

RULE 144

OVERVIEW

When you acquire restricted securities or hold control securities, you must find an exemption from the SEC's registration requirements to sell them in the marketplace. Rule 144 allows public resale of restricted and control securities if a number of conditions are met.

DEFINITION: RESTRICTED SECURITIES

Restricted securities are securities acquired in unregistered, private sales from the issuer or from an affiliate of the issuer. Investors typically receive restricted securities through private placement offerings, Regulation D offerings, employee stock benefit plans, as compensation for professional services, or in exchange for providing "seed money" or start-up capital to the company. Rule 144(a)(3) identifies what sales produce restricted securities.

DEFINITION: CONTROL SECURITIES

Control securities are those held by an affiliate of the issuing company. An affiliate is a person, such as a director or large shareholder, in a relationship of control with the issuer. Control means the power to direct the management and policies of the company in question, whether through the ownership of voting securities, by contract or otherwise. If you buy securities from a controlling person or "affiliate", you take restricted securities, even if they were not restricted in the affiliates' hands.

DEFINITION: RESTRICTED LEGEND

If you acquire restricted securities, you almost always will receive a certificate stamped with a "restricted" legend. The legend indicates that the securities may not be resold in the marketplace unless they are registered with the SEC or are exempt from the registration requirements. The certificates of control securities are usually not stamped with a legend.

DEFINITION: RULE 144

An SEC rule specifying the conditions under which a holder of restricted or controlled securities may publicly sell them. If certain conditions are met, the holder must file a form with the SEC (called "Form 144").

Traditionally, it has been used to permit a holder of a larger amount of "restricted securities" to sell a portion of their holdings every six months following a holding period of two years without having to file a registration statement with the SEC.

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DEFINITION: RULE 144A

A 1990 SEC rule that facilitates the resale of privately placed securities that are without SEC registration. The rule was designed to develop a more liquid and efficient institutional resale market for unregistered securities.

It is an administrative rule under the SEC allowing, under certain circumstances, for qualified institutional investors to trade certain securities with other institutional investors without registering the trade with the SEC. The rule requires the private placement be for investment purposes and not for resale to the general public. These securities are trading on the NASDAQ Portal Market. Only NASDAQ members who are qualified institutional investors have access to it. Some firms may trade under Rule 144A as a prelude to an IPO.

Specifically, the rule allows companies, both domestic and international, to sell unregistered securities, also known as Rule 144 securities, to qualified institutional buyers (QIBs) through a broker-dealer. The rule also permits QIBs to buy and sell these securities among themselves.

DEFINITION: QUALIFIED INSTITUTIONAL INVESTOR

An institutional investor allowed to privately place securities with other institutional investors without registering the trade with the SEC. This requires that the private placement be for investment purposes and not for resale to the general public; it also requires that the institutional investors have at least \$100 million dollars under management. It is also known as a Qualified Institutional Buyer (QIB).

DEFINITION: PRIVATE PLACEMENT MEMORANDUM

A document explaining a new offering of securities for private placement. Private placement involves selling securities without registering with the SEC. A private placement memorandum must then explain exactly why the offering complies with SEC Regulation D exempting certain companies from registration. This is done to protect both the issuer and the investors. According to Regulation D, a PPM must contain a complete description of the security and the terms of the sales. It must also include applicable information about the issuer's financial situation and applicable risk factors. Because securities for general issue must be registered under Regulation D, a PPM is not allowed to contain a general offer for investment.

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THE CONDITIONS FOR SALE UNDER RULE 144

If you want to sell your restricted or control securities to the public, you can follow the applicable conditions set forth in Rule 144. The Rule provides a "safe harbor" exemption to seller. There are 5 conditions:

Holding Period

Before you may sell any restricted securities in the marketplace, you must hold them for a certain period of time. The relevant holding period begins when the securities were bought and fully paid for. The holding period only applies to restricted securities. There is no holding period for an affiliate who purchases securities of the issuer in the marketplace. But the resale of the affiliate's shares is subject to the other conditions of the rule.

If the company that issued the securities is subject to the reporting requirements of the '34 Act, then you must hold the securities for at least 6 months.

If the issuer is not subject to the reporting requirements, then you must hold the securities for at least one year.

If you purchase restricted securities from another non-affiliate, you can tack on that (selling) non-affiliate's holding period to your holding period.

Adequate Current Information

There must be adequate current information about the issuer of the securities before the sale can be made. This generally means that the issuer has complied with the periodic reporting requirements of the '34 Act.

Trading Volume Formula

If you are an affiliate, the number of equity securities you may sell during any three-month period cannot exceed the greater of 1% of the outstanding shares of the same class being sold, or if the class is listed on the stock exchange or quoted on NASDAQ, the greater of 1% or the average reported weekly trading volume during the four weeks preceding the filing of a notice of sale on Form 144. Over-the-counter stocks, including those quoted on the OTC Bulletin Board and the Pink Sheets, can only be sold using the 1% measurement.

Ordinary Brokerage Transactions

If you are an affiliate, the sales must be handled in all respects as routine trading transactions, and brokers may not receive more than a normal commission. Neither the seller nor the broker can solicit orders to buy the securities.

Filing a Notice of Proposed Sale With The SEC

If you are an affiliate, you must file a notice with the SEC on Form 144 if the sale involves more than 5,000 shares or the aggregate dollar amount is greater than \$50,000 in any three-month period. The sale must take place within three months of filing the Form and, if the securities have not been sold, you must file an amended notice.

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BOTTOM LINE FOR NON-AFFILIATES

If you are not (and have not been for three months) an affiliate of the issuer and you have held the restricted securities for at least one year, you can sell the securities without regard to the above conditions. If the issuer of the securities is subject to the '34 Act reporting requirements and you have held the securities for at least six months but less than one year, you may sell the securities as long as you satisfy the current public information condition

Phase I: From 0 to Six Months

You cannot sell the restricted securities

[However, as in Six Flags, if there is an issuer registration statement that has been deemed to be effective, sales may be made only pursuant to the Registration Statement. In such sales, the registration statement is available only for transfers of shares and cannot be used simply to delegend shares absent a transfer. Paul Hastings *qua* issuer counsel provided a written opinion that applies to the shares proposed to be sold.

First, broker calls Transfer Agent to confirm that the opinion of counsel applies to the shares proposed to be sold.

Second, broker effects the trade and sends the certificate representing the shares to the the Transfer Agent with a request to remove the legend and transfer electronically to the buyer's brokerage account those shares that have been sold. There is no restriction on the persons to whom the shares can be transferred under the registration statement. You can sell stock to anyone.

Third, the Transfer Agent returns to the broker a stock certificate with a restrictive legend covering the unsold balance of the shares. There are two separate CUSIPS - one for those with and one for without a legend.)

Phase II: From Six Months to 1 Year

You can sell the restricted securities but they must continue to carry the restricted legend because of the possibility that the company fails to maintain its current periodic reporting requirements with the SEC during this period.

(In Six Flags, the registration statement is not available during this period. Sales must be made under Rule 144, assuming the conditions are satisfied. "Stock may not be delegend other than in connection with a sale."

Stock may only be sold to QIBs.)

Phase III: From 1 Year Onwards

You can sell the securities freely and without any legend, enabling their dematerialization and their electronic trading (and concomitant marginability). You may sell stock to anyone.

(In Six Flags, the Company will agree to delegend certificates representing shares held by non-affiliates.)

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DE-LEGENDING

Even if you have met the conditions of Rule 144, you cannot sell your restricted securities to the public until you've gotten the legend removed from the certificate. Only a transfer agent can remove a restrictive legend. But the transfer agent won't remove the restrictive legend unless you have obtained the consent of the issuer - usually in the form of an opinion letter from the issuer's counsel - that the restricted legend can be removed. Unless this happens, the transfer agent doesn't have the authority to remove the legend and execute the trade in the marketplace.

If a dispute arises about whether a restricted legend can be removed, the SEC will not intervene.

State law, not federal law, covers disputes about the removal of legends. Thus, the SEC will not take action in any decision or dispute about removing a restrictive legend.