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Client Alert

Latham & Watkins Corporate Department

SEC Reduces Restrictions on Resale of Restricted Securities

Effective February 15, 2008, the US Securities and Exchange Commission, or SEC, amended Rules 144 and 145 under the Securities Act of 1933 to increase the liquidity of privately placed securities.[1] In the most significant changes to Rule 144 since 1997, the amendments shorten the minimum holding period and, particularly for non-affiliates, reduce other restrictions on the resale of restricted securities acquired before or after the changes take effect.

"The amendments will substantially streamline the process by which "restricted securities" sold in private transactions can become "unrestricted" for Securities Act purposes."

In summary, the amendments:

- reduce from one year to six months the holding period for restricted securities issued by reporting companies;
- remove the volume limitation and other conditions for resales by non-affiliate holders of restricted securities issued by reporting companies once the holding period has been satisfied;
- remove all restrictions on sales of restricted securities, including those of non-reporting companies, for non-affiliates after a one-year holding period;
- remove the manner-of-sale condition for all debt securities;
- codify eight Staff interpretations relating to Rule 144;
- eliminate the presumptive underwriter provision of Rule 145, except with respect to Rule 145 transactions involving shell companies (other than business combination related shell companies), and conform the resale restrictions of Rule 145(d) to the revised provisions of Rule 144 that apply to the resale of securities issued by shell companies; and
- retain most of the requirements applicable to resales by affiliates.

The following table summarizes the key aspects of Rule 144 as revised.

Conditions to Resale of Restricted Securities under Revised Rule 144

Seller	**Affiliate**		**Non-Affiliate (at resale and three months before)**		
Issuer	Reporting	Non-Reporting	Reporting		Non-Reporting
Minimum Holding Period	6 months	1 year	6 months	1 year	1 year
Other Requirements	1. Current public information 2. Volume limits 3. Manner of sale (only for equity securities, not debt) 4. Form 144		Current Public	None	None

Rule 144 and the Amendments

Background

Generally, offers and sales of securities must be registered with the SEC unless an exemption from registration is available.[2] Rule 144 provides a non-exclusive safe harbor from being an "underwriter" for holders of "restricted securities" (securities acquired directly from the issuer in a transaction exempt from registration) and "control securities" (securities held by affiliates of the issuer acquired in secondary market transactions). The safe harbor enables selling security holders to use Section 4(1) of the Securities Act for the resale by complying with Rule 144.

The amendments to Rule 144 are intended to increase the liquidity of securities sold in private placements and thereby decrease the cost of capital for all issuers. The amendments will substantially streamline the process by which "restricted securities" sold in private transactions can become "unrestricted" for Securities Act purposes.

Market Impact

Given the breadth of the amendments as they affect resales by non-affiliates, the amendments to Rule 144 will have implications for a variety of types of unregistered offerings of securities. For example, the shorter holding period may lower the illiquidity discount that the market applies to privately placed securities. In addition, the rule changes may reduce the significance of registration rights in private offerings and could affect both US and non-US issuers assessing whether to become reporting companies under the Securities Exchange Act of 1934.

Issuers with outstanding registration rights agreements should review our *Client Alert, The Future of Registration Rights in Private Offerings of Debt Securities*, to determine the possible impact of the amendments on these contracts.

Amendments to Regulation S

Regulation S creates a distribution compliance period for issuers, distributors or their affiliates complying with the Rule 903 safe harbor. The distribution compliance period is designed to prevent "flow back" into the United States of securities sold in offshore transactions pursuant to the Rule 903 safe harbor.

In order to conform the distribution compliance period in Rule 903(b)(3)(iii) for offerings of equity securities by Category 3 issuers (US reporting issuers) to the new six-month holding period for reporting companies of Rule 144(d), the SEC amended Regulation S to reduce the distribution compliance period for securities by US reporting issuers from one year to six months.

The Amendments

Holding Period Applicable to Non-Affiliate Sales of Restricted Securities

Prior to the amendments, Rule 144(d) required that restricted securities be held for one year, calculated from the purchase and full payment for the securities, before any sale in reliance on the rule. After the one-year holding period, non-affiliates were permitted to sell restricted securities of a company that satisfied the current public information requirements[3] if the sales satisfied the manner of sale, volume limitation and Form 144 reporting conditions.[4] Prior to the amendments, a security holder who had not been an affiliate of the issuer for at least three months and had held the securities for at least two years was permitted to sell the securities without any volume or other limitation, even if the issuer did not satisfy the current public information reporting requirements. In satisfying the

one-year and two-year holding periods, non-affiliates could "tack" their own holding periods to those of other non-affiliates from whom they bought the restricted securities.

Under the amendments, a security holder who has not been an affiliate of the issuer for three months and holds restricted securities of a reporting[5] company that is current in its SEC filings may resell these securities without any restriction after satisfying a six-month holding period. Moreover, a non-affiliate security holder may resell restricted securities of a reporting company without any limitations after satisfying a one-year holding period even if the reporting company is not current in its SEC filings. A holding period of one year will apply to a non-affiliate's sale of restricted securities of a non-reporting company; however, thereafter sales will not be subject to any of the rule's volume, manner of sale or other requirements.[6] Tacking holding periods of non-affiliates continues to be permitted. Significantly, the SEC declined to adopt a proposal that would have tolled (or suspended) the holding period for up to six months for any period in which the holder had engaged in hedging activities. The SEC concluded that the tolling proposal, if adopted, would have unnecessarily complicated resales under Rule 144.

Holding Period Applicable to Sales of Restricted Securities by Affiliates

As with sales by non-affiliates, prior to the amendments, Rule 144(d) required restricted securities to be held for one year before any sale by affiliates in reliance upon the rule. After the one-year holding period, affiliates could make sales of restricted securities only in compliance with the current public information, manner of sale, volume and Form 144 reporting requirements.

Under the amendments, a clear distinction is drawn between restricted securities of a reporting company and a non-reporting company. For affiliates that comply with the current public information, manner of sale, volume limitation and reporting requirements, the rule reduces the holding period for sales of restricted securities of reporting companies from one year to six months. In the case of a non-reporting company, affiliates may not sell restricted securities until the completion of a one-year holding period, and thereafter must still comply with the information, manner of sale, and volume limitations of the rule.

Notably, the new rule provides for identical holding periods for non-affiliates and affiliates of non-reporting companies. In the new rule's regime, the duration of the holding period depends on whether the securities are issued by a reporting or a non-reporting issuer and not on the status of the holder.

Manner of Sale Requirements Amended for Equity Securities

Under the amendments, the manner of sale requirements apply only to sales of equity securities by affiliates and no longer apply to resales of debt securities or to resales of equity securities by non-affiliates. The removal of these conditions is based on the SEC's judgment that only a holding period and current public information are necessary to establish that a non-affiliate is not an underwriter of securities. This is a significant change from the SEC's historical perspective on the issue.

As part of the modernization of Rule 144 to "better reflect current trading practices and venues," the SEC further amended the manner of sale restrictions that apply to resales. First, the amendments permit the resale of restricted securities in "riskless principal transactions." To be reported as a riskless transaction, offsetting trades are executed at the same price (excluding any markup or markdown, commission or other fee). To meet the requirements

of amended Rule 144(f) in "riskless" transactions, a broker or dealer may not solicit or arrange for the solicitation of customers' orders to buy the securities in connection with the transaction, may not receive more than its customary markup or markdown, commission or other fee, and must conduct a reasonable inquiry regarding the underwriter status of the security holder for whose account the securities are to be sold.

In a second modernization, the SEC amended Rule 144(g) to accommodate new technology. The new rule provides that the posting of bid and asked quotations in an alternative trading system (such as call markets, electronic communication networks, crossing networks or matching systems) will be deemed not to involve a solicitation of a buy order in violation of Rule 144(f). This new provision permits a broker to insert bid and asked quotations for the security in an alternative trading system as long as the broker has published bona fide bid and asked quotations for the security in the alternative trading system on each of the last 12 business days.

Manner of Sale Requirements Eliminated for Debt Securities

The amendments eliminated the manner of sale requirements with respect to resales of debt securities and allow holders greater flexibility in the resale of their debt securities, including the option to negotiate privately their resale. The new definition of "debt securities" includes non-participating preferred stock,[7] which has debt-like characteristics, and asset-backed securities, where the predominant purchasers are institutional investors. In addition, the amendments relax the volume limitations with respect to debt securities by adding an alternative test allowing for resales of up to 10 percent of a tranche of debt securities in any three-month period.

Other Changes

Form 144 Reporting Requirements
Under the amendments, only affiliates of an issuer are required to file a Form 144 when making a resale in reliance on Rule 144, and the applicable threshold for a Form 144 filing is now increased to trades of 5,000 shares or $50,000 within any three-month period.

Coordination between Form 144 and Form 4
The proposing release for the amendments sought comment on whether the Form 4 and Form 144 reporting systems should be integrated. At the recommendation of the Staff, the SEC determined not to take action on this proposal at this time. Therefore, both Form 4 and Form 144 still need to be filed. However, there will likely be fewer Form 144 filings due to the increase in the filing thresholds under the amendments.

Codification of SEC Staff Interpretative Positions
The SEC codified eight Staff interpretations:

- Securities acquired under Section 4(6) of the Securities Act are considered to be "restricted securities;"
- Tacking of holding periods is generally permitted when a company reorganizes into a holding company structure;
- Tacking of holding periods for conversions and exchanges of securities;
- Tacking of holding periods for cashless exercise of options and warrants;
- Aggregation of pledged securities;
- Securities issued by "reporting and non-reporting shell companies;" and
- Representations required from security holders relying on Rule 10b5-1(c).

Conclusions

The amendments to Rule 144 will substantially streamline the process by which "restricted securities" sold in private transactions can become "unrestricted" for Securities Act purposes. These amendments are likely to improve the liquidity for privately placed securities and to reduce the needs for registration rights in private placements. We have separately published a Client Alert addressing the impact of these amendments on registration rights.

Endnotes

[1] "Revisions to Rules 144 and 145," Release No. 33-8869 (Dec. 6, 2007), available at http://www.sec.gov/rules/final/2007/33-8869.pdf.

[2] Section 4(1) of the Securities Act exempts from registration transactions by any person other than an issuer, underwriter or dealer. Section 2(a)(11) of the Securities Act defines an underwriter to include "any person who has purchased from the issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking."

[3] Current public information under both the prior rule and the amended rule is deemed available for reporting issuers if the issuer has been subject to the Exchange Act reporting requirements for at least 90 days and has filed all required reports (other than Form 8-K reports) during the 12 months preceding the sale (or such shorter period that the issuer was required to file such reports). If the issuer is a non-reporting issuer, current public information is deemed available if the information specified in Rule 144(c)(2) is publicly available for such issuer.

[4] Requirements relating to the availability of current public information are set forth in Rule 144(c), requirements relating to volume limitations are set forth in Rule 144(e), requirements relating to manner of sale are set forth in Rules 144(f) and 144(g), and requirements with respect to holding periods are set forth in Rule 144(d). These sub-paragraphs are carried over into the amended Rule 144.

[5] For purposes of Rule 144, a reporting company is a company that has been subject to the reporting requirements of the Exchange Act for at least 90 days prior to the sale of the security. Exchange Act reporting requirements are generally triggered under Section 13 or 15(d) for companies with a security registered on a national exchange or with total assets exceeding $10 million and a class of equity securities (other than an exempted security) held of record by more than 500 persons. Rule 3b-4 under the Exchange Act defines foreign private issuers so that the holders-of-record requirement focuses on US holders, rather than holders on a worldwide basis.

[6] We expect the one-year holding period would also apply in the case of unsold restricted securities held by non-affiliates of a reporting company that for any reason ceased to be current in its SEC filings in the year following issuance.

[7] Non-participatory preferred stock is defined in amended Rule 144(a) as "non-convertible capital stock, the holders of which are entitled to a preference in payment of dividends and in distribution of assets on liquidation, dissolution, or winding up of the issuer, but are not entitled to participate in residual earnings or assets of the issuer."

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