

CLIENT ALERT

FEBRUARY 2008

SEC LIBERALIZES RULES REGARDING REALES OF SECURITIES; ADOPTS AMENDMENTS TO RULES 144 AND 145 EFFECTIVE FEBRUARY 15, 2008

On November 15, 2007, the Securities and Exchange Commission (SEC) adopted amendments to Rules 144 and 145 under the Securities Act of 1933 that substantially liberalize the rules governing the resale of securities issued in private transactions or held by affiliates. The amendments shorten the holding periods for restricted securities of public companies, significantly reduce the conditions applicable to sales of restricted securities by non-affiliates, and modify other aspects of the rules. The adopting release, which includes the text of the amendments, is available on the SEC website at <http://www.sec.gov/rules/final/2007/33-8869.pdf>. The amendments will be effective for resales of securities occurring on or after February 15, 2008. As discussed at the end of this Client Alert, these changes have important consequences for public and private companies and their stockholders.

Summary of Current Rule 144

Rule 144 provides an exemption from registration under the Securities Act of 1933 for sales by holders of "restricted securities" (*i.e.*, securities acquired directly or indirectly from the issuer or an affiliate of the issuer in a transaction or chain of transactions not involving a public offering) and for sales of "control securities" (*i.e.*, securities held by affiliates, regardless of how they acquired

them). The current rule contains five conditions, as summarized below:

- *Current public information.* There must be adequate current public information available about the issuer. Reporting companies must have been subject to public reporting requirements for at least 90 days immediately before the Rule 144 sale and must have filed all required reports (other than Forms 8-K) during the 12 months (or shorter period that the company was subject to public reporting) before the sale. For non-reporting companies (including companies that have been subject to the public reporting requirements for less than 90 days), certain other specified public information must be available.
- *Holding period.* Restricted securities must be held for at least one year before they may be sold (securities issued in registered transactions are not subject to a holding period).
- *Volume limitations.* In any three-month period, resales may not exceed a sales volume limitation

equal to the greater of (i) the average weekly trading volume for the preceding four calendar weeks, or (ii) one percent of the outstanding securities of the class.

- *Manner-of-sale requirements.* Resales must be made in unsolicited "brokers' transactions" or transactions directly with a "market maker" and must comply with other specified requirements.
- *Filing of Form 144.* The seller must file a Form 144 if the amount of securities being sold in any three-month period exceeds 500 shares or \$10,000 in aggregate sales price.

Non-affiliates who have not been an affiliate during the three months preceding the sale may sell their securities freely without any restrictions if they have held those securities for more than two years.

Summary of Amended Rule 144

The following table summarizes the operation of the new rule with respect to sales of restricted securities:

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RESALES OF RESTRICTED SECURITIES UNDER AMENDED RULE 144 Applicable Conditions

Issuer of the Securities	Holding Period	Affiliates ¹	Non-affiliates ²
Reporting Company³	<i>Up to six months</i>	No resales permitted	No resales permitted
	<i>Six months to one year</i>	<i>All conditions apply:</i> <ul style="list-style-type: none"> • Current public information • Volume limitations • Manner-of-sale requirements (for equity securities) • Filing of Form 144 	<i>Only one condition applies:</i> <ul style="list-style-type: none"> • Current public information
	<i>After one year</i>	<i>All conditions apply:</i> <ul style="list-style-type: none"> • Current public information • Volume limitations • Manner-of-sale requirements (for equity securities) • Filing of Form 144 	No restrictions on resales
Non-Reporting Company³	<i>Up to one year</i>	No resales permitted	No resales permitted
	<i>After one year</i>	<i>All conditions apply:</i> <ul style="list-style-type: none"> • Current public information • Volume limitations • Manner-of-sale requirements (for equity securities) • Filing of Form 144 	No restrictions on resales

¹Includes (i) affiliates, (ii) persons that have been affiliates during the prior 90 days, and (iii) persons selling restricted or any other securities on behalf of affiliates or such other former affiliates.

²The seller cannot be an affiliate at the time of sale nor can the seller have been an affiliate during the preceding three months.

³Throughout this Client Alert, "reporting company" means a company that has been subject to the public reporting requirements of the Securities Exchange Act of 1934 for at least 90 days immediately before the sale. In addition, "non-reporting company" includes companies that have been subject to the public reporting requirements for less than 90 days.

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Shortening of Holding Period under Rule 144

Under amended Rule 144, holders of restricted securities of reporting companies (*i.e.*, companies that have been subject to public reporting requirements for at least 90 days before the sale) will be able to sell their securities after holding them for only six months, subject to specified conditions. Holders of restricted securities of non-reporting companies (*i.e.*, companies that are not, or have not for at least 90 days before the sale been, subject to public reporting requirements) will continue to be subject to a one-year holding period.

Relaxed Conditions for Sales by Non-Affiliates under Rule 144

After six months but prior to one year from the date of acquisition of securities from the issuer or an affiliate of the issuer, non-affiliates of reporting companies may resell those securities under Rule 144 subject only to the current public information requirement. They will no longer have to file a Form 144, follow manner-of-sale requirements, or stay within the volume limitations. After holding securities for one year, non-affiliates of both reporting and non-reporting companies may resell those securities freely without any additional conditions under Rule 144. See **Appendix A** for a table summarizing the rule changes for non-affiliates.

Changes under Rule 144 for Sales by Affiliates

In general, affiliates will remain subject to all of the current requirements under Rule 144, subject to certain changes.

- *Current public information.* The current public information requirement will remain unchanged.
- *Holding period.* The holding period for restricted securities of reporting companies will be shortened from one year to six months. The holding period for restricted securities of non-

reporting companies will remain at one year.

- *Volume limitations.* Although the volume limitations for equity securities will remain unchanged, the volume limitations for debt securities will be relaxed to alternatively permit the sale of up to 10% of a tranche or class of debt securities in any three-month period.
- *Manner-of-sale requirements.* The manner-of-sale requirements will be modified for equity securities to permit "riskless principal transactions" (in addition to "brokers' transactions" and transactions directly with a "market maker") and will be eliminated for debt securities.
- *Filing of Form 144.* The threshold for filing a Form 144 will be raised to the lesser of 5,000 shares or \$50,000 in aggregate sales price (up from 500 shares or \$10,000). Note that because many affiliates under Rule 144 are also insiders under Section 16 of the Securities Exchange Act of 1934, the SEC is considering combining Form 4 and Form 144 and expects to issue a separate release about this in the future.

See **Appendix B** for a table summarizing the rule changes for affiliates.

Changes to Rule 145

Under current Rule 145, the issuance of securities in a reclassification, merger, consolidation, or transfer of assets that is the subject of a stockholder vote is generally considered to be a sale requiring registration or an exemption under the Securities Act of 1933, and affiliates of the parties to such transactions have historically been presumed to be "underwriters," whose resales of those securities must comply with the restrictions of Rule 145. These restrictions were generally the same as, or a subset of, the resale restrictions of Rule 144.

Under amended Rule 145, only those persons receiving securities in these types of transactions from shell companies (other than business-combination-related shell companies) will be subject to this underwriter characterization. Recipients of securities in these transactions from non-shell companies will no longer be considered underwriters, and will therefore no longer need to comply with Rule 145 resale restrictions. Their ability to resell such securities will now be determined under Rule 144 based on (i) whether the securities are "restricted securities" or not, (ii) whether the issuer is a reporting or non-reporting company, and (iii) whether the seller is an affiliate or a non-affiliate at the time of the resale. For shell companies, the resale provisions in Rule 145(d) will be harmonized with the corresponding revised Rule 144 requirements.

Considerations for Public Companies

Short term

The amendments to Rules 144 and 145 may have a number of effects in the short term, including:

- Possible increased sales volume levels in the days immediately following the February 15 effective date of the amendments, especially if a company currently has a significant amount of stock outstanding that was issued in private transactions in the past two years.
- Increased requests from stockholders to companies and their transfer agents to have the restrictive legends removed from stock certificates.

Longer term

Other than the obvious reduction in the lengths of time that stockholders must hold their shares prior to resale and in the restrictions applicable to non-affiliates, the longer-term effects of the amendments to

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Rules 144 and 145 are somewhat uncertain, but may include:

- For newly public companies, greater activity and thus volatility in their stock at the time that the IPO lock-up expires, given the fact that, in most cases, **all** restricted securities issued prior to the IPO will be eligible for resale at the expiration of a typical six-month lock-up period. Companies and underwriters may wish to consider whether to modify the standard formulation of IPO lock-ups that expire as to all shares after 180 days in favor of a staged lock-up.
- Greater negotiating power to avoid having to file a registration statement with the SEC to cover the resale of restricted securities issued in private transactions, such as PIPEs and Rule 144A transactions, given the shortened holding period under Rule 144.
- A similar possible ability to avoid registering the resale of securities issued in acquisition transactions.
- Smaller liquidity discounts for securities issued in private transactions.

Considerations for Private Companies

The possible effects of the amendments to Rules 144 and 145 on private companies are even less clear, but could include:

- Increased transfers among stockholders prior to a company's initial public offering.
- Larger and less controlled stockholder bases, as a result of the increased number of transfers.
- Greater need to impose rights of first refusal and other transfer restrictions,

either contractually or through bylaw provisions, on rank-and-file stockholders, **including investors**, to control transfers (*e.g.*, to competitors or in general).

- Greater risk that a company will be forced to become a public company merely because of the size of its stockholder base. Companies that have 500 or more stockholders and total assets exceeding \$10,000,000 at the end of a fiscal year are required to become reporting companies, even though they have not engaged in a public offering. Companies may wish to consider contractual or bylaw provisions to reduce this risk.
- Greater need to ensure that all stockholders are subject to lock-up agreements in connection with an initial public offering.
- Possible greater negotiating leverage against investors to drop or limit heretofore standard registration rights (although most current registration rights terminate automatically once a stockholder may sell all of its securities in a single three-month period under Rule 144).
- Increased viability of private-company stock as an acquisition currency, given that the stock can be resold freely by non-affiliates after only one year rather than two years.
- The possible development of informal trading markets in a company's stock while it is still a private company, although such activities would remain subject to other securities laws limitations.

If you have any questions regarding the new rules, please do not hesitate to contact any member of Wilson Sonsini Goodrich & Rosati's corporate practice.



Wilson Sonsini Goodrich & Rosati
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650 Page Mill Road
Palo Alto, CA 94304-1050
Tel: (650) 493-9300 Fax: (650) 493-6811
email: wsg_resource@wsg.com

www.wsg.com

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APPENDIX A
SUMMARY OF CHANGES TO RULE 144 FOR
SALES OF RESTRICTED SECURITIES BY
NON-AFFILIATES¹

REQUIREMENTS OF THE RULE (subsection of the old rule)	APPLICABLE CONDITIONS UNDER:	
	OLD RULE	NEW RULE
Current public information (Rule 144(c))	<p>There must be adequate current public information available about the issuer:</p> <ul style="list-style-type: none"> • <i>Reporting companies:</i>² The company must have filed all required reports (other than 8-Ks) during the 12 months (or shorter period that the company was subject to public reporting) before the sale • <i>Non-reporting companies:</i> Certain specified public information must be available 	<p><i>Reporting companies:</i>² Applicable for resales of securities with a holding period of at least six months but less than one year</p> <p>Non-reporting companies: Not applicable. Securities may not be resold until the one-year holding period is met, after which no restrictions are applicable.</p>
Holding period (Rule 144(d))	One year	<p><i>Reporting companies:</i>² Six months</p> <p>Non-reporting companies: One year</p>
Volume limitations (Rule 144(e))	<p>During any three-month period, resales may not exceed a sales volume limitation equal to the greater of:</p> <ul style="list-style-type: none"> • The average weekly trading volume for the preceding four calendar weeks, or • 1% of the outstanding securities of the class 	Not applicable to non-affiliates
Manner of sale (Rule 144(f) and (g))	<p>The resale must comply with manner-of-sale requirements. Sales must be made in:</p> <ul style="list-style-type: none"> • Unsolicited “brokers’ transactions,” or • Transactions directly with a “market maker” 	Not applicable to non-affiliates
Form 144 notice of sale (Rule 144(h))	<p>The seller must file a Form 144 if the amount of securities being sold in any three-month period exceeds:</p> <ul style="list-style-type: none"> • 500 shares, or • \$10,000 in aggregate sales price 	Not applicable to non-affiliates
Rule 144(k)	Non-affiliates may publicly resell restricted securities freely without conditions if the securities have been held for at least two years	Removed, but effectively embodied in the new rule, which permits resales by non-affiliates without conditions after a one-year holding period

¹The seller cannot be an affiliate at the time of sale nor can the seller have been an affiliate during the preceding three months.

²To be a reporting company, the company must have been subject to public reporting requirements for at least 90 days immediately before the Rule 144 sale.

APPENDIX B

SUMMARY OF CHANGES TO RULE 144 FOR SALES OF SECURITIES BY AFFILIATES¹

REQUIREMENTS OF THE RULE (subsection of the old rule)	APPLICABLE CONDITIONS UNDER:	
	OLD RULE	NEW RULE
Current public information (Rule 144(c))	<p>There must be adequate current public information available about the issuer:</p> <ul style="list-style-type: none"> • <i>Reporting companies:</i>² The company must have filed all required reports (other than 8-Ks) during the 12 months (or shorter period that the company was subject to public reporting) before the sale • <i>Non-reporting companies:</i> Certain specified public information must be available 	<p>Same as the old rule</p>
Holding period (Rule 144(d))	<p>One year, applicable only to restricted securities</p>	<p>The holding period is still applicable only to restricted securities and is:</p> <ul style="list-style-type: none"> • <i>Reporting companies:</i>² Six months • <i>Non-reporting companies:</i> One year (same as the old rule)
Volume limitations (Rule 144(e))	<p>During any three-month period, resales may not exceed a sales volume limitation equal to the greater of:</p> <ul style="list-style-type: none"> • The average weekly trading volume for the preceding four calendar weeks, or • 1% of the outstanding securities of the class 	<p>Still applicable, but with an alternative limit for debt securities³ equal to 10% of the tranche or class</p>
Manner of sale (Rule 144(f) and (g))	<p>The resale must comply with manner-of-sale requirements. Sales must be made in:</p> <ul style="list-style-type: none"> • Unsolicited “brokers’ transactions,” or • Transactions directly with a “market maker” 	<p>Still applicable to equity securities, with certain changes:</p> <ul style="list-style-type: none"> • “Riskless principal transactions” are now also permitted • In “brokers’ transactions,” posting of bid and asked quotations in alternative trading systems is now permitted, subject to specified conditions <p>Not applicable to debt securities³</p>
Form 144 notice of sale (Rule 144(h))	<p>The seller must file a Form 144 if the amount of securities being sold in any three-month period exceeds:</p> <ul style="list-style-type: none"> • 500 shares, or • \$10,000 in aggregate sales price 	<p>Still applicable, but filing thresholds are increased to:</p> <ul style="list-style-type: none"> • 5,000 shares, or • \$50,000 in aggregate sales price

¹Includes (i) affiliates, (ii) persons that have been an affiliate during the prior 90 days, and (iii) persons selling securities on behalf of an affiliate or such other former affiliates.

²To be a reporting company, the company must have been subject to public reporting requirements for at least 90 days immediately before the Rule 144 sale.

³Debt securities are defined to include any security other than an equity security (debt securities are also defined to include certain non-participatory, non-convertible preferred stock and asset-backed securities).