

Management Alert

SEC Shortens the Holding Periods under Rule 144

On November 15, 2007, the Securities and Exchange Commission (SEC) adopted amendments to Rules 144 and 145 under the Securities Act of 1933. The SEC hopes these amendments will increase the liquidity of restricted securities, decrease the cost of capital and increase the access to capital, especially for smaller public companies.

Background of Rules 144 and 145

Restricted securities are securities that have been issued by a company pursuant to an exemption from the registration requirements of the Securities Act. Absent a registration statement, most sales by anyone who acquires securities other than in a registered public offering need to comply with the exemption from registration provided by Rule 144 under the Securities Act. The same restriction applies to most sales by "affiliates" of the company regardless of how the shares were acquired. An affiliate is someone in a control relationship with the company, generally all directors, most executive officers and significant shareholders.

Prior to the amendments, to take advantage of the Rule 144 exemption, a purchaser who acquired securities from a company other than pursuant to a registered public offering was required to hold the restricted securities for a minimum of one year. Following the one-year holding period, securities could be resold in broker transactions, subject to volume limitations and other conditions. If a nonaffiliate held restricted securities for at least two years, the securities could be resold without restriction. Resales by affiliates under Rule 144, even when the securities were

acquired in a registered public offering, needed to comply with the manner of sale and other restrictions, regardless of how long the securities were held.

Rule 145 requires registration of various business combination transactions. Prior to the amendments, parties to one of these business combination transactions (and affiliates of those parties) were deemed to be underwriters in any public sale of securities received in one of these transactions. As a result of this "presumptive underwriter doctrine," even when an acquiring company registered the issuance of securities in a business combination transaction, affiliates of the target company could not resell the securities they received other than pursuant to a resale registration statement or in accordance with Rule 144.

Summary of the Amendments

As amended, the holding period under Rule 144 has been reduced from one year to six months where the issuer has been a reporting company for at least 90 days. Restricted securities of a nonreporting company remain subject to a one-year holding period.

In addition, the amendments simplify Rule 144 compliance for nonaffiliates. Restricted securities of reporting companies may be freely resold by nonaffiliates following the six-month holding period, subject only to the requirement of Rule 144(c) that there be available current public information about the company. Restricted securities of both reporting and nonreporting companies

held for at least one year may be freely resold by nonaffiliates without having to comply with any other Rule 144 condition.

Affiliates remain subject to the manner of sale and other Rule 144 restrictions, but those restrictions have been eased:

- the manner of sale requirements with respect to debt securities have been eliminated;
- the volume limitations for debt securities have been relaxed by adding a new alternative test that will permit the sale of up to 10% of a tranche in any three-month period; and
- the threshold that triggers the requirement to file a Form 144 has been raised from 500 shares or \$10,000 to 5,000 shares or \$50,000.

The adopting release also simplifies the Preliminary Note and text of Rule 144 using plain English principles and codifies certain long-standing SEC positions.

Among other things, the amendments codify the SEC's position that securities sold pursuant to Section 4(6) of the Securities Act are "restricted securities" and may be resold under Rule 144. The Section 4(6) exemption generally allows offerings not involving any advertising or public solicitation that do not exceed \$5,000,000 to be made only to accredited investors, provided that the issuer files a Form D in connection with the offering.

Also codified is the SEC's position on the ability to tack holding periods in certain conversions and exchanges of securities. In "tacking," holders may count the period that the securities are held before the conversion or exchange as part of the period they must hold the securities to meet the Rule 144 holding period requirement. Generally, tacking of holding periods is now expressly permitted in connection with the following:

1. securities issued solely in exchange for the securities of a predecessor company as part of a reorganization of the predecessor company into a holding company structure;
2. securities acquired from the issuer solely in exchange for other securities of the same issuer, even if the securities surrendered were not convertible or exchangeable by their terms; and
3. securities acquired from the issuer upon the cashless exercise of options or warrants, even if the options or warrants originally did not provide for cashless exercise by their terms.

The amendments also codify, with some modification, the prohibition against relying on Rule 144 for the resale of securities issued by current or former shell companies. Under the amendments, a person who wishes to resell securities issued by a company that is, or was, a shell company would not be able to rely on Rule 144 to sell the securities unless:

- the issuer of the securities has ceased to be a shell company;
- the issuer of the securities is subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act and has filed all reports and material required to be filed during the preceding 12 months (or for such shorter period that the registrant was required to file such reports and materials); and
- at least one year has elapsed from the time the issuer has filed current "Form 10 information" with the Commission reflecting its status as an entity that is not a shell company.

Form 10 information is ordinarily filed on Form 8-K and is equivalent to information that a company would be required to file if it were registering a class of securities on Form 10, Form 10-SB, or Form 20-F under the Exchange Act.

The adopting release also amends Rule 903(b)(3) under Regulation S, which provides a safe harbor for offers and sales made outside the United States. Paragraphs (iii) and (iv) of Rule 903(b)(3) set forth the period during which those complying with the safe harbor must meet the requirements of Regulation S. Prior to the amendments, this compliance period was one year, which coincided with the holding period under Rule 144. Accordingly, under the amendments to Rule 903(b)(3), the compliance period for U.S. reporting companies has been shortened to six months to coincide with the holding period for securities of reporting companies under Rule 144.

Rule 145 was amended to eliminate the presumptive underwriter doctrine, except with respect to transactions involving blank check or shell companies. Under the amendments, affiliates of the target company in a business combination transaction generally no longer will be deemed to be underwriters and will be able to freely resell the securities they receive in a business combination transaction. Affiliates of blank check or shell companies will continue to be deemed underwriters and may resell securities acquired in connection with the transaction only in accordance with Rule 145(d).

As amended, Rule 145(d) permits presumed underwriters to resell their securities to the same extent that affiliates of a shell company are permitted to resell their securities under the amended Rule 144. The securities may be sold only after any company that was a shell company and a party to the transaction has ceased to be a shell company and at least 90 days have elapsed since the securities were acquired in the transaction, subject to Rule 144 conditions. As in the amended Rule 144, after six months have elapsed since the securities were acquired in the transaction, the persons and parties are permitted to resell their securities, subject only to the current public information condition in Rule 144(c), provided that the sellers are not affiliates of the issuer at the time of sale and have not been affiliates during the three months before the sale. As in the amended Rule 144, one year after the

securities are acquired in the transaction, the persons and parties are permitted to freely resell their securities, provided that they are non-affiliates at the time of sale and have not been affiliates during the three months before the sale.

Conclusion

Shortening the holding periods for restricted securities, eliminating the manner of sale and volume limitations for nonaffiliates and relaxing those limitations for affiliates represent a significant reduction in the restrictions on resales of restricted securities. This should significantly increase the liquidity of restricted securities, and as a result, reduce the cost of capital by reducing the liquidity discount imposed on restricted securities and the need to file and maintain the effectiveness of a registration statement to cover resales by investors who purchase restricted securities. Together with the elimination of the presumptive underwriter doctrine, these amendments also should increase the attractiveness of restricted securities as a form of consideration in business combination transactions. This should be especially beneficial for smaller public companies, which generally have less access to cash for acquisitions, thereby providing access to capital that previously was not available.

These amendments will be effective February 15, 2008.

If you have any questions regarding this Management Alert, please contact the Seyfarth Shaw attorney with whom you work or any Corporate attorney on our website, www.seyfarth.com.

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