate maximum monthly amount of \$10,000.

CASH DISTRIBUTION: Under this election, cash distributions on all common shares held in certificate and book form will be paid to the participant by check or direct deposit. Distributions on all dividend reinvestment plan shares (up to a total of 300,000 dividend reinvestment plan shares) will automatically be reinvested to purchase additional common shares. Participants enrolled in this investment election may also make optional cash payments of not less than \$200 per payment, nor more than an aggregate maximum monthly amount of \$10,000.

Regardless of which method of participation is selected, distributions paid on all whole and/or fractional dividend reinvestment plan shares will be reinvested automatically.

A participant may change his, her or its distribution election online at www.computershare.com, over the telephone at (800) 956-3378 or through the mail by completing a new shareholder enrollment form and returning it to the address provided in Question 18. Any election or change of election concerning the reinvestment of distributions must be received by the agent prior to the established record date for a particular distribution payment in order for the election or change in election to become effective with that distribution. If the request is received on or after the record date established for a particular distribution payment, the election or change in election may not be effective until the following distribution payment. A trading day is a day on which the New York Stock Exchange is open for business. A distribution record date normally precedes the payment of distributions by approximately two weeks. A schedule of the anticipated distribution record and payment dates is set forth in Exhibit A, subject to change at ProLogis discretion. For future periods not covered in Exhibit A, ProLogis will provide participants a schedule of the relevant record and payment dates.

If a participant signs and returns a shareholder enrollment or initial enrollment form without checking a desired option, or checks the partial distribution reinvestment election without specifying a

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number of shares, the participant will be deemed to have selected the full distribution reinvestment option.

Reinvestment of distributions

7. What limitations apply to the reinvestment of distributions?

For each distribution payment, a participant can reinvest cash distributions on any number of common shares up to a maximum of 300,000 certificate, book and dividend reinvestment plan shares. This limit is subject to change at any time at ProLogis' sole discretion. For purposes of applying this limitation, all plan accounts considered to be under the common control or management of a participant may be aggregated. Distributions on any common shares for an account (or combination of accounts considered to be under common control or management) in excess of the 300,000 common share participation limitation will not be reinvested; instead such distributions will be paid to the participant by check or direct deposit. In addition, participants may not acquire more than 9.8% of the number or value of the outstanding common shares and preferred shares of beneficial interest of ProLogis, as described in Question 38.

8. When will distributions be reinvested?

Purchases of common shares directly from ProLogis using cash distributions will be made on the relevant distribution payment date. Newly issued shares will be credited to participants' accounts as of such date. Purchases in the open market using cash distributions will begin on the relevant distribution payment date and will be completed no later than 30 days after such date, except where completion at a later date is necessary or advisable under any applicable securities laws or regulations. Shares purchased in the open market will be credited to participants' accounts after the transaction settles. Settlement usually occurs three business days after the purchase is completed.

Participants should note that distributions are paid as and when declared by ProLogis' Board of Trustees. There can be no assurance as to the declaration or payment of a distribution and nothing contained in the plan obligates ProLogis to declare or pay any distribution on the common shares. The plan does not represent a guarantee of future distributions.

Optional cash payments

9. Who may make optional cash payments?

Any eligible person, as described in Question 4, may make optional cash payments, whether or not the person is already a shareholder, subject to ProLogis' right to modify, suspend, terminate or refuse participation in the plan. Investors may make optional cash payments regardless of which method of participation they have elected.

10. How does the optional cash payment option work?

Interested investors may make their first optional cash payment (i.e., their initial investment) concurrently with establishing a plan account by following the procedures provided in Question 5. Once enrolled in the plan, any participant may purchase additional common shares by sending optional cash payments to the agent at any time. The amount of each optional cash payment may vary but the total of all optional cash payments may not exceed \$10,000 per month, as described in

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Question 12. For purposes of applying this limitation, all plan accounts considered to be under the common control or management of a participant may be aggregated. A participant may make optional cash payments in the following ways:

(1) Accessing his, her or its plan account online at *www.computershare.com* and authorizing a one-time optional cash investment for a minimum of \$200 from his, her or its U.S. bank account.

(2) Remitting a check to the agent for a minimum investment amount of \$200. All checks should be accompanied by a cash investment form (or the shareholder enrollment form, if submitted at the time of enrollment) and mailed to the address indicated on the form. A cash investment form is attached to each plan statement. All checks must be payable to Computershare ProLogis, payable in U.S. funds and drawn against U.S. banks. Checks drawn against non-U.S. banks or not payable in U.S. funds will be returned to the participant without interest as will any cash or third-party checks.

(3) Establishing an automatic monthly investment for a minimum of \$200. By electing this option, a participant is authorizing the agent to automatically withdraw a designated dollar amount every month from his, her or its bank account at a qualified financial institution. Participants may establish an automatic monthly investment online at *www.computershare.com* or by completing an automatic monthly investment form and returning it to the agent at the address provided in Question 18. The automatic monthly investment form (or the initial purchase form, if a new investor) should be accompanied by a voided blank check (for a checking account) or deposit slip (for a savings account) for bank account and routing number verification. Automatic monthly investment forms may be obtained by contacting the agent. Participants should allow 4 to 6 weeks for the first investment to be initiated. Once established, funds will be deducted from the participant's designated bank account on the 6th day of each month. If the 6th day of any month is not a business day, funds will be deducted the following business day. Participants may change their automatic monthly investment information or terminate their automatic monthly deduction by contacting the agent as described above. In order for any change in the amount of funds withdrawn or for any termination to be effective for a particular month, the agent should receive notification at least 7 business days prior to the debit date. Changes in bank information (routing and account number), however, may require 4 to 6 weeks to take effect.

All optional cash payments must be payable in U.S. dollars and drawn against a U.S. bank. **Do not send cash, traveler's checks, money orders or third-party checks.** In the event that any deposit is returned unpaid for any reason, the agent will consider the request for investment of such money null and void and will immediately remove from the participant's account shares, if any, purchased upon the prior credit of such money. The agent will thereupon be entitled to sell these shares to satisfy any uncollected amounts. If the net proceeds of the sale of such shares are insufficient to satisfy the balance of the uncollected amount, the agent shall be entitled to sell such additional shares from the participant's account to satisfy the uncollected balance. In addition, a \$25.00 returned funds fee will be charged for any deposit returned unpaid.

Plan participants should note that ProLogis reserves the right to terminate any account or deny any request for investment if ProLogis believes the investor is making excessive optional cash payments through multiple shareholder accounts, is engaging in arbitrage activities such as flipping or is otherwise engaging in activities under the plan in a manner which is not in the best interest of

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ProLogis or which may cause the participant to be treated as an underwriter under the federal securities laws. For purposes of terminating any account or denying any request for investment, all plan accounts considered to be under the common control or management of a participant may be aggregated. Persons who acquire common shares through the plan and resell them shortly after acquiring them, including coverage of short positions, under some circumstances, may be participating in a distribution of securities which would require compliance with Regulation M under the Securities Exchange Act of 1934, and may be considered to be underwriters within the meaning of the Securities Act of 1933. ProLogis will not extend to any such person any rights or privileges other than those to which it would be entitled as a participant in the plan, nor will ProLogis enter into any agreement with any such person regarding that person's purchase of those shares or any resale or distribution thereof.

Participants have no obligation to make any optional cash payments.

11. When will optional cash payments received by the agent be invested?

In the case of optional cash payments, ProLogis has set two investment dates for each month. The investment dates typically occur on or around the 15th and last business day of each month; however, the investment dates have been adjusted in distribution paying months so optional cash payments may be commingled with the distribution funds and invested on the distribution payment date. Expected investment dates are outlined in Exhibit A and are subject to change at ProLogis' discretion. For future investment dates, ProLogis will provide participants a schedule of the relevant investment dates.

Optional cash payments received by the agent will be invested according to the following procedures:

Online investments

If a participant authorizes a one-time investment online at www.computershare.com, the estimated debit date and investment date are provided on the confirmation page at the conclusion of the online purchase process. Participants should review this information carefully prior to confirming an online purchase request.

Check investments

If a participant submits a check to purchase additional common shares, the agent will apply the optional cash payment to the purchase of common shares on the next investment date provided the agent receives the check at least two business days prior to the investment date. Any optional cash payment received less than two business days prior to the next investment date will be held by the agent and will be applied to the purchase of shares on the following investment date.

Automatic monthly investments

If a participant has authorized automatic monthly investments from his, her or its U.S. bank account, the agent will invest the funds received on the first investment date of each month.

Common shares to be purchased by the agent directly from ProLogis will be purchased on the applicable investment date. Accordingly, the entire investment will be made on the applicable investment date and newly issued shares will be credited to participants' accounts as of such date.

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Common Shares to be purchased by the agent on the open market or in negotiated transactions with third parties will begin on the applicable investment date and will be completed no later than 30 days after that date, except where completion at a later date is necessary or advisable under any applicable securities laws or regulations. Shares purchased on the open market will be credited to participants' accounts after the transaction settles. Settlement usually occurs three business days after the purchase is completed.

12. What limitations apply to optional cash payments?

Optional cash payments are subject to a minimum of \$200 per payment and a maximum of \$10,000 per month. For purposes of applying the maximum monthly amount, all optional cash payments, including initial investments, will be aggregated. In addition, all plan accounts considered to be under the common control or management of a participant will be combined. ProLogis reserves the right to terminate any account that ProLogis considers to be making excessive optional cash payments through multiple shareholder accounts. The minimum and maximum amounts for optional cash payments may be changed at any time at ProLogis' sole discretion.

Optional cash payments of less than the minimum amount and the portion of any optional cash payment that exceeds the maximum monthly amount will be returned to the participant by check, without interest, as soon as practicable. Participants may make optional cash payments of up to the aggregate maximum monthly amount without the prior approval of ProLogis, subject to ProLogis' right to modify, suspend, terminate or refuse participation in the plan at its sole discretion.

13. May optional cash payments be returned to a participant?

Uninvested optional cash payments will be returned to the participant without interest upon his, her or its written request provided the request is received by the agent at least five business days prior to the applicable investment date.

Purchases

14. What is the source of common shares purchased under the plan?

At ProLogis' option, the agent may purchase common shares for the plan directly from ProLogis out of its authorized but unissued common shares, in the open market or in negotiated transactions with third parties. Initially, ProLogis anticipates that the agent will purchase common shares for the plan directly from ProLogis, but this may change from time to time at ProLogis' election.

15. When will common shares be purchased for a participant's account?

As previously indicated, purchases of common shares directly from ProLogis will be made on the relevant distribution payment date or on the relevant investment date. Purchases in the open market will begin on the relevant distribution payment date or on the relevant investment date and will be completed no later than 30 days after that date, except where completion at a later date is necessary or advisable under any applicable securities laws or regulations. The exact timing of open market purchases, including determining the number of common shares, if any, to be purchased on any day or at any time on that day, the prices paid for those common shares, the markets on which the purchases are made and the persons, including brokers and dealers, from or through which the purchases are made, will be determined by the agent or the broker selected by it for that purpose.

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Neither ProLogis nor the agent will be liable when conditions, including compliance with the rules and regulations of the Securities and Exchange Commission, prevent the purchase of common shares or interfere with the timing of the purchases. The agent may purchase common shares in advance of a distribution payment date or investment date for settlement on or after that date.

Notwithstanding the above, funds will be returned to participants if not used to purchase common shares within 30 days of the investment date for optional cash payments or within 30 days of the distribution payment date for distribution reinvestments.

In making purchases for a participant's account, the agent may commingle the participant's funds with those of other participants in the plan.

16. What is the purchase price of common shares purchased by participants under the plan?

Common shares purchased directly from ProLogis may be priced at a discount from the market price at the time of the investment. Information on any applicable discounts may be found on ProLogis' website at <http://ir.prologis.com> under the Dividend Reinvestment & Direct Purchase Plan section. There are two types of discounts that may be available to participants:

Distribution reinvestment discount

Common shares purchased directly from ProLogis under the plan in connection with the reinvestment of distributions may be purchased at a discount ranging from 0% to 2%. Therefore, the purchase price will be equal to the average of the high and low sale prices of the common shares as reported in the New York Stock Exchange Composite Transactions list on the distribution payment date, less the distribution reinvestment discount as determined by ProLogis at its sole discretion.

Optional cash payment discount

Common shares purchased directly from ProLogis under the plan in connection with optional cash payments may be purchased at a discount ranging from 0% to 2%. Therefore, the purchase price will be equal to the average of the high and low sale prices of the common shares as reported in the New York Stock Exchange Composite Transactions list on the relevant investment date, less the optional cash payment discount as determined by ProLogis at its sole discretion.

Setting a discount for a distribution payment date, an investment date or an investment period will not affect the setting of a discount for any subsequent distribution payment dates, investment dates or investment periods.

In the event that common shares are purchased in the open market or in negotiated transactions with third parties, the purchase price will be:

Distribution reinvestment

The weighted average cost for all common shares purchased under the plan on the relevant distribution payment date (and any subsequent trading days needed to complete the purchase order).

Optional Cash Payments

The weighted average cost less brokerage commissions (currently \$0.05 per share, subject to change), for all common shares purchased under the plan on the relevant investment date (and any subsequent trading days needed to complete the purchase order).

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Common shares will not be purchased on the open market or in negotiated transactions with third parties with cash payments.

Participants will not be able to instruct the agent to purchase shares at a specific time or at a specific price or through a specific broker.

17. How many common shares will be purchased for a participant?

The number of common shares to be purchased for a participant's account as of any distribution payment date or investment date will be equal to the total dollar amount to be invested for the participant divided by the applicable purchase price, as described in Question 16. For new investors, the total dollar amount to be invested will be equal to the amount submitted less the \$10.00 initial enrollment fee as described in Question 5.

The amount to be invested for a participant with reinvested cash distributions will be reduced by any amount ProLogis is required to deduct for U.S. federal tax withholding purposes.

Plan administration

18. Who administers the plan?

Computershare Trust Company, N.A., as agent for participants, administers the plan, keeps records, sends statements of account to participants and performs other duties relating to the plan. All costs of administering the plan are paid by ProLogis, except as provided in this prospectus.

The following address may be used to contact the plan agent: Computershare Trust Company, N.A., P.O. Box 43078, Providence, RI 02940-3078 or call toll free (800) 956-3378. Participants should be sure to include a reference to ProLogis in any correspondence.

Participants may also obtain information about their accounts and perform a variety of transactions online at www.computershare.com. To access their accounts, participants will need ProLogis' New York Stock Exchange symbol, PLD, their account number, which can be found on their distribution check or statement, and their password. If a participant does not know or has not received his, her or its password, a new one can be requested online or over the telephone.

19. What reports are sent to participants in the plan?

After an investment is made for a participant's plan account, whether by reinvestment of distributions or investment of optional cash payments, the participant will be sent a plan statement which will provide a record of the costs of the common shares purchased for that account, the purchase date, the number of common shares purchased and the number of common shares in that account. These statements should be retained for income tax purposes as there may be a fee incurred if the agent must supply an additional account history. Each plan statement will include a tear off coupon which can be completed and returned to the agent when submitting an optional cash payment, depositing certificates for safekeeping, requesting the sale of shares, requesting a stock certificate or terminating a plan account. In addition, each participant will be sent the same information sent to every holder of common shares, including but not limited to ProLogis' notice of annual meeting and proxy statement and income tax information for reporting distributions received and proceeds derived from the sale of any dividend reinvestment plan shares.

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All reports and notices from the agent to a participant will be addressed to the participant's last known address. Participants should notify the agent promptly of any change in address.

20. What are the responsibilities of ProLogis and the agent under the plan?

ProLogis and the agent, in administering the plan, are not liable for any act done in good faith or for any good faith omission to act, including, without limitation, any claim of liability:

- (1) with respect to the prices and times at which common shares are purchased or sold for a participant;
- (2) with respect to any fluctuation in market value before or after any purchase or sale of common shares; or
- (3) arising out of any failure to terminate a participant's account upon that participant's death or adjudicated incompetence prior to receipt by the agent of notice in writing of the death or adjudicated incompetence.

Neither ProLogis nor the agent can provide any assurance of a profit or protect a participant from a loss on common shares purchased under the plan. These limitations of liability do not affect any liabilities arising under the federal securities laws, including the Securities Act of 1933.

The agent may resign as administrator of the plan at any time, in which case ProLogis will appoint a successor administrator. In addition, ProLogis may replace the agent with a successor administrator at any time.

Common share certificates

21. Are certificates issued to participants for common shares purchased under the plan?

Normally, stock certificates for shares purchased under the plan will not be issued. Instead, such shares will be held electronically by the agent on behalf of the participant as dividend reinvestment plan shares. The agent will send each participant a plan statement reporting the number of shares (including fractional shares) credited to his, her or its account as promptly as practicable after each purchase.

In order to request a certificate, participants may access their accounts online at www.computershare.com, call the agent at (800) 956-3378 or complete and return the transaction form attached to each plan statement. The agent will issue a certificate for any number of whole common shares within 5 business days of receipt of a participant's request. Any remaining whole and fractional common shares will continue to be held as dividend reinvestment plan shares by the agent. Certificates for fractional common shares will not be issued under any circumstances. There is no fee for this service.

22. What happens to the reinvestment of distributions when a participant requests a certificate for a portion of his, her or its dividend reinvestment plan shares?

Cash distributions paid on all dividend reinvestment plan shares are automatically reinvested. When a participant requests a certificate for a portion of his, her or its dividend reinvestment plan

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shares and the issued shares remain registered in the participant's name, the reinvestment of distributions is effected in the following manner:

(a) If the participant is enrolled in full distribution reinvestment, distributions paid on the issued shares will continue to be reinvested under the plan in the same manner as prior to the request;

(b) If the participant is enrolled in partial distribution reinvestment, distributions paid on the issued shares may or may not continue to be reinvested depending on the number of common shares specified for payment; or

(c) If a participant is enrolled in cash distribution, distributions paid on the issued shares will no longer be reinvested under the plan; instead, such distributions will be sent to the participant by check or direct deposit.

23. *May common shares held in certificate form be deposited in a participant's plan account?*

Yes, regardless of which investment option is selected, certificates registered in the participant's name may be surrendered to the agent for deposit into the participant's plan account, free of charge. All distributions on any common shares evidenced by certificates deposited in accordance with the plan will automatically be reinvested. Since the participant bears the risk of loss in transit, certificates should be sent to Computershare Trust Company, N.A., P.O. Box 43078, Providence, RI 02940-3078 by registered or certified mail, with return receipt requested, or some other form of traceable mail, and properly insured. Participants should include a letter of instruction with the certificates. The transaction form attached to each plan statement may be used for this purpose. Participants should **not** endorse the certificates.

Termination

24. *May a participant terminate participation in the plan?*

Yes, a participant may terminate his, her or its participation in the plan at any time. Participants can make such a request online at www.computershare.com, over the telephone at (800) 956-3378 or in writing by completing the transaction form attached to each plan statement and returning it to the address provided in Question 18.

25. *What happens when a participant terminates his, her or its plan account?*

As soon as practicable after notice of termination is received, the agent will move all whole shares from the plan to non-plan book shares or send a certificate, as directed by the participant. If no direction is received, the agent will move the whole shares to non-plan book shares. Additionally the agent will send a check representing the then current market value of any fraction of a dividend reinvestment plan share. After an account is terminated, all distributions will be paid to the shareholder unless the shareholder re-elects to participate in the plan.

Alternatively, a participant may terminate his, her or its plan account by requesting the agent to sell all dividend reinvestment plan shares, both whole and fractional, or to issue a certificate for a certain number of dividend reinvestment plan shares and to sell the remaining shares. The agent will remit to the participant the proceeds of any sale of common shares, less a service fee and any related

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trading fees, transfer taxes or other fees incurred by the agent allocable to the sale of those common shares. See Sale of common shares.

In order to ensure termination for a particular distribution payment, the agent must receive a participant's request prior to the to the distribution record date.

In addition, pending optional cash payments may affect the termination of a plan account. Therefore, participants, if applicable, should expressly request the return of any optional cash payment prior to submitting a request for termination. Optional cash payments will be refunded if a written request to return the cash payment is received by the agent at least 5 trading days prior to the relevant investment date.

Participants should note that the agent is authorized to terminate any account that contains less than five full common shares of ProLogis. The agent will terminate the account by selling the shares and fraction of a share and mailing a check to the participant for the proceeds of the sale, less any related trading fees, transfer taxes or other fees incurred by the agent allocable to the sale of those common shares.

26. When may a former participant re-elect to participate in the plan?

Generally, any former participant may re-elect to participate in the plan at any time. However, the agent reserves the right to reject any shareholder authorization or initial purchase form on the grounds of excessive joining and withdrawing. This reservation is intended to minimize unnecessary administrative expense and to encourage use of the plan as a long-term investment service.

Sale of common shares

27. May a participant request that common shares held in a plan account be sold?

Yes, a participant may request that all or any number of dividend reinvestment plan shares held by the agent be sold.

Within 5 business days after receipt of a participant's request to sell dividend reinvestment plan shares, the agent will place a sell order through a broker or dealer designated by the agent. If the dollar value of the sale is expected to be \$25,000 or less, participants can request to sell shares online at www.computershare.com or over the telephone at (800) 956-3378. If the dollar value of the sale is expected to be greater than \$25,000, participants must submit their sale request in writing to the address provided in Question 18. Participants must also submit a written request to sell shares if they have changed their address within 30 days of the sale request.

The participant will receive the proceeds of the sale, less a service fee and any trading fees, transfer taxes or other fees incurred by the agent allocable to the sale of those common shares. No participant will have the authority or power to direct the date or price at which common shares may be sold. The sale price will equal the weighted average price for all shares sold by the agent on the day of the sale less brokerage commissions, currently \$0.12 per share, subject to change. Proceeds of the sale, less a \$15.00 service fee and applicable transfer taxes, will be forwarded by the agent to the participant within 10 business days after receipt of the participant's request to sell.

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28. *What happens when a participant sells or transfers all of his, her or its certificate and book shares?*

If a participant disposes of all his, her or its certificate and book shares, the agent will continue to reinvest the distributions on his, her or its dividend reinvestment plan shares and the participant may continue to make optional cash payments, unless the participant notifies the agent that he, she or it wishes to terminate his, her or its participation in the plan.

In the event that a participant disposes of his, her or its whole common shares and only a fractional common share remains in the participant's account, the agent is authorized to terminate the account as provided in Question 25.

Other information

29. *May common shares held in the plan be pledged?*

Book shares held in the plan may **not** be pledged and any such purported pledge will be void. A participant who wishes to pledge book shares must request that a certificate for those book shares first be issued in the participant's name.

30. *What happens if ProLogis authorizes a share distribution or splits its shares?*

If there is a distribution payable in common shares or a common share split, the agent will receive and credit to the participant's plan account the applicable number of whole and/or fractional common shares based on the number of dividend reinvestment plan shares.

31. *What happens if ProLogis has a rights offering?*

If ProLogis has a rights offering in which separately tradable and exercisable rights are issued to registered holders of common shares, the rights attributable to whole common shares held in a participant's plan account will be transferred to the plan participant as promptly as practicable after the rights are issued.

32. *How are the participant's common shares voted at shareholder meetings?*

Common shares held for a participant in the plan will be voted at shareholder meetings only as that participant directs. Participants will receive proxy materials from ProLogis. Common shares held in a participant's plan account may also be voted in person at the meeting.

33. *May the plan be suspended or terminated?*

While ProLogis expects to continue the plan indefinitely, ProLogis may suspend or terminate the plan at any time. ProLogis also reserves the right to modify, suspend, terminate or refuse participation in the plan to any person, at any time as described in this prospectus. In addition, ProLogis may modify, suspend, terminate or refuse participation in the plan to any person at any time, if participation, or any increase in the number of common shares held by that person, would, in the opinion of the Board of Trustees of ProLogis, jeopardize the status of ProLogis as a real estate investment trust under the Internal Revenue Code of 1986.

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34. May the plan be amended?

The plan may be amended or supplemented by ProLogis at any time. Any amendment or supplement will only be effective upon notice at least 30 days prior to the effective date thereof. Notice is not required when an amendment or supplement is necessary or appropriate to comply with the rules or policies of the Securities and Exchange Commission, the Internal Revenue Service or other regulatory authority or law, or when an amendment or supplement does not materially affect the rights of participants. The amendment or supplement will be deemed to be accepted by a participant unless prior to the effective date thereof, the agent receives notice of the termination of a participant's plan account. Any amendment may include an appointment by the agent or by ProLogis of a successor bank or agent, in which event ProLogis is authorized to pay that successor bank or agent for the account of the participant all distributions and distributions payable on common shares held by the participant for application by that successor bank or agent as provided in the plan.

35. What happens if the plan is terminated?

If the plan is terminated, whole shares will continue to be held by the agent in book form or distributed to each participant in certificate form at the discretion of ProLogis. Fractional shares will be sold based on the price of the actual trade for the shares and a check representing the value of the fraction of a share will be issued to each applicable participant. A check representing any uninvested distributions or optional cash payments held in the account will also be issued.

36. Who interprets and regulates the plan?

ProLogis is authorized to issue interpretations, adopt regulations and take such action as it may deem reasonably necessary to effectuate the plan. Any action to effectuate the plan taken by ProLogis or the agent in good faith exercise of its judgment will be binding on participants.

37. What law governs the plan?

The terms and conditions of the plan and its operation will be governed by the laws of the State of Maryland.

38. How does the ownership limit set forth in ProLogis' declaration of trust affect purchases of common shares under the plan?

Subject to the exceptions specified in ProLogis' declaration of trust, no shareholder may own, or be deemed to own, more than 9.8% of the number or value of ProLogis' outstanding common shares and preferred shares of beneficial interest. To the extent any reinvestment of distributions elected by a shareholder or investment of an optional cash payment would cause any shareholder, or any other person, to exceed the ownership limit or otherwise violate ProLogis' declaration of trust, the reinvestment or investment, as the case may be, will be void ab initio, and the shareholder will be entitled to receive cash distributions or a refund of his, her or its optional cash payment, each without interest, in lieu of the reinvestment or investment.

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Individual retirement accounts

39. May a participant open an individual retirement account with the agent?

Yes. The agent offers an individual retirement account (IRA) that invests in ProLogis common shares through the plan. After receiving a copy of this prospectus and the agent's IRA trust agreement and disclosure statement, a participant may open an individual retirement account by completing and signing an IRA enrollment form and returning it to the agent with an initial contribution. The minimum initial contribution for the IRA program is \$200. Enrollment forms and trust agreement and disclosure statements are available upon request from the agent.

Some of the options and services generally available to plan participants may not be applicable to the IRA program. Please refer to the IRA trust agreement and disclosure statement for individual retirement account program details.

The three individual retirement account options are:

Traditional Individual Retirement Account

Roth Individual Retirement Account

Coverdell Education Savings Account (formerly known as Education IRA)

The agent has the right to charge reasonable fees for its individual retirement account services. Such fees are described in the IRA disclosure statement as in effect from time to time. To obtain more information about individual retirement accounts, participants may call the agent's IRA department at (800) 472-7428.

Participation in the IRA constitutes a separate agreement between the participant and Computershare. Such agreement is administered by Computershare separate from its administration of the plan, as agent on behalf of ProLogis. ProLogis assumes no responsibility for the operation or administration of the individual retirement account program nor is ProLogis responsible for the contents of the trust agreement or disclosure statements. The trust agreement and disclosure statements do not constitute a part of this prospectus.

FEDERAL INCOME TAX CONSIDERATIONS RELATING TO THE PLAN

Participants are encouraged to consult their personal tax advisors with specific reference to their own tax situations and potential changes in the applicable law as to all U.S. federal, state, local, foreign and other tax matters in connection with the reinvestment of distributions and purchase of common shares under the plan, the participant's tax basis and holding period for common shares acquired under the plan and the character, amount and tax treatment of any gain or loss realized on the disposition of common shares. The following is a brief summary of the material U.S. federal income tax considerations applicable to the plan, is for general information only, and is not tax advice.

Tax consequences of distribution reinvestment

In the case of common shares purchased by the agent from ProLoFinance at Viatrix, a German pharmaceutical firm. From July 1995 to December 2002, he served as Business Unit and Finance & Administration Director for Nike Germany. Prior to Nike, Mr. Rohaly was Symantec's Finance & Administration Officer for Central and Eastern Europe. He received his MBA degree from Rice University, and holds a Bachelor of Science and Business Administration, Magna Cum Laude in Mathematics and Computer Information Systems Management from Houston

Baptist University.

Class II Directors Whose Terms Expire in 2009

Werner Koepf, age 65, has served as a director of SCM since February 2006 and as Chairman of the Board of Directors since March 2007. Mr. Koepf is a director of telent plc (formerly Marconi Corporation), where he serves on the audit, nominations, remunerations and operations review committees. Mr. Koepf also serves as chairman of the supervisory board of telent GmbH. Mr. Koepf is a director of Gemplus International SA and is chairman of the board of directors of PXP Software AG. Mr. Koepf also is an advisor to venture capital firms Techno Venture Management GmbH and Invision AG. From 1993 to 2002, Mr. Koepf held a variety of senior management positions with Compaq Computer Corporation GmbH, including Vice President and General Manager of the General Business Group from 1993 to 1999; Vice President and General Manager of Compaq Europe, Middle East and Africa (EMEA) from 1999 to 2000; and Chief Executive Officer and Chairman for Compaq Computer, EMEA from 2000 to 2001. From 1989 to 1993, Mr. Koepf was Chairman and Chief Executive Officer for European Silicon Structures SA, an ASIC manufacturer. Prior to 1993, Mr. Koepf held various senior management positions at Texas Instruments Inc., including Vice President and General Manager of several divisions of the group. Mr. Koepf received a master's degree in business administration from the University of Munich and a bachelor's degree with honors in electrical engineering from the Technical College in St. Poelten, Austria.

Simon Turner, age 55, has served as a director of SCM since July 2000. Since January 2006, Mr. Turner has served as Group Sourcing Director for consumer electronic retailer DSG international plc. From January 2002 to January 2006, Mr. Turner was Managing Director of the PC World Group of DSG, responsible for operations at PC World, PC World Business and Genesis Communications in the UK and PC City in Europe. From February 1999 to January 2002, Mr. Turner was Managing Director of PC World, a large UK reseller of PCs and PC-related equipment. From December 1996 to February 1999, Mr. Turner was Managing Director of Philips Consumer Electronics, UK and Ireland. Prior to that, he also served as Senior Vice President of Philips Media, Commercial Director of Belling and Company and Group Marketing Manager at Philips Consumer Electronics. Mr. Turner holds a B.S. degree from the University of Surrey.

Directors not Standing for Re-election at Our 2007 Annual Meeting

Dr. Manuel Cubero, 44, has served as a director of SCM since April 2002. In December 2005, Dr. Cubero was named Managing Director for Kabel Deutschland GmbH, the largest cable network operator in Europe. From November 2003 to November 2005, Dr. Cubero served as Vice President, Digital TV for Kabel Deutschland. From January 2002 to October 2003, he was a consultant for the media, IT and telecom markets with Egon Zehnder International, an international management consultant firm based in Hamburg, Germany. From April 2000 to June 2001, he was Managing Director of alloo AG, an Internet gaming company that he co-founded, based in Salzburg, Austria. From January 1994 to March 2000, he held various senior management positions with the Kirch Group, the largest television broadcast company in Germany, including Co-chairman of the commercial module requirements committee of the European Digital Video broadcasting project for five years and Managing Director of the technology investment division of the company. Dr. Cubero holds M.S. and Ph.D. degrees in physics from the Technical University in Darmstadt, Germany and an M.B.A. from INSEAD in Fontainebleau, France.

Robert Schneider, 58, founded SCM in May 1990 as President, Chief Executive Officer, General Manager and Chairman of the Board and served as a director of the Company until his resignation in June 2007. He served as our

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Chief Executive Officer from April 2000 until his resignation in June 2007, and also previously held that position from May 1990 to January 1997. Mr. Schneider served as our President and Chairman of the Board from May 1990 until July 1996, and also served as our Chairman of the Board from January 1997 until April 2000. Prior to founding SCM, Mr. Schneider held various positions at Intel Corporation. He holds a B.S. degree in engineering from HTBL Salzburg and a B.A. degree from the Akademie for Business Administration in Ueberlingen.

To our knowledge, there are no family relationships between any of our directors and any other of our directors or executive officers.

Vote Required and Recommendation of the Board of Directors

At the Annual Meeting, the nominee receiving the highest number of affirmative votes of the shares present in person or represented by proxy at the Annual Meeting and entitled to vote on the election of directors will be elected to our Board of Directors. Abstentions and votes withheld from or against any director will be counted for purposes of determining the presence or absence of a quorum, but have no other legal effect under Delaware law in the election of directors. Stockholders may not cumulate votes in the election of directors.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE CLASS III DIRECTOR NOMINEE NAMED ABOVE

PROPOSAL TWO: APPROVAL OF THE 2007 STOCK OPTION PLAN

General

The Company's stockholders are being asked to approve the SCM Microsystems, Inc. 2007 Stock Option Plan (the 2007 Plan). The Board of Directors of the Company unanimously approved the 2007 Plan on August 1, 2007. The principal provisions of the 2007 Plan are summarized below. This summary is qualified in its entirety by reference to the actual 2007 Plan, a copy of which is attached as Exhibit A to this Proxy Statement.

The 2007 Plan is intended to be the successor to the SCM Microsystems, Inc. 2000 Non-statutory Stock Option Plan, the SCM Microsystems, Inc. Amended 1997 Stock Plan, and the SCM Microsystems, Inc. 1997 Director Option Plan. The 2007 Plan will govern the grant of stock-based awards to our employees, directors and consultants. Its purpose is to promote the interests of the Company by providing eligible persons with the opportunity to acquire a proprietary interest or increase their proprietary interest in the Company as an incentive for them to remain in the service of the Company.

Purpose of Adopting the 2007 Plan

Adoption of the 2007 Plan will provide the Company with the continued ability to provide equity-based compensation to eligible employees, directors and consultants of the Company, thereby aligning their interest with those of the Company's stockholders to increase the Company's value over the long term.

If stockholders approve the 2007 Plan, the Company will use the 2007 Plan to compensate eligible employees, directors and consultants. If stockholders do not approve the 2007 Plan, the Company will continue to be able to grant options to its employees under the 2000 Non-statutory Stock Option Plan to the extent shares remain available for issuance under the plan.

Summary of the Key Terms of the 2007 Plan

The following is a brief description of the 2007 Plan. The full text of the 2007 Plan is attached as Exhibit A to this Proxy Statement, and the following description is qualified in its entirety by reference to the text of the 2007 Plan.

Eligibility. All employees, directors and consultants of the Company or of any parent or any subsidiary of the Company are eligible to receive stock options under the 2007 Plan. Each employee, director or consultant who receives such an option award is an optionholder. Optionholders in the 2007 Plan will receive grants of options at the discretion of the Board as compensation for their services to the Company.

Types of Awards. Non-qualified stock options are the only form of option award that may be granted under the 2007 Plan.

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Administration of the 2007 Plan. The Board shall administer the 2007 Plan unless and until the Board delegates administration to a committee (the Committee). The Board has the power and authority to, among other things: (i) designate eligible participants in the 2007 Plan, (ii) determine the terms, conditions and restrictions applicable to each stock option and shares acquired upon the exercise of a stock option, (iii) approve one or more forms of written agreements specifying the terms and conditions of an individual stock option grant, (iv) interpret the 2007 Plan and establish, amend and revoke rules and regulations to administer the 2007 Plan, (v) amend the 2007 Plan or any option award granted pursuant thereto and (vi) exercise such powers and perform such acts as the Board deems necessary, desirable, convenient or expedient to promote the best interests of the Company that are not in conflict with the provisions of the 2007 Plan. If the Board delegates administration to the Committee, the Committee may exercise, in connection with the administration of the 2007 Plan, any of the powers and authority granted to the Board under the 2007 Plan. The Committee may delegate to a subcommittee any of the administrative powers the Committee is authorized to exercise, subject to such resolutions as may be adopted from time to time by the Board (and references in the 2007 Plan and this summary to the Board shall thereafter be to the Committee or the subcommittee, as applicable). The Board may abolish the Committee at any time and revert in the Board the administration of the 2007 Plan.

Stock Subject to the 2007 Plan. The maximum aggregate number of shares of our Common Stock that may be issued pursuant to stock options under the 2007 Plan may not exceed one million five hundred (1,500,000) shares (the Share Reserve). Any option award will reduce the Share Reserve by one share. Shares of Common Stock covered by options that expire, are cancelled, terminate, or are reacquired by us prior to vesting will revert to or be added to the Share Reserve and become available for issuance under the 2007 Plan. Shares of Common Stock that are not acquired by a holder of an option granted under the 2000 Plan, the 1997 Plan or the 1997 Director Plan shall not revert or be added to the Share Reserve or become available for issuance under the 2007 Plan.

Other Share Limits. No employee shall be eligible to be granted options covering more than 200,000 shares of Common Stock during any calendar year. However, in connection with a new employee, we may grant options for up to an additional 200,000 shares of Common Stock.

Fair Market Value. Generally, fair market value of the Company's Common Stock will be the closing sales price of the Company's Common Stock on any established stock exchange (including the Nasdaq Stock Market) or on the Nasdaq Global Market or Nasdaq Capital Market (if applicable) on the date of determination. On August 31 2007, the fair market value per share of the Company's Common Stock determined on such basis was \$2.87.

Terms and Conditions of Options. The 2007 Plan provides that options must have an exercise price that is at least equal to 100% of the fair market value of our Common Stock on the date the option is granted. To the extent permitted in his or her option agreement and to the extent permitted by law, an optionholder may exercise an option by payment of the exercise price in a number of different ways, including: (i) in cash or by check at the time the option is exercised, or (ii) in the discretion of the Board: (1) by delivery to the Company of other Common Stock, (2) pursuant to a same day sale program to the extent permitted by law, or (3) by some combination of the foregoing. Unless there is a provision to the contrary in the individual optionholder's option agreement, payment for Common Stock pursuant to an option may only be made in the form of cash, check or pursuant to a same day sale program. The vesting of options generally will be determined by the Board.

If an optionholder's continuous service terminates for any reason other than disability, death or misconduct he or she will generally have 90 calendar days from the date of such termination to exercise his or her options (to the extent that the optionholder was entitled to exercise such options as of the date of such termination), unless his or her option agreement provides otherwise. If an optionholder's continuous service terminates as a result of the optionholder's disability or death, he or she will generally have twelve months to exercise (or for his or her estate to exercise) his or her options (to the extent that the optionholder was entitled to exercise such options as of the date of such

termination), unless his or her option agreement provides otherwise. If an optionholder's continuous service is terminated for misconduct, his or her options will immediately terminate, unless his or her option agreement provides otherwise. In no event may an optionholder or estate exercise an option past the expiration of its term as set forth in the option award agreement. The term of each option granted under the 2007 Plan will generally be seven years from the date of grant.

Automatic Options for Non-Employee Directors. The 2007 Plan provides that in addition to any other options that non-employee directors may be granted, non-employee directors will automatically be granted options as

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follows: (i) an initial grant of options to acquire 10,000 shares and (ii) annual grants of options to acquire 5,000 shares. Initial and annual grants will vest as to one-twelfth (1/12th) of the total award each month so that the option is fully vested on the first anniversary of the grant. If an optionholder's status as director terminates for any reason other than death, he or she will have 90 calendar days to exercise his or her options (to the extent that the optionholder was entitled to exercise such options as of the date of such termination). If an optionholder's status as director terminates due to death, his or her estate will have twelve months to exercise his or her options (to the extent that the optionholder was entitled to exercise such options as of the date of such termination).

Acceleration of Option Awards. The Board shall have the power to accelerate exercisability and/or vesting of any option granted pursuant to the 2007 Plan upon a Change in Control (as defined below) or upon the death, disability or termination of continuous service of an optionholder, notwithstanding any provision in any option agreement to the contrary.

Adjustment. The maximum number of shares of Common Stock subject to the 2007 Plan, the maximum number of shares of Common Stock that can be granted to an employee during any fiscal year pursuant to options, and the number of securities and exercise or base price of securities subject to outstanding options will be appropriately and proportionally adjusted by the Board on account of mergers, consolidations, reorganizations, recapitalizations, reincorporations, stock splits, spinoffs, stock dividends, extraordinary dividends and distributions, liquidating dividends, combinations or exchanges of shares, changes in corporate structure or other transactions in which the Company does not receive any consideration (except that conversion of convertible securities of the Company shall not be treated as a transaction in which the Company does not receive any consideration). Subject to any required action by the stockholders, the Board shall make such adjustments and the Board's determinations with respect to any adjustment will be final, binding and conclusive.

Effect of Change in Control. In the event of a Change in Control (as defined below) other than a dissolution or liquidation of the Company, the Board or the board of directors of any surviving entity or acquiring entity may provide or require that the surviving or acquiring entity (a) assume or continue all or any part of the options outstanding under the 2007 Plan or (b) substitute substantially equivalent options for those outstanding under the 2007 Plan. If the outstanding options will not be so continued, assumed, or substituted, then with respect to options held by optionholders whose continuous service has not terminated, the Board in its discretion may (1) provide for payment of a cash amount in exchange for the cancellation of the options, (2) continue the options, or (3) terminate the options upon the consummation of the Change in Control, but only if optionholders have been permitted to exercise any portion of (including at the discretion of the Board, any unvested portion of) any option at or prior to the Change in Control. In the event of a Change in Control involving dissolution or liquidation of the Company, all outstanding options will terminate immediately prior to such dissolution or liquidation.

Definition of "Change in Control" means the occurrence of any of the following: (a) the sale, exchange, lease or other disposition of all or substantially all of the assets of the Company to a person or group of related persons, as such terms are defined or described in Sections 3(a)(9) and 13(d)(3) of the Exchange Act, (b) a merger, consolidation or similar transaction involving the Company, (c) any person or group is or becomes the beneficial owner (as defined in Rule 13d-3 promulgated under the Exchange Act), directly or indirectly, of more than 50% of the total voting power of the voting stock of the Company, including by way of merger, consolidation or otherwise, (d) a change in the composition of the Board occurring within a two-year period, as a result of which fewer than a majority of the directors are either (i) Directors of the Company as of the date the Plan first becomes effective (ii) elected, or nominated for election, to the Board with the affirmative votes of at least a majority of those Directors whose election or nomination was not in connection with any transaction described above or in connection with an actual or threatened proxy contest relating to the election of Directors to the Company or (e) a dissolution or liquidation of the Company.

Amendment and Termination of the 2007 Plan. The Board may amend, suspend or terminate the 2007 Plan in any respect and at any time, subject to stockholder approval, if such approval is required by applicable law or stock exchange rules. Further, any amendment or termination of the 2007 Plan will not materially impair the rights of any optionholder with respect to any options already granted to such optionholder without such optionholder's consent.

Effective Date; Term of the 2007 Plan. The 2007 Plan will become effective immediately upon its approval by the Company's stockholders. Unless earlier terminated by the Board, the 2007 Plan will terminate on the day before the tenth anniversary of the date that the 2007 Plan is approved by the stockholders.

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Tax Consequences of the 2007 Plan

The following discussion of the federal income tax consequences of the 2007 Plan is intended to be a summary of applicable federal law as currently in effect. Foreign, state and local tax consequences may differ and laws may be amended or interpreted differently during the term of the 2007 Plan or of options granted thereunder. Because the federal income tax rules governing options and related payments are complex and subject to frequent change, optionholders are advised to consult their individual tax advisors.

An optionholder is not taxed when a non-qualified stock option is granted. On exercise, however, the optionholder recognizes ordinary income equal to the difference between the option's exercise price and the fair market value of the underlying Common Stock on the date of exercise. Any gain (or loss) on subsequent disposition of the shares of Common Stock acquired through exercise of an option is long-term capital gain (or loss) if the shares are held for at least one year following exercise.

Under Section 162(m) of the Internal Revenue Code, our ability to deduct compensation paid to our chief executive officer, chief financial officer and the three other most highly paid executive officers in a particular year is limited to \$1 million per person, except that compensation that is performance-based, as defined under Section 162(m), will be excluded for purposes of calculating the amount of compensation subject to this \$1 million limitation. Our ability to deduct compensation paid to any other executive officer or employee is not affected by this provision.

New 2007 Plan Benefits

No options have been granted under the 2007 Plan. The effectiveness of the 2007 Plan is dependent upon receiving stockholder approval. The granting of options under the 2007 Plan to employees and consultants is discretionary, and we cannot now determine the number of options to be granted in the future to any particular person or group of employees.

Recommendation of the Board of Directors

The Board unanimously recommends a vote FOR the approval of the SCM Microsystems, Inc. 2007 Stock Option Plan.

**PROPOSAL THREE: RATIFICATION OF THE APPOINTMENT OF
INDEPENDENT REGISTERED PUBLIC ACCOUNTANTS**

Our Audit Committee has appointed Deloitte & Touche, an independent registered public accounting firm, as our independent registered public accountants, to audit our financial statements for the current year ending December 31, 2007. Deloitte & Touche has audited our consolidated financial statements since 1999. At the Annual Meeting, our stockholders are being asked to ratify the appointment of Deloitte & Touche as our independent registered public accountants to audit our financial statements for the current fiscal year ending December 31, 2007. We do not expect that a representative of Deloitte & Touche will be available at the Annual Meeting.

Stockholder ratification of the selection of Deloitte & Touche as our independent registered public accountants is not required by our Bylaws or any other applicable legal requirement. However, the Board is submitting the selection of Deloitte & Touche to the stockholders for ratification as a matter of good corporate practice. In the event that our stockholders fail to ratify the appointment of Deloitte & Touche as independent registered public accountants to audit our financial statements for the current year ending December 31, 2007, our Audit Committee may reconsider its selection. Even if the selection is ratified, the Audit Committee at its discretion may direct the appointment of a different independent accounting firm at any time during the year if it determines that such a change would be in the

best interests of the Company and our stockholders.

Vote Required and Recommendation of the Board of Directors

The affirmative vote of the holders of a majority of the Votes Cast (as defined under "Voting Procedures" on page 1 of this proxy statement) will be required to approve the proposed ratification of Deloitte & Touche as our independent registered public accountants, to audit our financial statements for the current year ending December 31, 2007.

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**THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR
THE RATIFICATION OF THE APPOINTMENT OF
DELOITTE & TOUCHE AS THE COMPANY'S
INDEPENDENT REGISTERED PUBLIC ACCOUNTANTS FOR THE
FISCAL YEAR ENDING DECEMBER 31, 2007**

REPORT OF THE AUDIT COMMITTEE OF THE BOARD OF DIRECTORS

The Audit Committee assists the Board of Directors in fulfilling its responsibility for oversight of the quality and integrity of our financial reporting processes, system of internal control, process for monitoring compliance with laws and regulations, audit process and standards of business conduct. The Audit Committee manages the relationship with our independent registered public accountants, who report directly to the Audit Committee. The Audit Committee also oversees the Internal Audit and Sarbanes-Oxley Compliance functions of SCM, which report directly to the Audit Committee. The Audit Committee has the authority to obtain advice and assistance from outside legal, accounting or other advisors as the Audit Committee deems necessary to carry out its duties and to allocate appropriate funding, as determined by the Audit Committee, for such advice and assistance.

The Audit Committee has reviewed and discussed with management the audited financial statements of SCM for the fiscal year ended December 31, 2006. The Audit Committee also has discussed with Deloitte & Touche, our independent registered public accountants, the matters required to be discussed by Statement on Auditing Standards No. 61, as amended, as adopted by the Public Company Accounting Oversight Board in Rule 3200T.

Furthermore, the Audit Committee has received the written disclosures and the letter from Deloitte & Touche required by Independence Standards Board Standard No. 1, as adopted by the Public Company Accounting Oversight Board in Rule 3600T, and the Audit Committee has discussed the independence of Deloitte & Touche with that firm.

In performing all these functions, the Audit Committee acts only in an oversight capacity and necessarily relies on the work and assurances of our management and independent registered public accountants, which, in their report, express an opinion on the conformity of our annual consolidated financial statements to accounting principles generally accepted in the United States. In reliance on the reviews and discussions referred to in this report, and in light of its role and responsibilities, the Audit Committee recommended to the Board of Directors that the audited financial statements for the three years ended December 31, 2006 be included for filing with the Securities and Exchange Commission in the Company's Annual Report on Form 10-K for the year ended December 31, 2006, and the Board of Directors has approved such inclusion.

AUDIT COMMITTEE OF THE BOARD OF DIRECTORS

Simon Turner, Chairman
Dr. Hagen Hultzsch
Steven Humphreys

Table of Contents**PRINCIPAL ACCOUNTING FEES AND SERVICES**

The aggregate fees billed or to be billed to us for the following professional services for the fiscal years ended December 31, 2006 and December 31, 2005 from Deloitte & Touche, our independent registered public accountants, are as follows (in thousands):

	2006	2005
Audit Fees	\$ 792,501	\$ 1,027,765
Audit-Related Fees		
Tax Fees	26,677	33,075
All Other Fees		
Total	\$ 819,178	\$ 1,060,840

Audit Fees. Audit fees include fees associated with the audit and review of our annual financial statements included in our Annual Report on Form 10-K, reviews of those financial statements included in our quarterly reports on Form 10-Q and services provided in connection with statutory and regulatory filings or engagements.

Audit-Related Fees. Audit-related fees principally include fees for the audits of subsidiaries, due diligence procedures, registration statements and consultations on accounting and auditing matters.

Tax Fees. Tax fees principally include assistance with preparation of federal, state and foreign tax returns, tax compliance, tax planning and tax consulting.

All Other Fees. Represents fees for all other services, including Sarbanes-Oxley consultation and training.

Independent Registered Public Accountants

The appointment of our independent registered public accountants is approved annually by the Audit Committee of our Board of Directors. Deloitte & Touche, an independent registered public accounting firm, has been our auditor since 1999 and was our independent registered public accountants for fiscal year 2006. The Audit Committee of our Board of Directors has appointed Deloitte & Touche as our independent registered public accountants for the fiscal year ending December 31, 2007.

Policy on Audit Committee Pre-Approval of Audit and Permissible Non-Audit Services of Our Independent Registered Public Accountants

In accordance with the charter of the Audit Committee of our Board of Directors, the Audit Committee pre-approves all audit and non-audit services provided by our independent registered public accountants, including the estimated fees and other terms of any such engagement. In certain circumstance, the Audit Committee may provide subsequent approval of non-audit services not previously approved. Services provided by our independent registered public accountants may include audit services, audit-related services, tax services and other services. The Audit Committee considers whether such audit or non-audit services are consistent with the Securities and Exchange Commission rules on auditor independence. The Audit Committee has determined that the services provided by Deloitte & Touche as set forth herein are compatible with maintaining Deloitte & Touche's independence. All audit, audit-related, tax and other

fees set forth in the table above were pre-approved pursuant to this policy.

Table of Contents**SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT****Beneficial Ownership**

The table below sets forth information known to us as of August 31, 2007 with respect to the beneficial ownership of our common stock by:

- (1) each person who is known by us to be the beneficial owner of more than 5% of our outstanding common stock;
- (2) each of our directors;
- (3) each of the Named Executive Officers (as listed below); and
- (4) all of our directors and Named Executive Officers, as a group.

Except as otherwise indicated, and subject to applicable community property laws, to our knowledge, the persons named in the table below have sole voting and investment power with respect to all shares held by them. Applicable percentage ownership in the following table is based on 15,735,615 shares of our common stock outstanding as of August 31, 2007.

Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission. In computing the number of shares beneficially owned by a person and the percentage ownership of that person, shares of common stock subject to options held by that person that are currently exercisable or exercisable within 60 days of August 31, 2007 are deemed outstanding. Such shares, however, are not deemed outstanding for the purpose of computing the percentage ownership of each other person.

Unless specified below, the mailing address for each individual, officer or director is c/o SCM Microsystems, Inc., Oskar-Messter-Str. 13, 85737 Ismaning, Germany.

Name of Beneficial Owner	Shares Beneficially Owned	
	Number	Percent
Royce & Associates, LLC(1) 1414 Avenue of the Americas New York, NY 10019	1,581,425	10.0%
Dimensional Fund Advisors, Inc.(2) 1299 Ocean Avenue, 11 th Floor Santa Monica, Calif., 90401	1,166,659	7.4%
Robert Schneider(3)	802,972	5.0%
Steven Humphreys(4)	97,498	*
Manfred Mueller(5)	74,443	*
Stephan Rohaly(6)	83,128	*
Simon Turner(7)	39,583	*
Dr. Manuel Cubero(8)	29,583	*
Dr. Hagen Hultzsch(9)	29,583	*
Werner Koepf(10)	14,583	*

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All directors and executive officers as a group (8 persons)(11)	1,171,373	7.1%
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* Less than one percent.

- 1) Based solely on information contained in a Schedule 13F filed for the period ending June 30, 2007.
- 2) Based solely on information contained in a Schedule 13F filed for the period ending June 30, 2007.
- 3) Mr. Schneider resigned from SCM effective June 30, 2007 but was still considered to be an insider of the Company as of August 31, 2007, the date for which this table was prepared. The amounts in the table above include (i) 13,510 shares held by Robert Schneider's wife, Ursula Schneider, (ii) options to purchase 2,500 shares of common stock exercisable within 60 days of August 31, 2007 held by Ursula Schneider

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- and (iii) options to purchase 333,775 shares of common stock exercisable within 60 days of August 31, 2007 held by Robert Schneider.
- 4) Includes options to purchase 85,998 shares of common stock exercisable within 60 days of August 31, 2007.
 - 5) Includes options to purchase 55,496 shares of common stock exercisable within 60 days of August 31, 2007.
 - 6) Includes options to purchase 61,875 shares of common stock exercisable within 60 days of August 31, 2007.
 - 7) Consists of options to purchase 39,583 shares of common stock exercisable within 60 days of August 31, 2007.
 - 8) Consists of options to purchase 29,583 shares of common stock exercisable within 60 days of August 31, 2007.
 - 9) Consists of options to purchase 29,583 shares of common stock exercisable within 60 days of August 31, 2007.
 - 10) Consists of options to purchase 14,583 shares of common stock exercisable within 60 days of August 31, 2007.
 - 11) Includes options to purchase 697,559 shares of common stock exercisable within 60 days of August 31, 2007 that may be deemed to be beneficially owned by our directors and certain executive officers. These shares are shown as being held by our directors and officers for purposes of this table only.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Exchange Act requires our executive officers, directors and persons who beneficially own more than ten percent of a registered class of our equity securities (10% stockholders), to file reports on Forms 4 and 5 reflecting transactions affecting their beneficial ownership of our equity securities with the Securities and Exchange Commission and with the National Association of Securities Dealers. Such officers, directors and 10% stockholders are also required by the Securities and Exchange Commission's rules and regulations to provide us with copies of all such reports on Forms 4 and 5 that they file under Section 16(a) of the Exchange Act.

Based solely on our review of copies of such reports on Forms 4 and 5 received by us, and on written representations from our officers, directors and the 10% stockholders known to us, we believe that, with the exception of one Form 4 that was not filed timely for Mr. Schneider, during the period from January 1, 2006 to December 31, 2006, our executive officers, directors and the 10% stockholders known to us filed all required reports under Section 16(a) of the Exchange Act on a timely basis.

Table of Contents**EXECUTIVE OFFICERS**

Information concerning our current and former executive officers, including their backgrounds and ages as of August 31, 2007, is set forth below:

Name	Age	Position(s) Held	Term of Office	Length of Time in Office
Felix Marx	40	Chief Executive Officer (effective November 1, 2007)	Until removed by the Board of Directors	Mr. Marx appointment was announced August 1, 2007
Stephan Rohaly	42	Vice President Finance and Chief Financial Officer; and Acting Chief Executive Officer	Until removed by the Board of Directors	Since March 2006
Dr. Manfred Mueller	37	Vice President Sales EMEA	Until removed by the Board of Directors	Since February 2006
Robert Schneider	58	Former Chief Executive Officer and General Manager	N/A	April 2000 - June 2007
Steven L. Moore	52	Former Chief Financial Officer	N/A	June 2003 - June 2006
Colas Overkott	44	Former Executive Vice President, Sales and Marketing	N/A	November 2002 - January 2006

Felix Marx, age 40, will become our Chief Executive Officer effective November 1, 2007. From 2003 to the present, Mr. Marx has held a variety of management positions with NXP Semiconductors, a specialty semiconductor manufacturer for the smart card industry. Most recently, Mr. Marx has served as General Manager of NXP's Near Field Communication (NFC) business. Prior to this, he served as General Manager of NXP's Contactless & Embedded Security business. From 2002 to 2003, Mr. Marx was a business consultant with Team Training Austria. Prior to this, he worked for several years in the data and voice networking sector, where he held various sales, marketing, product management and business line management positions with companies including Global One Telecommunications and Ericsson. He holds a bachelor's degree in engineering from the Technical Academy in Vienna and a Master of Advanced Studies in Knowledge Management from Danube University in Austria.

Stephan Rohaly, age 42, has served as Vice President Finance and Chief Financial Officer since March 2006. Mr. Rohaly has also served as Acting Chief Executive Officer since the resignation of Robert Schneider on June 30, 2007. Before joining SCM, from February 2003 to February 2006, Mr. Rohaly was Director of Corporate Finance at Viatrix, a German pharmaceutical firm. From July 1995 to December 2002, he served as Business Unit and Finance & Administration Director for Nike Germany. Prior to Nike, Mr. Rohaly was Symantec's Finance & Administration Officer for Central and Eastern Europe. He received his MBA degree from Rice University, and holds a Bachelor of Science and Business Administration, Magna Cum Laude in Mathematics and Computer Information Systems Management from Houston Baptist University.

Dr. Manfred Mueller, age 37, joined SCM Microsystems in August 2000 as Director of Strategic Business Development. From July 2002 to July 2005, he served as Director of Strategic Marketing. He was appointed Vice President of Strategic Business Development in July 2005. He served as Vice President Marketing from February 2006 to April 2007, at which time he was named Vice President Sales, EMEA. Prior to SCM, from August 1998 to July 2000, Dr. Mueller was Product Manager and Business Development Manager at BetaResearch GmbH, the digital TV technology development division of the Kirch Group. Dr. Mueller holds masters and Ph.D degrees in Chemistry from Regensburg University in Germany and an MBA from the Edinburgh Business School of Heriot Watt University in Edinburgh, Scotland.

To our knowledge, there are no family relationships between any of our executive officers and any of our directors or other executive officers.

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EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

General Philosophy/Objectives

The primary goals of our compensation program, including our executive compensation program, are to attract and retain employees whose abilities are critical to our long-term success and to motivate employees to achieve superior performance.

To achieve these goals, we attempt to:

offer compensation packages that are competitive regionally and that provide a strong base of salary and benefits;

maintain a portion of total compensation at risk, particularly in the case of our executive officers, with payment of that portion tied to achievement of specific financial, organizational or other performance goals; and

reward superior performance.

Our compensation program includes salary, performance-based annual or quarterly bonuses, long-term compensation in the form of stock options and various benefits and perquisites.

Role of the Compensation Committee

Our Compensation Committee oversees all aspects of executive compensation. The committee plays a critical role in establishing our compensation philosophy and in setting and amending elements of the compensation package offered to our named executive officers.

The members of the Compensation Committee during fiscal 2006 were Manuel Cubero, Steven Humphreys, Simon Turner and Andrew Vought. Mr. Vought served as chairman of the Compensation Committee until his resignation from the committee on April 12, 2006, at which time Mr. Humphreys was appointed chairman. Each current member of our Compensation Committee is an independent, non-employee director. During 2006, the Compensation Committee met three times.

On an annual basis, or in the case of promotion or hiring of an executive officer, the Compensation Committee reviews and makes recommendations to the Board of Directors regarding the compensation package to be provided to our chief executive officer, our other executive officers and our directors. On an annual basis, the Compensation Committee undertakes a review of the base salary and bonus targets of each of our named executive officers and evaluates their respective compensation based on the committee's overall evaluation of their performance toward the achievement of our financial, strategic and other goals, with consideration given to each executive officer's length of service and to comparative executive compensation data. Based on its review, from time to time the Compensation Committee has increased the salary and/or potential bonus amounts for our executive officers.

The majority of the Compensation Committee's activities in 2006 related to specific situations and near-term goals, including: the hiring of a new chief financial officer; the transition and termination of employees related to cost reductions and to the consolidation of the Company's transfer of corporate finance and compliance functions to Germany; the retention of key personnel during these corporate actions; and implementing incentives to achieve profitability.

During 2006, annual salary levels, target bonus amounts and option amounts for our chief executive officer, former chief financial officer and current chief financial officer were set by the Compensation Committee. Compensation for our other executive officers, including certain of our named executive officers, was generally set by the chief executive officer, subject to approval by the Compensation Committee, and was determined in part based on the outcome of annual performance reviews and on corporate and personal performance under our Management by Objective (MBO) program, which is described below.

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Overview of Compensation Program

SCM was originally formed in Germany in 1990 and has continued to have an active presence in Germany and throughout Europe in our target product markets. Since our initial public offering in October 1997, our common stock has been dually traded on the U.S. NASDAQ stock exchange and the German technology exchange, originally known as the Neuer Markt and now the Prime Standard. As a result, although we are a small company, we have maintained a relatively high level of visibility in the German marketplace and financial markets. Additionally, for the past several years the majority of our executive staff has operated from our European headquarters in Ismaning, Germany, with the exception of the position of chief financial officer. In fiscal 2006, we transferred our corporate financial and compliance functions, including the chief financial officer responsibilities, from the U.S. to Ismaning as well. Currently, all of our executive officers operate out of our headquarters in Germany. Our German corporate culture directly influences the elements of our compensation program.

We do not employ an overall model or policy to allocate among the compensation elements we utilize. In general, we employ cash bonuses to motivate and reward our executive officers for the achievement of quarterly or other short-term performance objectives and we employ annual grants of stock options that vest over time to motivate and reward contributions to the Company's performance over the longer term. From time to time, however, we also utilize stock options with shorter vesting periods to provide additional incentive for the achievement of short-term objectives that are seen as critical to the Company's success, for example the transfer of our corporate functions from the U.S. to Germany during 2006.

While we utilize common elements of compensation for each of our executive officers, each compensation package takes into account the disparate backgrounds and entry points to our company of each of our executive officers. For example, our chief executive officer is also the founder of the Company and as such already owns a significant number of shares in the Company. Therefore, the Compensation Committee elected to include a higher level of cash bonus incentives in the compensation package for our chief executive officer than for our other executive officers.

We believe that our compensation practices, as described below, allow us to achieve an appropriate balance of compensation elements for our executive officers that supports our overall compensation program goals.

Compensation Elements

Base Salary. Base salary provides fixed compensation based on competitive market practice and is intended to acknowledge and reward core competence in the executive role relative to skills, experience and contributions to the Company. Base salaries for executives are reviewed annually, or more frequently should there be any changes in responsibilities.

The Compensation Committee reviewed base salary levels for our chief executive officer and former chief financial officer at the beginning of fiscal 2006. The Compensation Committee considered informal data on salaries of executive officers in similar positions based on: (1) prior access to benchmarking data from the Economic Research Institute and Salary.com; (2) the professional experience of the Compensation Committee and Board members; (3) the recommendations of management; and (4) knowledge of the specific needs of SCM at the time and in the foreseeable future. In setting executive salaries, the committee also considered each officer's salary history, scope of responsibility, prior experience and past performance, and also considered recommendations from management. Based on its evaluation, the Compensation Committee determined that salary levels for our chief executive officer and former chief financial officer should be set around the median level for companies of similar size, and left unchanged their respective annual base salaries. The Compensation Committee conducted a similar evaluation to set the salary of the current chief financial officer when he joined the Company in March 2006.

Incentive Cash Bonuses. Incentive cash bonuses are intended to motivate and reward executives for their contributions towards achieving corporate performance targets as well as specific corporate objectives that support the Company's short-term goals. During 2006, key goals of the Company were to complete the transfer of operational functions from Singapore to outside contract manufactures and to effect the additional transition of our corporate financial and compliance functions from the U.S. to Germany; to complete a transaction to sell the Company's Digital TV solutions business; and to significantly reduce fixed operating expenses. Therefore,

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incentive bonuses in 2006 were designed to reward not only corporate performance, but also the achievement of specific operational and strategic goals within areas under control of the relevant employees.

During 2006, our chief executive officer and our former chief financial officer were eligible to receive annual incentive cash bonuses based on specific criteria set by the Compensation Committee, while our other executive officers were eligible to receive incentive cash bonuses on a quarterly basis, based on criteria established in collaboration with the chief executive officer and approved by the Compensation Committee under our Management by Objective, or MBO plan. Under the MBO Plan, each participant is eligible to receive a quarterly cash bonus, of which 50% is based on the participant's performance against specific personal objectives approved by the Compensation Committee, and 50% is based on the achievement of corporate performance targets, established by management and approved by the Board of Directors. The amount of quarterly bonus for which each participant is eligible varies by participant and for our current executive staff ranged from 16.67% to 30% of base salary in 2006.

Bonus Structure for Chief Executive Officer

At the beginning of fiscal 2006 the Compensation Committee established a target cash bonus for Robert Schneider, our chief executive officer, equal to 50% of his base salary, or 175,000. Payment of the bonus was based on the achievement of three, equally weighted, performance related criteria: an annual revenue target, quarterly operating performance targets and the judgment of the Compensation Committee. Additionally, the Compensation Committee established a target bonus of 20,000 tied to the achievement of operating profit in the fourth quarter of 2006.

Bonus Structure for Former Chief Financial Officer

Steven Moore, our former chief financial officer, was eligible to receive a target cash bonus of up to 50% of his annual base salary, or \$100,000, based on criteria established by the chief executive officer. Additionally, the Compensation Committee established an additional target bonus of \$75,000 for Mr. Moore for the successful sale of the Company's Digital TV solutions business.

Bonus Structure for Other Executives

The Compensation Committee established a target cash bonus for Colas Overkott, our former vice president, sales and marketing, of \$100,000 for the successful sale of the Company's Digital TV solutions business. Due to his departure from the Company in January 2006, Mr. Overkott did not participate in the MBO program during 2006.

During 2006, Stephan Rohaly, our chief financial officer beginning in March 2006, and Manfred Mueller, our vice president marketing in 2006, were eligible to receive quarterly cash incentive bonus awards under our MBO program, based on the achievement of equally weighted personal objectives and corporate performance. Corporate performance criteria included the achievement of equally weighted net sales and gross profit margin targets set by the Board of Directors. In light of the Company's focus during 2006 on major restructuring efforts, including the transfer of its corporate finance compliance functions from the U.S. to Germany and the sale of a major component of its business, the Compensation Committee waived some of the criteria for corporate performance in 2006 in the determination of MBO payments to eligible executive officers. Corporate performance results for the purposes of MBO payments during 2006 were 87%, 87%, 73% and 100% for the four fiscal quarters respectively.

Mr. Rohaly was eligible to receive quarterly cash bonus awards of up to 30% of his base salary in 2006. The personal performance component of his target bonus was evaluated against key objectives including:

supporting the transition of the Company's corporate financial functions from the U.S. to Germany;

building up corporate finance capabilities in Germany; and

reducing operating expenses, including developing a framework to plan, execute and measure cost reduction activities.

The Compensation Committee determined that Mr. Rohaly achieved 100% performance against his personal objectives in each of the three quarters of 2006 in which he was measured.

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Dr. Mueller was eligible to receive quarterly cash bonus awards of up to 16.67% of his base salary in 2006. The personal performance component of his target bonus was evaluated against key objectives related to the Company's transfer of manufacturing operations from Singapore to contract manufacturers and to the reduction of overall expenses, including:

increasing product margins through inventory reduction, competitive component sourcing and product design cost reductions;

supporting development of new processes to manage external contract manufacturers; and

reducing sales and marketing program costs.

The Compensation Committee determined that Dr. Mueller achieved 88% performance against his personal objectives the first quarter; 100% in the second quarter, plus 50% of an additional target bonus tied to the objectives listed above; 40% in the third quarter, plus 20% of an additional target bonus tied to the objectives listed above; and 100% in the fourth quarter of 2006. Dr. Mueller was further awarded a one-time bonus of \$3,600 in the third quarter of 2006 because it was determined that Dr. Mueller's performance had in fact been superior but that Dr. Mueller had not been able to achieve some of his objectives during the third quarter due to changes in the Company's priorities during the period.

Long-Term Equity Incentives. Our stock option program is designed to attract, retain and reward talented employees and executives through long-term compensation that is directly linked to long-term performance. As the bulk of our employees are in Germany and India, where stock options are not commonly awarded to non-executive employees, we regard stock options as a competitive tool in our overall compensation program.

We grant equity incentives in the form of stock options to each of our executive officers, at the time of hiring, on an annual basis and from time to time as an incentive to achieve specific performance objectives.

We grant stock options to our executive officers when they are hired and grant additional top-up options on an annual basis. The number of stock options granted to newly hired executive officers is determined by the Compensation Committee, based on the Company's historical practices and on the position of the new executive. Initial options vest 1/4th after one year and then 1/48th per month for the next three years, at which time they are fully vested. Annual top-up grants are made based on the positive results of annual performance reviews and are generally in an amount ranging between 25% and 33% of the options received in the executive officer's initial grant. Annual top-up options must be held for four years before they begin to vest, and then vest at a rate of 1/12 per month over one year. As options are granted annually, some portion of an executive officer's options vest each year, rewarding the executive for past service, while an often greater portion remains unvested, creating a long-term incentive to remain with the Company.

In 2006, the Compensation Committee determined that special one-year vesting, performance-based option grants also should be given to senior management as incentive awards for the achievement of specific goals related to operating margin targets for the fourth quarter of 2006.

The exercise price of all options awarded is the closing price of our stock on the NASDAQ Stock Market on the date of grant.

Benefits and Perquisites. Because we have a strong regional presence in Germany and the majority of our executives and key employees have been based in Germany, we follow the standard European practice of providing either a company car or a car allowance to our executive officers in Germany. We lease BMW cars or provide a comparable

allowance for our executive officers.

Retirement Payments. On behalf of our executive officers in Germany we make payments to a government-managed pension program, to government-managed or private health insurance programs, and in some cases for unemployment insurance, as mandated under German employment law. During 2006 we also made payments on behalf of our U.S.-based former chief financial officer for health and disability insurance and 401(k) retirement savings.

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Severance Benefits

We do not have a policy regarding severance or change of control agreements for our executive officers and historically we have not offered severance as part of our employment contracts. Under standard employment practice in Germany, notice of termination is required to be given by either the employer or the employee, generally six months before any termination, and the employer is required to continue to compensate the employee during this period. In lieu of continuing the employment relationship for six months, our employment agreements provide that we can cash out the employee who has given notice. Alternatively, we can require that the employee continue to work his or her six month notice period. This practice is included in the majority of our employment agreements with our executive officers.

In recognition of the additional risks involved and the additional effort and commitment required from our executive officers due to our various restructuring and strategic actions in 2006, during the year we entered into employment agreements containing severance or change of control provisions with each of our current executive officers, as well as with our former executive vice president, sales and marketing and our former chief financial officer.

The purpose of these agreements was to provide additional incentives for each executive officer to remain with the Company during a challenging time and to motivate our executive officers to work towards those strategic initiatives that were determined to be in the best long-term interests of the Company and of our stockholders, even if not beneficial to individual executive officers.

2007 Executive Bonus Plan

On April 12, 2007, the Board of Directors approved a new Executive Bonus Plan for 2007 (the 2007 Plan) as recommended by the Compensation Committee. The 2007 Plan was effective as of January 1, 2007.

Payments under the 2007 Plan are based both on the achievement of quarterly operating profit by the Company and on the achievement of aggregate annual operating profit by the Company. Under the Plan, operating profit is defined as gross margin, less research and development, sales and marketing, and general and administrative expenses, as well as various expenses determined by the Company to be extraordinary.

Under the 2007 Plan, certain executive officers of the Company are eligible to receive quarterly cash bonuses amounting to 10% of their respective annual base salaries, if the Company achieves operating profit for that quarterly period. The maximum amount that any executive officer may earn in quarterly bonus payments in the fiscal year is 40% of his respective annual base salary.

All executive officers are also eligible to receive additional variable bonuses under the 2007 Plan amounting to between 20% and 40% of their respective annual base salaries, based upon the achievement by the Company of the following annual operating profit targets:

20% of annual base salary will be paid if the Company records at least \$1.0 million of annual operating profit;

30% of annual base salary will be paid if the Company records at least \$1.5 million of annual operating profit; and

40% of annual base salary will be paid if the Company records at least \$2.0 million of annual operating profit.

The maximum amount that any executive officer may earn in combined quarterly and annual bonus payments under the 2007 Plan in the fiscal year is 80% of his respective annual base salary.

Executive officers eligible to participate in the 2007 Plan with respect to both the quarterly and annual bonus components are the Chief Executive Officer and the Chief Financial Officer.

Dr. Manfred Mueller, vice president sales EMEA, is eligible to receive an annual bonus payment under the 2007 Plan. Dr. Mueller is also eligible to receive a quarterly bonus under the 2007 Plan for the first quarter of 2007, during which he served as vice president marketing. As a result of Dr. Mueller's promotion to vice president sales

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EMEA on April 1, 2007, however, for the second, third and fourth quarters of 2007, Dr. Mueller is not eligible to receive quarterly bonuses under the 2007 Plan but instead is eligible to receive quarterly bonus payments under the Company's Sales Commission Plan.

Under the Company's Sales Commission Plan, for the second, third and fourth quarters of 2007, Dr. Mueller is eligible to receive a quarterly bonus payment of up to 10% of his annual base salary, two-thirds of which will be based on the achievement of quarterly revenue targets set forth in the Company's budget and sales forecasts and typically approved by the Board at the beginning of the year, and one-third of which will be based upon the achievement of quarterly sales management objectives typically approved by the Compensation Committee at the beginning of each quarter.

Summary of Executive Compensation in 2006

The following table sets forth certain information with respect to the compensation of our Chief Executive Officer, Chief Financial Officer and the three most highly compensated executive officers other than the CEO and CFO, based on total compensation excluding change in pension value and nonqualified deferred compensation earned during fiscal year 2006, for their services with us in all capacities during the 2006 fiscal year.

Summary Compensation Table

Name and Principal Position	Year	Salary (\$)	Bonus (\$)	Stock Awards (\$)	Option Grants (\$)(1)(2)	Non-Equity Qualified		All Other Compensation (\$)	Total (\$)
						Plan Compensation (\$)(3)	Change in Pension Value and Non- Qualified Deferred Earnings (\$)(4)		
Robert Schneider Chief Executive Officer (14)(15)	2006	\$ 435,406			\$ 17,978	\$ 217,277(4)		\$ 89,474(9)	\$ 760,135
Stephan Rohaly Chief Financial Officer (14)(16)	2006	\$ 200,896			\$ 27,303	\$ 57,353(5)		\$ 19,693(10)	\$ 305,245
Steven L. Moore Former Chief Financial Officer(17)	2006	\$ 77,692			\$ 40,508	\$ 116,667(6)		\$ 252,889(11)	\$ 487,756
Dr. Manfred Mueller Vice President Marketing (14)(18)	2006	\$ 178,386			\$ 19,797	\$ 35,637(7)		\$ 35,133(12)	\$ 268,953
Colas Overkott Former Executive Vice President, Sales and Marketing (14)(19)	2006	\$ 31,719				\$ 100,000(8)		\$ 221,927(13)	\$ 353,646

Option Awards

1) The amounts in this column represent the dollar amount recognized for financial statement reporting purposes with respect to the fiscal year in accordance with SFAS 123(R). These amounts may reflect options granted in years prior to 2006. See Note 2 to the financial statements in our Annual Report on Form 10-K for the year ended December 31, 2006 for more information about how we account for stock based compensation.

2) Reflects both time-based initial or annual options as well as performance-based options to purchase shares of the Company's stock granted under our 1997 Stock Option Plan and our 2000 Stock Option Plan, as discussed in Compensation Discussion and Analysis under Compensation Elements: Long-Term Equity Incentives.

Non-Equity Incentive Plan Compensation

3) Reflects cash bonus awards earned under our 2006 Executive Bonus Plan, in the case of Messrs. Schneider and Moore, and under our Management by Objective Plan, in the case of Mr. Rohaly and Dr. Mueller. Also reflects performance-based bonuses tied to the achievement of specific goals established or approved by the Compensation

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Committee. Also discussed in Compensation Discussion and Analysis under Compensation Elements: Incentive Bonuses.

4) Reflects a cash bonus of 146,000 earned in 2006 and paid in 2007, based on a target bonus equal to 50% of Mr. Schneider's annual base salary, or 175,000, as determined by the Compensation Committee for Mr. Schneider at the beginning of fiscal 2006. The performance criteria related to Mr. Schneider's 2006 target bonus comprised three categories, each equal in value: an annual revenue target, quarterly operating performance targets and the judgment of the Compensation Committee. The amount of the cash bonus award of 146,000 was made based on Compensation Committee's determination that Mr. Schneider achieved 100% of the annual revenue target, 50% of the quarterly operating performance targets and 100% of the portion of the bonus related to the Compensation Committee's judgment. Also reflects a cash bonus of 20,000 based on the Company's achievement of operating profit in the fourth quarter of 2006.

5) Reflects quarterly performance bonus awards under the Company's Management by Objective Program. Also discussed in Compensation Discussion and Analysis under Compensation Elements: Bonus Structure for Other Executives.

6) Reflects a performance bonus award of \$41,867, which is the prorated portion of Mr. Moore's total potential performance bonus of \$100,000, related to the achievement of objectives established by the Compensation Committee. Also reflects a bonus of \$75,000 for Mr. Moore's contributions related to sale of the Company's Digital TV solutions business.

7) Reflects quarterly performance bonus awards under the Company's Management by Objective program and a discretionary bonus awarded to Dr. Mueller for the third quarter of 2006. Also discussed in Compensation Discussion and Analysis under Compensation Elements: Bonus Structure for Other Executives.

8) Reflects a bonus of \$100,000 for Mr. Overkott's contributions related to sale of the Company's Digital TV solutions business.

All Other Compensation

9) Reflects a payment of \$80,000 related to Mr. Schneider's agreement to accept certain restrictions to his ability to compete with Kudelski S.A. and its subsidiaries after SCM's sale of the Digital TV solutions business to Kudelski S.A. Also reflects payments of 2,175 and 5,522 made on Mr. Schneider's behalf in 2006 for pension and health insurance, respectively.

10) Reflects payments of 3,504, 2,339 and 9,807 made on Mr. Rohaly's behalf in 2006 for pension and employee saving contributions, health and unemployment insurance and car allowance and leasing expenses, respectively.

11) Reflects a severance payment of \$200,000 following Mr. Moore's departure from the Company in June 2006. Also reflects a payment of \$34,181 for accrued but unused vacation and payments of \$18,708 made on Mr. Moore's behalf for health and disability insurance coverage and under the Company's 401(k) matching program.

12) Reflects payments of 6,462, 4,502 and 17,227 made on Dr. Mueller's behalf in 2006 for pension and employee saving contributions, health and unemployment insurance and car leasing expenses, respectively.

13) Reflects a severance payment of \$220,000 following Mr. Overkott's departure from the Company in January 2006. Also reflects payments of 491 and 1,118 made on Mr. Overkott's behalf for pension and unemployment insurance and car leasing expenses, respectively.

Exchange Rate

14) Messrs. Schneider, Rohaly and Overkott and Dr. Mueller are paid in local currency, which is the euro. Due to fluctuations in exchange rates during the year, amounts in U.S. dollars varied from month to month. Amounts shown in dollars under Salary and All Other Compensation above were derived using the following average exchange rates: 0.835 per dollar for the first quarter, 0.811 per dollar for the second quarter, 0.786 per dollar for

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the third quarter and 0.785 per dollar for the fourth quarter. Amounts shown in dollars under Non-Equity Incentive Plan Compensation were derived using exchange rates that correspond to the period in which award payments were made, generally the quarter after they were earned, and are as follows: 0.811 per dollar for the second quarter of 2006, 0.786 per dollar for the third quarter of 2006, 0.785 per dollar for the fourth quarter of 2006 and 0.764 per dollar for the first quarter of 2007.

Salary

15) Mr. Schneider was paid a base salary of 350,000 in 2006.

16) Mr. Rohaly joined the Company in March 2006 at a base salary of 200,000, of which he received a prorated amount of 160,000 for 2006.

17) Mr. Moore served as our Chief Financial Officer until March 2006, at which time the Company announced its decision to move its corporate finance functions from the U.S. to Germany. Mr. Moore remained with the Company until June 2006. Mr. Moore's base salary was \$200,000, of which he received a prorated payment of \$77,692 for 2006.

18) In January 2006 Dr. Mueller was promoted to Vice President Marketing and was named an executive officer of the Company. During 2006 Dr. Mueller's base salary was raised from 138,333 to 145,000, and his total salary payments were 143,333.

19) Mr. Overkott served as our Executive Vice President, Sales and Marketing until January 2006, at which time he left the Company. Mr. Overkott's base salary was 200,000, for which he received a prorated payment of 10,480 in 2006.

The following table sets forth certain information with respect to the grant of non-equity and equity incentive plan awards under our quarterly and annual bonus programs and our stock option plans.

Grant of Plan-Based Awards in Fiscal 2006

Name	Grant Date	Approval Date	Estimated	Estimated	All Other Option Awards; Number of Securities Underlying Options(#)(2)	Exercise or Base Price of Option Awards (\$/share)	Grant Date Fair Value of Stock and Option Awards(\$)(3)
			Future Payouts Under Non-Equity Plan Awards(1) Target(\$)	Future Payouts Under Equity Incentive Plan Awards(2) Target (#)			
Robert Schneider Chief Executive Officer	12/11/2006	12/09/2006	\$ 328,782(5)	50,000(4)		\$ 3.27	\$ 82,690
Stephan Rohaly	3/14/2006				30,000(6)	\$ 3.21	\$ 54,648

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Chief Financial Officer	9/28/2006		50,000(4)		\$ 3.41	\$ 89,125
		\$ 61,406(5)				
Steven L. Moore Former Chief Financial Officer	None	\$ 175,000	None	None	None	None
Dr. Manfred Mueller Vice President Marketing	2/2/2006			5,000(7)	\$ 3.23	\$ 9,165
	7/5/2006			6,200(8)	\$ 3.03	\$ 9,820
	9/28/2006	\$ 38,097(5)	20,000(4)		\$ 3.41	\$ 35,650
Colas Overkott Former Executive Vice President, Sales and Marketing	None	None	None	None	None	None
		\$ 100,000				

1) Refers to the potential payouts for 2006 under our 2006 Executive Bonus Plan, our Management by Objective Plan, bonuses tied to the sale of our Digital TV solutions business, and additional performance bonus targets established during 2006, as further discussed in Compensation Discussion and Analysis. Actual bonus amounts

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paid to our executives for 2006 are shown in the Non-Equity Incentive Plan Compensation column of the Summary Compensation Table.

- 2) We grant options to our executives under our 1997 Stock Option Plan and our 2000 Stock Option Plan. All options have an exercise price that is the closing price of our common stock on the NASDAQ stock market on the date of grant and expire ten years from the date of grant.
- 3) The grant date fair value of the options awards is calculated using the Black Scholes valuation model using the following assumptions: a dividend rate of zero, interest rate of approximately 4.81%, an expected option life of 3.92 years, and volatility of approximately 67%. See Note 2 to the financial statements in our Annual Report on Form 10-K for the year ended December 31, 2006 for more information about how we account for stock based compensation.
- 4) Reflects performance-based incentive options tied to the achievement of operating profit in the fourth quarter of 2006. These options vest 100% one year from the date of grant.
- 5) Amounts shown in dollars are converted from euros, in which currency our German-based executives are paid, and were derived using exchange rates that correspond to the period in which award payments would typically be made, which generally is the quarter after they were earned. Exchange rates used in this conversion are therefore: 0.811 per dollar for the second quarter of 2006, 0.786 per dollar for the third quarter of 2006, 0.785 per dollar for the fourth quarter of 2006 and 0.764 per dollar for the first quarter of 2007.
- 6) Reflects initial options to purchase shares of our common stock, granted upon joining the Company. These options vest 25% one year from the date of grant and then vest 1/48th per month for 36 months.
- 7) Reflects options awarded for promotion, which vests 100% one year from date of grant.
- 8) Reflects annual top-up options that vest 1/48th per month commencing on the fourth anniversary of the date of grant.

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The following table sets forth certain information with respect to the outstanding equity awards held by the named executive officers at the end of 2006.

Outstanding Equity Awards at Fiscal Year-End

Name	Number of Securities		Option Awards Equity Incentive Plan Awards:		
	Number of Securities Underlying Unexercised Options (#)	Number of Securities Underlying Unexercised Options (#)	Number of Securities Underlying Unexercised Options (#)	Option Exercise Price (\$)	Option Expiration Date
Robert Schneider	35,000	0		\$ 8.10	6/10/2007
Chief Executive Officer	85,000	0		\$ 9.50	8/11/2007
	30,000	0		\$ 30.00	10/9/2008
	30,000	0		\$ 45.5625	7/21/2009
	30,000	0		\$ 52.6250	7/26/2010
	4,811	0		\$ 4.68	12/1/2010
	18,000	0		\$ 8.08	7/17/2011
	31,604	0		\$ 8.08	7/17/2011
	0	15,601(1)		\$ 3.31	4/16/2013
	0	15,000(1)		\$ 2.78	9/16/2014
	69,360	0		\$ 2.78	9/16/2014
	0	15,000(1)		\$ 3.08	7/27/2015
	0	50,000(2)		\$ 3.27	12/11/2016
Stephan Rohaly	0	30,000(3)		\$ 3.21	3/14/2016
Chief Financial Officer	0	50,000(2)		\$ 3.41	9/28/2016
Steven L. Moore	None	None			
Former Chief Financial Officer(4)					
Dr. Manfred Mueller	20,000	0		\$ 8.08	7/17/2011
Vice President Marketing	0	3,329(1)		\$ 3.31	4/16/2013
	3,832	0		\$ 3.31	4/16/2013
	0	6,000(1)		\$ 2.78	9/16/2014
	5,000	0		\$ 2.78	9/16/2014
	0	6,000(1)		\$ 3.08	7/27/2015
	0	5,000(2)		\$ 3.23	2/02/2016
	0	6,200(1)		\$ 3.03	7/05/2016
	0	20,000(2)		\$ 3.41	9/28/2016

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Colas Overkott Former Executive Vice President, Sales and Marketing(5)	46,041	18,989(3)	\$	3.87	1/29/2013
	0	10,000(1)	\$	2.78	9/16/2014
	25,610	0	\$	2.78	9/16/2004

- 1) Vests 1/12th per month over one year, commencing four years from date of grant.
- 2) Vests 100% one year from date of grant.
- 3) Vests 25% after one year, then 1/48th vests monthly for 36 months.
- 4) Mr. Moore left SCM in June 2006. As of December 31, 2006, all previously granted but unexercised options had been exercised or canceled.
- 5) Mr. Overkott left SCM in January 2006. The period during which Mr. Overkott was allowed to exercise his options was extended through December 31, 2006. As of January 1, 2007, all previously granted but unexercised options had been canceled.

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The following table sets forth certain information with respect to options exercised by the named executive officer and stock that vested during fiscal year 2006.

Option Exercises and Stock Vested in Fiscal Year 2006

Name	Option Awards	
	Number of Shares Acquired on Exercise (#)	Value Realized Upon Exercise (\$)
Robert Schneider Chief Executive Officer	None	
Stephan Rohaly Chief Financial Officer	None	
Steven L. Moore Former Chief Financial Officer	10,000	\$ 1,470
Dr. Manfred Mueller Vice President Marketing	None	
Colas Overkott Former Executive Vice President, Sales and Marketing	None	

Pension Benefits

We do not offer pension benefits and have, therefore, omitted the Pension Benefits table. As described in Compensation Discussion and Analysis, on behalf of our executives in Germany we make payments to a government-managed pension program, to government-managed or private health insurance programs, and in some cases for unemployment insurance, as mandated under German employment law. These payments were detailed under the All Other Compensation column of the summary compensation table. Any use of the term pension in the Compensation Discussion and Analysis or the related tables are references to the government-managed pension program.

Termination / Change in Control Payments

We have entered into employment agreements containing severance or change of control provisions with each of our current executive officers, and also had agreements in place with Colas Overkott, our former Executive Vice President, Sales and Marketing, who left our employ in January 2006, and with Steven L. Moore, our former Chief Financial Officer, who left our employ in June 2006. Below are the material terms of each agreement. None of our current or former executive officers included below are of retirement age and none of their respective agreements contain provisions for additional payments upon retirement. The Company does not offer our executive officers severance benefits in the case of death, disability or voluntary termination.

Employment Agreements with Robert Schneider

Through our wholly owned subsidiary, SCM Microsystems GmbH, on August 26, 1993 we entered into an employment agreement with Robert Schneider, our Chief Executive Officer, pursuant to which he serves as managing director of our German subsidiary. The agreement continues for an indefinite term and each party may terminate the agreement at any time with six to twelve months notice.

On May 22, 2006, SCM Microsystems GmbH entered into an amended employment agreement with Mr. Schneider pursuant to which Mr. Schneider would be entitled to receive severance, in part, for his signing a Restrictive Covenant

that imposes certain restrictions on Mr. Schneider's ability to compete with Kudelski S.A., the company to which we sold our Digital TV solutions business in May 2006. Pursuant to his amended employment agreement, Mr. Schneider also received a one-time signing bonus of \$80,000 in May 2006. Under Mr. Schneider's amended employment agreement, if we were to terminate Mr. Schneider's employment without cause or if Mr. Schneider were to resign within 90 days of an event constituting good reason (defined as a material diminution in Mr. Schneider's title, reporting relationships, or scope of responsibilities or authorities without his written consent), Mr. Schneider would be entitled to receive monthly payments equal to his then-current monthly base salary payment for 24 months following his departure from us. Had Mr. Schneider been terminated as of December 31, 2006, the total severance amount payable would have been 700,000, or approximately \$900,901, based on the average exchange rate for December 2006 of one dollar being equal to 0.777 euros. The right to receive

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the monthly severance payments is subject to Mr. Schneider's agreement to abide by the Restrictive Covenant as described above, as well as a general release of claims in customary form by Mr. Schneider and his continued compliance with SCM's policies on confidentiality of operational and business secrets. Mr. Schneider is furthermore subject to a non-compete provision for a period of one year after the termination of his employment with us.

On June 18, 2007, SCM Microsystems, Inc. and its wholly-owned subsidiary SCM Microsystems GmbH entered into a resignation and severance agreement with Robert Schneider. Under the terms of the Resignation Agreement, effective June 30, 2007 (the Termination Date), Mr. Schneider resigned from all of his positions with the Company, including chief executive officer and director of SCM and managing director of SCM GmbH, and terminated his employment with the Company. Following the Termination Date, Mr. Schneider became entitled to receive monthly payments equal to his current gross monthly salary of EUR 29,166.67 for a period of thirty (30) months, for a total amount of EUR 875,000, or approximately US\$1,183,087.50 based on an average exchange rate for June 2007 of 1 Euro = US\$1.3521. Mr. Schneider will also be entitled to receive a bonus for the period of fiscal 2007 prior to the Termination Date, the amount of which shall be determined by the Board of Directors of SCM or the Compensation Committee of the Board, and shall be paid in accordance with the Company's executive bonus plan dated April 12, 2007. In May 2007, he received a bonus of EUR 35,000, or approximately US\$45,822 based on the average exchange rate for the three months ended March 31, 2007 of Euro 1 = USD 1.3092, based on the Company's achievement of operating profit in the first quarter. No bonus will be payable for any period after the Termination Date. All of Mr. Schneider's outstanding unvested stock options will continue to vest, in accordance with their respective vesting schedules, through December 31, 2007, and all vested and outstanding stock options will be exercisable until March 31, 2008, at which time they will expire and be canceled.

Employment Agreements with Stephan Rohaly

On March 14, 2006, through our wholly owned subsidiary, SCM Microsystems GmbH, we entered into an employment agreement with Stephan Rohaly, who became our Chief Financial Officer on March 21, 2006. Either Mr. Rohaly or SCM Microsystems GmbH may terminate the agreement and Mr. Rohaly's employment with us upon at least six months' prior written notice.

On December 12, 2006, through SCM Microsystems GmbH, we entered into a supplemental employment agreement (the Supplement) with Mr. Rohaly, which provides Mr. Rohaly with the right to a severance payment under various circumstances following a Take Over of the Company, which is defined in the Supplement as the completed acquisition of the majority of voting stock of SCM Microsystems, Inc. or the completed acquisition of all or substantially all assets of the Company by a third party buyer.

Pursuant to the Supplement, Mr. Rohaly is eligible to receive a one-time severance payment equal to 174,000 in the event that we, or the buyer in a Take Over, terminate Mr. Rohaly's employment for any reason other than severe and avoidable conduct or for cause within six months of such Take Over (the Notice Period). The severance amount is payable in a lump sum, through SCM Microsystems GmbH. The supplement further provides that Mr. Rohaly is eligible to receive the Severance Amount if, during the Notice Period following a Take Over, he gives ordinary notice of termination of his employment due to either a significant change in his tasks and responsibilities that is unacceptable to Mr. Rohaly, or a change in his place of employment to a location outside of Europe or to a location within Europe that is more than 100 kilometers from an international airport.

Mr. Rohaly's rights to any Severance Amount provided for by the Supplement shall be terminated if, during the Notice Period, the Company, the buyer in a Take Over, or an affiliate of either, offers Mr. Rohaly a position with the surviving company that is monetarily similar or better compared to his current position and within Europe and not more than 100 kilometers from an international airport, regardless of whether or not he accepts such an offer. Had Mr. Rohaly been terminated due to a Take Over at the end of fiscal 2006, he would have been entitled to receive

approximately \$223,938, based on the average exchange rate for December 2006 of one dollar being equal to 0.777 euros.

Following any termination, under his employment agreement, Mr. Rohaly agrees to keep as secret all confidential information related to SCM, including but not limited to operational and business secrets.

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Employment Agreement with Dr. Manfred Mueller

On June 8, 2006, through our wholly owned subsidiary, SCM Microsystems GmbH, we entered into an amended employment agreement with Dr. Manfred Mueller, our vice president of marketing during 2006 and currently our Vice President Sales, EMEA. Either Dr. Mueller or SCM may terminate the agreement and Dr. Mueller's employment with us upon at least six months' prior written notice. Should Dr. Mueller be terminated without cause, he is entitled to receive a severance payment at the time of termination equal to 12 months of his then-current base salary and target bonus, payable in a lump sum by SCM Microsystems GmbH. If Dr. Mueller had been so terminated at the end of fiscal 2006 he would have been entitled to 169,172, or approximately \$217,725, based on the average exchange rate for December 2006 of one dollar being equal to 0.777 euros.

Following any termination, under his employment agreement, Dr. Mueller agrees to keep as secret all confidential information related to SCM, including but not limited to operational and business secrets.

Employment and Separation Agreements with Colas Overkott

In January 2006, we entered into a separation agreement with Mr. Overkott. Mr. Overkott left his position as executive vice president, sales and marketing with us effective January 15, 2006. Under the separation agreement, Mr. Overkott received a severance payment of approximately \$220,000. In addition, the period during which he was able to exercise his SCM stock options was extended through December 31, 2006, subject to the provisions of our employee stock option plan. Under the separation agreement, Mr. Overkott continued to provide limited support to SCM on various matters through the end of February 2006.

Employment Agreement with Steven L. Moore

In January 2006, we entered into an employment agreement with Steven L. Moore, formerly our Chief Financial Officer until March 21, 2006. Under the agreement, if SCM were to terminate Mr. Moore without cause or if Mr. Moore were to terminate his employment with us within 90 days of an event constituting good reason (defined as either the relocation of Mr. Moore's primary work place or the relocation of the place from which SCM directs that the responsibilities of the chief financial officer be discharged, in either case, to a location more than 50 miles from Fremont, California; or a material diminution in Mr. Moore's title, reporting relationships, or scope of responsibilities or authority, without Mr. Moore's written consent), then Mr. Moore would be entitled to a severance package consisting of 1) payment of his then-current monthly base salary for one year following the termination of his employment; 2) payment of any bonus earned during 2005 (if not already paid) under our MBO Plan and a pro rata portion of any bonus earned under the MBO Plan during 2006; and 3) payment of any special bonus earned with respect to projects completed within 180 days of the date of Mr. Moore's termination. In addition, Mr. Moore would be entitled to receive coverage under SCM group health insurance program until the earlier of coverage being provided by another employer or up to one year following the date of termination. Following the announcement of our intention to move our corporate headquarters to Germany and the subsequent appointment of a new German-based chief financial officer, Mr. Moore left our employ in June 2006. Upon his departure, Mr. Moore received his full severance package, as detailed above, which included severance of \$200,000 paid out in a lump sum and a prorated bonus payment for 2006 of \$41,667 based on the achievement of objectives established by the chief executive officer and the Board of Directors.

Compensation Committee Interlocks and Insider Participation

The Compensation Committee of our Board of Directors reviews and makes recommendations to our Board of Directors regarding our compensation policies and the compensation to be provided to our chief executive officer, our other executive officers and our directors. During fiscal year 2006, the Compensation Committee was comprised of

Messrs. Cubero, Humphreys and Turner, and Mr. Andrew Vought. Mr. Vought served as chairman of the Compensation Committee until his resignation from the committee on April 12, 2006, at which time Mr. Humphreys was appointed chairman. On April 12, 2007, Mr. Humphreys moved off the Compensation Committee and Dr. Hultsch and Mr. Koepf joined the Compensation Committee. Currently, the Compensation Committee is comprised of Messrs. Cubero, Koepf and Turner and Dr. Hultsch, with Dr. Hultsch serving as chairman. Our Board of Directors has determined that each current member of the Compensation Committee meets

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the independence standards of the Marketplace Rules of the NASDAQ Stock Market and the requirements set forth in Rule 10A-3(b)(1) under the Exchange Act.

During the fiscal year 2006, Mr. Koepf had a relationship requiring disclosure under Item 404 of Regulation S-K. Please see the section entitled "Certain Relationships and Related Transactions" of this Proxy Statement for additional information about this relationship.

Compensation Committee Report

The Compensation Committee has reviewed and discussed with management of the Company the Compensation Discussion and Analysis contained in this Proxy Statement on Schedule 14A. Based on the Compensation Committee's review of and the discussions with management with respect to the Compensation Discussion and Analysis, the Compensation Committee recommended to the Board of the Directors of the Company that the Compensation Discussion and Analysis be included in this Proxy Statement on Schedule 14A for the fiscal year ended December 31, 2006.

Compensation Committee

Dr. Hagen Hultzsch, Chairman
Werner Koepf
Dr. Manuel Cubero
Simon Turner

August 30, 2007

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The following table summarizes information as of December 31, 2006 and June 30, 2007 about our common stock that may be issued upon the exercise of options, warrants and rights granted to employees, consultants or members of our Board of Directors under all of our existing equity compensation plans, including our 1997 Stock Plan, Director Plan, 1997 Employee Stock Purchase Plan (the Employee Stock Purchase Plan) and 2000 Nonstatutory Stock Option Plan (the Nonstatutory Plan). Each of the 1997 Stock Plan, Director Plan and Employee Stock Purchase Plan expired in March 2007 and no additional awards will be granted under such plans.

Plan Category	(a)	(b)	(c)
	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column(a))
As of December 31, 2006:			
Equity compensation plans approved by stockholders(1)	1,149,613	\$ 17.6465	4,492,514
Equity compensation plans not approved by security holders(2)	621,082	\$ 3.2660	101,462
Total(3)	1,770,695	\$ 12.6205	4,593,976(4)
As of June 30, 2007:			
Equity compensation plans approved by stockholders(1)	1,265,331	\$ 15.3958	
Equity compensation plans not approved by security holders(2)	613,964	\$ 3.2774	96,792
Total(3)	1,879,295	\$ 11.4368	96,792

1) Equity plans approved by stockholders consist of the 1997 Stock Plan, the Director Plan and the Employee Stock Purchase Plan.

2) Equity plans not approved by stockholders consist of the Nonstatutory Plan.

- 3) Does not include options to purchase an aggregate of 16,360 shares of common stock, 13,213 of which were awarded under Dazzle Multimedia plans prior to our acquisition of Dazzle Multimedia in 2000 and 3,147 of which were awarded under Shuttle Technologies plans prior to our acquisition of Shuttle Technologies in 1998. These options have a weighted average exercise price of \$7.4646 and were granted under plans assumed in connection with transactions under which no additional options may be granted.
- 4) Includes securities available under the following plans that have formulas for determining the amount of securities available for issuance each year: 1) the 1997 Stock Plan, under which the maximum aggregate amount which may be optioned and sold increases on each anniversary date of the adoption of the Plan by an amount equal to the lesser of (i) 500,000 Shares, (ii) 4.9% of the outstanding shares on such date or (iii) a lesser amount determined by the Board; 2) the Director Plan, under which the maximum aggregate amount which may be optioned and sold increases on July 1 of each year by an amount equal to (i) the optioned stock underlying options granted in the immediately preceding year, or (ii) a lesser amount determined by the Board; and 3) the Employee Stock Purchase Plan, under which the maximum amount available increases on each anniversary date of the adoption of the Plan by an amount equal to the lesser or (i) 150,000 shares, (ii) 1% of the outstanding shares on such date or (iii) a lesser amount determined by the Board.

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Additionally, the following table summarizes information about options outstanding as of June 30, 2007:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$ 2.65 - \$ 3.21	384,247	7.98	\$ 2.93	162,963	\$ 2.86
\$ 3.23 - \$ 4.02	475,895	7.56	3.56	151,638	3.36
\$ 4.15 - \$ 8.08	594,697	5.81	6.56	446,236	7.26
\$ 8.25 - \$52.63	427,987	1.86	32.82	427,793	32.83
\$63.00 - \$83.00	12,829	1.58	66.51	12,829	66.51
\$ 2.65 - \$83.00	1,895,655	5.77	\$ 11.40	1,201,459	\$ 15.91

The weighted-average grant date fair value per option for options granted during the six months ended June 30, 2007 was \$1.91. The total intrinsic value of options exercised during the six months ended June 30, 2007 was \$8,331. Cash proceeds from the exercise of stock options were \$33,135 for the six months ended June 30, 2007.

Material features of plans not approved by stockholders

Under the Nonstatutory Plan, non-qualified stock options may be granted to our employees, including officers, and to non-employee consultants. The plan's administrators, as delegated by our Board of Directors, may set the terms for each option grant made under the plan, including the rate of vesting, allowable exercise dates and the option term of such options granted. The exercise price of a stock option under the Nonstatutory Plan shall be equal to the fair market value of our common stock on the date of grant. While our Board of Directors or its appointed committee may, at its discretion, reduce the exercise price of any option to the then current fair market value if the fair market value of the common stock covered by such option shall have declined since the date the option was granted, no such action has ever been taken by our Board of Directors. 750,000 shares are reserved for issuance under the Nonstatutory Plan, and options for 1,066,456 shares have been granted under the plan to date.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

During fiscal 2006, we incurred license expenses of approximately \$200,000 to Gemplus International S.A., a company engaged in the development and distribution of smart-card based systems. At Gemplus, Mr. Koepf serves as a director and as chairman of the compensation committee. Our business relationship with Gemplus has been in existence for many years and predates Mr. Koepf's appointment to our Board of Directors in February 2006. Approximately \$76,000 of the incurred license expense for 2006 relates to continuing operations. License expenses of approximately \$400,000 and \$100,000 were incurred for 2005 and 2004, respectively, of which approximately \$232,000 and \$25,000 related to continuing operations in 2005 and 2004, respectively. As of December 31, 2006, approximately \$30,000 was due as accounts payable to Gemplus. No accounts payable to Gemplus were due as of December 31, 2005 and 2004. To our knowledge, Mr. Koepf was not directly compensated for revenue transactions between the two companies.

Related Party Transaction Policy

The Audit Committee of our Board of Directors, among its other duties and responsibilities, reviews and monitors all related party transactions and in February 2007 adopted our Related Party Transaction Policies and Procedures (the Policy). Under the Policy, our Board of Directors is required to review and approve the material terms of all Interested Transactions involving a related party, subject to certain exceptions. An Interested Transaction is any transaction, arrangement or relationship or series of similar transactions, arrangements or relationships (including any indebtedness or guarantee of indebtedness) in which (1) the aggregate amount involved will or may be expected to exceed \$100,000 per year or \$30,000 in any quarter, (2) the Company is a participant and (3) any related party has or will have a direct or indirect interest (other than solely as a result of being a director or a less than 10 percent beneficial owner of another entity). In determining whether to approve or ratify an Interested

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Transaction, our Board of Directors is required to take into account, among other factors it deems appropriate, whether the Interested Transaction is on terms no less favorable than terms generally available to an unaffiliated third-party under the same or similar circumstances and the extent of the related person's interest in the transaction.

Exceptions to the Policy include Interested Transactions for which standing pre-approval has been authorized, such as the hiring of executive officers and the payment of compensation to directors, where such compensation is required to be disclosed in the Company's annual, quarterly or current filings; transactions involving competitive bids; and regulated transactions, such as for the rendering of regulated services, for example with a public utility.

To ensure the Policy is being followed, we require each of our non-employee directors and each of our executive officers to provide and update information about related party relationships and related party transactions on a quarterly and annual basis. This information is reviewed by our Corporate Accounting personnel, which also reviews our sales and purchasing transactions on an ongoing basis to identify any transactions with known related parties.

Our Related Party Transaction Policy is in writing and has been communicated by management to our employees.

Table of Contents**STOCK PERFORMANCE GRAPH**

The following performance graph compares the cumulative total return to holders of our common stock since December 31, 2001, to the cumulative total return over such period of the NASDAQ Composite index and the RDG Technology Index.

The performance graph assumes that \$100 was invested on December 31, 2001 in our common stock and in each of the comparative indices. The performance graph further assumes that such amount was initially invested in our common stock at a price of \$14.64 per share, the closing price on December 31, 2001.

Our historic stock price performance is not necessarily indicative of future stock price performance. The information contained in the performance graph shall not be deemed to be soliciting material or to be filed with the Commission, nor shall such information be incorporated by reference into any existing or future filing by the Company under the Securities Act of 1933 or the Exchange Act except to the extent that we specifically incorporate such information by reference into any such filing.

**COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*
AMONG SCM MICROSYSTEMS, INC., THE NASDAQ COMPOSITE INDEX
AND THE RDG TECHNOLOGY COMPOSITE INDEX**

* \$100 invested on 12/31/01 in stock or index-including reinvestment of dividends.
Fiscal year ending December 31.

Measurement Period (Fiscal Year Covered)	Dec-01	Dec-02	Dec-03	Dec-04	Dec-05	Dec-06
SCM Microsystems	100	29	53	33	23	21
NASDAQ Composite	100	70	105	116	120	133
RDG Technology	100	63	95	97	100	110

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OTHER MATTERS

We do not intend to bring any matters before the Annual Meeting other than those set forth herein, and our management has no present knowledge that any other matters will or may be brought before the Annual Meeting by others. However, if any other matters properly come before the Annual Meeting, it is the intention of the persons named in the enclosed proxy to vote the shares they represent as our Board of Directors may recommend.

BY ORDER OF THE BOARD OF DIRECTORS
SCM MICROSYSTEMS, INC.

Stephan Rohaly
Secretary

Fremont, California
September 11, 2007

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SCM MICROSYSTEMS, INC.

PROXY FOR

2007 ANNUAL MEETING OF STOCKHOLDERS

THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS

The undersigned stockholder of SCM MICROSYSTEMS, INC., a Delaware corporation, hereby acknowledges receipt of the Notice of 2007 Annual Meeting of Stockholders and Proxy Statement, each dated September 11, 2007, and hereby appoints each of Werner Koepf and Stephan Rohaly as proxies and attorneys-in-fact, with full power of substitution, on behalf and in the name of the undersigned, to represent the undersigned at the 2007 Annual Meeting of Stockholders to be held at our U.S. sales office, at 41740 Christy Street, Fremont, California 94538, on November 9, 2007 at 10:00 a.m. local time, and any adjournment(s) and postponement(s) thereof, and to vote all shares of common stock that the undersigned would be entitled to vote thereat if then and there personally present, on the matters in the manner set forth below:

(CONTINUED AND TO BE SIGNED ON REVERSE SIDE.)

[SEE REVERSE SIDE]

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Annual Meeting Proxy Card

[X] PLEASE MARK YOUR VOTES AS IN THIS EXAMPLE

Proposal 1 Election of Director

The Board of Directors recommends a vote FOR the election of the Nominee listed below. For

Withhold 01 **Dr. Hagen Hultzschoo Proposal 2 Stock Option Plan The Board of Directors**

recommends a vote FOR the following proposal: To approve the 2007 Stock Option

Plan For Against Abstain **Proposal 3 Ratification of Independent Registered**

Public Accountants The Board of Directors recommends a vote FOR the following proposal:

For Against Abstain To ratify the appointment of Deloitte & Touche as the Company's

independent registered public accountants for the fiscal year ending December 31, 2007.

In their discretion, the proxies are authorized to vote upon such other matter(s) which may properly come before the annual meeting, or at any adjournment(s) or postponement(s) thereof.

THIS PROXY WILL BE VOTED AS DIRECTED AND, IF NO DIRECTION IS INDICATED, THIS PROXY WILL BE VOTED FOR THE LISTED NOMINEE FOR ELECTION AS A DIRECTOR, TO APPROVE THE 2007 STOCK OPTION PLAN AND TO RATIFY THE APPOINTMENT OF DELOITTE & TOUCHE AS INDEPENDENT REGISTERED PUBLIC ACCOUNTANTS FOR OUR FISCAL YEAR ENDING DECEMBER 31, 2007.

Both of the foregoing attorneys-in-fact or their substitutes or, if only one shall be present and acting at the annual meeting or any adjournment(s) or postponement(s) thereof, the attorney-in-fact so present, shall have and may exercise all of the powers of said attorney-in-fact hereunder.

SIGNATURE(S) _____ DATE _____

NOTE: THIS PROXY SHOULD BE MARKED, DATED AND SIGNED BY THE STOCKHOLDER EXACTLY AS HIS, HER OR ITS NAME APPEARS HEREON. PERSONS SIGNING IN A FIDUCIARY CAPACITY SHOULD SO INDICATE AND IF SHARES ARE HELD BY JOINT TENANTS OR AS COMMUNITY PROPERTY, BOTH HOLDERS SHOULD SIGN AND DATE THE DOCUMENT AND INDICATE THAT THEY ARE SIGNING AS JOINT TENANTS

MATERIALS ELECTION

As of July 1, 2007, SEC rules permit companies to send you a Notice indicating that their proxy materials are available on the Internet and how you can request a mailed copy. Check the box to the left if you want to receive future proxy materials by mail at no cost to you. Even if you do not check the box, you will still have the right to request a free set of proxy materials upon receipt of a Notice.

VOTE YOUR PROXY OVER THE INTERNET OR BY TELEPHONE! It's fast, convenient, and your vote is immediately confirmed and tabulated. Most important, by choosing either option, you help us reduce postage and proxy tabulation costs.

OPTION 1: VOTE OVER THE INTERNET 1. Read the accompanying Proxy Statement. 2. Have your 12-digit control number located on your voting ballot available. 3. Point your browser to <http://www.proxyvote.com>. 4. Follow the instructions to cast your vote.

OPTION 2: VOTE BY TELEPHONE 1. Read the accompanying Proxy Statement. 2. Have your 12-digit control number located on your voting ballot available. 3. Using a touch-tone phone, call the toll-free number shown on the voting ballot. 4. Follow the recorded instructions.

YOUR VOTE IS IMPORTANT Using the Internet or telephone, you can vote anytime, 24 hours a day. Or if you prefer, you can return the enclosed paper ballot in the envelope provided. Please do not return the enclosed paper ballot if you are voting using the Internet or telephone.