

- ▶ Loosening securities sale restrictions aligns issuer and investor interests
- ▶ Streamlining Rule 144 will simplify attorneys' decision-making processes
- ▶ SEC questions purpose of holding period
- ▶ Amendments will enable faster securities sales
- ▶ Increased liquidity will help companies raise money in private markets

By Howard Berkenblit

# Smoothing the path

Simplification is not a word typically associated with SEC capital raising and compliance requirements. But things should soon get a whole lot easier for companies where resales of restricted securities are concerned, thanks to proposed changes expected to be adopted later this year.

Amendments to Rule 144 under the Securities Act of 1933 would significantly ease the burdens for companies, streamlining procedures for security holders reselling outstanding securities. And that, in turn, means a more efficient process for the in-house and outside counsel who must bless each sale.

In an even broader context, the changes should improve liquidity and access to capital, while reducing costs tied to private placements and acquisitions. SEC chairman Christopher Cox has said the changes will 'alleviate unnecessary burdens' and 'remove obstacles that impede the growth of small companies.'

From a corporate counsel perspective, it's almost certain the chairman's prediction will bear fruit. But let's back up a bit first.

## A cumbersome process

When individuals want to resell outstanding securities that have not been registered with the SEC, or when an affiliate of a company wants to sell any securities, one of two things must happen. The issuers must register resales of those securities on behalf of the sellers. Or, the sellers must rely on some exemption from registration. The aforementioned Rule 144 offers one of the most common exemptions.

Technically speaking, Rule 144 is not a true exemption. Rather, it is a 'safe harbor' that gives a seller the assurance that the sale won't run afoul of the securities laws. (Providing, of course, that the seller does not have a plan or scheme to evade those laws.)

Yet, in their current form, the requirements behind Rule 144 are cumbersome at best, forcing security holders to comply with a series of restrictions that, in point of fact, make resale unnecessarily complex. For starters, there are holding period requirements and limits on amounts that may be sold. There are restrictions that require sales to be through brokers or market makers and strict requirements for SEC notification. And, of course, companies must be up to date in all of their quarterly and annual filing obligations.

Fortunately, the proposed amendments would substantially improve the reporting landscape. Among the changes, the new rules would:

- Shorten the minimum holding period for restricted securities of SEC reporting companies from one year to six months from the date of acquisition from the issuer or an affiliate (ie, directors, executive officers and significant stockholders) and eliminate all restrictions for non-affiliates after a period of one year rather than two. The SEC has proposed, however, to 'toll' the holding period – that is, not give credit for the time – if the seller has entered into hedging arrangements for any securities of the same class as those being sold. (The proposal would cap the maximum, even with tolling, at one year.)
- For sellers that have not been affiliates for at least three months, remove restrictions on volume and man-



ner of sale and the Form 144 filing requirement so that, between six months and one year, the only remaining requirement will be that the issuer is current in its reporting obligations. After a year, even the issuer reporting condition would go away. This means the opinion giver would only need to verify the holding period and – between six and 12 months – corroborate that the last year of periodic reports had been filed.

- Remove all of the restrictions for restricted securities held at least a year by sellers that have not been affiliates of non-SEC reporting companies for at least three months.

- For affiliates, raise the minimum thresholds that trigger the need to file a Form 144 and eliminate a restriction on the manner of resales of debt securities. Though not yet formally proposed, the SEC is also considering combining Form 144 with 'Section 16' reports regarding insider stock transactions by directors, officers and 10 percent stockholders.

- Clarify other standing unofficial interpretations and make several technical and 'plain English' tweaks to the regulations. Among the more significant refinements, the new rules would make clear that the holding period for warrants or options that have cashless exercise features would begin when the warrants or options are issued, and not upon exercise, even if the cashless exercise feature was added at a later date.

Individually, each of these changes will streamline procedures. Taken in total, they represent a dramatic

boon for the attorneys who must issue formal opinions on these sales. (Remember, too, that without that legal opinion, the sale can't go through. Only rarely these days are formal opinions from counsel not a requirement for resale.)

As things currently stand, counsel must verify that all the conditions of Rule 144 have been satisfied. Some of those conditions are relatively straightforward to verify and approve, by examining a stock certificate, for example, or reviewing company or transfer agent records to determine how long the securities have been held. The volume limits require slightly more effort to calculate, but they are also objectively verifiable.

Yet other elements, such as holding period and manner of sale verifications, require counsel to delve much deeper, necessitating input, letters and certifications from sellers and brokers, and with rapid-fire turnaround. Practically speaking, this means layers of phone calls, faxes and attention to detail in a fast-moving world. For companies that use outside counsel, the cost can run into the thousands.

And at what benefit to the public? Why should security holders be forced to hold their securities for a year or two before they can liquidate their investments? And whom do these restrictions really protect, especially where the seller has no control over the issuer?

After analyzing the real world trading of securities and investment patterns, the SEC has at last concluded that the liquidity of restricted and affiliate-held securi-

### RULE REFINEMENTS

Summary of original adopting release for Rule 144:

The rule shall not be available to any individual or entity with respect to any transaction that, although in technical compliance, is part of a plan to either distribute or redistribute securities.

New amendment: Statement that the Rule 144 safe harbor is not available with respect to any transaction part of a plan to evade registration requirements.

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

**FORM 144**

**NOTICE OF PROPOSED SALE OF SECURITIES  
PURSUANT TO RULE 144 UNDER THE SECURITIES ACT OF 1933**

**ATTENTION: Transmit for filing 3 copies of this form concurrently with either placing an order with a broker to execute sale or executing a sale directly with a market maker.**

1- (a) NAME OF ISSUER (If not type or print)		(b) BUSINESS NO.	(c) S.E.C. FILE NO.	WORK LOCATION	
1- (b) ADDRESS OF ISSUER: STREET CITY STATE ZIP CODE		(d) BUSINESS ADDRESS	(e) TELEPHONE NO.	FAX NO.	
2- (a) NAME OF PERSON FOR WHOM ACCOUNT THE SECURITIES ARE TO BE SOLD		(b) RELATIONSHIP TO ISSUER	(c) ADDRESS: STREET CITY STATE ZIP CODE		

*INSTRUCTION: The person filing this notice should contact the issuer to obtain the I.R.S. Identification Number and the S.E.C. File Number*

1- (a) Title of Class of Securities To Be Sold	1- (b) Name and Address of Each Broker Through Whom the Securities are to be Offered or Each Market Maker with Whom Acquiring the Securities	SEC USE ONLY		1- (d) Aggregate Number of Shares or Other Units To Be Sold (See instr. 1- (c))	1- (e) Aggregate Market Value (See instr. 1- (c))	1- (f) Number of Shares or Other Units Outstanding (See instr. 1- (c))	1- (g) Approximate Date of Sale (See instr. 1- (c))	1- (h) Name of Each Securities Exchange (See instr. 1- (c))
		1- (c) Broker-Dealer File Number	1- (c) S.E.C. File Number					

**INSTRUCTIONS:**

- (a) Title of the class of securities to be sold.
- (b) Name and address of each broker through whom the securities are intended to be sold.
- (c) Number of shares or other units to be sold (If debt securities, give the aggregate face amount).
- (d) Aggregate market value of the securities to be sold as of a specified date within 30 days prior to the filing of this notice.
- (e) Number of shares or other units of the class outstanding, or if debt securities the face amount thereof outstanding, as shown by the most recent report or statement published by the issuer.
- (f) Approximate date on which the securities are to be sold.
- (g) Name of each securities exchange, if any, on which the securities are intended to be sold.

Potential percent who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number. SEC 1147 (08-07)

ties can be improved – and the cost of capital for issuers reduced – without compromising investor protection.

**Transforming the landscape**

If the Rule 144 reforms are adopted by year’s end as anticipated, holders of restricted securities and affiliates will have greater liquidity and will be able to sell faster and with fewer restrictions, especially if they are not affiliates of the issuer. Companies, meanwhile, will save valuable time and money when preparing legal opinions or instructions allowing such sales. And corporate counsel will have more time to focus their energies on so many other regulatory requirements.

Beyond the very practical logistical implications of Rule 144 reform, these modifications have the potential to transform the entire private capital raising process and acquisition structures. Here’s why:

In private placements of securities, companies often apply discounts to the initial security sale price because of the Rule 144 restrictions that buyers would encounter upon investing. In other words, existing rules that require purchasers to hold the securities for at least a year if they want to sell at all – or hold for two years to sell with no restrictions – have been a capital raising roadblock for smaller companies.

Put simply, purchasers are not willing to pay the same amount for securities under these conditions as they would to buy shares in a registered offering where the securities are immediately liquid. By shortening the Rule 144 holding period to six months and by eliminating most of the other restrictions, companies will be able to reduce their discounts and increase their ability to raise more money in the private markets.

Similarly, many smaller companies use restricted securities to pay service providers when cash may be hard to come by. With greater perceived liquidity, securities will likely become a more attractive form of vendor payment. And, with liquidity increased, companies may be able to issue smaller amounts of shares as payment in lieu of cash.

The rule changes will also have a positive effect on private investments in public equity, or PIPE transactions, where accredited investors purchase securities at typically below-market prices. In these instances, resales of the securities are registered with the SEC in order to be quickly liquidated later by investors. But with a shorter holding period, these registration statements may no longer be necessary. If investors know

they can resell their securities after only six months without restrictions, they may no longer insist on the registration statement, saving yet more in legal costs for the issuers.

Likewise, investors in a company that is being sold may be more willing to accept issuer securities as consideration for an acquisition – and to accept them without registration rights – because the new rules would permit liquidation only a few months down the road.

Even if a registration statement is still required as part of a private placement or acquisition, the agreed upon duration of the registration statement may be significantly shortened. As a result of current Rule 144, registration rights agreements frequently provide that registration statements covering resales of purchased

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securities be effective for two years. Shortening this obligation to six months or a year saves costs for issuers and reduces potential liability.

One other important part of the SEC’s proposals would scale back Rule 145 for mergers and acquisitions that utilize registered securities. Under the new rules, affiliates of an acquired company would no longer be subject to any restrictions if they don’t continue on in a post-acquisition affiliate role. In other words, these directors, officers and others would be free to sell registered shares from the acquisition, without worrying about volume, manner of sale or other restrictions.

**Kudos to the SEC**

The SEC gets more than its share of criticism for saddling companies with costly regulations that do little to protect investors. It can improve things for investors by easing the burdens on companies. Combined with other pending proposals by the SEC to reform small public company and private capital raising rules, the landscape for both issuers and those who buy securities might just become simpler and more efficient.



▶ Howard Berkenblit is a partner at Sullivan & Worcester LLP.