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SEC Considers Proposed Revisions to Rules 144 and 145 to Shorten Holding Period for Affiliates and Non-Affiliates

Introduction

On May 23, 2007, the Securities and Exchange Commission (the "SEC") proposed several revisions to Rules 144 and 145 under the Securities Act of 1933, as amended (the "Securities Act"), that are intended to ease the burden and cost of complying with Rules 144 and 145 for issuers and securities holders, increase the value and liquidity of restricted securities, and limit the regulatory restrictions governing the resale of restricted securities.[1]

Comments on these proposals should be received by the SEC by within 60 days of their publication in the Federal Register. The full text of the SEC's detailed release (Release No. 33-8813) concerning the foregoing proposals is available on the SEC website at http://www.sec.gov/rules/proposed.shtml.

Rules 144 and 145 under the Securities Act

Section 5 of the Securities Act requires any offer to sell or sale of securities to be registered with the SEC unless such offer to sell or sale is exempt from registration. Rule 144 under the Securities Act creates a safe harbor for the sale of securities under the exemption from registration set forth in Section 4(1) of the Securities Act.

Rule 145 regulates offers to sell and sales of certain securities acquired pursuant to a transaction involving the reclassification of securities, merger, consolidation or transfer of assets of the issuer of the securities, where such transaction was subject to the consent of the holders of the underlying securities ("Rule 145 Transactions"). Pursuant to Rule 145(c), persons (other than the issuer) or such persons' affiliates who are parties to a Rule 145 Transaction are presumed to be underwriters with respect to the acquired securities and are restricted in their ability to resell such securities. Rule 145(d) contains a safe harbor provision for the resale of restricted securities by those presumed underwriters.

Proposed Revisions to Rule 144

Establishment of Six-Month Holding Period for Exchange Act Reporting Companies. Rule 144(d) generally requires that a minimum "holding period" of one year must pass between the later of the date restricted securities were acquired from the issuer (or its affiliate) and any resale of such securities in reliance on Rule 144 for the account of either the acquiror or any subsequent holder of the securities. The SEC proposes to shorten the holding period to six months for restricted securities of issuers who are subject to the reporting requirements of the Securities Exchange Act of 1934 (the "Exchange Act"). Under the proposed revision, both affiliates and non-affiliates would be permitted to resell restricted securities of Exchange

1 The SEC posted a detailed release summarizing its proposed revisions to Rules 144 and 145 on its website on June 22, 2007.

Act reporting companies (a "Reporting Company") publicly after holding the securities for six months, subject to the other resale requirements[2] of Rule 144 and subject to a tolling provision in certain instances (discussed below). A one-year holding period would continue to apply to restricted securities of companies that are not Reporting Companies.

The reduction in the holding period for restricted securities of Reporting Companies will benefit holders of such securities by increasing the liquidity of those securities.

Tolling Provision. The proposed tolling provision would suspend the minimum holding period (*i.e.,* six months) applicable to restricted securities of a Reporting Company while the holder of the securities (or the previous owner of the securities) engaged in certain hedging transactions (*e.g.,* equity swap agreements, single stock futures, short sales) involving the securities. The proposed tolling provision would not apply if the holder holds the securities for a period of at least one year, regardless of any hedging activity by the holder (or the previous owner of the securities) during such one-year period. As originally adopted in 1972, Rule 144 tolled the holding period during hedging transactions. Such tolling provisions were eliminated in 1990. The proposed tolling provision is the only proposed provision whose purpose is not to make it easier to sell. However, since the tolling would not apply to securities held at least one year, the net effect is that, at worst, resales will not be delayed any longer than they are under the current rule.

Reduction of Rule 144 Requirements Applicable to Non-Affiliates. Rule 144(d) requires non-affiliates to hold their restricted securities for a minimum of one year before they may resell those securities. Once the minimum holding period has been met, a non-affiliate may resell his or her restricted securities publicly, provided that he or she complies with the resale requirements of Rule 144. Generally, a non-affiliate may resell his or her restricted securities without limitation if the non-affiliate has held the securities for at least two years.

The SEC proposes to reduce or eliminate the Rule 144 holding periods and resale restrictions applicable to non-affiliates. A non-affiliate who holds restricted securities of a Reporting Company would be able to freely resell the securities after the six-month holding period has been met (subject to the tolling provision discussed above), provided that any such resale would be subject to Rule 144(c)'s requirement that current public information regarding the issuer of the securities is available. A non-affiliate would be able to resell his or her restricted securities (regardless of whether the issuer of the securities is a Reporting Company) without limitation if he or she has held the securities for at least one year.

Sale of Debt Securities by Affiliates. Rule 144(f) establishes the "manner of sale" requirements for the resale of restricted securities during a period when the requirements of Rule 144 still apply. Generally, a person selling restricted securities may not solicit orders to purchase the securities or make 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. The SEC proposes to eliminate Rule 144(f)'s "manner of sale" requirements with respect to the sale by affiliates of debt securities (*e.g.,* fixed income securities). The Rule 144(f) definition of "debt securities" would include securities that have "debt-like" characteristics, such as asset-backed securities and non-participating preferred stock. If enacted, this proposal would allow holders of debt securities greater flexibility in the resale of such securities, including the option to privately negotiate the resale of the securities.

Revisions to Form 144. Under this proposal, the thresholds that trigger the Form 144 filing requirement would be increased from 500 shares (or other units of interest) and an aggregate sale price of $10,000 or more to 1,000 shares (or other units of interest) and an aggregate sale price of $50,000 or more, respectively. Furthermore, non-affiliates would no longer be required

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2 A sale of restricted securities made in reliance on Rule 144 must comply with Rule 144's resale requirements, which include a minimum holding period applicable to the securities, a requirement that current public information with respect to the issuer of the securities is available at the time of the resale, volume of sale limitations, manner of sale limitations and a notice of sale requirement.

to file a Form 144 in connection with their sales of restricted securities.

Codification of Certain SEC Interpretive Positions Regarding Rule 144. The SEC intends to codify several of its interpretive positions relating to Rule 144. Although these proposed codifications will not substantively change Rule 144, they would provide additional guidance and clarification with respect to specific provisions of Rule 144. These proposals include:

- Amending the definition of "restricted securities" under Rule 144(a)(3) to include securities acquired from an issuer pursuant to an exemption from registration under Section 4(6)[3] of the Securities Act.
- Amending Rule 144(d) to permit holders of restricted securities, subject to certain conditions, to "tack" the Rule 144 holding period in connection with transactions made solely to form a holding company.
- Amending Rule 144(d) to permit the "tacking" of the Rule 144 holding period in connection with conversions or exchanges of securities where the holder acquired securities from the issuer solely in exchange for other securities of the same issuer.
- Amending Rule 144(d) to provide that, 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, even if the options or warrants originally did not provide for cashless exercise by their terms.
- Adding an interpretive note to Rule 144(e)(2)(ii) that would permit a pledgee to sell pledged securities without having to aggregate the sale with sales by other pledgees of the same securities from the same pledgor as long as there is no concerted action by those pledgees.
- Amending Rule 144 to expressly state that it is not available for the resale of securities issued by issuers, other than asset-backed issuers and business combination related shell companies,[4] that are "shell companies"[5] including "blank check" companies.[6] Once the shell company has ceased to be such and at least 90 days has passed since the filing of information with the SEC indicating that the shell company is no longer a shell company, Rule 144 is available.
- Amending Form 144 to reconcile the security holder's representation in Form 144 with Rule 10b5-1(c)'s affirmative defense language – that a person's sale of restricted securities was not on the basis of material nonpublic information.

Modifications to Preliminary Note to Rule 144; Solicitation of Comments on Additional Proposals to Amend Rule 144. The SEC proposes to revise the Preliminary Note to Rule 144 using plain English principles. The SEC is also soliciting comments on whether to coordinate the Form 144 filing requirements

3 Section 4(6) of the Securities Act provides an exemption from registration for an offering made only to accredited investors that does not exceed $5 million, does not involve any advertising or public solicitation by the issuer or anyone acting on the issuer's behalf, and for which a Form D has been filed with the SEC.

4 A "business combination related shell company" is a shell company (as defined in Rule 405 under the Securities Act) that is (1) formed by an entity that is not a shell company solely for the purpose of changing the corporate domicile of that entity solely within the United States; or (ii) formed by an entity that is not a shell company solely for the purpose of completing a business combination transaction (as defined in Rule 230.165(f)) among one or more entities other than the shell company, none of which is a shell company.

5 A "shell company" is a registrant, other than an "asset-backed issuer," that has: (1) no nominal operations; and (2) either (i) no or nominal assets; (ii) assets consisting solely of cash and cash equivalents; or (iii) assets consisting of any amount of cash and cash equivalents and nominal other assets.

6 A "blank check" company is a company that: (i) is in the development stage; (ii) 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 (iii) issues penny stock.

with the Form 4 filing requirements under Section 16 of the Exchange Act. The SEC is also soliciting comments on whether it should revise Item 701 of Regulation S-K to require additional disclosure about the resale status of securities issued in unregistered transactions at the time the issuer first issues the securities.

Proposed Revisions to Rule 145

This proposal would eliminate the presumed underwriter and resale provisions in Rule 145(c) and (d), except with regard to Rule 145 Transactions involving shell companies (other than business combination related shell companies). Thus, only parties to a Rule 145 Transaction that involved a shell company (other than a business combination related shell company) would be deemed presumed underwriters of the transaction. This proposal would also harmonize the resale restrictions of Rule 145(d) with the proposed revisions to Rule 144 that apply to the resale of securities of shell companies (discussed above).