RULE 144

TO OUR CLIENTS:

The adoption of Rule 144, effective April 15, 1972, brings to fruition a basic part of the 1969 Wheat Report proposals. The concept of applying lesser 1933 Act standards to companies that report under the 1934 Act, or otherwise make available publicly comparable information, is now extended to determination of whether exemption from 1933 Act registration is available. Rule 144 provides standards for unregistered public sales by control persons and holders of privately placed securities. Rule 144 replaces former Rule 154 with respect to sales by control persons ("affiliates") and for the first time provides an official rule for determining when and how securities acquired from a company ("issuer") or an affiliate in a nonpublic transaction ("restricted securities") may be sold.

Rule 144 applies if the following conditions are met:

(1) Adequate current public information with respect to the issuer is available;

(2) If the securities are restricted securities, a two-year holding period is satisfied;

(3) The amount sold in each six-month period does not exceed 1% of the outstanding securities of that class and in the case of listed securities the lesser of such 1% or the average weekly reported exchange volume of trading during the four-week period prior to the date of the notice referred to in (5) below;

(4) The sales are made in ordinary brokerage transactions; and

(5) The seller files a notice of sale with the SEC concurrently with placing the order to sell.

The following is an explanation of Rule 144 taking into account recent unofficial SEC interpretations.

Current Public Information

The information requirement is met if the issuer has (1) registered under either the 1933 Act or the 1934 Act, (2) been subject to SEC periodic reporting requirements for a period of at least 90 days prior to the sale, and (3) filed all required reports, including the most recent required annual report. There is no requirement that the annual report have been filed if at the time of the sale the time for filing the annual report has not yet arrived. Where an issuer registers under the 1933 Act for the first time, the 90-day waiting period applies even though no 1934 Act reports are required during that period.

The 1934 Act report forms have been amended to require issuers to state whether they have met the reporting requirements. The 144 seller is entitled to rely on the issuer's statement in the latest of such reports or on a written statement from the issuer that the reports have been filed, unless he knows or has reason to believe that the issuer has not complied with the reporting requirements.

Small companies that are not subject to the Section 12(g) registration requirements of the 1934 Act (less than 500 shareholders or $1 million in assets) may voluntarily register and thus make Rule 144 sales available to their security holders. Purchasers in private placements should obtain the agreement of the issuer to register and maintain registration and file timely the requisite periodic reports in order to assure the availability of Rule 144 sales. This should be in addition to the usual 1933 Act registration agreements.

With respect to nonreporting insurance companies, the information requirement is met if the company is regulated by and files reports with its state of domicile.

The information requirement can be met by nonreporting companies if the information required by Rule 15c2-11 to permit a broker to quote an OTC security is available. Brokers are advised to consult with counsel or the SEC

before relying on 15c2-11 information as the basis for Rule 144 sales. If a 1933 Act registration statement is filed by a 15c2-11 issuer, the 15c2-11 information can no longer be relied on and Rule 144 is not available until 90 days after the registration statement has become effective.

Holding Period

The acquirer of restricted securities must take the full economic risk of a two-year holding period. Thus, restricted securities must be fully paid for and held for two years before they can be sold under Rule 144.

If securities are purchased with notes or other obligations, they are not considered fully paid unless (1) the notes or other obligations are with full recourse, (2) there is adequate collateral other than the purchased securities equal to the unpaid portion of the purchase price and (3) the note or obligation is paid in full before the sale.

Fungibility does not apply to Rule 144 situations. The acquisition of restricted securities will not restart the holding period on previously acquired restricted securities. The SEC has stated that it is reconsidering its position as to fungibility in non-Rule 144 situations. Until the SEC clarifies its position, doubt remains as to whether acquisition of restricted securities taints unrestricted securities previously acquired, and if so, whether the period of taint is limited to two years. It would seem that the concept of Rule 144 is not consistent with subsequently acquired unrestricted securities being tainted by previously acquired restricted securities, if that ever was a real SEC position.

Underwriters compensation securities may not be sold under Rule 144. The SEC continues to take the position that their public sale can only be effected through a registered offering.

The two-year holding period is suspended for any period that the holder of the restricted securities has a short position in or option to sell securities of the same class (or convertible into the same class).

Successive private placements each start a new two-year holding period. The holding of the previous private placee cannot be tacked to the holding of the subsequent placee.

The SEC has stated that Rule 133 (merger no-sale rule) will be replaced with new rules such as proposed in the 1969 Securities Act Release No. 5012 extending (reinstating) the registration requirements to business combinations, with a private placement exemption for combinations which involve less than 25 security holders. Until the new business combination rules are announced, the relationship of Rule 144 with Rule 133 is in some doubt. A literal reading of Rule 144 requires that securities received in non-Rule 133 transactions be treated as restricted securities subject to the two-year holding period without the benefit of tacking.

The SEC is still considering tacking in the partnership distribution situation. At present, the SEC is concerned with the loophole possibilities of partnerships being able to distribute to numerous partners and each partner being able to tack and sell independently. The SEC position is that partnership tacking is only permitted to the extent of the amount of restricted securities distributed to the partners which the partnership could sell under Rule 144. Otherwise, a partnership distribution of restricted securities is treated the same as a new private placement.

Tacking is permitted for stock dividends and splits, recapitalization, conversions of convertible securities (does not include warrants and the SEC is considering applicability to warrants exercisable with debentures) and securities acquired as contingent payments in business combination. In each of these situations, Rule 144 provides that the subsequently acquired securities are deemed to have been acquired at the time the related restricted securities were acquired. Since tacking with respect to convertible securities is permitted, Rule 155 becomes obsolete and it is rescinded effective April 15, 1972, except for convertibles acquired prior thereto and not sold in compliance with Rule 144. With the repeal of Rule 155, privately placed convertibles themselves can be sold under Rule 144 if all of the other provisions are complied with.

Tacking is permitted for bona fide pledgees, donees of gifts and trusts. Restricted securities are deemed to have been acquired when they were acquired by the pledgor, donor or settlor. In each of these situations, the corollary of tacking is aggregation -- the two parties are treated as one for the purpose of determining the amount that can be sold under the volume limitations of the Rule. Thus, pledgees who rely on Rule 144 to provide salability of collateral in the case of default must restrict by contract and/or escrow the pledgor in order to be sure of the availability of Rule 144.

Where an estate is an affiliate tacking is permitted, and the volume limitations apply. Where the estate is not an affiliate, tacking is permitted and the volume limitations do not apply, but the other conditions of Rule 144 as to current information, manner of sale and notice of sale do apply.

Tacking is permitted of holding periods that have been broken only by transfers of restricted securities from one entity to another within a "person" as defined in the Rule (see below) such as between spouses or from or to a controlled corporation. See above with respect to the SEC position as to partnerships.

The SEC has indicated that tacking probably will be permitted in connection with an exchange of a restricted security for another security of the issuer in a transaction exempt from registration under Section 3(a)(9) of the 1933 Act. The new security will continue to be restricted.

Limitation on Amount of Securities Sold

For OTC securities, the limitation is 1% of the outstanding securities of the class every six months. For listed securities, the limitation is the lesser of 1% of the outstanding or the average weekly volume on all exchanges for the four weeks prior to the date of the notice of sale.

There is no prohibition on sales in successive six-month periods, but carryforward and accumulation are not permitted. Sales pursuant to registered offerings and in private placements (the Rule incorrectly refers to § 4(2) sales) are not aggregated for determining the amount permitted

to be sold under the Rule. If there is a shelf registration, unsold securities may not be sold under the Rule; the shares must be deregistered before they can be sold under the Rule. The two-year holding period is not suspended during the period the securities are registered.

Both restricted and unrestricted securities are aggregated for determining the limitation on sales by affiliates. Only restricted securities are considered for determining the limitation on sales by nonaffiliates.

Private placees' resales of restricted securities are not aggregated. As noted above, tacking is not permitted between private placees.

Sales by persons acting in concert are aggregated. The mere fact that several affiliates sell at the same time will not in and of itself be considered acting in concert, but it does give rise to a situation which must be considered carefully. The treatment for aggregation purposes of several funds or other accounts under the same investment management is not covered specifically. Unless clarified by the SEC, it will have to be considered ad hoc on the particular facts of each situation. In addition, "person" is defined in Rule 144 to include close relatives of the seller, trusts and estates in which the seller and such relatives collectively own a 10% or greater beneficial interest and corporations or other entities in which the seller, such relatives and such trusts and estates together have a 10% equity interest or own 10% of a class of equity securities. Thus, sales by all those included in the definition of person are aggregated for the purpose of Rule 144.

As stated above, in the pledge, gift and trust situations there is aggregation with sales by the pledgor, donor or settlor. Such aggregation terminates after two years after the original transfer to the pledgee, donee or trust. For estates and beneficiaries which are affiliates the aggregation period is six months. There is no aggregation for estates and beneficiaries which are not affiliates.

Where there is aggregation, particularly in the pledge situation as discussed above, the parties subject to aggregation should provide for allocation of the sale privileges under the Rule by contract, escrow or delayed delivery.

Section (e)(3)(A) of the Rule is a rather confusing provision which appears to provide that where both a convertible and the underlying security are being sold the amount of the underlying security for which the convertible may be converted is aggregated with the underlying security.

Manner of Sale

Sales under the Rule can only be made in brokers transactions within the meaning of Section 4(4) of the 1933 Act. The seller cannot solicit or arrange for the solicitation of buy orders or make any payment in connection with the sale other than to the broker who executes the order.

Brokers' transactions are defined as those in which the broker (1) does no more than execute a sell order as agent for the usual commission and (2) does not solicit buy orders. The broker may inquire of other brokers who have indicated an interest within the preceding 60 days. The SEC has indicated that such inquiry may also be made of institutional clients. The release accompanying Rule 144 specifically states that brokers may not put quotations in interdealer quotation services on the basis of the Jaffee reasoning that this is a 10b-6 violation. The SEC has also indicated that there may be a solication problem if the broker has been in the sheets immediately prior to receipt of the 144 order. The SEC has promised clarification of the Jaffee problem. Until then, brokers must be cautious in this area.

In addition, Rule 144 provides that the broker should obtain and retain a copy of the notice of sale and make a reasonable inquiry to ascertain whether the seller is engaged in a distribution. Reasonable inquiry should include the following:

(1) The length of time the securities have been held by the person for whose account they are to be sold. If practicable, the inquiry should include physical inspection of the securities;

(2) The nature of the transaction in which the securities were acquired by such person;

(3) The amount of securities of the same class sold during the past six months by all persons whose sales are required to be aggregated;

(4) Whether such person intends to sell additional securities of the same class through any other means;

(5) Whether such person has solicited or made any arrangement for the solicitation of buy orders in connection with the proposed sale of securities;

(6) Whether such person has made any payment to any other person in connection with the proposed sale of the securities; and

(7) The number of shares or other units of the class outstanding, or the relevant trading volume.

In addition to the foregoing, the broker should also obtain and retain a copy of the 1934 Act filing or the written statement of the issuer on which the seller is predicating satisfaction of the availability of current information requirement.

Annexed hereto is a form of clients representation letter that may be used by brokers in connection with Rule 144 sales.

Notice of Proposed Sale

Concurrently with the placing of the sell order with the broker, the seller must transmit (place in the mail) to the SEC in Washington three copies of a notice of sale on Form 144 signed by the seller. There is considerable uncertainty as to the amount of securities to be sold that may be stated in the notice. The SEC apparently takes the position that the notice amount cannot exceed the weekly volume limitation in the case of listed securities even though the 1% limitation would permit a greater amount. Thus, increased volume of trading after the notice cannot be availed of and apparently the notice cannot be amended to increase the amount to be sold. Also, the SEC has stated that the notice cannot be amended to take advantage of an increase in the 1% amount arising from an increase in the amount of the class outstanding. The SEC is apparently reading the notice requirement as directly relating to the

actual sell order placed and on this reasoning has indicated that Section (i) of Rule 144 requiring a bona fide intent to sell the securities referred to in the notice is of no meaning being but a vestige of the previous proposal requiring 10-day prior notice.

Until the notice requirements are clarified, the safe course appears to be to program the placing of the order and filing of the notice to take advantage of what appears to be the best weekly volume, specify the full amount that can be sold under the volume limitation and place the sell order at limit prices. There is no restriction on changing the sell order prices or converting it to a market order.

No notice on Form 144 is required if the amount of securities to be sold during any six months does not exceed 500 shares or units and the aggregate sales price does not exceed $10,000. Brokers should obtain a representation to this effect from customers placing such small orders and while the possibility of liability or disciplinary proceedings if the customer later violates the representation seems remote, the better procedure is to not rely on the small order exception where the customer owns more than small order limit, but to insist that the Form 144 be filed.

If the sale referred to in a 144 notice is not completed within 90 days, an amended notice must be filed before further sales can be made.

Exclusivity and Operation of Rule 144

Rule 144 is exclusive with respect to affiliates, whether they are selling restricted or unrestricted securities. It is the only way in which affiliates can sell absent registration or private placement.

Rule 144 is not exclusive with respect to non-affiliates' sales of restricted stock. However, the SEC has strongly stated that persons selling restricted securities acquired after April 14, 1972 outside the Rule will hve a strong burden of establishing exemption and that brokers participate in such sales at their risk. The "change of circumstances" test will no longer apply to such sales and the SEC will not issue no-action letters. Length of holding continues to be a factor, but the two-year provision of the Rule is not relevant in determining what such holding period should be.

Restricted securities acquired before April 15, 1972 may be sold pursuant to Rule 144 or outside the Rule. Here, the change of circumstances test will continue to apply and no action letters will be issued on the basis of administrative interpretations in effect at the time of the sale (not time of purchase).

Rule 144 is not available where there is technical compliance, but the 144 sales are part of a plan to effect a distribution. Rule 144 does not exempt sales from the antifraud, civil liability or short swing profits provisions of the securities laws. The Rule is to be strictly construed and persons selling under the Rule have the burden of proving its availability.

In view of the strong policy statements of the SEC in the Rule 144 release that (1) availability of information, (2) holding period and (3) impact on the trading markets are the prime concerns in interpreting the 1933 Act, it would appear that counsel will render favorable opinions as to sales outside the Rule of post-144 restricted securities only in very limited situations -- those where the issuer is a major listed company, the amount can be sold readily without material effect on the market and there has been a holding period substantially more than two years (probably in the area of five years). Until further clarification by the SEC, counsel will probably render favorable opinions with respect to pre-144 restricted securities on substantially the same standards, except that the current three-year holding period will be considered adequate. Opinions will probably not be available in either situation where the company is marginal or the amount of securities cannot be readily absorbed, no matter what the holding period. Brokers would be well advised to insist on at least these standards.

Related Matters

The SEC has promulgated Rule 237 providing that persons who are not affiliates and not brokers may sell limited amounts (not more than the lesser of 1% of the outstanding or $50,000) of restricted securities of domestic issuers with respect to which Rule 144 is not available if they satisfy a five-year holding period and sell in negotiated transactions not involving brokers. The SEC has

amended Regulation A to broaden its availability. Affiliates can now sell up to $100,000 per year under Regulation A with a maximum of $500,000 per year for the issuer and affiliates combined. Nonaffiliates can sell up to $100,000 with a maximum of $300,000 for all nonaffiliates and with no effect on the amount available to the issuer and affiliates.

Rule 144 is of relatively little use to institutional investors. The need for carefully drawn registration agreements continues and the SEC release on Rule 144 emphasizes this point. In light of Rule 144, the sometimes used in futuro opinion as to salability of institutional debt issues can no longer be rendered by counsel. In separate Securities Act Release No. 5226 the SEC has warned that detailed disclosure of the restrictions on resale of privately placed securities must be made to purchasers. This will require new boilerplate in investment representations and is worth a reference in institutional private placement agreements. The SEC further again called attention to the need to legend restricted securities and to place stop orders with transfer agents.

M. Lipton