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SEC Changes to Rules 144 and 145 Dramatically Simplify the Process for Selling Outstanding Securities of Public and Private Companies

The Securities and Exchange Commission has adopted rule changes that will make it much easier for investors to sell securities they acquire in both private and public companies. Beginning on February 15, 2008, these changes are expected to decrease the cost of raising capital and enhance the perceived value of stock used as consideration in acquisitions, with minimal impact on investor protection. These reforms are part of a broader package of changes being approved piece by piece by the SEC intended to make capital raising in the U.S. more efficient, particularly for smaller companies.

Most significantly under the amended rules, to sell securities pursuant to Rule 144 under the Securities Act of 1933, a holder of restricted securities of a public company (that has been public at least 3 months) who is not an affiliate of the company (directors, executive officers and large shareholders and others controlling the company) only needs to hold the securities for a period of 6 months before being able to resell, subject merely to the company being up-to-date in its SEC periodic reporting. After a year, even the reporting requirement goes away. For nonpublic companies, a one year holding period applies, after which nonaffiliates may sell freely.

Affiliates are still subject to essentially the same restrictions as they are now – volume limits, manner of sale requirements, need for a notice filing – but the holding period for restricted securities for affiliates of public companies has been reduced to 6 months and affiliates will benefit from other more minor changes described below.

In addition, the SEC has removed a presumption that affiliates of target companies in acquisitions are deemed to be underwriters. This change (to Rule 145 under the Securities Act) removes obstacles that had forced affiliates of acquired companies who had no role with the acquiring company after the completion of the acquisition to comply with restrictions even when selling securities that had been registered in connection with the acquisition.

Background - Current Rules 144 and 145

Under the Securities Act, any offers and sales of securities must be registered with the SEC unless otherwise exempted from

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registration. Rule 144 provides such an exemption for resales of restricted securities (those not issued in a public offering) and control securities (those held by affiliates, whether issued publicly or privately). Rule 144 is not a true exemption but a "safe harbor" that gives a seller the assurance that he or she is not an "underwriter" and that therefore the sale qualifies for an exemption from the Securities Act for sales by a person other than an issuer, underwriter or dealer.

The conditions to be met in order to rely on the current version of Rule 144 are cumbersome. For starters, securities must be held a minimum of one year and between 1 year and 2 years may only be sold in accordance with a variety of limits (for affiliates, these limits continue as long as they remain affiliates). Generally, sellers are limited in any 3-month period to selling less than the greater of 1% of the outstanding securities or the average trading volume for the 4 weeks prior to a sale. Sales must be made only through brokers or market makers and sellers have to file a notice filing (Form 144) with the SEC regarding their intent to sell. Lastly, companies themselves are required to be up-to-date in all their quarterly and annual SEC reporting obligations. Historically, in cases of mergers and acquisitions or other transfers of securities requiring a vote of the shareholders, the SEC deemed certain of the parties (other than the issuer) and their affiliates to be "underwriters," essentially requiring them to comply with certain of the limits in Rule 144, even though the shares in the merger or acquisition had been registered and the sellers were nonaffiliates of the surviving company.

Life Under Amended Rules 144 and 145

The amended rules eliminate most of the limits under Rules 144 and 145 for nonaffiliates, such that reselling securities will become much more straightforward and efficient. The following sets forth the new regime for reselling securities under these safe harbors:

Resales of securities of public companies under Rule 144:

- Nonaffiliates (who have not been affiliates for at least 3 months): the minimum holding period for restricted securities is shortened from 1 year to 6 months from the date of acquisition from the issuer or an affiliate. Between 6 months and 1

year, the only other condition is that the issuer be up-to-date in its SEC periodic reporting. After 1 year has elapsed, no limits apply. For nonaffiliates, the existing volume and manner of sale restrictions are totally removed, as is the Form 144 filing requirement.

- Affiliates: the existing limits continue to apply, with the only modifications being (1) the minimum holding period is shortened from 1 year to 6 months, (2) de minimis thresholds below which a Form 144 is not required to be filed have been raised to the lesser of 1,000 shares or a sale price of \$50,000 (up from 500 shares or \$10,000) and (3) the manner of sale provisions no longer apply to debt securities, nonparticipating preferred stock and asset-backed securities and the volume limits for such securities will increase to 10% of the applicable tranche.

Resales of securities of private companies under Rule 144:

- Nonaffiliates (who have not been affiliates for at least 3 months): the minimum holding period for restricted securities will be 1 year from the date of acquisition from the issuer or an affiliate. After 1 year has elapsed, no limits apply.
- Affiliates: the same changes described above for public companies' affiliates apply, but the holding period remains 1 year.

Resales of securities acquired in a merger or acquisition under Rule 145:

- If the securities are not registered, the Rule 144 analysis above applies.
- If the securities are registered, Rule 145 limits will only apply if the transaction involved a shell company or blank check company. Otherwise, nonaffiliates of the surviving company who were affiliates of the acquired company are no longer presumed to be affiliates and may generally freely resell securities acquired.

Most other aspects of Rule 144 remain unchanged, such as how the holding period is calculated under various scenarios such as pledges, conversions and gifts.

However, the SEC has codified some of its informal interpretations regarding Rule 144, including (1) making clear that the holding period for warrants that have cashless exercise features begins when the warrants are issued, and not upon exercise, even if the cashless exercise feature was added at

a later date (as long as it was added for no additional consideration), (2) allowing tacking of holding periods when a company reorganizes into a holding company structure, (3) clarifying holding period commencement for securities that have been converted or exchanged and (4) stating that sales by pledgees will not be aggregated with sales by other unrelated pledgees of the same securities. A change to Form 144 was also made to make representations in the form compatible with Rule 10b5-1 sales plans set up in advance of sales.

Other Possible Benefits

The SEC's changes to Rules 144 and 145 are expected to increase the liquidity of privately placed securities by eliminating most of the current limitations on resales by nonaffiliates. This may decrease the cost of capital for companies - by reducing the barriers to liquidation of securities, potential investors will find these securities more attractive and may be willing to pay smaller discounts than have been traditionally applied to unregistered securities. To the extent investors negotiate registration rights, companies should expect these rights to have much shorter durations and result in fewer penalties if problems arise in the registration process. In addition, unregistered securities may be a more attractive form of consideration in mergers and acquisitions where such consideration can be liquidated only 6 months after a deal closes and, in the case of registered securities, immediately after closing with no need to comply with any limits.

These changes will also make life simpler for attorneys, brokers and transfer agents who must frequently deal with the logistics of selling shares under Rules 144 and 145. Various representation letters will be streamlined and less paperwork will be required - counsel issuing an opinion allowing nonaffiliate sales must only verify the holding period and (between 6 and 12 months) corroborate that the last year of periodic reports had been filed. This should save companies time and money, allowing transfers of securities to be approved and processed much more quickly.

The SEC has stated that it will monitor transactions for patterns of abusive practices which take advantage of the loosening of these rules to defraud investors. However, the consensus is that the benefits to companies of all sizes in increased

liquidity and reduced reporting and legal costs will outweigh the potential risks to investors. The SEC had hoped to combine Form 144 with Section 16 reports required for transactions by certain affiliates to further ease reporting burdens. Although the task proved too complicated for the time being, the SEC continues to review ways to further reduce reporting burdens for smaller companies.

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The summary above is intended to describe the major changes affecting resales of outstanding securities as a result of the amendments to Rules 144 and 145. For a more comprehensive analysis of these changes, or for further information about the impact of these and other changes to the U.S. securities laws, please contact the lawyer at Sullivan & Worcester LLP with whom you regularly consult, or the lawyers listed above.

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