

SEC Rule 144:

Restricted and Control Stock Transactions

Rule 144 allows persons who hold restricted stock and affiliates to sell or transfer their shares without having to comply with the registration or prospectus delivery requirements of the Securities Act of 1933.

Corporate and Executive Services

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DESCRIPTION OF RULE 144

Securities and Exchange Commission (SEC) Rule 144 governs the resale of securities acquired in a private placement or held by an affiliate of the issuer. Provided its conditions are met, Rule 144 allows persons who hold restricted stock and affiliates to sell or transfer their shares without having to comply with the registration or prospectus delivery requirements of the Securities Act of 1933. The conditions of Rule 144 vary for affiliates and non-affiliates, as described below.

AFFILIATE STATUS

A person is regarded as an affiliate of a company if they, directly or indirectly, control the company. Those considered to be affiliates of a company include:

- Directors of the company
- Executive officers of the company
- Beneficial owners of 10% or more of the outstanding voting securities of the company
- Spouses and relatives of the affiliate living in the same home
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RESTRICTED STOCK AND CONTROL STOCK

Restricted stock is stock that has been issued in a private placement or other transaction not registered with the SEC. These securities usually have a legend on the stock certificate stating that the securities have not been registered and may not be sold until certain requirements are met. Affiliates and non-affiliates alike are limited in their ability to sell restricted stock by Rule 144.

Control stock is stock owned by an affiliate that was acquired in the open market or in a registered offering or stock held by an affiliate the resale of which has been registered with the SEC. The ability of affiliates to sell their control stock is limited by Rule 144.

CONDITIONS ON SALE OF RESTRICTED STOCK BY NON-AFFILIATES

Under Rule 144, persons may not sell restricted stock until the shares have been fully paid for and held for at least six months.

After six months, persons who are not affiliates of a company (and have not been affiliates during the preceding three months) may sell shares of restricted stock of that company so long as adequate current public information with respect to the company is available. Such public information is deemed to be available if the company has been a reporting company (i.e., a company that is required to file annual, quarterly and current reports and proxy statements under the Securities Exchange Act of 1934) for at least 90 days prior to the sale and has timely filed all required reports under the Exchange Act during the 12 months preceding the sale (or for such shorter period that the company was required to file reports).

After a non-affiliate has held restricted stock for at least one year, he or she may sell the restricted stock without regard to the current public information or any other requirement of Rule 144.

A non-affiliate is not required to comply with the manner of sale requirement, volume limitation or Form 144 filing obligation of Rule 144 in connection with the sale of restricted stock. Those requirements apply only to sales by affiliates.

CONDITIONS ON SALE OF RESTRICTED STOCK BY AFFILIATES

Under Rule 144, persons may not sell restricted stock until the shares have been fully paid for and held for at least six months. After six months, affiliates may sell those shares in accordance with current public information requirements, volume limitations, manner of sale conditions and filing obligations:

Current Public Information

The current public information requirement for affiliates is the same as the requirement for non-affiliates described above: the company must be a reporting company for at least 90 days prior to the sale and have timely filed all required reports under the Exchange Act during the 12 months preceding the sale (or for such shorter period that the company was required to file reports).

Volume Limitations

In a three-month period, an affiliate may not sell restricted or control stock of a company in excess of the greater of:

- An amount equal to 1% of the company's outstanding shares of the same class, or
- The average weekly volume of trading in the security during the four weeks preceding the sale.

For example, if the company has 20,000,000 outstanding shares of common stock and the average weekly trading volume for the past four weeks was 250,000 shares, the affiliate may sell up to 250,000 shares since the average weekly trading volume exceeds 1% of the total number of outstanding shares (or 200,000).

Manner of Sale

Both the affiliate and the broker are prohibited from soliciting or arranging for the solicitation of orders to buy the stock in anticipation of or in connection with a Rule 144 sale. The affiliate may not make any payment in connection with the sale to any person other than the broker or dealer who executes the order. The securities may be sold in brokers' transactions, transactions directly with a market maker and, provided certain conditions are met, riskless principal transactions.

Form 144 Filing Requirement

The affiliate must file a Form 144 prior to the sale if the amount of restricted stock the affiliate intends to sell over a three-month period is at least 5,000 shares or \$50,000. The Form 144 is valid for three months. A new form must be filed if the affiliate intends to sell stock after this three-month period expires.

CONDITIONS ON SALE OF CONTROL STOCK

Affiliates may sell control stock without regard to a holding period so long as the sale complies with the current public information, volume limitation, manner of sale and filing requirements (as described above).

The following chart explains the different requirements for sales of restricted stock of reporting companies by affiliates and non-affiliates:

Sales of Restricted Stock	
Affiliates	Non-Affiliates
If held for less than 6 months, no sales.	If held for less than 6 months, no sales.
If held for 6 months, sales okay subject to the following conditions: <ul style="list-style-type: none"> • Current public information • Volume limitation • Manner of sale • Form 144 filing (5,000 shares or \$50,000) 	If held for 6 months, sales okay subject to the following conditions: <ul style="list-style-type: none"> • Current public information
If held for 1 year, sale okay subject to same conditions as above.	If held for 1 year, sales okay with no Rule 144 conditions.

RULE 145

Similar to Rule 144, Rule 145 governs the resale of registered securities received by an affiliate of a company in connection with a merger, consolidation, asset sale, stock reclassification, or other reorganization or business combination involving that company that was approved by its shareholders. In order for Rule 145 to apply, however, the entity issuing its securities must be a “shell company.” A “shell company” is a company with no or nominal operations and assets (other than cash) that has filed a registration statement for the issuance of its securities in the transaction. This does not include a shell company that was formed by a non-shell company for the purpose of changing its corporate domicile or completing a business combination with other non-shell companies.

Affiliates Acquiring Registered Stock of Shell Companies in Business Combinations

As mentioned above, Rule 145 applies when an affiliate of a company that is a party to a business combination received registered stock of a shell company. Before that affiliate can sell the stock, the company must no longer be a shell company as a result of filing its Form 10 information at least 90 days previously indicating that it is no longer a shell company, is a reporting company and, files its reports under the Securities Exchange Act in a timely manner. In addition, one of the following conditions (based on the applicable holding period) must be met:

- The stock must be held for at least 90 days and the sale meets the Rule 144 current public information, volume limitation and manner of sale requirements; or
- The stock must be held for at least six months and the company must meet the Rule 144 current public information requirement; or
- The stock must be held for at least one year

Sale of Registered Shares Received in Business Combinations

If no shell company is involved in the transaction and the securities issued in the transaction are registered, the recipients of the securities may freely sell them so long as they are not affiliates of the issuing company. If the recipient of the registered securities issued in a business combination is an affiliate of the issuing company, he or she holds control stock and must comply with the current public information, volume limitation, manner of sale and filing requirements of Rule 144. See “Conditions on Sale of Restricted Stock by Affiliates” and “Conditions on Sale of Control Stock” above.

Sale of Restricted Stock Received in Business Combinations

If securities issued to shareholders in business combinations are not registered, they take on the status of restricted stock, and holders interested in selling those securities need to comply with the Rule 144 requirements for sales of restricted stock. Those requirements differ depending on whether or not the holder is an affiliate of the issuer. See “Conditions on Sale of Restricted Stock by Non-Affiliates” and “Conditions on Sale of Restricted Stock by Affiliates” above.

OTHER CONSIDERATIONS

Insider Trading

Regardless of whether a person can sell securities pursuant to Rule 144, that person is prohibited from selling securities when he or she is in possession of material information about the company that is not publicly available. Rule 144 does not alleviate a person from these insider trading rules. Insider trading considerations are more prevalent with affiliates such as directors and officers given their access to material, non-public information.

In addition, companies often have internal policies of prohibiting their officers and directors from trading in their securities except during certain window periods (generally these begin after quarterly earnings are announced and remain open until the company’s results for the current quarter are more predictable).

Lock-Up Agreements

Persons who hold restricted stock in companies that have recently completed public offerings may be bound by lock-up agreements prohibiting them from selling shares for a period of time following the offering (90 to 180 days, usually), notwithstanding the ability to sell under Rule 144.

FREQUENTLY ASKED QUESTIONS

What are the procedures to be followed and documents to be completed in a Rule 144 sale?

In order to sell restricted stock under Rule 144, a holder will be required to sign a Rule 144 seller’s representation letter and deliver that to his or her Baird Financial Advisor. For a non-affiliate, the seller’s representation letter will contain a certification as to the holding period for the shares, the seller’s non-affiliate status and the company’s compliance with the current public information requirement.

For affiliates, the seller’s representation letter will also state that the seller is an affiliate and that the seller has complied with the volume limitation. Affiliates will also have to sign a Form 144 if the sale involves 5,000 or more shares or \$50,000 or more in sale proceeds.

If the shares are represented by a stock certificate (which is generally true for restricted stock), the seller will need to deliver the certificate together with a stock power for the transfer of the shares.

Baird will forward the seller’s representation letter, as well as the stock certificate with stock power, to the issuer company and its stock transfer agent. Baird will also deliver a broker’s representation to the company and transfer agent, along with other information about the transaction. If the paperwork is in good order, the company will have its counsel provide a legal opinion to the transfer agent and the company will instruct its transfer agent to remove the restrictive legend and terminate the stop transfer instructions for the shares being sold.

When does the six-month or one-year holding period begin for restricted stock?

The applicable holding period begins when the stock was acquired by the person. If the stock was acquired by purchase, the holding period begins when the full purchase price or other consideration was paid. If the purchase price

was paid by means of an installment contract or promissory note, the holding period does not begin until all of the installment payments have been made or the promissory note has been repaid in full.

What if a person gives up his affiliate status before selling the shares?

A person who is no longer an affiliate and would like to sell his or her shares will nonetheless be treated as an affiliate under Rule 144 for a period of three months after the date he or she loses their affiliate status.

What effect do sales by family members and other related parties have on the volume limitations that apply to affiliates?

Generally, relatives who live in the same house must aggregate all sales made in a three-month period in determining how many shares can be sold under Rule 144. Aggregation is also required between such family members and the following:

- Any trust or estate in which a family member or members collectively own 10% or more of the beneficial interest or of which any family member or members serve as trustee, executor or in a like capacity; and
- Any corporation or other entity in which a family member or members are the beneficial owners collectively of 10% or more of any class of equity security or equity interest

What impact does Rule 144 have on gifts of stock to family members, charities, colleges, foundations and other non-profit organizations?

In the case of gifts of restricted stock, the recipient can begin selling the shares when the combined amount of time those shares were held by the donor and recipient exceeds six months.

In the case of a gift by an affiliate of unrestricted control stock, there is no required holding period before the recipient can sell the stock. However, for a period of six months following the gift, the recipient must aggregate the number of shares that the recipient desires to sell with the number of shares that the donors sells for purposes of complying with the volume limitation.

How soon after a Rule 144 sale will the person receive the proceeds?

A Rule 144 transaction in restricted stock is usually not completed in the normal period of three business days. The stock certificate is considered to be a "legal transfer item" and must be sent to the transfer agent for clearance before payment is made. The transfer agent will in turn require a legal opinion from the counsel of the company whose stock is being sold. Receipt of funds should not be anticipated for a minimum of two to three weeks. If there is an emergency need for funds prior to the clearance of the transfer, Baird may be able to provide a loan to the seller.

Shares of control stock held in street name will generally settle within the normal three day settlement period.