
Legal Updates & News

Legal Updates

SEC Adopts Revisions to Rules 144 and 145

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On December 6, 2007, the Securities and Exchange Commission ("SEC") issued its final rules ("New Rules") that reduce restrictions on unregistered resales of securities into the public markets. The New Rules amend Rule 144 to relax a number of impediments to reselling both restricted and control securities into the public market and codify a number of SEC staff interpretive positions related to tacking of holding periods. The New Rules also amend Rule 145 to eliminate most resale restrictions on shares acquired in registered business combination transactions.

I. Background

The safe harbor provided by Rule 144 permits unregistered public resales of securities acquired directly from an issuer, referred to as "restricted" securities, and unrestricted securities held by affiliates of the issuer, referred to as "control" securities, without having to comply with the costly and time consuming process of registering with the SEC, so long as the requirements of Rule 144 are met. These requirements, as they exist prior to the effectiveness of the New Rules, include limitations of the number of shares that can be sold in any three-month period, manner-of-sale restrictions and, in the case of restricted securities, a minimum holding period of at least one year before public resales in accordance with the limitations of Rule 144 are permitted. Rule 145 applies to securities issued in business combination transactions and, before giving effect to the New Rules, it imposed Rule 144-type resale restrictions for up to two years on securities acquired in the business combination. The New Rules significantly relax the restrictions of Rule 144 by:

- reducing the current minimum holding period for restricted securities from one year to six months;
- permitting persons who have been non-affiliates of the issuer for the past 90 days to sell unlimited amounts of restricted securities after a six month holding period, as long as the issuer meets Rule 144's current public information requirement, and to sell restricted securities without any conditions after a one-year (vs. the current two-year) holding period; and
- eliminating the Form 144 notice requirement for sales by non-affiliates and increasing the thresholds that trigger the Form 144 filing requirement for proposed sales by affiliates.

The New Rules also eliminate the current resale restrictions for affiliates of an acquired company in a business combination transaction subject to Rule 145, except in the case of resales of securities of a shell company. The New Rules will have a significant impact on a wide range of transactions, including venture capital, PIPEs, private equity, strategic business combinations, and alternative public offerings.

The new rules will become effective on February 15, 2008, and will be available for resales of securities that were acquired prior to or after that effective date.

II. Description of Revisions to Rule 144

A. Non-Affiliates

1. Exchange Act Reporting Companies

Under the New Rules, the Rule 144 holding period for non-affiliates has been reduced from one year to six months if the issuer of the securities has been subject to the Exchange Act reporting requirements for 90 days prior to the sale. Following that six-month holding period, a non-affiliate may engage in unlimited public resales so long as the issuer of the securities is current in its reporting with the SEC (that is, the issuer has filed all Periodic Reports required to be filed with the SEC) during the twelve-month period preceding such sale, or for such shorter period of time that the issuer was required to file such Periodic Reports (which must be a minimum of 90 days). The current public information requirement excludes Current Reports on Form 8-K. A selling security-holder can rely on a statement in the issuer's most recent Periodic Report (usually a "check box" on the cover page) that the issuer has satisfied the current public information requirement. After a one-year holding period, non-affiliates may engage in unlimited public resales without complying with any other requirements of Rule 144, including the current public information requirement.

2. Non-Reporting Companies

The New Rules provide for a minimum one-year holding period for non-affiliated security- holders if the issuer of the securities is not subject to the Exchange Act reporting requirements. However, after the one-year holding period expires, the selling security-holder may engage in unlimited public resales without any conditions.

B. Affiliates

While the revisions to Rule 144 shorten the initial holding period for affiliates from one year to six months for restricted securities, the New Rules will continue to impose a number of Rule 144's current restrictions on resales by affiliates. Sales of control securities remain subject to the requirements of Rule 144, although there is no holding period imposed before a sale may be made.

1. Exchange Act Reporting Companies

The New Rules reduce the Rule 144 holding period for affiliates from one year to six months if the issuer has been subject to the Exchange Act reporting requirements for at least 90 days prior to the sale. Following this six-month holding period, an affiliate may engage in public resales so long as all of the requirements of Rule 144 are satisfied, including:

- the current public information requirement;
- volume limitations;
- manner-of-sale requirements (for equity securities only); and
- if applicable, the filing of a notice of proposed sale on Form 144. In this regard, the threshold for triggering the Form 144 filing requirement has been increased to capture proposed sales over a three-month period of securities consisting of either more than 5,000 shares or other units, or with an aggregate sales price of \$50,000.

2. Non-Reporting Companies

There is a minimum one-year holding period for affiliates if the issuer is either not subject to the Exchange Act reporting requirements, or has not been subject to such reporting requirements for at least 90 days. After this one-year holding period elapses, an affiliate may engage in resales that are conditioned upon the following requirements of Rule 144:

- the current public information requirement;
- volume limitations;
- manner-of-sale requirements (for equity securities only); and
- if applicable, the filing of a notice of proposed sale on Form 144.

The following table provides a helpful summary of the application of the revised Rule 144 for public resales of securities of an issuer (other than for securities issued by shell companies):

	Affiliate or Person Selling on Behalf of an Affiliate	Non-Affiliate (and Has Not Been an Affiliate During the
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		Prior Three Months)
Restricted Securities of Reporting Issuers	<p><u>During six-month holding period:</u></p> <p>No resales under Rule 144 permitted.</p>	<p><u>During six-month holding period:</u></p> <p>No resales under Rule 144 permitted.</p>
	<p><u>After six-month holding period:</u></p> <p>May resell in accordance with all Rule 144 requirements including:</p> <ul style="list-style-type: none"> • Current public information; • Volume limitations; • Manner-of-sale requirements for equity securities; and • Filing of Form 144. 	<p><u>After six-month holding period but before one year:</u></p> <p>Unlimited public resales under Rule 144 except that the current public information requirement still applies.</p> <p><u>After one-year holding period:</u></p> <p>Unlimited public resales under Rule 144; need not comply with any other Rule 144 requirements.</p>
Restricted Securities of Non-Reporting Issuers	<p><u>During one-year holding period:</u></p> <p>No resales under Rule 144 permitted. After one-year holding period may resell in accordance with all Rule 144 requirements, including:</p> <ul style="list-style-type: none"> • Current public information; • Volume limitations; • Manner-of-sale requirements for equity securities; and • Filing of Form 144. 	<p><u>During one-year holding period:</u></p> <p>No resales under Rule 144 permitted.</p> <p><u>After one-year holding period:</u></p> <p>Unlimited public resales under Rule 144; need not comply with any other Rule 144 requirements.</p>
	<p><u>No holding period:</u></p> <p>May resell in accordance with all Rule 144 requirements,</p>	<p><u>No holding period:</u></p> <p>Unlimited public resales under Section 4(1) of the Securities</p>

Unrestricted Securities	including: <ul style="list-style-type: none"> • Current public information; • Volume limitations; • Manner-of-sale requirements for equity securities; and • Filing of Form 144. 	Act.

III. Description of Revisions to Rule 145

In the business combination context, Rule 145 has imposed on affiliates of either the acquiror or the target company restrictions on public resales of securities received in a business combination, even where the securities to be issued in the business combination were registered under the Securities Act. These restrictions were designed to prevent the rapid distribution of securities into the public markets after a registered business combination by those who were in a position to influence the business combination transaction. The New Rules eliminate these restrictions in most circumstances.

Under the New Rules, affiliates of a target company who receive registered shares in a Rule 145 business combination transaction, and who do not become affiliates of the acquiror, will be able to immediately resell the securities received by them into the public markets without registration (except for affiliates of a shell company as discussed in the following section). However, those persons who are affiliates of the acquiror, and those who become affiliates of the acquiror after the acquisition, will still be subject to the Rule 144 resale conditions generally applicable to affiliates, including the adequate current public information requirement, volume limitations, manner-of-sale requirements for equity securities, and, if applicable, a Form 144 filing.

Securities issued in business combination transactions conducted as private placements will continue to be “restricted securities” that must be resold in accordance with the applicable Rule 144 restrictions, as amended by the New Rules, pursuant to an effective registration statement or pursuant to an available exemption from the registration requirements. The SEC has not yet taken a position on whether the elimination of the Rule 145 restrictions for affiliates of a target company who do not become affiliates of the acquiror applies to transactions approved in a fairness hearing that are exempt from the registration requirements pursuant to Section 3(a)(10) of the Securities Act. Historically, the SEC imposed the same resale restrictions on affiliates of the acquiror and the target company in a Section 3(a)(10) transaction as those that would apply to a registered business combination transaction subject to Rule 145. The Division of Corporation Finance announced that it intends to issue a revised Staff Legal Bulletin No. 3 prior to the effective date of the New Rules to clarify its position on transactions exempt from registration pursuant to Section 3(a)(10).

IV. New Restrictions for Shell Companies

Because of perceived abusive practices involving shell companies, the New Rules amend Rules 144 and 145 to impose additional restrictions on public resales of securities initially issued by a shell company. A shell company is a company with nominal or no operations and nominal or no assets (or assets consisting solely of cash and cash equivalents). It is important to note that the Rule 144 shell company restrictions imposed by the New Rules apply to both reporting and non-reporting shell companies, whereas the Rule 145 shell company restrictions imposed by the New Rules apply only to Exchange Act reporting shell companies. These revisions to Rule 144 and Rule 145 for public resales of securities of shell companies will create additional complexities for transactions that involve shell companies, including acquisitions by special purpose acquisition companies (SPACs) and “alternative public offerings” (APOs).

A. Application of Rule 144 to Shell Companies

Under the New Rules, any securities that were initially issued by a reporting or non-reporting shell company cannot be resold into the public markets in reliance on Rule 144 unless the issuer:

- ceases to be a shell company;
- becomes an Exchange Act reporting company;
- is current in its periodic reports; and
- has filed current "Form 10 information," which includes financial statements of the acquired operating company.

In addition, a selling security-holder (whether an affiliate or a non-affiliate) cannot use Rule 144 for resales of securities initially issued by shell companies until one year has elapsed from the date that the issuer filed the "Form 10 information" with the SEC.

B. Application of Rule 145 to Shell Companies

Under the New Rules, public resales of securities acquired by affiliates of acquirors and target companies in business combination transactions involving shell companies will continue to be subject to restrictions imposed by Rule 145. If the business combination transaction is not registered under the Securities Act, then the affiliates must look to Rule 144 to resell their securities (with the additional Rule 144 conditions applicable to shell company securities). If the business combination transaction is registered under the Securities Act, then affiliates of the acquiror and target company may resell the securities acquired in the transaction, subject to the following conditions:

- The issuer must meet all of the conditions applicable to shell companies under Rule 144;
- After 90 days from the date of the acquisition, the affiliates may resell their securities subject to Rule 144's volume limitations, adequate current public information requirement, and manner-of-sale requirements;
- After six months from the date of the acquisition, selling security-holders who are not affiliates of the acquiror may resell their securities subject only to the adequate current public information requirement of Rule 144; and
- After one year from the date of the acquisition, selling security-holders who are not affiliates of the acquiror may resell their securities without restriction.

V. Other Notable Features of the New Rules

A. Codification of Interpretive Positions

The New Rules codify a number of Rule 144 interpretive positions that the Division of Corporation Finance has developed over time in its administration of Rule 144. The codifications of interpretive positions primarily relate to tacking of the applicable Rule 144 holding period. In particular, the New Rules:

- permit tacking of the holding period in connection with holding company reorganizations;
- permit tacking of the holding period in connection with a conversion or exchange of securities by the same issuer; and
- permit tacking in connection with a cashless exercise of options or warrants that have been purchased for cash or property (which excludes employee stock options).

The New Rules also codify the following interpretive positions:

- deeming securities issued in a transaction exempt from registration under Section 4(6) of the Securities Act to be "restricted securities";
- allowing a pledgee of restricted securities to sell its restricted securities without aggregation with sales by other pledgees for purposes of the Rule 144 volume limitations; and
- allowing Form 144 filers to make the required representations "as of" the date that they adopted written trading plans that satisfy Rule 10b5-1.

Finally, the SEC included two footnotes in the adopting release that are noteworthy. First, in footnote 65, the SEC indicated that it does not object to the practice of removing restrictive legends

from securities held by non-affiliates prior to an actual public resale, so long as the applicable conditions of Rule 144 have been satisfied. Second, in footnote 90, the SEC reiterated its interpretive position that, for the purposes of Section 5 of the Securities Act, a “sale” occurs at the time a short position is established, rather than when shares are delivered to close out the short position. According to the SEC interpretive position, an investor cannot close a short position with restricted securities unless the short sale occurred at a time when the conditions of Rule 144 were satisfied.

For a complete description of the new rules and the text of the new rules, the SEC adopting release can be found [here](#).