M&A Implications of New Changes to Rules 144 and 145 -- SEC Delivers an Early Holiday Gift to M&A Deal Makers

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Amendments to Rules 144 and 145 recently approved by the SEC should make the "private placement" alternative in M&A transactions more attractive to privately held target companies and their stockholders in stock-for-stock transactions with public company acquirers. Among other things, the amendments shorten the holding period under Rule 144 to six months and remove the more burdensome restrictions on target company "affiliates" under Rules 144 and 145. These changes will offer target company stockholders the potential for earlier liquidity in deals structured as private placements and, as a result, give acquirers and targets greater structuring flexibility, with the potential for earlier--and more certain--closing.

When an acquirer issues stock to target company stockholders in a merger, the issuance either must be registered (typically with an S-4 registration statement) or made under an exemption from the registration requirements of the Securities Act of 1933. Currently, stock issued in a private placement under the safe harbor of Regulation D or otherwise will be restricted stock and may only be resold in the market after being held for one year pursuant to Rule 144. Stock registered on Form S-4 may be resold immediately, offering target stockholders significantly earlier liquidity. Resale registration rights can shrink or even eliminate the "liquidity gap" (especially if the acquirer is a well-known seasoned issuer, or "WKSI"), but resale registration undertakings often impose disclosure burdens on acquirers and are subject to "blackout" periods and other limitations that limit sellers' liquidity. By reducing the holding period for restricted stock from one year to six months and eliminating some of the restrictions that had previously applied to target stockholders who were "affiliates" of the target but not of the acquirer, the new amendments to Rules 144 and 145 will significantly shrink this "liquidity gap" and narrow the difference in timelines between signing of the definitive acquisition agreement and first liquidity, (i.e., the time when target stockholders are able to begin selling the shares they receive in the transaction).

A typical timeline from signing to closing in a stock-for-stock or mixed cash-stock acquisition involving an S-4 registration statement is 90 to 120 days or more. In contrast, a private placement may allow a simultaneous sign-and-close (at least where there are no post-signing/pre-closing regulatory approvals or waiting periods or third-party consents). As a result, the new six-month holding period under Rule 144 may reduce the effective liquidity advantage of an S-4 to between 60 and 90 days--or about one calendar quarter. This compares to an expected "liquidity gap" of about nine months (or more) under the current holding period under Rule 144. As a practical matter, target companies and selling stockholders are likely to have more visibility into the near-term business and market outlook than the longer-term outlook, and are more likely to accept a one-quarter delay in liquidity than a three-quarter delay.

Faster and more certain closing may be attractive to buyers and targets for additional reasons. In a registered deal, the transaction cannot close (and generally stockholders cannot even vote) until after the S-4 is declared effective by the SEC. In times of heightened business uncertainty (including potential interlopers), as well as market uncertainty and volatility, the ability to close quickly can reduce the risks resulting from stock price, business and macroeconomic volatility and can mean the difference between a completed deal and a broken deal, a deal at a different price or no deal at all.

In addition to shortening the holding period under Rule 144, the SEC also approved changes to Rule 145. The exact details of the changes will not be known with certainty until the amendments are published in the Federal Register, but they appear to loosen or eliminate some of the restrictions that have, until now, applied to stockholders who are "affiliates" of the target company (but not of the acquirer). Specifically, "target-only" affiliates will no longer be subject to volume and manner-of-sale restrictions.

The new amendments to Rule 144 and Rule 145 will be effective 60 days after they are published in the Federal Register. Some limitations are worth noting. The shorter holding period will not apply to stock issued by acquirers that are "shell" companies (or "blank check" companies) or voluntary filers, or acquirers that are not current in their reporting obligations at the relevant time. In addition, the private placement structure will not be available in every private company acquisition. Target companies with a large number of "non-accredited" stockholders will not qualify. Careful analysis is required to determine if a transaction can be structured as a valid private placement, and whether risks exist (e.g., a large overhang of exercisable stock options) that may jeopardize a transaction's status as a valid private placement. But where a private placement is possible, the new amendments to Rule 144 may make it advantageous to all parties to consider private placement structures for M&A transactions.

Authors

Hal J. Leibowitz

PARTNER

Co-Chair, Mergers and Acquisitions Practice

hal.leibowitz@wilmerhale.com

+1 617 526 6461