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Implementing Rule 144 of the Securities Act of 1933, as Amended

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*** Disclaimer: This article does not constitute legal advice. The discussion set forth below is limited to a summary of the Rule 144 amendments deemed relevant to transfer agents and does not provide a comprehensive discussion of SEC Final Rule Release No. 33-8869, nor of all of the conditions applicable to transfers under the amended Rule. In connection with transfer requests under Rule 144, transfer agents should consult with the issuer and/or its counsel to determine whether all of the applicable Rule 144 conditions have been satisfied.**

I. Introduction

In December 2007, the U.S. Securities & Exchange Commission approved significant amendments to Rule 144 of the Securities Act of 1933. The amended rules include the first reductions to the holding periods for restricted securities in 10 years, and represent the SEC's efforts to simplify Rule 144 in order to reduce the cost to qualifying issuers and their security holders of complying with the Rule and to decrease the cost of raising capital.

Generally speaking, the amendments reduce the holding period to six months for restricted securities of Exchange Act reporting companies and one year for restricted securities of non-reporting companies. In addition, the amendments significantly reduce certain other requirements formerly imposed by Rule 144, particularly with respect to sales by non-affiliates. Finally, the Final Rule Release contains codifications of certain interpretive SEC staff positions, including those relating to the tacking of holding periods for restricted securities and the treatment of securities issued by shell companies.

In connection with processing requests for the transfer of restricted equity securities, transfer agents must be familiar with changes to Rule 144 in order to ensure receipt of information sufficient to demonstrate compliance with U.S. securities laws. While no specific rules govern the obligation of transfer agents to assure compliance with federal securities laws, requesting and obtaining documentation to demonstrate the propriety of a request for legend removal in compliance with Rule 144 will protect against claims of complicity, liability or wrongdoing for improper transfer requests.

The purpose of Rule 144 is to provide objective criteria for determining that the person selling securities to the public has not acquired the securities from the issuer for distribution. Accordingly, whether a transfer request complies with the amended rules is primarily based upon the following factual determinations: (1) whether the seller is an affiliate or non-affiliate of the issuer; (2) whether the issuer is an Exchange Act reporting company or a non-reporting company; (3) the duration of the seller's holding period for the securities; and (4) whether the issuer is or was a shell company. Treatment of each transfer request will be determined by the answers to these questions.

Sellers of securities under Rule 144 can be grouped into one of the following five categories, with different holding period and other requirements applicable to each category: (1) Non-affiliates of Exchange Act reporting companies; (2) Non-affiliates of non-reporting companies; (3) Affiliates of Exchange Act reporting companies; (4) Affiliates of non-reporting companies; and (5) security holders of shell companies. The requirements applicable to each of the first four categories of sellers are summarized in a helpful table on p. 21 of the Final Rule Release (p. 71551 of the Federal Register version).

II. Sales of Restricted Securities under Amended Rule 144

Sales by Non-affiliates

Under the amendments, non-affiliates of reporting companies with current public information may resell their restricted securities without limitation after a six month holding period (subject only to the public information requirement of Rule 144(c), which remains in effect for one year from the date of acquisition, or an additional six months after the initial six month holding period is satisfied). Accordingly, when processing transfer requests for securities that have been held for more than six months but less than one year, it is advisable to obtain confirmation that the issuer is current in its filings. This confirmation can be provided by the issuer or its counsel.

For non-affiliates of non-reporting companies, the amendments permit unlimited resales after a one year holding period (a non-affiliate of a reporting company that does not satisfy the public information requirement of Rule 144(c) is treated the same as a non-affiliate of a non-reporting company). None of the remaining Rule 144 conditions remain applicable to sales by non-affiliates of either reporting or non-reporting companies once the one year holding period has been met.

The consequences of eliminating the Form 144 conditions applicable to sales by non-affiliates are significant. First, non-affiliates are no longer required to file a Form 144 with the SEC, which means that a copy of the filed Form 144 will no longer be required to be provided in connection with transfer requests. Secondly, as a result of the elimination of the condition relating to volume

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limitations, there is no limit to the number of shares that can be sold by non-affiliates under Rule 144. In addition, paragraph (k) has been stricken from Rule 144 altogether, thereby eliminating the prior distinction between Rule 144(d)'s one year holding period and Rule 144(k)'s two year holding period. As a result of the changes to Rule 144, the scope of written representations required to be provided by security holders and brokers in connection with Rule 144 transfer requests will likely be reduced as well. However, certain representations from non-affiliate security holders will still be appropriate, particularly with respect to holding period (date of acquisition), non-affiliate status, and, when the holding period is greater than six months but less that one year, intent to sell and to resubmit the certificate for relegending if the sale does not occur. While a sale remains a condition of Rule 144(d)(1)(i) when the holding period is greater than six months but less that one year, the rule is silent as to whether the sale must be a public sale (as discussed below under the heading "Privately Negotiated Sales by Non-Affiliates").

The rules governing when the holding period for restricted securities begins, and whether an issuer is a reporting issuer, remain unchanged under the amendments, and can be summarized as follows: The holding period under Rule 144 is deemed to begin when the full purchase price or other consideration is paid or given by the person acquiring the securities. The non-affiliate making the sale must not have been an affiliate during the three months prior to the sale. For purposes of Rule 144, an "Exchange Act reporting company" is one that has been subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act for at least 90 days prior to the Rule 144 sale. Current public information requirement in Rule 144(c) is satisfied if the issuer has been subject to the Exchange Act reporting requirements for at least 90 days and has filed all required reports, including quarterly and annual reports (but not Form 8-K reports) during the 12 months preceding the Rule 144 sale (or such shorter period that the issuer was required to file such reports). A non-reporting issuer, on the other hand, is an issuer that is not subject to these reporting requirements, and has not been for a period of at least 90 days prior to the Rule 144 sale. Because of this distinction in the treatment of reporting and non-reporting issuers, it will be necessary to obtain confirmation as to whether the issuer is an Exchange Act reporting company with current public information available.

Sales by Affiliates

According to the Final Rule Release, the SEC believes that most abuses in sales of restricted securities involve affiliates of issuers and securities of shell companies (sales of securities of shell companies are discussed below). As a result, Rule 144 continues to treat affiliates of the issuer more strictly than it treats non-affiliates. In connection with a Rule 144 sale, the selling security holder must continue to provide a representation regarding their affiliate status. Rule 144 defines an affiliate as "a person that directly or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such issuer". As a practical matter, affiliates of an issuer include its executive officers, directors, and certain large shareholders.

Under the amendments, affiliates of reporting issuers with current public information available are subject to a six month holding period, while affiliates of non-reporting companies are subject to a one year holding period. Once the holding period has been met, limited resales are permitted in accordance with all of the Rule 144 requirements. These requirements include the current public information requirement, volume limitations, and manner of sale requirements. The manner of sales requirement, which is set forth in paragraph (f) of the Rule, stipulates that Rule 144 sales must be made through a brokers' transaction or directly through a market maker. The volume limitations for equity securities remain unchanged, at the greater of, for any 90 day period: (1) one percent of the shares or other units of the class outstanding as stated in the most recent report or statement published by the issuer, or (2) the average weekly volume of trading in such securities, calculated in accordance with the rule).

Under the amendments, affiliates remain subject to the Form 144 filing requirement. However, the Form 144 filing thresholds for affiliates have been increased to 5,000 shares or an aggregate sale price of more than $50,000 in a three-month period. The affiliate seller must have a bona fide intention to sell the shares at the time he or she files the Form 144.

Removal of Restrictive Legends from Securities held by Non-Affiliates

The buyer in a Rule 144 transaction receives unlegended, free trading shares. However, any balance certificate(s) representing shares still held by the seller after the sale retain their restrictive legend pending another valid Rule 144 sale. In fact, many law firms may not render a Rule 144 legal opinion unless a sale has already occurred.

The SEC's Division of Corporation Finance had previously issued guidance indicating that the removal of legends from stock certificates held by non-affiliates would not be inappropriate if the securities were eligible for resale under paragraph (k) of Rule 144. Now that paragraph (k) has been eliminated from Rule 144, the applicability of this guidance is an open question.

A footnote to the Final Rule Release states that the SEC

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does not object if issuers remove restrictive legends from securities held by non-affiliates after all of the applicable Rule 144 conditions are satisfied. However, the Release further qualifies this statement by indicating that the removal of legends is solely in the discretion of issuers. The removal of restrictive legends after one year but prior to a valid Rule 144 sale will be a matter to be determined based upon the particular facts and circumstances of the shareholder.

Privately Negotiated Sales by Non-Affiliates

The manner of sale requirement set forth in paragraph (f) of Rule 144, which requires sales to be made in brokers' transactions or in transactions directly with a market maker, effectively prevents privately negotiated transfers from qualifying for the Rule 144 exemption.

However, the elimination of the manner of sale requirement for sales by non-affiliates raises the question as to whether privately negotiated transfers between non-affiliates now qualify for the Rule 144 exemption. This issue is not specifically addressed in the Final Rule Release and accordingly is likely to remain an open issue until such time as additional guidance is available.

III. Codification of SEC Staff Positions

The Final Rule Release codifies the following interpretive positions previously issued by the staff of the SEC's Division of Corporation Finance. For purposes of the following discussion, "tacking" refers to a security holder's ability to add the period during which the previous owner held the security to his holding period for purposes of meeting Rule 144's holding period requirement. Tacking is only permitted under certain circumstances.

Treatment of Securities Issued by Reporting and Non-Reporting Shell Companies. Rule 144 cannot be relied upon for the resale of restricted or unrestricted securities originally issued by a shell company or an issuer that has at any time previously been a shell company (other than a business combination related shell company), regardless of its reporting status, unless the following conditions are met: (i) The issuer has ceased to be a shell company; (ii) The issuer is subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act, and has filed all required reports, including quarterly and annual reports (but not Form 8-K reports) during the 12 months preceding the Rule 144 sale (or such shorter period that the issuer was required to file such reports); and (iii) At least one year has elapsed from the time that the issuer filed current Form 10 type information with the SEC (the filing of Form 10 type information reflects that the entity is no longer a shell company). As a result, it will be advisable to obtain confirmation that the issuer satisfies the foregoing requirements prior to processing a transfer request. The issuer or its counsel can provide such confirmation. This provision does not, however, affect shares that were issued by a company that was not a shell at the time of issuance but subsequently becomes a shell company.

For purposes of the Rule, a "shell company" is defined as a registrant, other than an "asset-backed issuer," that has: (i) no nominal operations; and (ii) either (a) no or nominal assets; (b) assets consisting solely of cash and cash equivalents; or (c) assets consisting of any amount of cash and cash equivalents and nominal other assets. The definition of shell company includes "blank check" companies, which is defined as a company that: (i) is in the development stage; (ii) has no specific business plan or purpose, or has indicated that is business plan is to merge with or acquire an unidentified third party; and (iii) issues penny stock.

Tacking of Holding Periods When a Company Reorganizes Into a Holding Company Structure. When a predecessor issuer is reorganized into a holding company structure and a security holder receives restricted securities of a newly formed holding company, tacking of the security holder's holding period for the predecessor company's restricted securities is permitted if the following three conditions are satisfied: (i) The newly formed holding company's securities were issued solely in exchange for the securities of the predecessor company as part of the reorganization; (ii) Security holders of the predecessor company received securities of the same class evidencing the same proportional interest and substantially the same rights and interests; and (iii) The newly formed holding company has the same assets and liabilities as the predecessor company.

Tacking of Holding Periods for Conversions and Exchanges of Securities. If securities to be sold were acquired from the issuer solely in exchange for other securities of the same issuer, the holding period for the newly acquired securities is deemed to begin at the time the surrendered securities were acquired. However, if the original surrendered securities did not permit cashless conversion or exchange, and the holder provides consideration to the issuer to amend the securities to permit cashless conversion (and the consideration is not solely in the form of the issuer's securities), then the holding period is deemed to begin at the time of the amendment.

Tacking of Holding Periods for Cashless Exercise of Options and Warrants. Upon a cashless exercise of options or warrants, the holding period for the newly acquired underlying securities is deemed to begin when the corresponding options or warrants were acquired, even if the options or warrants did not originally allow the cashless exercise of the options or warrants. However, the

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treatment of amendments is the same as for conversions or exchanges of securities discussed above: if the holder of options or warrants provides consideration to the issuer to amend the options or warrants to permit cashless exercise (and the consideration is not solely in the form of the issuer's securities), then the holding period is deemed to begin at the time of the amendment.

IV. Conclusion

Each year, more than half of U.S. public companies have had at least one transaction reported on Form 144. In 2006, transactions filed under Rule 144 had an aggregate value of over $71 billion. A primary objective of the Rule 144 amendments is to reduce the costs of complying with Rule 144. Indeed, by reducing the restrictions applicable to non-affiliates, the SEC estimates that Form 144 filings will decrease by 45%. Increasing the Form 144 filing thresholds for affiliates is expected to further reduce Form 144 filings by an additional 30%.

Another primary objective of the amendments is to reduce the cost of capital for issuers by increasing the liquidity of restricted securities, thereby reducing the liquidity premium that investors can demand from issuers.

To the extent that the reduced Rule 144 restrictions (i) encourage security holders to resell their securities and (ii) enhance of the financial well-being of issuers, the amendments could strengthen the demand for transfer agents' services.

*** The Rule 144 amendments are set forth in the SEC's Final Rule Release No. 33-8869, which is effective as of February 15, 2008. The amendments are applicable to securities acquired before or after the February 15 effective date. The Final Rule Release can be downloaded from the SEC's website at www.sec.gov. The Release was also published in the December 17, 2007 edition of the Federal Register, which provides a more concise format for printing. The amended text of Rule 144, as well as revised Form 144, is included in the Final Rule Release.**

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