

Navigating Stock Restrictions: Rule 144/145 and 10b5-1 Plans

Company stock often represents a significant portion of the wealth owned by corporate executives and their families, creating the need for a sound diversification strategy. Corporate insiders or affiliates, however, face multiple restrictions on the sale of their stock. William Blair works with owners of restricted stock and corporate insiders to help them navigate these barriers and implement a diversification strategy that is aligned with their wealth management goals.

What Are Restricted and Control Securities?

Restricted securities are securities acquired in unregistered, private sales from the issuing company or from an affiliate of the issuer. Investors typically receive restricted securities through private placement offerings, Regulation D offerings, employee stock benefit plans, as compensation for professional services, or in exchange for providing “seed money” or start-up capital to the company. Rule 144(a)(3) identifies what sales produce restricted securities.

Control securities are those held by an affiliate of the issuing company. An affiliate is a person, such as an executive officer, a director or large shareholder, in a relationship of control with the issuer. Control means the power to direct the management and policies of the company in question, whether through the ownership of voting securities, by contract, or otherwise. If you buy securities from a controlling person or “affiliate,” you take restricted securities, even if they were not restricted in the affiliate’s hands.

If you acquire restricted securities, you almost always will receive a certificate stamped with a “restrictive” legend. The legend indicates that the securities may not be resold in the marketplace unless they are registered with the SEC or are exempt from the registration requirements. Certificates for control securities usually are not stamped with a legend.

What Are the Conditions of Rule 144?

If you want to sell your restricted or control securities to the public, you can meet the applicable conditions set forth in Rule 144. The rule is not the exclusive means for selling restricted or control securities, but provides a “safe harbor” exemption to sellers. The rule’s five conditions are summarized below:

Additional securities purchased from the issuer do not affect the holding period of previously purchased securities of the same class. If you purchased restricted securities from another non-affiliate, you can tack on that non-affiliate’s holding period to your holding period. For gifts made by an affiliate, the holding period begins when the affiliate acquired the securities and not on the date of the gift. In the case of a stock option, including employee stock options, the holding period begins on the date the option is exercised and not the date it is granted.

Holding Period

Before you may sell any restricted securities in the marketplace, you must hold them for a certain period of time. If the company that issued the securities is a “reporting company” in that it is subject to the reporting requirements of the Securities Exchange Act of 1934, then

Restricted and control securities

Owners of restricted securities or control securities cannot sell the securities to the public unless the conditions set forth in SEC Rule 144 (and in some cases Rule 145) have been met.

Restricted securities are securities that were issued through a private placement and are not registered with the SEC. Corporate executives often receive restricted securities through the exercise of stock options, as bonus compensation, or as the result of a corporate merger.

Control securities are securities that are owned by “corporate affiliates,” such as officers, board members, executives, large shareholders, or other people with the ability to influence the company. Spouses and family members who live at home are also considered to be corporate affiliates.

you must hold the securities for at least six months. If the issuer of the securities is not subject to the reporting requirements, then you must hold the securities for at least one year. The relevant holding period begins when the securities were bought and fully paid for. The holding period only applies to restricted securities. Because securities acquired in the public market are not restricted, there is no holding period for an affiliate who purchases securities of the issuer in the marketplace. But the resale of an affiliate's shares as control securities is subject to the other conditions of the rule.

Current Public Information

There must be adequate current information about the issuing company publicly available before the sale can be made. For reporting companies, this generally means that the companies have complied with the periodic reporting requirements of the Securities Exchange Act of 1934. For non-reporting companies, this means that certain company information, including information regarding the nature of its business, the identity of its officers and directors, and its financial statements, is publicly available.

Trading Volume Formula

If you are an affiliate, the number of equity securities you may sell during any three-month period cannot exceed the greater of 1% of the outstanding shares of the same class being sold, or if the class is listed on a stock exchange, the greater of 1% or the average reported weekly trading volume during the four weeks preceding the filing of a notice of sale on Form 144. Over-the-counter stocks, including those quoted on the [OTC Bulletin Board](#) and the [Pink Sheets](#), can only be sold using the 1% measurement.

Ordinary Brokerage Transactions

If you are an affiliate, the sales must be handled in all respects as routine trading transactions, and brokers may not receive more than a normal commission. Neither the seller nor the broker can solicit orders to buy the securities.

Filing a Notice of Proposed Sales with the SEC

If you are an affiliate, you must file a notice with the SEC on Form 144 if the sale involves more than 5,000 shares or the aggregate dollar amount is greater than \$50,000 in any three-month period.

If I am Not an Affiliate of the Issuer, What Conditions of Rule 144 Must I Comply With?

If you are not (and have not been for at least three months) an affiliate of the company issuing the securities and have held the restricted securities for at least one year, you can sell the securities without regard to the conditions in Rule 144 discussed above. If the issuer of the securities is subject to the Exchange Act reporting requirements and you have held the securities for at least six months but less than one year, you may sell the securities as long as you satisfy the current public information condition.

Can the Securities Be Sold Publicly if the Conditions of Rule 144 Have Been Met?

Even if you have met the conditions of Rule 144, you can't sell your restricted securities to the public until you've gotten the legend removed from the certificate. Only a transfer agent can remove a restrictive legend. But the transfer agent won't remove the legend unless you've obtained the consent of the issuer—usually in the form of an opinion letter from the issuer's counsel—that the restrictive legend can be removed. Unless this happens, the transfer agent doesn't have the authority to remove the legend and permit execution of the trade in the marketplace.

To begin the legend removal process, an investor should contact the company that issued the securities, or the transfer agent for the securities, to ask about the procedures for removing a legend. Removing the legend can be a complicated process requiring you to work with an attorney who specializes in securities law.

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