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SECURITIES UPDATE

SEC Rule 144 Amendments Make Resales of Restricted Securities Easier

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The Securities and Exchange Commission has adopted amendments to Rule 144 under the Securities Act of 1933, and certain related rules, that are intended to increase the liquidity of restricted securities and decrease the cost of capital for all companies without compromising investor protection (**Release 33-8869**). Adopted on November 15, 2007, the amendments become effective on February 15, 2008.

The amendments to Rule 144 shorten the holding period for restricted securities of reporting companies to six months; and reduce the restrictions on resale of restricted securities by non-affiliates. (Restricted securities of non-reporting issuers remain subject to a one-year holding period.) The amendments also revise the manner of sale requirements and eliminate them for sales of debt securities. Additionally, the amendments increase the volume limitations for debt securities and the thresholds that require the filing of Form 144. Several staff interpretive positions applicable to Rule 144 have been codified by the amendments. The SEC also amended Rule 145, relating to securities acquired in a merger or similar transaction, to eliminate the presumptive underwriter provision, except for transactions involving a shell company, and to revise the resale requirements in Rule 145(d).

Role of Rule 144. Section 4(1) of the Securities Act exempts transactions by any person other than an issuer, underwriter or dealer. Section 2(a)(11) of the Securities Act defines an underwriter as a person who has purchased securities from an issuer with a view to distribution, among other things, but does not specify what constitutes a view to distribution. It also defines an issuer to include any person in a control relationship with an issuer for purposes of this definition. Rule 144 creates a safe harbor for the sale of securities under the exemption set forth in Section 4(1) of the Securities Act for sales by any person holding "restricted securities" of an issuer, and for sales by affiliates (i.e., control persons) of any securities, whether or not restricted, by establishing specific criteria so that security holders satisfying the applicable conditions of that rule will not be deemed to be engaged in a distribution of the securities they are selling and therefore will not be considered underwriters of such securities. As a result, sales pursuant to Rule 144 are entitled to the exemption provided by Section 4(1).

The revisions to Rule 144 are discussed below:

Holding Periods. For purposes of Rule 144, restricted securities generally are securities acquired directly or indirectly from the issuer or its affiliates in transactions not involving any public offering, including securities issued under Regulation D, Regulation S and Rule 144A transactions, among others. Prior to the amendments, Rule 144 required a one year holding period before restricted securities could be sold. The amendments adopted by the SEC reduce the holding period requirement for restricted securities of companies that are subject to the reporting requirements of the Securities Exchange Act of 1934 to six months (if they have been reporting companies for at least 90 days). Restricted securities of companies that are not subject to the Exchange Act reporting requirements continue to be subject to a one-year holding period prior to any public resale.

Resales by Non-Affiliates. The amendments significantly reduce the restrictions on the public resale of securities by non-affiliates. Under the amendments, after the applicable holding period requirement is met, non-affiliates reselling restricted securities under Rule 144, who have not been affiliates during the prior three months, will not be subject to the Rule 144 conditions relating to volume limitations, manner of sale requirements, and filing Form 144 although, with regard to the resale of securities of a reporting issuer, the current public information requirement in Rule 144(c) will apply for an additional six months.

A chart, reproduced from the SEC's adopting release, summarizing the conditions applicable to the resale under Rule 144 of restricted securities held by affiliates and non-affiliates following the effectiveness of the amendments, is attached to this Update as Appendix A.

Manner of Sale Requirements for Affiliates. Rule 144(f) requires public sales in reliance on Rule 144 to be made in brokers' transactions. A broker's transaction is defined as a transaction in which the broker does no more than execute the order as agent, receives no more than the usual and customary brokerage commission, does not solicit or arrange the solicitation of the buy order and, after reasonable inquiry, is not aware of circumstances indicating that the seller is an underwriter with respect to the securities being sold or that the transaction is a part of a distribution of securities of the issuer. As amended, the manner of sale requirements only apply to sales by affiliates, whether or not their securities are restricted. As further amended, Rule 144(f) has been expanded to permit the resale of securities through riskless principal transactions in which trades are executed at the same price — exclusive of any explicitly disclosed markup or markdown, commission equivalent, or other fee — and the rules of a self-regulatory organization permit the transaction to be reported as riskless. The SEC equates riskless principal transactions with agency trades, and as with agency trades, in order to qualify as a permissible manner of sale under the revised rule, the broker or dealer conducting the riskless principal transaction may neither solicit nor arrange for the solicitation of customers' orders to buy the securities in anticipation of, or in connection with, the transaction; must receive no more than the usual and

customary markup or markdown, commission equivalent, or other fee; and must conduct a reasonable inquiry regarding the underwriter status of the person for whose account the securities are sold.

The SEC has also amended Rule 144(g) to specify that the posting of bid and ask quotations in alternative trading systems will not be deemed to be a solicitation, provided that the broker has published bona fide bid and ask quotations for the securities in the alternative trading system on each of the last 12 business days.

Debt Securities. The amendments eliminate the manner of sale restrictions with respect to debt securities. For the purposes of Rule 144, debt securities include nonparticipatory preferred stock (which has debt-like characteristics) and asset-backed securities (where the predominant purchasers are institutional investors including financial institutions, pension funds, insurance companies, mutual funds and money managers) in addition to other types of nonconvertible debt securities.

The revised rule also raised the volume limitations for debt securities, permitting the public resale of debt securities in an amount that does not exceed 10 percent of a tranche (or class when the securities are non-participatory preferred stock), together with all sales of securities of the same tranche (or class) sold for the account of the selling security holder within a three-month period.

Form 144. The amendments increase the Form 144 filing thresholds so that the form is only required to be filed to report sales by affiliates during any three month period with an aggregate sale price over $50,000 or sales of over 5,000 shares or other units.

Codification of Division of Corporation Finance Interpretations. The amendments codify a number of the Division of Corporate Finance's Rule 144 interpretations:

- **Securities acquired under Section 4(6) of the Securities Act are considered "restricted securities."** Section 4(6) provides for an exemption from registration for an offering that does not exceed $5,000,000 and is made only to accredited investors, that does not involve any advertising or public solicitation by the issuer or anyone acting on the issuer's behalf, and for which a Form D has been filed. The revised rule codifies the staff's position that securities acquired under Section 4(6) of the Securities Act are "restricted securities" under Rule 144(a)(3).
- **Tacking of holding periods for holding company formations.** As amended, Rule 144 permits tacking of the holding period in connection with transactions solely to form a holding company if the following three conditions are satisfied:
  - The newly formed holding company's securities are 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 receive securities of the same class evidencing the same proportional interest in the holding company as they held in the predecessor company, and the rights and interests of the holders of such securities are substantially the same as those they possessed as holders of the predecessor company's securities; and

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

- **Tacking of holding periods for conversions and exchanges of securities.** The Rule 144 amendments codify the staff's position that if securities were acquired from the issuer solely in exchange for other securities of the same issuer, the newly acquired securities should be deemed 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. In addition, the amendments clarify the Division's position that if the original securities do not permit cashless conversion or exchange by their terms, the parties amend the original securities to allow for cashless conversion or exchange, and the security holder provides consideration, other than solely securities of the issuer, for that amendment, the shares will be deemed to have been acquired on the date that the original securities were so amended.
- **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. (For the purposes of this discussion, "cashless exercise" refers to the exercise of an option or warrant on a "net" basis, by deducting from the shares delivered upon exercise the number of shares having a fair market value equal to the exercise price based on the current market price of the underlying securities, without any cash payment of the option or warrant exercise price, and does not refer to the practice of arranging for a simultaneous market sale by a broker of the underlying securities in an amount sufficient to cover the exercise price.) If the original options or warrants do not permit cashless exercise by their terms and the holder provides consideration, other than solely securities of the issuer, to amend the options or warrants to allow for cashless exercise, then the options or warrants would be deemed to have been acquired on the date that the original options or warrants were so amended.

  The amendments also codify the staff's position that if options or warrants are not purchased for cash or property and do not create any investment risk in the holder, such as employee stock options, the holder would not be allowed to tack the holding period of the option or warrant and would be deemed to have acquired the underlying securities on the date the option or warrant was exercised, so long as the full purchase price or consideration has been paid at the time of exercise.
- **Aggregation of pledged securities.** The amendments codify the staff's position with respect to multiple pledgees of the same securities such that, so long as the pledgees are not the same "person" under Rule 144(a)(2), a pledgee of securities may sell the pledged securities without having to aggregate the sale with sales by other

pledgees of the same securities from the same pledgor, as long as the loans and pledges are bona fide transactions and there is no concerted action by the pledgees.

- **Treatment of securities issued by "reporting and non-reporting shell companies".** A person who wishes to resell securities that were issued by a company that is, or was, a reporting or a non-reporting shell company, other than a business combination related shell company, may not rely on Rule 144 to sell the securities. However, the amendments permit reliance on Rule 144 for resales by a security holder when:
  - » The issuer of the securities that was formally a reporting or non-reporting shell company has ceased to be a shell company;
  - » The issuer of the securities is subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act;
  - » The issuer of the securities has filed all reports and material required to be filed during the preceding 12 months (or for such shorter period that the registrant was required to file such reports and materials); and
  - » At least one year has elapsed from the time the issuer files current "Form 10 information" with the SEC reflecting its status as an entity that is not a shell company.
- **Representations required from security holders relying on Exchange Act Rule 10b5-1(c).** The amendments specify that Form 144 filers selling securities pursuant to Rule 10b5-1 plans may make the representation required by Form 144 that they do not know any material adverse information with regard to the current and prospective operations of the issuer of the securities to be sold, which has not been publicly disclosed, as of the date that they adopted written trading plans or gave trading instructions that satisfy Rule 10b5-1(c) rather than as of the date they sign the Form 144.

Rule 145. Rule 145 under the Securities Act provides that exchanges of securities constitute sales of securities for purposes of the registration requirements of the Securities Act if they are made in connection with reclassifications of securities, mergers, consolidations or transfer of assets that are subject to shareholder vote. Consequently, such exchanges must be registered unless an exemption is available. Prior to the amendments, Rule 145 deemed persons who were parties to such a transaction, other than the issuer, or affiliates of such parties to be underwriters and established resale limitations on these deemed underwriters. The amendments eliminate these presumptive underwriter provisions, except for transactions involving a shell companies. In addition, the resale provisions of Rule 145 have been harmonized with the amendments to Rule 144.

Conforming Amendments. The SEC amended some other rules to conform to the Rule 144 amendments.

- Regulation S has been amended so that the distribution compliance period in Rule 903(b)(3)(iii) for Category 3 reporting issuers conforms to the new holding periods

for Rule 144. As a result, US reporting issuers will be subject to a distribution compliance period of six months under Regulation S.

- Rule 190, covering the registration requirements of underlying securities in asset backed securities transactions, has been revised to retain the current two-year period for resecuritizations that do not require registration of the underlying securities. Rule 190 will now provide that if the underlying securities are restricted securities, Rule 144 will be available for the sale of the securities in the resecuritization if at least two years have elapsed since the date the securities were acquired from the issuer of the underlying securities or, if later, from an affiliate of the issuer of the underlying securities.
- The resale provisions of Rule 701, dealing with securities acquired pursuant to employee benefit plans, has been amended to delete cross references to requirements of Rule 144 that have been eliminated by the amendments.

Form 4/Form 144 Coordination. The SEC did not adopt amendments to coordinate Form 144 and Form 4 filing requirements. However, the adopting release indicated that the SEC contemplates action in the future to provide affiliates that are subject to both the Form 4 and Form 144 filing requirements with greater flexibility in satisfying their requirements.

Practical Considerations.

- The amendments to Rule 144 will enhance the liquidity of restricted securities. This should reduce some of the costs associated with securities issued in private offerings that are attributable to illiquidity.
- Issuers often remove restrictive legends from restricted securities held by non-affiliates once all of the conditions of Rule 144 have been met. This option will now be available at an earlier date, which will make transfer of the shares procedurally easier.
- Restrictive legends reflecting presumptive underwriter status will no longer be needed for securities issued in Rule 145 transactions and may be removed from any such existing certificates.
- It is possible that the loosening of resale restrictions on restricted securities could add to selling pressure on an issuer's shares or otherwise accentuate the market overhang associated with the shares. Companies with large amounts of restricted shares should consider whether this is a risk that should be identified in their public disclosure documents.
- With the Rule 144 holding period shortened, holders of restricted securities will be able to resell their restricted securities more quickly. Issuers that have filed shelf registration statements to permit selling shareholders to sell their restricted securities in a registered transaction may find that they do not need to maintain the effectiveness of such registration statements for as long as they were previously maintained. It is worthwhile to review existing registration rights agreements to see if the requirement of maintaining registration statements ends once the restricted shares may be sold pursuant to Rule 144.

- When drafting or negotiating new registration rights agreements, be sure that the duration requirements for shelf registration statements correspond with the new Rule 144 holding periods.

If you have any questions regarding the applicability of the Rule 144 and related rule amendments, please contact any of the attorneys listed below or any other member of our corporate and securities group.

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APPENDIX A

Summary of conditions applicable to the resale under Rule 144 of restricted securities held by affiliates and non-affiliates as set forth in the SEC's adopting release.

	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, and • Filing 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 other 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, and • Filing 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 withany other Rule 144 requirements.