

## **CLIENT ALERT: SEC CHANGES RULE 144, SHORTENS HOLDING PERIOD**

February, 2008

On December 6, 2007 the SEC adopted wide ranging amendments to Rule 144 which will significantly shorten the holding period for both restricted and control securities. The SEC stated the purpose of these amendments was to increase the liquidity of privately sold securities and reducing the costs of capital for companies. It is anticipated these changes will have a significant impact on financing transactions.

### **What is Rule 144?**

Rule 144 is a safe harbor that allows resales of restricted securities and resales of unrestricted securities held by affiliates of the issuer without registration of such resale under the Securities Act. Currently, a person may sell a limited number of securities in any three-month period through a broker provided such person has held the securities for at least one year. Alternatively, a person not affiliated with the issuer may sell an unlimited number of securities after holding them for at least two years.

### **When are these changes effective?**

These changes will become effective on February 15, 2008, and will be available for resales of securities that were acquired prior to or after that effective date.

### **Am I an affiliate of the issuer?**

An affiliate of the 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.” Most of the time, affiliate status will be obvious. An affiliate would include an officer or a director of the issuer and a person that owns a large enough stock in the issuer to exert control. Determination of affiliate status based on stock ownership is a “facts and circumstances” analysis. Not only is the percentage of ownership a factor, but also whether the security holder has other rights to affect control over the issuer.

### **I am not an affiliate of an issuer. When may I sell?**

- The holding period by non-affiliates for the resale of restricted securities of reporting companies is now six months.
- The holding period by non-affiliates for the resale of restricted securities of non-reporting companies is one year.

### **I am an affiliate of an issuer. When may I sell?**

- The holding period by affiliates for the resale of restricted securities of reporting companies is now six months.
- The holding period by affiliates for the resale of restricted securities of non-reporting companies is one year, but there must exist certain minimum current information about the issuer.
- For affiliates holding non-restricted securities, there is no holding period requirement.
- Affiliates must still comply with the “volume limitation” and the “manner of sale requirements.”
- Insiders are still subject to other limitations, such as Section 16(a) reporting, Section 16(b) short swing profits, insider trading considerations, and trading when the trading “window” is open.

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### **Must I still file Form 144?**

No, unless you are an affiliate of the issuer. Affiliates must still file a notice of proposed sale on Form 144, however, the threshold for triggering the Form 144 filing requirement has been increased to proposed sales over a three-month period of securities consisting of either more than 5,000 shares or with an aggregate sales price of \$50,000.

### **Will I need a legal opinion?**

Yes. Restricted securities with a restrictive legend will generally require a legal opinion before a sale may occur. Once you have held your securities for at least six months, you can get a qualified opinion – which essentially means that you may sell shares provided the issuer is current in its Exchange Act reporting requirements. After you have held for one year, you can have the resale legend removed. In footnote 65 of the SEC's release, the SEC indicated that it does not object to the practice of removing restrictive legends from securities held by non-affiliates prior to resale, so long as the applicable conditions of Rule 144 have been satisfied.

### **May I still tack my holding period?**

Yes. The rules on tacking are generally unchanged. Revised Rule 144 codifies several of the SEC's existing interpretive positions to permit holders of restricted securities to "tack" the holding period in connection with:

- The acquisition of underlying securities upon a cashless exercise of options or warrants, even if the options or warrants originally did not provide for cashless exercise by their terms;
- Conversions or exchanges of securities where the holder acquired securities from the issuer solely in exchange for other securities of the same issuer; and
- Transactions made solely to form a holding company.

### **I have a cashless option. May I tack my holding period?**

Maybe. If the option holder paid for the option, then tacking is generally permitted. If the option holder did not pay for the option, such as an employee granted compensatory stock options, then no.

### **I have a convertible note. May I tack my holding period?**

Generally, yes. The SEC codified its position that the holder of a convertible security is entitled to tack the holding period back to the date the holder acquired the convertible security, provided the holder gives no additional consideration when converting. If however, the security is amended to become convertible, the holding period starts on the date of the amendment if:

- The original security did not permit conversion;
- The parties amend the securities to allow for cashless conversion; and
- The security holder gives some consideration for the conversion amendment.

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### **What if I have shares in a shell company?**

Any securities that were initially issued by a “shell” company (generally, a company with no or nominal assets or operations) cannot be resold into the public markets in reliance on Rule 144 unless the issuer:

- Is no longer a shell company;
- Becomes a reporting company;
- Has filed all of its Exchange Act reports for the prior 12 months; and
- At least one year has elapsed since the issuer filed information equivalent to a “Form 10.”

### **What if I receive shares in a business combination?**

Rule 145 imposed restrictions on resales of securities by affiliates of either the acquiror or the target company received in a business combination. After the amendments, affiliates of a target company who receive shares in a registered business combination, and who do not become affiliates of the acquiror, will be able to resell the shares without registration. Affiliates of the acquiror, and those who become affiliates of the acquiror after the acquisition, will still be subject to the Rule 144 resale conditions generally applicable to affiliates. Securities issued in a business combination without registration will continue to be “restricted securities” that may be resold only pursuant to an effective registration statement or pursuant to an exemption from registration such as revised Rule 144.

### **What if the business combination involved a shell company?**

Resales of securities acquired by affiliates of acquirors and target companies in business combinations involving shell companies will continue to be subject to restrictions imposed by Rule 145. If the business combination is not registered, then the affiliates must look to Rule 144 to resell their securities, including the additional Rule 144 conditions applicable to shell companies. If the business combination is registered, an affiliate of the acquiror and target company may resell the securities acquired in the transaction, provided the issuer meets all of the conditions applicable to shell companies under Rule 144, and:

- After 90 days from the date of the combination, the affiliate may resell his securities subject to Rule 144’s volume limitations, adequate current public information requirement, and manner-of-sale requirements;
- After six months from the date of the combination, a selling security holder who is not an affiliate of the acquiror may resell his securities subject only to the adequate current public information requirement of Rule 144; or
- After one year from the date of the combination, a selling security holder who is not an affiliate of the acquiror may resell his securities without restriction.