January 9, 2008

Resales of Securities—An Expanded Safe Harbor
Revisions to Rules 144 and 145

The Securities and Exchange Commission recently adopted a number of amendments to Rules 144 and 145 under the Securities Act of 1933 that are intended to increase the liquidity of privately sold securities and decrease the cost of capital for all issuers, while maintaining adequate investor protection.[1] The amendments, the first of substance in ten years to Rule 144, shorten the required holding period for resales of "restricted securities" of issuers who are required to file reports with the SEC under the Securities Exchange Act of 1934, or "reporting issuers." The amendments also significantly reduce the burden of complying with Rule 144 for non-affiliate security holders of reporting issuers and exempt resales of debt securities from certain requirements of Rule 144.[2] The SEC has also codified several interpretations under Rule 144 that were previously only interpretive positions of the staff of the Division of Corporation Finance.

We expect that these amendments will increase liquidity in connection with resales of restricted securities in general, including resales of debt and convertible securities issued by reporting issuers in private transactions and resales by affiliates of target companies of securities received in stock-for-stock acquisitions. The amendments to Rules 144 and 145 will become effective on February 15, 2008. Once effective, the revised holding periods and other amendments will apply to securities acquired before or after the effective date.

Overview

Rule 144 provides a safe harbor that allows for the resale of "restricted securities" and "control securities" without registration under the Securities Act, provided that certain conditions are met.[3] Restricted securities are securities acquired under one of the transactions listed in Rule 144(a)(3).[4] Control securities, although not defined in Rule 144, are commonly understood to be securities held by an affiliate of the issuer, regardless of how they were originally acquired.

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[1] *See* Revisions to Rules 144 and 145, Rel. No. 33-8869 (Dec. 6, 2007) ("Adopting Release"). The Adopting Release is available on the SEC's website at http://www.sec.gov/rules/final/2007/33-8869.pdf.

[2] An "affiliate" of an 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. *See* Rule 144(a)(1).

[3] Rule 144 creates a non-exclusive safe harbor under Section 2(a)(11) of the Securities Act from the definition of "underwriter." A person satisfying the applicable conditions of Rule 144 will not be viewed as having "purchased [the securities being resold] from an issuer with a view to…distribution" and will therefore not be considered an underwriter of the securities for purposes of Securities Act registration requirements.

[4] Generally speaking, restricted securities are securities acquired in unregistered, private sales from the issuer or from an affiliate of the issuer. Investors typically receive restricted securities through angel and venture capital rounds and other private placements, Regulation D offerings, Rule 144A offerings, certain Regulation S offerings and stock incentive plans as compensation for services. *See* Rule 144(a)(3) for a complete list of what are "restricted securities" under the rule.

Before the recent amendments, security holders could resell restricted securities under Rule 144, subject to volume and manner of sale limitations, after holding their securities for one year. After two years, restricted securities could be sold without restriction so long as the security holder had not been an affiliate of the issuer for three months prior to the sale.

Amendments to Rule 144

Amendments to Holding Periods for Restricted Securities

The SEC has reduced the required holding period for restricted securities of reporting issuers from one year to six months.[5] The SEC hopes that this shortened holding period will make private offerings more attractive and, as a result, help public issuers raise capital more easily and at less cost. Restricted securities of a "non-reporting issuer" will continue to be subject to a one year holding period requirement. For convenience, *Appendix A* summarizes the conditions applicable to the resale under Rule 144 of restricted securities held by affiliates and non-affiliates of an issuer.

In June 2007, the SEC proposed to add a provision to Rule 144 that would toll the holding period for restricted securities of reporting issuers while a security holder is engaged in certain hedging transactions. This proposal met with significant opposition, and the SEC did not adopt this amendment to Rule 144. The SEC stated that it will continue monitoring the hedging activities of holders of restricted securities.

Reduction of Conditions Applicable to Non-Affiliates

The amendments to Rule 144 substantially reduce the requirements for resales of restricted securities by non-affiliates. Prior to the amendments, both affiliates and non-affiliates were subject to all applicable conditions of Rule 144, including current information requirements about the issuer of the securities, restrictions on the manner of sale of the securities themselves, limitations on the amount of securities that may be sold in any three-month period and the Form 144 notice requirement.

Under amended Rule 144, after the applicable six-month or one year holding period is met, non-affiliates may resell restricted securities without regard to any other conditions of Rule 144, except that, for the resale of the securities of reporting issuers, the current public information requirement must be satisfied until one year after the acquisition of the securities. Affiliates of an issuer, on the other hand, still must comply with all conditions of Rule 144 following the applicable holding period. However, as discussed below, the Rule 144 conditions applicable to affiliates have been somewhat liberalized.

Modifications to Restrictions on Sales by Affiliates

Prior to the recent amendments to Rule 144, the manner of sale requirements in Rule 144(f) required securities to be sold in "brokers' transactions" or in transactions directly with a "market maker," as that term is defined in Section 3(a)(38) of the Exchange Act. Additionally, Rule 144(f) prohibited a selling security holder from soliciting or arranging for the solicitation of orders to buy the securities in anticipation of, or in connection with, the Rule 144 transaction or making any payment in connection with the offer or sale of the securities to any person other than the broker who executes

[5] The six-month holding period requirement will apply to the securities of an issuer that has been subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act for at least 90 days before the Rule 144 sale.

the order to sell the securities. These requirements and prohibitions applied to both debt and equity securities.

Notably, the SEC has completely eliminated the manner of sale limitation and increased the volume limitation for resales of debt securities under Rule 144.[6] Rule 144(f) has also been liberalized for resales of equity securities. The SEC will now permit the resale of equity securities through riskless principal transactions in which trades are executed at the same price, exclusive of any explicitly disclosed markup or markdown, commission equivalent, or other fee, so long as the rules of a self-regulatory organization permit the transaction to be reported as riskless.[7] In addition, the SEC has amended Rule 144(g) to allow a broker to insert bid and ask quotations for a restricted security in an alternative trading system, provided that the broker has published bona fide bid and ask quotations for the security in the alternative trading system on each of the last 12 business days.

The SEC has also amended the Rule 144(e) volume limitations for debt securities. The current rule limits the amount of securities that may be sold in a three-month period to the greater of (a) one percent of the "shares or other units of the class outstanding" as shown by the most recent report or statement published by the issuer or (b) the average weekly trading volume of trading "in such securities." Most debt securities have a low weekly trading volume and, as a result, security holders wishing to resell debt securities in reliance on Rule 144 have generally been stymied by the volume limitation condition. Recognizing the misfit of this condition in the context of resales of debt securities by affiliates, the SEC has amplified the volume limitation requirement to allow sales of up to 10% of the principal amount of a tranche of debt securities in a three-month period.[8] This amendment should greatly increase the amount of debt securities that can readily be sold by affiliates under Rule 144.

Changes to Form 144

Rule 144(h) currently requires a selling security holder to file a notice with the SEC on Form 144 if the security holder's intended sale exceeds either $10,000 or 500 shares within a three-month period. The SEC has amended Rule 144(h) to eliminate the need for non-affiliates to file a Form 144 notice and to increase the filing thresholds to $50,000 or 5,000 shares within a three-month period. The change to the dollar threshold was made to reflect inflation since 1972, when the filing thresholds were last modified. The SEC believes that a 5,000 share threshold is an appropriate alternative threshold for trades that do not trip the $50,000 threshold but that still merit notice to the market. The increased filing thresholds should significantly reduce the number of Form 144 notices that affiliates of issuers will be required to file with the SEC. All in all, the SEC expects the number of Form 144 notices required to be filed each year to fall from approximately 60,000 filings to fewer than 24,000 filings.

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[6] Non-participatory preferred stock and asset-backed securities are defined as debt securities for purposes of Rule 144.

[7] A "riskless principal transaction" means a principal transaction where, after having received an order to buy from a customer, a broker or dealer purchases the security as principal in the market to satisfy the order to buy or, after having received an order to sell from a customer, sells the security as principal to the market to satisfy the order to sell.

[8] The term "tranche," which is not defined in Rule 144 or any other SEC rule, has generally been used by the SEC to mean a subset of securities, most typically debt and drawn from a larger pool, with identical terms. *See*, e.g., Rule 902(f) of Regulation S under the Securities Act ("in a continuous offering of non-convertible debt securities offered and sold in identifiable *tranches*, the distribution compliance period for securities in a *tranche* shall commence upon completion of the distribution of such *tranche* …"[emphasis added]). As a practical matter, we expect discrete issuances from open-ended Indentures (including any subsequent issuances of identical securities pursuant to reopening provisions) to constitute separate tranches for purposes of this provision.

Codification of Staff Provisions

The SEC has also codified several interpretive positions that were previously issued by the staff of the Division of Corporation Finance, including the following:

- securities issued under the exemption from registration under Section 4(6) of the Securities Act are considered to be restricted securities;[9]
- tacking of holding periods is permitted when a company reorganizes into a holding company structure, in connection with certain conversions and exchanges of securities and in connection with the cashless exercise of options and warrants;
- pledged securities held by multiple pledgees will not be aggregated for purposes of calculating Rule 144(e) volume limitations, absent concerted action by the pledgees; and
- Rule 144 is not available for the resale of securities of a "shell company,"[10] other than a shell company organized as part of certain business combinations.

Amendments to Rule 145

Rule 145 under the Securities Act provides that exchanges of securities in connection with reclassifications of securities, mergers, consolidations or transfers of assets that require shareholder vote constitute "sales" of those securities. Rule 145(c) presumes that persons who were affiliates of the target company at the time of the vote or consent on the transaction are deemed to be "underwriters" of these securities, and Rule 145(d) subjects these affiliates to certain of the requirements of Rule 144. The effect of these rules has been to decrease the liquidity of securities of reporting issuers issued to the target's affiliates in stock-for-stock acquisitions.

The SEC has amended Rule 145(c) to remove this "presumptive underwriter" provision, except with respect to transactions involving a shell company. Rule 145(d) has been modified to conform to the amendments made to Rule 144 for the resale of securities of shell companies. As a result of these amendments, the provisions of Rule 145 are no longer applicable to the resale of securities received in connection with reclassifications of securities, mergers, consolidations or transfers of assets that are subject to shareholder vote, unless the issuer is a shell company.

Modifications to Regulation S

Regulation S under the Securities Act provides that certain offerings will be deemed to take place outside of the United States and, as a result, not require registration of the securities being offered. Regulation S contains a "distribution compliance period" that is intended to ensure that during the offering period and in subsequent aftermarket trading that takes place offshore, persons taking advantage of the Regulation S safe harbor are not engaged in an unregistered, non-exempt distribution of securities into the United States. During this period any subsequent sale of the

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[9] Section 4(6) of the Securities Act exempts from registration transactions involving offers or sales by an issuer solely to one or more accredited investors, if the aggregate offering price of the securities does not exceed $5.0 million and there is no advertising or public solicitation in connection with the transaction.

[10] A "shell company" is defined in Rule 405 under the Securities Act as a company, other than an asset-backed issuer, that has (1) no or 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.

securities made in reliance upon Regulation S must comply with certain restrictions laid out in Rule 903 under the Securities Act.

Prior to the amendments, "Category 3" issuers (U.S. reporting issuers) were subject to a one year distribution compliance period under Regulation S. In order to align the distribution compliance period with the new Rule 144(d) holding period, the SEC has amended Regulation S to make U.S. reporting issuers subject to a distribution compliance period of six months under Regulation S rather than one year.

Implications

The SEC's revisions to Rules 144 and 145 represent a significant expansion in the "underwriter" safe harbor for resales of securities, particularly resales by non-affiliates. This in turn has the effect of expanding the exemption from Securities Act registration requirements in Section 4(1). With this expansion come a number of practical implications for market participants in transactional settings.

- Investors in private debt offerings by reporting issuers and affiliates in stock-for-stock acquisitions by reporting issuers should benefit from increased liquidity in their securities.

- The equity derivative markets may also benefit from additional clarity provided by the SEC's decision to refrain from imposing the tolling provision contained in the amendments as initially proposed.

- For issuers in Regulation S offerings to be listed on the Alternative Investment Market of the London Stock Exchange, shorter holding and distribution compliance periods should provide the opportunity to move more quickly to electronic settlement of shares, which in turn should increase liquidity and eliminate paper settlement discounts on AIM.

The SEC estimates that in 2006 the volume of transactions noticed under Rule 144 exceeded $71 billion, and more than 50% of U.S. public companies had at least one transaction reported on Form 144. By reducing the burdens associated with resales of privately issued securities, the SEC expects to reduce the cost of raising capital to a broad range of issuers and increase the value of privately issued securities to their holders through the reduction of liquidity discounts and resale transactional costs.

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This information is not intended as legal advice. Readers should seek specific legal advice before acting with regard to the subjects mentioned herein.

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Appendix A

Summary of New Rule 144 Conditions Applicable to Resales of Restricted Securities

	Affiliate or Person Selling on Behalf of an Affiliate	**Non-Affiliate and Has Not Been an Affiliate During Prior Three Months**
Restricted Securities of *Reporting* Issuers	During six-month holding period No resales under Rule 144 permitted After six-month holding period May resell in accordance with all Rule 144 requirements including • Current public information • Volume limitations • Manner of sale requirements for equity securities • Filing of Form 144	During six-month holding period No resales under Rule 144 permitted After six-month holding period but before one year Unlimited public resales under Rule 144, except that the current public information requirement still applies After one year holding period No restrictions on resale under Rule 144
Restricted Securities of *Non-Reporting* Issuers	During one year holding period No resales under Rule 144 permitted After one year holding period May resell in accordance with all Rule 144 requirements including • Current public information • Volume limitations • Manner of sale requirements for equity securities • Filing of Form 144	During one year holding period No resales under Rule 144 permitted After one year holding period No restrictions on resale under Rule 144