

## *SEC Adopts Amendments to Rules Governing the Sale of Restricted and Control Securities*

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### **Executive Summary**

To increase the liquidity of privately sold securities and decrease the cost of capital for issuers, while still providing sufficient investor protection, the Securities and Exchange Commission adopted a number of amendments to Rule 144, promulgated under the Securities Act of 1933 (the "Securities Act"). The amendments, which became effective February 15, 2008 and are applicable to securities acquired before and after the effective date, have liberalized the resale of restricted securities. The significant amendments to Rule 144 have accomplished the following:

- Reduced the initial holding period for the resale of restricted securities of a reporting issuer to six months.
- Removed all manner of sale requirements for the sale of restricted securities by a non-affiliate, except that with regard to the securities of reporting issuers, the current public information requirement will continue for an additional six months.
- Altered the manner of sale requirements in connection with the resale of securities by an affiliate of the issuer.
- Removed all manner of sale requirements and increased the volume of sale limitations for the resale of debt securities by an affiliate of the issuer.
- Altered the thresholds which require a security holder to file a Form 144 in connection with the resale of their securities.

The new amendments also include a codification of a number of SEC staff interpretations of Rule 144, which has helped to clarify many elements of the

resale of restricted securities. These codifications include the following:

- Securities issued in connection with a reorganization shall be deemed to have been held from the time the security holder acquired the securities of the predecessor company.
- The holding period for conversions and exchanges will be deemed to have commenced on the date the original securities were acquired.
- The holding period for securities received upon the execution of options and warrants will be deemed to have commenced on the date the options and warrants were acquired.
- A pledgee of securities may sell their pledged securities without having to aggregate their sale with the sales by other pledgees of the same security.
- Security holders will not be permitted to rely upon Rule 144 for the resale of restricted securities issued by a shell company.
- Securities issued pursuant to Section 4(6) of the Securities Act, for offerings of less than \$5 million, shall be considered restricted securities.
- Form 144 has been amended in order to reconcile it with the required representations of Rule 10b-5 of the Exchange Act.

### **Background of Rule 144**

The Securities Act requires the registration of any sale or offer to sell a security unless such sale or offer to sell is exempted from registration. One such exemption is provided by Section 4(1) of the

Securities Act, which relieves any person other than an issuer, underwriter or dealer from the registration requirement. In 1972, the SEC adopted Rule 144 which provides security holders with a safe harbor from the definition of an underwriter, and thus the requirement to register, so long as the resale of their securities meet the specific conditions of Rule 144, including:

- The availability of adequate public information about the issuer;
- Required holding periods for securities acquired directly from an issuer in any transaction listed in Rule 144(a)(3) (“restricted securities”);
- Sales volume limitations;
- Compliance with specific manner of sale requirements; and
- The filing of a Form 144 if the amount of securities sold exceeds certain thresholds.

Once a security holder had met each of these requirements, they were permitted to take advantage of the exemption under Section 4(1) of the Securities Act since they will no longer be considered an underwriter. With the recent adoption of the amendments to Rule 144, the SEC has streamlined the process of meeting these requirements, and in many cases, significantly lightened the burden placed on security holders seeking to qualify for the safe harbor offered by Rule 144.

## **Amendments to Rule 144**

### ***Required Holding Periods for the Sale of Restricted Securities***

Previously under Rule 144, holders of restricted securities of an issuer that is subject to the reporting requirements of Section 13 or Section 15(d) of the 1934 Securities Exchange Act (the “Exchange Act”) were required to hold their securities for a period of one year prior to any resale. Under the newly adopted amendments, the holding period has been shortened to six months. The required holding period for restricted securities of a non-reporting issuer remains one year. The different holding periods reflect a reporting issuer’s obligation to file periodic reports with updated financial information.

### ***Sale of Securities by Non-Affiliates after the Holding Period***

Rule 144 has always drawn a distinction between the sales of securities by affiliates (as defined in Rule 12b-2 of the Exchange Act) and non-affiliates. As adopted, the amendments substantially dilute the restrictions that are placed on the public resale of securities by non-affiliates. Now, sales by non-affiliates of restricted securities of non-reporting issuers after the required holding period are no longer subject to any of the additional Rule 144 requirements. However, if the securities to be sold are those of a reporting issuer, then the current public information requirement will continue for additional six months after the holding period. The current public information requirement is a one-year requirement. This means that sales following a one-year holding period would be permitted even though a reporting issuer was delinquent in its filings after that first year.

## **Manner of Sale Requirements for Affiliates**

### ***Introduction***

The Rule 144(f) manner of sale requirements dictate that securities must be sold in “brokers’ transactions,” as defined in Rule 144(g), or in transactions directly with a “market maker” as the term is used in Section 3(a)(38) of the Exchange Act. Furthermore, a selling security holder is not permitted to solicit or arrange for the solicitation of orders to buy the securities in anticipation of or in connection with such transaction, nor are they allowed to make 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. Under the amendments, the SEC has reduced the burden imposed on affiliate security holders by these manner of sale requirements.

First, Rule 144(f) has been changed to permit the resale of securities through riskless principal transactions. A riskless principal transaction is one in which after having received a customer order to buy or sell, a broker or dealer purchases or sells the securities as a principal in the market in order to satisfy the customer order to buy or sell. However, the broker or dealer must still meet each of the requirements of a brokers’ transaction, except those requirements referring to the execution of an order as

an agent for the person whose account the securities are sold.

Second, the SEC has amended Rule 144(g)(3) which sets forth certain activities that are not deemed to be a solicitation, and therefore may be engaged in by a broker without violating the requirements of Rule 144(g). Under the new provision, a broker is permitted to post bid and ask quotations for the securities in an alternative trading system without it being deemed a solicitation if the broker has published bona fide bid and ask quotations for the security in the alternative trading system for each of the previous 12 business days.

### ***Volume Limitations on Sales of Equity Securities by Affiliates***

The new rules did not change the amount of equity securities that affiliates can sell during any three-month period. Such sales cannot exceed the greater of one percent of the total shares of that class outstanding or the average weekly trading volume over the preceding four weeks on all national exchanges.

### ***Resale of Debt Securities by Affiliates***

The amendments to Rule 144 have made two significant changes to the requirements for the resale of debt securities by affiliates of the issuer. First and foremost, the SEC has removed all manner of sale requirements in conjunction with the resale of debt securities by an affiliate. The SEC noted that such an amendment was imperative due to the unnecessary burdens the manner of sale requirements placed on the resale of fixed income securities.

The amendments also addressed the Rule 144(e) volume limitations for debt securities. Under the previous rule, the amount of securities sold in a three-month period could not exceed the greater of one percent of the outstanding class or the average weekly volume of trading in the securities as calculated under the rule. This has been amended to permit the resale of debt securities in an amount not to exceed ten percent of a single tranche or class within a three month period.

### ***Form 144 Reporting Threshold***

Previously, Rule 144(h) required a security holder to file a Form 144 if the intended sale of securities was

to exceed 500 shares or \$10,000 within a three-month period. Now, Rule 144(h) applies only to affiliates whose intended sales are to exceed 5,000 shares or \$50,000 within a three-month period.

### ***Codification of Interpretive Positions of the Staff of the Division of Corporation Finance***

The SEC also codified a number of interpretive positions relating to Rule 144 previously issued by the Division of Corporation Finance.

#### **A. Restricted Securities under Rule 144(a)(3):**

The SEC has now codified its position that securities acquired from the issuer under the exemption offered by Section 4(6) of the Securities Act are to be considered restricted securities. Section 4(6) of the Securities Act exempts from registration securities that are issued pursuant to an offering that does not exceed \$5 million dollars, is made only to accredited investors, does not involve advertising or public solicitation and is accompanied with the filing of a Form D.

#### **B. Tacking of Holding Periods When A Company Reorganizes:**

Under this amendment to Rule 144, security holders may count the period during which they held the securities of a predecessor company prior to the company being reorganized into a holding company when calculating the holding period of the securities received in the reorganization. Such tacking will be permitted if the following conditions are met: (i) the newly formed company's securities were issued in exchange for the securities of the predecessor company as a part of a reorganization of the prior company into a holding company; (ii) the security holders received securities of the new company that were of the same class, with the same proportional interest and have the same rights and interests as the securities they held in the predecessor company; and (iii) following the transaction, the new company had no substantial assets other than the securities of the predecessor company.

#### **C. Tacking of Holding Periods for Conversions and Exchanges of Securities:**

While Rule 144 was previously quiet on such matters, the SEC has now codified its interpretation that for the purposes of calculating the required holding period, securities acquired from an issuer in exchange for other

securities of the same issuer will be deemed to have been acquired when the original securities were issued.

**D. Tacking of Holding Periods for Cashless Exercises of Options and Warrants:** The SEC has also amended the tacking provisions in conjunction with the cashless exercise of an option or warrant. For the purposes of calculating the required holding period for a Rule 144 resale, the new securities received in exchange for the exercise of the option or warrant will be deemed to have been acquired on the date the original options or warrants were acquired. If the original terms of the options or warrants did not allow for a cashless exercise, then the options or warrants will be deemed to have been acquired on the date of the amendment to the terms to allow for such an exercise. However, securities received pursuant to the exercise of warrants or options that were not purchased for cash or property will still be deemed to have been acquired on the date of exercise.

**E. Aggregation of Pledged Securities for the Calculation of Volume Limitations:** Under the provision added by the SEC at Rule 144(e)(3), the SEC has addressed how a pledgee of securities should calculate the volume limitation requirement under Rule 144. Pursuant to the new provision, so long as the pledgees are not the same “person” (as defined in 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, so long as such sale is not part of a concerted effort by the pledgees.

**F. Securities Issued by Shell Companies:** The SEC has now codified its stance that Rule 144 sales will not be available to holders of securities issued by companies that are or were reporting or non-reporting shell companies. It should be noted that the SEC’s use of the term “shell company” is much broader under this amendment than in the Rule 405 definition of a shell company since it applies to any “issuer” and not just a “registrant” or public company. However, the SEC will allow resales under Rule 144 if (i) the issuer has ceased to be a shell company; (ii) the issuer is subject to Exchange Act reporting requirements; (iii) the issuer has filed all required Exchange Act reports during the preceding twelve months; and (iv) at least one year has passed since the time the issuer filed the appropriate Form 10 information reflecting that it had ceased to be a shell company prior to any securities being sold in reliance upon Rule 144.

**G. Reconciling Rule 144 Representations with Rule 10b-5:** Form 144 has been amended in order to reconcile its required representations with those of Rule 10b5-1(c). Now, a security holder selling pursuant to a written pre-planned trading plan (10b5-1 plan) will be allowed to make their representation regarding the lack of the possession of material adverse information as of the date of the adoption of the trading plan. Before the amendments, the security holder was required to make two representations regarding the lack of possession of material adverse information, one at the time of the adoption of the plan, and again at the time of filing the Form 144.

## New Rule 144 Restrictions on Resales of Restricted Securities

	<b>Affiliate or Person Selling on Behalf of an Affiliate</b>	<b>Non-Affiliate (and Has Not Been an Affiliate During the Prior Three Months)</b>
<b>Restricted Securities of Reporting Issuers</b>	<ul style="list-style-type: none"> <li>• <b>During Six-Month Holding Period:</b> Resales under Rule 144 are not permitted</li> <li>• <b>After Six-Month Holding Period:</b> May resell, but must be done in accordance with all Rule 144 requirements                             <ul style="list-style-type: none"> <li>• Current Public Information*</li> <li>• Volume Limitations*</li> <li>• Manner of Sale Requirements *</li> <li>• File Form 144*</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• <b>During Six-Month Holding Period:</b> Resales under Rule 144 are not permitted</li> <li>• <b>After Six-Month Holding Period, but Prior to One-Year:</b> Unlimited and unrestricted public resales, except that current public information requirement still applies</li> <li>• <b>After One-Year Holding Period:</b> Unlimited and unrestricted public resales, need not comply with Rule 144 requirements</li> </ul>
<b>Restricted Securities of Non-Reporting Issuers</b>	<ul style="list-style-type: none"> <li>• <b>During One-Year Holding Period:</b> Resales under Rule 144 are not permitted</li> <li>• <b>After One-Year Holding Period:</b> May resell, but must be done in accordance with all Rule 144 requirements                             <ul style="list-style-type: none"> <li>• Current Public Information*</li> <li>• Volume Limitations*</li> <li>• Manner of Sale Requirements*</li> <li>• File Form 144*</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• <b>During One-Year Holding Period:</b> Resales under Rule 144 are not permitted</li> <li>• <b>After One-Year Holding Period:</b> Unlimited and unrestricted public resales, need not comply with Rule 144 requirements</li> </ul>

\* The Current Public Information requirement of Rule 144(c) provides that current information concerning the issuer be publicly available. The Volume Limitation requirement of Rule 144(e) sets forth the amount of securities that can be sold. The Manner of Sale requirements of Rule 144(f) and (g) provide the manner in which sales must be made so as not to amount to special selling efforts or involve special compensation. Rule 144(h) sets forth a notice requirement on Form 144 when the order to sell is placed with a broker or the securities are sold to a market maker unless the number of securities does not exceed 5,000 shares and the aggregate sale price does not exceed \$50,000.

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