

SEC Proposes Revisions to Rules 144 and 145

August 16, 2007

The Securities and Exchange Commission has proposed significant revisions to Rules 144 and 145 under the Securities Act of 1933.¹

The revisions would

- shorten the minimum holding period required for resales of restricted securities under Rule 144 from one year to six months for securities of reporting issuers;
- toll this minimum six-month holding period for up to an additional six months during the time in which the holder engages in hedging transactions;
- end all resale restrictions on sales by non-affiliates of restricted securities held for at least one year;
- relax other Rule 144 requirements; and
- eliminate Rule 145 restrictions on securities acquired in most business combination transactions.

The SEC believes that the proposed changes will increase the liquidity of restricted securities and decrease the cost of capital. The due date for submitting comments to the SEC on the proposed revisions is September 4, 2007.²

Background

Section 5 of the Securities Act requires that any offer to sell or sale of securities be registered with the SEC unless the offer or sale is made pursuant to an exemption from the registration requirements. Section 4(1) of the Securities Act allows securities to be sold without registration in "transactions by any person other than an issuer, underwriter, or dealer." Section 2(11) of the Securities Act defines an underwriter as "any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking." Rule 144, which the SEC adopted in 1972 and has

¹ See Securities Act Release No. 33-8813 (June 22, 2007), 72 FR 36822 <http://www.sec.gov/rules/proposed/2007/33-8813fr.pdf> (July 5, 2007).

² The Securities Industry and Financial Markets Association (SIFMA) has submitted a comment letter requesting that the SEC extend this comment period for an additional 30 days. Comments of Gerard G. Quinn, Esq., Managing Director, Associate General Counsel of SIFMA (August 10, 2007).

not amended since 1997, provides a non-exclusive safe harbor for resales of restricted and control securities under the Section 4(1) exemption.

Restricted securities are securities acquired directly or indirectly from the issuer or from an affiliate of the issuer in a transaction or chain of transactions not involving a public offering. Control securities are any securities owned by an affiliate of the issuer regardless of how the affiliate acquired the securities. Rule 405 under the Securities Act provides that “[a]n ‘affiliate’ of, or person ‘affiliated’ with, a specified person, is a person that directly, or indirectly through one or more intermediaries, controls or is controlled by, or is under common control with, the person specified.” Rule 405 under the Securities Act also states that “[t]he term ‘control’ (including the terms ‘controlling,’ ‘controlled by’ and ‘under common control with’) means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.”

If a selling securityholder complies with the conditions of Rule 144 in connection with a transaction, it will be deemed not to have purchased with a view to distribution and will therefore be deemed not to be an “underwriter.” The securityholder will then qualify for the exemption from registration requirements under Section 4(1) of the Securities Act for transactions by any person other than an issuer, underwriter or dealer.

Current Rule 144 Requirements

Both non-affiliates and affiliates must currently wait until the conclusion of the one-year holding period specified in Rule 144(d) before they may resell restricted securities under Rule 144. Non-affiliates may resell restricted securities held between one and two years in accordance with the following Rule 144 requirements:

- availability of adequate current public information about the issuer under Rule 144(c);
- volume limitations under Rule 144(e);
- manner of sale specifications under Rules 144(f) and (g); and
- filing of a Form 144 under Rule 144(h).

Pursuant to Rule 144(k), a non-affiliate that has not been an affiliate of the issuer during the three months prior to the sale may freely resell restricted securities held for more than two years without compliance with the Rule 144 conditions. Affiliates must comply with the Rule 144 conditions in connection with all resales of restricted and control securities under Rule 144.

Under certain circumstances, Rule 144 permits a securityholder to combine, or tack, its holding period with that of a previous owner. A securityholder may tack the Rule 144 holding period of restricted securities it purchases from a non-affiliate, but any securities purchased from an affiliate are subject to a new Rule 144 holding period.

Rule 144 currently does not toll the holding period of a holder of restricted securities when the securityholder enters into short sales or other hedging arrangements to gain synthetic short exposure to the restricted securities.

The SEC's Proposals

The SEC's proposing release contains the following chart³ that summarizes the proposed requirements for the resale of restricted securities by affiliates and non-affiliates:

	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 Companies	<p><u>During six-month holding period*</u> - no resales under Rule 144 permitted.</p> <p><u>After six-month holding period*</u> - 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 for equity securities, and • Filing of Form 144. 	<p><u>During six-month holding period*</u> - no resales under Rule 144 permitted.</p> <p><u>After six-month holding period* but before one year</u> - may resell in accordance with the current public information requirement.</p> <p><u>After one year</u> - unlimited public resale under Rule 144; need not comply with other Rule 144 requirements.</p>
Restricted Securities of Non-Reporting Companies	<p><u>During one-year holding period</u> - no resales under Rule 144 permitted. Tolling provision does not apply.</p> <p><u>After one-year holding period</u> - may resell in accordance with all Rule 144 requirements except holding period, including:</p> <ul style="list-style-type: none"> • Current public information, • Volume limitations, • Manner of sale for equity securities, and • Filing of Form 144. 	<p><u>During one-year holding period</u> - no resales under Rule 144 permitted. Tolling provision does not apply.</p> <p><u>After one-year holding period</u> - unlimited public resale under Rule 144; need not comply with other Rule 144 requirements.</p>

* Such holding period may be longer than six months (but not longer than one year), depending on hedging activities.

³ Securities Act Release No. 8813, 72 FR at 36828.

Shortened Minimum Holding Period for Restricted Securities

The SEC's proposals would shorten the holding period required for reliance on the Rule 144 safe harbor from one year to six months for restricted securities of reporting issuers, defined as issuers that are, and have been for at least 90 days before a sale, subject to the reporting requirements under Section 13 or Section 15(d) of the Securities Exchange Act of 1934. The SEC notes that the assumption of the economic risk of an investment is a critical factor in determining whether a securityholder purchased securities with a view to distribution. The SEC believes that, in the current market environment, a minimum holding period of six months for the securities of reporting issuers is a reasonable indicator that the securityholder held the security for investment purposes and not with a view to distribution and that the securityholder is therefore not an underwriter. The holding period would remain one year for securities of non-reporting issuers, defined as issuers that are not, or have not been for at least 90 days immediately before a sale, subject to the reporting requirements under Section 13 or Section 15(d) of the Exchange Act.

Relaxed Rule 144 Requirements

The proposals would permit non-affiliates to resell restricted securities held for longer than one year without compliance with any of the Rule 144 conditions. For Rule 144 resales of restricted securities of reporting issuers held for longer than the minimum six-month holding period but less than one year, non-affiliates would need to comply only with the adequate current public information about the issuer condition.

The proposals would permit affiliates to resell restricted securities of reporting or non-reporting issuers held for longer than the minimum six-month holding period in accordance with the Rule 144 conditions of adequate current public information about the issuer, volume limitations, manner of sale restrictions and Form 144 filing requirements. For a reporting issuer, the adequate current public information condition would require that the issuer have filed all required reports under Section 13 or Section 15(d) of the Exchange Act, other than Form 8-K reports, during the 12 months preceding the sale (or for the shorter period during which the issuer was required to file such reports). For a non-reporting issuer, the adequate current public information condition would require the public availability of basic information about the issuer, including three years of financial statements.

Tolling of Holding Period for Certain Hedge Positions

Under the proposals, the minimum six-month holding period for securities of reporting issuers would be extended for up to an additional six months by the amount of time during which any holder of restricted securities engaged in certain hedging transactions, but the maximum holding period for securities of reporting issuers would be one year. (As the minimum holding period for securities of non-reporting issuers would already be one year, holders of restricted securities of non-reporting companies would not be subject to the tolling provision.) The SEC's rationale for tolling the holding period is that hedging arrangements that shift the economic risk of an investment away

from the securityholder make it more difficult to conclude that the securityholder held the security for investment purposes and not with a view to distribution that would trigger underwriter status.

The proposed revisions would toll the Rule 144 holding period during any period in which the securityholder has a short position or a “put equivalent position,” as defined by Rule 16a-1(h) under the Exchange Act, with respect to any securities of the same class as the restricted securities or any securities convertible into securities of such class (or, in the case of restricted non-convertible debt securities, any nonconvertible debt securities of the same issuer) (we will refer to such short position or put equivalent position as a “short hedge position”). Put equivalent positions are derivative securities positions, such as a long put option or a short call option, that increase in value as the value of the underlying security decreases. Under the proposals, the existence of any short hedge position, regardless of size, would toll the holding period for the entire amount of equivalent or related securities of the issuer held by the securityholder. A commenter has suggested that the SEC clarify the new rule so that only the holding period in the hedged portion of the restricted securities is tolled or alternatively only the long securities offsetting any short hedge position should be required to be held for one year prior to eligibility for resale under Rule 144.⁴ A Rule 144 tolling provision in effect prior to 1990 tolled the holding period only for securities in an offsetting amount equivalent to the securities subject to a short position or put option rather than tolling the holding period for a securityholder’s entire position.

The proposed revisions would require a securityholder tacking to the holding periods of previous owners to factor in any tolling of the holding periods of those previous owners in connection with hedging arrangements unless the selling securityholder “reasonably believes” that the previous owners did not hold any short hedge positions. The proposals would require brokers executing transactions that qualify as “brokers’ transactions” for purposes of the Rule 144 manner of sale requirements to inquire as to the existence and character of any short hedge positions to the extent that the securities have been held for less than one year and would require affiliates to disclose such information in Form 144 filings.

Elimination of Manner of Sale Requirements for Resales of Debt Securities

The Rule 144 manner of sale requirements provide that a person selling restricted securities may not solicit orders to purchase the securities or make any payments in connection with the offer or sale of the securities other than to the broker. Although the proposals would completely exempt non-affiliates from compliance with the manner of sale requirements, affiliates would remain subject to such requirements with respect to resales of restricted equity securities. The proposals would eliminate the manner of sale requirements for, and would allow privately negotiated resales of, debt

⁴ Comments of David N. Feldman, Esq., Managing Partner of Feldman, Weinstein and Smith LLP (July 19, 2007). This comment letter also recommends that the SEC adopt the Canadian model of a four-month holding period prior to resales of unregistered securities held by non-affiliates of reporting issuers.

securities, which include fixed income securities as well as securities such as asset-backed securities and non-participating preferred stock that have debt-like characteristics.

Increased Thresholds for Form 144 Filings

Form 144 filings are currently required to be transmitted to the SEC concurrently with or prior to sales of greater than 500 shares or \$10,000 worth of covered restricted or control securities within three months. The proposals would eliminate Form 144 filings for non-affiliates and would increase the filing thresholds for affiliates to 1,000 shares or \$50,000 worth of securities within three months.

Stylistic Revisions to Rule and Codification of SEC Staff Interpretations

The proposals would simplify and streamline the language of the Preliminary Note to Rule 144 and the text of Rule 144 in accordance with plain English principles. These revisions are not meant to effect substantive changes. The revisions would also codify various SEC staff interpretations, including the following, to provide greater certainty regarding the treatment of restricted securities:

- Securities acquired under Section 4(6) of the Securities Act, which provides an exemption from registration for offerings below \$5 million that are made to accredited investors, do not involve advertising or public solicitation and for which a Form D filing is made, are restricted securities.
- In connection with a transaction solely to form a holding company, a securityholder may tack to the Rule 144 holding period of a predecessor company, provided that the securityholder's percentage ownership and the characteristics of the security do not change in connection with the formation of the holding company and the assets and liabilities of the holding company substantially mirror those of the predecessor company prior to the transaction.
- Securities acquired in exchange for or upon conversion of other securities will be deemed to have been acquired on the date the securityholder acquired the original securities. This tacking of holding periods is permitted even if the original securities were not exchangeable or convertible by their terms as long as the securityholder did not provide consideration other than securities of the issuer for the amendment to the securities.
- Securities acquired from the issuer upon cashless exercise of options or warrants will be deemed to have been acquired on the date the securityholder acquired the original securities. This tacking of holding periods is permitted even if the original securities did not provide for cashless exercise as long as the securityholder did not provide consideration other than securities of the issuer for the amendment to the securities. For securities not purchased with cash or property, such as employee stock options, the Rule 144 holding period commences on the date the security is exercised, provided that the full consideration for the exercise is given at the time of exercise, because that is the date upon which the holder assumed investment risk with respect to the securities.

- In calculating the volume of securities a pledgee may sell within the Rule 144 volume restrictions, the pledgee need not aggregate its sales with sales by other pledgees as long as there is no concerted action by the pledgees. Each pledgee must still aggregate its sales with sales by the pledgor.
- Rule 144 is not available for resales of securities of reporting and non-reporting shell companies and blank check companies, other than asset-backed issuers and business combination related shell companies. Rule 144 is available for resales of securities of an issuer that was formerly a shell company, provided that the issuer is subject to reporting requirements under Section 13 or Section 15(d) of the Exchange Act and has filed all required reports during the preceding 12 months (or shorter time period during which it was subject to reporting requirements) and that at least 90 days have elapsed since the issuer filed "Form 10 information" with the SEC indicating that it is no longer a shell company.
- The SEC permits selling securityholders relying on Rule 144 and a Rule 10b5-1 trading plan to modify the representation on Form 144 to indicate that the selling securityholder had no knowledge of material nonpublic information about the issuer as of the date of adoption of the trading plan, as opposed to the date the Form 144 is signed. The proposals would revise Form 144 to reflect this modification. The revised Form 144 will also require disclosure of hedging activities involving securities held for less than one year.

Coordination of Form 4 and Form 144 Filings

The SEC is soliciting comments on a proposal to combine reporting obligations on Form 144 with those on Form 4 for entities that are affiliates of the issuer and are also subject to reporting requirements under Section 16 of the Exchange Act. Although Form 4 filings must be made within two business days after a reportable transaction, Form 144 filings must be transmitted for filing prior to or concurrently with a sale. In addition to harmonizing the filing deadlines, the SEC has proposed allowing Form 4 filings to fulfill Form 144 filing requirements.

Issuer Disclosure of Resale Status of Securities

The SEC is soliciting comments on a proposal to revise Item 701 of Regulation S-K to require issuers to provide in registration statements and periodic reports disclosure about whether securities issued in unregistered transactions are restricted securities. If the securities are not restricted, the issuer would describe their resale status. If the securities are restricted, the issuer would state the first date on which the securities could meet the Rule 144(d) holding period.

Changes to Rule 145

Rule 145 provides that exchanges of securities in business combination transactions that are subject to a shareholder vote constitute sales of such securities. Pursuant to the "presumptive underwriter" doctrine under Rule 145(c), parties to a Rule 145 transaction and their affiliates, other than the issuer, are presumed to be underwriters with respect to the securities they acquire in the transaction.

Because the parties are deemed to be underwriters, the securities they acquire are subject to Rule 145(d) resale restrictions, which are similar to the resale restrictions under Rule 144.

The proposals would eliminate Rule 145 resale restrictions for securities acquired in most business combination transactions. Such securities would still be subject to Rule 144 restrictions if the securityholder becomes an affiliate of the acquiring company. The proposals would retain the “presumptive underwriter” doctrine for restricted securities acquired in registered business combinations involving shell companies (other than business combination related shell companies). The proposals would also conform the resale provisions of Rule 145(d) with the proposed revisions to the Rule 144 resale provisions for the securities of shell companies.

This memorandum is for general information purposes and should not be regarded as legal advice. Please contact your relationship partner if we can be of assistance regarding these important developments. The names and office locations of all of our partners, as well as memoranda regarding recent corporate reporting and governance developments, can be obtained from our website, www.simpsonthacher.com.