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SEC ADOPTS MAJOR AMENDMENTS TO RULES GOVERNING RESALES OF SECURITIES

The Securities and Exchange Commission recently adopted major amendments to Rules 144 and 145 under the Securities Act of 1933. The amendments, which took effect February 15, 2008, relax significantly the limitations on resales of securities under these rules by shortening the holding period for restricted (unregistered) securities of SEC reporting companies, liberalizing the condition that sales occur through a broker or with a market maker, raising the Form 144 filing threshold and eliminating the restrictions on resales of securities received in connection with most mergers and other business combination transactions.

What is Rule 144?

By way of background, all offers and sales of securities, whether by the issuer or any person holding securities of the issuer, must be registered under the 1933 Act unless an exemption is available. Section 4(1) of the 1933 Act exempts from the registration requirements transactions by any person who is not an issuer, underwriter or dealer. (That's how Ma and Pa Jones can sell their IBM stock without registration.) The key question for a security holder seeking to sell securities is whether they may be considered an underwriter, which is basically defined as a person who purchases securities from an issuer with a view to, or who offers or sells securities for an issuer in connection with, a public distribution of that security. While it's obvious that an investment banking firm which arranges a public offering for an issuer is an underwriter, individual investors who are not securities business professionals may also be underwriters if they act as links in a chain of transactions through which securities move from an issuer to the public. To eliminate the uncertainty that sometimes existed under the latter scenario, the SEC adopted Rule 144 in 1972 as a "safe harbor" from underwriter status for persons selling securities in compliance with the conditions of the rule.

Rule 144 covers two categories of securities – "restricted securities," which are securities acquired in a transaction or series of transactions not registered under the 1933 Act, and "control securities," which are securities held by the issuer's affiliates (typically directors, executive officers and greater than 10% stockholders), regardless of how the securities were acquired. Control securities therefore may or may not also be restricted securities.

What were the conditions of Rule 144 before the amendments?

Prior to the amendments, Rule 144 imposed a one-year holding period on resales of restricted securities. The rule also placed the following conditions on resales by affiliates of control securities and on resales by all other persons of restricted securities held for at least one year but less than two years:

- if the issuer is an SEC reporting company, it must have been subject to SEC reporting requirements for at least

90 days and have filed all Forms 10-K and 10-Q due within the preceding 12 months (or for the shorter period the issuer was an SEC reporting company); if the issuer is not an SEC reporting company, it must make certain information publicly available, including, among other things, the nature of its business and the products and services it offers, the identity of its chief executive officer and the members of its board of directors and its most recent balance sheet and income statement (this condition is referred to below as the "Current Public Information Condition");

- the number of securities of the same class sold during the preceding three months by the seller and all other persons with whom sales must be aggregated with the seller (such as family members sharing the same household, trusts of which the seller is a trustee or in which the seller has a 10% or greater interest or companies of which the seller owns 10% or more of the equity interests) may not exceed the greater of (1) one percent of the total securities of the class outstanding or (2) the average weekly trading volume in the securities during the preceding four calendar weeks (this condition is referred to below as the "Volume Condition");

- the securities must be sold in a "brokers' transactions" or in transactions directly with a market maker (this condition is referred to below as the "Manner of Sale Condition"); and

- a notice of the sale on Form 144 must be transmitted to the SEC and the principal exchange, if any, on which the securities are listed, prior to or concurrent with executing the sell order if the amount of securities to be sold in any three-month period exceeds 500 shares or if the aggregate sale price exceeds $10,000 (this condition is referred to below as the "Notice Condition").

A person could sell restricted securities held for two years or more without complying with the above restrictions, as long as he or she was not, and had not been during the preceding three months, an affiliate of the issuer.

What were the amendments to Rule 144?

The amendments shortened the holding period for restricted securities issued by SEC reporting companies from one year to six months. The holding period remains one year for restricted securities issued by non-SEC reporting companies. A person who is not an affiliate and was not an affiliate during the preceding three months may sell restricted securities of an SEC reporting company held for at least six months but less than one year if the Current Public Information Condition is met; after one year has passed, the securities may be sold without restriction. An affiliate may sell restricted securities of an SEC reporting company held for at least six months, restricted securities of a non-SEC reporting company held for at least one year *and* non-restricted securities regardless of how long held, if the Current Public Information, Volume, Manner of Sale (for equity securities) and Notice Conditions are met.

The Current Public Information Condition was not substantively changed by the amendments to Rule 144. The amendments also leave the Volume Condition unchanged for equity securities, but provide a new, alternative volume calculation for debt securities, which includes asset-backed

securities and non-participatory preferred stock that has debt-like characteristics. The alternative calculation permits 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.

The amendments eliminate the Manner of Sale Condition for debt securities and liberalize that condition for equity securities by allowing resales through so-called "riskless principal" transactions and expanding the definition of "brokers' transactions."

A riskless principal transaction occurs where 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 buy order or (2) after having received a customer's order to sell a security, sells the security as principal to the market to satisfy the sell order. To qualify as a riskless principal transaction, the offsetting trade must be executed at the same price, exclusive of any explicitly disclosed markup or markdown, commission equivalent or other fee, and the transaction must be reportable as riskless under the rules of a self-regulatory organization. The SEC views riskless principal transactions as equivalent to agency trades, but prior to the amendments these transactions were not permitted because there was a technical requirement that a broker do no more than execute the order to sell as agent for the seller's account.

The revised definition of "brokers' transactions" allows brokers to insert bid and ask quotations for a security in an alternative trading system if the broker has published bona fide bid and ask quotations for that security in the alternative trading system for each of the last 12 business days. This activity has been added as an exception to the general requirement of the "brokers' transactions" definition that a broker neither solicit nor arrange for the solicitation of customers' orders to buy the securities in anticipation of, or in connection with, the sale transaction.

The amendments revise the Notice Condition by increasing the threshold for filing a Form 144 from sales of 500 shares or an aggregate sale price of $10,000, to sales of 5,000 shares or an aggregate sale price of $50,000. As was the case prior to the amendments, the revised requirement applies to sales during any three month period. The SEC had solicited comments on the possibility of somehow combining Form 144 and Form 4 (which requires purchases and sales by most affiliates to be reported to the SEC within two business days), but decided not to do so, for the time being.

What is Rule 145 and how was it amended?

Rule 145 provides that an issuance of securities in connection with a reclassification of securities, merger or consolidation or transfer of assets that is subject to a shareholder vote constitutes a sale of securities for purposes of the 1933 Act. Prior to the amendments to Rule 145, the rule contained a "presumptive underwriter" doctrine which deemed the affiliates of any party to the transaction other than the issuer (for example, directors and executive officers of the target company in a merger transaction), to be underwriters with respect to the securities they acquired in the transaction. These securities could be sold without registration if, during the first year after the transaction, the Current Public Information, Volume and Manner of Sale Conditions of Rule 144 were met and, during the second year after the transaction, the Current Public Information Condition were met. Thereafter, the securities could be sold without condition as long as the

seller was not, and had not been during the preceding three months, an affiliate of the issuer.

The amendments to Rule 145 eliminated the presumptive underwriter doctrine for all transactions other than those involving shell companies (but not business combination-related shell companies, such as a subsidiary formed by the issuer to facilitate a merger transaction). Accordingly, in most merger transactions, affiliates of the target company will no longer be subject to limitations on selling securities of the acquiror that they receive in connection with the merger.

What else did the amendments to Rule 144 accomplish?

The amendments to Rule 144 codified several interpretive positions issued over the years by the SEC staff, including, among others, the following:

- Security holders may "tack" the Rule 144 holding period for restricted securities when an issuer reorganizes into a holding company structure or when a conversion or exchange of securities from the same issuer occurs, provided that certain conditions are met. "Tacking" enables a security holder to count the period during which they held the securities of the predecessor issuer or the predecessor securities (prior to conversion or exchange).

- Upon a cashless exercise of options or warrants, the newly acquired underlying securities generally are deemed to have been acquired for purposes of the Rule 144 holding period when the corresponding options or warrants were acquired.

- A pledgee of securities (Bank A) is not required to aggregate its sales of the pledged securities with sales by another pledgee (Bank B) of the same securities from the same pledgor, as long as there is no concerted action by those pledgees. Accordingly, absent concerted action, Bank A need not track and coordinate with Bank B sales of pledged securities of the same pledgor, and vice versa. Bank A and Bank B must individually aggregate their own sales with sales by the pledgor, however.

- Form 144 requires a selling security holder to represent, as of the date the form is signed, that he or she is not aware of any material adverse information regarding the issuer. Consistent with what the SEC staff had informally permitted, Form 144 has been revised to allow a security holder selling pursuant to a pre-arranged trading plan under SEC Rule 10b5-1 to make the required representation as of the plan adoption date, rather than as of the date on which the Form 144 is signed. (SEC Rule 10b5-1 insulates a seller or purchaser of securities from insider trading liability if a trade occurs at a time when he or she is aware of material inside information, as long as the trade was made pursuant to a plan previously established at a time when he or she was not aware of material inside information.)

What are the practical implications of the amendments?

Although the amendments became effective February 15, 2008, they apply to securities acquired before or after that date. For persons holding restricted securities of an SEC reporting company, this resulted in a shortening (if the securities were acquired less than six months before February 15, 2008) or lapsing (if the securities were acquired more than six months but less than

one year before February 15, 2008) of the *legal* holding period under Rule 144. These securities may nevertheless be subject to a one year (or longer) holding period by *contract*, which could require that restrictive legends on share certificates remain in place absent a waiver by the issuer or other applicable party. For persons who were affiliates of a party (other than the issuer) to a merger or other Rule 145 transaction that occurred less than two years before February 15, 2008, any remaining legal restrictions under Rule 145 on selling securities received in the transaction – the Current Public Information, Volume and Manner of Sale Conditions of Rule 144 if less than one year has passed since the transaction and the Current Public Information Condition if less than two years have passed since the transaction – lapsed on February 15, 2008. As with restricted securities, notwithstanding the elimination of the Rule 145 legal restriction, these persons may be, and typically are, subject to contractual restrictions on resales that should be examined before any restrictive legends on their share certificates are removed.

Especially in the case of existing SEC reporting companies, the amendments are expected to increase the liquidity of privately sold, restricted securities and may decrease issuers' costs of raising capital by enabling them to negotiate a smaller discount to market price. In addition, the shortening of the holding period for such securities and the elimination of the Volume and Manner of Sale Conditions for resales by non-affiliates after the holding period has lapsed may obviate or lessen an investor's need for registration rights in a private placement.

From a compliance perspective, brokerage firms have had to update their standard seller and broker representation letters to reflect the amendments. Many issuers and transfer agents have seen an increase in requests to remove restrictive legends from stock certificates evidencing restricted securities and securities issued in Rule 145 transactions. These requests should only be honored where *all* remaining restrictions on resale have lapsed – for example, it would be premature to remove a legend from a certificate for restricted securities of an SEC reporting company after six months but less than one year has passed since the date of issuance, since, even for a non-affiliate, resales are still subject to satisfaction of the Current Public Information Condition.

As with any major rule revision, the amendments to Rules 144 and 145 have required some changes in procedures and a need to educate the principal parties involved in the resale process – the issuer, the broker, the transfer agent and the selling security holder. Unlike most of the SEC rule changes adopted in the wake of the Sarbanes-Oxley Act however, the amendments to Rules 144 and 145 actually represent a significant easing of regulatory restrictions that should benefit both issuers and investors.

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For over 30 years, Silver, Freedman & Taff, L.L.P. has represented financial institutions and other companies nationwide in connection with initial public offerings and other capital raising transactions, mergers and acquisitions, regulatory and enforcement issues, tax and compensation matters, and corporate governance matters. With attorneys who previously served with the federal banking and thrift regulators as well as the Securities and Exchange

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