

# The Deal

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JUDGMENT CALL



BY LLOYD HARMETZ

## FOLLOW THE RULES

THE SEC'S AMENDMENTS TO RULES 144 AND 145:  
A LITTLE SOMETHING FOR EVERYONE

IN DECEMBER 2007 THE SECURITIES AND EXCHANGE Commission issued several amendments to its Rules 144 and 145, which govern the resale of “restricted securities.” The amendments will not revolutionize capital-raising transactions. However, many market participants, including public and private companies, investment banks, private equity sponsors and investors in private rounds, are all likely to derive significant benefits.

Rule 144 is a key SEC rule governing the resale of securities issued in private placements. It is a “safe harbor” from SEC registration. This means, in effect, that if an investor resells these so-called restricted securities in compliance with the rule, the investor will not be deemed to be an “underwriter” and therefore does not need a registration statement to sell the securities.

Rule 144 is designed to differentiate between an investor that holds securities as a bona fide investment before a resale (and therefore can sell under the rule) from an investor that is merely acting as a “conduit” for a public distribution (and therefore cannot sell under the rule). To make this distinction, Rule 144, among other things, imposes certain required holding periods and other resale limitations. Rule 145 is a companion rule to Rule 144, limiting the resale of securities acquired by the shareholders of a target

in certain stock-for-stock merger transactions.

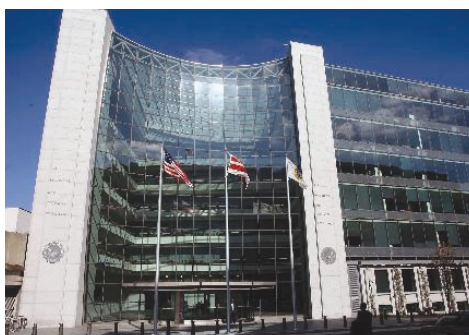
What are some key aspects of the amendments? For securities of public companies, the required holding period for both affiliated and nonaffiliated investors has been reduced from one year to six months. For nonaffiliates of public companies, after the initial six-month period has elapsed, the investor may make unlimited resales, provided that, during months seven through

12, the issuer complies with certain informational requirements. Previously, a two-year holding period would apply before unlimited resales could be made. For nonaffiliates of nonpublic companies, after a one-year holding period, the holder may make unlimited resales. Again, previously, a two-year holding period was required.

Investors will now be subject to fewer “manner of sale” limitations when selling equity securities. Resales of debt securities will be subject to fewer volume restrictions and will no longer be subject to the “manner of sale” limitations. Finally, Rule 145 has been revised to eliminate the so-called presumptive underwriter rule.

Who will benefit from these amendments?

**Issuers of privately placed securities:** Issuers will likely encounter a smaller “liquidity discount” when selling their securities in private placements, potentially increasing the



**SEC headquarters**  
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net proceeds from their offerings. In some cases, they must also maintain the effectiveness of a resale registration statement for a shorter period of time. In the case of Rule 144A offerings of debt securities by public companies, the requirement to file a registration statement may be eliminated entirely in many cases.

**Existing shareholders of issuing companies:** These shareholders will likely suffer reduced dilution from private placements as the liquidity discount received by new investors declines.

**Underwriters and placement agents:** They will face fewer obstacles in selling securities in private placement rounds, as investors need to be less concerned about having reduced liquidity.

**Venture capitalists:** VCs will have enhanced flexibility after the issuer's initial public offering to resell privately placed securities, often without the need for extensive registration rights in their

initial financing agreements.

**Investors in private rounds by public companies:** This group will have enhanced flexibility to resell privately placed securities when market conditions justify.

**Private equity sponsors and other shareholders of acquired private companies:** As a result of the removal of the presumptive underwriter rule, following the receipt of stock of a public company in a stock-for-stock merger, a shareholder of a private company will generally not need extensive registration rights to resell those shares. Different parties will need some time to update their documents and practices to comply with the rules. A variety of market practices are likely to evolve from these developments. But all in all, there will be mostly smiles on Wall Street. ■

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