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Corporate and Securities Update:

Review of the New E-Proxy Rules and Other Recent SEC Rulemakings

This Corporate and Securities Update summarizes the following key rulemakings recently published by the Securities and Exchange Commission ("SEC"):

- Final E-Proxy Rules (Release No. 34-56135, July 26, 2007)
- Proposed Rules on Proxy Access for Shareholder Nominations of Directors (Release Nos. 34-56160 and 34-56161, July 27, 2007)
- Proposed Rules Relating to Form S-3 and Shelf Registration (Release No. 33-8812, June 20, 2007)
- Proposed Rules Relating to Rule 144 (Release No. 33-8813, June 22, 2007)

I. SEC Adopts Final E-Proxy Rules

The SEC has modernized the proxy rules to address the *method* as well as the *timing* of the distribution of proxy materials to shareholders with its July 2007 adoption of the "e-proxy rules." These new rules will allow shareholders to receive proxy materials – including proxy statements and annual reports to shareholders – by paper copy, by e-mail (in certain cases), or through the Internet. The e-proxy rules become effective January 1, 2008 for large accelerated filers and January 1, 2009 for others.

With the e-proxy rules, the SEC has furthered its stated goal of increasing reliance on technology to improve proxy distribution. By requiring Internet availability of proxy materials, the SEC seeks to enhance the ability of shareholders to make informed voting decisions and, at the same time, lower the costs of proxy solicitations.

The e-proxy rules build on the SEC's prior interpretive guidance on the use of electronic delivery under the federal securities laws and the voluntary "notice and access" proxy delivery model adopted by the SEC as an interim step in January 2007. The voluntary "notice and access" delivery model permits companies, beginning July 1, 2007, to satisfy their proxy delivery obligations by posting their proxy materials on a publicly-accessible Internet Web site (other than the SEC's EDGAR Web site) and sending a "Notice of Internet Availability of Proxy Materials" to shareholders at least 40 days before the shareholder meeting date, indicating that the proxy materials are available and explaining how to access those materials. The Notice also must explain how a shareholder can request a copy of the proxy materials and how a shareholder can indicate a preference to receive a paper or e-mail copy of any current or future proxy materials.

The e-proxy rules take the next step by permitting companies and other soliciting persons to select one of the following two methods of delivering proxy materials to shareholders: (i) the "notice only option" and (ii) the "full set delivery option." The method selected need not be exclusive; rather, the "notice only option" may be used for some shareholders, while the "full set delivery option" may be used for other shareholders. Regardless of the method selected by the company or other soliciting persons, shareholders will have the ability to choose whether to receive proxy materials in paper form or through the Internet, or by e-mail where the proxy materials are posted on the Internet in connection with the "notice only option."

"Notice Only Option." This option is substantially identical to the voluntary "notice and access" option and requires that:

- The company must send a Notice of Internet Availability of Proxy Materials (the "Notice") to shareholders at least 40 calendar days prior to the shareholder meeting date. The Notice must be written in plain English and contain, among other things, the following disclosures:
 - a bold-face legend stating that the proxy materials are available at a specified Web site address (other than the SEC's EDGAR Web site);
 - a statement that shareholders may request a paper or e-mail copy of the proxy materials for the particular meeting or for all future meetings through a designated toll-free telephone number, e-mail address and Internet Web site;
 - a clear and impartial identification of each separate matter to be acted on at the meeting, and the company's recommendations, if any (without any supporting statement); and
 - instructions for accessing the proxy card, provided that the instructions do not enable a shareholder to execute a proxy card without having access to the proxy statement.
- The Notice may contain only the information required by Rule 14a-16(e), except that a company may choose to combine the Notice with any shareholder meeting notice required under state law.
- The company must file its Notice with the SEC no later than the date it first sends the Notice to shareholders. All proxy materials identified in the Notice must be publicly accessible, free of charge, on a Web site address specified in the Notice (other than the SEC's EDGAR Web site) on or before the date the Notice is sent to shareholders, and must remain available on that Web site address through the conclusion of the shareholder meeting.
- The company must provide shareholders with information on methods to execute proxies as of the time the Notice is first sent to shareholders. Acceptable methods include electronic voting over the Internet, telephone voting, and voting on a proxy card printed or downloaded from the Web site.
- The company may send a paper or e-mail proxy card to shareholders only if (i) at least 10 calendar days have passed since delivery of the Notice and the proxy card is accompanied by a copy of the Notice (thereby providing sufficient time for shareholders to access the electronic copy of the proxy materials or request paper copies), or (ii) the proxy card is accompanied or preceded by a copy, via the same medium, of the proxy statement and any required annual report to shareholders.
- The company must provide paper copies (by first class mail or other reasonably prompt means) or e-mail copies of the proxy materials, free of charge, to any shareholder within three business days after receiving a request.

The "notice only option" also addresses the delivery obligations by companies to intermediaries who hold stock on behalf of their beneficial owners. A company must provide an intermediary or its agent with the relevant information in sufficient time for the intermediary to prepare and send its own Notice (which is similar to but more streamlined than the company's Notice and tailored to the needs of its beneficial owners) and post the proxy materials on a Web site at least 40 days before the shareholder meeting date.

"Full Set Delivery Option." A company may continue to deliver paper copies of its proxy materials under the "full set delivery option." This option, which applies to the delivery of the proxy statement, the annual report to shareholders, and the proxy card (hence, a "full set"), involves the following steps:

- The company mails out a full set of the proxy materials to its shareholders;
- A Notice – essentially containing the same information as the Notice described above under the "Notice Only Option" – must accompany the full set of proxy materials, or the proxy statement and proxy card must contain all of the information required to appear in the Notice; and
- The company must post the proxy materials on a publicly accessible Web site no later than the date the Notice is first sent to shareholders.

Intermediaries must forward the company's full set of proxy materials to beneficial owners within five business days of receipt from the company. Also, under the "full set delivery option," intermediaries must prepare a Notice or incorporate the information required in the Notice in their request for voting instructions from beneficial owners.

Under both the "full set delivery option" and the "notice only option," a company must maintain the Web site on which it posts its proxy materials in a manner that does not infringe the anonymity of a person accessing the Web site. In addition, a company may not use an e-mail address provided by a shareholder to request a copy of proxy materials for any purpose other than to send a copy of those materials to that shareholder.

Soliciting persons other than the company generally are subject to the same rules under the "notice only option" and the "full set delivery option." One exception is that the Notice under the "notice only option" must be sent by the later of (i) 40 calendar days before the meeting, or (ii) 10 calendar days after the company first sends its proxy materials to shareholders.

Practical Implications. It is too early to predict the impact of the e-proxy rules. Certainly, companies must address the new Notice requirement and Internet posting of proxy materials in their annual meeting timelines. Among the questions that will be answered in the 2008 proxy season are:

- Will shareholders accept Internet access to proxy materials or will they insist on paper copies?
- Will companies be able to reduce their printing quantities given that shareholders will have Internet access to the proxy materials?
- Will the e-proxy options result in any significant savings given the unpredictability of shareholder response and the requirement to provide paper copies by first class mail within three business days of a shareholder request?
- Will the e-proxy rules increase or (more likely) reduce the number of shareholders voting on annual meeting matters?
- How will the e-proxy options interact with the elimination of broker votes for directors and majority voting for directors?
- How will the e-proxy options interact with certain state law requirements and current Nasdaq rules with respect to the delivery of annual reports to shareholders (*e.g.*, California requires a shareholder consent for the electronic transmission of the annual report)?

II. SEC Proposes Alternative Approaches to Proxy Access

On July 27, 2007, the SEC proposed two alternative approaches to proxy access for shareholder nominations of directors. The SEC's competing proposals are a response to the Second Circuit's decision in *American Federation of State, County & Municipal Employees, Employees Pension Plan v. American International Group, Inc.* That decision involved the proper interpretation of Rule 14a-8(i)(8), which permits the exclusion of a proposal that "relates to an election for membership on the company's board of directors or analogous governing body." The Second Circuit held that AIG could not rely on Rule 14a-8(i)(8) to exclude a shareholder proposal seeking to amend the company's bylaws to establish a procedure under which the company would be required to include shareholder nominees for director in the company's proxy materials at future meetings.

In Release No. 34-56161, the SEC proposes to confirm its historical position that any proposal that could result in an election contest may be excluded from a company's proxy materials under Rule 14a-8(i)(8). Specifically, the release states the view that a proposal may be excluded under Rule 14a-8(i)(8) if it would (i) result in an immediate election contest (*e.g.*, by making or opposing a director nomination for a particular meeting), or (ii) set up a process for shareholders to conduct an election contest in the future by requiring the company to include shareholders' director nominees in the company's proxy materials for future meetings. The SEC also seeks comment on a number of items, including a proposed amendment that would revise Rule 14a-8(i)(8) to permit exclusion of a proposal that "relates to a nomination or an election for membership on the company's board of directors or analogous governing body or a procedure for such nomination or election."

In Release No. 34-56160, the SEC proposes a different response to the Second Circuit's decision in *AFSCME*. It proposes to amend Rule 14a-8(i)(8) to permit certain shareholders eligible to file on Schedule 13G to have their proposals for bylaw amendments regarding the procedures for nominating directors included in a company's proxy materials, if permitted under applicable state law and the company's charter and bylaws. To ensure adequate disclosure about the shareholder proponent and its plans, the SEC proposes to amend Schedule 13G and establish new Rule 14a-17, "Shareholder Nominations for Election as Director," new Rule 14a-18, "Electronic Shareholder Forms," new Item 24, "Relationships with Shareholder Proponents," and new Item 25, "Relationships with Nominating Shareholders" to Schedule 14A.

Comments on the two competing proposals are due on or before October 2, 2007. SEC Chairman Christopher Cox has stated that the SEC intends to have a final rule in place for the 2008 proxy season.

III. SEC Proposes Relaxed Form S-3 Standards

Under the current rules, an issuer may use Form S-3 or F-3 for a primary offering of securities only if the issuer has a public float of at least \$75 million. Issuers with a smaller public float that want to access public markets must either use Form S-1 or SB-2, which do not allow "forward" incorporation by reference and cannot be used as shelf registration statements under Rule 415(a)(1)(x), or resort to a transaction like a PIPE, where the public sale is structured as a secondary offering by a selling security holder. The SEC recently has questioned the legitimacy of certain PIPE transactions and announced a rule of thumb that any PIPE involving more than 30% of an issuer's outstanding stock will be presumed to be a primary offering (and therefore not a valid PIPE).

The SEC proposal would amend Forms S-3 and F-3 to allow any issuer, other than a "shell company," to use those forms for a primary offering, regardless of the size of the issuer's public float, as long as the issuer does not use this provision to sell more than the equivalent of 20% of its public float over any period of 12 calendar months. What constitutes 20% of an issuer's public float would be tested at the time of each offering, not when the registration statement is filed or declared effective, so that the cap will rise as a company grows. The cap also will fall if a company's public float shrinks, but any reduction will not invalidate any offering that was completed under a higher cap.

IV. SEC Proposes Relaxed Rule 144 Standards

Rule 144 provides a safe harbor as to when a selling security holder will be deemed not to be an underwriter. It addresses two different situations: sales of restricted securities by any seller (regardless of whether it is an affiliate of the issuer), and sales of securities by an affiliate of the issuer (regardless of whether the securities are restricted). Rule 145 generally provides that the issuance of securities in a business combination transaction will be deemed to be a public offering, but it also sets forth a “presumptive underwriter doctrine” that says that every affiliate of any party to a business combination transaction will be deemed to be an underwriter unless he or she sells in accordance with certain paragraphs of Rule 144.

When the SEC shortened the Rule 144 holding periods in 1997, it also proposed a variety of other amendments to Rule 144, on which the SEC took no further action. The current release reprises and builds on a number of those proposed amendments. The current proposal would:

- Shorten the holding period for restricted securities to six months;
- Provide that, if the security holder has engaged in certain hedging transactions, the six-month holding period will be tolled for the duration of those transactions, but not beyond one year;
- Allow non-affiliates (that is, someone who has not been an affiliate within the past three months) to resell restricted securities without limitation;
 - after the six month holding period, if there is “current public information” about the issuer; and
 - after a one year holding period, if there is not current public information;
- Eliminate the volume limitations, manner of sale restrictions and Form 144 requirement for any resale by non-affiliates;
- Eliminate the manner of sale restrictions for any resales of debt securities;
- Increase the threshold for Form 144 (which, as noted above, would apply only to affiliates) to 500 shares or \$10,000 within a three-month period; and
- Limit the “presumptive underwriter” provision in Rule 145 to a business combination involving a shell company.

The proposal also codifies a number of the SEC staff’s positions, primarily regarding the holding period for restricted securities, and when the holding period for one security can be tacked to that of a predecessor.

For Further Information

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