ALERT MEMORANDUM

Proposed SEC Rule 144 Amendments Would Increase Transparency of Trading by Affiliates of Foreign Private Issuers

January 6, 2021

On December 22, 2020, the Securities and Exchange Commission (the "SEC") published proposed amendments to Rule 144 under the Securities Act of 1933 (the "Securities Act").[1] Rule 144 is a safe harbor allowing for public resales of securities without registration under the Securities Act.[2] It includes two separate sets of requirements – one applicable to "control securities" and one applicable to "restricted securities" – both of which the SEC proposed to amend. Although the proposed change to the tacking provisions applicable in certain limited circumstances to restricted securities may appear to be the only substantive change being proposed, we believe the proposed amendments to the reporting requirements applicable to control securities, while largely technical in nature, would have the more significant practical effect of increasing the amount and timeliness of disclosure regarding sales by affiliates of foreign private issuers.

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[1] SEC Release No 33-10911 (December 22, 2020) (the "Proposing Release").

[2] Rule 144 is a non-exclusive safe harbor from the definition of "underwriter" in Section 2(a)(11) of the Securities Act. Because they are deemed not to be underwriters, investors that resell in compliance with the requirements of the safe harbor can rely on Section 4(a)(1) of the Securities Act to exempt resales from the registration requirements of Section 5 of the Securities Act.

Proposed Changes to the Requirements Applicable to Control Securities

Whether a security is a "control security" depends on the investor's relationship with the issuer – whether the investor is an "affiliate"[3] – and not how the securities were acquired. Investors holding "control securities" can rely on Rule 144 only if the issuer meets certain public information requirements, the resale complies with strict manner of sale and volume requirements and (unless the resale fits under certain *de minimis* thresholds) the investor files a Form 144 with the SEC. In the Proposing Release, the SEC proposed three significant changes to Form 144 filing requirements:

— Eliminating the filing requirement for resales of securities issued by companies that are not "subject to"[4] reporting requirements of the Securities Exchange Act of 1934 (the "Exchange Act").

— Requiring the Form 144s to be filed electronically on the SEC's EDGAR system, which will make them immediately and readily available to the public.

— Changing the filing deadline from the date that an order is placed with a broker or sale executed with a market maker to the second business day after the transaction has been executed, which would make the filing deadline consistent with the requirement for Form 4 filing.[5]

Investors currently have the ability to file Form 144s in paper form, rather than electronically, by mailing the forms to the SEC at the filing deadline. As the SEC notes in the Proposing Release, currently the "vast majority" of Form 144s are filed in paper form.[6] Form 144s filed in paper form are not readily available to the public – they can be accessed only at the SEC's public reference room or via a third-party commercial database. In the Proposing Release, the SEC notes that prior to the COVID-19 pandemic most Form 144s became available via a commercial database six days after receipt by the SEC.[7] Form 144s filed on EDGAR become immediately available to the public on the SEC's website.

For affiliates of foreign private issuers, which are not subject to Section 16 of the Exchange Act,[8] a Form 144 is the only public disclosure the affiliate seller may be required to make at or around the time of sale.[9] As a result, under the current rules the market

[3] An "affiliate" of an issuer is defined as "a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such issuer." Whether or not a person is an affiliate of an issuer is a facts and circumstances determination that depends on an evaluation of all indicia of control that the person might have – for example, the size of that person's holdings, status as a director or officer (or rights to appoint a director), contractual rights, limitations on matters such as voting or resales and the level of influence held by other holders and persons.

[4] Under the proposed rule, it appears that investors would not be required to file Form 144s with respect to securities issued by companies that voluntarily file reports under the Exchange Act. See Securities Act Rules, Compliance and Disclosure Interpretations Question 131.07.

[5] Section 16 insiders – generally holders of more than 10% of a class of Exchange Act-registered voting equity securities (or members of a "group" that holds more than 10%), officers and directors – are required to file a Form 4 to report transactions in equity securities of the relevant issuer within two business days of executing the transaction unless the transaction falls within a limited number of exemptions.

[6] Proposing Release at 18. Since April 2020, the SEC has been accepting emailed submissions of Form 144s due to the COVID-19 pandemic.

[7] Proposing Release at 45.

[8] Securities issued by foreign private issuers are exempt from Section 16. See Exchange Act Rule 3a12-3.

[9] Investors that beneficially own (or that are part of a group that beneficially owns) more than 5% of a class of Exchange Act-registered voting equity securities are required to file a Schedule 13D disclosing their beneficial ownership within 10 days after exceeding the 5% threshold and, among other items, any transactions in the relevant class that occurred within the 60 days preceding the filing. Investors are required to "promptly" amend Schedule 13D when there is any material change in the information disclosed. Exchange Act Rule 13d-2(a) provides that "an acquisition or disposition of beneficial ownership of securities in an amount equal to one percent or more of the class of securities shall be deemed 'material'; … acquisitions or dispositions of less than those amounts may be material,

may not become aware of sales by affiliates for an extended period of time because disclosure requirements other than filing of a Form 144 often do not apply to their sales, there is a significant delay between when a paper Form 144 is submitted and when it becomes electronically available and, even when Form 144s filed in paper become electronically available, they are accessible only through commercial databases. Under the SEC's proposal, the market would become aware of sales made by affiliates in reliance on Rule 144 within two business days of when the transaction is executed.[10]

Proposed Changes to the Requirements Applicable to Restricted Securities

In contrast to "control securities," whether a security is a "restricted security" is determined by how the securities were acquired and not on the investor's relationship with the issuer – whether the securities were acquired "directly or indirectly from the issuer, or from an affiliate of the issuer, in a transaction or chain of transactions not involving any public offering" or in certain types of exempt offerings listed in the definition of "restricted securities" in Rule 144. The key requirement of Rule 144 applicable to restricted securities is that the securities need to be held for a certain period of time before the safe harbor is available. The holding period begins to run when the securities are fully paid for and is either 6 or 12 months long, depending on whether the issuer has been subject to reporting requirements under the Exchange Act for at least 90 days and is current with certain reporting requirements.

Rule 144(d)(3) sets out "tacking" rules – situations in which a period prior to an investor's acquisition of the securities being sold can be included as part of (or "tacked" onto) that investor's holding period. Under the current tacking rules, an investor that obtains securities from an issuer ("underlying securities") in exchange solely for other securities of the issuer ("overlying securities") can include the period during which that investor held the overlying securities when determining its holding period with respect to the underlying securities. That tacking rule is widely relied on in connection with, for example, convertible notes and cashless exercises of warrants.

The SEC proposed narrowing that tacking rule to exclude underlying securities if:

— the terms of the overlying securities provide that the number of underlying securities received on conversion or exchange of the overlying securities will be adjusted, in whole or part, for declines in the "market value" of the underlying securities (other than for "stock splits, dividends, or other issuer-initiated changes in its capitalization"); and

— at the time of the conversion or exchange, the issuer does not have a class of securities listed or approved for listing on a national securities exchange.

The SEC's rationale for the proposed change is that under the current rules an investor could purchase a "market-adjustable security," hold that security for the requisite period under Rule 144 and then convert or exchange it for underlying securities – knowing that the conversion or exchange rate will be below the market value of the underlying securities at the time it

depending upon the facts and circumstances." However, shareholders that acquired their stake in an issuer prior to its initial public offering, including controlling shareholders, are often able to rely on Exchange Act Rule 13d-1(d) to file a short-form Schedule 13G, which need be amended only annually in mid-February, rather than a Schedule 13D.

[10] The SEC's proposal to allow holders to delay filing of a Form 144 to the second business day after a trade is executed may also affect the calculation of the volume limit under Rule 144. That limit (the greater of 1% of the outstanding securities of the relevant class and the average reported weekly trading volume for the past four calendar weeks) is determined as of the time the Form 144 is filed. However, because the SEC allows investors to file an amended Form 144 to take advantage of increases in the volume limit, it is unlikely the increased time to file a Form 144 will have a material effect. Of course, the impact of the filing timing on calculation of the volume limit may induce investors to file in advance of the two day deadline if the deadline falls in the next calendar week and they expect that the limit will decline because a higher volume week is replaced in the calculation.

receives those securities (because the conversion or exchange rate is adjusted based on the market value at the time of the conversion or exchange). The investor would then hold seasoned restricted securities that it could immediately resell, allowing the investor to distribute the securities to the market while pocketing the difference between the conversion or exchange rate and the market value of the securities.

Although "market value" is not defined in the release or the text of the proposed rule, the proposing release indicates that securities that provide for adjustments to the conversion rate as a result of new capital raises by the issuer at a price lower than the conversion price or market price at the time of the issuance would not be affected be this proposal (they would still benefit from the tacking rule).[11] Additionally, because the proposed change does not affect securities listed or approved for listing on a national securities exchange, preferred stock or other instruments that convert upon closing of an initial public offering should not be affected.

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[11] See the Proposing Release at 11 ("They also may contain anti-dilution provisions designed to protect the holder's economic interest if the issuer subsequently issues shares of the underlying securities at a price below their current market value or below the holder's original purchase price. The terms of market-adjustable securities, however, go beyond these typical adjustments and anti-dilution provisions to adjust for, and protect the holder against, general decreases in market value of the underlying securities.")