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A Basic Overview of Rule 144

The following is written by Laura Anthony, Esq., a going public attorney focused on OTC listing requirements, direct public offerings, going public transactions, reverse mergers, Form 10 and Form S-1 registration statements, SEC compliance and OTC Market reporting requirements.

The Securities Act of 1933 (“Securities Act”) Rule 144 sets forth certain requirements for the use of Section 4(1) for the resale of securities. Section 4(1) of the Securities Act provides an exemption for a transaction “by a person other than an issuer, underwriter, or dealer.” The terms “Issuer” and “dealer” have pretty straightforward meanings under the Securities Act, but the term “underwriter” does not. Rule 144 provides a safe harbor from the definition of “underwriter.” If all the requirements for Rule 144 are met, the seller will not be deemed an underwriter and the purchaser will receive unrestricted securities.

Although not set out in the statute, all transfer agents and Issuers, along with most clearing and brokerage firms, require an opinion of counsel as to the application of Rule 144 prior to removing the legend from securities and allowing their sale under Rule 144. The opinion letter must set forth that the facts regarding that Issuer, particular stock and selling shareholder comply with the requirements under Rule 144.

Rule 144 only addresses the resale of restricted or control securities, not unrestricted securities or sales directly by an Issuer. Unrestricted securities (such as securities that have been registered under the Securities Act) may be sold without reference or regard to the Rule. Control securities are those securities held by an affiliate of the issuing company, and restricted securities are securities acquired in unregistered, private sales from the issuing company or from an affiliate of the Issuer.

Rule 144 provides certain conditions that must be met for sales by both affiliates and non-affiliates which conditions vary depending on whether the Issuer of the securities is a reporting or non-reporting Issuer. The following summarizes the Rule 144 requirements:

- 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 Issuers
- During six-month holding period - no resales under Rule 144 Permitted

After six-month holding period; May resell in accordance with all Rule 144 requirements, including:

- Current public information
- Volume limitations
- Manner of sale requirements
- Filing of Form 144

During six-month holding period; No resales under Rule 144 permitted

After six-month holding period but before one year – unlimited public resales under Rule 144, except that the current public information requirement still applies

After one-year holding period – unlimited public resales under Rule 144; need not comply with any other Rule 144 requirements

Restricted Securities of Non-Reporting Issuers During one-year holding period – no resales under Rule 144 permitted

After one-year holding period–may resell in accordance with all Rule 144 requirements, including:

- Current public information
- Volume limitations
- Manner of sale requirements
- Filing of Form 144 During one-year holding period – no resales under Rule 144 permitted
- After one-year holding period - unlimited public resales under Rule 144; need not comply with any other Rule 144 requirements

The six-month holding period only applies to Issuers that are subject to the reporting requirements of the Securities Exchange Act of 1934 (“Exchange Act”). A voluntary filer is not subject to the Exchange Act reporting requirements, and the longer one-year holding period is applicable. However, the determination of whether the Issuer is reporting or non-reporting is made as of the time of the proposed sale, as is the determination of the other Rule 144 requirements. Accordingly, if, following the issuance of securities, a non-reporting issuer files a Form 10 registration statement and becomes subject to the reporting requirements of the Exchange Act, the six-month holding period would apply.

The current public information requirement is measured at the time of each sale of securities. That is, the Issuer, whether reporting or non-reporting, must satisfy the current public information requirements as set forth in Rule 144(c) at the time that each resale of securities is made in reliance on Rule 144. Many Form 144’s and attorney opinion letters cover a three-month period and a majority of Sellers’ market securities over that three-month period. However, the Seller (or person selling on behalf of the Seller, such as the broker-dealer) is required to make a determination that the current public information is available at the time of each sale.

The holding period is determined as of the date of the proposed sale—provided, however, that Rule 144 makes numerous specific provisions for the calculation of the holding period and enumerates specific instances in which a holding period may be tacked onto the holding period of previously issued securities. For example, in determining the holding period where the securities were paid with a promissory note, installment contract or other obligation to pay in the future, the holding period does not begin until payment has been made in full—that is, unless the promissory note or installment contract provides for full recourse against the purchaser of the securities, is secured by fair value collateral other than the securities purchased, and has been paid in full prior to the proposed Rule 144 sale date.

As another example, securities acquired from the Issuer as a dividend or pursuant to a stock split, reverse split or recapitalization shall be deemed to be acquired at the same time as the securities on which the dividend is paid or the securities surrendered in the recapitalization. If securities were acquired by the Issuer solely in exchange for other securities of the same Issuer, such as in a 3(a)(9) transaction, the newly acquired

securities are deemed to be acquired at the same time as the securities surrendered in the exchange or conversion.

When relying on Rule 144 for the resale of over-the-counter traded securities (pinksheets or bulletin board), sellers may only sell 1% of the outstanding securities of the Issuer in every 90-day period. Calculations of volume restrictions based on trading volume are only available for the sale of exchange traded securities.

The manner of sale requirements require that securities sold in reliance on Rule 144 be sold only in broker's transactions, directly with a market maker or in riskless principal transactions. Moreover, the person selling the securities may not arrange for the solicitation of any sale orders. The posting of a customer limit order is not considered a solicitation for purposes of this rule.

Finally, and importantly, Issuers and sellers must be aware that Rule 144 is not available to shell companies. A shell company is an Issuer with no or nominal operations or no or nominal non-cash assets. The rule is unavailable for the sale of securities initially issued by a shell company or any Issuer that has, at any time, previously been a shell company unless all the requirements of Rule 144(i)(2) are met. These requirements include that the Issuer no longer be a shell company, is subject to the reporting requirements of the Exchange Act for 12 months following the time that it filed Form 10 information indicating it was no longer a shell company, and is current with all Exchange Act reporting requirements.

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Securities Law Blog is written by Laura Anthony, Esq., a going public lawyer focused on OTC Listing Requirements, Direct Public Offerings, Going Public Transactions, Reverse Mergers, Form 10 Registration Statements, and Form S-1 Registration Statements. Securities Law Blog covers topics ranging from SEC Compliance, FINRA Compliance, DTC Chills, Going Public on the OTC, and OTCQX and OTCQB Reporting Requirements. Ms. Anthony is also the Producer and host of LawCast.com, The Securities Law Network.

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