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SEC Significantly Liberalizes Rules 144 and 145

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The Securities and Exchange Commission recently adopted major amendments[1] to Rules 144 and 145 under the Securities Act of 1933. The SEC believes that the amendments, which represent the first revisions to these rules since 1997, will decrease the cost of capital for issuers by reducing the illiquidity discount for securities sold in private transactions. The amendments will, among other things:

- substantially reduce Rule 144 compliance obligations for non-affiliates[2]
  - for restricted securities of reporting companies, the amendments:
    - shorten the holding period required prior to Rule 144 resales from one year to six months;
    - allow resales of securities held for between six months and one year, subject only to the current public information condition; and
    - allow free resales of securities held for at least one year
  - for restricted securities of non-reporting companies, the amendments allow free resales of securities held for at least one year;
- reduce Rule 144 compliance obligations for affiliates[3] by:
  - shortening the holding period required prior to Rule 144 resales of securities of reporting companies to six months (one year for securities of non-reporting companies);

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1 See Securities Act Release No. 33-8869 (December 6, 2007), 72 FR 71546 http://www.sec.gov/rules/final/2007/33-8869fr.pdf (December 17, 2007).

2 Rule 144(a)(1) provides that "[a]n affiliate of an issuer is a person that directly, or indirectly through one or more intermediaries, controls or is controlled by, or is under common control with, such issuer."

3 With respect to resales of control securities and restricted securities held for longer than the required holding period, affiliates must still comply with the current public information condition, volume limitations, manner of sale restrictions and Form 144 notice filing requirements.

- with respect to debt securities, eliminating the manner of sale restrictions and establishing a new volume test;

- revising the manner of sale restrictions applicable to Rule 144 resales of equity securities; and

- raising the Form 144 filing thresholds from sales within a three-month period that exceed either 500 shares or $10,000 worth of securities to sales within a three-month period that exceed either 5,000 shares or $50,000 worth of securities;

- simplify and streamline the language of the Preliminary Note to Rule 144 and the text of Rule 144 in accordance with "plain English" principles and codify various SEC staff interpretations under Rule 144; and

- eliminate Rule 145 restrictions for securities acquired in most business combination transactions.

The amendments are similar in most respects to the proposals made by the SEC in June 2007,[4] except that the SEC elected not to adopt provisions that would have tolled the six-month holding period for restricted securities of reporting issuers for up to an additional six months during the time in which a holder of such securities engaged in hedging transactions. This significant change from the amendments as initially proposed appears to have been made in response to comments arguing that such tolling could frustrate the objective of reducing the cost of capital for issuers because the proposed tolling provision would have required securityholders and brokers to incur significant costs to monitor hedging positions in order to determine compliance with holding period requirements.

The amendments will become effective as of February 15, 2008 and will apply to securities held prior to the date of effectiveness of the amendments.

Background

Section 5 of the Securities Act requires registration of all offers and sales of securities unless an exemption from the registration requirements is available. Section 4(1) of the Securities Act provides one such exemption from registration for securities sold in "transactions by any person other than an issuer, underwriter, or dealer." Section 2(a)(11) of the Securities Act, in turn, 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." The key question in analyzing the availability of the

[4] 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).

Section 4(1) exemption is whether the holder purchased the securities "with a view to . . . distribution."

Rule 144, which the SEC adopted in 1972, provides a non-exclusive safe harbor for resales of securities under the Section 4(1) exemption from the Securities Act registration requirements. This safe harbor provides assurance that a selling securityholder complying with Rule 144 will qualify for the Section 4(1) exemption because it will be deemed not to have purchased "with a view to . . . distribution" and, therefore, will not be an "underwriter."

The Rule 144 safe harbor is available for resales of both "restricted securities" and "control securities." "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. Although not defined in Rule 144, the term "control securities" is commonly used to refer to any securities owned by an affiliate of the issuer regardless of how the affiliate acquired the securities.

Rule 144 Requirements Prior to Effectiveness of Amendments

Prior to the amendments, both non-affiliates and affiliates were required to wait until the conclusion of the one-year holding period specified in Rule 144(d) before reselling restricted securities under Rule 144. Non-affiliates and affiliates could resell restricted securities held between one and two years subject to compliance with the following Rule 144 requirements:

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

Pursuant to Rule 144(k), an investor that had not been an affiliate of the issuer during the three months prior to a sale could freely resell restricted securities held for more than two years without compliance with the Rule 144 conditions. Affiliates were required to 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. The amendments have not altered this ability of securityholders to tack to the holding periods of previous owners under Rule 144 under certain circumstances.

Rule 144 does not toll the holding period for 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, although care must be taken in respect of any short sales or other hedging

transactions involving restricted securities to make sure that the covering or close-out transaction does not violate Section 5 of the Securities Act.

Amendments to Rules 144 and 145

Holding Periods of Six Months for Securities of Reporting Issuers and One Year for Securities of Non-Reporting Issuers

The amendments shorten the holding period applicable to the restricted securities of reporting issuers from one year to six months.[5] The SEC has concluded that a holding period of six months for the securities of reporting issuers is a reasonable indicator that the securityholder has sufficiently assumed the economic risk of investment and that the securityholder has held the security for investment purposes and not with a view to distribution and, accordingly, the securityholder is not an underwriter.

The holding period will remain one year for securities of non-reporting issuers.

Relaxed Rule 144 Requirements for Restricted Securities

Non-Affiliates: Under amended Rule 144, a non-affiliate (one who has not been an affiliate during the three months prior to a sale) may freely resell restricted securities held for longer than six months and less than one year, subject only to the condition requiring adequate current public information about the issuer.[6] Non-affiliates may freely resell restricted securities held for at least one year without compliance with any of the Rule 144 conditions regardless of whether such securities are restricted securities of reporting or non-reporting issuers.

Affiliates: Under amended Rule 144, affiliates may resell (1) securities of reporting issuers held for longer than six months and (2) securities of non-reporting issuers held for longer than one year, in each case, in accordance with the following Rule 144 conditions to the extent applicable:

- adequate current public information about the issuer;

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[5] For these purposes, reporting issuers are issuers that are, and have been for at least 90 days prior to a sale, subject to the reporting requirements under Section 13 or Section 15(d) of the Exchange Act.

[6] For a reporting issuer, compliance with the adequate current public information condition requires the issuer to 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, compliance with the adequate current public information condition requires the public availability of basic information about the issuer, including three years of financial statements.

- volume limitations;[7]
- manner of sale requirements for equity securities;[8] and
- notice through Form 144 filing requirements.[9]

Annex A to this Memorandum contains a chart summarizing the amended Rule 144 requirements for resales of restricted securities.

Amendments to Volume Limitations

Although amended Rule 144 exempts non-affiliates from compliance with the volume limitations, affiliates remain subject to the volume limitations for resales of equity and debt securities, but they may use a new volume calculation for debt securities.[10] Because debt securities are often traded over-the-counter rather than on a national securities exchange, prior to the amendments, sellers of debt securities were often unable to take advantage of the test based upon the average weekly volume as quoted on a national securities exchange. Amended Rule 144 provides an alternative volume limitation calculation for debt securities, permitting Rule 144 sales of up to 10% of a tranche of debt securities (or up to 10% of a class of non-participatory preferred stock) during any three-month period.

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7 Under Rule 144, sales are generally limited to the greater of the following during any three-month period: (1) one percent of the shares or other units of the class outstanding as shown by the most recent report or statement published by the issuer or (2) the average weekly reported volume of trading in such securities during the preceding four calendar weeks.

8 The manner of sale requirements under Rule 144(f) require securities to be sold in "brokers' transactions" or in transactions directly with a "market maker" (defined in Section 3(a)(38) of the Exchange Act). Additionally, the rule prohibits a selling securityholder from: (1) soliciting or arranging for the solicitation of orders to buy the securities in anticipation of, or in connection with, the Rule 144 transaction or (2) 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.

9 A Form 144 must be submitted to the SEC prior to or concurrently with a sale under Rule 144 if the volume of sales that the affiliate has made or intends to make in a three-month period exceeds the applicable filing thresholds.

10 For purposes of the amendments, "debt securities" are defined to include fixed income securities as well as securities such as asset-backed securities and non-participating preferred stock that have debt-like characteristics.

Elimination of Manner of Sale Requirements for Debt Securities

The amendments to Rule 144 eliminate the manner of sale requirements for resales of debt securities by affiliates, although affiliates remain subject to such requirements with respect to resales of equity securities.

Amended Manner of Sale Requirements for Equity Securities

Although affiliates remain subject to Rule 144 manner of sale requirements for resales of equity securities, these requirements were revised to (1) permit resales through riskless principal transactions[11] and (2) expand the definition of "brokers' transaction".

The SEC believes that riskless principal transactions are equivalent to agency trades. Accordingly, the SEC will deem such trades to satisfy the manner of sale requirements if (a) the trades are executed at the same price, exclusive of any explicitly disclosed markup or markdown, commission equivalent or other fee and (b) the rules of a self-regulatory organization permit the transaction to be reported as riskless.

The amendments also provide that the following activity will not be deemed to be a solicitation of orders to buy that would disqualify a transaction from being a "brokers' transaction": a broker's insertion of bid and ask quotations for the security in an alternative trading system, as defined in Rule 300 of Regulation ATS, provided that the broker has published bona fide bid and ask quotations for the security in the alternative trading system on each of the last 12 business days.

Increased Thresholds for Form 144 Filings

Amended Rule 144 increases the Form 144 filing thresholds for affiliates to sales of more than 5,000 shares or $50,000 worth of securities during any three-month period. The previous filing thresholds were sales of more than 500 shares or $10,000 worth of securities during any three-month period.

[11] A riskless principal transaction is a transaction in which a broker or dealer, (1) after having received a customer's order to buy a security, purchases the security as principal in the market to satisfy the order to buy or (2) after having received a customer's order to sell a security, sells the security as principal to the market to satisfy the order to sell. When a fund purchases a security from an affiliated broker or dealer in a riskless principal transaction, the broker or dealer simultaneously acquires that security from another party. Because the broker or dealer is not selling the security out of its inventory, the broker or dealer is acting like an agent for all intents and purposes even though the transaction is structured so that title momentarily passes through the broker or dealer.

Codification of SEC Staff Interpretations and Stylistic Revisions to Rules

Amended Rule 144 simplifies and streamlines the language of the Preliminary Note to Rule 144 and the text of Rule 144 in accordance with "plain English" principles and codifies various SEC staff interpretations under Rule 144. These revisions are not meant to effect substantive changes.

To provide greater certainty and transparency regarding the treatment of restricted securities, the amendments also codify various SEC staff interpretations with respect to restricted securities, including the following:

- Securities acquired under Section 4(6) of the Securities Act[12] 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 following conditions are satisfied: (1) the newly formed holding company's securities are issued solely in exchange for securities of the predecessor company as part of a reorganization of the predecessor company into a holding company structure; (2) securityholders received 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 interest of the holders of such securities are substantially the same as those they possessed as holders of the predecessor company's securities and (3) immediately following the transaction, the holding company had no significant assets other than securities of the predecessor and its existing subsidiaries and had substantially the same assets and liabilities on a consolidated basis as the predecessor had before the transaction.

- Securities acquired from an issuer solely in exchange for or upon conversion of other securities of the same issuer will be deemed to have been acquired on the date the securityholder acquired the exchanged or converted securities. This tacking of holding periods is permitted even if the securities surrendered for conversion or exchange were not originally convertible or exchangeable by their terms, as long as the securityholder provided no additional consideration (other than securities of the issuer) for the amendment to the securities. If the securityholder provides other consideration for the amendment, the newly acquired securities will be deemed to have been acquired on the date of the amendment.

- Securities acquired from an issuer upon the cashless exercise of options or warrants are deemed to have been acquired on the date the securityholder acquired the original securities. This tacking of holding periods is permitted even if the exercised securities did not initially provide for cashless exercise, as long as the securityholder provided no consideration other than securities of the issuer in exchange for the amendment to the

[12] Section 4(6) of the Securities Act 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.

securities to permit cashless exercises. If the securityholder provides other consideration for such an amendment, the newly acquired securities will be deemed to have been acquired on the date of such amendment. The amendments also codify the SEC staff's position that the holding period for securities underlying options or warrants that are not purchased, such as options granted under an employee benefit plan, does not begin until the date the option or warrant is exercised.

- In calculating the volume of securities that 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[13] and blank check companies,[14] other than asset-backed issuers and business combination related shell companies, such as those formed in connection with a merger. [15] 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 one year has elapsed since the issuer filed "Form 10 information"[16] with the SEC to indicate that the company is no longer a shell company. The proposing release would have required that 90 days rather than one year elapse since the issuer filed such information with the SEC. Both restricted securities and unrestricted securities of former shell companies will be subject to this one-year waiting period, which the SEC deemed to be necessary for investor protection in light of comments it received regarding abuse and micro-cap fraud involving shell company securities.

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[13] A shell company is a company that has (1) no or nominal operations and (2) at least one of the following characteristics: (a) no or nominal assets; (b) assets consisting solely of cash or cash equivalents or (c) assets consisting of any amount of cash and cash equivalents and nominal other assets.

[14] A blank check company is a company that (1) is in the development stage, (2) has no specific business plan or purpose, or has indicated that its business plan is to merge with or acquire an unidentified third party and (3) issues penny stock.

[15] A business combination related shell company is a shell company formed by an entity that is not a shell company solely for the purpose of (a) changing the corporate domicile of that entity solely within the United States or (b) completing a business combination transaction among one or more entities other than the shell company, none of which is a shell company.

[16] Form 10 information is equivalent to information an issuer would be required to file if it were registering a class of securities on Form 10 or Form 20-F under the Exchange Act.

- Rule 10b5-1(c) provides a Rule 10b-5 affirmative defense that a purchase or sale was not on "on the basis of" material nonpublic information if the transaction was made under a Rule 10b5-1 trading plan. Form 144 contains a representation that the selling securityholder is not aware of material nonpublic information about the issuer. Prior to the adoption of the Rule 144 amendments, the SEC permitted a selling securityholder 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 was signed. The amendments revise Form 144 to incorporate this modification into the text of the representation.

Coordination of Form 4 and Form 144 Filings

Although the SEC solicited 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, it did not adopt these changes but expects to issue a separate proposing release regarding changes that would give greater flexibility to affiliates required to make both Form 144 and Form 4 filings.

Conforming Amendments to Regulation S and other SEC Rules

The SEC also (1) amended Regulation S to conform the one-year distribution compliance period in Rule 903(b)(3)(iii) for Category 3 issuers (U.S. reporting issuers) to the new Rule 144(d) six-month holding period; (2) amended Rule 190 under the Securities Act to provide that, if the underlying assets for an asset-backed securities offering are restricted securities, Rule 144 is available for the sale of securities in the resecuritization if at least two years (rather than the new six-month Rule 144 holding period) have elapsed from the later of the date the securities were acquired from the issuer or an affiliate of the issuer and (3) amended Rule 701(g)(3) under the Securities Act, which outlines the resale limitations for securities acquired pursuant to employee benefit plans, to delete references to paragraphs (e) and (h) of Rule 144, which no longer apply to resales by non-affiliates.

Changes to Rule 145

Rule 145 provides that an exchange of securities in a reclassification of securities, merger or consolidation or transfer of assets that is subject to a shareholder vote constitutes a sale of those securities. The "presumptive underwriter" doctrine under Rule 145(c) deems any parties and affiliates of parties to a Rule 145 transaction (other than the issuer) to be underwriters with respect to the securities they acquire in the transaction. Because these entities 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, even for securities that were registered in the acquisition transaction.

The amendments eliminate Rule 145 resale restrictions for securities acquired in most business combination transactions. Such securities will still be subject to Rule 144 restrictions if the securityholder becomes an affiliate of the acquiring company. The amendments retain the

"presumptive underwriter" doctrine for restricted securities acquired in registered business combinations involving shell companies (other than business combination related shell companies). The amendments also harmonize the remaining resale provisions of Rule 145(d), now applicable only to securities of shell companies, with the revisions to the Rule 144 resale provisions.

Practical Implications of Amendments

The amendments to Rule 144 represent a significant liberalization of the applicable restrictions under such Rule, particularly with respect to the holding periods for the resale of restricted securities. Securities that have been issued by reporting companies and held for more than six months will generally be freely transferable, subject to the availability of current information and, in the case of sales by affiliates, compliance with other Rule 144 requirements. The rule changes will also permit the transfer of securities that have been issued by non-reporting companies and held for more than one year, subject, in the case of sales by affiliates, to compliance with other Rule 144 requirements. While the amendments, which become effective on February 15, 2008, will have the immediate effects described above, it may take some time for practices applicable to offerings of unregistered securities to evolve to take advantage of the new rules.

We believe that private capital raising protocols relating to registration rights and associated provisions for the payment of additional interest in the event of registration defaults will likely be modified or eliminated as a result of the amendments to Rule 144.

With respect to registration rights in the context of private offerings of non-convertible debt securities, such as Rule 144A offerings of high yield non-convertible securities, we anticipate that so-called "Exxon Capital" or "back-end" exchange offers will no longer be required in some circumstances. We believe that, unless investors identify legal impediments preventing them from holding securities that have not been registered but that are transferable pursuant to Rule 144, such back-end registrations should be unnecessary because the securities will usually be freely transferable not later than one year after initial issuance, which is within the historical timeframes for the completion of back-end exchange offers prior to the amendments. We expect that, in most cases, the indentures relating to such debt securities will provide that restrictive legends will be removed from such securities or that such securities will be exchanged for unlegended securities one year after their initial issuance and that the instruments will allow for the securities to trade freely after six months when the issuer is a reporting company about which current information is available. It remains to be seen, however, whether deemed representations or certifications might be necessary in connection with transfers made sooner than one year after the initial issuance of the securities.

In the event that a reporting issuer fails to meet the current information condition during the period beginning six months after the date of initial issuance and ending one year after the date of initial issuance (or any such longer period when the securities may not be freely transferable), investors may require that the issuer pay additional interest, much the same as issuers have long been required to pay additional interest under past practices when they have been unable or unwilling to

perform their registration obligations. To the extent that additional interest requirements are retained, it may be necessary to differentiate restricted securities from unrestricted securities in order to enable the issuer to identify which securities are entitled to receive additional interest. For example, in circumstances where some securities have been sold seven months after the closing (and are therefore unrestricted) but other securities have not been sold and the reporting issuer subsequently fails to satisfy the current information requirement, thereby resulting in such securities not being able to be sold in reliance upon Rule 144 until a year has elapsed from the closing, issuers would presumably prefer to pay additional interest only with respect to securities that remain restricted.

In the past, convertible securities sold in reliance upon Rule 144A have also customarily benefited from resale registration rights. In light, however, of the changes to Rule 144 permitting securities to be freely transferable by non-affiliates within six months of the closing provided that the issuer satisfies the current information condition, it should generally be unnecessary for an issuer (which would be a reporting company in virtually all cases because the common stock underlying the convertible security would be listed), to file a resale registration statement. If the current information condition is not satisfied during the period from six to 12 months after the initial issuance, developing practices may require that additional interest be payable in relation to the securities that remain transfer-restricted.

In the case of private offerings by companies that are not reporting companies, notwithstanding the reduced need for back-end registration statements as a result of the reduced holding period, there will be issues regarding what information must be reported to investors under the terms of the indenture and how it is to be reported. Although investors may see some marginal benefit from having the information for all of the companies in which they invest appear in one central location, i.e., the SEC's EDGAR website, and from the general oversight by the SEC of an issuer's public disclosures, we expect that non-reporting issuers will seek to make disclosures of financial information solely by posting specified information on their websites.

Even if the past paradigm of registration rights is largely abandoned, we anticipate that back-end exchange offers and resale shelf registration statements may continue to occur in connection with certain transactions. For example, shelf registration statements may be required where affiliates acquire securities and wish to resell them or where an initial purchaser is affiliated with an issuer and wishes to make a market in the relevant securities.

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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.

ANNEX A

The following chart summarizes the amended Rule 144 requirements applicable to resales of securities by affiliates and of restricted securities by non-affiliates:

	Affiliate or Person Selling on Behalf of an Affiliate	Non-Affiliate (and Has Not Been an Affiliate During the Prior Three Months)
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 resale under Rule 144; need not comply with other Rule 144 requirements.
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 resale under Rule 144; need not comply with other Rule 144 requirements