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SEC Amends Rules 144 and 145 under the Securities Act of 1933

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Client Advisory
February 7, 2008 by Guy P. Lander, Stephen V. Burger and Aaron Salsberg

Introduction

The SEC recently amended Rules 144 and 145 (the "Amendments") under the Securities Act of 1933 (the "Securities Act"). The major changes to the Rules are to:

- shorten to six months from one year the Rule 144(d) holding period for resales of restricted securities of "reporting companies", i.e., companies subject to the reporting requirements of the Securities Exchange Act of 1934 (the "Exchange Act"), such as Forms 10-K and 10-Q;
- shorten to one year from two years the holding period after which non-affiliates of both reporting companies and non-reporting companies may resell restricted securities of those companies without conditions;
- significantly reduce the Rule 144 restrictions on resales of restricted securities by non-affiliates of the issuers so that after the holding period is met, the resale of restricted securities by a non-affiliate will no longer be subject to any other condition of Rule 144, except that, for the resale of securities of a reporting company, the current public information requirement in Rule 144(c) will apply for an additional six months after the six-month holding period requirement is met;
- eliminate the "manner of sale" requirement for debt securities;
- amend the volume limitation for debt securities to permit resales of debt securities of up to 10% of a tranche of securities, when aggregated with all sales of securities of the same tranche within a three-month period;
- amend the manner of sale requirement to permit the resale of equity securities through "riskless principal transactions," and amend the definition of "brokers' transactions" to include the posting of bid and ask quotations in alternative trading systems;
- increase the Form 144 filing thresholds below which no filing is required, from 500 shares to 5,000 shares, or from $10,000 to $50,000, in both cases within a three-month period;
- codify certain SEC staff interpretive positions that relate to Rule 144; and
- eliminate the "presumptive underwriter" provision in Rule 145 (except for transactions involving a shell company), and revise the resale requirements in Rule 145(d) to conform to certain amendments to Rule 144.

The SEC intended these amendments to increase the liquidity of privately sold securities, make private offerings more attractive to investors and decrease the cost of capital for all issuers, without compromising investor protection.

These amendments will become effective on February 15, 2008, and will apply to securities acquired before or after this effective date.

Background – Rule 144 before the Amendments

Rule 144 provides to security holders a safe harbor for relying on the Section 4(1) exemption for resales of securities. Section 4(1) of the Securities Act exempts from Securities Act registration transactions by any person other than an issuer, underwriter or dealer. If a selling security holder meets all the requirements of Rule 144, then he or she is deemed not to be engaged in a distribution of securities (i.e., is not an underwriter) and may resell the applicable securities without registration under the Securities Act. Rule 144 applies to (a) the sale of "restricted securities" (including securities acquired from an issuer in a transaction not involving a public offering), and (b) the sale of "control securities" (generally, securities held by an affiliate of the issuer, regardless of how the affiliate acquired the securities).

Formerly, the conditions to Rule 144 included the following:

- there must be available adequate current public information about the issuer (the issuer's Exchange Act filings are the most common source of information for purposes of this condition);
- the security holder could resell restricted securities after holding them for one year, subject to all other Rule 144 requirements; and non-affiliates could resell restricted securities without restrictions after two years;
- the amount of securities sold must be within specified volume limitations;
- the resale must comply with certain manner of sale requirements for ordinary (unsolicited) brokerage transactions; and
- a Form 144 must be filed with the SEC if the amount of securities being sold exceeds de minimis thresholds.

Amendments

1. Shortening Holding Period to Six Months for Reporting Companies

Now, both affiliates and non-affiliates can resell restricted securities of reporting companies (i.e., companies that were reporting under the Exchange Act for at least 90 days before the resale) after holding the restricted securities for six months. Restricted securities of a non-reporting company (i.e. a company that has not been reporting under the Exchange Act for at least 90 days before the sale) will remain subject to the one-year holding period.

2. Reduction of Conditions that Apply to Non-Affiliates

After the six month holding period has been met, non-affiliates of reporting companies who have not been affiliates during the three months before the sale of securities are not subject to any conditions of Rule 144, other than the current public information requirement, which applies for an additional six months. After the one-year holding period has been met, non-affiliates of reporting companies will be able to resell securities with no Rule 144 conditions at all.

Non-affiliates of a non-reporting company (i.e., a private company) may resell securities with no limitations after a one-year holding period. No resales by non-affiliates of securities of a non-reporting company are permitted under Rule 144 before the end of this one-year period.

3. Conditions That Remain Applicable to Affiliates

After the six-month holding period, affiliates of reporting companies may resell securities only in accordance with all the conditions of Rule 144, including current public information, volume limitations, manner of sale requirements for equity and filing Form 144.

After a one-year holding period, affiliates of a non-reporting company may resell securities only in compliance with all the conditions of Rule 144. No resales by affiliates of securities of a non-reporting company are permitted under Rule 144 before the end of this one-year period.

4. Summary

The chart below summarizes the conditions imposed by Rule 144 after the Amendments for the resale of restricted securities held by affiliates and non-affiliates of the issuer:

	Affiliate or Person Selling on Behalf of an Affiliate	Non-Affiliate (and Has Not Been an Affiliate During the Prior Three Months)
Restricted Securities of Reporting Issuers	During six-month holding period – no resales under Rule 144 permitted.After six-month holding period – may resell in accordance with all Rule 144 requirements including:current public information,volume limitations,manner of sale requirements for equity securities, andfiling of Form 144.	During six-month holding period – no resales under Rule 144 permitted.After six-month holding period but before one year – unlimited public resales under Rule 144 except that the current public information requirement still applies.After one-year holding period – unlimited public resales under Rule 144; need not comply with any Rule 144 requirements.
Restricted Securities of Non-Reporting Issuers	During one-year holding period – no resales under Rule 144 permitted.After one-year holding period – may resell in accordance with all Rule 144 requirements, including:current public information,volume limitations,manner of sale requirements for equity securities, andfiling of Form 144.	During one-year holding period – no resales under Rule 144 permitted. After one-year holding period – unlimited public resales under Rule 144; need not comply with any other Rule 144 requirements.

5. Elimination of Manner of Sale Requirements for Resales of Debt Securities

The Amendments eliminate the manner of sale requirements for resales of debt securities (including non-participating preferred stock and asset-backed securities) held by affiliates of the issuer. This amendment allows the holders of debt and similar securities to have greater flexibility in the manner (including the option to privately resell the securities) and amount of the resale of their securities.

6. Manner of Sale Requirements

Formerly, Rule 144(f) required that securities be sold in "brokers' transactions" as defined in Rule 144(g), or in transactions directly with a "market maker" as defined in Section 3(a)(38) of the Exchange Act. The Rule also prohibited a selling security holder from (a) soliciting or arranging for the solicitation of orders to buy securities in anticipation of, or in connection with, a Rule 144 transaction and (b) making any payment in connection with the offer or sale of the securities to any person other than the broker who executes the order to sell the securities.

First, the SEC amended the Rule 144(f) manner of sale requirements (which still apply to resales of equity securities by affiliates). This change permits the resale of securities through riskless principal transactions in which offsetting trades are executed at the same price, excluding mark-ups, mark-downs and other commissions like fees.

Second, the SEC amended Rule 144(g) to permit the posting of bid and ask quotations in alternative trading systems; they are no longer a solicitation prohibited under the definition of brokers' transactions. However, the broker must have published bona fide bid and ask quotations for the security in the alternative trading system on each of the last 12 business days.

7. Raising Volume Limitations for Debt Securities

Formerly, Rule 144(e) provided that the amount of securities sold in a three-month period may not exceed the greater of: (i) 1% of the outstanding shares and (ii) the average weekly volume of trading in such securities on all national securities exchanges and automated quotation systems (such as Nasdaq) during the four calendar weeks preceding the filing of the Form 144. These limits effectively made Rule 144 unavailable for the resale of debt securities. Now, Rule 144(e) provides an alternative volume limitation specifically for the resale of debt securities. The rule now permits the resale of debt securities that does not exceed 10% of a tranche (or class for non-participatory preferred stock), when aggregated with all sales of securities of the same tranche sold by the security holder within three months. This amendment, along with the elimination of the manner of sale requirements for debt securities, permits greater trading in debt securities under Rule 144.

8. Increase Form 144 Filing Thresholds

Formerly, Rule 144(h) required a selling security holder to file a notice on Form 144 if the intended sale exceeded either 500 shares or other units, or an aggregate sale price in excess of $10,000, within a three-month period. Now, under Rule 144(h), the dollar threshold required for the filing of a Form 144 is $50,000, and the share threshold is 5,000 shares, for sales to be made within three months. Additionally, Form 144 is now only required for sales by an affiliate of the issuer.

Codification of Staff Positions Concerning Rule 144

1. Securities Acquired under Section 4(6) of the Securities Act are Considered "Restricted Securities"

The Amendments codify the SEC staff position that securities acquired from an issuer in a transaction exempt under Section 4(6) are, like securities received in other non-public offerings, restricted securities under Rule 144. Section 4(6) is an exemption from registration for an offering that does not exceed $5,000,000, is made only to accredited investors, does not involve any advertising or public solicitation, and for which a Form D has been filed.

2. Tacking of Holding Periods When a Company Reorganizes into a Holding Company Structure

The Amendments codify the SEC staff position that security holders may tack the Rule 144 holding period for securities acquired in transactions made solely to form a holding company. The amended Rule 144(d)(3)(ix) permits the tacking of the holding period of the restricted securities of the predecessor company to the holding period of the restricted securities of the holding company received in the reorganization. This provision permits tacking if three conditions are met:

- The newly formed holding company's securities were issued solely in exchange for the securities of the predecessor company as part of a reorganization of the predecessor company into a holding company structure;
- Security holders received securities of the same class, evidencing the same proportional interest in the holding company as that previously held in the predecessor company, and the rights and interests of the security holders are substantially the same as those they possessed in the predecessor company's securities; and

- Immediately following the transaction, the holding company had no significant assets other than the securities of the predecessor company and its subsidiaries, and has substantially the same assets and liabilities on a consolidated bases as the predecessor company.

3. Tacking of Holding Periods for Conversions and Exchanges of Securities

The Amendments clarify Rule 144(d)(3)(ii) to specifically include securities that are not convertible or exchangeable by their terms. The new rule states that if securities to be sold were acquired from the issuer solely in exchange for other securities of the same issuer, the newly acquired securities shall be deemed to have been acquired at the same time as the securities surrendered for conversion or exchange, even if the securities surrendered were not convertible or exchangeable by their terms.

Additionally, the SEC added a note to Rule 144(d)(3)(ii) stating that if: (i) the original securities do not permit cashless conversion or exchange by their terms, (ii) the parties amend the original securities to allow for cashless conversion or exchange, and (iii) the security holder provides consideration, other than solely securities of the issuer, for that amendment, then the newly acquired securities will be deemed to have been acquired on the date of the amendment of the original securities (not the date the securities were originally purchased) as long as, in the conversion or exchange, the securities to be sold were acquired from the issuer solely in exchange for other securities of the same issuer.

4. Cashless Exercise of Options and Warrants

The Amendments codify the staff's position that upon a cashless exercise of options or warrants, the newly acquired underlying securities are deemed to have been acquired when the corresponding options or warrants were acquired, even if the options or warrants originally did not provide for cashless exercise by their terms. As indicated above, the amendments added a note to Rule 144(d)(3)(x) stating that if (i) the original options or warrants do not permit cashless exercise, and (ii) the security holder provides consideration, other than solely securities of the issuer, to amend the options or warrants to allow for cashless exercise, then the amended options or warrants would be deemed to have been acquired on the date that the original options or warrants were so amended (similar to the treatment of conversions and exchanges above).

Additionally, the grant of certain options or warrants that are not purchased for cash or property (e.g., employee stock options) does not create an investment risk for the security holder. Consequently, the holder cannot tack the holding period for the options or warrants to the holding period for the securities received upon exercise of the options or warrants. Therefore, the security holder would be deemed to have acquired the underlying securities on the date the option or warrant was exercised (not the date granted), so long as the full purchase price for the newly acquired securities has been paid at the time of exercise.

5. Aggregation of Pledged Securities

A note to Rule 144(e) has been added to address how two or more pledgees of securities should calculate the Rule 144 volume limitations. The note states that so long as two or more pledgees are not the same "person" for Rule 144 purposes, are not acting in concert, and the pledges are bona fide transactions, one pledgee may resell the pledged securities without having to aggregate its sale with the sales of other pledgees of the same securities from the same pledgor. But, each pledgee must separately aggregate its sales with the sales of the pledgor.

6. Treatment of Securities Issued by "Reporting and Non-Reporting Shell Companies"

The Amendments attempt to curtail the abuse of Rule 144 by codifying a staff position concerning shell companies. A shell company is defined as a registrant, other than an asset-backed issuer, that has: (i) no or nominal operations, and (ii) either no or nominal assets, assets consisting solely of cash and cash equivalents, or assets consisting of any amount of cash and cash equivalents and nominal other assets. These amendments apply to a broader category of companies than provided for in the above definition, as it applies to any "issuer" meeting the above standard, not just any registrant. The SEC calls these companies "reporting and non-reporting shell companies" and this includes blank-

check companies (i.e., development stage companies with no specific business plan other than to merge with or acquire another company, and that issues penny stock).

First, under Rule 144(i), Rule 144 is not available for the resale of securities initially issued by a reporting or non-reporting shell company or an issuer that has been at any time previously a reporting or non-reporting shell company, unless the issuer is a former shell company that meets all the conditions discussed below.

However, Rule 144 is available for the resale of restricted or unrestricted securities that were initially issued by an issuer that is or was a reporting or non-reporting shell company if the following conditions are met: (a) the issuer: (i) has ceased to be a shell company, (ii) is subject to the reporting requirements of Section 13(a) or 15(d) of the Exchange Act and (iii) has filed all Exchange Act reports and materials required to be filed during the preceding 12 months (or for such shorter period that the issuer was required to file such reports and materials), other than certain Form 8-K reports; and (b) at least one year has elapsed since the issuer initially filed current Form 10 type information with the SEC reflecting its status as an entity that is not a shell company. (Form 10 type information is information that a company would be required to file if it were registering under the Exchange Act a class of securities on Forms 10 or 20-F. Shell companies must file this information on a Form 8-K for the transaction by which they cease to be a shell company.)

7. Representations Required from Security Holders Relying on Rule 10b5-1(c) under the Exchange Act

Rule 10b5-1(c) provides an affirmative defense to the prohibition against insider trading, i.e., trading "on the basis of" material nonpublic information. The defense is available if the person can show that:

- before becoming aware of the material nonpublic information, that person had entered into a binding contract to purchase or sell the securities, provided instructions to another person to execute the trade for his account, or adopted a written plan for trading the securities;
- the contract, instructions or written trading plan meet the conditions of Rule 10b5-1; and
- the purchase or sale that occurred was pursuant to the contract, instruction or plan.

Form 144 requires a selling security holder to represent that when he or she signed the Form, he or she does not know any material adverse information concerning the current and prospective operations of the issuer of the securities to be sold which has not been publicly disclosed. The Amendments codify the staff's position that a selling security holder who meets the conditions of Rule 10b5-1(c) may modify the Form 144 representation to indicate that he or she had no knowledge of material adverse information about the issuer when the holder adopted the written trading plan or gave the trading instructions. But, the holder must specify the date and indicate that the representation speaks as of that date.

Simplification of the Preliminary Note and Text of Rule 144

The Amendments simplified the Preliminary Note to Rule 144 by rewriting parts of it in plain English without altering the substantive operation of the rule. A statement was also added to the Preliminary Note that the Rule 144 safe harbor is not available for any transaction that, although in technical compliance with the rule, is part of a plan or scheme to evade the registration requirements of the Securities Act.

Amendments to Rule 145

Rule 145 provides that exchanges of securities in connection with business combinations (i.e., reclassifications of securities, mergers, consolidations or transfers of assets) that are subject to shareholder vote are sales of those securities that must be registered, unless an

exemption is available. Formerly, under Rule 145(c), persons who were parties to such transactions, other than the issuer or affiliates, were deemed to be underwriters. (This is called the "presumptive underwriter provision"). Rule 145(d) permits the resale of securities received in such transactions by persons deemed underwriters if certain conditions are met.

The Amendments eliminate the presumed underwriter provision of Rule 145(c), except for transactions involving a shell company. Rule 145(c) had been used to limit resales by affiliates of a company that is a party to a Rule 145 business combination. These affiliates were presumptive underwriters, and as such, could not resell securities acquired in the Rule 145 transaction without meeting the volume, manner of sale and other limitations of Rule 145(d). The amended rule will allow affiliates of a company that is a party to a Rule 145 transaction (who do not immediately become affiliates of the acquirer) to immediately resell the securities received in the transaction without regard to volume, manner of sale and other restrictions of Rule 145(d). These affiliates will also be able to hedge their positions prior to the closing of the transaction as a result of this amendment.

Because of the SEC's experience with abusive sales of securities involving shell companies, any party, other than the issuer, to a Rule 145 transaction involving a shell company which publicly offers or sells securities of the issuer acquired in connection with the transaction, will continue to be deemed an underwriter. If the issuer meets the conditions of new Rule 144(i)(2) (i.e., that Form 10 information is filed indicating that the company is no longer a shell company), the presumptive underwriters may only resell their securities if:

- the current public information, volume limitation and manner of sale requirements of Rule 144(c), (e), (f) and (g) are met and at least 90 days have elapsed since the securities were acquired; or
- after six months have passed since the securities were acquired, the Rule 144(c) current public information condition is met, and the seller is not an affiliate at the time of sale and has not been an affiliate during the three months before the sale; or
- at least one year has passed since the securities were acquired, and the seller is not an affiliate at the time of sale and has not been an affiliate during the three months before the sale.

Similar to the amendment to the Preliminary Note to Rule 144, a note to Rule 145(c) and (d) states that these Rules are not available for any transaction or series of transactions that, although in technical compliance with the rule, is part of a plan or scheme to evade the registration requirements of the Securities Act. The changes to Rule 145 concerning shell companies were made to harmonize Rule 145 with the previously described changes to Rule 144.

Conforming and Other Amendments

With the amendments to Rule 144, the SEC also adopted conforming amendments to Regulation S, Rule 190 and Rule 701.

1. Regulation S Distribution Compliance Period for Category Three Issuers

The Amendments conform the distribution compliance period in Rule 903(b)(3)(iii) of Regulation S for Category 3 reporting issuers to six months (formerly one year), the same as the new Rule 144 holding period. The SEC noted that there is no reason for the distribution compliance period, which ensures that during an offering and in subsequent after-market trading those relying on Rule 903 are not engaged in an unregistered, non-exempt distribution of securities into the United States, to be longer than the Rule 144 holding period.

2. Underlying Securities in Asset-Backed Securities Transactions and Rule 190

Rule 190 governs whether registration of the sale of underlying assets is required at the time of a registered offering of asset-backed securities. When dealing with underlying securities that are restricted securities under Rule 144, Rule 190 required, in order for the underlying securities not

to be registered, that under the provisions of Rule 144(k), at least two years must have elapsed between the date the underlying securities were acquired from the issuer or an affiliate and the date they are pooled and resecuritized pursuant to Rule 190. Rule 144(k) has been eliminated under the Amendments, therefore Rule 190 is being amended to remove the reference to Rule 144(k) and independently set forth the requirement for a two-year holding period.

3. Rule 701(g)(3)

Rule 701(g)(3) outlines the resale limitations for securities issued under Rule 701 pursuant to certain compensatory benefit plans. The limitations for resales by non-affiliates under this rule make reference to Rule 144(e) and (h), which under the Amendments no longer apply to resales by non-affiliates. Accordingly, the SEC conformed the resale restrictions of securities acquired pursuant to employee benefit plans under Rule 701 to remove the references to Rule 144(e) and (h).

Practical Implications of Amendments

The most significant effect of the Amendments will be to reduce the restrictions on the resale of restricted securities, especially the holding period, thereby increasing the liquidity of these securities and decreasing the cost of capital for issuers of restricted securities.

The changes to Rule 144 should, among other things:

- reduce the pricing difference between private placements and registered offerings of similar securities,
- reduce the need for offering registered debt securities in exchange for privately placed debt securities ("Exxon Capital Exchange Offers" or "A/B Exchange Offers"), and
- reduce the need for registration rights agreements, and
- affect the valuations of the stock consideration issued as a result of a merger or similar transaction with a public company, including PIPE transactions.

Rule 145 will now permit affiliates of a target company who do not become affiliates of the acquiring company to immediately sell or hedge the securities they receive in the acquirer in a Rule 145 transaction without regard to the volume, manner of sale and other restrictions of Rule 145. Those companies involved in business combinations and who engage in Rule 145 transactions should consider whether contractual provisions addressing these types of transactions by affiliates of target companies would be appropriate.

The SEC intends to issue before February 15, 2008, a new Staff Legal Bulletin amending SLB 3 in light of the revisions to Rules 144 and 145. This will likely change the language we currently place in information circulars for plans of arrangement done in reliance on Section 3(a)(10) of the Securities Act. We expect that change to be that a shareholder who is an affiliate of a party before the transaction will be free to resell, immediately and without restriction, securities received in the transaction if he is not an affiliate of the issuer of the securities received in the transaction.

While the six-month abbreviated holding period in Rule 144 applies only to securities of Exchange Act registered companies, the resale provision of Rule 144(k) that was reduced to one year from two years will apply to all issuers to and hence should apply to most non-U.S. issuers.

Private equity sponsors should be aware that because of the increased liquidity rights of all involved, the sponsor's management team and co-investors, many of whom may not be affiliates of an issuer, may be able to front-run the sponsor in selling securities of the portfolio company post-IPO once the underwriters' lock-up period expires. Contractual post-IPO transfer restrictions might need to be more strictly imposed on management and co-investors to limit this risk.

The Amendments will require financial institutions and transfer agents to update their standard Rule 144 documentation. The SEC stated that it will not object to the removal of legends from restricted securities held by non-affiliates once all the applicable Rule 144 conditions have been met (a decision within the sole discretion of the issuer). The significant easing of restrictions on sales by non-affiliate holders of restricted securities may cause issuers and broker-dealers to work with transfer agents to streamline the process of removing restrictive Securities Act legends from security certificates, which may extend to affiliates for sales of debt securities.

Issuers should review the terms of their registration rights agreements to determine if they are still required to maintain the effectiveness of an existing resale shelf registration statement to comply with the terms of a registration rights agreement.

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