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Securities & Corporate Governance *Update*

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Resale of Securities – Significant Changes to Rules 144 and 145

On Feb. 15, 2008, the holding periods for the resale of restricted securities under Rule 144 of the Securities Act of 1933 will be shortened and the other burdens of complying with Rule 144 will be reduced. The changes to Rule 144 will significantly increase the liquidity of privately sold securities and decrease the cost of capital. At the same time, the presumptive underwriter provisions in Rule 145 of the Securities Act will be eliminated, except for transactions involving a shell company.

Changes to Rule 144

Background. Rule 144 provides a safe harbor that allows for the resale of "restricted securities" and "control securities" without registration under the Securities Act of 1933—so long as certain conditions are met. Restricted securities are generally securities that have been issued in a private placement exempt from registration under the Securities Act. Control securities are commonly understood to be securities held by affiliates of the issuer (which generally include directors, executive officers and significant shareholders of the issuer) regardless of how such securities were acquired.

Before the amendments take effect, security holders can resell restricted or control securities under Rule 144, subject to volume, manner of sale and other limitations, after holding the securities for one year. After two years, restricted securities may be sold without restriction so long as the security holder has not been an affiliate of the issuer for three months prior to the sale.

Amendments to Rule 144. As amended, Rule 144 permits a non-affiliate security holder to resell restricted securities after holding the securities for six months if the issuer is subject to the reporting requirements of the Securities Exchange Act of 1934 and is current in its SEC filings. After holding securities for one year, a non-affiliate of the issuer may freely resell securities of a reporting or non-reporting issuer. In addition, the revisions to Rule 144 eliminate the need for non-affiliates to file a Form 144 notice.

Affiliates of an issuer may resell control securities of a reporting issuer after six months and of a non-reporting issuer after one year. Resales of control securities will continue to be subject to volume, manner of sale and other limitations. However, the limitations have been liberalized, especially with regard to the resale of debt securities. Revised Rule 144 eliminates the manner of sale limitation for the resale of debt securities and increases the volume limitation for the resale of debt securities to up to 10% of the principal amount of a tranche of debt securities in a three-month period. In addition, the amendments to Rule 144 increase the Form 144 filing threshold to $50,000 or 5,000 shares within a three-month period.

Changes to Rule 145

Rule 145 provides that exchanges of securities in connection with certain reclassifications of securities,

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mergers, consolidations or transfers of assets that require shareholder approval constitute "sales" of those securities and presumes that persons who were affiliates of the target company at the time of the vote on the transaction are "underwriters" of the securities being issued in the transaction. As a result, Rule 145 subjects affiliates of the target, even if such persons receive registered shares in the transaction and are no longer affiliates of the combined entity, to certain resale limitations under Rule 144. The revisions to Rule 145 remove the "presumptive underwriter" status for affiliates of a target, except with respect to transactions involving a shell company. Therefore, affiliates of the target will no longer be subject to resale restrictions of under Rule 145 (unless the transaction involves a shell company) and will be able to immediately resell registered securities they receive in the transaction.

Investor Relations Update: Electronic Shareholder Forums and Proposals to Require Company Funded Proxy Contests

Two recent developments could impact the way public companies interact with activist investors. While neither development will transform investor relations overnight, they should contribute to an increasingly dynamic and interactive discourse between management and shareholders.

First, in the regulatory field, the SEC has published its safe-harbor rule for electronic shareholder forums. By adopting changes to Regulation 14A governing proxy solicitations, the SEC hopes to allow more frequent, substantive "town hall" discussions among company stakeholders than are currently possible through the annual proxy process.

While shareholder activists and third-party developers may be the first to deploy these tools, the SEC envisions management participating in, or even sponsoring, sites where shareholders and companies can exchange views. The new rules grant immunity to e-forum participants from securities law liability for communications posted by other, unaffiliated parties on the e-forum site, analogous to that enjoyed by hosts of Internet chat sites. It is important to note, however, that the rules do not completely insulate parties who ultimately choose to engage in solicitations about a shareholder vote – that is, who seek the power to act as a proxy. Depending on the operation of the site, statements by such parties may be subject to filing obligations under Regulation 14A, especially if they occur within 60 days of any shareholder meeting. All participants in e-forum should also be aware that their statements are subject to other securities laws, such as the antifraud and fair disclosure rules.

A second development involves proxy proposals submitted this season by the American Federation of State, County, and Municipal Employees (AFSCME). In one prototype case, ASCME asked for a binding bylaw amendment to be included in the company's proxy statement that calls for the reimbursement of:

"reasonable expenses … incurred in connection with nominating one or more candidates in a contested election of directors to the corporation's board of directors, including, without limitation, printing, mailing, legal, solicitation, travel, advertising and public relations expenses …."

Since the SEC blocks so-called "access" proposals by activist shareholders who wish to include their nominees on management's proxy statement, this approach would have the company pay for a separate proxy statement by outside shareholders. It is too early to determine whether these proposals will gain substantial support from shareholders during the 2008 proxy season.

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