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***via* e-mail to: rule-comments@sec.gov**

Ms. Nancy M. Morris, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: File No. S7-11-07

Ladies and Gentlemen:

The Committee on Federal Regulation of Securities (the "Committee") of the American Bar Association Section of Business Law submits this letter in response to the request of the Securities and Exchange Commission (the "Commission") for comments on Revisions to Rule 144 and Rule 145 to Shorten Holding Period for Affiliates and Non-Affiliates, Release No. 33-8813 (June 22, 2007) [72 Fed. Reg. 128 at 36822 (July 5, 2007)] (the "Proposing Release").

The views expressed in this letter have not been approved by the American Bar Association's (the "Association") House of Delegates or Board of Governors and should not be construed as representing policy of the Association. In addition, this letter does not represent the official position of the Association's Section of Business Law, nor does it necessarily reflect the views of all members of the Committee.

The general agreement of the majority of the members who drafted or reviewed this comment letter may be summarized as follows:

- The purpose and meaning of Rule 144[1] under the Securities Act of 1933 (the "Securities Act"),[2] are well understood and the retention of a "Preliminary Note" is no longer necessary. If a Preliminary Note is retained, the Commission should also retain paragraph (j) of Rule 144,[3] which provides that the Rule 144 safe harbor is not the exclusive means to comply with Section 4(1)[4] of the Securities Act. We further recommend that the Commission amend Rule 144(j) to provide that the Rule 144 safe harbor is not the exclusive means to comply with the trading exemptions provided by Section 4(3)[5] or Section 4(4)[6] of the Securities Act.

- We support the Commission's proposal to codify the Staff interpretations identified in the Proposing Release. If any particular facts and circumstances require a different application than the interpretation(s) codified in the rule as adopted, as with any Commission rule practitioners would be free to seek no-action or interpretative relief from the Staff.

- We support the Commission's proposed amendments to shorten the Rule 144(d)[7] holding periods.

- Given the lack of empirical evidence cited in the Proposing Release of abuses in the process of hedging restricted securities and the lack of any policy rationale or discussion of investor protection needs in the Proposing Release, we respectfully submit that tolling of holding periods should not be reinstated, even in the limited manner proposed.

- We do not believe a new definition of the term "affiliate" should be adopted specifically for Rule 144.

- The manner of sale and volume conditions should be eliminated for debt securities. Unlike common stock, it would not be practical to impose volume limitations on debt securities, some of which may be viewed as "trading by appointment."

- We agree with the elimination of the manner of sale requirements of Rule 144(g)[8] for resales of restricted securities by non-affiliates, but do not object to their retention for

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[1] Persons deemed not to be engaged in a distribution and therefore not underwriters, 17 C.F.R. §230.144 (2007).

[2] 15 U.S.C. §77a-§77z-3 (2004).

[3] Non-exclusive rule, 17 C.F.R. §230.144(j) (2007).

[4] 15 U.S.C. §77d(1) (2004).

[5] 15 U.S.C. §77d(3) (2004).

[6] 15 U.S.C. §77d(4) (2004).

[7] 17 C.F.R. §230.144(d) (2007).

[8] Brokers' transactions, 17 C.F.R. §230.144(g) (2007).

resales by affiliates. Brokers serve a useful function as "gatekeepers" and can provide substantial assistance with resales by affiliates effected pursuant to the rule.

- Generally, we see no need to retain the requirement to file a notice of sales made under Form 144.[9] If the Commission, however, decides to retain the notice requirement, we recommend that (i) it be restricted to persons required to file reports under Section 16(a)[10] of the Securities Exchange Act of 1934 (the "Exchange Act");[11] (ii) the reporting thresholds should be increased and (iii) Form 4[12] be amended to replace Form 144 by providing space for disclosure of resales made pursuant to Rule 144.
- The Commission should delete the presumptive underwriter doctrine of Rule 145(c)[13] under the Securities Act.
- The holding periods for resales of restricted securities should be identical, irrespective of whether the resales involve employee benefit plan securities pursuant to Rule 701(g)(3)[14] under the Securities Act or equity securities of reporting issuers acquired pursuant to Regulation S[15] under the Securities Act.

I. SINCE THE PURPOSE AND MEANING OF RULE 144 UNDER THE SECURITIES ACT ARE WELL UNDERSTOOD, THE RETENTION OF A "PRELIMINARY NOTE" IS NO LONGER NECESSARY. IF A PRELIMINARY NOTE IS RETAINED, THE COMMISSION SHOULD RETAIN PARAGRAPH (j) OF RULE 144, WHICH PROVIDES THAT THE RULE 144 SAFE HARBOR IS NOT THE EXCLUSIVE MEANS TO COMPLY WITH SECTION 4(1) OF THE SECURITIES ACT. WE ALSO RECOMMEND THAT THE COMMISSION AMEND RULE 144(j) TO PROVIDE THAT THE RULE 144 SAFE HARBOR IS NOT THE EXCLUSIVE MEANS TO COMPLY WITH THE TRADING EXEMPTIONS PROVIDED BY SECTION 4(3) OR SECTION 4(4) OF THE SECURITIES ACT.

The Commission proposes to streamline and simplify the text of the Preliminary Note to Rule 144. The Preliminary Note (and the revised version proposed in 1997[16]) describes the purposes and policies of the rule and outlines the regulatory analysis used to support the

[9] Notice of Proposed Sale of Securities Pursuant to Rule 144 Under the Securities Act of 1933, 17 C.F.R. §239.144 (2007).

[10] 15 U.S.C. §78p(a) (2004).

[11] 15 U.S.C. §78a-§78mm (2004).

[12] Statement of Changes of Beneficial Ownership of Securities, 17 C.F.R. §249.104 (2007).

[13] Reclassification of securities, mergers, consolidations and acquisitions of assets, 17 C.F.R. §230.145(c) (2007).

[14] Resale limitations, 17 C.F.R. §230.701(g)(3) (2007).

[15] Offers or sales of securities by the issuer, a distributor, any of their respective affiliates, or any person acting on behalf of any of the foregoing; conditions relating to specific securities, 17 C.F.R. §230.903(b)(3)(iii)(A) (2007).

[16] Revision of Rule 144, Rule 145 and Form 144, Release No. 33-7391 [File No. S7-7-97] (Feb. 20, 1997).

Commission's determination that one who sells securities in accordance with the conditions of Rule 144 will not be deemed an "underwriter" of a securities offering, so that the trading exemptions provided by Sections 4(1), 4(3),[17] and 4(4)[18] of the Securities Act are available to the selling security holder and the broker/dealer to whom or through whom the sale is made.

When the rule was adopted in 1972,[19] it was the first in a series of safe-harbor exemptions the Commission adopted. [20] Unlike today, the Commission had no exemptive rulemaking authority, so that a rule prescribing detailed conditions to use the Securities Act trading exemptions was a radical departure from the historical norm, under which rules narrowly defined discrete statutory terms. Moreover, the rule covered the entire resale process in terms of Sections 4(1), 4(3) and 4(4). As a result, it appears that the Commission perceived the necessity of explaining its actions in the Preliminary Note, with its strong emphasis on investor protection as the purpose of the rule. The proposed revised preliminary note, however, does not preserve any of the substantive premises on which Rule 144 was originally based.

We believe that the commentary included in the current Preliminary Note is valuable (even to the rare lay reader seeking explication of the rule) and, whatever action the Commission takes, it should reaffirm the principles stated in the Preliminary Note. Nevertheless, the underlying rationale for the Preliminary Note was based on considerations that may no longer be necessary. More than ten years have passed since the Congress amended the Securities Act to confer broad exemptive authority on the Commission,[21] so the question of authority in the promulgation of Rule 144 is no longer an issue. Moreover, the Commission and the securities bar have more than 35 years of experience in the administration, interpretation and application of the rule. A comprehensive body of literature, largely consisting of the Division of Corporation Finance Staff's interpretative correspondence, has developed. The results of these events are that the purpose and meaning of the rule are well understood and the retention of a "Preliminary Note" is no longer necessary. Accordingly, we recommend that the Commission reaffirm the principles of the Preliminary Note in any adopting release and remove the Preliminary Note in its entirety, rather than substitute the proposed revision.

If the Commission determines to include the proposed revised "Preliminary Note," we recommend that the second paragraph (as well as the proposed revision to Rule 144(b)(2)) be revised to remove the statement that suggests that an affiliate who sells unrestricted securities might be an underwriter. Under Section 2(a)(11)[22] of the Securities Act, an intermediary

[17] 15 U.S.C. §77d(3) (2004).

[18] 15 U.S.C. §77d(4) (2004).

[19] Notice of Adoption of Rule 144, Release No. 33-5223, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,487 (Jan. 11, 1972) ("Release 5223").

[20] Rules 145, 146, 147 and 148 under the Securities Act [17 C.F.R. §§230.145-148 (2007)].

[21] Section 28 of the Securities Act, Pub.L. 104-290, Oct. 11, 1996, Title I, §105(a) (110 Stat. 3424), and amended, Pub.L. 105-353, Nov. 3, 1998, Title III, §301(a)(5) (112 Stat. 3235) [codified at 15 U.S.C. §77z-3 (2004)].

[22] 15 U.S.C. §77b(a)(11) (2004).

distributing securities for the account of a party that controls the issuer would be defined as an underwriter, and not the affiliate itself. However, as proposed, the commentary implies that the affiliate would be an underwriter, an interpretation that is inconsistent with the Securities Act and could inappropriately suggest unwarranted legal exposure for any affiliate selling unrestricted securities under a registration statement or under an exemption from registration other than the Rule 144 safe harbor.

We recommend that the Commission retain current paragraph (j) of Rule 144, which provides that the safe harbor of the rule is not the exclusive means for establishing an exemption from registration for resales of restricted or control securities pursuant to Section 4(1) of the Securities Act. We also recommend that the Commission amend Rule 144(j) to provide that the Rule 144 safe harbor is not the exclusive means to comply with the trading exemptions provided by Sections 4(3) and 4(4) of the Securities Act. While securities practitioners understand that the safe harbor is non-exclusive, Rule 144(j) can be helpful in convincing others that there are other means by which restricted securities can be resold[23] (including trading activities by broker-dealers) in compliance with the federal securities laws.

II. We support the Commission's proposal to codify the Staff interpretations identified in the Proposing Release. If any particular facts and circumstances require a different application than the interpretation(s) codified in the rule as adopted, as with any Commission rule practitioners would be free to seek no-action or interpretative relief from the Staff.

We support the decision to codify Staff interpretations in the revisions to Rule 144. All seven of the positions in question frequently occur in practice, so that their inclusion within the rule itself, rather than solely in the releases, correspondence, telephone interpretations, and other sources where these views were originally expressed, should reduce legal research costs for persons facing these situations for the first time. We believe that if particular facts and circumstances require a different application than the interpretation(s) codified in the rule as adopted, practitioners may seek no-action or interpretative relief from the Staff as with any rule that the Commission adopts.

The addition of the codified interpretations would give the Commission the opportunity to add commentary concerning the interpretative processes of its Division of Corporation Finance. In response to the myriad of different fact patterns in the past 35 years, the Staff of the Division of Corporation Finance has provided to the private bar thousands of interpretations applying its views of the rule to particular facts and circumstances.[24] It would be a valuable

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[23] "Section 4(1½)" and Rule 144A [Private resales of securities to institutions, 17 C.F.R. §230.144A (2007)] under the Securities Act are two examples.

[24] Although Staff interpretations are an important part of the administration of federal securities laws, we wish to express our concern about the position in recently published paragraph 201.06 in the Division of Corporation

addition to the release adopting the rule changes if the Commission would endorse both the Staff's interpretative practices and the continuation of flexibility in the administration of Rule 144, so that the Staff may continue to provide no-action and interpretative letters in response to particular facts and circumstances.

III. AMENDMENTS TO SHORTEN THE RULE 144(d) HOLDING PERIODS SHOULD BE ADOPTED.

Rule 144 was the Commission's first effort to apply objective standards in interpreting the provisions of the Securities Act. The rule was considered experimental and was intended to eliminate the wide disparity of legal interpretations of the circumstances under which a seller of securities acquired in private placements would not be deemed an underwriter and, therefore, entitled to resell those securities without registration. When Rule 144 was originally adopted, it provided for a two-year holding period. In 1981, the Commission adopted Rule 144(k), to allow unlimited resales by an unaffiliated security holder, subject to a three-year holding period but not to the current public information or manner-of-sale requirements.[25] At that time, the securities bar generally sought satisfaction of all these conditions as a basis for rendering opinions that sales outside the rule were exempt from registration under the Securities Act. Over the years, the Commission has reduced the required holding periods.[26] Now it is contemplating a further reduction in those holding periods. Given the speed at which markets now function and the role that technology, particularly the Internet, has played to make markets more efficient, we believe shorter holding periods can be adopted consistent with investor protection and the public interest. We fully support the Commission's proposal to reduce the required holding period for restricted securities issued by Exchange Act reporting companies.

The Commission has proposed reducing the holding period under Rule 144 for Exchange Act reporting companies to six months to increase the liquidity of privately placed securities and to decrease the cost of capital for reporting companies. For the same reasons, we believe that the rule should not impose any restrictions on the resale of securities beyond that which is necessary to carry out the intent and purposes of the Securities Act. For restricted securities of Exchange

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Finance's *Manual of Telephone Interpretations*. This Staff interpretation covers the common situation of when a person who terminates his status as an affiliate of the issuer may effect sales of unrestricted securities without reliance on Rule 144. Contrary to what we believe the law to be and what we had understood to be the Staff's historical position, which stated that there *might* be circumstances recommending continued sales under the rule for some period after termination of affiliate status, paragraph 201.06 could be read to suggest that the former affiliate *must* continue to sell under the rule either until the filing of the next Exchange Act report or three months (a borrowing from Rule 144). We believe that the residual effect of the party's former affiliate status is entirely circumstantial—as noted even in the interpretation itself—and that the position that continued sales must be made pursuant to Rule 144 would not be supported by applicable law. The adopting release for these proposals can also serve as the medium to conform this interpretation to applicable law.

[25] Resales of Securities, Release No. 6286 (Feb. 6, 1981).

[26] Revision of Holding Period Requirements in Rules 144 and 145, Release No. 33-7390 [File No. S7-17-95] (Feb. 20, 1997).

Act reporting companies, the requirement that current public information be available for the issuer largely assures this objective.

Shorter holding periods should apply uniformly to resales by both affiliates and non-affiliates of the issuer. We do not view a six-month holding period as being unduly restrictive or a substantial burden on the capital-raising efforts of reporting companies.

Finally, we see no reason to further reduce the required holding period for resales of securities of non-reporting companies because we view the current public information requirement as the principal form of investor protection provided by the rule.

IV. GIVEN THE LACK OF EMPIRICAL EVIDENCE CITED IN THE PROPOSING RELEASE OF ABUSES IN THE PROCESS OF HEDGING RESTRICTED SECURITIES AND THE LACK OF ANY POLICY RATIONALE OR DISCUSSION OF INVESTOR PROTECTION NEEDS IN THE PROPOSING RELEASE, WE RESPECTFULLY SUBMIT THAT TOLLING OF HOLDING PERIODS SHOULD NOT BE REINSTATED, EVEN IN THE LIMITED MANNER PROPOSED.

The Commission is also proposing to reinstate the tolling provision, which it had eliminated in 1990, in modified form. In support of its proposal, the Commission expressed concern, as it did in the 1995 and 1997 Releases, "about the effect of hedging activities designed to shift the economic risk of investment away from the security holder with respect to restricted securities to be resold under Rule 144[,]"[27] particularly when economic risk is transferred by the security holder to a third party "soon after the [security holder] acquire[d] the securit[ies]."[28] The Commission singled out, as an example, an equity swap arrangement.[29]

The Commission failed to offer any quantitative empirical (or even anecdotal) data about transactions where abuses have occurred. In contrast, the Commission identified abusive practices of U.S. issuers offering equity securities in reliance on Regulation S prior to proposing and adopting amendments.[30]

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[27] Proposing Release at 19.

[28] *Id*.

[29] *Id.* In a typical equity swap arrangement, a corporate insider will swap with a counterparty the "all-in return" on his issuer common stock, consisting of the market appreciation or depreciation plus any dividends or other distributions, for an agreed-upon period in exchange for the return on an alternative, interest-bearing or better-diversified investment. At the end of the swap term, the parties also agree that a "balancing" sum must be paid by either the corporate insider or the counterparty depending on whether the issuer common stock has appreciated or declined in value. The corporate insider retains title to and the voting rights with respect to the issuer common stock during the swap term. In order to hedge its risk that the issuer common stock will decline in value during the swap term, the counterparty will engage in short sales of shares of the same class as the swapped shares.

[30] Problematic Practices Under Regulation S, Release No. 33-7190 (June 27, 1995) 60 Fed. Reg. 35663 (July 10, 1995) ("Interpretive Release"). The Commission ultimately amended Rule 903 of Regulation S, amended Rule 144(a)(3) under the Securities Act [17 C.F.R. §230.144(a)(3) (2007)], and adopted new Rule 905 of Regulation S [17 C.F.R. §230.905 (2007)] to curtail these abusive practices. *See* Offshore Offers and Sales, Release No. 33-7505 [File No. S7-8-97] (Feb. 17, 1998).

Any concern the Commission may have about engaging in hedging activities immediately or within a brief period after acquisition is outweighed by our belief that hedging activities can enhance private placements as a means of capital formation and should be allowed to continue because they do not raise substantial concerns about unregistered distributions of securities. We also remain firmly committed to our view that "fungibility" is an outdated theory that has no place in Rule 144 jurisprudence. Imposing a tolling provision can result in tracing securities holdings which will result in higher costs through tracking and tracing, as well as confusion by market participants, with no measurable enhancement to investor protection.

A. HEDGING SHOULD NOT TOLL THE RULE 144 HOLDING PERIOD

We believe that the Commission should not impose any additional consequences of hedging restricted securities. There have been a number of enforcement actions involving violations of Section 5 of the Securities Act and Rule 105 of Regulation M[31] under the Exchange Act in connection with covering hedging transactions in connection with private investments in public equity (or "PIPE" transactions).[32] As these recent enforcement actions demonstrate, the Commission already has adequate "tools in its toolbox" through Section 5 of the Securities Act and Rule 105 of Regulation M to pursue such abuses. We believe that the ability of holders of restricted securities to engage in hedging enhances private placements as a means of capital formation.[33] Accordingly, it is our view that if hedging becomes significantly easier and less costly by the adoption of the reduced proposed Rule 144 holding period, this would be a positive development for the capital markets and not, as the Proposing Release implies, a negative development.

In addition to the reasons described above, we believe that hedging should continue to be allowed without negative consequences for the reasons discussed below.

1. *Absence of Leakage into the Public Market*

As previously noted in the Committee's letter to the Commission dated September 6, 1995 (the "1995 Letter") relating to Release No. 33-7187 (June 27, 1995) and the Committee's letter to the Commission dated May 9, 1997 (the "1997 Letter") related to Release No. 33-7391

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[31] 17 C.F.R. §242.105 (2007).

[32] *SEC v. Guillaume Pollet,* Litigation Release No. 19984 (Jan. 29, 2007); *In re Spinner Asset Mgmt.,* Release No. 33-8763 (Dec. 20, 2006); *In re DB Inv. Managers, Inc.,* Release No. 34-51707 (May 19, 2005); *SEC v. Galleon Mgmt., L.P.,* Litigation Release No. 19228 (May 19, 2005); *In re Oaktree Capital Mgmt., LLC,* Release No. 34-51709 (May 19, 2005); *In re Shane,* Release No. 34-51839 (June 14, 2005); *SEC v. Rhino Advisors, Inc.,* Litigation Release No. 18003 (Feb. 27, 2003).

[33] The Commission has noted that hedging in connection with a PIPE transaction is not necessarily illegal under the Securities Act; *provided,* that the investor closes out its short position with shares purchased in the open market. *Spinner, supra* at 2-3.

(Feb. 20, 1997), a common element of all the risk-reducing strategies[34] used in hedging is the short sale. Whether a short sale is effected by the holder of restricted or control securities or a counterparty, unrestricted securities of the same class as the restricted or control securities are delivered to the purchaser of the securities sold short. Importantly, these short sales are separate and distinct transactions not involving restricted or control security positions. As the Commission's enforcement actions cited above emphasize, the short sales must be solely of borrowed unrestricted securities, and the short positions created by these short sales must be covered solely with other unrestricted securities. In practice, restricted securities are not used to cover short positions, even after the Rule 144 restrictions lapse.[35]

As a result of the separation maintained between restricted or control securities and the unrestricted securities used to cover short positions, restricted securities do not leak into the public market. Thus, there is no unlawful distribution into the public trading markets.[36] The obligation to maintain such strict separation is clearly on the person engaging in the risk-reducing strategy, because a failure to maintain strict separation would result in a violation of Section 5[37] of the Securities Act.

2. *No Harm to Participants or Issuer*

No participant[38] directly involved in any risk-reducing strategy is harmed by the strategy. The purchaser of the securities sold short has made a conscious investment decision to purchase publicly traded securities and thus is in the same shoes as any other investor who purchases securities in the secondary market.

The securities sold short come from the portfolio of unrestricted securities held by another investor—usually a financial institution—that willingly loans them for use in a short sale. A lender of securities sold short will receive a portion of the proceeds of the short sale as collateral for the loaned securities and will participate, either fully or partially depending on the identity of the investor to whom the securities were lent, in the investment income generated

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[34] For a discussion of equity swaps, double-prints, deep-in-the-money call options and other risk-reducing strategies associated with hedging, *see* the 1995 Letter, nn.14-18.

[35] *See* Resales of Restricted and Other Securities, Release No. 33-6099, Q. 82 (Aug. 2, 1979) ("Release 6099").

[36] We agree that covering a short position with restricted securities does not comply with Section 5 of the Securities Act unless the short position is covered in the manner described in *Goldman Sachs & Co.,* SEC No-Action Letter (Dec. 20, 1999) or *Goldman Sachs & Co.,* SEC No-Action Letter (Oct. 9, 2003). Additionally, we also believe that it would be unlawful for a purchaser who acquires restricted securities as part of a private placement to immediately sell short against such securities as part of an arrangement, agreement or understanding between the purchaser and the issuer of such securities.

[37] 15 U.S.C. §77e (2004).

[38] These participants include the purchaser of the securities sold short, the lender of those securities, and the seller of those securities. The seller of the securities sold short can be either the holder of restricted or control securities or a counterparty participating in a risk-reducing strategy (*e.g.*, a swap agreement) initiated by such holder. The issuer of the securities sold short is not a participant in the short sale.

from the reinvestment of these proceeds. This lender, which has the right to call back its securities at any time, will receive unrestricted securities when the loan is extinguished, not restricted or control securities.

The seller of securities sold short creates greater, but not absolute, certainty for itself through the short sale. By selling short borrowed unrestricted securities, the seller will have potentially secured a spread between its purchase price of the restricted securities and the sales price of the shorted publicly traded securities. Contrary to the view expressed in the Proposing Release that such seller's risk has been eliminated, however, we believe the seller continues to bear certain risks. *First*, the seller retains the risk that the lender of the unrestricted securities sold short will call them back, either in whole or part,[39] prior to the time the seller's restricted securities become eligible for resale under Rule 144. If the seller is unable to borrow additional shares from another party at that time,[40] the seller will have to purchase publicly traded securities in the open market and at current market prices because the seller is prohibited from selling its restricted securities under Rule 144. *Second*, if the current market price of the publicly traded securities rises, the seller likely will have to put up cash as collateral for its short position in a manner not dissimilar to satisfying a margin call, because the seller cannot use its restricted securities as collateral for the short sale.

The issuer of the securities sold short is not a direct or indirect participant in the short sale, nor does it exercise any control over whether any particular short sale is effected. Importantly, the issuer is not affected to any greater or lesser extent than when ordinary course short sales in its securities occur. In the common stock context, at any given time market participants have long and short positions in the stock of that issuer. While short sales relating to restricted stock, like ordinary course short sales, need no longer occur on "upticks,"[41] short sales relating to restricted stock occur in sizes small enough to have only a marginal impact on the current market price of that stock. Indeed, material downward pressure on a stock's market price resulting from the shorting of large blocks of that stock would likely remove the participants' incentives for engaging in a particular risk-reducing strategy in the first place.

Issuers, in fact, have generally benefited from the elimination of the tolling provision since 1990. Prior to the elimination of the tolling provision, an issuer that sold shares of restricted stock to investors in connection with an acquisition or other corporate transaction did

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[39] An example of this is when such securities become the subject of a tender offer. In such a case, the seller of securities sold short will be forced to buy unrestricted securities in the open market at a price most likely higher than the price at which the securities were sold short in order to cover its short position and thus allow the lender of the securities to participate in the tender offer. Although the seller is also allowed to tender its restricted or control securities into the tender offer and thus offset its loss in such a situation, if the tender offer is not consummated, the seller will have its restricted securities returned and will have incurred a loss equal to the difference between the price at which it purchased securities to cover its short position and the price at which it sold securities short.

[40] *See infra* Part IV.A.3.

[41] Regulation SHO and Rule 10a-1, Release No. 34-55970 [File No. S7-21-06] (June 28, 2007) 72 Fed. Reg. 127 at 36348 (July 3, 2007) (Final Rule) (removing the price test requirement of former Rule 10a-1 under the Exchange Act).

so at a significant discount to the current market price of publicly traded shares of the same class. This resulted from the illiquid nature of the restricted shares issued and the risk associated therewith. By allowing holders of restricted stock the opportunity to effectively hedge their position through the use of various risk-reducing strategies, the elimination of the tolling provision has had a beneficial effect: issuers are now in a position to negotiate a reduction in the magnitude of the discount at which they issue restricted securities in private placements. Thus, the elimination of the tolling provision has actually facilitated capital formation and enhanced the capital raising ability of issuers.

3. *Natural Ceiling on the Amount of Hedging Activity*

The ability of a holder of restricted securities to hedge its risk is entirely dependent on the availability of unrestricted securities that can be delivered to the counterparty in the short sale. The supply of unrestricted securities is far from endless. Indeed, for small, publicly-traded corporations, the supply of unrestricted shares of common stock is quite limited. Occasions often arise when the holder of restricted securities desires to hedge its position, but the unrestricted securities needed to effect a given risk-reducing strategy are simply not available to the holder or a counterparty. Accordingly, limitations on the supply of unrestricted securities that can be borrowed in connection with short sales places a natural, or market-based, ceiling on the amount of hedging activity that can occur.

Based on the reasons discussed above, it is our view that the reintroduction of a tolling provision is not only unnecessary but could actually be counterproductive. In any event, the abuses relating to the hedging of restricted securities are already proscribed by Section 5 and subject to enforcement action by the Commission.[42]

B. THE THEORY OF "FUNGIBILITY"

In the Proposing Release, the Commission asked whether it is "unnecessarily restrictive to require tolling if the security holder has engaged in hedging transactions with respect to any of his or her securities of the same class (or, in the case of nonconvertible debt, with respect to any nonconvertible debt securities of the same issuer)[.]"[43] *"Yes"* is our emphatic answer. The last vestige of the theory that restricted and unrestricted securities were "fungible" was removed from Rule 144 in 1990 when the Commission eliminated the tolling requirement that the Proposing Release now seeks to reinstate.[44] For the reasons set forth below, we do not support this reintroduction of fungibility into Rule 144.

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[42] *See* note 32, *supra.*

[43] Proposing Release at 30.

[44] Resale of Restricted Securities; Changes to Method of Determining Holding Period of Restricted Securities Under Rules 144 and 145, Release No. 33-6862 [File No. S7-23-88] (April 23, 1990) 55 Fed. Reg. 17933 (April 30, 1990).

Under fungibility, the holding period used in determining whether a purchaser acquired restricted securities with the requisite investment intent is "measured from the time of the most recent acquisition"[45] of securities of the same class. In 1972 the Staff explained the rationale behind the theory as follows:

> [S]hares of stock (as distinguished from certificates evidencing the shares) are considered fungible in that each share represents the same economic interest in the issuer as any other share. It is thus questionable whether a purchaser can have a bona fide investment intent with respect to any particular shares if, at the time he acquires them, he intends to distribute publicly other shares of the same issuer. When, therefore, a purchaser acquires shares from an issuer in a transaction not involving a public offering, he necessarily indicates an absence of any intent to distribute to the public any other shares of the same issuer that he then holds. In other words the economic effect of a sale of any shares would be the same as that of a sale of the shares most recently purchased, with the result that any such sale would constitute a distribution of securities purchased from an issuer from which no exemption from the registration requirements of the [Securities] Act would be available.[46]

The concept of fungibility, however, "posed serious problems for persons holding investment securities."[47] The Commission-sponsored *Wheat Report*[48] thoroughly examined whatever utility the concept had and rejected it. In doing so, it stated that "the present 'fungibility concept' bears little relationship to the needs of investors for disclosure."[49] The *Wheat Report* further added that fungibility "introduces an additional element of uncertainty into an already clouded situation."[50]

The Commission wisely followed the lead of the *Wheat Report* when it first proposed Rule 144 in 1970.[51] Acknowledging that the theory of fungibility "never has been formalized as a Commission rule or interpretative release, and hence introduces an additional element of uncertainty . . ."[52], the Commission decided that "fungibility will no longer be considered in

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[45] *Roto Am. Corp.,* SEC No-Action Letter, [1970-1971 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,026, at 80,248 (Feb. 19, 1971).

[46] *Computer Automation, Inc.,* SEC No-Action Letter, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,848, at 81,853 (May 10, 1972).

[47] 7B J. WILLIAM HICKS, SECURITIES LAW SERIES, EXEMPTED TRANSACTIONS UNDER THE SECURITIES ACT OF 1933 § 9.02[2][c][ii][C] (1994).

[48] Disclosure to Investors: A Reappraisal of Federal Administration Policies Under the '33 and '34 Acts (1969) (the "*Wheat Report*").

[49] *Id*. at 174.

[50] *Id*.

[51] Notice of Proposed Rule 144, Release No. 33-5087, [1970-1971 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,909 (Sept. 22, 1970) ("Release 5087").

[52] *Id*.

determining when a person is an underwriter . . . ."[53] The Commission reiterated this position in the Rule 144 adopting release, stating that "[f]or purposes of the rule, the doctrine of fungibility will not apply."[54] This, of course, was entirely consistent with one of the fundamental purposes behind the adoption of Rule 144: "to create certainty and predictability in the application of the registration provisions of the [Securities] Act by replacing subjective standards with more objective ones."[55]

Interestingly, an aspect of fungibility remained in both proposed Rule 144 of 1970 and re-proposed Rule 144 of 1971.[56] Both proposed rules would have, with respect to any particular person, started the holding period *de novo* if during the holding period certain additional restricted securities[57] of the same issuer were acquired by such person. However, neither proposed rule would have restarted the holding period with respect to a holder of restricted securities that purchased unrestricted securities of the same issuer in the open market. The Commission ultimately eliminated this aspect of fungibility when it adopted Rule 144 in 1972.[58]

The notion that the use of a risk-reducing strategy could result in a *de facto* distribution in violation of Section 5 of the Securities Act rests upon the assumption that restricted securities and unrestricted securities are fungible. But by definition this cannot be and is not the case. While the economic attributes of restricted securities mirror those of unrestricted securities, restricted securities have different transferability and liquidity attributes and, hence, different risk profiles. Restricted securities cannot be freely transferred to the public until the holder thereof has complied with the provisions of Rule 144 or another available exemption from registration, or has registered such resales under the Securities Act. Therefore, such holder's securities are not liquid. The market clearly recognizes this and, accordingly, prices restricted and unrestricted securities of the same class differently.

This distinction between restricted and unrestricted securities is especially highlighted when an investor either (a) holds both restricted securities and unrestricted securities of the same class or (b) acquires restricted securities of the same class at different times. When attempting to dispose of restricted securities pursuant to Rule 144, an investor in either situation must clearly identify the restricted securities being sold and be able to trace those shares back to the particular

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[53] *Id.*

[54] Release 5223, *supra* note 19.

[55] *Id.*

[56] *See* proposed Rule 144(a)(1)(C) in Release 5087, *supra* note 51; *see also* re-proposed Rule 144(d)(2) in Notice of Proposed Rule 144, Release No. 33-5186, 1971 WL 17002 (SEC) (Sept. 10, 1971) ("Release 5186").

[57] Proposed Rule 144(a)(1)(C) would have restarted the holding period anew if additional restricted securities of the same class of the issuer in question were purchased, while re-proposed Rule 144(d)(2) would have restarted the holding period anew if any additional restricted securities (regardless of class) of such issuer were purchased. *See* proposed Rule 144(a)(1)(C) in Release 5087, *supra* note 51, and re-proposed Rule 144(d)(2) in Release 5186, supra note 56.

[58] Release 5223, supra note 19.

date on which he acquired them.[59] The burden, therefore, is on the seller of restricted securities to prove that the specific restricted securities being sold have been held for the applicable holding period of Rule 144(d).[60] The existence of this burden is sufficient to negate any need for the fungibility concept. In other words, the answer to fungibility is tracing.

C. FULL COMPLIANCE WITH RULE 144

The Commission has asked whether, as an alternative to tolling, "we [should] preclude security holders who hedge securities during the holding period from relying on Rule 144[.]"[61] We interpret this to mean that security holders must fully comply with the provisions of Rule 144 ("Full Compliance") prior to their engaging in any risk-reducing strategies, because hedging activities would constitute "sales" of the underlying securities. Assuming that Full Compliance means satisfying the requirements described below, Full Compliance would represent a cure more drastic than the reintroduction of a tolling provision because Rule 144 as originally adopted never prohibited the use of risk-reducing strategies, but only tolled the holding period of the security holder for the period of time during which his restricted securities position was hedged.

D. PROPOSALS DEPENDING ON THE REINTRODUCTION OF TOLLING

Notwithstanding our views against reintroducing tolling, if the Commission nevertheless adopts such a provision, we have the following comments on provisions proposed and questions raised by the Proposing Release that depend on the reintroduction of tolling.

1. *Scope of the Tolling Provision*

The Commission has asked whether "the proposed language requiring that the security holder toll the holding period if the holder had 'a short position, or had entered into a "put equivalent position" as defined by Exchange Act Rule 16a-1(h)' [is] appropriate[.]"[62] We note that the Commission's proposed language would cover the majority of hedging activities because most hedging activities involve the security holder selling an equivalent number of unrestricted shares short. We further note that the additional term "put equivalent position" would likely cover most of the remaining hedging activity. Nevertheless, we believe that the Commission's proposed language is not appropriate for the following four reasons.

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[59] Release 6099, supra note 35, Q. 21.

[60] While Rule 144 is not explicit as to how restricted securities acquired at various times are to be identified, we understand that issuers customarily place a legend on each stock certificate to identify restrictions on resale of specific restricted securities acquired on any particular date, a general policing mechanism "strongly suggested" by the Commission in the private placement context. Release 5223, *supra* note 19; Use of Legends and Stop Transfer Instructions, Release No. 33-5121, [1970-1971 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,943 (Dec. 30, 1970).

[61] Proposing Release at 31.

[62] Proposing Release at 29.

First, there is nothing inherently wrong with hedging. The Commission itself has stated that it is "lawful"[63] if done properly.[64] In this regard, the Commission has noted that covering short sales with actual shares received in a PIPE transaction violates Section 5[65] because "shares used to cover a short sale are deemed to have been sold when the short sale was made."[66] The Commission has indicated, however, that covering short positions with "open market shares"[67] is entirely appropriate if done properly. We strongly agree with the Commission and believe that it is inappropriate to place the consequences of tolling on an activity that is perfectly legal.

Second, the use of the term "put equivalent position" (as defined in Rule 16a-1(h) under the Exchange Act) in the proposed language would bring into Rule 144 jurisprudence case law interpretations of an Exchange Act term that is used in an entirely different context. We believe that it is inappropriate to do so, particularly in light of the potential uncertainty and confusion it would introduce into a rule designed as a "safe harbor." Specifically, the term "put equivalent position" is used under Section 16 of the Exchange Act as part of a comprehensive framework and is designed to determine only the timing of a transaction that *may be* subject to Section 16(b).[68] The Section 16 rule framework relies on a factual inquiry under Rule 16b-6(c)[69] to determine whether and the extent to which a derivative security transaction may represent a disposition of some or all of the economic risk associated with the underlying transaction.[70] Simply incorporating the "put equivalent position" definition into Rule 144 thus would pick up transactions that do not in fact involve a hedge or reduction of the investment risk of the underlying securities. Additionally, the definition of "put equivalent position" was designed for application to equity securities and thus focuses on an instrument whose value is tied to the underlying fundamentals that drive the value of an equity security. In the context of Rule 144, as proposed, however, the definition would be applied to debt and other securities and thus could inappropriately encompass any interest rate sensitive instrument regardless of its connection with the value of a particular issuer's debt. Additionally, the classification of a variety of debt-related derivative transactions, including but not limited to credit-default swaps, is entirely novel and

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[63] Complaint of SEC in *SEC v. Langley Partners, L.P.* (D.C. Cir., Case No. 1:06CV00467) (Mar. 14, 2006), at ¶17 (*"Langley Complaint"*); Complaint of SEC in *SEC v. Lyon* (S.D.N.Y.) (Dec. 12, 2006), at ¶24 (*"Lyon Complaint"*). *See also* Spinner, *supra* note 32 at 2-3 ("there is nothing per se illegal about 'hedging' a PIPE investment by selling short the issuer's securities . . . if, among other things, the investor closes out the short position with shares purchased in the open market"); Release 6099, *supra* note 35 (Illustration to Q. 29) (acknowledging the legality of a holder of restricted securities "cover[ing] his short with the securities that he purchased in the open market").

[64] The prime example of this would be a "double print" transaction, in which the holder uses securities that were obtained in open market transactions to cover the short position established to hedge its restricted securities.

[65] *Langley Complaint, supra* note 63 at ¶ 16; *Lyon Complaint, supra* note 63 at ¶ 23.

[66] *Id.*

[67] *Lyon Complaint, supra* note 63 at ¶ 2.

[68] 15 U.S.C. §78p(b) (2004).

[69] Derivative securities, 17 C.F.R. §240.16b-6(c) (2007).

[70] Thus, under the Section 16 rules, a put equivalent position transaction in a convertible debt instrument could be found not to involve a disposition of a pecuniary interest in the underlying equity security when the value of the transaction is established under Rule 16b-6(c) to be attributable to the value of the debt instrument.

would always be subject to some uncertainty. In our view, it is inappropriate for a safe harbor provision to use a term that is being interpreted by courts—often in conflicting ways[71]—in the context of a strict liability statutory provision.

Third, if the Commission were to reintroduce the tolling of the holding periods for short positions, it would be a practical impossibility to determine when Rule 144A securities are freely saleable under Rule 144(k)[72] thereby impairing the market for Rule 144A securities. We are quite concerned that the practical consequence of the reintroduction of tolling into these markets will be to create a *de facto* one-year restricted period, and thus, significantly reduce the benefit of reducing the period to six months elsewhere in the rule.

Lastly¸ if the Commission determines to reinstitute tolling of holding periods, the proposed language must be clarified so that tolling of the holding period would only occur for the actual shares of restricted stock that have been hedged.[73] As written, the proposed language would toll the holding period for an investor's restricted stock if that investor "had a short position, or had entered into a 'put equivalent position' . . . with respect to *any equity securities of the same class* . . . ."[74] Thus, for example, if an investor acquired 10,000 shares of restricted stock today, and then hedged 5,000 shares two months later, the proposed language would toll the holding period for the entire 10,000-share position. In fact, hedging a single share of restricted stock would toll the holding period for all of the shares. We do not believe this is the result the Commission is seeking. Therefore, if the Commission determines to reinstitute tolling of holding periods, we request that the Commission clarify the proposed language so that tolling would only occur for the actual shares of restricted stock that have been hedged.

2. *"Reasonable Belief" Standard*

With respect to tacking and the proposed tolling provision, the Proposing Release states that "a selling security holder would be required to determine whether a previous owner of the

[71] *Compare At Home Corp. v. Cox Communications, Inc.,* 446 F.3d 403 (2nd Cir. 2006) (holding "hybrid" convertible instrument with both a fixed and a variable conversion price constituted a derivative security) with *Levy v. Clearwater Fund IV, Ltd.,* Fed. Sec. L. Rep. (CCH) ¶90,938 (D. Del. 2000) (holding a hybrid instrument did not constitute a derivative security).

[72] *See* Keith F. Higgins, Chair, Committee on Federal Regulation of Securities, Letter to John W. White, Director of the Division of Corporation Finance, dated Mar. 22, 2007 ("March 2007 Letter") at 29. In that letter, we also noted the development of the derivatives market "since the original adoption of Rule 144, and indeed since 1990," and that "liquidity of the resale market for private securities includes activity in both the physical market and the derivatives market. This activity, like activity in the derivatives market generally, has virtually uniformly been found to be a positive development for markets and for investors. Reinstatement of this tolling period would have adverse consequences for the derivatives market and therefore the liquidity of the resale market." *Id.* at n. 22.

[73] Note that, when tolling existed prior to 1990, the Staff of the Commission indicated that the holding period "tolled only for the number of restricted securities equivalent to the number of securities subject to the short, put or other option to sell." Release 6099, *supra* note 35, Q. 29.

[74] Proposing Release at 21 (*emphasis added*).

securities had engaged in hedging activities with respect to the securities, if the holding period includes a period in which a previous owner held the securities."[75] In this regard, the Commission has asked whether "security holders [should] be held to a 'reasonable belief' standard with regard to the previous owner's hedging activities, or [whether] . . . a '*bona fide* belief' or some other standard [is] more appropriate[.]"[76]

We support a "reasonable belief" standard because it measures the security holder's determination about a previous owner's hedging activities against an objective, reasonable person standard. A "*bona fide* belief" standard, by contrast, measures that determination by a subjective standard. In other words, a security holder could hold a belief in good faith that is not considered reasonable by an objective third party.

Most importantly, and whichever standard is employed, we respectfully request the Commission to confirm that a written letter of representation from a previous owner to a subsequent owner stating that the previous owner had not engaged in hedging activities would be sufficient for a subsequent owner to satisfy the "reasonable belief" standard, so long as the subsequent owner does not have actual knowledge to the contrary. In other words, we ask the Commission to confirm that it will not require extensive due diligence on the part of the subsequent owner to determine the nature and extent of the prior owner's hedging activities.

3. *One Year "Tolling Ceiling"*

As proposed, a security holder's hedging activities would toll the holding period equal to the time that the restricted securities were subject to the hedge, but in no event would the holding period exceed one year.[77] The Commission has asked whether its proposed maximum tolling period of one year (the "tolling ceiling") is appropriate.[78]

If the Commission adopts the one-year tolling ceiling, we would request that the Commission confirm that any hedging activity occurring after the six-month holding period has run would not in any way impact the security holder's ability to sell its restricted securities at any time thereafter.

4. *Broker's Reasonable Inquiry*

The Commission proposes to require that the broker make a reasonable inquiry, which will include, if the restricted securities in question have been held less than one year, whether hedging has occurred and whether the seller has made similar inquiries about the activities of any

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[75] Proposing Release at 21.

[76] *Id*. at 30.

[77] *Id*. at 22.

[78] *Id*. at 31.

previous owner.[79] Given our belief that brokers play an important role as gatekeepers, we support a "reasonable belief" standard for the brokers' due diligence obligation in Rule 144(g).

We, therefore, request that the Commission confirm that a written letter of representation from a security holder to a broker stating that neither he nor, based on his reasonable belief, any previous owner of restricted securities engaged in hedging activities would be sufficient for the broker to meet the "reasonable belief" standard, so long as the broker does not have actual knowledge to the contrary. In other words, we ask the Commission to confirm that it will not require extensive due diligence on the part of the broker to determine the nature and extent of the security holder's (or prior owner's) hedging activities.

5. *Form 144 Hedging Disclosure*

The Commission has asked whether Form 144 should be amended "to require disclosure of hedging transactions[.]"[80] Generally, we would support such an amendment, noting that Form 144 required such disclosure prior to the elimination of the tolling provision in 1990. However, the Commission has also proposed the elimination of the Form entirely with respect to non-affiliates who sell restricted securities after the expiration of the holding period.[81] We, therefore, favor inclusion of hedging transaction information only if Form 144 were retained going forward.

V. WE DO NOT BELIEVE A NEW DEFINITION OF THE TERM "AFFILIATE" SHOULD BE ADOPTED SPECIFICALLY FOR RULE 144.

We do not believe it would be worthwhile to adopt a definition of affiliate (beyond the one already in Rule 144(a)(1)[82]). In our March 2007 Letter, we discussed several approaches that the Commission might consider to provide a little more clarity to this area,[83] and we do not propose to repeat that discussion here.

VI. WE AGREE WITH THE ELIMINATION OF THE MANNER OF SALE REQUIREMENTS OF RULE 144(g) FOR RESALES OF RESTRICTED SECURITIES BY NON-AFFILIATES, BUT DO NOT OBJECT TO THEIR RETENTION FOR RESALES BY AFFILIATES. BROKERS SERVE A USEFUL FUNCTION AS "GATEKEEPERS" AND CAN PROVIDE SUBSTANTIAL ASSISTANCE WITH RESALES BY AFFILIATES EFFECTED PURSUANT TO THE RULE.

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[79] *Id*.

[80] *Id*. at 32.

[81] *Id*. at 24-25.

[82] Definitions, 17 C.F.R. §230.144(a)(1) (2007).

[83] *See* March 2007 Letter, *supra* note 72 at pp. 30-32.

In our March 2007 Letter, we advocated the elimination of the manner of sale requirements of Rule 144. The Commission has adopted this recommendation in proposing to eliminate them for resales of restricted securities by non-affiliates, but is proposing to retain these requirements for resales of equity securities by affiliates. We do not object to the retention of the manner of sale requirements for affiliates because, in our experience, affiliates find the assistance of a broker helpful in navigating compliance with Rule 144 and thus brokers serve a useful function that is not unduly burdensome in practice. Based on our experience, brokerage firms are more effective than transfer agents as gatekeepers because they are involved in the transaction at an earlier stage, have regulatory obligations to know their customer, and need to assure themselves of the availability of the trading exemptions of the Securities Act for their execution of customer orders to sell restricted securities.

In retaining the manner of sale requirement for equity securities, the Commission and the Staff should recognize through interpretative guidance, as appropriate, the development of trading practices that are consistent with the objectives of obtaining best execution of the customer's securities orders. Specifically, the Commission should confirm that, in the conduct of brokers' transactions permitted under Rule 144, a broker's efforts to satisfy its best execution obligations for agency orders under current trading practices rules would not be deemed a "solicitation" for purposes of the manner of sale requirements.

The safe harbor for compliance with Section 4(4)[84] of the Securities Act afforded by paragraph (g) of Rule 144[85] provides that "brokers' transactions"[86] are deemed to include transactions in which the broker (a) executed the sell order(s) as agent for the customer and received only the usual and customary broker's commission; (b) did not solicit (or arrange for the solicitation of) buy orders in anticipation of, or in connection with, the proposed sale of restricted securities and (c) was not aware, after reasonable inquiry, that the customer is an *underwriter* or that the proposed transaction is part of a *distribution* of securities of the issuer.

Rule 144(g)(2) provides that the broker may engage in certain solicitation activities in connection with executing customer orders to sell restricted securities. The broker may contact other brokers or dealers that indicated an interest in the securities during the prior sixty days. The broker also may contact its customers who indicated an unsolicited *bona fide* interest in the securities during the prior ten business days. Finally, the rule would permit the broker to publish bid and ask quotations for the security in an inter-dealer quotation system, if the quotations are incident to the maintenance of a *bona fide* interdealer market for the security for the broker's account and the broker has published *bona fide* bid and ask quotations for the security in an

[84] 15 U.S.C. §77d(4) (2004).

[85] Brokers' transactions, 17 C.F.R. §230.144(g) (2007).

[86] Section 4(4) of the Securities Act generally exempts from securities offering registration requirements the broker's execution of customer orders on any exchange or in the over-the-counter market; *provided,* that the broker did not solicit the order(s) from its customer.

inter-dealer quotation system on each of at least twelve days during the prior thirty calendar days with no more than four consecutive business days without publishing two-way quotations.

In 1964, Congress amended Section 4(4) to exempt broker's transactions executed on any exchange or in the over-the-counter ("OTC") market.[87] More recently, with the adoption of the Commission's order execution rules,[88] electronic communications networks have become important sources of liquidity. Today's equity securities trading markets are no longer confined principally to exchange floors or inter-dealer quotations in the OTC market. Rather, a number of electronic venues (including alternative trading systems, crossing networks and electronic communications networks) provide liquidity for investors.[89]

The exception for *soliciting* transactions provided by the safe harbor for brokers' transactions in paragraph (g)(2), however, is limited to publication of quotations for the security in inter-dealer quotation systems. As a consequence, the safe harbor for brokers' transactions has not kept pace with innovations in public trading markets and changes to market practices as a result of advances in trading technology and the full implementation of Regulation NMS.[90]

We encourage the Commission to use its general exemptive authority in Section 28[91] of the Securities Act to expand the trading venues where brokers may execute customer orders to sell securities in reliance on the safe harbor afforded by paragraph (g) of Rule 144 to include electronic venues where the broker's identity is anonymous prior to trade execution. This would ensure that the executing broker did not use the electronic venue to solicit order flow in that security in a manner that could render the transaction a distribution of the securities.[92]

VII. THE MANNER OF SALE CONDITIONS SHOULD BE ELIMINATED FOR DEBT SECURITIES. UNLIKE COMMON STOCK, IT WOULD NOT BE PRACTICAL TO IMPOSE VOLUME LIMITATIONS ON DEBT SECURITIES, SOME OF WHICH MAY BE VIEWED AS "TRADING BY APPOINTMENT."

We support elimination of the manner of sale requirement for debt securities and securities with similar characteristics, as well as elimination of the volume restriction for such

[87] Pub. L. 88-467, §12, Aug. 20, 1964, 78 Stat. 580.

[88] Order Execution Obligations, Release No. 34-37619A (Sept. 6, 1996) (Final Rules).

[89] For example, a consulting firm estimated that dark pools and crossing networks captured almost ten percent of the total equity market, and project that their market share will increase to 15 percent (or 1.5 billion shares a day) by 2010. Press Release, TABB Group, Dark Pool and Crossing Network Volumes to Triple to 1.5 Billion Shares a Day in 2010, Says TABB Group (Jan. 30, 2007) http://www.tabbgroup.com.

[90] Regulation NMS Final Rules and Amendments to Joint Industry Plans, Release No. 34-51808 [S7-10-04] (June 9, 2005) 70 Fed. Reg. 124 at 37496 (June 29, 2005) (Final Rule Release).

[91] 15 U.S.C. §77z-3 (2004).

[92] In addition, of course, solicitation is permitted in connection with market maker transactions meeting the requirements of Rule 144.

securities. These two requirements have, if anything, contributed to debt securities trading largely in an institutional, Rule 144A marketplace, thereby reducing liquidity and transparency in public debt markets.[93] As the Commission recognized in the Proposing Release, these securities trade largely in a dealers' marketplace.

Due to the nature of this marketplace, we believe that the conduct addressed by the manner of sale requirement restricts to a disproportionate degree traditional dealers' market selling methods that are not emblematic of a distribution. Likewise, due to the fact that each offering by an issuer of debt securities typically results in a different "class" of securities and the limited information that may be available on the trading volume and size of a class of debt (or similar) securities outstanding at any particular time, the trading volume limitation has the effect of prohibiting public resales at volumes that should not be viewed as constituting a distribution. Thus, particularly in this market, the holding period alone should serve as a sufficient barrier to unregistered distributions.[94]

We also support the Commission's proposal to treat non-participating preferred stock and asset-backed securities the same as debt securities. We believe that the definition of "debt securities" should be broadened to include "other securities with similar characteristics" so that the rule incorporates flexibility to accommodate additional types of securities that issuers, investors and the Staff may determine to have similar trading characteristics that reduce the risk of improper distributions. We recommend that the Commission provide a definition of "debt securities" in the definitions under Rule 144(a), instead of in a note to Rule 144(f). We also note that in order to treat preferred securities as debt equivalents, the proposed definition of preferred securities would require that the preferred securities have a liquidation preference in excess of par. In our view, this requirement is not essential to the Commission's purposes. As reflected in former Item 601(b)(7)[95] of Regulation S-K, liquidation preferences in excess of par may still raise legality issues in certain jurisdictions thereby precluding their use. We, therefore, recommend that the definition of preferred stock exclude any requirement that there be a liquidation preference in excess of par.

VIII. GENERALLY, WE SEE NO NEED TO RETAIN THE REQUIREMENT TO FILE A NOTICE OF SALES MADE UNDER FORM 144. IF THE COMMISSION, HOWEVER, DECIDES TO RETAIN THE NOTICE REQUIREMENT, WE RECOMMEND THAT (i) IT BE RESTRICTED TO PERSONS REQUIRED TO FILE REPORTS UNDER SECTION 16(A) OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED (THE "EXCHANGE ACT"); (ii) THE REPORTING THRESHOLDS BE INCREASED SUBSTANTIALLY

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[93] *See also*, Leslie Wines, "Phoning it in: How fixed-income assets are traded," MarketWatch (July 13, 2007) http://www.marketwatch.com.

[94] Eliminating the manner of sale and volume limitations for debt securities and securities with similar characteristics is particularly important if the Commission were to retain any conditions on sales by non-affiliates after six months, including the current public information condition.

[95] 17 C.F.R. §229.601(b)(7).

AND (iii) FORM 4 BE AMENDED TO REPLACE FORM 144 BY PROVIDING SPACE FOR DISCLOSURE OF RESALES MADE PURSUANT TO RULE 144.

The Commission has proposed to limit the application of the requirement to file a notice of sale under Rule 144 solely to affiliates and to increase the thresholds for filing the notice. Further, it has proposed to expand the scope of the notice to require information regarding the seller's hedging activities and lack of awareness of material adverse information regarding the issuer at the time of adopting a trading plan or giving trading instructions pursuant to Rule 10b5-1[96] under the Exchange Act. Finally, the Commission has requested comment on the best approach to coordinating the requirement to file a Rule 144 notice with the requirement to file a Form 4 report under Section 16(a)[97] of the Exchange Act.

We welcome the Commission's proposals to reduce the burdens of the notice requirement. Before addressing these proposals, however, we wish to make clear our view that the notice requirement does not appear to serve a useful function and therefore should be eliminated.

A. ELIMINATION OF NOTICE REQUIREMENT

We believe there are a number of reasons why the notice requirement should be eliminated:

1. *Primary Purpose Has Been Served.*

We understand that the notice requirement was included in the original version of the rule adopted in 1972 primarily to provide information that would help assess the rule's effectiveness. As the first safe harbor rule adopted by the Commission, Rule 144 was considered an experiment whose usage should be monitored to help determine its utility in dealing with issues involving restricted and control securities. The notice requirement has long since served this purpose, as the rule universally is recognized as a resounding success that prompted the adoption of numerous other safe harbor rules, some of which (such as Rule 147 under the Securities Act) have never had a notice requirement.

2. *Unnecessary for Compliance Purposes.*

Some persons have argued that the notice requirement serves a "gatekeeping" function, in the sense that it reminds sellers and brokers contemplating a transaction pursuant to Rule 144 to pay special attention to the applicable conditions of the rule. While a reminder of this sort may have been appropriate and useful during the early years of the rule, it is not needed today. Brokers concerned with compliance have developed well-established procedures that, by all accounts, have produced an extremely high level of compliance with the requirements of the

[96] Trading "on the basis of" material nonpublic information in insider trading cases, 17 C.F.R. §240.10b5-1 (2007).

[97] 15 U.S.C. §78p(a) (2004).

rule. Moreover, affiliates are highly motivated to comply with the requirements of Rule 144 because of the safe harbor protection provided by it. As a result of the extensive resources available for surveillance of market trading by the Commission, by exchanges and by the investing public, the Form 144 no longer is (if it ever was) an important component of the regulatory scheme. Accordingly, retention of the notice requirement solely on the ground it is an aid to compliance no longer can be justified.

3. *Information of Doubtful Utility.*

We believe the information provided in Form 144 notices generally is of limited or no use to investors in making investment decisions, and we are not aware of any studies or data to the contrary. It is generally understood that sales of restricted or control securities may be made for many reasons having nothing to do with the seller's view of the issuer's prospects. Moreover, the information in Form 144 filings is not entirely reliable as a barometer of sales activity because only proposed sales rather than actual sales are shown. Proposed sales may or may not happen, and if they do, may be lower in amount than the number reported.

4. *Duplicative*

The notice requirement is duplicative to a significant extent because many of the transactions subject to the notice requirement are reported after their completion on Form 4 or Schedule 13D.[98] Therefore, we see no need to retain the notice requirement in any form, and recommend that it be deleted as a condition of the rule.

B. SUMMARY OF VIEWS ON NOTICE PROPOSALS

If the Commission believes it would be appropriate to retain the notice requirement, we recommend that it adopt the five-fold approach to amending the requirement, which is described below:

- Limit the application of the notice requirement to persons required to file reports on Form 4;
- Unless it is combined with Form 4, increase the filing thresholds to trades of 10,000 shares or units, or $100,000.
- Eliminate Form 144 and designate Form 4 as its replacement;

[98] Information to be included in statements filed pursuant to §240.13d-1(a) and amendments thereto filed pursuant to §240.13d-2(a), 17 C.F.R. §240.13d-101 (2007).

- Modify Form 4 to:

(1) Include a box on the front side of the form that would be checked when the form is being used to report a sale pursuant to Rule 144;

(2) Add to both tables of the form a column at the far right headed "Rule 144 Sales," with two sub-columns labeled "Non-Restricted Securities" and "Restricted Securities Acquisition Date," respectively. The first sub-column would be checked if non-restricted securities are being sold by an affiliate, and the second would be checked if restricted securities are being sold by an affiliate and indicate the date of acquisition of those restricted securities sold pursuant to the rule. If necessary, the second sub-column would be supplemented by a footnote containing additional information regarding the date of payment (if different from the date of acquisition) and the nature, date and circumstances of any transaction that caused the holding period for the sold securities to be tolled under the rule;

(3) Include a legend next to the signature line stating that signature on the form constitutes a representation, with respect to any Rule 144 sale being reported, that the seller was not aware of any material adverse information regarding the issuer at the time of making the sale or (if applicable) the time of adopting a trading plan or giving trading instructions pursuant to Rule 10b5-1 that resulted in the reported sale; and

(4) Add a general instruction to Form 4 explaining the manner of reporting a Rule 144 sale, including the need to check the Rule 144 box previously mentioned, and to identify in the appropriate columns of the applicable table (i) the type of security sold, (ii) the transaction date, (iii) the amount sold, (iv) the per share selling price, (v) whether the sale involves non-restricted securities, and (vi) the date of acquisition of restricted securities sold (supplemented, if necessary, by a footnote as described above).

- Eliminate the penalty for not filing the notice of proposed sale on a timely basis.

C. PERSONS REQUIRED TO FILE THE NOTICE

We concur generally with the concept that if the filing obligation were retained, an obligation to file the notice of sale pursuant to Rule 144 should be limited solely to persons who may be deemed affiliates. We believe there is little or no interest by investors or the Commission in Rule 144 sales by non-affiliates, and are not aware of any information to the contrary. Therefore, relieving non-affiliates of the obligation to file reports would eliminate an unnecessary filing and recordkeeping burden on them.

One problem with applying the reporting obligation solely to affiliates is the difficulty of determining who is an affiliate. The determination of affiliate status is based on individual facts

and circumstances, and there is no "one size fits all" objective standard that can be used to designate affiliates, as indicated in our comment letter on the Rule 144 proposals published in 1997. On the other hand, there is a need for an objective filing standard to provide certainty as to the persons required to file. In these circumstances, we recommend an approach that would not require a determination of affiliate status, but nonetheless would encompass the large majority of persons who might be affiliates. If the Commission were to retain a filing requirement, we suggest that the Commission apply the filing requirement to all persons required to file reports under Section 16(a) where the thresholds for reporting a Rule 144 sale are met.

The effect of the filing standard we are proposing would be to require only Section 16 reporting persons to file reports of Rule 144 sales, with the result that other persons exceeding the filing thresholds would not have to file such reports. It is essential, however, that the Commission clarify that the "Section 16 reporting standard" is simply the benchmark for filing information about resales pursuant to Rule 144, and is not a determination as to affiliate status for any purpose under federal securities laws.

We recognize that the foregoing approach is not perfect in the sense that some putative affiliates may escape the filing requirement, while some non-affiliates may be required to file. However, this approach would provide certainty while restricting the reporting obligation to the persons most likely to be affiliates. Moreover, it would not impose an undue burden on these persons, because they already would be required to file reports on Form 4 disclosing their sales and other transactions involving the issuer's securities and, therefore, would be familiar with the electronic reporting system and its application to sales.

D. Increase in Filing Thresholds

We agree that the current thresholds for filing a notice of sale should be increased, but believe the proposed new thresholds are too low. The existing thresholds (500 shares or other units, or $10,000 in total value) have been in place since 1972 when the rule was adopted and have long been outdated. To the extent the investing public might have any interest in knowing about sales pursuant to Rule 144 (which we have reason to doubt), we think investors' interest would be limited to transactions of significant size. Accordingly, we recommend that the thresholds be increased to 10,000 shares or units, or $100,000.

E. Replacement of Form 144 With Form 4

We believe there are a number of reasons why it would be advantageous to replace Form 144 with Form 4:

1. *Form 144 Deficiencies*

As previously indicated, we believe much of the information required by Form 144 is of dubious value. In large measure, the information relates to compliance with the various requirements of the rule and is not useful to investors. For example, the name of the broker, the

identity of the securities exchange, and the nature of the transaction in which the securities were acquired, seem to be little more than technical details in which neither the Commission nor investors appear to have much interest. Compliance is not an issue under Rule 144, as noted previously. This is a direct result of the interest of the brokerage community in assuring the availability of the safe harbor for the Section 4(3) or Section 4(4) exemption for Rule 144 sales in which they are involved, the desire of affiliates to comply with the requirements of the rule because of the protection afforded by it, and the potential criminal liability that can attach to sellers if they make false representations relating to their sales. Indeed, we are not aware of a single instance in which the Commission has commenced an enforcement action directed at non-compliance with the notice requirement. Under the circumstances, we think that much of the information required in Form 144 can be omitted in reports of Rule 144 sales. In our view, the essential information is the date of sale, the number of units sold and the sale price (all of which presently are required by Form 4), and information relevant to the date of acquisition of restricted securities (which could easily be added to Form 4).

2. *Greater Reliability of Form 4 Information*

As mentioned previously, Form 144 provides inaccurate information on some occasions because it is a notice of proposed sales (which may not occur as indicated) rather than actual sales. Form 4, on the other hand, reports only actual sales and therefore provides information that should be completely accurate.

3. *Superior Accessibility of Form 4*

Form 4 is filed electronically and is immediately available to the public, in contrast to Form 144, which is mailed and often not placed in the public record by the Commission until a considerable period of time has elapsed after the event triggering the filing of the form.

4. *Reduction in Filing Burdens*

Replacing Form 144 with Form 4 would reduce filing burdens because reporting persons who are required to file Form 4 reports would not have to file a second report for the same transaction, as is currently the case.

F. ELIMINATION OF PENALTY FOR FAILURE TO FILE BY THE DEADLINE

One of the longstanding difficulties with the notice requirement of Rule 144 is that it requires, as a condition to reliance on the rule, that the notice be filed in a timely manner (*i.e.,* "transmitted for filing concurrently with either the placing with a broker of an order to execute a sale of securities in reliance upon [the] rule or the execution directly with a market maker of such a sale"). The experience of our members indicates that it is not uncommon for this deadline to be breached, through mistake or oversight.

We believe the penalty for such an error (*i.e.,* loss of the ability to rely on the safe harbor provided by the rule) is too severe. The notice requirement is a technical detail that has nothing to do with the substance of the transaction. In other similar situations, such as Rule 508[99] of Regulation D under the Securities Act, the Commission has indicated that a failure to comply with a term, condition or requirement of a safe harbor that was not directly intended to protect the individual or entity will not result in loss of the exemption where the error was insignificant, other material terms of the safe harbor were complied with, and a good faith attempt to comply with all requirements was made. We think the same approach should apply where a report of the Rule 144 sale was not made on a timely basis on Form 4, despite a good faith effort to file on time and the presence of the other circumstances mentioned above.

IX. THE COMMISSION SHOULD DELETE THE PRESUMPTIVE UNDERWRITER DOCTRINE OF RULE 145 UNDER THE SECURITIES ACT.

We generally support the Commission's proposed amendment to Rule 145. Rule 145(c) (deeming affiliates of parties to Rule 145(a) transactions to be underwriters) and Rule 145(d) (providing safe-harbor exemptions for such parties based on conditions borrowed from Rule 144) are relics of the Securities Act treatment of extraordinary transactions under the no-sale theory repudiated by the Commission when it replaced Rule 133 with Rule 145. As the Commission noted in 1997, when it called for the entire rescission of paragraphs (c) and (d), these provisions are premised on the presumptive underwriter doctrine, which has been discredited and is not applied in other contexts under the Securities Act.

The Commission has proposed to retain Rule 145(c) for the affiliates of shell companies. We appreciate the concerns that have been expressed over the years about shell companies and note that in other areas the Commission has adopted specific rules addressing these entities. In our view, however, if the presumptive underwriter doctrine is wrong, it is wrong in all cases, uniformly and without exception. The justification offered in the Proposing Release—a reference to "abusive resales" without specification of the abuse—seems to be inadequate in our view.

X. THE HOLDING PERIODS FOR RESALES OF RESTRICTED SECURITIES SHOULD BE IDENTICAL, IRRESPECTIVE OF THE WHETHER THE RESALES INVOLVE EMPLOYEE BENEFIT PLAN SECURITIES PURSUANT TO RULE 701(g)(3) UNDER THE SECURITIES ACT OR EQUITY SECURITIES OF REPORTING ISSUERS ACQUIRED PURSUANT TO REGULATION S UNDER THE SECURITIES ACT.

A. RULE 701(g)(3) UNDER THE SECURITIES ACT

We concur with the Commission's proposal to conform the resale provisions of Rule 701(g)(3) to the proposed revisions to Rule 144. Holders of restricted securities issued pursuant

[99] Insignificant deviations from a term, condition or requirement of Regulation D, 17 C.F.R. §230.508 (2007).

to employee benefit plans should not be subject to greater holding periods than those applicable to other private equity investors in the issuer.

B. CATEGORY 3 OF REGULATION S

Resale conditions applicable to equity securities sold in reliance on Category 3 of Regulation S should be conformed to the changes applicable to other types of restricted securities. We are not aware of any regulatory reason or policy that would justify stricter conditions for resales of Category 3 securities. The statutory objectives are fully served through the satisfaction of the same resale conditions applicable to shares sold privately in the United States.

We appreciate the opportunity to provide these comments. Members of the Committee are available to discuss them should the Commission or the Staff so desire.

Respectfully submitted,

/s/ Keith F. Higgins

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