

New SEC Staff Guidance on Rule 144

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On January 26, 2009, the staff of the SEC's Division of Corporation Finance issued updated Compliance and Disclosure Interpretations ("C&DIs") relating to a variety of rules under the Securities Act of 1933 (the "Securities Act")². The C&DIs include interpretive guidance on Rule 144, as discussed below. Among the topics addressed are: aggregation of sales for purposes of the Rule 144(e) volume limitations; circumstances in which tacking is permitted; calculation of holding periods; and the cessation of affiliate status. The updated C&DIs also omit certain prior staff guidance.

A REVIEW OF RULE 144

Rule 144 provides a non-exclusive safe harbor for the resale of restricted or control securities into the public market without registration under the Securities Act.

Restricted securities are securities acquired directly or indirectly from an issuer or its affiliate in a transaction or chain of transactions not involving a public offering. Control securities are securities held by an affiliate of the issuer. An investor that holds or controls 10 percent or more of an issuer's equity securities, or that has appointed a director to the issuer's board, is presumptively an affiliate of the issuer.

Restricted Securities

Rule 144(d) provides that if a non-affiliate investor wishes to resell under Rule 144 the restricted securities of an issuer that has been a reporting company under the Securities Exchange Act of 1934 (the "Exchange Act") for at least 90 days, the investor must have held the securities for at least six months.

Once this six-month holding period has lapsed, the non-affiliate investor may resell the securities freely under Rule 144, so long as the issuer is current in filing its Exchange Act reports. Once the non-affiliate investor has held the restricted securities for 12 months, it may sell the securities without limitation, whether or not the issuer is an Exchange Act reporting company or is current in its reporting obligations.

Control Securities

An affiliate that wishes to sell control securities in reliance on Rule 144 must comply with the current public information, volume, manner-of-sale and notice requirements set forth in Rule 144(c), (e), (f) and (h), respectively. If the control securities are also restricted securities, the six-or 12-month holding period requirement of Rule 144(d) will apply as well.

UPDATED C&DIS

Highlighted below are certain of the new or revised C&DIs that may be relevant to investors seeking to resell securities under Rule 144. C&DI numbers are indicated parenthetically.

Volume Limitations—No Aggregation of Non-Affiliates' Sales of Restricted Securities Received in Distributions from Investment Funds (533.04 and 533.05)

Consider a limited partnership that: (i) is an affiliate of the issuer (or whose general partner is an affiliate); (ii) holds restricted securities of the issuer; and (iii) distributes these securities in-kind to all of its partners.

Memorandum

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"On January 26, 2009, the staff of the SEC's Division of Corporation Finance issued updated Compliance and Disclosure Interpretations ("C&DIs") relating to . . . interpretive guidance on Rule 144."

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² Available at www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm. The updated C&DIs supplant the staff's previous interpretations relating to the Securities Act rules.

In determining whether the Rule 144(e) volume limitations and aggregation requirements apply to the partners' subsequent Rule 144 sales, the partners must look to their own affiliate or non-affiliate status.

To determine its Rule 144(e) volume limitations with respect to the distributed securities, a partner that is an affiliate of the issuer must aggregate its sales with (i) the Rule 144 sales of the distributed securities by any other partner that is an affiliate of the issuer and (ii) the Rule 144 sales of the same class of securities by the limited partnership. This aggregation requirement persists for six months following the distribution of the securities by the limited partnership (or one year, if the issuer has not been a public company for at least 90 days prior to the distribution or is not current in its Exchange Act reporting). An affiliate partner, so long as it does not act in concert with a non-affiliate partner, need not aggregate its sales of the distributed securities with sales by non-affiliate partners.

In contrast, partners receiving restricted securities from the limited partnership, but that are not otherwise affiliates of the issuer, are not subject to Rule 144(e)'s volume limitations and need not aggregate their Rule 144 sales of the distributed securities, so long as these non-affiliate partners are not acting in concert with any affiliate partners or with the limited partnership.

Volume Limitations—Aggregating Domestic and Foreign Sales (533.10)

When sales of securities are required to be aggregated to determine compliance with the volume limitations of Rule 144(e), an investor's non-U.S. sales must be aggregated with its domestic sales. Therefore, if an investor is an affiliate of an issuer, all of its Rule 144 sales of the issuer's securities within a three-month period—whether within or outside the U.S.—count toward the maximum sale amount allowable under Rule 144(e).

Tacking—Calculation of Holding Period May Include Tacking (130.01)

The tacking provisions of Rule 144(d)(3) may be applied to determine whether, under Rule 144(b)(1)(i), the Rule 144(c)(1) condition has been met for the one-year period. In other words, an investor that is relying on having fulfilled a one-year holding period in order to resell restricted securities, whether or not the issuer has filed all of its required reports under the Exchange Act, may apply the tacking provisions of Rule 144(d)(3) with respect to stock dividends, the cashless conversion, exchange or exercise of securities, pledged securities and gifts.

Tacking—Holding Period of Convertible Notes May Not Be Tacked When Shares Paid as Interest (532.24)

Consider a company that has issued convertible notes with interest payable in shares of common stock. An investor receiving the company's shares as interest prior to conversion of the notes may not tack the holding period of the notes to the holding period of the shares, because the shares were not acquired from the company in exchange for other securities of the company. The prohibition on tacking is not affected by the company or the investor having the discretion to pay/receive interest in shares or in cash.

Voluntary Filers—Current Public Information Requirement and Six-Month Holding Period Inapplicable (131.07 and 132.09)

The current public information requirement of Rule 144(c)(1) and the six-month holding period mandated by Rule(d)(1)(i) apply only to issuers that are, and have been for at least 90 days immediately before the Rule 144 sale, subject to the reporting requirements of Section 13 or 15(d) under the Exchange Act. An issuer that voluntarily files Exchange Act reports is not "subject to" Section 13 or 15(d). Therefore, an investor looking to use Rule 144 to resell the restricted securities of a voluntary filer may not take advantage of the abbreviated six-month holding period applicable to

issuers subject to reporting under the Exchange Act—i.e., must hold the securities for at least one year prior to resale in reliance on Rule 144.

Holding Period—Applicable Period Determined at Time of Sale (132.13)

Whether an investor is required to hold restricted securities for six months or one year prior to reselling under Rule 144 is determined at the time of the proposed sale.

Assume, for instance, that an investor acquired restricted securities from a non-reporting issuer on August 1, 2008; the issuer registered its common stock and became subject to Exchange Act reporting requirements three weeks later; and the investor wanted to resell the restricted securities on February 15, 2009. The required holding period would be six months because at the date of sale, the issuer was, and had been for at least the immediately preceding 90 days, subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act.

Conversely, if the issuer had been an Exchange Act reporting company on August 1, 2008, but no longer was as of February 15, 2009, the one-year holding period would apply to the resale. In this case, the investor would not have met the one-year holding period requirement and would not be able to resell its restricted securities under Rule 144 on February 15, 2009.

Affiliates—Cessation of Affiliate Status (528.06)

The cessation of affiliate status is a facts-and-circumstances determination and it should not be assumed that a person instantly ceases to be an affiliate upon resignation from his or her position as an officer or director of the issuer.

In this C&DI, unlike its prior equivalent interpretation, the SEC staff does not suggest that a former affiliate should wait some amount of time, such as three months or until the issuer files its next periodic report,

before publicly selling (former) control securities without compliance with Rule 144. Therefore, if the facts and circumstances show that a person indeed is no longer an affiliate of the issuer, the person may resell securities of the issuer under the trading exemption provided by Section 4(1) of the Securities Act.

Affiliates—Recent Affiliate May Not Rely on Non-Affiliate Provisions of Rule 144 (530.05)

Notwithstanding C&DI 528.06, the SEC staff has reissued its prior guidance stating that a person entering into a contract to sell restricted securities within three months after ceasing to be an affiliate may not use the non-affiliate resale provisions of Rule 144 (b)(1). This prohibition applies even if delivery of the securities occurs more than three months after the person's loss of affiliate status and conforms with Rule 144's limitation of its liberalized selling requirements for restricted, as opposed to control, securities to "any person who is not an affiliate of the issuer at the time of the sale, and has not been an affiliate during the preceding three months."

In other words, while the language of Rule 144(b)(1) may preclude a former affiliate from relying on the rule's non-affiliate resale provisions within three months of ceasing to be an affiliate, the former affiliate is not precluded from using the trading exemption of Section 4(1) under the Securities Act as a means of reselling securities.

OMISSIONS OF PRIOR GUIDANCE

The January 2009 C&DIs omit some guidance that had appeared in the SEC staff's prior Rule 144 interpretations published April 2, 2007.

Restricted Securities—Issuances Under Section 4(6)

Section 4(6) of the Securities Act provides an exemption from registration for securities issued in transactions involving offers or sales solely to

accredited investors, if the aggregate offering price does not exceed \$5 million, there is no advertising or public solicitation and the issuer files any requisite notice with the SEC. The April 2007 guidance stated that securities issued under Section 4(6) were deemed restricted securities. The January 2009 C&DIs dropped this guidance.

Tacking—Amendment of Convertible Securities

Assume that (i) a convertible debenture was, by its original terms, convertible into common stock of the issuer and (ii) the issuer unilaterally modified the terms to provide for conversion into either common stock or bonds. The April 2007 guidance stated that the holding period for the bonds received upon conversion could be tacked to the holding period for the convertible debentures, even though the debentures were not convertible into bonds as originally issued. The January 2009 C&DIs do not include this guidance.

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If you have any questions regarding the matters discussed in this memorandum, please call your usual contact at Richards Kibbe & Orbe LLP or one of the persons listed below.

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