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SEC Eases Restrictions on Resale of Restricted Securities

On December 7, 2007, the U.S. Securities and Exchange Commission (SEC) issued final rules amending existing Rules 144 and 145 under the Securities Act of 1933 (Securities Act).¹ The revisions are intended to increase the liquidity of privately sold, restricted securities and decrease issuers' cost of raising capital. Rule 144 provides a non-exclusive safe harbor that permits investors to resell restricted securities without registration pursuant to the exemption under Section 4(1) of the Securities Act. The amendments reduce the holding period required before restricted securities may be sold, liberalize the manner of sale and volume limitations, simplify the Form 144 filing requirements, and codify certain SEC staff interpretations relating to Rule 144. The final rules further eliminate the "presumptive underwriter" doctrine under Rule 145. The revised rules take effect on February 15, 2008.

Implications of the Amendments

The amendments to Rule 144 and Rule 145 allow issuers to negotiate a smaller discount to market price when selling unregistered securities in an exempt offering such as a Regulation D offering. Furthermore, because of the shortened holding period, registration rights may be unnecessary for issuers negotiating a private placement. Issuers currently required to maintain effective resale registration statements may be able to terminate those registration statements earlier than anticipated, given that holders of restricted securities may be able to sell those securities more quickly. Finally, in business combination transactions, restricted securities may be more favorably received as consideration due to their increased liquidity.

Overview of Rule 144

The Securities Act requires the registration of all offers and sales of securities made in interstate commerce or by U.S. mail unless a statutory exemption is available for the transaction. Section 4(1) of the Securities Act provides an exemption for transactions by a person who is not an issuer, underwriter, or dealer. An underwriter is defined as a

¹For a complete copy of the adopting release, see SEC Release No. 33-8869 "Revisions to Rules 144 and 145" at <http://www.sec.gov/rules/final/2007/33-8869.pdf>.

person who purchases securities “with a view ... to the distribution” of the securities. Rule 144 provides a non-exclusive safe harbor from the definition of an underwriter to permit investors to resell restricted securities and control securities without registration pursuant to the Section 4(1) exemption. Restricted securities are securities acquired directly from an issuer, including securities acquired in private placement offerings, Regulation D offerings, employee stock benefit plans, as compensation for professional services, or in exchange for providing start-up capital. Control securities refer to securities held by an affiliate of an issuer regardless of how the securities were acquired. A person who satisfies Rule 144 may resell restricted securities and control securities without registering these shares with the SEC.

Holding Period Shortened

Rule 144 requires that a person hold restricted securities for a period of time to demonstrate that he or she assumes economic risk upon acquisition of the securities and lacks an intent to distribute those securities.²

The amendments decrease the holding period to six months for restricted securities of issuers subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934 (Exchange Act). The holding period for securities of issuers that are not subject to Exchange Act reporting requirements continues to be one year. These holding periods are the same for both affiliates and non-affiliates of the issuer.

Current Information, Volume Limitations, and Manner of Sale Requirements Liberalized

Prior to the amendments, both affiliates and non-affiliates were subject to all of the conditions of Rule 144, including public availability of current information about the issuer at the time of the resale, limitations on the volume of securities that could be

sold at any time, requirements regarding the manner of the sale of the securities, and a requirement to file Form 144 with the SEC when sales exceed a certain dollar or volume threshold. The amendments to Rule 144 eliminate these conditions for non-affiliates except for the current information requirement, which now only applies when non-affiliates sell securities of Exchange Act reporting issuers prior to holding such securities for one year. After one year, the current information requirement ceases for non-affiliates. Affiliates continue to be subject to current information, volume limitations, revised manner of sale, and Form 144 filing requirements until 90 days after they cease to be affiliates.

Form 144 Filing Requirements Liberalized

Non-affiliates will no longer be required to file Form 144. Affiliates will continue to be required to file Form 144, but only if resales exceed 5,000 shares or \$50,000 within a three-month period. Previously, the thresholds were 500 shares or \$10,000. Although the proposed rules solicited comments on combining Form 144 and Form 4, the SEC has chosen to reconsider this issue in the future.

Application of Amendments to Rule 144

The table below summarizes the application of amended Rule 144 with respect to affiliates and non-affiliates:

	Affiliate (or Person Selling on Behalf of an Affiliate)	Non-Affiliate (and Has Not Been an Affiliate During the Prior 90 Days)
Restricted Securities of Reporting Issuers	<p><u>During the six-month holding period:</u> no resales permitted under Rule 144</p> <p><u>After the six-month holding period:</u> 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</p>	<p><u>During the six-month holding period:</u> no resales permitted under Rule 144</p> <p><u>After the six-month holding period but before one year:</u> unlimited public resales permitted under Rule 144; current public information requirement still applies</p> <p><u>After one-year holding period:</u> unlimited public resales permitted under Rule 144; need not comply with any other Rule 144 requirements</p>
Restricted Securities of Non-Reporting Issuers	<p><u>During one-year holding period:</u> no resales permitted under Rule 144</p> <p><u>After one-year holding period:</u> 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</p>	<p><u>During one-year holding period:</u> no resales permitted under Rule 144</p> <p><u>After one-year holding period:</u> unlimited public resales permitted under Rule 144; need not comply with any other Rule 144 requirements.</p>

² Although proposed, the SEC did not adopt a change to Rule 144 that would have required tolling the holding period while restricted securities are hedged. The adopting release states that the SEC staff will revisit this issue if they observe abuse relating to hedging activities.

Manner of Sale Requirements Relaxed for Affiliates

The SEC has adopted two changes to the manner of sale requirements applicable to affiliates. First, Rule 144 was amended to permit the resale of securities through riskless principal transactions. Second, the term “brokers’ transactions” has been redefined to allow brokers to insert bid and ask quotations for a restricted 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 on each of the 12 preceding business days.

Affiliates Can More Easily Resell Debt Securities

Resales of debt securities by affiliates are no longer subject to the manner of sale requirements.³ Additionally, the Rule 144 volume limitations have been amended to permit the resale of debt securities in an amount that does not exceed 10 percent of a tranche, aggregated with all sales of securities of the same tranche sold for the account of the selling security holder within a three-month period.

Codification of Various SEC Staff Positions

The amendments also codify several interpretative positions that have been issued over the years by the staff of the SEC’s Division of Corporation Finance, as follows:

- Securities acquired pursuant to Section 4(6) of the Securities Act are considered restricted securities under Rule 144(a)(3).
- Security holders may “tack” their holding period when an issuer reorganizes into a holding company structure or when a conversion or exchange of securities from the same issuer occurs.
- Upon a cashless exercise of options or warrants, the newly acquired underlying securities are deemed to

have been acquired when the corresponding options or warrants were acquired.

- Provided that pledgees have not acted in concert, a pledgee is not required to aggregate its sales of restricted securities with sales by another pledgee of the same securities when considering the applicable volume limitations. Therefore, pledgees will not be required to track and coordinate resale of restricted securities with other pledgees of the same pledgor.
- Rule 144 generally is not available for the resale of securities initially issued by a shell company. However, Rule 144 has been amended to permit the resale of securities issued by shell companies provided that (i) the issuer is no longer a shell company; (ii) it is subject to Exchange Act reporting requirements; (iii) it has timely filed its periodic reports for a period of one year; and (iv) at least one year has elapsed from the time the issuer filed current Form 10 type information with the SEC reflecting its status as a non-shell company.
- Form 144 has been revised to state that the filer was not trading on the basis of material, non-public information as of the date he or she adopted a written trading plan or gave trading instructions that satisfied Rule 10b5-1 of the Exchange Act.

Amendments to Rule 145

The final rules also amend Rule 145, which applies to the offer and sale of certain securities received in business combination transactions such as reclassifications, mergers, consolidations, and asset transfers. Previously, the presumptive underwriter doctrine under Rule 145(c) stated that affiliates of corporations that engage in a merger or sale of assets in exchange for

³ Non-participatory preferred stock and asset-backed securities and other non-convertible debt securities will all be treated similarly.

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securities were deemed to be underwriters under the Securities Act unless they resold the securities in accordance with certain requirements of Rule 144 or in a registered transaction. The amendments eliminate this doctrine except with respect to transactions involving shell companies. The resale provisions in Rule 145(d) also have been revised in a manner similar to the Rule 144 revisions. As a result of the revisions to Rule 145, affiliates of a target in a business combination may more easily resell securities received as consideration in accordance with revised Rule 145(d).