

DAVIS POLK & WARDWELL
450 LEXINGTON AVENUE
NEW YORK, NY 10017
212 450 4000

Date: December 21, 2007
To: Interested Persons
Re: SEC Publishes Final Rule 144 and Rule 145 Amendments

The Securities and Exchange Commission (the “SEC”) has issued a final rule release containing amendments to Rules 144 and 145 under the Securities Act of 1933 (the “**Securities Act**”).¹ The amendments, which are substantially as proposed except for the omission of the proposed “tolling” provision, are effective as of February 15, 2008.

The final amendments reduce the holding period applicable to non-affiliate resales to six months in the case of securities issued by reporting companies. The holding period remains at one-year in the case of securities issued by non-reporting companies. The amendments also substantially reduce the restrictions on non-affiliate resales and ease the restrictions on affiliate resales.

Overall, the rules should simplify the private capital raising process and improve the liquidity of privately placed securities. This memorandum discusses the amendments and, in the section entitled “**Implications of Amendments for Transactions**”, provides some points to consider when assessing the impact of these amendments on future transactions. For example,

- Given the shorter holding period applicable under the new rules, will investors continue to require registration rights in exempt offerings and, if not, will they require the issuer to covenant that it will comply with the one-year current public information requirement during the one-year holding period?
- Should issuers agree to remove the restricted legend on non-registered securities at the end of the six-month holding period or wait until the end of the one-year holding period given the current public information requirement?

Annexes A & B contain quick reference tables that summarize the amendments and compare them to the current regulatory regime.

¹ The final rule release, SEC Release No. 33-8869 (December 6, 2007), is available at <http://www.sec.gov/rules/final/2007/33-8869.pdf>.

Overview of Rule 144

Rule 144 is a safe harbor for sales of securities by both non-affiliates and affiliates. The rule applies in two contexts. First, it permits resales of “restricted securities”—so long as the conditions of Rule 144 are met. A selling security holder that satisfies all of Rule 144’s applicable conditions in connection with a transaction is not deemed to be an “underwriter” and therefore the Section 4(1) exemption is available for the resale of the securities.

Second, it permits resales of securities held by an affiliate of an issuer. Even if an affiliate holds shares that were acquired in a registered transaction, those shares in the hands of an affiliate are considered “control securities” and Rule 144 provides a safe harbor for future sales of those securities by such affiliate.

Reduced Holding Period

As mentioned above, consistent with the proposal, the final rules reduce the holding period during which non-affiliates and affiliates may not sell restricted securities issued by reporting companies from one year to six months.² The final rules do not amend the holding period applicable to restricted securities issued by non-reporting companies. Accordingly, affiliates and non-affiliates continue to be required to hold restricted securities issued by non-reporting companies for at least one year before any sales may take place. The longer holding period for restricted securities issued by non-reporting companies reflects the SEC’s concern that the market does not have sufficient information about these companies to provide adequate investor protection.

Significantly, the final rules do not include proposed provisions that would have “tolled” the holding period for holders of restricted securities who had entered into certain hedging transactions with respect to those restricted securities. The release cites objections to this proposal received in comment letters from several industry groups, who pointed out the complexity that would have been introduced by requiring buyers of restricted securities to determine if previous holders had hedged. The release does take the opportunity, however, to express the SEC’s continuing concern with the implications of hedging transactions.³

² Under the revised rules, a reporting company is an issuer that is, and has been for at least 90 days immediately before the sale, subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act. A non-reporting company is an issuer that is not, or has not been for at least 90 days immediately before the sale, subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act.

³ Footnote 90 of the final rule release provides “the Commission has previously indicated that, in a short sale, the sale of securities occurs at the time the short position is established . . . for

Significantly Reduced Requirements for Non-Affiliates

Under the amended rules, a person or entity that is not an affiliate of the issuer at the time of the sale or at any time during the preceding three months may freely resell restricted securities after satisfaction of the applicable holding period (six months in the case of securities issued by a reporting company and one-year in the case of securities issued by a non-reporting company) although the current public information requirement still remains for the first year. In order to satisfy the current public information requirement applicable for the first year, the issuer must be current in its Exchange Act reports for the previous 12 months (or such shorter period as the issuer was required to file such reports).⁴

This is a substantial benefit because under the pre-amended rules a non-affiliate was required to hold the securities for at least two years before being able to freely resell them pursuant to Rule 144(k). Before the end of this two-year period, selling security holders were subject to volume, manner of sale, filing and current public information requirements.⁵

Reduced Manner of Sale Restrictions for Affiliates

Rule 144 continues to impose manner of sale restrictions on resales of equity securities by affiliates. The Rule 144 manner of sale restrictions place brokers in a gatekeeping role with regard to compliance with Rule 144 by requiring that securities 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, the manner of sale restrictions prohibit a selling security holder from: (1) soliciting or arranging for the solicitation of orders to buy the securities in anticipation of, or in connection with, the Rule 144 transaction; or (2) making any payment in connection with the offer or sale of the securities to any person other than the broker who executes the order to sell the securities. Although the SEC did not eliminate the manner of sale requirements for equity securities as was requested by some commenters, the SEC did respond by broadening the types

purposes of Section 5 of the Securities Act.” One court has taken a contrary view. See *U.S. Securities and Exchange Commission v. Mangan et al.*, 3:06-CV-00531 (G.M.), (W.D.N.C. Filed Dec. 28, 2006).

⁴ This is the current public information applicable to securities issued by reporting companies. Securities issued by non-reporting companies are subject to a one-year holding period and are eligible to be freely resold by non-affiliates, without regard to a public information requirement, subsequent to that one-year period.

⁵ Although note that under the pre-amended rule, an affiliate holding unrestricted securities could freely sell those securities *immediately* upon ceasing to be an affiliate under Rule 144(k). Under the amended rule, a holder cannot take advantage of the rules applicable to non-affiliates until three months after ceasing to be an affiliate.

of transactions that meet the manner of sale requirements applicable to affiliate resales of equity securities to include riskless principal transactions and to allow for the posting of bid-and-ask quotations in alternative trading systems.

The final Rule 144 amendments eliminate the manner of sale limitations for debt securities as proposed. The amendment is intended to provide greater flexibility with respect to the resale of debt securities, including the option to negotiate privately the resale of the debt securities, because the SEC believes that transactions involving debt securities carry less risk of abuse than transactions involving equity securities. For purposes of this rule, “debt securities” include non-participating preferred stock, asset-backed securities and other types of nonconvertible debt securities.

Higher Volume Limits for Affiliate Resales of Debt Securities⁶

Unlike the proposal, the final rules also amend the volume limitations for the resale of debt securities by affiliates in a manner that is likely to almost always increase those volume limitations. Under the amended rules, affiliates are permitted to resell an amount of debt securities that does not exceed 10% of a tranche (or class when the securities are non-participatory preferred stock), together with all sales of securities of the same tranche sold for the account of the selling security holder within a three-month period. Prior to the amendments, the amount of securities sold in a three-month period could not exceed the greater of: (1) 1% of the shares or other units of the class outstanding as shown by the most recent report or statement published by the issuer, or (2) the average weekly volume of trading in such securities, as calculated pursuant to provisions in the rule.

Higher Form 144 Filing Threshold

Prior to the amendments, Rule 144(h) required any selling security holder to file Form 144 if the security holder’s intended sale exceeded either 500 shares or \$10,000 within a three-month period. Under the amended rules, only affiliates of the issuer are required to file a notice of proposed sale on Form 144, and the Form 144 thresholds are increased to trades of 5,000 shares or \$50,000 within a three-month period. This is a change from the proposal, which would have only raised the share threshold to 1,000 shares rather than 5,000.

The SEC had previously suggested that it was considering coordinating or combining the filing deadline for Form 144 with the filing deadline for Form 4, on which insiders report changes in beneficial ownership of securities. While the final rules do not contain any such amendments, the SEC staff has indicated that it is continuing to look at the issue and expects to issue a separate release in the

⁶ As discussed above, non-affiliate resales are no longer subject to volume limitations.

future to provide affiliates that are subject to both the Form 4 and Form 144 filing requirements with greater flexibility in satisfying their requirements.

Restrictions on the Use of Rule 144 by Shell Companies or Former Shell Companies such as SPACs

Historically, the SEC staff has taken the position that promoters and underwriters could not utilize Rule 144 to resell securities issued by companies that are, or previously were, blank check companies.⁷ The SEC has codified and expanded this position in the final rule by prohibiting *anyone* from using Rule 144 to resell securities issued by a shell company (other than a business combination related shell company)⁸, including blank check companies, or an issuer that has been at any time previously a shell company. However, the SEC has provided a limited amount of leeway by also providing that the prohibition does not apply if the following conditions are met:

- The issuer of the securities that was formerly a shell company has ceased to be a shell company;
- The issuer of the securities is subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act;
- The issuer of the securities has filed all Exchange Act reports and material required to be filed, as applicable, during the preceding 12 months (or such shorter period that the issuer was required to file such reports and materials), other than Form 8-K reports; and
- At least one year⁹ has elapsed from the time that the issuer filed current Form 10 type information with the SEC reflecting its status as an entity that is not a shell company.

The inclusion of these provisions is noteworthy given the increase in the number of transactions involving Special Purpose Acquisition Companies (“SPACs”). SPACs are shell companies under the SEC definition with little or no

⁷ Blank check companies are companies that are in the development stage; have no specific business plan or purpose, or have indicated that its business plan is to merge with or acquire an unidentified third party; and issue penny stock.

⁸ A shell company is generally defined in the rules as an issuer that has (A) no or nominal operations; and (B) either (1) no nominal assets; (2) assets consisting solely of cash and cash equivalents; or (3) assets consisting of any amount of cash and cash equivalents and nominal other assets.

⁹ This is a significant change from the proposal, which would have only required 90 days to have elapsed.

operations that conduct a public offering with the intention of using the proceeds to acquire or merge with an operating company. To date, it has not been unusual for a SPAC to do a 144A initial public offering and/or list its securities on the London Stock Exchange AIM with the understanding that the unregistered shares, other than those issued to the promoters or underwriters, would be freely tradeable pursuant to Rule 144(k) at the end of a two-year holding period. Under the revised rules, however, Rule 144 will not be available for the resale of these securities unless and until one year after the SPAC ceases to become a shell company *and* becomes an Exchange Act reporting company. This reduced liquidity may impair the attractiveness of unregistered SPACs, including those listed on the London Stock Exchange AIM or other non-U.S. markets, making SPACs more likely to consider conducting registered offerings in order to raise capital.

Rule 145 Amendments

Rule 145 relates to offerings of securities in connection with certain business combinations and their resales. The Rule provides that exchanges of securities in certain business combinations such as mergers, that are subject to a shareholder vote, constitute a sale of those securities that requires registration, unless an exemption is available.

Prior to the amendments, Rule 145(c) provided that the parties to a business combination (other than the issuer), or affiliates of such parties, would be permitted to resell registered securities acquired in the transaction only in accordance with certain of the restrictions set forth in Rule 144 (or pursuant to a registration or exemption), even if they are not an affiliate of the issuer subsequent to the transaction.

The Rule 145 amendments eliminate this Rule 144 resale restriction for persons who would not otherwise be an affiliate of the issuer (except with regard to transactions that involve certain shell companies). Under the new rule, target affiliates who receive *registered* shares in a business combination transaction who are not affiliates of the issuer, will be able to immediately resell their securities. As before, sales of unregistered securities received in a business combination will continue to require an exemption, such as Rule 144.

Codification of Historical SEC Staff Positions

Substantially consistent with the proposal, the final rule release also codifies several of the Division of Corporation Finance staff historical positions. The codifications relate to the staff's positions with respect to:

- The classification of securities issued under Section 4(6) of the Securities Act as “restricted securities”;

- Tacking of holding periods when a company reorganizes into a holding company structure;
- Tacking of holding periods for conversions and exchanges of securities;
- Cashless exercise of options and warrants;
- Aggregation of pledged securities; and
- Representations required from security holders relying on Rule 10b5-1(c).

Implications of Amendments for Transactions

The adoption of the final amendments to Rule 144 and Rule 145 should increase the liquidity of privately issued securities making the private capital markets more attractive to both issuers and investors. The extent of the impact of these amendments on the capital-raising process remains to be seen but some of the questions that are being raised about their effect on future transactions are as follows:

Will investors continue to require registration rights in exempt offerings?

Historically, investors purchasing restricted securities in exempt offerings have typically required the issuer to agree to register the securities with the SEC, thereby increasing their liquidity, at some point in the future. Due to the time involved in SEC registration, however, the registration of these securities is often not effective until six months to a year after the issuance of these securities. Because non-affiliate holders of restricted securities may now freely sell these securities after holding the securities for six months or a year at the most, some issuers may question whether it makes sense for them to incur the time and expense required for them to subsequently register the securities. Ultimately we expect that reporting issuers will no longer be required to agree to make registered exchange offers or file resale shelf registration statements in connection with offerings pursuant to Rule 144A. There may be a transition period, however, since investors are used to receiving registration rights and may be reluctant to give up this right until they become more familiar with the new rules and the market for these securities begins to reflect the value of their increased liquidity. During the transition period we could envision a hybrid approach where issuers agree to typical registration rights that would be effective only if the securities were not freely tradeable and delegendated at the end of one year.

Some have also suggested that because the use of the six-month holding period depends on the issuer remaining a reporting company and therefore current

in its public reports, investors that do agree to forego registration rights may require the issuer to at least covenant that it will make the filings necessary for it to remain a reporting company for a year after the issuance of the securities. Such a covenant would provide the holder of the securities some assurance that it would be able to utilize the six-month rather than the one-year holding period. Investors may also require the issuer to pay liquidated damages for the breach of such a covenant. This type of liquidated damages provision would compensate the holder for the diminished liquidity and corresponding decrease in value of the securities that would result if the securities were no longer able to be sold after satisfaction of a six-month holding period because of the issuer's failure to meet its reporting obligations.

Will issuers agree to remove the restricted legend currently contained on restricted securities at the end of the six-month or one-year holding period?

Issuers typically include a restricted legend on non-registered securities that provides that the securities are subject to transfer restrictions. In the past the SEC staff has expressed the view that it was not inappropriate for issuers to remove restrictive legends from securities that could be sold freely in accordance with Rule 144(k). In Footnote 65 of the final rule release, the SEC confirms that it will “not object if issuers remove restrictive legends from securities held by non-affiliates after all of the applicable conditions in Rule 144 are satisfied.” The release goes on to say, however, that this is a matter of discretion of the issuer and disputes regarding the removal of legends are governed by state law.

Accordingly, because securities held by non-affiliates will now be freely tradeable six months (in the case of reporting companies) or one year (in the case of non-reporting companies) after being acquired from an issuer or an affiliate, purchasers of securities may request removal of the restrictive legend after satisfaction of these periods.

Affiliates of acquired companies (that are not affiliates of the issuer) will be able to freely resell registered shares received in business combinations.

The changes to Rule 145 have positive as well as potentially negative implications. On the positive side, there is no longer a need to build a resale shelf into a Form S-4 registration statement when the issuer wants the target's affiliates to be able to freely resell shares they receive in a registered business combination. On the potentially negative side, issuers can no longer rely on Rule 145 to restrict the resale of such shares and thereby reduce the immediate overhang effect.

DAVIS POLK & WARDWELL
 450 LEXINGTON AVENUE
 NEW YORK, NY 10017
 212 450 4000

ANNEX A

Summary of Amendments

| | Affiliate or Person Selling on Behalf of an Affiliate | Non-Affiliate (and Has Not Been an Affiliate During the Prior Three Months) |
|---------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Restricted Securities of Reporting Companies | <p>During six-month holding period – no resales under Rule 144 permitted.</p> <p>After six-month holding period – may resell in accordance with all Rule 144 requirements including:</p> <ul style="list-style-type: none"> • Current public information, • Volume limitations, • Manner of sale requirement for equity securities, and • Filing of Form 144. | <p>During six-month holding period – no resales under Rule 144 permitted.</p> <p>After six-month holding period but before one year – unlimited public resales under Rule 144 except that the current public information requirement still applies.</p> <p>After one year – unlimited public resale under Rule 144; need not comply with other Rule 144 requirements.</p> |
| Restricted Securities of Non-Reporting Companies | <p>During one-year holding period – no resales under Rule 144 permitted.</p> <p>After one-year holding period – may resell in accordance with all Rule 144 requirements except holding period, including:</p> <ul style="list-style-type: none"> • Current public information, • Volume limitations, • Manner of sale requirements for equity securities, and • Filing of Form 144. | <p>During one-year holding period – no resales under Rule 144 permitted.</p> <p>After one-year holding period – unlimited public resale under Rule 144; need not comply with other Rule 144 requirements</p> |

ANNEX B

Comparison of Rules Pre- and Post-Amendment

| | Rules Prior to Amendment | Rules as Amended |
|--------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Resales of Restricted Securities by Non-Affiliates Under Rule 144 | <ul style="list-style-type: none"> - Limited resales after holding restricted securities for one year. - Unlimited resales after holding restricted securities for two years under Rule 144(k) if seller has not been affiliate during the prior three months. | <ul style="list-style-type: none"> - Unlimited resales after holding restricted securities of Exchange Act reporting companies for six months if seller has not been affiliate during the prior three months, except that such resales would be subject to the current public information requirement between the end of the six-month holding period and one year after the acquisition date of the securities. - Unlimited resales after holding restricted securities of non-reporting companies for one year if seller has not been affiliate during the prior three months. |
| Resales by Affiliates Under Rule 144 | <ul style="list-style-type: none"> - Limited resales after holding restricted securities for one year. - Limited resales of unrestricted securities at any time | <ul style="list-style-type: none"> - Limited resales after holding restricted securities of Exchange Act reporting companies for six months or of non-reporting companies for one year. - Limited resales of unrestricted securities at any time |
| Manner of Sale Restrictions | <ul style="list-style-type: none"> - Apply to resale by both affiliates and non-affiliates of any type of security under Rule 144, except for sales by non-affiliates after two year holding period under Rule 144(k) | <ul style="list-style-type: none"> - The manner of sale restrictions are eliminated with respect to all resales by non-affiliates and all resales of debt securities. The types of transactions that comply with the manner of sales restrictions applicable to the sale of equity securities by affiliates are broadened to include riskless principal transactions. |
| Form 144 | <ul style="list-style-type: none"> - Filing threshold at 500 shares or \$10,000 for both affiliates and non-affiliates. | <ul style="list-style-type: none"> - No Form 144 filing required for non-affiliates. With respect to affiliates, filing threshold is 5,000 shares or \$50,000. |
| Rule 145 | <ul style="list-style-type: none"> - Presumptive underwriter provision applies to all Rule 145(a) transactions. | <ul style="list-style-type: none"> - Presumptive underwriter doctrine is eliminated except with respect to Rule 145(a) transactions involving shell companies, with revised resale requirements in Rule 145(d). |