

Tips for Using the Rule 144 Safe Harbor Exemption

If you are going to purchase or receive restricted stock, be aware of the following issues to ensure you can remove the restrictive legend when you want to sell your shares.

- Check whether the company is a former shell company.
 - If the company issuing your restricted stock is a former shell company, there are additional requirements in order to qualify to use Rule 144 to lift the legend.

Former shell companies need to:

1. Cease to be a shell company;
2. Be “subject to” the Securities Exchange Act of 1934 by filing either a Form 10 or Form 8A, meaning being required to file reports with the SEC;
3. Be current in their filings, meaning all Quarterly Reports on Form 10-Q and Annual Reports on Form 10-K have been filed;
4. Have filed current “Form 10 information,” (Form 10, Super 8-K, or similar) which includes financial statements of the acquired operating company; and
5. Wait one year since filing the Form 10 information described above.

- Determine whether you are an affiliate.
 - An affiliate is an officer, director, or 10% or more shareholder of the issuing company. Make sure to check the company’s outstanding shares to see whether you will be an affiliate by owning 10% or more of the company’s outstanding shares.

Remember that you are still an affiliate for 90 days after you cease to be an officer, director, or 10% shareholder.

If you are an affiliate, there are four additional requirements in order to qualify to use Rule 144 to lift the legend.

Affiliates need to ensure:

1. There is current public information on the company;
2. They do not exceed volume limitations – the greater of 1% of the shares outstanding (for Bulletin Board companies) or the average weekly trading volume for the four prior calendar weeks;
3. Manner of sale requirements for equity securities – brokers’ transaction, transaction directly with market maker or riskless principal transaction; and
4. Filing of Form 144 if intended sales exceed 5,000 shares or \$50,000.

- The minimum holding period for restricted securities is six months, but can be one year if the company is non-reporting.
 - If you do not meet the holding period, there is a possibility that you can tack your holding period to the previous owner’s holding period. If you want to tack your

holding period, make sure the previous owner was not an affiliate when you purchase the shares.

- If you have convertible securities, such as debt or preferred stock, it may also be possible to tack your holding period if no additional consideration was given for the conversion. The most common example of this is when you hold a convertible note for longer than six months and convert into restricted shares, you will be able to tack your holding period for the shares to when you acquired the convertible note.

Remember, the holding period starts running when consideration has been fully paid for the securities, whether that consideration is cash, services, or otherwise.



- Be aware that if you have stock options, the holding period starts running when the options are exercised, not when they are granted unless you exercise the options on a cashless basis.
- Restricted shares may be issued as compensation, especially when a company is just starting out and does not have enough cash to pay for your services. If you are consulting or providing other services for the company, instead of asking for a lump sum of shares at the end of each year, structure the agreement so that you receive shares on a rolling basis. Every month, as long as you complete your services for that month, you receive a portion of the total shares you are entitled to. This way you are able to free up some of your shares earlier than if you received all the shares at the end of a year.

Using Rule 144 to remove the legend from restricted securities can be confusing and complex because many of the rules do not address the myriad of situations that can arise. The best strategy is to consult with a lawyer before purchasing or receiving restricted shares to confirm that you will be able to sell the securities when you want to and, if you are dealing with penny stock, to have a trusted broker to deposit the shares with as many brokerage firms are hesitant to accept new clients depositing restricted penny stock.

Although I have not gone into all of the details of utilizing Rule 144, the above are the most common issues I see from clients on a day-to-day basis and issues that you should be aware of at the outset when purchasing or receiving restricted securities.

For those of you who are unfamiliar with the process, the easiest way to remove a restrictive legend is:

1. Meet all Rule 144 requirements;
2. Deposit the shares with a broker;
3. Contact an attorney to obtain a legal opinion as only attorneys are allowed to issue legal opinions under Rule 144;
4. Once the legal opinion is complete, have your broker send your original certificate and other necessary paperwork to the transfer agent; and
5. Have the new certificate without a restrictive legend deposited with your broker so your shares can be sold on the public market.

If you have any questions about the process, or need a restrictive legend removed from securities you currently own, please don't hesitate to contact me.



Ashley Bolduc is an attorney with FitzGerald Yap Kreditor LLP in Irvine, California, specializing in corporate and securities law. She handles Rule 144 legal opinions for the firm's www.144opinions.com division, along with other transactional matters such as entity selection and formation matters for businesses just getting started; contract negotiations, review, and drafting; mergers and acquisitions; private offerings; public offerings; and public company reporting with the Securities and Exchange Commission. You can reach Ashley at abolduc@fyklaw.com or at 949.788.8900.