

PUBLICATION UPDATE

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Federal Securities Act of 1933

And Related Publications Federal Securities Exchange Act of 1934 Securities Primary Law Sourcebook

Publication 627 Release 148

February 2024

HIGHLIGHTS

Federal Securities Act of 1933

- Chapter 6, Restricted and Control Securities under the Federal Securities Laws

Federal Securities Exchange Act of 1934

- Chapter 5, Civil Liabilities Under the Exchange Act
- Chapter 7, Proxy Regulation

Securities Primary Law Sourcebook

- Volumes A, B, D, and E have been revised and updated.

Federal Securities Act of 1933.

Chapter 6, Restricted and Control Securities under the Federal Securities. In this release, this chapter has been updated to include the most recent case law and legislative developments.

Federal Securities Exchange Act of 1934.

Chapter 5, Civil Liabilities Under the Exchange Act. This updated chapter has been amended to reflect recent developments in Supreme Court jurisprudence relevant to the Exchange Act, with most attention devoted to *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pens. Fund* and *Lorenzo v. Sec. & Exch. Comm'n*, as well as the appli-

cation of these cases by lower courts. This chapter also contains revisions discussing other notable Supreme Court cases, principally (i) *Goldman Sachs Grp., Inc. v. Arkansas Tchr. Ret. Sys.*, (ii) *Salman v. United States*, (iii) *China Agritech, Inc. v. Resh*, (iv) *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Manning*, and (v) *Cyan, Inc. v. Beaver Cnty. Emps. Ret. Fund*. Additionally, this chapter has been revised to reflect significant developments in appellate case law on topics including (i) the application of *Janus Cap. Grp., Inc. v. First Derivative Traders*, (ii) SLUSA's pre-emption of state-court class actions, (iii) the application of *Morrison v. Nat'l Australia Bank Ltd.*, (iv) the fraud-on-the-market theory of liability under the Exchange Act, (v) a company's duty to disclose information, and (vi) facts which give rise to a strong inference of scienter.

Chapter 7, Proxy Regulation.

The chapter updates reflect more "subtraction" than "addition." That is, the United States Securities and Exchange Commission's most public

changes this year to the field of proxy regulation were to repeal several rules passed in the previous administration regarding proxy voting advice. Further, this was the first year after the adoption of the Universal Proxy Card and many registrants were working through the new process. We also discuss the SEC's new proposed rules regarding excluding shareholder proxy submissions. Additionally, we discuss a new SEC-investment adviser settled enforcement action that had an effect on proxy voting and its effect on small advisers. Finally, we have also added new citations to reflect more recent decisions rendered over the last year in this field.

Securities Primary Law Sourcebook. Securities Primary Law Sourcebook. Statutes in Volumes A, B, and E are current through Current as of Pub. Law 118-19, October 6, 2023. Federal Regulations in Volumes A, B, D, and E are current through the Federal Register of November 7, 2023.

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CHAPTER 6

Restricted and Control Securities under the Federal Securities Laws

*Arthur F. McMahon, III, and Bryar W. Brandvold**

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SUMMARY OF THIS CHAPTER

The restricted or control status of a security matters immensely because Section 4(a)(1) of the Securities Act, the most common mechanism for secondary sales of securities under the federal securities laws, is not available for them. The reason for this is that Section 4(a)(1) is not available for sale of securities held by, *inter alia*, issuers, persons deemed by

the law to be functionally equal to the issuer (control securities) and persons acting on behalf of the issuer (restricted securities) whom the law calls “underwriters”.

While the law makes many of the same sales mechanisms that issuers use available to secondary sellers, including registration and many of the so-called private placement exemptions from registration, the most common vehicle secondary sellers use to sell restricted and control securities of a class registered under Section 12 of the Exchange Act, is Rule 144. Rule 144 provides two safe harbors for such sellers. For seller of control securities, Rule 144 provides a time and volume based mechanism that allows control persons to “dribble” their securities into the market in small amounts over time. For sellers of restricted securities, Rule 144 provides that they will no longer be deemed an underwriter (and therefore may sell pursuant to Section 4(a)(1)) if they hold their securities for minimum time period and certain other conditions are satisfied.

More specifically, the term “restricted securities” is defined in Rule 144(a)(3) to include all securities acquired from the issuer or an affiliate of the issuer in a transaction or series of transactions not involving any public offering. All securities acquired from the issuer in a private offering are restricted. Securities acquired from affiliates of the issuer or from unaffiliated third parties may be restricted or not depending on the nature of the transaction and their status in the hands of the prior holder.

While not “restricted,” “control securities” are also subject to certain limitations, including the non-availability of the Section 4(a)(1) resale exemption. Securities obtained from a person other than an issuer or affiliate can become subject to limitations if sold to a person to whom restrictions apply (e.g. an officer or director). *See* § 6.04 *infra*.

Rule 144 provides that resales of restricted and control securities by the issuer and affiliates of the issuer will not be deemed a “distribution” if certain specified conditions are met. While Rule 144 is not the exclusive lawful method of effecting sales of restricted and control securities, for some transactions (such as the public resale of control securities) other methods may not be available. Those relying on the resale exemption under Section 4(a)(1) for public resales in the absence of compliance with Rule 144 must meet a substantial burden of proof to sustain that exemption. Rule 144 is also available for resales of those few categories of unrestricted securities that are not freely tradeable by non-affiliates. Rule 144 imposes different conditions on resales depending whether the seller is an affiliate or non-affiliate of the issuer.

Rule 144(c) requires that there be adequate current information available about the issuer. This requirement is satisfied if the issuer is subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act for at least 90 days prior to the time of the proposed sale and has filed all reports required to be filed during the preceding 12 months. If the issuer is a non-reporting issuer, it may meet the adequate current information requirement by voluntarily filing reports or by making publicly available the information specified in clauses (1) through (14) and (16) of Rule 15c2-11(a)(4) under the Exchange Act.

Rule 144(d) imposes a six-month holding period for restricted securities when the issuer is a reporting company under the Exchange Act and one year holding period when the issuer is not a reporting company under the Exchange Act and does not make public information specified under Rule 15c2-11(a)(4) under the Exchange Act. This time period generally commences on the day the securities are acquired from the issuer or an affiliate of the issuer. Where restricted securities are purchased, the holding period will not

commence until the purchaser becomes the beneficial owner and the entire purchase price is paid. In transactions not involving a purchase, the time when economic risk commences must be determined from the nature of the transaction. In general, holders of restricted securities may “tack” the period for which they held the securities to the period for which the securities were held by a previous holder unaffiliated to the issuer. Under certain circumstances, securities may even be deemed to have been acquired by a non-affiliate as of a date when the securities were actually held by an affiliate. In addition, under certain circumstances, the holder of restricted securities may tack on to the applicable holding period the period during which securities that were economically equivalent to the restricted securities proposed to be sold were held.

Rule 144(e) imposes volume limitations for sales by affiliates. The amount of securities to be sold pursuant to Rule 144 together with the amount of the securities already sold during the three month period preceding the date of the proposed sale must be limited to the greater of one percent of the outstanding securities of the class being sold or the average weekly trading volume for the class during the four week period preceding the date of the proposed sale.

Rule 144(f) requires that sales of securities by affiliates under Rule 144 be made either in brokers’ transactions, in transactions directly with a market maker, or in certain riskless principal transactions. Except in the case of riskless principal transactions, the seller is precluded from soliciting or arranging for the solicitation of orders to buy the securities proposed to be sold and from making any payments respecting the proposed sale to anyone other than the broker executing the order to sell the securities. *See* § 6.05[6] *infra*. Under Rule 144(h), prior to any sale of restricted or control securities under Rule 144 above a specified threshold, a notice on Form 144 must be filed in connection with sales by affiliates with the Commission and with the principal exchange on which the securities proposed to be sold are admitted to trading.

If the seller is unfamiliar with the rule’s requirements and does not have counsel, an experienced broker can assist in compliance with the rule. Although compliance with Rule 144 is the seller’s primary responsibility, it is also the issuer’s responsibility to guard against unauthorized sales of restricted securities by obtaining investment representations from the purchaser, placing legends on the stock certificates, and placing stop transfer instructions with its transfer agent. *See* § 6.05[9] *infra*.

In theory, public sales of restricted securities may take place outside Rule 144 in reliance on the resale exemption under Section 4(a)(1) and exemptions under Sections 3(a)(10) and 3(a)(11), and Regulation A. The Commission has warned that those selling outside Rule 144 in reliance on the resale exemption will have a heavy burden of proving the availability of the exemption. As a practical matter, Rule 144A is most commonly used in capital raising transactions by issuers, in which an investment bank acts as underwriter uses Rule 144A to place securities with large institutional investors. Accordingly, while Rule 144A is technically a resale safe harbor, as a business matter Rule 144A is more commonly associated with transactions that are ultimately for the issuer’s account, not true secondary sales. Because Rule 144A is not available for securities that are fungible with listed securities, Rule 144A is not useful for holder of restricted or control securities of a class that is public.

Rule 144A provides an exemption from registration for resales of restricted securities made in accordance with its conditions. Any holder of restricted securities other than the issuer may resell securities to a “qualified institutional buyer” as defined in Rule 144A.

Such a resale will be deemed not part of a distribution and the seller, whether an ordinary investor or dealer, will be deemed not an underwriter. *See* § 6.07 *infra*.

Outside Rule 144A, restricted and control securities may be resold privately in transactions not amounting to “distributions” and thus entitled to the resale exemption. An exemption for private resales is more readily available when the prospective purchasers are a limited number of sophisticated investors who have access to information about the issuer. Industry practice has established so-called “Rule 4(1 1/2)” for private resales. A newly-created statutory exemption applies to private resales to accredited investors when certain information is provided and other conditions are met. *See* § 6.08 *infra*.

Restricted and control securities may also be resold outside the United States in reliance on Regulation S. Restricted securities of U.S. issuers resold in this manner remain restricted. *See* § 6.09 *infra*.

§ 6.01 Introduction

The Securities Act of 1933 and the Securities Exchange Act of 1934 generally permit members of the investing public to resell their securities in reasonable amounts in ordinary trading transactions without registering the offering of those securities under the Securities Act. Most such sales rely on the exemption from registration provided by Section 4(a)(1) of the Securities Act.¹ Accordingly, most publicly held outstanding securities are freely tradeable in the marketplace.

Certain resales of outstanding securities, however, may not be made routinely in reliance upon the exemption from registration contained in Section 4(a)(1) (the “resale exemption”).² Most of those resales fall into two categories.³ The first includes all resales of the large number of presently outstanding restricted securities.⁴ The second

¹ *See generally* § 6.02 *infra*.

² The conditions under which Section 4(a)(1) is available are discussed in more detail in § 4.01 *supra*. *See also* § 6.02[2] *infra*. Section 4(a)(1) of the 1933 Act is reprinted in the Securities Primary Law Sourcebook, Volume A, Section B (Matthew Bender).

³ A third, if less common, circumstance under which resales of securities are often constrained occurs when the parties anticipate that securities will not be resold publicly. Often these securities are restricted through buy-back arrangements or with a restriction that they can be sold only to others active in the business. A fourth circumstance occurs when securities can only be held by licensed professionals, and holding by others is prohibited by law, for example doctors in a medical professional corporation. A fifth instance is found where regulatory restrictions place a limitation on the amount of securities which can be held prior to triggering a requirement for regulatory filings, as is sometimes the case with early stage insurance companies and banks. The anomalous case of securities sold in reliance on the exemption from registration for “crowdfunding” under Section 4(a)(6) of the Securities Act, which can only be resold to certain persons from a year, is discussed in § 6.03[4][e][xiv] *infra*.

⁴ An extensive SEC study undertaken in 2012 and updated in 2013 indicated that offerings made in reliance on Regulation D (which would not represent the entirety of the private placement market) were approaching \$1 trillion per year at that time. Capital Raising in the U.S.: An Analysis of Unregistered Offerings Using the Regulation D Exemption 2009–12, Vladimir Ivanov and Scott Baugess, Division of Economic and Risk Analysis, U.S. Securities and Exchange Commission, July 2013. This study has been updated several times (and expanded to cover other types of offerings exempt from SEC registration), reflecting a total market size of more than \$3 trillion in 2017. Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009–2017, Scott Baugess, Rachita Gullapalli and

category includes all resales of any outstanding securities, restricted or unrestricted, by a person who is in a control relationship with the issuer of those securities.⁵

In the case of restricted securities, the limitations on resale derive generally from the manner in which the securities were acquired. In the case of securities held by a person in a control relationship with the issuer, known as “control securities,” the limitations on resale result only from the relationship between the existing security holder and the issuer and exist only as long as the securities are held by that controlling security holder.⁶ Certain securities are subject to restrictions on resale on both counts because they are restricted securities held by a controlling person. As a matter of the federal securities laws, the difference, an important one as will be seen, between restricted securities and control securities, on the one hand, and all other outstanding securities, so-called “free-trading securities,” on the other hand, is that restricted securities and control securities are not freely tradable.⁷

With limited exceptions, resales of restricted securities and control securities, at least outside Rule 144, are not routine trading transactions. Accordingly, the Section 4(a)(1) resale exemption is generally unavailable for their public resale.⁸

The general unavailability of the resale exemption for the public resale of restricted securities and control securities, however, does not mean that such securities cannot be lawfully resold under the federal securities laws. Their resale is simply made more difficult because sellers must find another legal basis for selling their securities. The difficulty is substantially mitigated by the broad availability of the Rule 144 safe harbors for certain public resales of securities that were previously not considered freely tradeable under Section 4(a)(1).⁹

Alternatively, such securities may sometimes be sold in reliance on Rule 144A.¹⁰ Where Rule 144 or Rule 144A are not available, it may still be possible to resell restricted or control securities privately (through so-called “Section 4(a)(1/2)” transactions, for example).¹¹

Vladimir Ivanov, Division of Economic and Risk Analysis, U.S. Securities and Exchange Commission, Aug. 1, 2018. While the study now covers several exemptions from registration, not all of which result in the issuance of restricted securities, offerings under Regulation D, where securities are restricted, comprise the overwhelming majority of such offerings. *Id.*, p.8.

⁵ Rule 144(a)(1) labels such a person an “affiliate”; regarding such definition, see § 6.04[2] *infra*. 1933 Act Rule 144 is reprinted in the Securities Primary Law Sourcebook, Volume A, Section C (Matthew Bender).

⁶ *But see* the exception described in § 6.04[5] *infra*.

⁷ *But see* § 6.02[5] *infra* for exceptions to the freely tradable nature of unrestricted securities held by other than a controlling person of the issuer.

⁸ For an extensive analysis of this difference, see § 6.02[2] and [3] *infra*.

⁹ For an extensive analysis of Rule 144, see § 6.05 *infra*.

¹⁰ *See* § 6.07 *infra*.

¹¹ *See* §§ 6.06 and 6.08 *infra*.

§ 6.02 Why It Matters that Securities Are Restricted or Control Securities: Limitations on Disposition

[1] Introduction

In addition to complying with the antifraud provisions of the federal securities laws, every investor proposing to sell any securities of whatever nature in the United States must also either sell them pursuant to an effective registration statement or in reliance on an available exemption from the registration requirements of Section 5 of the Securities Act.¹ While some holders may have registration rights or another way to induce the issuer to make a resale registration statement available for them, many holders do not have registration rights, and using such registration rights may be impractical or unduly expensive in many circumstances.² Accordingly, most members of the investing public desiring to lawfully resell securities must rely on an exemption from the registration requirements of the Securities Act. The exemption customarily relied on for most resales of outstanding securities is that contained in the Section 4(a)(1) resale exemption.³

[2] General Availability of the Resale Exemption

Section 4(a)(1) exempts from the Securities Act's registration and prospectus delivery requirements all "transactions by any person other than an issuer, underwriter, or dealer."⁴ Those terms are defined in Sections 2(a)(4),⁵ 2(a)(11),⁶ and 2(a)(12)⁷ of the Securities Act, respectively. As becomes obvious from reviewing those definitions, the resale exemption is designed to allow ordinary holders of outstanding securities who are not acting for the issuer or for a controlling person of the issuer and who are not involved in the securities industry to sell their securities without concern for the

¹ See Ch. 7 *infra*.

² Frequently, the purchasers of securities from the issuer in a private placement under Section 4(a)(2) of the Act or one of the related rules (see § 4.02 *supra*) will require the issuer to register the privately placed securities upon the request of a specified percentage of the holders within a particular time frame. In other cases, the purchasers of privately placed securities will be satisfied with "piggy-back" registration rights. In the latter case, the holders of the privately placed securities will be able to cause their securities to be registered only if the issuer happens to be preparing a registration statement in connection with an unrelated offering. In light of the difficulty of lawfully selling restricted securities other than through a restricted offering or pursuant to Rule 144 or Rule 144A, see § 6.06 and § 6.08 *infra*, investors should consider registration rights if they do not wish to risk the need to hold restricted securities for the applicable holding period.

³ Section 4(a)(2), which exempts non-public transactions from registration, is available to the issuer only, and not for resale. Section 4(a)(2) is also discussed in § 4.03 *supra*.

⁴ Section 4(a)(1). With respect to resales generally, see R. Campbell, Jr., *Resales of Securities Under the Securities Act of 1933*, 52 Wash. & Lee L. Rev. 1333 (1995).

⁵ Section 2(a)(4), discussed in § 4.02[1] *supra*, defines the term "issuer" as a "person who issues or proposes to issue any security." The definition is straightforward. It clearly means a corporation and includes other persons such as promoters, for example, involved in the issuance of securities. It does not include, however, ordinary investors.

⁶ See the text accompanying n.28 *infra*.

⁷ The Section 2(a)(12) definition of a dealer is discussed in § 4.02[3], and § 4.05 *supra*.

registration provisions of the Securities Act. The ordinary investor, in other words, being neither the issuer of the securities to be sold nor a dealer as that term is defined in the Securities Act,⁸ is permitted to sell securities without concern for the Securities Act's registration requirements, provided that neither the selling investor⁹ nor any other participant in the transaction is an underwriter within the meaning of Section 2(a)(11) of the Securities Act. Section 2(a)(11) provides in pertinent part that an underwriter is:

[A]ny person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has participation in the direct or indirect underwriting of any such undertaking . . . As used in this paragraph the term "issuer" shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.¹⁰

The result of this definition, as discussed more fully below, is that the Section 4(a)(1) resale exemption is available for all private resales of outstanding securities by any person other than the issuer or a dealer, but for only some public resales of some outstanding securities by some holders, including some to routine trading transactions.

Upon close scrutiny of the language of Section 2(a)(11), it becomes clear that only where the transaction itself is a part of a "distribution of any security" may the investor be found to be an underwriter. Since a distribution requires a public offering,¹¹ it is simply not possible for the selling investor, its agent, or any other participant in the sale to be a statutory underwriter where the transaction as a matter of all the relevant factors is itself a private rather than a public offering and does not constitute, together with certain other sales, a public offering.¹² Accordingly, the resale exemption is available for *all* private resales of any outstanding securities by any investor. It is available to the investor even if a broker is used to effect the private sale;¹³ the selling investor is an affiliate of the issuer of the securities;¹⁴ or the securities involved are restricted

⁸ The term "dealer" includes persons who act as agents for investors in buying and selling transactions, as well as persons who buy and sell for their own accounts. In other words, persons who function as brokers in a selling or purchasing transaction fall within the definition of dealer for purposes of Section 4(a)(1) of the Act.

⁹ The term "investor" will be used throughout this chapter to refer to a holder of outstanding securities who is not a dealer within the meaning of Section 2(a)(12).

¹⁰ Section 2(a)(11) is discussed further in § 4.02[2] *supra*.

¹¹ See § 4.02 *supra*.

¹² See § 4.03 *supra* regarding the meaning of the term "public offering."

¹³ *Value Line Fund, Inc. v. Marcus*, 1965 U.S. Dist. LEXIS 9464, [1964–1966 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,523, at ¶ 94,972 (S.D.N.Y. Mar. 31, 1965).

¹⁴ *Id.*

securities.¹⁵ Thus, private resales of restricted securities are always entitled to the resale exemption.¹⁶

A public resale of outstanding securities will often, but not always, involve a “distribution” within the meaning of Section 2(a)(11), which generally means that an underwriter is involved and the transaction cannot rely on the resale exemption. The term “distribution,” though crucial to the issue of whether a selling investor or any broker or other person involved in the transaction is a statutory underwriter rendering the resale exemption unavailable, is not defined in the Securities Act, although various differing definitions have been endorsed for differing circumstances.¹⁷ The courts and the Commission appear to view particular cases in light of the purposes of the resale exemption. There is no question that the resale exemption’s primary purpose is to permit routine trading transactions.¹⁸ It is also clear, however, that the resale exemption was not intended to permit large secondary distributions by affiliates of the issuer or others that would be substantially equivalent to a primary distribution from the perspective of the purchasing members of the investing public.¹⁹ Neither was it intended to provide a way around the registration requirements for an issuer by allowing the immediate resale of securities privately placed by the issuer with affiliates or others committed or likely to resell them to members of the investing public. The vehicle Congress relied upon to separate permissible trading transactions from secondary distributions and two-step primary distributions was the concept of the “statutory underwriter,” that is, underwriter as defined in Section 2(a)(11). It follows that the courts and the Commission are likely to interpret the critical term “distribution” and the other key phrases contained in the definition of underwriter with this legislative intent in mind.

¹⁵ Gilligan, Will & Co. v. Securities & Exchange Com., 267 F.2d 461 (2d Cir. 1959), *cert. denied*, 361 U.S. 896 (1959); Value Line Income Fund, Inc. v. Marcus, n.31 *supra*, at ¶ 94,972.

¹⁶ For a discussion of the various methods of resale under Section 4(a)(1), see §§ 6.05–6.09 *infra*.

¹⁷ See § 4.02 *supra*. One court has equated the term “distribution” with “public offering,” at least in the context of an attempted sale of restricted securities. Gilligan, Will & Co. v. Securities & Exchange Com., 267 F.2d 461 (2d Cir. 1959), *cert. denied*, 361 U.S. 896 (1959). In a case before the Commission involving a series of sales of unrestricted securities by affiliates of the issuer, the Commission found that a distribution is “the entire process by which in the course of a public offering the block of securities is dispersed and ultimately comes to rest in the hands of the investing public.” In the Matter of Ira Haupt & Co., 23 S.E.C. 589, 597, [1945–1947 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 75,690 at ¶ 77,559 (1946), *citing* Oklahoma-Texas Trust, 2 S.E.C. 764, 769 (1937), *aff’d*, 100 F.2d 888 (10th Cir. 1939). More recently, the Commission has indirectly defined a distribution at least in the context of attempted resales of restricted securities and of “control securities” by deeming no distribution to exist if all of the conditions contained in Rule 144 or Rule 144A are satisfied. See *generally* §§ 6.05 and 6.07 *infra* for a discussion of those conditions. In the context of “pump and dump” schemes, Judge Easterbrook held that a plan to “move securities from the issuer to the public, where they would trade freely” is a plan to engage in distribution. SEC v. McNamee, 481 F.3d 451, 455 (7th Cir. 2007).

¹⁸ Ira Haupt & Co., 23 S.E.C. 589, 597, [1945–1947 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 75,690 at ¶ 77,559 (1946), at 602; H.R. Rep. No. 85, 73d Cong., 1st Sess., 13–14 (1933).

¹⁹ *Id.*

A public resale of outstanding securities will constitute or be a part of such a secondary or two-step primary distribution rather than an exempt resale transaction only if an underwriter is involved. Either the selling investor or any broker or other participant in the transaction could conceivably be a statutory underwriter and cause the loss of the resale exemption. If the selling investor is an affiliate of the issuer and uses a broker to effect a public resale, then the broker would be a statutory underwriter.²⁰ Accordingly, the resale exemption is ordinarily unavailable for the public resale of “control securities” through a broker’s transaction.

If the selling investor is not an affiliate of the issuer, the resale exemption is lost only if it or someone it uses to effect the sale falls within the category of a statutory underwriter. An ordinary investor or its agent may become a statutory underwriter in one of the following ways:

- by purchasing from the issuer or controlling person, albeit through others, with a view to distribution, rather than with investment intent;²¹
- by offering or selling securities “for the issuer” or a controlling person in connection with a distribution, whether or not pursuant to an actual agreement;²² or
- by simply participating in a distribution involving the issuer or a controlling person.²³

While an investor’s intent at the time of the purchase is in theory determinative of whether he falls within the category of an underwriter, it has proved an unworkable standard. In reality, the best evidence of investment intent is the absence of any sale or attempted sale of the securities in question for a substantial period of time. Of course, the longer the period of time during which the investor holds the securities, the more persuasive is the evidence that the investor is not a statutory underwriter.

It is, of course, ultimately a question of fact whether a particular seller is a statutory underwriter. The availability of the exemption, however, must be proved by the investor seeking to rely on it,²⁴ a tough burden particularly in the context of an enforcement proceeding brought by the Commission. In light of the risk of enforcement by the Commission or of a suit by a purchaser and the severity of the remedies available in either case,²⁵ the resale exemption should not be relied upon casually for other than

²⁰ See discussion in § 6.02[3] *infra*.

²¹ See text accompanying n.21 *supra*.

²² *Id.* See also *Securities & Exchange Com. v. Chinese Consol. Benevolent Ass’n*, 120 F.2d 738, 740 (2d Cir. 1941), *cert. denied*, 314 U.S. 618 (1941).

²³ See text accompanying n.21 *supra*; see also *Securities & Exchange Com. v. Chinese Consol. Benevolent Ass’n*, 120 F.2d 738, 740 (2d Cir. 1941), *cert. denied*, 314 U.S. 618 (1941), at 741. A person need not be involved in the final step of a distribution to have participated in it. *Geiger v. SEC*, 363 F.3d 481, 487 (D.C. Cir. 2004).

²⁴ *SEC v. Continental Tobacco Co.*, 463 F.2d 137, 156 (5th Cir. 1972); *SEC v. Ralston Purina Co.*, 346 U.S. 119, 126, 73 S. Ct. 981, 97 L. Ed. 1494 (1953).

²⁵ See Chs. 9–11 *infra*.

ordinary trading transactions in the absence of a no-action letter from the staff of the Commission.

Given the purposes of the resale exemption, which are to allow private resales and ordinary trading transactions, but not to permit secondary or two-step distributions without registration, it is not surprising that the resale exemption, as interpreted by the courts and the Commission, is broadly available for the resale of unrestricted securities by non-affiliates of the issuer. In general, only in the case of an attempted sale of a substantial amount of securities held for less than the holding period specified by Rule 144(d) or in a few other limited circumstances is the Commission likely to deem or presume that a non-affiliate holder of unrestricted securities is an underwriter and therefore unable to rely on Section 4(a)(1) for the public resale of those securities. It is also not surprising that an investor holding restricted securities is generally regarded by the Commission as an underwriter and therefore unable to rely on Section 4(a)(1) except pursuant to Rule 144 when it makes a public resale of those securities, at least until the securities become freely tradable under Rule 144.²⁶ As discussed below, the resale exemption is normally also unavailable for the public resale of control securities because of the involvement of a statutory underwriter, whether the affiliate itself or the broker acting for the affiliate.

If the resale exemption is not available to an investor for the sale of outstanding securities because it falls within the category of an underwriter, that investor may not lawfully resell its securities unless the transaction is registered under the Securities Act or some other exemption from registration is available. Often the staff will permit such a holder of unrestricted securities to sell limited amounts of securities immediately in compliance with certain of the conditions of Rule 144.²⁷

A second effect of a proposed seller of securities being an underwriter is that any broker used for the sale will be unable to rely on either Section 4(a)(3)²⁸ or 4(a)(4)²⁹ of the Securities Act to exempt its part of the transaction.³⁰ In light of the rather

²⁶ See “Resales of Restricted Securities under Revised Rules 144 and 145 and Section 4(1/2)”. Davidson, Gordon K. Practising Law Institute Corporate Law and Practice Handbook Series PLI Order No. 13990, New York City, April 10–11, 2008.

²⁷ See Rule 144 and discussion in § 6.05[3][e] *infra*.

²⁸ Section 4(a)(3) is discussed in § 4.05 *supra*.

²⁹ A broker’s transaction is limited to a transaction where the broker, among other things, “after reasonable inquiry is not aware of circumstances indicating that the person for whose account the securities are sold is an underwriter” Rule 144(g)(3), discussed in § 6.05[7][c] *infra*. See also *In the Matter of Ira Haupt & Co.*, 23 S.E.C. 589, 597, [1945–1947 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 75,690 at ¶ 77,559 (1946), at 598.

³⁰ Unlike the presence of an underwriter, the presence of a broker does not render the resale exemption unavailable to the selling investor despite the reference to dealers contained in Section 4(a)(1). Ruder, *Federal Restrictions on the Sale of Securities*, 67 Nw. U.L. Rev. 1, 36–37 (Supp. 1972). The broker, however, will violate Section 5 of the Act unless it relies on some other available exemption. Normally, the broker will look to the exemption for brokers’ transaction contained Section 4(a)(4) of the Act for the broker’s part of the transaction. Section 4(a)(4) of the Act is discussed § 4.04 *supra*.

Another option sometimes available for the broker is the dealer’s exemption contained in Section

substantial penalties for a broker that sells securities in violation of Section 5,³¹ a seller who is, or even may be regarded by the staff as, an underwriter may encounter difficulty finding a reputable broker willing to publicly sell his securities.

[3] Limitations on Availability of Resale Exemption for Public Sales of Restricted Securities

[a] **General.** At the risk of gross tautology, the sole, but critical, legal difference between restricted securities³² and unrestricted securities is that unrestricted securities may be freely traded by ordinary investors in reliance on the resale exemption,³³ whereas restricted securities are not freely tradeable. The unavailability of the Section 4(a)(1) exemption for the public resale of restricted securities is the source of that difference. This unavailability derives from the application of a broader interpretation of the term “underwriter” when restricted securities rather than unrestricted securities are involved. In short, dealings in restricted securities are treated differently from ordinary trading transactions for securities regulation purposes.³⁴ That difference in treatment is based upon both the purpose of the Securities Act, which is to protect investors through disclosure in the form of a registration statement and the resulting periodic reports,³⁵ and the purposes of the resale exemption.³⁶

An ordinary investor may resell securities in reliance upon Section 4(a)(1) of the Securities Act provided that neither that investor nor any broker involved in the transaction is an underwriter within the meaning of Section 2(a)(11) of the Securities Act.³⁷ Since an investor cannot become an underwriter unless it is involved in (or deemed to be involved in) a distribution, a private sale even of restricted securities by any investor may lawfully be made in reliance upon the resale exemption.³⁸ It is, therefore, only in the context of a proposed public sale that the holder of restricted securities is in a different position from a counterpart holder of unrestricted securities.

4(a)(3), discussed in § 4.03 *supra*. In that regard, see *Resale by Institutional Investors of Debt Securities Acquired in Private Placements*, 34 Bus. Law. 1927, 1945–46 (1979).

³¹ In addition to the possible liabilities as described in Chs. 9–11 *infra*, the Commission may see fit to revoke the broker’s registration as a broker-dealer or suspend it from membership in Financial Industry Regulatory Authority (“FINRA”). See Section 15(b)(4)(D) (which permits the Commission to impose a sanction upon a broker-dealer who has willfully violated the Securities Act) and Section 15A(g)(2) (which permits a national securities association upon direction by the Commission to deny membership or association with a member to any broker-dealer subject to a statutory disqualification); see, e.g., *Ira Haupt & Co.*, 23 S.E.C. 589, 597, [1945] 1947 Transfer Binder] Fed. Sec. L. Rep. (CCH) 75,690 at 77,559 (1946).

³² See § 6.03 *infra* for the definition of the term “restricted securities” and an extended analysis thereof.

³³ See § 6.02[2] *supra*; but see § 6.02[5] *infra*, for the limited exceptions to that general rule.

³⁴ Alan J. Bowton, *Public Resales of Restricted Securities in Reliance upon Section 4(1) of the Securities Act*, in *Sales and Resales of Restricted Securities 1979*, at 385, 388 (PLI Corporate L. & Practice Course Handbook Series No. 314, 1979).

³⁵ Preamble of the Securities Act; see also the message of President Franklin D. Roosevelt, S. Rep. No. 47, 73d Cong., 1st Sess., 6–7 (1933) and H.R. Rep. No. 85, 73d Cong., 1st Sess., 1–2 (1933).

³⁶ See § 6.02[2] *supra*.

³⁷ See § 6.02[2] *supra*.

³⁸ See § 6.02[2] *supra*.

[b] Legal Limitations. By definition, restricted securities were acquired, directly or indirectly in a series of transactions, from the issuer or an affiliate of the issuer without a public offering.³⁹ A significant aspect of a lawful private offering is that the purchasers are likely to have been not ordinary investors, but rather sophisticated investors who had no need for the protection afforded by a registration statement and who did not purchase “with a view” to distribution.⁴⁰ As a practical matter, no current public information about the issuer may be available, even if investors had wanted it.⁴¹ If substantial public resales of the restricted securities were to occur pursuant to the resale exemption soon after the private offering, then the result would be the same as an unregistered primary distribution by the issuer or secondary distribution by an affiliate, though in two steps, pursuant to the Section 4(a)(2) and 4(a)(1) exemptions, respectively. Because of the very real risk that the registration provisions of the Securities Act would be frequently circumvented by this two-step distribution, virtually every public resale of any restricted securities, at least for a material period of time following the relevant private offering,⁴² is regarded separately as a distribution in itself⁴³ or, together with the initial private offering and perhaps other resales, as a part of “the entire process by which in the course of a public offering the block of securities is dispersed and ultimately comes to rest in the hands of the investing public.”⁴⁴ Accordingly, only private resales of restricted securities are clearly not distributions for at least six months or a year following the private placement.⁴⁵

Since most public resales of restricted securities appear to involve a distribution within the meaning of Section 2(a)(11)⁴⁶ the investor may rely on the resale exemption for such a sale only if it can establish that:

- the original purchase was with investment, or at least not distributive, intent;
- the resale is other than a sale for the issuer or for a controlling person; and

³⁹ Rule 144(a)(3), discussed in § 6.03[2] *infra*.

⁴⁰ Prior to 1990, such purchasers were generally required to show that they were purchasing with “investment intent” and not with a view to resale. Since the adoption of Rule 144A in 1990, however, and in view of Rule 144A’s objective of increasing secondary market liquidity for restricted securities, it is not necessary that investors in private placements not purchase with a view to resale. It is merely necessary that they not take with a view to *public* resale, or “distribution.” See the discussion of Rule 144A at § 6.07.

⁴¹ Current information would not be available unless voluntarily made so by the issuer or unless required by Section 13 or 15(d) of the Exchange Act. The Section 13 reporting of information requirements are triggered by the registration of securities under the Securities Act or the Exchange Act. Those reporting requirements are not triggered by a private offering of securities.

⁴² See § 6.05[5] *infra*.

⁴³ *Gilligan, Will & Co. v. Securities & Exchange Com.*, 267 F.2d 461 (2d Cir. 1959), *cert. denied*, 361 U.S. 896 (1959), at 466–67.

⁴⁴ In the Matter of *Ira Haupt & Co.*, 23 S.E.C. 589, 597, [1945–1947 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 75,690 at ¶ 77,559 (1946).

⁴⁵ See § 6.05[5] *infra* and discussion of “Section 4(a)(1) 1/2,” § 6.08 *infra*.

⁴⁶ See § 6.02[3] *supra*.

- the resale does not amount to a participation in a two-step distribution.⁴⁷

As discussed above, if the investor is an affiliate of the issuer, the public resale will usually involve an underwriter and the resale exemption will be therefore unavailable regardless of the restricted or unrestricted character of the securities.⁴⁸

Unlike a routine resale of unrestricted securities by an ordinary investor, an attempted public resale of restricted securities is itself strong evidence that the non-affiliate investor is a statutory underwriter. The attempted sale is generally regarded as a strong contradiction of an investment intent,⁴⁹ making it virtually impossible for an investor to argue that he or she did not take with a view to a distribution. Even if the investor could convince the Commission of original non-distributive intent, the Commission may still view the investor as an underwriter. At the time it adopted Rule 144, the Commission made clear that in its view “it is insufficient to conclude that a person is not an underwriter solely because he did not purchase securities from an issuer with a view to a distribution”⁵⁰ Rather, the Commission indicated that the presence of a distribution is, in the case of restricted securities, synonymous with underwriter status.⁵¹ In other words, despite the express language of Section 2(a)(11) the Commission apparently believes that all resales prior to the expiration of the holding period⁵² are deemed to be “for the issuer” or the “controlling person” and therefore render the selling investor a statutory underwriter unable to rely on the resale exemption. In light of that view and the refusal of the staff of the Commission to issue no-action letters regarding the availability of the Section 4(a)(1) exemption outside Rule 144 for securities acquired since April 15, 1972,⁵³ it is extremely difficult for any holder of restricted securities to resell them publicly in reliance upon the resale exemption outside the rule within a year (or six months, depending on the nature of the issuer) of the private placement without risking a violation of the registration requirements of the Securities Act.⁵⁴

The public resale of securities is usually possible only with the assistance of a broker. As explained above, the broker will violate the Securities Act unless its part of the transaction is exempt from the registration requirements. Typically, the broker relies on the dealer’s exemption contained in Section 4(a)(3) or the exemption for brokers’ transactions contained in Section 4(a)(4) of the Securities Act. Neither of those

⁴⁷ SEC v. Ralston Purina Co., 346 U.S. 119, 126, 73 S. Ct. 981, 97 L. Ed. 1494 (1953).

⁴⁸ See § 6.04[1] *infra*.

⁴⁹ Alan J. Bowton, *Public Resales of Restricted Securities in Reliance upon Section 4(1) of the Securities Act*, in *Sales and Resales of Restricted Securities 1979*, at 392 (PLI Corporate L. & Practice Course Handbook Series No. 314, 1979). Since the adoption of Rule 144A, the phrase “investment intent” should generally be replaced with “non-distributive intent.”

⁵⁰ Preliminary note to Rule 144.

⁵¹ *Id.*

⁵² Rule 144(d).

⁵³ Sec. Act Rel. No. 33-6253, 1 Fed. Sec. L. Rep. (CCH) ¶ 134A at ¶ 1017-6 (1980).

⁵⁴ *But see* § 6.06 *infra*.

exemptions is available to the broker if the selling investor is an underwriter.⁵⁵ Accordingly, because, as discussed above, any investor attempting to publicly sell restricted securities is also most certainly an underwriter at least in the Commission's view, reputable brokers are likely to refuse to effect the transaction except where all of the conditions for a resale under Rule 144 can and will be satisfied.

In 1962, the Commission issued a release providing detailed guidance as to the expected standards of conduct for broker-dealers. Under the Commission's guidelines, broker-dealers involved in the sale of large quantities of securities must ensure that they are not participating in an illegal distribution. The broker-dealer must take affirmative steps to verify the identity of the seller and any claimed registration exemptions, and cannot rely on the statements of the seller or seller's counsel. The thoroughness of the investigation expected of a broker-dealer increases with the quantity of securities involved in the sale. Failure to conduct a sufficient investigation may lead to liability under the anti-fraud provisions of the securities laws if as a result the broker-dealer makes recommendations without adequate basis or fails to disclose material information.⁵⁶

[c] Other Limitations on Public Sales of Restricted Securities. An investor seeking to publicly resell restricted securities who believes that it falls outside the category of a statutory underwriter and is therefore entitled to rely on the resale exemption or who wishes to risk a possible violation of the Securities Act may find that the resale will be difficult to complete because of limitations from sources other than the possible unavailability of the Section 4(a)(1) resale exemption.

All restricted securities were acquired directly or indirectly from the issuer of those securities or from an affiliate of the issuer in a private offering that was exempt from registration under the Securities Act by reason of one of the private offering exemptions.⁵⁷ Normally those securities, if certificated, will bear a legend indicating that they may not be transferred in the absence of registration or an available exemption from registration. In addition, stop transfer instructions will generally have been issued to the transfer agent. These precautions against resale will exist where explicitly required by regulation for reliance upon a particular exemption. They are also typically utilized by an issuer selling securities in reliance upon the statutory "private placement" exemption contained in Section 4(a)(2) of the Securities Act to ensure the availability of that exemption. The reason is that while neither the legend nor the stop transfer instructions are necessary for the perfection of that exemption,⁵⁸ (and may well be ignored by issuers in smaller offerings), they assist in preventing resales to non-qualifying investors that could at least in theory cause the loss of the exemption for the

⁵⁵ See text accompanying n.34 *supra*.

⁵⁶ Securities Act Release No. 4445, Fed. Sec. L. Rep. (CCH) ¶ 76,820 (February 2, 1962).

⁵⁷ See § 4.02 *supra*.

⁵⁸ C. Schneider, *Developments in Definition of a "Security"—1983/84 Update*, 17 Rev. Sec. Reg. 851, at 880 (1984).

earlier offering and subject the issuer to liability for a violation of the Securities Act.⁵⁹ As a result, the transfer agent will not effect the transfer of the restricted securities without direction from the issuer. The issuer is not likely either to direct the removal of the legends or the stop transfer instructions or to authorize the transfer of the securities until expiration of the holding period without an opinion of its or other counsel⁶⁰ experienced in securities law that either Section 4(a)(1) or some other exemption from the registration requirements of the Securities Act is available for the proposed resale and that all of the requirements of that exemption have been or will be complied with by the selling parties.⁶¹

[4] Limitations on Availability of Resale Exemption for Public Sales of Control Securities

Section 4(a)(1) exempts from the registration and prospectus delivery requirements of the Securities Act any transactions by a person “other than an issuer, underwriter, or dealer.”⁶² As discussed above in connection with the resale of securities other than “control securities,”⁶³ the availability of the resale exemption depends upon the lack of involvement of anyone who falls within the category of a statutory underwriter. If none of the selling security holder, the participating broker, or any other person involved in the transaction is an underwriter, the seller may rely on the resale exemption; and the broker, despite being a dealer, may rely on either the dealer exemption or the exemption for brokers’ transactions contained in Sections 4(a)(3) and 4(a)(4) of the Securities Act, respectively, without depriving the seller of the resale exemption.⁶⁴

The resale exemption contains no express language regarding an affiliate or a control person. Rather, Section 2(a)(11) goes on to specify that for purposes of defining an underwriter only, the term “issuer” shall include “any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common

⁵⁹ Ruder, *Federal Restrictions on the Sale of Securities*, 67 Nw. U.L. Rev. 1, 36–37 (Supp. 1972), at 45.

⁶⁰ There have been recent cases where attorneys were sanctioned for inappropriately issuing Rule 144 “clean” letters. In *Packetport*, the attorney issued an opinion letter to the transfer agent stating that the transferor was a non-affiliate and had held the securities for two years. In response, the transfer agent removed the restrictive legends from the shares. The attorney knew that this information was false. The SEC charged the attorney and his accomplices with fraud and registration violations. *See SEC v. Packetport.com, Inc.*, Civ. No. 3:05-CV-1747 (D. Conn. 2005).

⁶¹ In this regard, the Commission is of little help. The staff takes the position that the placement and removal of restrictive legends on securities is completely within the discretion of the issuer, that the Commission has no authority to require the imposition or removal of those legends, and that the staff will take no view respecting any right or duty of removal. *See, e.g., Buck-Man Electronics Inc., SEC No-Action Letter*, 1981 SEC No-Act. LEXIS 3170, (March 4, 1981). *But see SEC Act Rel. No. 33-8869* (2007), in which the Commission noted it would not object to legend removal for non-control securities if all conditions of Rule 144 are met after a 1 year hold period.

⁶² Section 4(a)(1), discussed in § 4.02 *supra*.

⁶³ *See* § 6.02[1] *supra*.

⁶⁴ *See* ns. 32–35 and accompanying text *supra*.

control with the issuer.”⁶⁵ In other words, an affiliate of the issuer is, as a result of that language, an issuer for purposes of determining whether another person is an underwriter. When an affiliate attempts to effect a public sale of securities, she will generally engage a broker. The broker, because the affiliate is an issuer under Section 2(a)(11), will be selling “for an issuer” in connection with a distribution and therefore become an underwriter. Since an underwriter, i.e., the broker, is involved in the transaction, the transaction falls outside the resale exemption, rendering that exemption unavailable to the affiliate.⁶⁶ Accordingly, regardless of whether the affiliate is itself an underwriter for purposes of Section 2(a)(11), it may almost never publicly sell “control securities” in reliance upon Section 4(a)(1) of the Securities Act except pursuant to Rule 144.⁶⁷

The primary effect of that result on the affiliate of the issuer is that the affiliate may not lawfully resell any securities of the issuer publicly without causing a registration statement to be filed and to become effective or finding another available exemption. Another effect of that result is that even a holder of securities who either believes that she is not an affiliate of the issuer or desires to risk possible liability for a violation of the registration requirements of the Securities Act will find it virtually impossible to complete the contemplated sale of securities.

Unlike restricted securities, control securities will occasionally contain no legend and are generally not subject to stop transfer instructions. While technically the issuer has no securities law obligation or reasons to prevent their resale it does have a general interest in not participating in a violation of any of the securities laws and needs insiders to disclose accurate information about their holdings in order to make accurate disclosure itself. The affiliate then will often not encounter any difficulty from the issuer’s transfer agent although many reputable brokers will be alert to the problems posed by control securities.

[5] Limitations on Availability of Resale Exemption for Public Sales of Unrestricted Securities by Non-Affiliates

[a] General. While a non-affiliate holder of unrestricted securities generally may sell those securities freely in reliance upon Section 4(a)(1) of the Securities Act, there are a few exceptions to this rule.⁶⁸

[b] Underwriters’ Compensation Securities. As discussed further below,⁶⁹ underwriters’ compensation securities, at least those acquired in a registered public

⁶⁵ Section 2(a)(11), discussed in § 4.06 *supra* in connection with controlling persons.

⁶⁶ *United States v. Wolfson*, 405 F.2d 779, 782 (2d Cir. 1968), *cert. denied*, 394 U.S. 946 (1969).

⁶⁷ *Id.*

⁶⁸ In addition, holders of securities originally issued under the “crowdfunding” exemption from registration under Section 4(a)(6) of the Securities Act, while able to rely upon Section 4(a)(1) for their resales cannot be said to resell them “freely” as they may make those sales only to a specified universe of transferees for a period of one year. *See* § 6.03[4][e][iv].

⁶⁹ *See* § 6.03[4][e][ii] *infra*.

offering, are regarded by the staff of the Commission as unrestricted securities, because of their acquisition in a transaction involving a registered public offering. Unlike most other unrestricted securities, including even such atypical categories of unrestricted securities as those acquired through employee benefit plans,⁷⁰ underwriters' compensation securities are not freely tradeable. The holders of these securities are literally underwriters and, as such, are in the staff's view forever excluded from relying upon any Section 4 exemption. As a result, underwriters' compensation securities, at least until 1975, could not be sold unless they were registered by the issuer.⁷¹ Since 1975, however, the staff has allowed the resale of certain underwriters' compensation securities in conformity with most of the requirements of Rule 144, even though the rule is technically not applicable to unrestricted securities.⁷²

[c] Underwriters as Result of Rule 145(d)⁷³ Reorganizations or Similar Transactions. Where the surviving party to a business combination involving certain shell companies uses securities as all or part of the consideration for the business deal, security holders in the acquired company could be deemed to be underwriters if they publicly resold the securities acquired in such a transaction. Rule 145(a) specifies that an "offer" or "sale" will be deemed to occur with exchanges of securities in connection

⁷⁰ See, e.g., Allied Technology, Inc. SEC No-Action Letter, 1980 SEC No-Act. LEXIS 2909 (March 3, 1980), allowing resales of such securities by non-affiliates in reliance upon Section 4(a)(1).

⁷¹ D. Goldwasser, *A Guide to Rule 144 at 125–27* (2d ed. 1978).

⁷² The Division of Corporation Finance now generally allows holders of underwriters' compensation securities acquired in a public offering who are not affiliates of the issuer to resell those securities to members of the public in compliance with all of the requirements of Rule 144 (other than the filing of Form 144), provided certain other conditions are satisfied. These include the treatment of the securities so sold as restricted (in which case tacking is permitted) in certain circumstances. Division of Corporation Finance, Compliance and Disclosure Interpretations, Section 528.04 (Jan. 26, 2009). See also Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(A), Question 10 n.8; Communications Properties, Inc., SEC No-Action Letter 1978 SEC No-Act. LEXIS 1000 (April 13, 1978), Paulson Investment Company, Inc., SEC No-Action Letter 1997 SEC No-Act. LEXIS 994 (November 10, 1997). This policy exception to the Division's previous rule that underwriters' compensation securities could never be resold pursuant to the exemption contained in Rule 144 has been extended to underwriters' compensation shares issued in connection with a Regulation A offering, Florafax International, Inc., SEC No-Action Letter, 1979 SEC No-Act. LEXIS 2209 (February 12, 1979), but not to such securities inadvertently not included in the original registration statement, Dicomed Corp., SEC No-Action Letter 1981 SEC No-Act. LEXIS 4086 (October 5, 1981). It has also been extended to permit the resale of stock acquired upon exercise of warrants issued as underwriters' compensation, provided that the stock so acquired has been held for a full two years from the date of exercise of the warrants. American Growth Fund Sponsors, Inc., SEC No-Action Letter, 1981 SEC No-Act. LEXIS 2720 (May 26, 1981). It has been extended to allow a broker-dealer liquidating in bankruptcy to sell securities acquired by an underwriter in connection with registered offerings but which admittedly were not underwriter's compensation. Drexel Burnham Lambert Inc., SEC No-Action Letter 1990 SEC No-Act. LEXIS 989 (July 25, 1990).

See § 6.03[4][e][ii] *infra* for a discussion of underwriters' compensation securities acquired in a private offering.

⁷³ The Commission has proposed elimination of this provision (which embodies the presumptive underwriter concept) and the resale provisions of Rule 145(c) and (d). Sec. Act Rel. No. 33-7391 [current decisions] Fed. Sec. L. Rep. (CCH) ¶ 85,908 (1997).

with certain reclassifications, mergers, consolidations and transfers of assets that are submitted for the vote or consent of the security holders of a corporation. Accordingly, the “sale” must be registered unless an exemption is available.

Under Rule 145(c), or the presumptive underwriter provision, any party to any transaction of the type set forth in Rule 145(a) (other than the issuer) or an affiliate of such party who publicly offers the securities acquired in such transaction is an “underwriter,” but only where any party to a Rule 145(a) transaction is a shell company, other than a business combination related shell company.⁷⁴

Any party to a transaction of the type set forth in Rule 145(a) involving a shell company, other than the issuer, may resell the securities acquired in the transaction only in compliance with the resale restrictions of Rule 145(d), which follow the requirements of Rule 144.⁷⁵ If a person has expressly acknowledged or agreed in writing to be subject to, and bound by, the previous provisions of Rule 145 with respect to securities acquired in a transaction, such persons will presumably remain bound by those terms. A holder currently subject to such restrictions may wish to seek a waiver or modification of such writing to reflect the amendments to Rule 145.

[d] Resale of Certain Securities Acquired Overseas. Securities of U.S. issuers sold overseas in reliance on Regulation S are restricted.⁷⁶ Generally, securities of non-U.S. issuers acquired overseas in reliance on Regulation S, at least once any applicable distribution compliance period has expired, are unrestricted.⁷⁷ This does not automatically mean, however, that securities acquired overseas can be resold back into the United States at the end of the distribution compliance period in reliance on the resale exemption.⁷⁸ The statutory definition of underwriter includes one who has

⁷⁴ Rule 145(c), prior to the 2007 amendments to Rule 144, defined any party to any transaction of the type set forth in Rule 145(a) (other than the issuer) or an affiliate of such party who publicly offers the securities acquired in such transaction as an “underwriter” (and did not limit the designation to transactions involving shell companies). Prior to the amendments, such a “presumptive underwriter” would be required to comply with Rule 145(d) in connection with resales of the acquired securities even if the person, following the transaction, were no longer an affiliate of the combined entity and even if such person received registered securities in the business combination. The 2007 amendments, in short, eliminated the presumptive underwriter provision of Rule 145(c), except with respect to transactions involving a shell company.

⁷⁵ Prior to 2007, the Commission had taken the position that Rule 145(d) applied to securities acquired pursuant to exempt exchanges under Section 3(a)(10). Staff Legal Bulletin 3A (CF), June 18, 2008, states that Rule 145(d) applies to Section 3(a)(10) exchanges only where a shell company is involved. *See* § 6.03[4][e][iii] *infra*.

⁷⁶ Sec. Act Rel. No. 33-7505 (1998); *see also* Ch. 4, *supra*.

⁷⁷ Sec. Act Rel. No. 33-6863, [1989–1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,524 (1990), at n.110. *See* § 6.03[4][e][ix] *infra*.

⁷⁸ The purpose of the distribution compliance period in Regulation S is to ensure that during the offering period and in the subsequent aftermarket trading that takes place offshore, the persons complying with the Rule 903 safe harbor (issuers, distributors and their affiliates) are not engaged in an unregistered, non-exempt distribution of securities into the U.S. capital markets. In connection with the 2007 amendments to Rule 144, the Commission amended Regulation S to conform the distribution compliance

purchased from an issuer (including affiliates) “with a view to . . . distribution.”⁷⁹ Thus, a person that purchases securities overseas with the intention of selling them back into the U.S. public markets at the end of any applicable distribution compliance period may be deemed to be an underwriter and thus unable to rely on the resale exemption. Although it may be difficult to prove that a public resale in these circumstances amounted to a public offering or distribution, such transactions should be examined carefully.

§ 6.03 Definition of Restricted Securities

[1] Introduction

The term “restricted securities” cannot be found in the original text of the Securities Act or indeed in any of the federal securities laws. Over the years, the term was applied by securities lawyers and other members of the securities industry to all securities that were not freely tradeable because of restrictions resulting from the Securities Act. As time went on the term was used more narrowly to refer to only that category of restricted securities commonly referred to privately placed securities, as opposed to the other category of restricted securities commonly called “control securities.” In 1972, the Securities and Exchange Commission promulgated Rule 144, which codified that narrower usage by expressly defining restricted securities to include only privately placed securities,¹ although that definition has been expanded by subsequent amendments to Rule 144.

[2] Rule 144 Definition

Paragraph (a)(3) of Rule 144 defines the term “restricted securities” to include:

- securities acquired directly or indirectly from the issuer, or from an affiliate of the issuer, in a transaction or chain of transactions not involving any public offering;
- securities acquired from the issuer that are subject to the resale limitations of Rule 502(d) under Regulation D or Rule 701(c) under the Securities Act;
- securities that are acquired in a transaction or chain of transactions meeting the requirements of Rule 144A;
- securities acquired from the issuer in a transaction subject to the conditions of Regulation CE (Rule 1001);
- equity securities of domestic issuers acquired in a transaction or chain of transactions subject to the conditions of Rule 901 or 903 under Regulation S;
- securities acquired in a transaction made under Rule 801 under the Securities

period in Rule 903(b)(3)(iii) for Category 3 reporting issuers to the amendments to the Rule 144 holding period. Accordingly, U.S. reporting issuers are subject to a distribution compliance period of six months under Regulation S (as opposed to the previous one-year distribution compliance period).

⁷⁹ See n.21 *supra* and accompanying text.

¹ See Sec. Act Rel. No. 33-5223, [1971–1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,487 (1972).

Act to the same extent and proportion that the securities held by the security holder of the class with respect to which the rights offering was made were, as of the record date for the rights offering, “restricted securities” within the meaning of paragraph (a)(3);

- securities acquired in a transaction made under Rule 802 under the Securities Act to the same extent and proportion that the securities that were tendered or exchanged in the exchange offer or business combination were “restricted securities” within the meaning of paragraph (a)(3);
- securities acquired from the issuer in a transaction subject to an exemption under Section 4(a)(5) of the Securities Act.

Securities that fall outside the rule’s definition are normally *unrestricted* securities for purposes of the federal securities laws, regardless of any limitations on their disposition imposed by agreement, by any state statute, or otherwise.² In other words, the lawful resale of unrestricted securities under the Securities Act is not limited as a result of the manner of their acquisition,³ though their resale may, of course, be constrained because they are held by a controlling person of the issuer⁴ or because of other circumstances.⁵

[3] Scope of Rule 144 Definition

[a] Securities. Any outstanding security of whatever nature, for example, stock, note, or investment contract, may be a restricted security, provided, of course, that the so-called security is in fact a security within the meaning of Section 2(a)(1) of the Securities Act.⁶ The form of a security is never determinative of whether that security is a restricted security.

² Certain securities, frequently those of private or close corporations, are subject to various share transfer restrictions imposed through shareholders’ agreements or otherwise. These restrictions on resale are governed by the applicable state corporation law. The sale of securities is also, of course, normally subject to the relevant state securities law or laws and to the Uniform Commercial Code, Article 8, in the form adopted by the relevant state or states. All of these limitations, although matters of concern for counsel representing the potential seller of securities, are outside the scope of this chapter. *See also* the discussion of the limitations on crowdfunded securities at § 6.03[4][e][14].

³ For discussion of such limitations, see § 6.02[3] *supra*.

⁴ For discussion of the limitations on the resale of securities by affiliates, see § 6.02[4] *supra*.

⁵ *See* § 6.02[5] *supra*, and *see* n.3.

⁶ Section 2(a)(1) of the 1933 Act, reprinted in the Securities Primary Law Sourcebook, Volume A, Section B (Matthew Bender), is discussed in § 2.01 *supra*. It is not always easy to determine whether a particular interest falls within that definition of a security. In that regard, *see generally* Schneider, *The Elusive Definition of a Security*, 14 Rev. Sec. Reg. 981 (1981), and its updates; Schneider *Developments in Defining a “Security,”* 16 Rev. Sec. Reg. 985 (1983); Schneider, *Definition of a “Security”—1983/84 Update*, 17 Rev. Sec. Reg. 851 (1984); and Schneider, *The Elusive Definition “Security”—1990 Update*, 24 Rev. Sec. Reg. 13 (1991) for summaries of the elusiveness of the definition of the terms under the Act. *See also* M. Steinberg & W. Kaulbach, *The Supreme Court and the Definition of “Security”*, 40 Vand. L. Rev. 489 (1987).

Certain securities, apparently either because of their intrinsic nature or because of the protection that results from regulation other than through the securities laws,⁷ are completely exempt from the Securities Act's registration requirements by one of Sections 3(a)(2) through 3(a)(8), regardless of the nature of the transactions in which they are involved.⁸ These so-called exempt securities, therefore, are regulated only by the antifraud provisions of the securities acts and are generally freely tradeable.⁹ Exempt securities, therefore, are outside the scope of this chapter.

[b] Method of Acquisition. A security takes on its restricted or unrestricted character primarily as a result of the private or public manner of its acquisition by a person other than the issuer. The actual method of acquisition,¹⁰ whether by purchase, gift, bequest or pledge, is unimportant. Any outstanding security, no matter how acquired, generally will be restricted if it was acquired from either the issuer or an affiliate of the issuer in a transaction or chain of transactions not involving any public offering.¹¹

[4] Sources of Restricted Securities

[a] Introduction. There are only two sources of all restricted securities: the issuer of those securities¹² or an affiliate of the issuer.¹³ In either case, the securities must have been acquired in a transaction or series of transactions not involving any public offering.¹⁴ While no other person can create a restricted security from an unrestricted security, whatever the manner of the transaction, any person can render a restricted security unrestricted by transferring it in a transaction involving a public

⁷ See Allen E. Throop & Chester T. Lane, *Some Problems of Exemption Under the Securities Act of 1933*, 4 Law & Contemp. Prob. 89 (1937).

⁸ Sections 3(a)(2) through 3(a)(8) are discussed in §§ 3.03–3.09 *supra*.

⁹ *But see* Consolidated Freightways, Inc., SEC No-Action Letter 1982 SEC No-Act. LEXIS 3110 (November 27, 1982), in which the staff states that Section 3(a)(6) securities “are not ‘restricted securities’ within the meaning of Rule 144(a)(3).”

¹⁰ In perhaps only one instance has it been argued that a transfer fell short of being an acquisition for purposes of Rule 144(a)(3). In the no-action letter Equimark Corp., SEC No-Action Letter 1988 SEC No-Act. LEXIS 279 (February 16, 1988), counsel argued that the distribution of unrestricted securities by a partnership that was an affiliate of the issuer to its individual partners was not an acquisition and that therefore the securities should remain unrestricted in the hands of those distributee partners. While the staff concurred in counsel's conclusion, it did not address the acquisition analysis, and its concurrence could well be based on the non-sale nature of the transaction. Regarding no-action letters generally, see n.16 *infra*.

¹¹ *But see* § 6.03[4][b] and § 6.03[4][e] *infra* for certain exceptions.

¹² The term “issuer” is precisely defined by Section 2(a)(4) and is discussed in § 4.01[1] *supra*.

¹³ See § 6.04[2] *infra* with regard to the definition of the term “affiliate.”

¹⁴ See § 6.03[4][b][ii] *infra* with regard to the meaning of the term “public offering.” If the securities were acquired from the issuer in a Rule 504 or 701 transaction, see § 6.03[4][e] *infra*, they are restricted even though a prior distribution of the same securities by the issuer could have been public rather than private.

offering or, generally only in the case of foreign securities, outside the United States.¹⁵ Otherwise, the security remains restricted whether held by a single holder or transferred any number of times in transactions not involving a public offering.¹⁶

[b] Status of Securities Acquired from the Issuer.

[i] General. If the holder of particular securities acquired them directly from the issuer in a private offering, the securities became restricted as a result of that transaction, are restricted in the holder's hands, and will remain restricted until transferred publicly.¹⁷ An issuer may create restricted securities by privately offering authorized but previously unissued securities, in a typical capital-raising transaction. An issuer may also create restricted securities by purchasing any of its outstanding securities, restricted or unrestricted, in a private or public transaction and by privately reoffering them. Their restricted character is determined by the non-public nature of the offering by the issuer.¹⁸

Since the existence of a public offering is in most cases the basis for separating restricted securities from unrestricted securities, the meaning of the term "public offering" is crucial. Although Section 4(a)(2) of the Securities Act exempts from its registration and prospectus delivery requirements "transactions by an issuer not involving any public offering,"¹⁹ the Securities Act contains no definition of the term "public offering."²⁰ At least for purposes of determining the availability of the so-called

¹⁵ See § 6.03[4][e][x] *infra* for a discussion of transactions outside the United States pursuant to Regulation S.

¹⁶ See, e.g., Analysis & Technology, Inc., SEC No-Action Letter 1979 SEC No-Act. LEXIS 2208 (February 12, 1979). This letter is an interpretive letter issued by the staff of the Division of Corporate Finance of the Commission. "An interpretive letter is one in which the staff provides an interpretation of a specific statute, rule or regulation in the context of an actual fact situation." Sec. Act Rel. No. 33-6253, Fed. Sec. L. Rep. (CCH) ¶ 134A (1980). Similarly, no-action letter is one in which a member of the staff "indicates that the staff will not recommend any enforcement action to the Commission if the proposed transaction described in the incoming correspondence is consummated. In some instances, the staff will state in response to a no-action request that it is unable to assure the writer that it will not recommend" such enforcement action if the transaction occurs as described. *Id.* Since December 1, 1970, these interpretive and no-action letters have been made available to the public and are widely regarded, particularly in the aggregate, as some evidence of the views of the Commission's staff on the subject of the inquiries involved. The Division has indicated that "[m]embers of the public are entitled to rely on no-action and interpretive letters as representing the views of the Division. Such letters, however, set forth staff positions only and do not constitute an official expression of the Commission's views." *Id.* All of the letters cited in this chapter are available through LexisNexis, and the cites within this chapter to each letter cite to the relevant electronic database where the letter can be located.

¹⁷ With respect to the status of restricted securities sold overseas, see § 6.09 *infra*.

¹⁸ *But see* § 6.03[4][b][ii] *infra* for limited exceptions.

¹⁹ Section 4(a)(2) is discussed in § 4.03 *supra*.

²⁰ By contrast, Section 1145(c) of the federal Bankruptcy Code specifically states that securities received pursuant to court-approved reorganization plans in bankruptcy proceedings are deemed to be received in a public offering. Accordingly, they are unrestricted and outside the scope of this chapter. See, e.g., Northeast Utilities, SEC No-Action Letter, 1991 SEC No-Act. LEXIS 264 (February 11, 1991); Zenith Laboratories, Inc., SEC No-Action Letters 1990 SEC No-Act. LEXIS 37 (January 12, 1990);

private placement exemption from registration contained in Section 4(a)(2), the term has been interpreted by numerous courts,²¹ and less directly by the Commission, in connection with the promulgation of various rules under Section 4(a)(2) and related sections of the Securities Act.²² Ultimately, the determination of whether a particular transaction was a public offering must be made after considering such factors as the number of persons to whom the securities were offered and sold, the amount of securities acquired, the manner of sale, the adequacy of the then available information about the issuer and the needs of the offerees at that time for the protection afforded by the registration requirements of the Securities Act.²³

While many transactions must be individually examined and measured in light of the existing judicial and administrative standards for public offering, two types of sale transactions are clearly public offerings for purposes of the definition of restricted securities. The first is the rather obvious case of an offering of securities by or through a securities broker in an open market transaction.²⁴ The second involves an offering that is registered under the Securities Act. Since registration of the securities can be accomplished by the issuer only by complying with the costly and otherwise burdensome procedures required by the Securities Act and since private offerings may take place in the absence of registration,²⁵ securities offerings are registered only if there is to be a public offering, and the securities sold under the registration statement are unrestricted.²⁶ In addition, a public offering probably occurs whenever securities are distributed to the holders of a class of securities which is required to be registered under the Exchange Act, even if Securities Act registration of the securities is not required either because no sale or offer to sell is involved or because the transaction is explicitly exempted from the registration requirement.

[ii] In a Public Offering. Public offerings are generally registered under the Securities Act because they cannot meet the specific requirements of any of the

Cyclops Industries, Inc., SEC No-Action Letter 1988 SEC No-Act. LEXIS 626 (June 2, 1988).

²¹ See, e.g., SEC v. Ralston Purina Co., 346 U.S. 119, 73 S. Ct. 981, 97 L. Ed. 1494 (1953).

²² See, e.g., Regulation D, discussed in § 4.04 *supra* and Rule 144A, discussed in § 6.07 *infra*.

²³ See generally C. Schneider, *The Statutory Law of Private Placements*, 14 Rev. Sec. Reg. 869 (1981).

²⁴ See, e.g., Rio Grande Industries, Inc., 1989 SEC No-Act. LEXIS 490 (April 5, 1989).

²⁵ See Ch. 4 *supra*.

²⁶ See, e.g., Hechinger Co., SEC No-Action Letter 1990 SEC No-Act. LEXIS 771 (May 8, 1990) (merger shares acquired in registered offering are not restricted); Nathan Golden, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,409 (1987). In fact, registered securities are unrestricted even if they were acquired in exchange for restricted securities. Vitro, Sociedad Anonima, SEC No-Action Letter 1991 SEC No-Act. LEXIS 1278 (November 19, 1991); Kaneb Services, Inc., SEC No-Action Letter 1981 SEC No-Act. LEXIS 3195 (March 9, 1981). *But see* R. B. Jones Corp., SEC No-Action 1974 SEC No-Act. LEXIS 2209 (May 27, 1974) in which the staff of the Commission deemed the shares issued in connection with the acquisition of a privately held company restricted despite their inclusion in a registration statement prepared for other purposes; Kaiser Industries Corp., SEC No-Action Letter 1977 SEC No-Act. LEXIS 2138 (August 25, 1977), in which the staff deemed shares included in a registration statement to be restricted securities even though an integral part of a public offering, because the cover page stated that those shares were being purchased by a particular individual and were not being publicly offered.

specialized exemptions available for those offerings. Certain public transactions, however, may take place without registration if all of the requirements of an applicable exemption can be satisfied. Where one of these exemptions is relied upon, the resulting unregistered securities are in *most* cases unrestricted.²⁷

The Securities Act, together with certain related rules, provides several possible transaction exemptions for an issuer proposing to sell securities in a public offering. If the aggregate offering price of the securities to be offered does not exceed \$20,000,000 or \$75,000,000, as the case may be, and meets certain other conditions, the issuer may be able to rely on the exemption for certain offerings contained in Regulation A promulgated by the Commission under Section 3(b) of the Securities Act. Most states require that the securities from such an offering be legended, even though the Commission does not require it, although certain intra-state legending exemptions are available. If the offering will be made only to residents of a single state by an issuer that is also a resident of and doing business primarily in that state, the issuer may be able to meet the requirements of the intrastate offering exemption contained in Section 3(a)(11) of the Securities Act or in the related Rule 147.²⁸ Securities sold pursuant to 3(a)(11) are generally not restricted,²⁹ although they cannot be transferred outside the applicable state for nine months. Similar considerations apply to offerings made under Section 4(a)(6) of the Securities Act and Regulation CF, the crowdfunding exemption. The offering is essentially a public offering, but the securities cannot be resold except to specified transferees for one year.³⁰ The remaining two alternatives available to the issuer are contained in Sections 3(a)(10)³¹ and 3(a)(9)³² of the Securities Act and are limited to certain qualifying transactions that involve exchanges of securities.

²⁷ *But see* § 6.03[4][e] *infra*. It is also possible for a transaction to be registered and yet not truly a public offering, as where an institutional purchaser buys a block of shelf-registered securities directly from the issuer. In such cases, the securities are not deemed to be restricted securities acquired from the issuer in a transaction not involving any public offering, but the purchaser will still have to determine whether it might be an underwriter in connection with the resale of such securities. Division of Corporation Finance, Compliance and Disclosure Interpretations, Question 128.04 (Jan. 26, 2009).

²⁸ Section 3(a)(11) and Rule 147 are discussed in § 3.12 *supra*.

For information regarding the scope of the intrastate offering exemption, see J. Hicks, Exempted Securities Transactions under the Securities Act of 1933, § 4.01 through § 4.09.

²⁹ Division of Corporation Finance, Compliance and Disclosure Interpretations, Question 127.01 (Nov. 26, 2008). *See* § 6.03[4][e][vi] *infra*.

³⁰ *See* § 6.03[4][e][iv], *infra*, for a discussion of the restricted nature of securities sold under Section 4(a)(6).

³¹ Section 3(a)(10) is discussed in § 3.11 *supra*. For information regarding the scope of the exchange exemption contained in that section, *see* Loo & Soderbeck, *The "Fairness Hearing" Exemption*, 18 Rev. Sec. & Comm. Reg. 73 (1985); Kreutz & Margiotta, *Section 3(a)(10) of the Securities Act of 1933, A Practical Alternative to the Private Offering Exemption in Mergers and Acquisitions*, 635 PLI Corp. 505 (1989); Ash, *Reorganizations and Other Exchanges Under Section 3(a)(10) of the Securities Act of 1933*, 75 Nw. U.L. Rev. 1 (1980). *See also* Staff Legal Bulletin No. 4 (CF), September 16, 1997. For information regarding abuse of the exemption to dump large amounts of unregistered securities into the public markets, *see* Thomas S. Glassman, *3(A)(10) Financing: New Predatory Financing Using the Securities Act*, 5 Mich. Bus. & Entrepreneurial L. Rev. 99 (2016).

Pursuant to Rule 701 of the Securities Act, an issuer who is not yet subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act may offer and sell limited amounts of its securities pursuant to certain compensatory benefit plans and written compensation agreements. Although the Rule 701 exemption is available for public as well as private qualifying offerings, the rule expressly provides that all securities issued pursuant to it are restricted.³³

Rules 801 and 802 under the Securities Act provide exemptions from registration for rights offerings and exchange offers made by non-U.S. issuers where a limited number of shareholders of the subject class of securities are located in the United States. The restricted status of the securities offered depends on the status of the subject securities.³⁴

The Bankruptcy Code provides an exemption from registration for reorganizations pursuant to Section 1145.³⁵ Since such transactions are public offerings, persons acquiring securities thereby (other than those persons deemed “underwriters” by the Bankruptcy Code) acquire unrestricted securities.³⁶

[iii] In a Private Offering. Since 1933 the traditional private placement by the issuer has been exempted from registration by Section 4(a)(2) of the Securities Act, which exempts all “transactions by an issuer not involving any public offering.”³⁷ The scope of this so-called private placement exemption turns on the meaning of the term “public offering,” which, as stated above, is a factual determination for the issuer (and counsel) after consideration of the relevant factors.³⁸ Securities offered in this way are restricted.

A holder of securities offered in this way will generally be aware of their restricted nature because of actual knowledge that the issuer relied on Section 4(a)(2). Normally there is no question that the issuer relied on the Section 4(a)(2) exemption. Usually, but not always, the issuer will place a conspicuous legend on the face of the privately offered securities. Typically, this restrictive legend would state that the securities were not registered under the Securities Act and that they may not be resold or otherwise transferred in the absence of registration or compliance with the requirements of an available exemption from registration. Often the issuer will indicate in the legend (or in the subscription agreement pursuant to which the investor acquires the securities)

³² Section 3(a)(9) is discussed in § 3.10 *supra*. For information regarding the more limited scope of that exemption, see Campbell, *Mergers, Acquisitions and Recapitalizations Under Section 3(a)(9) of the Securities Act of 1933*, 61 Va. L. Rev. 1957 (1975). See also Note, *Distress Contingent Convertible Bonds*, 104 Harv. L. Rev. 1857, 1871 n.77 (1991); *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 Nw. U.L. Rev. 5452 n.135 (1990).

³³ See Rule 701 and see 6.03[3][a][ii] *infra*.

³⁴ See Rules 801 and 802 and see § 6.03[4][e][xiii] *infra*.

³⁵ 11 U.S.C. § 1145.

³⁶ See, e.g., I.C.H. Corporation, SEC No-Action Letter 1997 SEC No-Act. LEXIS 528 (April 14, 1997).

³⁷ Section 4(a)(2) is discussed in § 4.02 *supra*.

³⁸ See § 6.03[3] *supra*.

that any transfer of the securities will require an opinion of its or other counsel respecting the availability of a claimed exemption from registration. Finally, the issuer will commonly give stop transfer instructions to the transfer agent, a fact that can be easily discovered by contacting the transfer agent before attempting a sale.

In addition, at least the first holder of privately placed securities will probably be expressly informed by the issuer that the securities are restricted and that they may be resold only in certain limited circumstances.³⁹ Since the failure of the issuer to so inform the purchasers of privately placed securities constitutes a material omission in violation of the antifraud provisions of the Securities Acts,⁴⁰ it is unlikely that the issuer will fail to make this disclosure. Where the previous reliance on the private offering exemption by the issuer is suspected but not obvious, however, the holder of the suspect securities (or counsel) must confirm the use of Section 4(a)(2) or another exemption through appropriate investigation.

Five other relevant private offering exemptions from registration are available to the issuer. First, Section 4(a)(5) of the Securities Act provides an exemption for up to \$5,000,000 of securities privately offered only to accredited investors.⁴¹ As in the case of reliance on Section 4(a)(2), an issuer relying on Section 4(a)(5) will normally include a legend on the certificates, issue stop transfer instructions to the transfer agent, and inform the purchasers of the restricted nature of the securities and the consequent limitations on the resale of those securities under the Securities Act. The 2007 amendments codified the Commission's position that securities acquired under Section 4(a)(5) are restricted.⁴²

In addition to the statutory exemptions under Sections 4(a)(2) and 4(a)(5), the issuer may sell unregistered securities privately in reliance upon one of the two exemptions contained in Regulation D, promulgated by the Commission under both Sections 4(a)(2) and 3(b) of the Securities Act.⁴³ All Regulation D securities are restricted securities.⁴⁴ Regulation D expressly requires that the purchaser be informed of the

³⁹ It is important to note that restrictions on resale of privately placed securities may be imposed both by applicable securities laws and by the terms of the offering. Since privately placed securities are restricted, they may not be freely resold and must be sold pursuant to a registration statement or in accordance with exemptions such as Rule 144, see § 6.05 *supra*, or Rule 144A, see § 6.07 *infra*. They could also be resold outside the United States in reliance on Regulation S, see § 6.09 *infra*, or resold in reliance on the "exemption" under so-called "Section 4(a)(1 1/2)," see § 6.08[2] *infra*. The terms of the offering, however, may restrict resale to only certain of these options. The permitted resale options should be clearly indicated to investors.

⁴⁰ Sec. Act Rel. No. 33-5226, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,483, at ¶ 81,037 (1972).

⁴¹ Section 4(a)(5) is discussed in § 4.06 *supra*.

⁴² See § 6.03[2] *supra*.

⁴³ See Regulation D, discussed in § 4.04 *supra*. Regulation D's Rules 504, 505 (now repealed), and 506 replaced former Rules 240, 242, and 146, respectively. Rules 240, 242, and 146 were repealed effective June 30, 1982. Sec. Act Rel. No. 33-6389, [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,106 (1982).

⁴⁴ Despite the fact that securities sold publicly in reliance on Section 3(b) might otherwise be

restricted status of the securities and the resulting limitations on their resale and that the certificates contain a legend to that effect.⁴⁵ Accordingly, the restricted nature of Regulation D securities is almost never in doubt.⁴⁶

As a result of the Rule 701 exemption adopted by the Commission in 1988 pursuant to Section 3(b) of the Securities Act,⁴⁷ an issuer who is not yet subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act may offer and sell limited amounts⁴⁸ of its securities pursuant to certain compensatory benefit plans and written compensation agreements.⁴⁹ Although the Rule 701 exemption is available for public as well as private qualifying offerings,⁵⁰ the rule expressly provides that all securities issued pursuant to it are restricted.⁵¹ Securities issued pursuant to Rule 701 may be resold as freely unrestricted securities 90 days following the issuer's becoming subject to the reporting requirements of the Exchange Act.⁵² Again, since recipients of Rule 701 securities must be provided with a copy of the underlying plan or arrangement, the restricted nature of their securities should be clear to them.⁵³

In some cases the investor knows that securities acquired privately from the issuer are restricted, but does not desire restricted securities. Through arrangements with existing stockholders the investor acquires shares that are unrestricted or are eligible for sale under Rule 144 and the existing shareholder is issued new shares by the issuer. The Commission disapproves of these transactions and holds that the new investor has acquired restricted securities with a holding period commencing at the time it acquired the shares from the existing stockholder. According to the SEC staff, a “public resale

unrestricted securities (*see* discussion of status of securities sold in reliance on Regulation A at § 5.02[6] *supra*), both Regulation D and Rule 144 deem such securities to be restricted. Rule 502(d), discussed in § 4.04 *supra*. *See also* Rule 144(a)(3).

But see Rule 504(b)(1), discussed in § 4.04 *supra*, for a very limited exception. Rule 504(b)(1) provides that intrastate offerings complying with its requirements and made in accordance with state securities laws may be made publicly without implicating restrictions on transfer under federal securities law, but nearly all states impose their own resale restrictions.

⁴⁵ Rule 502(d), discussed in § 4.04 *supra*.

⁴⁶ *See* NASAA Guidelines for Cover Legends, October 2, 2004.

⁴⁷ Sec. Act Rel. No. 33-6768, [1987–1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,231 (1988).

⁴⁸ While the maximum amount of securities that may be offered annually under Rule 701 depends upon the total assets and the number of outstanding securities of the same class of the issuer (essentially 15% tests), it may sell at least \$1,000,000 in any consecutive 12-month period. If it sells more than \$10,000,000 in a 12-month period, it is required to provide certain financial and other disclosure to the persons receiving securities.

⁴⁹ Rule 701(a) and (b). *See also* Jackson, Tufts, Cole & Black, SEC No-Action Letter 1988 SEC No-Act. LEXIS 757 (May 25, 1988).

⁵⁰ Sec. Act Rel. No. 33-6768, [1987–1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,231 (1988), at 89,064.

⁵¹ Rule 701(g)(1). Securities Act Rule 701(g)(3) outlines the resale limitations for securities issued under Rule 701.

⁵² Rule 701(g)(3).

⁵³ Rule 701(b)(3).

of the shares acquired from the stockholder without regard to the conditions of Rule 144 would raise serious issues under Section 5 of the Securities Act for all parties to the transaction.”⁵⁴

[c] Status of Securities Acquired from an Affiliate. If the holder of securities acquired them directly from an affiliate of the issuer in a private transaction, the securities are not always restricted, despite the literal language of the Rule 144(a)(3) definition. Unlike the case where the securities were acquired from the issuer,⁵⁵ the restricted or unrestricted status of the securities acquired from the affiliate may sometimes depend upon whether that private acquisition was through a sale or through a transaction not involving a sale under the Securities Act.

In the light of the importance of the sale versus the non-sale nature of the transaction in determining the character of securities acquired privately from an affiliate, the scope of the term “sale” is crucial. Section 2(a)(3) of the Securities Act broadly defines “sale” to mean “every . . . disposition . . . for *value*”;⁵⁶ and the courts, usually in the context of determining the applicability of the registration requirements of the Securities Act, have construed that definition broadly. For example, a pledge of securities as collateral for the repayment of a loan has been determined to be a sale.⁵⁷ Only where no value is given is it clear that the transfer involves no sale for purposes of the Securities Act generally.

If particular securities were acquired from an affiliate in a private transaction⁵⁸ involving a sale, then the securities are always, in accordance with the language of Rule 144(a)(3), restricted securities. As in the case of securities acquired from the issuer, the securities sold by the affiliate to the holder in a private transaction become restricted in the holder’s hands even if they were unrestricted in the affiliate’s hands.⁵⁹

Where, however, the securities were acquired from an affiliate in certain transactions not involving a sale, such as a gift, the donee is deemed to stand in the shoes of the

⁵⁴ Current Issues and Rulemaking Projects, SEC Division of Corporation Finance, November 14, 2000, at 56. Where the issuer controls the shareholder who purportedly transfers unrestricted shares in return for restricted shares, the recipient is acquiring shares from an affiliate in a non-public transaction and, therefore, is acquiring restricted shares. *See, e.g.* In the Matter of Energy & Engine Technology Corporation, Securities Release No. 8311 (October 23, 2003).

⁵⁵ *See* § 6.03[4][b] *supra*.

⁵⁶ Emphasis added. Section 2(a)(3) is also discussed in § 2.02 *supra*.

⁵⁷ *Rubin v. United States*, 449 U.S. 424, 101 S. Ct. 698, 66 L. Ed. 2d 633 (1981); *Securities & Exchange Com. v. Guild Films Co.*, 279 F.2d 485 (2d Cir. 1960), *cert. denied sub nom.*, *Santa Monica Bank v. Securities & Exchange Com.*, 364 U.S. 819 (1960).

⁵⁸ As discussed in § 6.02[4] above, an affiliate may not generally rely on the Section 4(a)(1) resale exemption for public resales because the transaction will be deemed to be part of a distribution and the affiliate will thus be an underwriter.

⁵⁹ Rule 144(a)(3); Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979) at Section II(A), Question 9; Division of Corporation Finance, Compliance and Disclosure Interpretations, Question 129.03 (May 16, 2013).

donor.⁶⁰ Although the donee-holder would have restricted securities that status would last only until the donor ceased to be an affiliate and could freely trade the securities if it still owned them.⁶¹ Even if the securities were not restricted in the hands of the affiliate (they were acquired, for example, in the open market), they are restricted in the hands of the donee. As such securities would not be subject to any holding period requirement in the affiliate donor's hands, however, the donee need not comply with the holding period requirement in Rule 144(d) for subsequent sales. If the donee is a non-affiliate and has not been an affiliate during the preceding three months, then the donee may resell the securities pursuant to Rule 144(b)(1) subject only to the current public information requirement in Rule 144(c)(1), as applicable.⁶²

As is always the case, any transfer of securities by an affiliate in a public transaction of any nature (sale or non-sale) would not result in restricted securities.⁶³

An affiliate proposing to sell securities in a public offering may rely on one of four possible exemptions from registration, provided all of the requirements for perfection of one of these exemptions can be satisfied. The affiliate may rely on Regulation A for an offering of up to the lesser of either (i) \$6,000,000 or \$15,000,000 depending on the "Tier" of Regulation A or (ii) 30% of the total public offering amount (for selling security holders),⁶⁴ on the intrastate offering exemption contained in Section 3(a)(11) (but not on Rule 147),⁶⁵ on the exchange exemption contained in Section 3(a)(10), or on Rule 144.⁶⁶ The resale exemption contained in Section 4(a)(1) outside Rule 144 is normally not available for a public offering by an affiliate because the transaction would ordinarily involve an underwriter within the meaning of the Securities Act.⁶⁷

[d] Status of Securities Acquired from Another Holder. If the holder of securities acquired them from a person other than the issuer or an affiliate of the issuer in a transaction not involving a public offering, they are restricted if, and only if, they were restricted in the hands of the transferor. The chain of transactions⁶⁸ would have to be examined until the transferor was the issuer or an affiliate of the issuer. If, when the securities were first acquired from the issuer or an affiliate of the issuer, they were

⁶⁰ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979) at Section II(A), Question 9.

⁶¹ *Id.* at Section II(b), Question 12.

⁶² Division of Corporation Finance, Compliance and Disclosure Interpretations, Question 129.03 (May 16, 2013).

⁶³ *But see* § 6.03[4][e] *infra* for certain exceptions.

⁶⁴ Rule 251.

⁶⁵ The "safe harbor" provided by Rule 147 is available only to the issuer. *See* Rule 147(a).

⁶⁶ *See* § 6.05[3][c] *supra*.

⁶⁷ *See* § 6.02[4] *supra*.

⁶⁸ *See* "chain of transactions" language of Rule 144(a)(3). It must be noted that such "chain of transactions" language does not cover securities acquired in a Rule 701 transaction, an apparent oversight that does allow the conclusion, however, that a holder who acquires those securities from the original transferee even in a private transaction holds unrestricted securities. The more logical view is that Rule 701 securities were intended to be and should be treated like Rule 504 securities.

restricted securities in the hands of the transferee and if the chain of transactions from that first holder to the present holder of the securities involved no public resale, then the securities are restricted.⁶⁹ Otherwise, they are unrestricted securities and may be traded freely in the marketplace.

[e] Special Categories of Securities

[i] General. The dichotomy between public offering and private offering exemptions from registration is generally determinative of the unrestricted or restricted status of the securities so offered. There are, however, several significant categories of securities that cannot be so easily labeled under that dichotomy. Since these securities have proved troublesome both to the Commission and to securities lawyers, they warrant special mention.

[ii] Underwriters' Compensation and Similar Securities. Frequently, the underwriters of an issuer's first public offering are given the opportunity to purchase an equity interest in the issuer at a price well below the public offering price as partial compensation for their services. Although these underwriters' compensation securities, or so-called "cheap" securities, were arguably offered privately to the underwriters, the staff of the Commission views them as securities acquired in a transaction or chain of transactions *involving* a public offering and therefore as unrestricted securities.⁷⁰ Notwithstanding this position, however, the staff has permitted resale of such securities pursuant to Rule 144. Otherwise, sale of such securities would be even more difficult than for restricted securities.⁷¹ If the securities were issued as compensation for arranging a private offering, on the other hand, then they would not have been acquired in connection with a public offering and would therefore be restricted securities as defined by Rule 144(a)(3).⁷²

Similarly, an issuer will often issue securities, usually contemporaneously with its public offering, to various other persons who rendered services in connection with that public offering. Any securities so issued to finders or financial consultants are normally viewed by the staff as unrestricted securities on the ground that they were issued in connection with the related public offering.⁷³ Securities acquired by lawyers and accountants for their services in connection with a public offering, however, are usually, but not always, regarded by the staff as privately placed by the issuer and therefore restricted.⁷⁴

⁶⁹ Arguably a resale overseas, as well as a public resale, results in the securities becoming restricted. *But see* § 6.09 *infra*.

⁷⁰ *See, e.g.*, Kleinberg, Bensley, Kaplan & Wolff, SEC No-Action Letter 1972 SEC No-Act. LEXIS 1474 (April 12, 1972).

⁷¹ *See* § 6.02[5][b] *supra*.

⁷² MetPath, Inc., SEC No-Action Letter 1975 SEC No-Act. LEXIS 1607 (August 6, 1975).

⁷³ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(A), Question 10.

⁷⁴ John C. Shaw, SEC No-Action Letter 1988 SEC No-Act. LEXIS 1376 (October 12, 1988). *See* Newbery Energy Corporation, SEC No-Action Letter 1975 SEC No-Act. LEXIS 1840 (August 29, 1975);

[iii] Securities Acquired Through Employee Benefit Plans. Securities are frequently sold or distributed to employees by employee benefit plans that are established by the employer.⁷⁵ These employee stock option, stock purchase, stock bonus and various other benefit plans vary widely in form,⁷⁶ but all are designed to provide employees with some equity interest in the employer. Commonly, the plan, which may be an affiliate of the employer,⁷⁷ will acquire the securities of the employer directly from the employer in a private transaction and subsequently distribute them to the beneficiaries of the plan. Alternatively, the plan may purchase the securities to be distributed in the marketplace. In either case, the distribution of those securities to a number of employees will usually constitute a “public offering” within the meaning of the Securities Act and the Rule 144(a)(3) definition of restricted securities.⁷⁸ Accordingly, under the literal analysis set forth above,⁷⁹ the securities acquired from the plan would usually be unrestricted securities because they were acquired in a public offering, regardless of whether the plan was an affiliate for, or merely an agent for, the issuer of those securities.

The Division of Corporation Finance of the Commission, however, has taken a different approach toward securities of an employer acquired by the participants of an employee benefit plan. In the case where these securities were registered, they are of course deemed unrestricted in the hands of the participants.⁸⁰ Frequently, the securities distributed pursuant to an employee benefit plan were not registered because no sale was involved,⁸¹ because a transaction exemption was available,⁸² or because the staff of the Division took a no-action position regarding the need for registration, presumably on the ground that since the employees never make any investment decision regarding their participation in the plan, they would not benefit in any way from registration of the plan or of the underlying securities.⁸³ Prior to 1976, the Commission took the position that, despite the literal language of Rule 144(a)(3), all unregistered securities of the issuer distributed pursuant to a stock bonus or other

but see Hosposable Products, Inc., SEC No-Action Letter 1977 SEC No-Act. LEXIS 397 (February 24, 1977) (shares received by attorney who drafted registration statement treated like underwriters’ compensation shares).

⁷⁵ See § 6.03[4][b][iii] *supra*, for a discussion of offerings to employees pursuant to Rule 701.

⁷⁶ See generally D. Goldwasser, *A Guide to Rule 144* (2d ed. 1978) at 141–143.

⁷⁷ As an affiliate, the plan may sell securities to the participants in reliance on Rule 144. Sec. Act Rel. No. 33-6281, Fed. Sec. L. Rep. (CCH) ¶ 1052 (1981), at Section IIIA.

⁷⁸ SEC v. Ralston Purina Co., 346 U.S. 119, 73 S. Ct. 981, 97 L. Ed. 1494 (1953).

⁷⁹ See § 6.03[3] *supra*.

⁸⁰ See, e.g., Itel Corp., SEC No-Action Letter 1980 SEC No-Act. LEXIS 3808 (October 15, 1980); see also Sec. Act Rel. 33-6188, 1 Fed. Sec. L. Rep. (CCH) ¶ 1051 (1980), at Section VI(A).

⁸¹ See, e.g., Peninsular & Oriental Steam Navigation Company, SEC No-Action Letter 2004 SEC No-Act. LEXIS 724 (August 30, 2004); Peoples Bancorporation, SEC No-Action Letter 1983 SEC No-Act. LEXIS 2266 (April 25, 1983).

⁸² See Sec. Act Rel. 33-6188, 1 Fed. Sec. L. Rep. (CCH) ¶ 1051 (1980), at Section IV (describing available exemptions).

⁸³ See, e.g., Sec. Act Rel. 33-6188, 1 Fed. Sec. L. Rep. (CCH) ¶ 1051 (1980), at Section III(B)(2).

employee benefit plan were restricted securities in the hands of the participants regardless of the public or private nature of the particular offering.⁸⁴

In 1976, the Commission reversed that rigid position and adopted a limited policy exception to its earlier rule.⁸⁵ That exception is now incorporated in Securities Act Releases Nos. 6188⁸⁶ and 6281⁸⁷ and reflected in literally dozens of no-action letters involving a wide variety of employee benefit plans.⁸⁸ Under this policy exception, securities of the employer issued under most employee benefit and similar plans will not be treated by the Commission as restricted securities and may be freely traded if the following three conditions are satisfied:

- the issuer of the securities is subject to the periodic reporting requirements of Section 13 or 15(d) of the Exchange Act;⁸⁹
- the stock being distributed under the plan is actively traded in the open market; and
- the number of shares being distributed under the plan is relatively small in relation to the number of shares of that class issued and outstanding.⁹⁰

⁸⁴ Sec. Act Rel. No. 33-5243, [Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,701 (1972). It appears that the Commission took and continues to take the same position with respect to all unrestricted securities of issuers other than the employer that are distributed by the employer pursuant to an employee stock plan. Catalyst Stock Plan I, Ltd., SEC No-Action Letter 1983 SEC No-Act. LEXIS 1765 (February 14, 1983). See also Division of Corporation Finance, Compliance and Disclosure Interpretations, Question 129.01 (Jan. 26, 2009).

⁸⁵ Sec. Act Rel. No. 33-5750, [1976–1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,766 (1976).

⁸⁶ 1 Fed. Sec. L. Rep. (CCH) ¶ 1051 (1980) at Section VI(B).

⁸⁷ 1 Fed. Sec. L. Rep. (CCH) ¶ 1052 (1981) at Section III(B).

⁸⁸ See, e.g., Norfolk Southern Corporation, SEC No-Action Letter 1992 SEC No-Act. LEXIS 1058 (November 20, 1992); Westinghouse Electric Corp., SEC No-Action Letter 1991 SEC No-Act. LEXIS 1067 (September 12, 1991) (one-time free stock bonus to all employees of a division); Intelligent Electronics, Inc., SEC No-Action Letter 1991 SEC No-Act. LEXIS 1024 (August 20, 1991) (bonus shares distributed in relatively broad class of employees); Total Assets Protection, Inc., SEC No-Action Letter 1990 SEC No-Act. LEXIS 612 (March 30, 1990) (one-time free stock bonus to all non-management employees); UJB Financial Corp., SEC No-Action Letter 1990 SEC No-Act. LEXIS 118 (January 30, 1990) (long-term performance stock plan); Pioneer Hi-Bred International Corp., SEC No-Action Letter 1983 SEC No-Act. LEXIS 1881 (February 24, 1983) (involving a typical plan). Based on the policy exception, securities were also deemed unrestricted where the plan participants were entitled to elect cash in lieu of some or all of the securities available to them, Alexander & Baldwin, Inc., SEC No-Action Letter 1983 SEC No-Act. LEXIS 2186 (April 11, 1983); and where the “plan” was in fact a series of door prize programs rather than a traditional employee benefit plan, Coca-Cola Company, SEC No-Action Letter 1983 SEC No-Act. LEXIS 1612 (January 7, 1983). However, the policy exception was not applicable to the securities of issuers other than the employer even though distributed as part of an employee benefit plan, see Catalyst Stock Plan I, Ltd., SEC No-Action Letter 1983 SEC No-Act. LEXIS 1765 (February 14, 1983).

⁸⁹ Or, although the issuer is not subject to the periodic reporting requirements of the Exchange Act, it submits to the Commission information as required under Section 12(f)(1)(A) of the Exchange Act. See B.A.T. Industries p.l.c., SEC No-Action Letter 1992 SEC No-Act. LEXIS 671 (May 20, 1992).

⁹⁰ Sec. Act Rel. No. 33-6281, Fed. Sec. L. Rep. (CCH) ¶ 1052 (1981), at Section III(B). The number

If any one of the three conditions is not strictly satisfied, then the securities issued by the plan fall outside the Commission's exception and, according to the staff, are restricted securities in the hands of the participants.⁹¹ For example, where the issuer's reporting obligations pursuant to Section 15(d) of the Exchange Act were suspended, the staff took the position that the unregistered securities distributed pursuant to a stock bonus or option plan were restricted securities.⁹² Similarly, where the number of securities expected to be issued to certain employees would exceed one percent of the total number of those securities outstanding in a year, the Division found that the amount to be distributed was not "relatively small" within the meaning of the third condition above and that the securities, therefore, should be treated as restricted securities.⁹³

Although the staff has elaborated on only a few occasions on the "actively traded" requirement, presumably it would require evidence of regular trading of a number of shares large enough to ensure that resales of the securities distributed pursuant to the plan would have no measurable effect on the trading market.⁹⁴ Accordingly, securities acquired from employee benefit plans should not be treated as unrestricted securities if the number of securities distributed in any one year may have exceeded one percent of the outstanding securities of the same class, or where the volume of shares traded on an exchange or over the counter is not clearly substantial, or indeed where the plan, the issuer, or the participants are in any other way different from the cases clearly falling within the Commission's policy exception. In addition, it must be kept in mind that securities issued pursuant to an employee benefit plan to an affiliate of the issuer will

of securities distributed pursuant to the plan and available for resale during a fiscal year generally must not exceed one percent of the total of the number of shares outstanding. *See, e.g.,* Norfolk Southern Corp., SEC No-Action Letter 1992 SEC No-Act. LEXIS 1058 (November 20, 1992). The exception also appears to apply to securities issued to foreign participants of employee benefit plans, Tandy Corporation, SEC No-Action Letter 1981 SEC No-Act. LEXIS 3809 (July 24, 1981), though perhaps with additional requirements to accord with the requirements of foreign law. *See* E.I. Du Pont de Nemours & Co., SEC No-Action Letter (letter available September 25, 1982), where the securities were deemed unrestricted based on the usual three requirements and the further condition that the shares be held by the plan participants for at least two years as required by the applicable local law. The exception also applies to securities issued to non-employee directors. Pacific Telesis Group, SEC No-Action Letter 1992 SEC No-Act. LEXIS 766 (June 30, 1992).

⁹¹ Hach Co. Employee Stock Ownership Plan, SEC No-Action Letter (January 21, 1983); Lamb Technicon Corp., SEC No-Action Letter 1982 SEC No-Act. LEXIS 2608 (July 8, 1982). *See also* Corporation Finance Compliance and Disclosure Interpretations, Question 129.01 (Jan. 26, 2009).

⁹² Marline Oil Corporation, SEC No-Action Letter 1979 SEC No-Act. LEXIS 2011 (January 4, 1979); *see also* Sulpetro Limited, SEC No-Action Letter 1982 SEC No-Act. LEXIS 2609 (July 8, 1982).

⁹³ Braniff International Corp., SEC No-Action Letter 1982 SEC No-Act. LEXIS 2434 (May 31, 1982); Intergraph Corporation, SEC No-Action Letter 2002 SEC No-Act. LEXIS 583 (May 15, 2002).

⁹⁴ Aristek Communities, Inc., SEC No-Action Letter 1983 SEC No-Act. LEXIS 2878 (October 1, 1983) (average monthly trading of 1.7% of outstanding was enough). *See also* two instances where average monthly trading volume of less than one percent of the outstanding shares was enough, Rose's Stores, Inc., SEC No-Action Letter 1983 SEC No-Act. LEXIS 1617 (January 7, 1983) (0.5%) and American Agronomics Corp., SEC No-Action Letter 1981 SEC No-Act. LEXIS 2810 (January 12, 1981) (0.8%).

be “control securities” regardless of whether they are restricted or unrestricted under the above analysis.⁹⁵

[iv] Section 3(a)(9) Securities. Section 3(a)(9) provides an exemption from registration for issuers in the case of certain recapitalizations in which the issuer exchanges outstanding securities for new securities.⁹⁶ In contrast to the situation under 3(a)(10) exchanges discussed below, perhaps because of the nature of judicial review involved in such transactions, securities exchanged by the issuer in reliance upon Section 3(a)(9) of the Securities Act take on the character of the securities for which they are exchanged: restricted securities if they were issued in exchange for restricted securities and unrestricted if issued in exchange for unrestricted securities.⁹⁷

[v] Section 3(a)(10) Securities. Section 3(a)(10) of the Securities Act provides an exemption from registration for securities that are issued in exchange for outstanding securities, claims (including legal fees) or other property, or partly in such exchange, provided that a court or authorized governmental authority has approved the transaction on the basis of a suitable fairness hearing.⁹⁸ Typically, this exchange exemption is relied upon for securities issued in court approved settlements of litigation⁹⁹ and for securities issued in reorganizations found to be fair by authorized state securities commissions¹⁰⁰ or by courts with proper jurisdiction.¹⁰¹ As noted above, it is an exemption available to both the issuer of the securities being exchanged and to affiliates of the issuer,¹⁰² the two sources of restricted securities. Since the availability of the Section 3(a)(10) exchange exemption is not limited by the amount of securities issued, the number of recipients of the Section 3(a)(10) securities, or the manner of offering, it is generally regarded as an exemption available for public

⁹⁵ See generally § 6.04 *infra*.

⁹⁶ Section 3(a)(9) of the 1933 Act, reprinted in the Securities Primary Law Sourcebook, Volume A, Section B (Matthew Bender), is discussed in § 3.10 *supra*.

⁹⁷ Mr. Coffee, Inc., SEC No-Action Letter 1991 SEC No-Act. LEXIS 766 (June 6, 1991).

⁹⁸ Section 3(a)(10) is discussed in § 3.11 *supra*. The conditions for availability of Section 3(a)(10) and the consequent status of the securities so issued are codified in the Division of Corporation Finance Staff Legal Bulletin No. 3A (CF), June 18, 2008.

⁹⁹ See, e.g., Sprint Corporation, SEC No-Action Letter 2003 SEC No-Act. LEXIS 681 (August 25, 2003); Carolco Pictures, Inc., SEC No-Action Letter 1991 SEC No-Act. LEXIS 89 (January 23, 1991).

¹⁰⁰ See, e.g., Microlog Corp., SEC No-Action Letter 1990 SEC No-Act. LEXIS 1263 (November 23, 1990).

¹⁰¹ See, e.g., Hong Kong and Shanghai Banking Corp., Ltd., SEC No-Action Letter 1991 SEC No-Act. LEXIS 93 (January 23, 1991); International Mahogany Corp., SEC No-Action Letter 1990 SEC No-Act. LEXIS 1223 (October 25, 1990). In Staff Legal Bulletin No. 3 as originally released, the SEC Staff expressed the view that the National Securities Markets Improvements Act of 1996 precluded reliance on a fairness hearing conducted under states securities law as the basis for a claim of exemption pursuant to Section 3(a)(10) for any security that was a “covered security” (i.e., as to which state jurisdiction was pre-exempted by federal law) prior to the hearing. Staff Legal Bulletin No. 3A provides that since the Securities Litigation Uniform Standards Act of 1998 adds Section 3(a)(10) securities to the definition of “covered securities,” an issuer may now rely on a fairness hearing conducted under state securities law.

¹⁰² See § 6.03[4] *supra*.

offerings. Accordingly, the securities issued in proper reliance upon the Section 3(a)(10) exemption from registration would normally be unrestricted securities because they were acquired in a public offering.

The staff now views even securities issued in exchange for restricted securities in a Rule 145(a) transaction exempt under Section 3(a)(10) that does not involve a shell company as being unrestricted, reversing an earlier position that securities issued in a Section 3(a)(10) exchange for restricted securities were restricted themselves.¹⁰³ Now persons who were affiliates of an acquired company but are not affiliates of the issuer after a transaction can resell the securities received in the exchange without regard to Rule 144.¹⁰⁴ Persons who are or become affiliates of the issuer after the transaction may resell the securities of the issuer only in accordance with the provisions of Rule 144.¹⁰⁵ Non-affiliates of the issuer and the acquired company, including those who relinquished restricted securities, are free to resell the unrestricted securities received in the exchange without regard to the limitations of Rules 144 or 145.¹⁰⁶ The same interpretations apply where Section 3(a)(10) exempts the issuance of unregistered securities in settlement of litigation.¹⁰⁷ Any party to a Section 3(a)(10) involving a shell company, other than the issuer, must resell the securities acquired in the transaction only in compliance with the resale restrictions of Rule 145(c) and (d).¹⁰⁸

[vi] Section 3(a)(11) Securities. The Section 3(a)(11) intrastate offering exemption from registration under the Securities Act is available for sales of securities by the issuer of those securities or by an affiliate of the issuer where the transaction is in every respect intrastate in nature.¹⁰⁹ Like the exchange exemptions contained in Sections 3(a)(10) and 3(a)(9) of the Securities Act, the intrastate offering exemption is available regardless of the amount of securities offered, the number of offerees involved, or the manner of the offering. Accordingly, Section 3(a)(11) is available for all intrastate offerings, including public offerings; and the securities once issued are therefore normally regarded as unrestricted securities.¹¹⁰ Once again, the staff of the Commission has taken the position that while most securities sold in reliance upon the

¹⁰³ St. Ives Holding Co., Inc., SEC No-Action Letter 1987 SEC No-Act. LEXIS 2250 (July 22, 1987). The revised position was first codified in Staff Legal Bulletin 3, July 25, 1997, and revised by Revised Staff Legal Bulletin No. 3 (CF), October 20, 1999.

¹⁰⁴ Staff Legal Bulletin 3A (CF) June 18, 2008.

¹⁰⁵ Staff Legal Bulletin 3A (CF) June 18, 2008.

¹⁰⁶ See, e.g., EIG Mutual Holding Company, SEC No-Action Letter 2006 SEC No-Act. LEXIS 652 (October 25, 2006); EquiServe Trust Company, N.A., SEC No-Action Letter 2000 SEC No-Act. LEXIS 121 (February 2, 2000).

¹⁰⁷ See, e.g., Transocean Inc. SEC No-Action Letter 2007 SEC No-Act. LEXIS 596 (September 26, 2007); SanDisk Corporation SEC No-Action Letter 2006 SEC No-Act. LEXIS 621 (September 21, 2006); Ashanti Goldfields Company Limited, SEC No-Action Letter 2002 SEC No-Act. LEXIS 609 (June 19, 2002).

¹⁰⁸ See §§ 6.03[4][b] and [c] *supra*.

¹⁰⁹ See § 6.03[4] *supra*. See also § 3.12.

¹¹⁰ John F. Davis, SEC No-Action Letter 1983, SEC No-Act. LEXIS 1693 (January 18, 1973).

Section 3(a)(11) (or the related Rule 147) intrastate offering exemption are unrestricted as to resale, those issued in a “private” Section 3(a)(11) or Rule 147 transaction are restricted securities within the meaning of Rule 144(a)(3).¹¹¹

Offerings made in reliance on Section 3(a)(11) must comply with applicable state laws regarding offerings in that state, which may require the offering to be “qualified” with the state securities regulator or be made in accordance with an exemption from such qualification. In response to the SEC’s delay in adopting final regulations for the exemption from registration for “crowdfunding” offerings under Section 4(a)(6),¹¹² a number of states have adopted their own crowdfunding regulations under Section 3(a)(11).¹¹³ The nature of crowdfunding, which is generally conducted over the Internet (albeit, in Section 3(a)(11) offerings, using a method that limits Internet communications to residents of the specific state),¹¹⁴ means that many of these offerings will likely be viewed as being public and the securities offered thus treated as unrestricted, but the Commission has not issued guidance on this point and it is not clear that all state crowdfunding statutes will be treated the same way. While most states adopted crowdfunding exemptions that fit within the Section 3(a)(11) federal exemption, one or two states have adopted crowdfunding exemptions under Rule 504 of Regulation D. With a limited exemption, predicated on registration or qualification at the state level, securities issued under Rule 504 are generally restricted.¹¹⁵

[vii] Securities Acquired as Stock Dividends or in Stock Splits. Normally, securities of the issuer distributed by it to its own shareholders as stock dividends or as a result of a stock split are not registered under the Securities Act because no sale is involved.¹¹⁶ As set forth above, under the literal analysis of the Rule 144(a)(3) definition of restricted securities, those securities would be restricted in the hands of the recipient shareholders only if the distribution did not involve a public offering within the meaning of the rule.¹¹⁷ Once again, the approach of the staff of the Commission is different. In the staff’s view, the public or private nature of the transaction is not the deciding factor. Instead, the staff deems unregistered securities distributed as stock dividends or as a result of a stock split as restricted if they were distributed in respect of restricted securities.¹¹⁸ Otherwise, they are regarded as unrestricted securities.¹¹⁹ As is always the case, any of these securities distributed to an affiliate of the issuer will be

¹¹¹ Electronic Data Systems Corporation, SEC No-Action Letter 1975 SEC No-Act. LEXIS 918 (May 14, 1975).

¹¹² See § 6.03[4][e][xiv] *infra*.

¹¹³ See, e.g., GA Comp. R. & Regs. § 590-4-2-.08.

¹¹⁴ Division of Corporation Finance, Compliance and Disclosure Interpretations, Question 141.04 (Apr. 10, 2014) and Question 141.05 (Oct. 2, 2014).

¹¹⁵ See § 6.03[2] *infra*.

¹¹⁶ See § 6.03[4][b] *supra*.

¹¹⁷ See § 6.03[4] *supra*.

¹¹⁸ Turner Broadcasting System, Inc., SEC No-Action Letter 1987 SEC No-Act. LEXIS 1480 (January 5, 1987); Associated Communications Corporation, SEC No-Action Letter 1983 SEC No-Act. LEXIS 2710 (August 18, 1983); Teleflex Incorporated, SEC No-Action Letter 1972 SEC No-Act. LEXIS 2149

“control securities” regardless of their restricted or unrestricted character.¹²⁰

One effect of this approach is that frequently some of the securities distributed as a stock dividend will be restricted securities in the hands of the recipients while others of the same issue will be unrestricted securities.¹²¹ In fact, any particular shareholder may receive some restricted securities and some unrestricted securities in the same distribution because she received them in respect of both types of securities. Though perhaps illogical in light of the Rule 144(a)(3) definition of restricted securities, these effects also exist in the case of those Section 3(a)(9) securities that are issued in a public offering, but are deemed restricted by the staff of the Commission on the ground that they were issued in exchange for restricted securities.¹²²

As noted above, the Division of Corporation Finance has taken a more flexible approach as to securities acquired through certain employee benefit programs.¹²³ As a result, those securities are often deemed unrestricted and therefore freely tradeable by most employee participants who receive them.¹²⁴ The staff also appears to be moving in a similar direction as to certain securities acquired in spin-offs or liquidating distributions.¹²⁵

[viii] Securities Acquired as Spin-Offs or Liquidating Distributions. A spin-off is a free distribution of the securities of an issuer other than the distributing entity to the distributing entity’s own security holders. As in the case of an ordinary stock dividend, the securities, albeit those of a different issuer, are received in respect of the outstanding securities of the distributing entity. A liquidating distribution is similar to a spin-off, except that the distribution is incident to the liquidation and dissolution of the distributing entity.¹²⁶ In effect, then the security holders of that liquidating entity receive the securities of a different issuer in exchange for their securities of the liquidating entity that become valueless as a result of the liquidation. Frequently, the liquidation is the final step in a reorganization that involved the sale of all of the assets of the distributing entity in exchange for the securities that are thereafter distributed as a liquidating dividend.

(May 31, 1972); Mini Mart Corporation, SEC No-Action Letter 1972 SEC No-Act. LEXIS 2450 (June 29, 1972).

¹¹⁹ Associated Communications Corporation, SEC No-Action Letter 1983 SEC No-Act. LEXIS 2710 (August 18, 1983); Teleflex Incorporated, SEC No-Action Letter 1972 SEC No-Act. LEXIS 2149 (May 31, 1972); Mini Mart Corporation, SEC No-Action Letter 1972 SEC No-Act. LEXIS 2450 (June 29, 1972).

¹²⁰ See generally § 6.02 *supra*.

¹²¹ This effect is significant given the difference in actual value between restricted securities and unrestricted securities of the same class of the same issuer.

¹²² See § 6.03[4][e][iv] *supra*.

¹²³ See § 6.03[4][e][iii] *supra*.

¹²⁴ See § 6.02 *supra*.

¹²⁵ See § 6.03[4][e][viii] *infra*.

¹²⁶ The distribution is of course a liquidating distribution when the securities being distributed are the only assets of the liquidating entity.

In the case of both a spin-off and a liquidating distribution, the securities that are distributed by the distributing entity may have been either restricted securities or unrestricted securities in the hands of that distributing entity. In the case of either transaction, the distribution may or may not constitute a public offering within the meaning of the Rule 144(a)(3) definition of restricted securities. Finally, the distributing entity may be unrelated to the issuer of the securities distributed (as is often the case where an investment company is divesting itself of some or all of the securities in its portfolio), or the distributing entity may be an affiliate, or even the parent, of the issuer of the securities distributed. In 1997, the staff of the Commission issued a Staff Legal Bulletin outlining the circumstances in which spin-off transactions are not required to be registered under the Securities Act.¹²⁷ Based on a “no-sale” theory, and taking into account the policy concern that adequate information be available about the issuer of the spun-off securities, the staff’s position is that a subsidiary does not have to register a spin-off if the following conditions are met, which is articulated in Staff List Bulletin 4:

- the parent shareholders do not provide consideration for the spun-off shares;
- the spin-off is pro rata to the parent shareholders;
- the parent provides adequate information about the spin-off and the subsidiary to its shareholders and to the trading markets;
- the parent has a valid business purpose for the spin-off; and
- if the parent spins off “restricted securities,” it has held those securities for at least two years.¹²⁸

By issuing the Bulletin, the staff hoped to decrease the considerable number of no-action letters it received on the subject of spin-offs.¹²⁹

Securities that are acquired in a registered spin-off or liquidating distribution, like all securities acquired in any other registered offering, are unrestricted securities in the hands of the distributees regardless of whether they were distributed in respect of restricted securities or whether the distributing entity was an affiliate of the issuer of those securities.¹³⁰

¹²⁷ Staff Legal Bulletin No. 4 (CF), September 16, 1997.

¹²⁸ *Id.* The Bulletin discusses each of these conditions in detail.

¹²⁹ For a transaction in which the staff took a no-action position on spin-offs of U.S. domestic affiliates of the distributing entity without registration, see PepsiCo, Inc., SEC No-Action Letter 1997 SEC No-Act. LEXIS 873 (September 15, 1997).

With respect to no-action positions on spin-offs of affiliates involving non-U.S. distributing entities, see AB Electrolux, SEC No-Action Letter 1997 SEC No-Act. LEXIS 569 (April 28, 1997).

See also Chugai Pharmaceutical Co., Ltd., SEC No-Action Letter 2002 SEC No-Act. LEXIS 456, (April 30, 2002), which covers the spin-off of a U.S. subsidiary by a non-U.S. parent, a situation not covered by the Bulletin, but granting no-action relief on essentially the same grounds as set forth in the Bulletin.

¹³⁰ Midwestern Financial Corporation; First Golden Bancorporation, SEC No-Action Letter 1973 SEC No-Act. LEXIS 2946 (June 25, 1973).

In the case of unregistered spin-offs or liquidating distributions, however, the restricted or unrestricted character of the securities in the hands of the distributees was, until issuance of Staff Legal Bulletin No. 4, less clear. If the literal analysis of the Rule 144(a)(3) definition of restricted securities were applied, the securities acquired in a spin-off or liquidating distribution would be restricted securities in the hands of the distributees only if the distribution were a private rather than a public transaction, and either the securities were restricted securities in the hands of the distributing entity or the distributing entity were an affiliate of the issuer.¹³¹ The Bulletin states that it is the view of the Division of Corporation Finance that securities received by shareholders in a spin-off that meets the conditions set out in the Bulletin are generally not restricted securities.¹³² Sales by the spun-off company's affiliates, however, would be subject to Rule 144(d), absent registration or another appropriate exemption.¹³³ The staff states that in rare situations, a large shareholder so controls the parent that the shareholder essentially decides whether to do the spin-off, in which case the staff would view the spin-off as a privately negotiated transaction, with that shareholder getting restricted securities (and other shareholders receiving unrestricted securities).¹³⁴

It would seem from these statements that the staff has returned to a more literal interpretation of the Rule 144(a)(3) definition. Previously, the staff had regarded all such securities as restricted securities,¹³⁵ then later viewed securities acquired in a spin-off or liquidating distribution as restricted securities in the hands of the distributees whenever they had been restricted securities in the hands of the distributing entity prior to the distribution.¹³⁶ This was the case even where the transaction appeared more public than private in nature.¹³⁷ A later view of the staff appeared to depend first upon whether the distributing entity was an affiliate of the issuer of the distributed securities at the time of the transaction. In the case of the non-affiliate distributing entity, the public or private nature of the spin-off or liquidating distribution was neither the determining nor even a relevant factor in determining the securities' character. The securities so acquired were viewed as restricted securities in the hands of the distributees if they had been such in the hands of the non-affiliate distributing entity.¹³⁸

¹³¹ See § 6.03[4] *supra*.

¹³² See Staff Legal Bulletin No. 4 (CF), September 16, 1997.

¹³³ See Staff Legal Bulletin No. 4 (CF), September 16, 1997.

¹³⁴ See Staff Legal Bulletin No. 4 (CF), September 16, 1997.

¹³⁵ D. Goldwasser, *A Guide to Rule 144* (2d ed. 1978), at 151–153.

¹³⁶ See, e.g., Virginia Real Estate Investment Trust, SEC No-Action Letter 1979 SEC No-Act. LEXIS 2858 (May 29, 1979).

¹³⁷ 20th Century Corp., SEC No-Action Letter 1977 SEC No-Act. LEXIS 2631 (November 7, 1977), involving a distribution to approximately 33 shareholders. Where the distributed securities had been unrestricted securities in the hands of the distributing entity, the staff reversed its earlier position and regarded them as unrestricted securities in the hands of the distributees. Kaiser Industries Corp., SEC No-Action Letter 1977 SEC No-Act. LEXIS 95 (January 21, 1977).

¹³⁸ Huntington Bancshares, Inc., SEC No-Action Letter 1980 SEC No-Act. LEXIS 3691 (September 21, 1980).

The staff's current position is consistent both with the express language of Rule 144(a)(3) and the stated purpose of Rule 144 "to prohibit the creation of public markets in securities of issuers concerning which adequate current information is not available to the public."¹³⁹ It is unlikely, despite the wording of Rule 144(a)(3), that the staff will extend its position to any public spin-offs or liquidating distributions of restricted securities that fail to conform to the disclosure requirements mentioned above because such distributions do create a public market without ensuring the availability of adequate public information. The securities acquired in such nonconforming transactions, therefore, should continue to be viewed as restricted securities with all of the accompanying restrictions on their tradability in the marketplace.

[ix] Rule 145 Securities. Rule 145 provides that certain business combinations, such as mergers, consolidations and acquisitions of assets, are subject to the registration requirements of the Securities Act.¹⁴⁰ Rule 145(a) specifies that, with limited exceptions, an "offer" or "sale" will be deemed to occur with exchanges of securities in connection with certain reclassifications, mergers, consolidations and transfers of assets that are submitted for the vote or consent of the security holders of a corporation. Accordingly, the "sale" must be registered unless an exemption is available. Under Rule 145(c), or the presumptive underwriter provision, any party to any transaction of the type set forth in Rule 145(a) (other than the issuer) or an affiliate of such party who publicly offers the securities acquired in that transaction is an "underwriter" if any party to a Rule 145(a) transaction is a shell company, other than a business combination related shell company.¹⁴¹

[x] Securities Acquired Overseas. In 1990, the Commission promulgated Regulation S, which provides that offers and sales of securities made outside the United States are not subject to the registration requirements of the Securities Act.¹⁴² The release adopting Regulation S stated that securities sold overseas in reliance on Regulation S were not "restricted securities."¹⁴³ It would be logical to suppose that securities acquired overseas otherwise than in reliance on Regulation S were similarly

¹³⁹ See Preliminary Note to Rule 144.

¹⁴⁰ See § 6.02[5][d] *supra*.

¹⁴¹ Rule 145(c), prior to the 2007 amendments to Rule 144, defined any party to any transaction of the type set forth in Rule 145(a) (other than the issuer) or an affiliate of such party who publicly offers the securities acquired in such transaction as an "underwriter" (and did not limit the designation to transactions involving shell companies). Prior to the amendments, such a "presumptive underwriter" would be required to comply with Rule 145(d) in connection with resales of the acquired securities even if the person, following the transaction, were no longer an affiliate of the combined entity and even if such person received registered securities in the business combination. The 2007 amendments, in short, eliminated the presumptive underwriter provision of Rule 145(c), except with respect to transactions involving a shell company.

¹⁴² Sec. Act Rel. No. 33-6863 [1989-1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,524 (April 24, 1990).

¹⁴³ At least once any "distribution compliance period" (imposed on certain types of offerings to limit the chances of unregistered distributions in the United States) had expired. *Id.*, at n.112. See, however, § 6.02[5][e] *supra*.

not restricted, although the Regulation S adopting release makes no reference to such transactions.¹⁴⁴

After the adoption of Regulation S, however, there were reports of its misuse for offerings by U.S. companies which purported to be made overseas in reliance on the Regulation, but where the securities so offered were intended to be sold back into the United States in an unregistered public offering.¹⁴⁵ In view of these perceived abuses, in 1995 the Commission issued a Concept Release expressing concerns about such practices,¹⁴⁶ and in 1998 adopted Rule 905, which stated that equity securities offered overseas by U.S. companies were restricted securities and would remain restricted notwithstanding any resales overseas.¹⁴⁷ Such securities are permitted to be resold under Rule 144.

[xi] Securities Acquired by “Underwriters” in Bankruptcy Code Section 1145 Transactions. Section 1145(c) of the Bankruptcy Code provides that transactions that take place pursuant to Section 1145(a) are public offerings, and thus, securities issued pursuant to that section are unrestricted, so long as the sellers are not deemed “underwriters” by that section.¹⁴⁸ Underwriters for that purpose include those offering to sell securities received under the plan or offering to buy such securities with a view to distribution. Such underwriters may resell their securities in “ordinary trading transactions” so long as there are no concerted selling efforts of recipients of the securities pursuant to the reorganization, no use of offering documents other than that used for the reorganization and special compensation to brokers.¹⁴⁹

[xii] Securities Acquired Pursuant to Regulation CE. Under Regulation CE (Rule 1001), offers and sales of securities that satisfy the conditions of California Corporations Code paragraph (n), Sec. 25102 are exempt from Section 5 of the Securities Act, provided that the sum of all cash and other consideration to be received do not exceed \$5,000,000, less the aggregate offering price for all other securities sold in the same offering, whether pursuant to this or another exemption.¹⁵⁰ Securities issued under this rule are “restricted securities” as defined by paragraph (a)(3) of Rule 144 and accordingly resales of such securities must be made in compliance with the Securities

¹⁴⁴ *But see* International Income Property, SEC No-Action Letter 1980 SEC No-Act. LEXIS 4064 (December 12, 1980) in which the staff permitted reliance on Rule 144 to resell securities acquired overseas.

¹⁴⁵ *See* Hanks, *Direct Regulation S Offerings and the SEC’s “Problematic Practices” Release*, Stanford J.L. Bus & Fin. Vol. 2 No. 2, 303, at n.2 (1996).

¹⁴⁶ Sec. Act Rel. No. 33-7190, 1 Fed Sec. L. Rep. (CCH) ¶ 3059 (1995).

¹⁴⁷ Sec. Act Rel. No. 7505 (1998).

¹⁴⁸ Division of Corporation Finance, Compliance and Disclosure Interpretations, Question 128.03 (Jan. 26, 2009). For an example of a situation where the staff declined to agree that Section 1145(a) was available, see XO Communications, Inc. (publicly available June 1, 2004).

¹⁴⁹ I.C.H. Corporation, SEC No-Action Letter 1997 SEC No-Act. LEXIS 528 (April 14, 1997).

¹⁵⁰ *See* 17 CFR 230.1001 (Regulation CE).

Act registration requirements or an exemption from them.¹⁵¹

[xiii] Securities Offered in Rule 801 or 802 Transactions. In 1999, the Commission adopted new rules to make it easier for non-U.S. companies to make rights offerings into the United States and for persons (U.S. or non-U.S.) to extend into the United States tender offers and exchange offers for securities of non-U.S. companies that are made primarily outside the United States.¹⁵² The rules exempt exchange offers and tender offers from registration under the Securities Act (and provide other regulatory relief) when 10% or less of the subject class of securities is owned by U.S. holders, and other procedural requirements are met. New securities issued in rights offerings under Rule 801 are unrestricted if the subject securities were unrestricted, and restricted only if the subject securities were restricted. The same principles apply in exchange offers under Rule 802.

[xiv] Securities Acquired in Section 4(a)(6) Crowdfunding Transactions. In 2012, the JOBS Act added Section 4(a)(6) to the Securities Act.¹⁵³ Section 4(a)(6) provides an exemption from registration under the Securities Act for offerings made by non-reporting issuers making offerings of less than \$1 million a year. The exemption limits the amount that investors may invest in any offerings of this type within a one-year period and imposes significant disclosure and filing requirements on the issuer. The conditions to the exemption are set out in Securities Act Section 4A and provide that securities issued in a Section 4(a)(6) transaction may not be transferred by the purchaser during a one-year period except:

- to the issuer;
- to an accredited investor;
- as part of an offering registered with the Commission; or
- to a member of the family of the purchaser in connection with the divorce or death of the purchaser.¹⁵⁴

In light of the fact that an offering under Section 4(a)(6) is by definition a public offering, made over the Internet, and the limits on investment amounts mean that investors are unlikely to be functioning as “underwriters” in any sense, it is logical that neither the statute nor the SEC’s implementing Regulation Crowdfunding¹⁵⁵ treats these securities as “restricted.” The resale exemption of Section 4(a)(1) is thus presumptively available, with an overlay of a separate statutory limitation on the persons to whom those Section 4(a)(1) resales may be made. From a drafting point of view the statutory limitation on transfer by “the purchaser of [securities issued pursuant

¹⁵¹ *Id.*

¹⁵² Sec. Act Rel. No. 33-7759 (1999).

¹⁵³ Jumpstart Our Business Startups Act, Pub. L. No. 112-106 §§ 301–05 (codified in 15 U.S.C.).

¹⁵⁴ Section 4A of the Securities Act of 1933.

¹⁵⁵ Sec. Act Rel. 33-9974 (Oct. 30, 2015).

to a Section 4(a)(6) transaction]”¹⁵⁶ might be interpreted as applying only to the purchaser in the Section 4(a)(6) transaction and not to any subsequent purchasers, who would be purchasing securities in a Section 4(a)(1) transaction, not a Section 4(a)(6) transaction. The Commission’s final rules established that the one-year restriction applies to all transactions made during that period, not just to the initial purchaser.¹⁵⁷

[xv] **Securities Acquired in Resales Under Section 4(a)(7).** On December 4, 2015, President Obama signed the Fixing America’s Surface Transportation Act, a highway funding law with several unrelated securities law provisions tacked on at the end (the “FAST Act”).¹⁵⁸ The FAST Act included a new statutory exemption for private resales of securities, Securities Act Section 4(a)(7).¹⁵⁹ Securities involved in a sale under Section 4(a)(7) are deemed by statute to be restricted securities.¹⁶⁰

[5] Duration of Restricted Status

Particular securities are unrestricted in any of the following four situations:

- where the security holder acquired those securities in a public offering, whether registered under the Securities Act¹⁶¹ or exempt from¹⁶² or not subject to the Securities Act’s registration requirements;¹⁶³
- where the security holder’s transferor (provided that the transferor was not then an affiliate of the issuer) acquired those securities in a public offering;¹⁶⁴
- where a previous security holder acquired those securities in a public offering;
or

¹⁵⁶ Section 4A(e) of the Securities Act of 1933.

¹⁵⁷ Rule 501 of Regulation Crowdfunding.

¹⁵⁸ Fixing America’s Surface Transportation Act, Pub L. No. 114-94 (2015).

¹⁵⁹ Section 4(a)(7) of the Securities Act of 1933.

¹⁶⁰ Section 4(e)(1)(C) of the Securities Act of 1933.

¹⁶¹ In certain circumstances securities held by “innocent persons” who purchased such securities in an unregistered chain of transactions which constituted an unrestricted public offering made in ignorance of, with disregard for, or under a misinterpretation of the Securities Act’s registration requirements have been permitted to be resold pursuant to Rule 144 in compliance with Rule 144’s requirements other than the holding period and the filing of notice requirement, despite the fact that they are not technically restricted securities. The availability of Rule 144 protects such persons from being deemed to be involved themselves in an unregistered public offering. *See, e.g.,* Fluid Power Pump Company, SEC No-Action Letter 1976 SEC No-Act. LEXIS 2667 (December 16, 1976); Hadron Inc., SEC No-Action Letter 1981 SEC No-Act. LEXIS 3836 (available July 31, 1981).

¹⁶² *See* § 6.03[4][b] *supra* for a list of the possible public offering exemptions from registration under the Act.

¹⁶³ Regulation S under the Act provides that offers and sales made outside the United States are not subject to (as opposed to exempt from) the Act’s registration provisions. *See* discussion of status of Regulation S securities in § 6.03[4][e][x] *supra*.

¹⁶⁴ If the security holder’s transferor was an affiliate, then the securities could nevertheless be restricted again at least in the hands of a purchaser from the security holder. *See* § 6.03[4][c] *supra* for further explanation.

- where the securities are of a non-U.S. issuer and were acquired by the security holder or a previous security holder outside the United States in a transaction that met the conditions of Regulation S.¹⁶⁵

Thus, involvement of securities in a public offering,¹⁶⁶ at any time after they were last held by the issuer or an affiliate of the issuer normally renders them unrestricted.¹⁶⁷ It is important to realize that while registered securities are normally unrestricted securities, unregistered securities are not restricted securities if they meet the above tests.

As mentioned above, once restricted securities have been created, they remain restricted throughout any number of sales, donations or other transfer until they are transferred in a public offering or overseas or the expiration of the applicable holding period since the securities were last held by the issuer or any affiliate of the issuer.¹⁶⁸ At that point, they become essentially unrestricted securities and may therefore be freely traded under the resale exemption contained in Section 4(a)(1) of the Securities Act.¹⁶⁹

§ 6.04 Definition of Control Securities

[1] Introduction

The second of the two major categories of resales limited by the general unavailability of the Section 4(a)(1) resale exemption (the first being restricted securities) includes, if an underwriter is involved, any resale of any outstanding securities by a person who at the time of the resale is in a control relationship with the issuer of the securities.¹ These securities, commonly referred to over the years as “control securities,” are restricted as to their public resale only for as long as they are held by a person who is in a control relationship with, or in the terminology of Rule 144, is an affiliate of the issuer.²

The Securities Act contains no definition of the term “control securities,” nor indeed any reference whatever to this category of securities. Unlike the case of restricted securities,³ the limitations on the resale of control securities derive from nothing other

¹⁶⁵ See § 6.03[4][e][x] *infra* for discussion of securities acquired overseas.

¹⁶⁶ See § 6.05[3][d] *infra* with respect to the implications of a public offering being registered.

¹⁶⁷ *But see* §§ 6.03[4][e] *supra*.

¹⁶⁸ See discussion in § 6.05[5] *infra*.

¹⁶⁹ In fact such securities remain by definition restricted securities in the hands of the seller but may be sold freely under Rule 144’s safe harbor within Section 4(a)(1). See Republic Resources Corporation, SEC No-Action Letter 1988 SEC No-Act. LEXIS 188 (February 15, 1988) and analysis in §§ 6.02[1] *supra* and 6.05[8] *infra*.

¹ See § 6.02[2] *supra*.

² See § 6.04[5] *supra*.

³ In the case of restricted securities, the limitations on their resale derive from the private manner of the acquisition from the issuer or an affiliate of the issuer and continue until the restricted taint is removed. See §§ 6.03[4] and [5] *supra*.

than the affiliate status of the holder. Simply put, control securities are securities that are owned by an affiliate of the issuer. To determine then whether securities that are proposed to be sold are control securities, it is necessary only to ascertain the affiliate or non-affiliate status of the holder.

[2] Rule 144 Definition of an Affiliate

Paragraph (a)(1) of Rule 144 defines the term “affiliate” of an issuer to mean “a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such issuer.” Three categories of persons⁴ are, under this definition, affiliates of the issuer:

- persons who *control* the issuer,
- persons who are *controlled by* the issuer, and
- persons who are *under common control with* the issuer.

It is, therefore, the concept of control that is determinative of affiliate status.

[3] Controlling Persons of the Issuer

While the concept of control runs throughout the federal securities laws,⁵ neither the Securities Act nor the Exchange Act contains a statutory definition of control. Rule 405, however, relating to registration under the Securities Act specifies that:

[t]he term “control” (including the terms “controlling,” “controlled by” and “under common control with”) means the possession, direct or indirect, of the *power* to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise (emphasis added).

As that definition makes clear, each of those persons who either actually controls or has the power to control the policies of the issuer is a controlling person and therefore an affiliate of the issuer. When Rule 144 was adopted, the Commission considered,⁶ but did not adopt, more objective standards for determining control status. Control status remains therefore, a question of fact and indeed a question of fact that must be resolved in most cases by either counsel for the proposed seller or counsel for the issuer.⁷

⁴ Section 2(a)(2) of the 1933 Act, reprinted in the Securities Primary Law Sourcebook, Volume A, Section B (Matthew Bender), defines the term “person” as:

an individual, a corporation, a partnership, an association, a joint stock company, a trust, any unincorporated organization, or a government or political subdivision thereof.

See Rule 144(a)(2) of the 1933 Act reprinted in the Securities Primary Law Sourcebook, Volume A, Section C (Matthew Bender).

⁵ See A. Sommer, *Who’s “In Control?”*, 21 Bus. Law. 559, 559–62 (1966); see, e.g., SEC v. Tuchinsky [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96, 917 at 93,805 (S.D. Fla. 1992).

⁶ Sec. Act Rel. No. 33-5223, [1971–1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,487 (1972); D. Goldwasser, *A Guide to Rule 144*, at 91–92 (2d ed. 1978).

⁷ The staff has repeatedly stated that it no longer makes determinations of affiliate status. Sec. Act Rel. No. 33-6253, 1 Fed. Sec. L. Rep. (CCH) ¶ 134A (1980). Its position is that affiliate status is a factual question best resolved by the parties involved in the transaction and their counsel. See, e.g., Hoedeman and Christy, P.A., SEC No-Action Letter 1991 SEC No-Act. LEXIS 1165 (October 10, 1991); Gulf Energy

Because there is no mathematical or other objective test, the determination of control status is often difficult or uncertain. As a practical matter, the staff of the Commission appears rather consistently to presume that persons who fall within certain categories are affiliates. Those categories include, in addition to persons able to cause the issuer to file a registration statement,⁸ the following persons:

- executive officers and directors of the issuer,⁹ including those who perform the functions of such persons;¹⁰
- persons who own more than 10 percent of the voting securities of the issuer;¹¹
- close family members of any of the above persons;¹² and
- creditors of the issuer who have control by reason of negative covenants in the relevant underlying loan agreements.¹³

The presumption of affiliate status is rebuttable by any of those persons, but the burden of proving that the person does not, even in conjunction with others, control or possess the power to control the issuer is substantial.¹⁴ The staff, on the other hand, has not suggested categories of persons who will be presumed not to be affiliates.

The term controlling person not only refers to an individual person, but also includes each of the members of a controlling group.¹⁵ Again, the concept of a control group has never been defined. Paragraph (a)(2) of Rule 144, however, does define the term

Corporation, SEC No-Action Letter 1981 SEC No-Act. LEXIS 4156 (October 30, 1981).

⁸ C. Israels, SEC Problems of Controlling Stockholders and in Underwritings 21 (1962), *quoting* Commissioner Manuel F. Cohen.

⁹ *See, e.g.*, Servo Systems, Inc., SEC No-Action Letter 1977 SEC No-Act. LEXIS 1172 (April 27, 1977); *see generally* A. Sommer, *Who's "In Control?"*, 21 Bus. Law. 559, 559–62 (1966), at 573. Some guidance regarding at least directors and officers who have been nominees for the position of director is provided by the issuer's proxy statements since the control status of such persons must be indicated. Item 6(b), Exchange Act of 1934 Schedule 14A.

¹⁰ Section 16 of the Exchange Act of 1934, reprinted in the Securities Primary Law Sourcebook, Volume B, Section F (Matthew Bender), provides a practical guideline for determining which persons other than directors are control persons. If a person under the regulations and case law interpreting that section is required to make regular filings of his stock ownership under Exchange Act of 1934 Section 16(a), then that person would probably also be a control person for purposes of determining the availability of Securities Act Section 4(a)(1) and Rule 144.

¹¹ *See, e.g.*, Del Electronics Corp., SEC No-Action Letter 1980 SEC No-Act. LEXIS 3473 (July 21, 1980) (holder of 13.43% of outstanding shares presumed affiliate).

¹² *See, e.g.*, Jesse M. Brill, Esq., SEC No-Action Letter 1979 SEC No-Act. LEXIS 3489 (September 24, 1979), in which the staff viewed all family members of an affiliate living in the same household as affiliates; Radiation Technology, Inc., SEC No-Action Letters 1973 SEC No-Act. LEXIS 1092 (December 26, 1973).

¹³ A. Sommer, *Who's "In Control?"*, 21 Bus. Law. 559, 559–62 (1966), at 573; Dan Goldwasser, *A Guide to Rule 144* (2d ed. 1978), at 92; *but see* Mangel Stores Corp., SEC No-Action Letter 1975 SEC No-Act. LEXIS 2429 (December 5, 1975).

¹⁴ D. Goldwasser, *A Guide to Rule 144*, at 94–95 (2d ed. 1978).

¹⁵ *See, e.g.*, Carnation Co., SEC No-Action Letter 1980 SEC No-Act. LEXIS 2742 (February 3, 1980); Comtech Laboratories, Inc., [1972–1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,231 (1973).

“person” when used with reference to a person whose securities are to be sold to include, in addition to the actual person, all of the following persons:

- relatives and spouses sharing the same home (a relative or spouse sharing the same home with an affiliate is always an affiliate and the affiliate status of a relative of a control person is rebuttable only when that relative does not share a residence with the control person);¹⁶
- trusts or estates in which the person and those in paragraph (1) above together have a 10 percent or more beneficial interest or of which one of those persons is a fiduciary;¹⁷ and
- any corporation or other organization in which the person and any relative or spouse sharing the same home own at least 10 percent of an equity interest.¹⁸

Though the staff does not limit the pool of possible affiliates to the persons specified in Rule 144(a)(2),¹⁹ the staff assumes that at least those persons are affiliates.²⁰ In addition, in certain cases, each different from the next and therefore of little general precedential value, the staff has also assumed that certain persons outside of the Rule 144(a)(2) categories are affiliates of the issuer.²¹ Accordingly, the issue of whether a person is, alone or as a member of a controlling group, a controlling person and therefore an affiliate of the issuer must be resolved on a case-by-case basis by appropriate counsel with limited guidance.

[4] Other Types of Affiliates

[a] General. As the Rule 144(a)(1) definition makes clear, a controlling person of the issuer is only one of the possible types of affiliates, though the most common type. In addition, a person may be an affiliate because that person is controlled by the issuer or is under common control with the issuer or even for reasons outside of the rule’s definition.²²

[b] Persons Controlled by the Issuer. The most obvious example of a person who is an affiliate because it is controlled by the issuer is a subsidiary of a corporate issuer.²³ Other common examples of these types of affiliates of an issuer include an

¹⁶ See *Carolina Securities Corp.*, [1979–1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,373, SEC No-Action Letter 1979 SEC No-Act. LEXIS 3766 (November 23, 1979).

¹⁷ *But see* discussion of fiduciaries *infra*.

¹⁸ Rule 144(a)(2); it should be noted that while this paragraph is primarily for the purpose of the rule’s aggregation requirements, see § 6.05[5][c][i] *infra*, it is also relevant to the definition of control.

¹⁹ See, e.g., the interpretive letters listed in D. Goldwasser, *A Guide to Rule 144*, at 97–99 (2d ed. 1978).

²⁰ D. Goldwasser, *A Guide to Rule 144*, at 100 (2d ed. 1978).

²¹ D. Goldwasser, *A Guide to Rule 144*, at 97–99 (2d ed. 1978).

²² See § 6.04[4][d] *infra* for discussion of persons otherwise deemed affiliates.

²³ A subsidiary of the issuer, however, may not rely on Rule 144 for the sale of the securities of the issuer that it owns. Sec. Act Rel. No. 33-6099, [Transfer Binder] Fed. Sec. L. Rep. ¶ 2705H (1979), at Section II(H), Question 83.

employee benefit plan²⁴ and corporations of which the issuer is a creditor empowered to exercise control through the lending instruments.²⁵ Again, these represent only the more common examples of such affiliates.

[c] Persons Under Common Control with the Issuer. The definition of affiliate contained in Rule 144(a)(1), clearly includes persons under common control with the issuer. The application of the “under common control” test for rendering a person an affiliate of the issuer is particularly troublesome in the case of trusts and estates that are related to an issuer through an affiliate of that issuer. Where the trust or estate owns an amount of voting securities of the issuer sufficient to constitute control, it is obviously an affiliate of the issuer because it is a controlling person in its own right.²⁶ Where, however, the only relationship between the trust or estate and the issuer is that the trustee or executor is an affiliate of the issuer, the affiliate status of the trust or estate is less certain. Arguably, the relationship is simply too remote and the trust or estate would be found to have inadequate control over the issuer through its fiduciary.

The staff’s view, however, at least as yet is unclear. The status of the fiduciary will not be automatically attributed to the trust or estate or to the respective beneficiaries.²⁷ In fact, the staff will not view a trust or estate as an affiliate of the issuer where the only basis is that a person who is an affiliate of the issuer is the trustee or executor *or* a beneficiary of that trust or estate.²⁸ Apparently, though, it will view the trust or estate as an affiliate of the issuer if a person who is an affiliate of the issuer is both the fiduciary *and* a beneficiary of the trust or estate.²⁹ Certainly, however, in that case the issue of affiliate status for the trust or estate will be affected by the extent of that affiliate’s interest in that estate or trust and perhaps by the amount of securities of the issuer held by the estate or trust. If the trust or estate owns no securities that might be rendered “control securities” by virtue of its affiliate status, the question of its affiliate status is irrelevant in the context of this chapter.

[5] Duration of Control Securities Status

Securities become “control securities” immediately upon their acquisition by an affiliate of the issuer of those securities or upon their holder becoming an affiliate of the issuer even if those securities were previously free trading. Once in that category with the consequent limitations on their resale, “control securities” remain such until they are sold to a non-affiliate of the issuer or until their affiliate holder loses his affiliate

²⁴ Winkelman Stores, Inc., [Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,771 (1972); *see generally* § 6.03[4][e][iii] *supra*.

²⁵ D. Goldwasser, *A Guide to Rule 144*, at 101 (2d ed. 1978).

²⁶ Rule 144(a)(2)(ii).

²⁷ *Id.*

²⁸ Sec. Act Rel. No. 33-6099, [Transfer Binder] Fed. Sec. L. Rep. ¶ 2705H (1979), at Section II(A), Question 9(c); Wells Fargo Bank, N.A., SEC No-Action Letter 1975 SEC No-Act. LEXIS 1998 (September 29, 1975).

²⁹ Jesse M. Brill, Esq., SEC No-Action Letter 1979 SEC No-Act. LEXIS 3489 (September 24, 1979).

status.³⁰ However, if a non-affiliate acquires “control securities” in a private *nonsale* transaction, those securities continue to be viewed as “control securities” (as opposed to restricted securities) in the hands of the recipient until the transferor is no longer an affiliate or until they are disposed of by the non-affiliate recipient. If the nonsale transaction is a bequest or spin-off or liquidating distribution and the transferor by reason of the transferring event is no longer an affiliate of the issuer, the securities lose their “control securities” status just as if they had been sold. In the case of a private gift of securities by an affiliate, however, they may continue to have the limitations as to resale that attach to “control securities,” while the donor remains an affiliate. Whether or not the limitations continue depends on the relationship of the donee to the donor. If the donee is deemed to be a “separate person” from the donor pursuant to Rule 144(a)(2), then the donee may sell the securities freely after the applicable holding period. Otherwise, the donee may resell the securities only as if it were an affiliate until such time as the transferor is no longer an affiliate of the issuer.³¹

§ 6.05 Public Resales of Restricted Securities and Control Securities under Rule 144

[1] Introduction

The Commission, after a lengthy period of study and consideration of several variations of proposed rules,¹ promulgated Rule 144 in 1972.² The Commission’s purpose was to clarify for the benefit of investors and members of the securities

³⁰ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(B), Question 11: *see also* Rule 144(a)(1) and (b).

³¹ Rule 144(a)(3); Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section 11(A), Question 9. The donee holder of securities privately acquired from an affiliate may resell those securities freely three (now one) years after the securities were acquired from the affiliate as long as the donee is not itself an affiliate. *See* Rule 144 and discussion in § 6.05[8] *infra*. *See* P. Michael Coleman and The Coleman Charitable Foundation, Inc., SEC No-Action Letter 1994 SEC No-Act. LEXIS 860 (December 29, 1994); R.E. Turner and The Turner Foundation, Inc., SEC No-Action Letter 1993 SEC No-Act. LEXIS 489 (March 19, 1993); The Gap, Inc., SEC No-Action Letter 1992 SEC No-Act. LEXIS 928 (September 16, 1992); The Moores Foundation, SEC No-Action Letter 1991 SEC No-Act. LEXIS 991 (August 14, 1991).

¹ On November 29, 1967, because of the increasing number of privately offered securities and the growing uncertainty regarding the resale of both “letter” securities and control securities under the prevailing subjective standards used to determine whether the transaction involved a statutory underwriter and was therefore outside the resale exemption, the Commission created a study group to consider the situation. In March of 1969, that group headed by Commissioner Francis M. Wheat, published its findings and recommendations in what came to be called “the Wheat Report,” SEC, Disclosures to Investors—A Reappraisal of Federal Administrative Policies Under the ‘33 and ‘34 Acts (the Wheat Report) (March 27, 1969).

In essence the Wheat Report called for a completely new set of rules for the resale of both restricted securities and control securities to provide greater certainty and to better effect the continuous disclosure purposes of the Act and the Exchange Act of 1934. *Id.* at 155. The securities bar generally agreed, calling upon the Commission to provide “greater certainty, predictability and consistency in applying and interpreting the 1933 Act.” Carl W. Schneider and Robert S. Kant, *Uncertainty Under the Securities Acts*, 26 Bus. Law 1623, 1623 (1971). Accordingly, the Commission proposed and considered a number of rules

industry and their counsel when and under what circumstances a holder of restricted securities or control securities may lawfully resell those securities in reliance upon the resale exemption contained in Section 4(a)(1) of the Securities Act.³ As a result of the adoption of Rule 144, a more objective and more certain exemption from the Securities Act's registration requirements became and remains available to allow the public resale of both restricted securities and control securities whenever all of the specific requirements pertaining to the potential seller can be satisfied. As a practical matter, the rule frequently provides the only reasonably available exemption for the public resale of these two categories of securities, restricted and control securities, that are not otherwise publicly tradable under the Securities Act.

[2] Nature of Rule 144

[a] General. During the several years prior to the adoption of Rule 144, considerable confusion had developed regarding the resale of the two common categories of restricted securities: those securities that had been privately placed by the issuer, then known as "letter securities," and those securities that had been acquired by a person in a control relationship with the issuer, known as "control securities." The rule was expressly made applicable to resales of these two types of securities only,⁴ thereby formally setting them apart from all other outstanding securities.

In addition, Rule 144 codified the distinction between these two categories of securities. First, it formally defined restricted securities to include only those outstanding securities that had been privately offered and sold and had never been the subject of a public distribution.⁵ Second, it confirmed that the term "control securities" includes only securities, that are owned by an affiliate of the issuer. Rule 144 then went on to

to cover resales of restricted securities and resales by affiliates prior to arriving at the form of Rule 144 finally adopted.

For a more detailed discussion of the origins of Rule 144, see Dan Goldwasser, *A Guide to Rule 144*, 47-64 (2d ed. 1978). 1933 Act Rule 144 is reprinted in the *Securities Primary Law Sourcebook*, Volume A, Part C (Matthew Bender 2008).

² Sec. Act Rel. No. 5223, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,487 (Jan. 11, 1972).

³ The purpose of the Commission in adopting the rule was clearly not to facilitate the sale of larger amounts of restricted securities, an effect perhaps desired by numerous securities law practitioners. *See Background and Purpose*, Sec. Act Rel. No. 33-5223, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78, 487 (1972); *PLI, The SEC Speaks 111* (1972) (comments of Alan B. Levenson, then Director of the Division of Corporation Finance of the Commission).

⁴ Rule 144(b).

⁵ Rule 144(a)(3). The 2007 amendments discussed herein added a new subparagraph (viii) to Rule 144(a)(3), which states that securities acquired in a transaction subject to exemption under Section 4(a)(5) of the Securities Act are now part of the definition of restricted securities. Section 4(a)(5) provides for an exemption from registration for an offering that does not exceed \$5,000,000 that is made only to accredited investors, that does not involve any advertising or public solicitation by the issuer or anyone acting on the issuer's behalf and for which a Form D has been filed. *See* 15 U.S.C. 77d(6). Section 4(a)(5) is discussed in § 4.06 *supra*.

formally define that critical person, the “affiliate.”⁶ In effect, much of the rule’s accomplishments amounted to substantial clarification of, but no real change in, the then existing law regarding the two categories of outstanding securities whose resale had been restricted under the Securities Act. In its approach to the actual resale of both restricted securities and control securities, however, the rule represented a radical departure from the subjective standards preceding its adoption.

[b] Approach of Rule 144. The Section 4(a)(1) resale exemption⁷ is available for resales by holders,⁸ whether or not a broker is involved,⁹ only if neither the investor nor any participating broker is an underwriter as that term is defined in Section 2(a)(11) of the Securities Act.¹⁰ At the time of Rule 144’s adoption, a non-affiliate holder wishing to publicly resell restricted securities could rely upon the resale exemption only if he or she could establish that:

- the original purchase was not “with a view to” a distribution of those securities; and
- he or she was not selling for the issuer or an affiliate of the issuer in connection with a distribution or otherwise participating in that distribution.¹¹

Despite the other aspects of the Section 2(a)(11) definition, the focus had been on the factual issue of intent.¹² As a result, the proposed seller of restricted securities could rarely be certain of the availability of the resale exemption until he or she had owned those securities for a substantial, but indefinite, period of time.¹³ If the proposed seller

⁶ *Id.*; Rule 144(a)(1).

⁷ *See* § 4.02 *supra*.

⁸ The term “investor” will be used throughout this chapter to refer to a holder of outstanding securities who is not a dealer within the meaning of Section 2(a)(12).

⁹ If Section 4(a)(1) is available to the selling investor because he is not an underwriter or an affiliate of the issuer, then the broker may normally rely on the brokers’ transactions exemption contained in Section 4(a)(4) or the dealer’s exemption contained in Section 4(a)(3). *See* § 4.03 *supra*. The Securities Act of 1933 is reprinted in the Securities Primary Law Sourcebook, Volume A, Part B (Matthew Bender 2008).

For a definition of the term “brokers’ transactions,” see Rule 144(g) and § 6.05[7][c] *infra*. Although the broker is a dealer as that term is defined by Section 2(a)(12), discussed in § 9.04 *infra*, that fact does not render the resale exemption unavailable to the selling investor despite the language of Section 4(a)(1). David S. Ruder, *Federal Restrictions on the Sale of Securities*, 67 Nw. U.L. Rev. 1, 36 (Supp. 1972).

¹⁰ *See* § 6.02[2] *supra*.

¹¹ *See* Section 2(a)(11), discussed in § 4.02[2] *supra*, and analysis contained in § 6.04[3] *supra*.

¹² Stephen R. Volk & Carl W. Schneider, *The Sale of Restricted Securities Outside of Rule 144*, 8 Inst. Sec. Reg. 135–48 (1977).

¹³ Sec. Act Rel. No. 33-5223, [1971–1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78, 487 (1972) at 80,629.

See Martin Lipton, *Rule 144 Updated*, N.Y. Law Journal, October 11, 1972, at 6, col.6, in which a highly respected securities lawyer indicated that a holding period of approximately five years would be necessary for resales of restricted securities under Section 4(a)(1) outside Rule 144 (the Rule 144 holding period at that time was three years).

See, e.g., Vicon Fiber Optics Corp., SEC No-Action Letter, 1982 SEC No-Act. LEXIS 2961 (October

was an affiliate of the issuer, the participating broker would be a statutory underwriter because it would be selling for a control person of the issuer in connection with a distribution.¹⁴ Accordingly, the resale exemption could be relied upon by an affiliate of the issuer only if no distribution were involved, that is, only for private resales of securities.¹⁵

Rule 144 introduced an entirely new objective set of standards for the public resale of both restricted and control securities. Conceptually, its approach is definitional. The Commission defined the term “distribution” to exclude those resales of restricted securities and those resales of any securities by affiliates that are completed in compliance with the applicable requirements of the rule.¹⁶ Under the current incarnation of Rule 144, for all resales of restricted securities, no distribution is involved under the following circumstances:¹⁷

If reselling equity securities:

Resales by affiliates of the issuer:

- if selling securities of a reporting company, a minimum of a six months has elapsed between the acquisition of the securities from the issuer or an affiliate of the issuer;¹⁸
- if selling securities of a non-reporting company, a minimum of one year has elapsed between the acquisition of the securities from the issuer or an affiliate of the issuer;¹⁹
- adequate current public information is available about the issuer;²⁰
- the amount of securities to be sold during any three-month period is less than the greater of one percent of the total number of shares outstanding or the average weekly trading volume in those securities over a four week period;²¹
- the sales effected are in brokers’ transactions, with a market maker or in riskless principal transactions;²²
- a notice of the proposed sale is timely filed;²³ and

25, 1982), an interpretive letter in which the staff refused to allow the resale of restricted securities held for ten years by a non-affiliate of the issuer.

¹⁴ See analysis contained in § 6.02 *supra*.

¹⁵ See generally §§ 6.07 and 6.08 *infra*.

¹⁶ Rule 144(b).

¹⁷ This text describes Rule 144 as it exists after the 2007 amendments. See § 6.05[2][e] *infra*.

¹⁸ For discussion of the holding period requirement of Rule 144(d), see § 6.05[5] *infra*.

¹⁹ *Id.*

²⁰ For discussion of the adequate current public information requirement of Rule 144 (c), see § 6.05[3] *infra*.

²¹ For discussion of the volume limitation requirement of Rule 144(e), see § 6.05[6] *infra*.

²² For discussion of the manner of sale requirement of Rule 144(f), see § 6.05[7] *infra*.

²³ For discussion of the notice of proposed sale requirement of Rule 144(h), see § 6.05[8] *infra*.

- the person filing the notice has a bona fide intention to sell the securities referred to in the notice within a reasonable period of time.²⁴

Resales by non-affiliates of the issuer:

- if selling securities of a reporting company, a minimum of a six months has elapsed between the acquisition of the securities from the issuer or an affiliate of the issuer;²⁵
- if selling securities of a non-reporting company, a minimum of one year has elapsed between the acquisition of the securities from the issuer or an affiliate of the issuer;²⁶ and
- adequate current public information is available about the issuer between the dates six months and one year after the acquisition of the securities from the issuer or an affiliate of the issuer.²⁷

If reselling debt securities:

Resales by affiliates of the issuer:

- all of the above requirements for resales by affiliates of equity securities apply except that there are no manner-of-sale requirements regarding resales of debt securities by affiliates;²⁸ and
- in addition to the above volume limitations pertaining to resales of equity securities by affiliates, there is an additional volume limitation imposed on resales of debt securities such that 10% of the principal amount of the tranche attributable to the securities sold, if the amount sold during any three month period is less than the greater of one percent of the total shares outstanding or the average weekly trading volume in those securities over a four week period.²⁹

Resales by non-affiliates of the issuer:

- all of the same requirements above for resales by non-affiliates of equity securities apply.

As to resales of unrestricted securities by affiliates, or control securities, no distribution is involved provided all of the same conditions, other than the holding period requirements set forth above,³⁰ are satisfied. Resales that comply with all of the applicable Rule 144 requirements are deemed not to involve a distribution. In the absence of a distribution, neither the selling investor nor any broker selling for an

²⁴ *Id.*

²⁵ For discussion of the holding period requirement of Rule 144(d), see § 6.05[5] *infra*.

²⁶ *Id.*

²⁷ For discussion of the adequate current public information requirement of Rule 144 (c), see § 6.05[4] *infra*.

²⁸ For discussion of the manner of sale requirement of Rule 144(f), see § 6.05[7] *infra*.

²⁹ For discussion of the volume limitation requirement of Rule 144(e), see § 6.05[6] *infra*.

³⁰ Rule 144(d).

affiliate (or a market maker who purchases from an affiliate or purchases restricted securities from a non-affiliate or securities sold in riskless principal transactions) or a non-affiliate selling restricted securities can be an underwriter under the Securities Act.³¹ Where no underwriter is involved, the transaction may be completed in reliance upon the resale exemption. In effect, through its definitional approach, the rule provides a safe harbor for the resale of both restricted securities and control securities under Section 4(a)(1) of the Securities Act.³²

[c] Construction of Rule 144. The adoption of Rule 144 by the Commission was initially on an experimental basis.³³ While the Commission selected the above-described approach to the statutory underwriter concept in an effort to achieve the certainty of more objective standards,³⁴ it also feared that the rule might provide a means for massive distributions of unregistered securities into the hands of unprotected members of the investing public.³⁵ In light of that fear, the Commission warned that the rule was to be strictly construed.³⁶

Although the staff of the Commission now appears to view Rule 144 with a more flexible attitude, especially in light of the most recent 2007 amendments to Rule 144,³⁷ it still takes the position that persons seeking to rely upon the rule's exemption from the Securities Act's registration requirements must sustain the burden of proving both that:

- the rule is available for the proposed resale; and
- every one of the applicable requirements has been or will be timely and fully satisfied.³⁸

In other words, substantial compliance with the conditions of the rule will normally not suffice.³⁹ Initially, the Commission took the position that even technical compliance with all the rule's requirements would not perfect the exemption where the proposed resale was in fact a part of an unregistered distribution.⁴⁰ Subsequently, however, the

³¹ See Section 2(a)(11), discussed in § 4.02[2] *supra*, and § 6.02[2] *supra*.

³² Section 4(a)(1), and its availability (or non-availability) for restricted and control securities, is discussed in § 4.02 *supra*.

³³ Sec. Act Rel. No. 5223, [1971–1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,487 (Jan. 11, 1972).

³⁴ See Richard B. Smith, *Fungibility, Tacking, and Registration Covenants*, 3 Inst. Sec. Reg. 55, 75 (1972) (comments of Commissioner Philip A. Loomis, Jr.).

³⁵ *Id.* See also PLI, *The SEC Speaks*, (1972) at 111 (comments of Alan B. Levenson, then Director of the Commission's Division of Corporation Finance).

³⁶ Sec. Act Rel. No. 5223, [1971–1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,487 (Jan. 11, 1972).

³⁷ Sec. Act Rel. No. 8869, 72 Fed. Reg. 71546 (Dec. 17, 2007).

³⁸ *Id.*

³⁹ See, e.g., *Wright Air Lines, Inc.*; SEC No-Action Letter, 1980 SEC No-Act. LEXIS 3393 (June 23, 1980).

⁴⁰ Sec. Act Rel. No. 33-5223, [1971–1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78, 487 (1972).

staff appeared to agree that where all of the rule's specific requirements are fully complied with, the proposed resale does indeed fall within the rule's safe harbor.⁴¹

Rule 144 is intended to be self-operating.⁴² In other words, the proposed seller of restricted securities or of control securities and their counsel must determine for themselves whether the rule is available for the proposed transaction, and comply with each of the rule's applicable conditions.⁴³ The staff will generally not issue no-action letters or otherwise furnish advisory opinions regarding proposed sales in reliance upon Rule 144.⁴⁴ As indicated in the release promulgating the rule, however, the staff will issue interpretive letters to assist persons in complying with all of the provisions of Rule 144.⁴⁵ Since its adoption, several thousand interpretive letters relating to Rule 144 have been issued and are publicly available.⁴⁶ Those letters, particularly in the aggregate, constitute the major source of guidance as to the staff's current interpretation of those aspects of the rule on which it will comment.⁴⁷

[d] Nonexclusivity of Rule 144. While Rule 144 provides an exemption for the public resale both of restricted securities and of control securities, it is not the exclusive lawful method of effecting resales of those two types of outstanding securities without registration under the Securities Act.⁴⁸ Both restricted securities and control securities may always be lawfully sold in private transactions, i.e., those not involving any public offering, in reliance upon the Section 4(a)(1) resale exemption.⁴⁹ In addition, both restricted securities and control securities may be sold publicly outside Rule 144 under some conditions. Both restricted securities and control securities may be resold in

⁴¹ WCS International, SEC No-Action Letter, 1979 SEC No-Act. LEXIS 2028 (January 12, 1979), in which the staff agreed that the safe harbor of the rule was available despite the possible adverse impact on the trading market.

⁴² Sec. Act Rel. No. 6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H, Section I, Question 2 (August 2, 1979).

See also Buck-Man Electronics, Inc., SEC No-Action Letter, 1981 SEC No-Act. LEXIS 3170 (March 4, 1981).

⁴³ The Lehigh Press, Inc., SEC No-Action Letter, 1983 SEC No-Act. LEXIS 2667 (August 5, 1983); Victor Kellering, Inc., SEC No-Action Letter, 1981 SEC No-Act. LEXIS 3939 (August 27, 1981).

⁴⁴ Sec. Act Rel. No. 33-5223, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78, 487 (1972).

⁴⁵ *Id.*

⁴⁶ Rule 144 interpretive letters are available on Lexis.

⁴⁷ One aspect of Rule 144 on which the staff will normally not comment is the affiliate or control status of a proposed seller because that determination involves a question of fact which it believes it is not in a position to resolve. Sec. Act Rel. No. 6253, ¶ 21 SEC Docket 320 (October 28, 1980). In addition, the staff will not provide advice respecting the removal of restrictive legends or the availability of Section 4(a)(1) outside Rule 144 for the sale of restricted securities except for those securities acquired prior to April 15, 1972. *Id.*

⁴⁸ Rule 144(j). Although paragraph (j) was added by an amendment to Rule 144 that became effective on March 12, 1979, see Sec. Act Rel. No. 6032, [Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,992 (March 5, 1979), it did not change, but only clarified, the position of the Commission at the time of the rule's adoption. Sec. Act Rel. No. 33-5223, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78, 487 (1972).

⁴⁹ See §§ 6.07 and 6.08 *infra*.

reliance upon one of the narrow Section 3 transaction exemptions from registration.⁵⁰ Under some circumstances, the Section 4(a)(1) exemption outside Rule 144 is available for the public resale of control securities.

As to restricted securities held by non-affiliates, however, Rule 144 provides a non-exclusive safe harbor for their public resale pursuant to the resale exemption. While the Commission chose not to make Rule 144 exclusive as to restricted securities, it nevertheless emphasized in the promulgating release that persons choosing to rely upon Section 4(a)(1) outside the rule for the sale of restricted securities will have a substantial burden of proof in establishing the availability of that exemption from registration and, further, that brokers who participate in those sales will do so at their own risk.⁵³ To further discourage resales of restricted securities by non-affiliates outside of Rule 144, the Commission put all persons on notice that it would no longer consider a change in circumstances as evidence of a person's being other than an underwriter and therefore able to rely upon Section 4(a)(1).⁵⁴ Finally, it indicated that no particular holding period in itself would be sufficient to establish the availability of the resale exemption outside of the rule.⁵⁵

As a result of those pronouncements by the Commission in 1972, reliance upon Section 4(a)(1) outside Rule 144, because of its substantial uncertainty, is normally avoided, particularly by reputable brokers concerned about the risk of being suspended from trading because of a sale in violation of the Securities Act.⁵⁶

[e] Amendments to Rule 144. The Commission has amended Rule 144 on numerous occasions since its adoption.⁵⁸ While many of the changes effected by those

⁵⁰ See § 6.06[2] *infra*.

^{51–52} [Reserved.]

⁵³ Sec. Act Rel. No. 33-5223, [1971–1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78, 487 (1972).

⁵⁴ *Id. But see* G. Eugene England Foundation v. First Federal Corp., 663 F.2d 988 (10th Cir. 1973), in which the court endorsed the change of circumstances doctrine.

⁵⁵ Sec. Act Rel. No. 33-5223, [1971–1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78, 487 (1972).

At present, however, there is no doubt that a specified holding period in itself establishes the availability of the Section 4(a)(1) exemption both outside and pursuant to Rule 144. See discussion of the introduction of Rule 144(k) in § 6.05[2][e] *supra*.

⁵⁶ See A. A. Sommer, *Considerations Leading to the Adoption of Rule 144*, 67 Nw. U.L. Rev. 65, 74 (Supp. 1972); see also Robert A. Barron, Some Comments on the Gift of Non-Restricted Securities by an Affiliate of the Issuer to a Non-Affiliate Donee, 35 Sec. Reg. L.J. 4 at pg. 2 (2007).

⁵⁷ [Reserved.]

⁵⁸ Those amendments were promulgated by the following releases; Sec. Act Rel. No. 5307, [1972–1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,001 (September 26, 1972); Sec. Act Rel. No. 5452, [1973–1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,633 (February 1, 1974); Sec. Act Rel. No. 5560, [1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,066 (January 24, 1975); Sec. Act Rel. No. 5613, [1975–1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,293 (September 11, 1975); Sec. Act Rel. No. 5717, [1976–1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,601 (June 8, 1976); Sec. Act Rel. No. 5979, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,731 (September 19, 1978); Sec. Act Rel. No. 5995, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,759 (November 8, 1978); Sec. Act Rel. No. 6032, [Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,992 (March 5, 1979); Sec. Act Rel. No. 6180,

amendments simply clarified existing interpretations of the rule⁵⁹ or conformed the rule's provisions to related changes in other rules under the Securities Act,⁶⁰ some of the changes broadened the rule's safe harbor to provide a Section 4(a)(1) exemption for an ever greater variety of sales transactions by affiliates and transactions involving restricted securities. Gradually, the rule's conditions became easier to satisfy. First, the requirement that the securities be sold in brokers' transactions was eased by permitting certain inquiries to be made without jeopardizing the requirement that there be no solicitations of buy orders.⁶¹ Then the rule's volume limitations were modified to allow a larger amount of securities to be sold in a shorter period of time.⁶² In addition, the manner of sale requirement was subsequently eased by an amendment permitting the securities to be sold in transactions directly with a market maker as well as in brokers' transactions.⁶³ In 1983, the Commission added paragraph (k) to the rule, which permitted the resale of restricted securities by non-affiliates without compliance with any of the rule's requirements provided that at least two years (three years at the time of original adoption of Rule 144(k)) had elapsed since the securities were acquired from the issuer or an affiliate of the issuer.⁶⁴ In 1990, the Commission revised Rule 144 to permit the tacking of holding periods so that the holding period would commence at the time securities were initially acquired from the issuer or an affiliate of the issuer and would continue throughout subsequent transfers, instead of commencing anew for each holder at the time that holder acquired the securities.⁶⁵ In 1997, the Commission amended the rule to permit limited volume resales to commence after a holding period of one year (previously two years) and to permit unlimited resales in reliance on Rule

[1979–1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,246 (January 17, 1980); Sec. Act Rel. No. 6286, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,821 (February 6, 1981); Sec. Act Rel. No. 6389, [1981–1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,106 (March 8, 1982); Sec. Act Rel. No. 6488; Sec. Act Rel. No. 6862, [1989–1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,523 (April 23, 1990); Sec. Act Rel. No. 6874, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,622 (September 24, 1990); Sec. Act Rel. No. 7035, [1993–1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,307 (December 15, 1993); Sec. Act Rel. No. 7390 [Current Decisions] Fed. Sec. L. Rep. (CCH) ¶ 85,907 (February 20, 1997); Sec. Act Rel. No. 8869, 72 Fed. Reg. 71546 (Dec. 17, 2007).

⁵⁹ See, e.g., paragraph (j) of Rule 144, which simply provides that the rule is not the exclusive means for reselling restricted securities or control securities without registration under the Act. That paragraph, added to Rule 144 effective March 12, 1979, by the amendment promulgated by Sec. Act Rel. No. 6032, [Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,992 (March 5, 1979), simply confirmed the position on nonexclusivity taken by the Commission at the time the rule was originally adopted.

⁶⁰ See, e.g., Sec. Act Rel. No. 6389, *supra* n.51, that amended the definition of restricted securities to take account of the adoption of Regulation D and the rescission of Rules 240, 242 and 146.

⁶¹ See the amendment to Rule 144 (g) contained in Sec. Act Rel. No. 5452, *supra* n.58.

⁶² See the amendments to Rule 144(e) contained in Sec. Act Rel. Nos. 5452, 5613, 5717 and 5979, *supra* n.58.

⁶³ See the amendment to Rule 144(f) contained in Sec. Act Rel. No. 5979, *supra* n.58.

⁶⁴ See Rule 144(k), as amended effective October 31, 1983.

⁶⁵ See Sec. Act Rel. No. 6862 [1989–1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,523 (April 23, 1990).

144(k) after two years (previously three years).⁶⁶

On November 15, 2007, the Commission adopted the first amendments to Rule 144 since 1997.⁶⁷ These amendments, effective February 15, 2008, are applicable to securities acquired before or after that effective date.⁶⁸ The Commission amended Rule 144 to “make it easier to understand and apply”⁶⁹ and stated that it believed that the new amendments would increase the liquidity of privately issued securities, enabling companies to raise private capital more efficiently.⁷⁰

The 2007 amendments adopted major changes to Rule 144,⁷¹ codified several of the Commission’s interpretations and substantially reduced the Rule 144 compliance obligations for resales by non-affiliates of an issuer.⁷² Prior to the adoption of the 2007 amendments to Rule 144, both affiliates and non-affiliates were subject to all of the requirements of Rule 144, with the exception that pursuant to Rule 144(k) a non-affiliate who had not been an affiliate during the three months prior to the sales could sell their restricted securities (and remove the restricted legends if the issuer permitted) after a two year holding period without complying with any of the other requirements of Rule 144. Now, given the amendments adopted to paragraph (d), paragraph (k) is moot and no longer part of Rule 144.

The 2007 amendments shortened the paragraph (d) holding period requirements, relaxed the requirements for sales of debt securities, and eliminated the necessity for non-affiliates to comply with any paragraph but the paragraph (d) holding periods, in that the only paragraph of Rule 144 that now applies to a non-affiliate seller is paragraph (d). When selling securities of a reporting issuer, a non-affiliate can sell securities after six months has elapsed (instead of the previous one year) and freely after one year has elapsed, while when selling securities of a non-reporting issuer a non-affiliate may sell securities after one year has elapsed. An affiliate seller is still subject to all of the requirements of Rule 144, but can take advantage of the shortened holding periods as well as the other modifications to Rule 144 provided by the 2007 amendments, all of which are discussed in this chapter, where applicable.

The following diagram, included in the 2007 Final Rule Release No. 8869 (the “Final Rule Release”), details the revisions to Rule 144 adopted by the 2007 amendments for restricted securities:

⁶⁶ Sec. Act Rel. No. 7390 [Current Decisions] Fed. Sec. L. Rep. (CCH) ¶ 85,907 (February 20, 1997).

⁶⁷ Sec. Act Rel. No. 8869, 72 Fed. Reg. 71546 (Dec. 17, 2007).

⁶⁸ Sec. Act Rel. No. 8869, 72 Fed. Reg. 71546 (Dec. 17, 2007).

⁶⁹ Sec. Act Rel. No. 8869, 72 Fed. Reg. 71546 (Dec. 17, 2007) at 79.

⁷⁰ Sec. Act Rel. No. 8869, 72 Fed. Reg. 71546 (Dec. 17, 2007).

⁷¹ See § 6.05[2] *supra*.

⁷² *Id.*

	Affiliate or Person Selling on Behalf of an Affiliate	Non-Affiliate (and Has Not Been an Affiliate During the Prior Three Months)
Restricted Securities of Reporting Issuers	<u>During six-month holding period</u> - no resales under Rule 144 permitted.	<u>During six-month holding period</u> - no resales under Rule 144 permitted.
	<u>After six-month holding period</u> - may resell in accordance with all Rule 144 requirements including: <ul style="list-style-type: none"> • current public information, • volume limitations, • manner of sale requirements for equity securities, and • filing of Form 144. 	<u>After six-month holding period but before one year</u> - unlimited public resales under Rule 144 except that the current public information requirement still applies.
	<u>After one-year holding period</u> - unlimited public resales under Rule 144; need not comply with any other Rule 144 requirements.	
Restricted Securities of Non-Reporting Issuers	<u>During one-year holding period</u> - no resales under Rule 144 permitted.	<u>During one-year holding period</u> - no resales under Rule 144 permitted.
	<u>After one-year holding period</u> - may resell in accordance with all Rule 144 requirements, including: <ul style="list-style-type: none"> • current public information, • volume limitations, • manner of sale requirements for equity securities, and • filing of Form 144. 	<u>After one-year holding period</u> - unlimited public resales under Rule 144; need not comply with any other Rule 144 requirements.

[3] Availability of Rule 144

[a] General. As explained above,⁷³ Rule 144 provides a safe harbor for the resale of certain categories of outstanding securities under the resale exemption contained in Section 4(a)(1) of the Securities Act.⁷⁴ Provided that the rule is available for the transaction proposed by the investor, any investor,⁷⁵ including an affiliate of the

⁷³ See § 6.02[2] *supra*.

⁷⁴ Rule 144 is, of course, never available for sales by the issuer because Section 4(a)(1) is available only for “transactions by any *person other than an issuer, underwriter, or dealer*” (emphasis added).

⁷⁵ Rule 144 is available to all investors including a broker-dealer that is selling its own securities through another broker (but not those as to which it is issuer) in compliance with all of the rule’s requirements.

See § 6.05[3][d][vi] *infra* for limitations on the availability of the rule for broker-dealers.

issuer of the securities involved, may rely upon Rule 144 exemption from the Securities Act's registration provisions by complying with all of the rule's applicable conditions. The two transactions that expressly fall within the scope of the rule are resales of restricted securities and resales of control securities. Some securities held by affiliates are both restricted and control securities. In addition, the rule may frequently be relied upon by a non-affiliate of the issuer for the resale of certain unrestricted securities that are not otherwise freely tradable under Section 4(a)(1) of the Securities Act.⁷⁶

[b] Resale of Restricted Securities. Paragraph (b) of Rule 144 provides that the rule is available for the resale of restricted securities by both affiliates and non-affiliates of the issuer of those securities.⁷⁷ The scope of the rule for resales of restricted securities, therefore, is dependent upon the scope of the term "restricted securities."⁷⁸

[c] Sales of Control Securities. Paragraph (b) of Rule 144 also provides that the rule may be relied upon for the sale of "any other securities" by an affiliate of the issuer of those securities.⁷⁹ In other words, all sales of control securities appear to come within the scope of Rule 144.⁸⁰ As in the case of transactions in restricted securities, the scope of the rule for resales of control securities turns on the scope of the phrase "affiliate of the issuer." As explained above, any investor who, directly or indirectly, controls, or is controlled by, or is under common control with, the issuer of the securities involved falls within the Rule 144(a)(1) definition of an affiliate and may therefore rely upon the rule for the sale of any securities of the issuer owned by the investor.⁸¹

[d] Limitations on Availability for Sales of Restricted Securities and Control Securities

[i] General. On its face, Rule 144 appears available for all resales of restricted securities and all resales of control securities, provided only that the several applicable requirements can be satisfied.⁸² In interpreting the scope of the rule, however, the Commission has added several substantial limitations on its apparent broad availability. Certain of those limitations on the rule's use have been softened or even abandoned in more recent interpretations. Nevertheless, even as presently

In the case of restricted securities held through an employee stock plan, the plan trustee may rely on Rule 144 for sales made at the direction of a plan participant as if it were the participant. *See* Intergraph Corporation, SEC No-Action Letter, 2002 SEC No-Act. LEXIS 583 (May 15, 2002).

⁷⁶ *See* § 6.02[5] *supra*.

⁷⁷ Rule 144(b).

⁷⁸ For an analysis of the meaning of the term "restricted securities," including the treatment of securities that do not fall within the literal definition of restricted securities but are treated as such, see § 6.03 *supra*.

⁷⁹ Rule 144(b).

⁸⁰ For an analysis of the meaning of the term "control securities," see § 6.04 *supra*.

⁸¹ *Id.*

⁸² Rule 144(b).

interpreted, the rule may not be used for certain resales of restricted securities or control securities.

Additionally, the use of equity swaps and other derivative instruments have given rise to a number of issues with respect to the availability of Rule 144. In 1995, the Commission stated that it was examining Rule 144 to address new trading strategies by which holders of restricted and control securities sold interests in their shares while retaining legal ownership of the “underlying” securities. The Commission asked whether it was appropriate to treat securities as held in the private markets when the economic risk of the investment was shifted to the public markets, and whether “tolling” of the holding period or other revisions should be introduced to reflect risk shifting transactions.⁸³ Some commenters on this concept expressed concern at the potential re-introduction of the concept of “fungibility” if tolling of the restricted period were to be introduced for risk—shifting transactions.⁸⁴

The Commission gave further consideration to whether hedging arrangements are inconsistent with the principles underlying registration under the Securities Act and the Rule 144 safe harbor. In 1997, it stated that:

The Commission recognizes that arguments can be made in favor of treating “short against the box” transactions and equity swaps as sales of the underlying restricted

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⁸³ Sec. Act Rel. No. 7187, 59 S.E.C. Docket 1630 (June 27, 1995).

⁸⁴ *See, e.g.*, comment letter of ABA Section of Business Law, September 6, 1995.

securities of its non-reporting wholly-owned subsidiary, the subsidiary is deemed to meet the reporting requirement.¹⁵⁶

[iii] Adequate Current Filings. With respect to a reporting issuer, adequate current public information is available if all the filings required to be made for the 12 months preceding the proposed sale have been made in a timely manner. It is not necessary that reports for the full 12 months preceding the sale be available unless the issuer has been subject to the reporting requirements for that entire time.¹⁵⁷ If the issuer has been subject to those requirements for a shorter period of time, then only the reports required to be filed during that shorter period of time are necessary.¹⁵⁸ An issuer that has not made a required filing does not meet this requirement, but it comes back into compliance when it files the missing report, the rule becomes available again.¹⁵⁹

Although Rule 144 is never available for sales of securities of a reporting issuer unless it or a predecessor has been a reporting issuer for at least 90 days and unless every required report has been filed,¹⁶⁰ the staff rarely questions the accuracy of the reports provided that they contain all the information specified by the respective forms. For example, where an issuer's counsel refused to opine that the issuer had satisfied all of its disclosure obligations, perhaps because the issuer was subject to an inactive private investigation that was never formally terminated by the Commission, the staff nevertheless permitted a proposed seller of restricted securities of that issuer to rely upon the rule.¹⁶¹ Generally, neither does an outstanding letter of comment on a particular report¹⁶² nor an accountant's disclaimer of an opinion respecting the financial statements in a report¹⁶³ render the information inadequate. Indeed, the staff has even allowed the rule to be relied upon by non-affiliates, but not by affiliates, where certain of the issuer's financial statements failed to meet the financial requirements of the respective forms.¹⁶⁴ Although the staff is unlikely to object to the use of Rule 144 by a non-affiliate holder of restricted securities because of a deficiency in a filed report that

¹⁵⁶ Division of Corporation Finance, Compliance and Disclosure Interpretations, Section 531.03 (Jan. 26, 2009).

¹⁵⁷ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(C), Question 16.

¹⁵⁸ *Id.*

¹⁵⁹ See Rule 12b-25 under the Exchange Act concerning a registrant's inability to timely file any required information, document, or report. See also Division of Corporate Finance, Compliance and Disclosure Interpretations, Question 131.02 (Sept. 30, 2008) (caution advised during 12b-25 period).

¹⁶⁰ A reporting issuer may not satisfy the adequate current public information requirement of Rule 144 by providing the information called for by paragraph (c)(2) of Rule 144. Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(C), Questions 15 and 18.

¹⁶¹ Love Oil Co. Inc., SEC No-Action Letter, 1978 SEC No-Act. LEXIS 2335 (December 14, 1978).

¹⁶² American Nuclear Corp., SEC No-Action Letter, 1972 SEC No-Act. LEXIS 2902 (July 31, 1972).

¹⁶³ See, e.g., Jetco, Inc., SEC No-Action Letter, 1975 SEC No-Act. LEXIS 1608 (August 11, 1975); Digital Information Devices, Inc., SEC No-Action Letter, 1972 SEC No-Act. LEXIS 1470 (April 12, 1972).

¹⁶⁴ Advanced Computer Techniques Corp., SEC No-Action Letter, 1983 SEC No-Act. LEXIS 2836

the holder would normally not be aware of, an affiliate, or a proposed seller who is actually aware of the deficiency, should not risk reliance upon Rule 144 in the absence of an interpretive letter from the staff of the Commission.

Issuers that are reorganizing or liquidating under the provisions of the United States Bankruptcy Code are permitted to file modified Exchange Act reports. Such issuers are not considered “current” in their reporting obligations.¹⁶⁵

[d] Requirements for Non-Reporting Issuers

[i] General. If the issuer of the securities proposed to be sold under Rule 144 is not required to file periodic reports by Section 13 or 15(d) of the Exchange Act, adequate current public information about that issuer may not be available. In such a case Rule 144 would not be an alternative to registration for proposed sellers of restricted securities or control securities of that non-reporting issuer unless that issuer chose to or was contractually required to satisfy the rule’s disclosure requirement.¹⁶⁶

The non-reporting issuer may satisfy the rule’s requirement of adequate current information by voluntarily registering a class of its equity securities under Section 12(g) of the Exchange Act (even if it has less than the threshold number of shareholders in the United States and has thus not triggered the Section 12(g) registration requirement)¹⁶⁷ thereby causing itself to be subject to that Act’s reporting requirements. Following a waiting period of 90 days from the effective date of the registration statement and upon completion of all required filing during that period, the rule would become available for proposed sellers of that issuer’s restricted securities and for its affiliates.¹⁶⁸ Where an issuer discovers that it is no longer required to file reports under Section 15(d) of the Exchange Act because the number of its shareholders has decreased to less than 300, it may voluntarily continue to file reports with no hiatus in the availability of Rule 144 for its affiliates and for the holders of its restricted securities.¹⁶⁹

(September 23, 1983). *See also* Minstar, Inc., SEC No-Action Letter, 1983 SEC No-Act. LEXIS 2797 (September 8, 1983).

¹⁶⁵ SEC Staff Legal Bulletin No. 2 (CF), Fed. Sec. L. Rep. (CCH) ¶ 60,002, (April 15, 1997).

¹⁶⁶ Under the circumstances, it is now commonplace and certainly advisable for purchasers of securities in private offerings to require the issuer to agree to register under Section 12(g) of the Exchange Act of 1934 and to timely file the required periodic reports in time to assure the availability of Rule 144 by the end of the six-month holding period required by Rule 144(d).

¹⁶⁷ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(C), Questions 17 and 18.

¹⁶⁸ *See* §§ 6.05[4][c][iii] and [iii] *supra*.

¹⁶⁹ Anitec Image Technology Corp., SEC No-Action Letter, 1986 SEC No-Act. LEXIS 1722 (February 10, 1986); Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(C), Question 17.

See also Andros Analyzers, Inc., *supra* n.149; Great American Management and Investment, Inc., SEC No-Action Letter, 1992 SEC No-Act. LEXIS 878 (August 17, 1992).

It should be noted, however, that if an issuer, in compliance with paragraph (c)(2) of Rule 144 through voluntarily having made the specified information publicly available, subsequently files a registration statement, it may no longer rely upon paragraph (c)(2) of the Rule and must wait until the 91st day after

[ii] Adequate Current Information. In addition to voluntary filings, paragraph (c)(2) of Rule 144 allows any non-reporting issuer to satisfy the rule's disclosure requirement simply by making certain specified information "publicly available." The information deemed adequate under paragraph (c)(2) of Rule 144 is that information concerning the issuer specified in clauses (1) through (14) and clause (16) of paragraph (a)(4) of Rule 15c2-11 under the Exchange Act.¹⁷⁰ If a non-reporting issuer is an insurance company, the information specified in Section 12(g)(2)(G)(i) of the Act will constitute compliance with the rule's requirement if current and publicly available.¹⁷¹

Although the rule provides that all of that enumerated information is required for compliance with Rule 144(c)(2),¹⁷² it prescribes no particular form for that information. Frequently, the information is provided in annual and quarterly reports or proxy statements, press releases, or any combination of those documents.¹⁷³ It is not necessary, however, that any of the commonplace documents be utilized or that all of

the effective date of that registration statement. Johnson, Swanson & Barbee, SEC No-Action Letter, 1980 SEC No-Act. LEXIS 3962 (November 24, 1980).

¹⁷⁰ See, e.g., Evergood Products Corp., SEC No-Action Letter, 1977 SEC No-Act. LEXIS 2721 (November 21, 1977); Tender Care, Inc., SEC No-Action Letter, 1975 SEC No-Act. LEXIS 1760 10318 (September 8, 1975); Educational Technology, Inc., SEC No-Action Letter, 1976 SEC No-Act. LEXIS 1081 (May 17, 1976).

Paragraph (a)(4) of Exchange Act Rule 15c2-11 specifies the information:

(i) The exact name of the issuer and its predecessor (if any); (ii) the address of its principal executive offices; (iii) the state of incorporation, if it is a corporation; (iv) the exact title and class of security; (v) the par or stated value of the security; (vi) the number of shares or total amount of the securities outstanding as of the end of the issuer's most recent fiscal year; (vii) the name and address of the transfer agent; (viii) the nature of the issuer's business; (ix) the nature of products or services offered; (x) the nature and extent of the issuer's facilities; (xi) the name of the chief executive officer and members of the board of directors; (xii) the issuer's most recent balance sheet and profit and loss and retained earnings statements; (xiii) similar financial information for such part of the 2 preceding fiscal years as the issuer or its predecessor has been in existence; (xiv) whether the broker or dealer or any associated person is affiliated, directly or indirectly, with the issuer; . . . and (xvi) whether the quotation is being submitted or published directly or indirectly on behalf of the issuer, or any director, officer or any person, directly or indirectly, the beneficial owner of more than 10 percent of the outstanding units or shares of any equity security of the issuer, and, if so, the name of such person, and the basis for any exemption under the federal securities laws for any sales of such securities on behalf of such person.

¹⁷¹ Section 12(g)(2)(G)(i) of the Exchange Act, discussed in § 7.04 *supra*, specifies only an annual statement in the form required by the state agency regulating the particular insurance company.

¹⁷² Rule 144(c)(2). See, e.g., Arlington TeleCommunications Corporation, SEC No-Action Letter, 1982 SEC No-Act. LEXIS 2372 (May 3, 1982) and Computel Systems, Ltd., SEC No-Action Letter, 1973 SEC No-Act. LEXIS 82 (July 2, 1973).

But see Energy Minerals Corporation, SEC No-Action Letter, 1972 SEC No-Act. LEXIS 3377 (September 8, 1972), in which the staff deemed the requirements of Rule 144(c)(2) satisfied by substantially all, rather than all, of the specified information.

¹⁷³ See, e.g., FilmTec Corp., SEC No-Action Letter, 1980 SEC No-Act. LEXIS 2605 (January 3, 1980).

the information be contained in a single rather than two or more documents.¹⁷⁴ Similarly, while the financial information provided is often audited or audited in part,¹⁷⁵ unaudited financial statements, which need not be prepared in accordance with Regulation S-X, are adequate under Rule 15c2-11(a)(4) under the Exchange Act and, in most cases, for purposes of complying with Rule 144(c)(2).¹⁷⁶

The required information must be current as well as complete. For purposes of Rule 144(c)(2), the information is satisfactory only if “reasonably current” as that term is defined in Rule 15c2-11(g) under the Exchange Act.¹⁷⁷ Under that rule, financial information will be presumed to be “reasonably current” only if it is less than six months old, and all other information will be so presumed only if it is less than 12 months old.¹⁷⁸ In the absence of meeting these presumptions, the staff will not consider the rule’s requirement satisfied.¹⁷⁹

Persons wishing to rely on Rule 144 must currently make their own determination whether the issuer of the securities has complied with Rule 144(c)(2), because the Commission staff has indicated it will no longer provide interpretive advice about either whether particular reports contain the required information or whether such reports have been made to the generally investing public.¹⁸⁰

In light of the role played by asset-backed securities in the financial crisis that began in 2007, the Commission proposed significant restrictions on the availability of Rule 144 for resales of such securities. The Commission proposed to condition the availability of Rule 144 for “structured finance products” issued by non-reporting issuers upon the provision of the same information that would be required with respect to such securities if they had been registered under the Securities Act.¹⁸¹

¹⁷⁴ Unicorn Oil and Development, SEC No-Action Letter, 1983 SEC No-Act. LEXIS 2678 (August 15, 1983); Scientific Energy Systems Corporation, SEC No-Action Letter, 1973 SEC No-Act. LEXIS 2992 (July 2, 1973).

¹⁷⁵ See, e.g., Reeves Southeastern Corporation, SEC No-Action Letter, 1981 SEC No-Act. LEXIS 3596 (May 25, 1981) (five years of audited annual and quarterly reports); FilmTec Corp., SEC No-Action Letter, 1980 SEC No-Act. LEXIS 2605 (January 3, 1980) (audited annual and unaudited quarterly reports).

¹⁷⁶ Division of Corporate Finance, Compliance and Disclosure Interpretations Question 131.06 (Jan.26, 2009). Unicorn Oil and Development, *supra* n.175; American Home Shield Corp., SEC No-Action Letter, 1975 SEC No-Act. LEXIS 1907 (September 15, 1975). *But see* Donut Kastle, Inc., SEC No-Action Letter, 1973 SEC No-Act. LEXIS 2945 (June 25, 1973) and Lucky Friday Extension Mining Company, SEC No-Action Letter, 1973 SEC No-Act. LEXIS 1950 (April 5, 1973), two early instances in which the staff decided that unaudited financial statements were insufficient.

¹⁷⁷ Classic Mining Corporation, SEC No-Action Letter, 1981 SEC No-Act. LEXIS 3410 (April 16, 1981); American Home Shield Corp., SEC No-Action Letter, 1975 SEC No-Act. LEXIS 1907 (September 15, 1975). *Cf.* the “reasonably current” information requirement of Rule 144A(d)(4)(ii), discussed at § 6.07 *infra*.

¹⁷⁸ See Rule 15c2-11(g)(1) and (2) under the Exchange Act concerning these presumptions.

¹⁷⁹ See, e.g., American Uranium Corporation, SEC No-Action Letter, 1981 SEC No-Act. LEXIS 3453 (April 27, 1981).

¹⁸⁰ See ANADAC, Inc., SEC No-Action Letter, 1990 SEC No-Act. LEXIS 671 (March 15, 1990).

¹⁸¹ Sec. Act Rel. No. 33-9117 (April 7, 2010).

[iii] Public Availability of Information. In addition to preparing adequate current information, the non-reporting issuer must ensure that the information is “publicly available” to fully comply with Rule 144(c)(2). Compliance with that standard is a factual matter and must be decided on a case-by-case basis. In general, information about an issuer is “publicly available” if it is made available on “an ongoing and continuous basis . . . to security holders, market makers, brokers, financial statistical services, and any other interested persons.”¹⁸² Normally, this requirement of regular dissemination is satisfied by regular mailings to a mailing list that includes all of those persons.¹⁸³ It is not sufficient if the information is provided only to the broker through whom the seller proposes to sell the securities,¹⁸⁴ though it is apparently permissible to provide the necessary information to the issuer’s sole market maker, when that information is also provided to the issuer’s shareholders, the press, and other interested persons.¹⁸⁵ Furthermore, the staff takes the position that the required information is not publicly available where the issuer fails to routinely provide it in response to all requests from all interested persons.¹⁸⁶

While the rule is not available to a proposed seller of securities of a reporting issuer until that issuer has been subject to those reporting requirements for at least 90 days,¹⁸⁷ there is no specified minimum period prior to a sale under Rule 144 during which the information required for a non-reporting issuer must be available.¹⁸⁸ Of course, the information will not be considered publicly available for purposes of Rule 144(c)(2) until enough time has passed since dissemination for the public to become aware of it. Presumably, by analogy to the Rule 144(c)(1) 90 day waiting period, information widely disseminated 90 days previous to the date of a proposed sale of securities would be considered “publicly available” on the date of actual sale.

An investor proposing to sell restricted securities or control securities of a non-reporting issuer is not entitled to rely upon a statement from the issuer that the required information is publicly available, unlike the proposed seller of such securities

¹⁸² Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(C), Question 20.

¹⁸³ See, e.g., FilmTec Corp., SEC No-Action Letter, 1980 SEC No-Act. LEXIS 2605 (January 3, 1980).

¹⁸⁴ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(C), Question 20 (Illustration).

¹⁸⁵ Reeves Southeastern Corporation, *supra* n.176. It should be noted that a foreign issuer must provide the required information to United States market makers and financial services, as well as those in the country of its domicile. Grove Explorations Ltd., SEC No-Action Letter, 1981 SEC No-Act. LEXIS 3413 (April 20, 1981).

¹⁸⁶ The Cannon Group, Inc., SEC No-Action Letter, 1980 SEC No-Act. LEXIS 3852 (October 27, 1980).

¹⁸⁷ Rule 144(c)(1).

¹⁸⁸ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(C), Question 19.

But see American Home Shield Corp., SEC No-Action Letter, 1975 SEC No-Act. LEXIS 1907 (September 15, 1975), representing a view now reversed by the Commission.

of a reporting issuer. The investor in that case takes the risk that Rule 144 is unavailable and that the sale will be in violation of the Securities Act. Accordingly, any investor proposing to rely upon Rule 144 for the sale of any securities of a non-reporting issuer should make a diligent investigation to determine whether all the information called for by Rule 144(c)(2) is indeed publicly available. Furthermore, in many cases, a broker-dealer will require a legal opinion of counsel authorized to write opinions on behalf of the issuer and accepted by the issuer's transfer agent, that all of the requirements of Rule 15c2-11 have been met prior to selling the securities.

[5] Holding Period Requirement—Rule 144(d)

[a] General. The second requirement that must be satisfied before a sale of restricted securities may be made pursuant to Rule 144 is that a period of at least six months must have elapsed for a reporting company and a period of at least one year must have elapsed for a non-reporting company¹⁸⁹ since those particular restricted securities were acquired from the issuer or an affiliate of the issuer and, if they were acquired by purchase from the issuer or an affiliate of the issuer, since the full purchase price was paid.¹⁹⁰ Unlike all of the other five conditions that must be complied with to ensure the availability of the Rule 144 exemption, the holding period requirement is applicable only to sales of restricted securities. Affiliates proposing to sell control securities that are not otherwise restricted pursuant to the rule may simply ignore it.¹⁹¹

[b] Basis for Condition of Rule 144(d). At the time of the adoption of Rule 144, the length of time an investor had held restricted securities was regarded as the best evidence of investment intent at the time of the purchase.¹⁹² Accordingly, after the passage of a substantial period of time, the investor was regarded as having purchased

¹⁸⁹ Issuers that voluntarily file reports with the Commission are treated as non-reporting companies. Division of Corporate Finance, Compliance and Disclosure Interpretations, Question 132.09 (Jan. 26, 2009).

¹⁹⁰ Rule 144(d)(1). The original holding period was two years, which was reduced in 1997 to one year. Sec. Act Rel. No. 7390 [current decisions] Fed. Sec. L. Rep. (CCH) ¶ 85,907 (February 20, 1997). Since the rule is available for specific restricted securities (they are no longer being regarded as fungible), an investor who acquired restricted securities at different times must be able to trace all of his securities to the date upon which each were last held by the issuer or an affiliate to ascertain whether two years have elapsed. Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(D), Question 21.

¹⁹¹ As explained in § 6.04 *supra*, where an affiliate transfers unrestricted securities to donee or beneficiary in a private nonsale transaction, that donee or beneficiary may acquire unrestricted securities despite the language of Rule 144(a)(3). That donee or beneficiary, however, may be deemed an affiliate for purposes of any resale of those securities for as long as the affiliate transferor remains an affiliate. Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(A), Question 9; § 6.03[4][c] and § 6.04[5] *supra*. In such cases, the holding period requirement of Rule 144 is not applicable to the sale of those securities by a donee or beneficiary. Gannett Co., Inc., SEC No-Action Letter, 1980 SEC No-Act. LEXIS 4042 (December 5, 1980). The SEC has also stated that the holding period requirement is not applicable to sale upon foreclosure by an affiliate pledgor, although on apparently different reasoning. First Bank System, Inc., SEC No-Action Letter, 1997 SEC No-Act. LEXIS 777 (July 30, 1997).

¹⁹² See § 6.02[2] *supra*.

the securities without a view to their distribution and, therefore, as not being an underwriter within the meaning of the Section 4(a)(1) resale exemption.¹⁹³ Although the rule seemed to codify that thinking and is consistent with the statutory language, the Commission's stated purpose for the holding period requirement was broader, in that it was also intended to assure that investors who purchased restricted securities indeed "have assumed the economic risks of investment and therefore are not acting as conduits" for the sale of unregistered securities to the public by the issuer.¹⁹⁴ This concept was modified in 1988, when the Commission first proposed changes to Rule 144 that would start the holding period from the time the securities were acquired from the issuer or an affiliate of the issuer, as opposed to restarting the holding period each time the securities changed hands. The Commission stated: "[a] single period running from the date of the purchase from the issuer or its affiliate would appear sufficient to prevent the distribution of restricted securities to the public."¹⁹⁵ The "at risk" concept is now relevant in more limited circumstances.

[c] Commencement of Holding Period

[i] General. The holding period for restricted securities, that is, six months for securities of a reporting issuer and one year for securities of non-reporting issuers, with certain exceptions, commences on the day that a person who is not the issuer or an affiliate of the issuer becomes the beneficial owner of those securities.¹⁹⁶ If the restricted securities were acquired by purchase, the holding period will not commence until the purchaser becomes the beneficial owner *and* the entire purchase price or other consideration has been paid or given.¹⁹⁷

American Depositary Receipts ("ADRs"), which represent non-U.S. securities, and the "underlying" securities that they represent have identical holding periods, and deposits or withdrawals of underlying securities from ADR facilities do not affect the holding period. ADRs may be sold in reliance on Rule 144 to the same extent that the underlying security could be sold.¹⁹⁸

[ii] Beneficial Ownership. Although beneficial ownership of securities is often defined in terms of voting or dividend rights,¹⁹⁹ for purposes of the commencement of the Rule 144(d) holding period, a holder of restricted securities becomes the

¹⁹³ See language of Sections 2(a)(11) and 4(a)(1), discussed in § 4.02 *supra*.

¹⁹⁴ Preliminary Note to Rule 144.

¹⁹⁵ Sec. Act Rel. No. 6806, [1988–1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,355 (October 25, 1988).

¹⁹⁶ Whether the applicable holding period is six months or one year is determined by reference to the time of proposed sale under Rule 144. Division of Corporation Finance Compliance and Disclosure Interpretations, Question 132.14 (Jan. 26, 2009).

¹⁹⁷ Rule 144(d)(1).

¹⁹⁸ Division of Corporation Finance, Compliance and Disclosure Interpretations, Section 532.16 (Jan 26, 2009).

¹⁹⁹ See, e.g., the Commission's discussion of the term "beneficial ownership" for purposes of Section 16 of the Exchange Act, concerning the disclosure requirements of corporate insiders and short-swing

beneficial owner when he assumes the full economic risks of loss.²⁰⁰ In an ordinary purchase of securities, the purchaser would become the beneficial owner upon the payment of the purchase price and the receipt of the securities, which are normally contemporaneous events.

A purchaser of restricted securities, however, can sometimes become the beneficial owner before the actual delivery of those securities. For example, when a securities purchase agreement is executed, the purchaser may become the beneficial owner of the securities on the effective date of the agreement if the purchaser is deemed to have paid for the securities by execution of the agreement and therefore to have assumed the full risk of loss prior to the delivery of the securities.²⁰¹ However, the period commences when the right to receive securities without further consideration matures, not the date of execution of the agreement.²⁰² If the securities are to be issued pursuant to a merger agreement or other plan of reorganization, beneficial ownership will commence when there is no question that the full economic risk has been assumed by the recipients.²⁰³ Where securities are held in an escrow account subsequent to a reorganization pending adjustments provided for in the plan of reorganization, the holding period will commence on the closing date of the reorganization, provided no further consideration is required for the issuance of the securities.²⁰⁴ Finally, where the alleged purchaser of securities is litigating his right to those securities, the holding period will normally commence on the date of the ratification or execution of the settlement agreement or court order settling the litigation,²⁰⁵ unless the agreement or order is persuasive evidence that the purchaser did, in fact, assume the economic risk of loss at an earlier date.²⁰⁶

trading, contained in Exch. Act Rel. No. 28,869, [1990–1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,709 (February 8, 1991).

²⁰⁰ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(D), Question 23. *See also* Digitech, Inc., SEC No-Action Letter, 1989 SEC No-Act. LEXIS 693 (February 3, 1989).

²⁰¹ *Id.* *See also* Hadron, Inc., SEC No-Action Letter, 1982 SEC No-Act. LEXIS 2995 (November 12, 1982), where the holding period was deemed to commence on the date the securities should have been delivered, but were not because of an inadvertent error.

²⁰² *See* John D. Elliott SEC No-Action Letter, 1990 SEC No-Act. LEXIS 893 (June 11, 1990); Société Générale, SEC No-Action Letter, 1990 SEC No-Act. LEXIS 1219 (October 30, 1990).

²⁰³ *See, e.g.,* DNA Medical Inc., SEC No-Action Letter, 1983 SEC No-Act. LEXIS 2783 (September 12, 1983) (effective date of merger agreement); Gearhart-Owen Industries, Inc., SEC No-Action Letter, 1980 SEC No-Act. LEXIS 3474 (July 18, 1980) (date disappearing corporation received securities to be distributed to its shareholders).

²⁰⁴ General Maritime Corporation, SEC No-Action Letter, 2002 SEC No-Act. LEXIS 606 (June 14, 2002), where the plan of reorganization provided for escrow accounts for various purposes, including indemnity and price adjustment.

²⁰⁵ Hesse & Jones, SEC No-Action Letter, 1996 SEC No-Act. LEXIS 928 (December 13, 1996); International Institute of Applied Technology, SEC No-Action Letter, 1983 SEC No-Act. LEXIS 1827 (February 21, 1983).

²⁰⁶ Vicon Fiber Optics, Inc., SEC No-Action Letter, 1990 SEC No-Act. LEXIS 604 (March 30, 1990); Onyx-IMI, Inc., SEC No-Action Letter, 1982 SEC No-Act. LEXIS 2747 (September 6, 1982).

When restricted securities are acquired in a private non-sale transaction, it is often more difficult to determine when the holder becomes the beneficial owner for purposes of the commencement of the holding period. Again, in some circumstances, the recipient will become the beneficial owner prior to the actual delivery of the securities, but only if all risk of economic loss has shifted from the transferor to the recipient. If restricted securities are acquired through an employee benefit plan, the employee usually becomes the beneficial owner on the date the securities are credited to his or her account,²⁰⁷ even if they are subject to forfeiture upon the employee's failure to provide additional service or otherwise,²⁰⁸ and even if they are subject to restrictions on resale for a period longer than the Rule 144 holding period.²⁰⁹ Where restricted securities are transferred to individual donees, controlled corporations, trusts, or similar persons, the facts must be carefully analyzed to determine if and when the transferee becomes the beneficial owner of those securities in order to ascertain the date of commencement of the holding period for those securities.

[iii] Full Payment of Purchase Price. If the restricted securities are purchased from the issuer or an affiliate of the issuer, then the holding period will not commence until the purchaser is the beneficial owner and the full purchase price has been paid.²¹⁰ Often securities are paid for by delivering to the seller a promissory note of another written obligation to pay.²¹¹ In that case, the full purchase price is unpaid for purpose of Rule 144(d)(1) and the holding period will not commence on the date of the purchase transaction unless the note or the obligation provides for full recourse against the purchaser of the securities, is secured by collateral having a market value at least equal to the amount of the note or obligation and is discharged by full payment before the date of the sale made in reliance on Rule 144.²¹² Acceptable collateral for purposes of causing the holding period to commence includes securities other than those

See also staff comments in Zenex Synthetic Lubricants, SEC No-Action Letter, 1981 SEC No-Act. LEXIS 3172 (March 5, 1981).

²⁰⁷ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(D), Question 22. *See also* Intergraph Corporation, SEC No-Action Letter, 2002 SEC No-Act. LEXIS 583 (May 15, 2002).

²⁰⁸ *Id.*

²⁰⁹ Monsanto Company, SEC No-Action Letter (July 8, 1983).

²¹⁰ Rule 144(d)(1).

²¹¹ If the purchaser pays for the restricted securities with cash, they are fully paid for purposes of Rule 144(d)(2) even if that cash was borrowed from a bank or other person unrelated to the issuer and the securities are pledged as collateral for the repayment of the loan. Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(D), Question 25. Securities may not be deemed paid for where the purchase is financed by a person who is, or who becomes at the same time, an affiliate of the issuer. *See* Clinical Technologies Associates, Inc., SEC No-Action Letter, 1991 SEC No-Act. LEXIS 1355 (December 10, 1991); Psychomedics Corp., SEC No-Action Letter, 1991 SEC No-Act. LEXIS 1259 (November 12, 1991).

²¹² Rule 144(d)(2).

purchased with the note or other obligation²¹³ as well as unconditional guarantees of the note or other obligation by a bank or other financial institution unrelated to the issuer.²¹⁴ Upon satisfaction of these conditions, the holding period will commence, but it will stop running for any period in which the collateral has a fair market value of less than the amount of the outstanding note or obligation. To prevent this tolling of the holding period, collateral may be added.²¹⁵ If the collateral becomes worth more than the note or obligation, that portion of it worth more than the obligation may be withdrawn without any tolling of the holding period.²¹⁶

Frequently, the purchaser will pay for the securities with an installment obligation. In that case the securities will become fully paid on a staggered basis as payments are made.²¹⁷ If the securities are to be paid for by an employee with future services, the holding period will not commence until those services allocable to those particular securities have been fully rendered.²¹⁸ Finally, when an investor acquires restricted securities from the issuer or an affiliate of the issuer upon exercise of an option, those securities are not acquired for purposes of the commencement of the holding period until the exercise price is paid.²¹⁹ Only then is that holder of the option to purchase restricted securities actually at risk with respect to the underlying securities, and only then does the six-month or one-year holding period, as applicable, begin to run. Additionally, the seller may only sell those securities whose specific acquisition date satisfies the holding period requirement.²²⁰ Securities sold pursuant to Rule 144 are not fungible with respect to the required holding period.²²¹

[d] Tacking Provisions

[i] **General.** As discussed above, Rule 144 generally requires that a six-month or one-year period, as applicable, elapse since the restricted securities proposed to be sold were acquired from the issuer or an affiliate of the issuer. Prior to its amendment

²¹³ See, e.g., Rollins, Inc., SEC No-Action Letter, 1980 SEC No-Act. LEXIS 3721 (September 26, 1980).

²¹⁴ See, e.g., MCI Corp., SEC No-Action Letter, 1980 SEC No-Act. LEXIS 2617 (January 3, 1980).

²¹⁵ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(D), Question 27.

²¹⁶ *Id.*

²¹⁷ Each time an installment payment is made a pro rata portion of the securities purchased is fully paid, as illustrated by Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(D), Question 28 (Illustration); Bio-Response, Inc., SEC No-Action Letter, 1981 SEC No-Act. LEXIS 4155 (October 29, 1981).

²¹⁸ Bourns, Inc., SEC No-Action Letter, 1974 SEC No-Act. LEXIS 1355 (January 28, 1974).

²¹⁹ Mosteck Corp., SEC No-Action Letter, 1981 SEC No-Act. LEXIS 4297 (November 23, 1981). See also Division of Corporation Finance Compliance and Disclosure Interpretations, Question 132.11 (Jan. 26, 2009).

²²⁰ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Question 21. However, depending on the method of exercise, tacking may be available. *Infra* § 6.05[d].

²²¹ See, e.g., Ultrasystems, Inc., SEC No-Action Letter, 1981 SEC No-Act. LEXIS 4455 (December 30, 1981).

in 1990, Rule 144 required that each holder hold for two years (then the holding period) before any securities could be sold, and only permitted the “tacking” of prior holding periods in certain circumstances. Since 1990, however, tacking is the rule rather than the exception.

Whether tacking of previous holding periods is permitted is now most relevant in transactions that would otherwise seem to require the holding period to start running again, such as recapitalizations or conversions, where new securities are acquired from the issuer or where securities are acquired from an affiliate of the issuer.

[ii] Securities Acquired as Stock Dividends, in Stock Splits or in Recapitalizations.

Paragraph (d)(3)(i) of Rule 144 permits an investor who is proposing to sell restricted securities received as a dividend or in a stock split to consider them held from the time the securities with respect to which they were issued were acquired from the issuer or an affiliate of the issuer.²²² The staff has also allowed holders of restricted debentures who received restricted common stock from the same issuer as one-time payment of interest contingent upon a net income formula as required by the provisions of the debentures²²³ or stock received in lieu of accumulated cash dividends²²⁴ to treat the stock as acquired at the time the debentures were acquired for purposes of satisfying the holding period requirement.

A merger is a recapitalization if there is “no change in the nature of the business or control of the management” of the company.²²⁵ The 1997 amendments to Rule 144 proposed to codify the Commission’s previous interpretive position that holders of restricted securities may tack the Rule 144 holding period in connection with transactions made solely to form a holding company but did not codify the interpretation at that time.²²⁶ The Commission proposed to codify that interpretive position in

²²² Rule 144(d)(3)(i). *See, e.g.*, Associated Communications Corporation, SEC No-Action Letter, 1983 SEC No-Act. LEXIS 2710 (August 18, 1983). The same applies to shares acquired pursuant to anti-dilution provisions. Division of Corporation Finance Compliance and Disclosure Interpretations, Question 132.06 (Jan. 26, 2009). For an analysis of when securities received as dividends or in stock splits are restricted securities, see § 6.03[4][e][vii] *supra*.

²²³ Shearson Hayden Stone, Inc., SEC No-Action Letter, 1979 SEC No-Act. LEXIS 2335 (March 2, 1979). *See also* Elliott Associates, SEC No-Action Letter, 1999 SEC No-Act. LEXIS 43 (January 18, 1999).

²²⁴ Warburg, Pincus Investors, L.P., SEC No-Action Letter, 1996 SEC No-Act. LEXIS 716 (September 4, 1996).

²²⁵ Sec. Act. Rel. No. 5306, [1972–1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,000 (September 26, 1972).

²²⁶ *See* Roper Industries, Inc., SEC No-Action Letter, 2007 SEC No-Act. LEXIS 535 (July 19, 2007); The Presley Companies, SEC No-Action Letter 1992 SEC No-Act. LEXIS 475 (March 30, 1992); Equitable Resources, Inc., SEC No-Action Letter, 2007 SEC No-Act. LEXIS 459 (April 25, 2007); Sec. Act Rel. No. 33-6806, [1988–1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,335 (1988), (1988) at n.209; Morgan, Olmstead, Kennedy & Gardner Capital Corp., SEC No-Action Letter, 1988 SEC No-Act. LEXIS 6 (January 8, 1988). The Commission has proposed codifying its position on tacking with respect to the formation of holding companies in a new rule. Sec. Act Rel. No. 33-7391 [current decisions] Fed. Sec. L. Rep. (CCH) ¶ 85,908 (1997). *See also* Biospecifics Technology Corp., SEC No-Action Letter, 1992

the 2007 Proposing Release,²²⁷ and adopted the position in the 2007 amendments in new Rule 144(d)(3)(ix), which provides for tacking if:

- the newly formed holding company's securities were issued solely in exchange for the securities of the predecessor company as part of a reorganization of the predecessor company into a holding company structure;
- holders received securities of the same class evidencing the same proportional interest in the holding company as they held in the predecessor company, and the rights and interests of the holders of such securities are substantially the same as those they possessed as holders of the predecessor company's securities; and
- immediately following the transaction, the holding company had no significant assets other than securities of the predecessor and its existing subsidiaries and had substantially the same assets and liabilities on consolidated basis as the predecessor had before the transaction.²²⁸

The Commission went on to say that tacking is permissible if the above are satisfied because there is no significant change in economic risk of the investment in restricted securities and the securities being exchanged are substantially equivalent.²²⁹

Reincorporation in a different jurisdiction is a recapitalization provided that "the substance of the corporation (that is, the nature of its business and management) remains the same as before."²³⁰ The 2007 amendments did not change this interpretive position, permitting tacking in connection with the reincorporation of the issuer in a different state in certain situations.²³¹ However, a transaction is not a recapitalization if other changes in capitalization and percentage ownership are accomplished at the same time such that the difference between the successor company and the predecessor company amounts to a new investment decision for the investor.²³² One of the primary

SEC No-Act. LEXIS 1036 (November 13, 1992) (Delaware holding company stock exchanged for substantially all shares of two operating companies, a New York corporation and a Netherlands Antilles corporation).

²²⁷ Sec. Act Rel. No. 8813, 72 Fed. Reg. 36822 (July 5, 2007).

²²⁸ Rule 144(d)(3)(ix).

²²⁹ Sec. Act Rel. No. 8869, 72 Fed. Reg. 71546 (Dec. 17, 2007).

²³⁰ Oncothyreon Inc. and Biomira Inc., 2008 SEC No-Act. LEXIS 762 (January 31, 2008); Southwestern Energy Company, SEC No-Action Letter, 2006 SEC No-Act. LEXIS 527 (June 29, 2006); Agristar, Inc., SEC No-Action Letter, 1990 SEC No-Act. LEXIS 250 (February 6, 1990); Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Question 35.

²³¹ Sec. Act Rel. No. 8869, 72 Fed. Reg. 71546 (Dec. 17, 2007).

²³² See RehabClinics, Inc., SEC No-Action Letter, 1993 SEC No-Act. LEXIS 411 (March 12, 1993) (tacking denied to holders of company, which was formed to avoid legal problems of predecessor company and which then merged with predecessor company, based on the differing levels of investment risk); Urcarco, Inc., SEC No-Action Letter, 1990 SEC No-Act. LEXIS 278 (February 6, 1990) (notes exchanged for stock and private placement conducted simultaneously with holding company formation); New Golf Concepts, Inc., SEC No-Action Letter, 1990 SEC No-Act. LEXIS 220 (February 6, 1990) (public offering conducted at same time); Pinnacle Environmental, Inc., SEC No-Action Letter, 1990 SEC No-Act. LEXIS

considerations of the staff in permitting tacking is that the investor continues to bear the economic risk of its initial investment.²³³

The concept of continuing to bear economic risk in the same enterprise means that where partnership interests are exchanged for shares in a new corporation formed to conduct the business formerly conducted by the partnership, the holding period applicable to the partnership interests could be tacked to that of the share where the partnership agreements contemplated that a transfer of the business to a corporation may take place,²³⁴ but where the partnership had not initially contemplated such a transfer, the holding period for the shares did not commence until the exchange took place, or until the partnership agreement was so amended.²³⁵

[iii] Securities Acquired in Conversions or Exchanges. Prior to the 2007 amendments, an investor who acquired securities upon voluntary surrender of other securities of the same issuer could tack the holding period of the converted securities to that of the newly acquired securities for the purpose of satisfying the holding period requirement of Rule 144,²³⁶ provided that the conversion involved no additional consideration.²³⁷ Where, however, stock was received partly in exchange for convert-

34 (January 17, 1990) (holding company purchased real property by issuing stock before it acquired two operating companies); Costilla Energy, Inc., SEC No-Action Letter, 1997 SEC No-Act. LEXIS 540 (April 18, 1997) (tacking denied upon conversion of limited liability company into a corporation). *But see* Biospecifics Technology Corp., SEC No-Action Letter, 1992 SEC No-Act. LEXIS 1036 (November 13, 1992) (public offering contemplated before and commenced six months after exchange).

²³³ *See* The ARA Group, SEC No-Action Letter, 1990 SEC No-Act. LEXIS 1318 (December 19, 1990).

²³⁴ Peapod, Inc., SEC No-Action Letter, 1997 SEC No-Act. LEXIS 999 (November 10, 1997); Hygeia Sciences, Inc., SEC No-Action Letter, 1986 SEC No-Act. LEXIS 1897 (March 13, 1986); Rule 144(d)(1) Up-C Structure (November 1, 2016); Bank of America, N.A., Merrill Lynch Pierce, Fenner & Smith, Inc. (March 14, 2016); *see also* SEC Division of Corporate Finance, Compliance and Disclosure Interpretations for Rule 144, Question 132.12 (January 26, 2009). Where the partnership agreement grants the general partner the right to make the decision to convert into a corporation, the limited partners may tack their partnership interest holding period to their holding period for the corporation shares, but the general partner's holding period for the shares starts on the date of succession. Juno Online Services, Inc., SEC No-Action Letter, 1999 SEC No-Act. LEXIS 906 (November 17, 1999). In the context of limited liability companies, *see* Cravath, Swaine, & Moore, 2000 SEC No-Act. LEXIS 141 (February 11, 2000); Texas Roadhouse, Inc., SEC No-Action Letter, 2005 SEC No-Act. LEXIS 654 (July 28, 2005); Smart Move, Inc., SEC No-Action Letter, 2007 SEC No-Act. LEXIS 479 (May 16, 2007) (staff rejected request to tack holding period of LLC ownership interests despite amended operating agreement arguably contemplating transfer to a corporation); Banc of America Investors, L.P., SEC No-Action Letter, 2004 SEC No-Act. LEXIS 376 (February 25, 2004).

²³⁵ The Petersen Companies, Inc., SEC No-Action Letter, 1998 SEC No-Act. LEXIS 892 (July 16, 1998); MarkWest Hydrocarbon, Inc., SEC No-Action Letter, 1997 SEC No-Act. LEXIS 466 (March 25, 1997). *See also* Division of Corporate Finance, Compliance and Disclosure Interpretations, Question 132.12 (Jan. 26, 2009).

²³⁶ 1933 Act Rule 144(d)(3)(ii), reprinted in the Securities Primary Law Sourcebook, Part C (Matthew Bender 2008). *See also* Division of Corporate Finance, Compliance and Disclosure Interpretations, Question 132.08 (Jan. 26, 2009).

²³⁷ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(D), Question

ible notes and partly in exchange for the interest owed on the notes, the staff had permitted tacking only for those shares of stock received for the notes and had commenced the holding period for those shares received on account of the interest on the date of issuance.²³⁸ It had also not been necessary that the surrendered securities be convertible by their terms.²³⁹ The 1997 Proposing Release had previously proposed codifying the Commission's aforementioned positions. The Commission again proposed such codification in the 2007 Proposing Release.²⁴⁰ The 2007 amendments codified the aforementioned amendment to Rule 144(d)(3)(ii) and added the following clarifying note:

If the surrendered securities originally did not provide for cashless conversion or exchange by their terms and the holder provided consideration, other than solely securities of the same issuer, in connection with the amendment of the surrendered securities to permit cashless conversion or exchange, then the newly acquired securities shall be deemed to have been acquired at the same time as such amendment to the surrendered securities, so long as, in the conversion or exchange, the securities sold were acquired from the issuer solely in exchange for other securities of the same issuer.

Tacking is permitted whether the exchange transaction is effected in reliance on Section 4(a)(2) or Section 3(a)(9).²⁴¹

Where the terms of the initially issued securities provide for their exchange into the securities of another entity without any investment decision by the holders of the securities, as with mandatorily exchangeable notes, the holding period begins at the date of the initially issued securities.²⁴² Finally, if the conversion takes place in a manner involving no investment decision by the holders of the convertible securities, the staff will sometimes permit tacking for policy reasons even though the securities received are those of an affiliate of the issuer of the convertible securities,²⁴³ or even

36; Technology Funding Secured Investors II, SEC No-Action Letter, 1991 SEC No-Act. LEXIS 912 (July 23, 1991); Northrop Corp., SEC No-Action Letter, 1991 SEC No-Act. LEXIS 765 (June 6, 1991) (exercise of warrants); Radyne Corp., SEC No-Action Letter, 1990 SEC No-Act. LEXIS 227 (February 6, 1990) (exchange of old debentures for new debentures or new debentures plus stocks); Mr. Coffee, Inc., SEC No-Action Letter, 1991 SEC No-Act. LEXIS 766 (June 6, 1991) (exchange of preferred stock for common); Sports/Leisure, Inc., SEC No-Action Letter, 1992 SEC No-Act. LEXIS 922 (September 11, 1992).

Additional consideration of no value, however, will not cause a loss of the tacking benefit. Ford Foundation, SEC No-Action Letter, 1982 SEC No-Act. LEXIS 2550 (June 25, 1982).

²³⁸ Energy Exchange Corporation, SEC No-Action Letter, 1983 SEC No-Act. LEXIS 2838 (September 26, 1983).

²³⁹ Sec. Act Rel. No. 7391 [current decisions] Fed. Sec. L. Rep. (CCH) ¶ 85,908 (February 20, 1997).

²⁴⁰ Sec. Act Rel. No. 8813, 72 Fed. Reg. 36822 (July 5, 2007).

²⁴¹ Division of Corporation Finance Compliance and Disclosure Interpretations, Question 132.17 (June 4, 2010).

²⁴² Division of Corporation Finance Compliance and Disclosure Interpretations, Question 132.18 (Mar. 4, 2011).

²⁴³ Gentiva Health Services, Inc. and Gentiva Trust, SEC No-Action Letter, 2001 SEC No-Act. LEXIS

where some additional consideration is paid to effect the conversion.²⁴⁴ The staff will permit tacking where the securities surrendered in exchange are issued by a wholly-owned subsidiary of the issuer of the new securities, but only if the parent has fully guaranteed payment by the subsidiary of the exchanged obligations of the subsidiary.²⁴⁵ The staff has also permitted tacking where debt securities that were issued by a predecessor corporation were assumed by the issuer of new securities in a merger by operation of law.²⁴⁶ Because the staff has not often permitted tacking in cases where one or more of the express requirements of this tacking provision is not satisfied, an investor should assume that it may not tack in a similar situation in the absence of a favorable interpretive letter.

[iv] Securities Acquired through Contingent Payment Provisions. If a person sells an equity interest in a business or all of the assets of a business and agrees to accept as part of the consideration for that business restricted securities of the purchaser on a later date if certain conditions later occur, those securities later received will be considered to have been held since the date of the sale of the interest or assets, as long as the conditions triggering the delivery of the securities were other than the payment of further consideration.²⁴⁷

[v] Pledged Securities. Paragraph (d)(3)(iv) of Rule 144 is the first of the rule's four express tacking provisions that allow non-affiliates under certain conditions to deem restricted securities not to have been held by the issuer or any affiliate of the issuer during a period in which the issuer or an affiliate in fact held the securities.²⁴⁸ Specifically, Rule 144(d)(3)(iv) provides that a holder of restricted securities, who acquired them from an affiliate of the issuer²⁴⁹ as security for the repayment of a loan

672 (July 27, 2001); Bairnco Corp., SEC No-Action Letter, 1981 SEC No-Act. LEXIS 2785 (July 27, 1981).

²⁴⁴ Specialized Systems, Inc., SEC No-Action Letter, 1983 SEC No-Act. LEXIS 2267 (April 25, 1983).

²⁴⁵ See, e.g., Vanguard Cellular Systems, Inc., SEC No-Action Letter, 1991 SEC No-Act. LEXIS 1017 (August 20, 1991); Attwoods plc, SEC No-Action Letter, 1991 SEC No-Act. LEXIS 150 (January 28, 1991). Holders may tack their holding periods for the exchanged obligations even if the guarantee was not established until after the issue date of the exchanged obligations. See Verio Inc., SEC No-Action Letter, 1999 SEC No-Act. LEXIS 551 (May 25, 1999). Tacking was denied where the obligations of the subsidiary were not guaranteed by the parent making the exchange offer. See Taro Vit Industries Ltd., SEC No-Action Letter, 1991 SEC No-Act. LEXIS 1219 (June 13, 1991).

²⁴⁶ See Auto Finance Group, Inc., SEC No-Action Letter, 1991 SEC No-Act. LEXIS 1313 (December 3, 1991).

²⁴⁷ Rule 144(d)(3)(iii). See, e.g., Medeva PLC, SEC No-Action Letter, 1993 SEC No-Act. LEXIS 1145 (December 10, 1993); T-G Enterprises, Inc., SEC No-Action Letter, 1982 SEC No-Act. LEXIS 2231 (April 1, 1982); Electronic Data Technologies, SEC No-Action Letter, 1989 SEC No-Act. LEXIS 832 (July 13, 1989).

²⁴⁸ The three others are paragraphs (d)(3)(v), (vi), and (vii) of Rule 144, discussed in § 6.05[5][d][vi], [vii] and [viii] *infra*.

²⁴⁹ If the pledgee accepts restricted securities from the issuer in a pledge transaction, the tacking benefit is not available, Rule 144(d)(3)(iv); and the pledgee's independent holding period will commence upon his

or other obligation,²⁵⁰ may tack to his holding period the holding period of the pledgor of those securities provided that the pledge was both with recourse and bona fide.²⁵¹ Although the bona fide requirement has been the subject of almost no comment,²⁵² it was apparently intended to prohibit the tacking of holding periods where either party to the loan transaction intended that the pledged securities would be the primary source of repayment of the loan rather than merely the security for the repayment from other sources.²⁵³ Regarding the “with recourse” requirement, paragraph (d)(3)(iv) further provides that if the restricted securities are pledged without full recourse, the pledgee’s holding period will commence at the time of the pledge transaction or, in the case of a person acquiring pledged securities upon a default of the obligation secured by the pledge, at the time of purchase.²⁵⁴

It should be noted that the language of paragraph (d)(3)(iv) extends the full benefit of this tacking provision to a nonpledgee purchaser of securities pledged with recourse. In other words, the purchaser may tack his holding period to both the pledgee’s holding period and the pledgor’s holding period, provided that the non-pledgee purchaser purchased the securities in a sale pursuant to a default in the underlying obligation.²⁵⁵ This extended tacking benefit does not, however, accrue to a purchaser of the restricted securities from a pledgee who has himself purchased them following a default in the underlying obligation.²⁵⁶ That purchaser and the purchaser following a default in the case of a pledge without recourse are treated in the same manner as any other purchaser

assuming the full economic risk of loss, normally at the time funds equal to or greater than the value of the pledged securities are advanced, Tokyu Building, Inc., SEC No-Action Letter, 1982 SEC No-Act. LEXIS 2505 (June 11, 1982). Since a subsidiary of an issuer is viewed as the issuer for purposes of the availability of Rule 144, *see* § 6.05[3][d][vii] *supra*, it is likely that a pledgee who acquires restricted securities from a subsidiary of their issuer will be treated as having received them from the issuer and therefore, unable to benefit from the Rule 144(d)(3)(iv) tacking provision.

²⁵⁰ The method of acquisition need not be foreclosure; realization of shares pursuant to a workout agreement in lieu of foreclosure may also result in a pledgee-bank tacking its holding period with that of the pledgor. Bankers Trust New York Corp., SEC No-Action Letter, 1995 SEC No-Act. LEXIS 517 (May 16, 1995).

²⁵¹ Rule 144(d)(3)(iv). A hypothecation agreement together with an irrevocable stock power is the equivalent of a pledge for this purpose. Division of Corporate Finance, Compliance and Disclosure Interpretations, Section 532.23 (Jan. 26, 2009).

²⁵² Puritan Investors Corp., [Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,920 (July 5, 1974). *Cf.* Internal Revenue Service, SEC No-Action Letter, 1972 SEC No-Act. LEXIS 3125 (August 21, 1972).

²⁵³ Securities & Exchange Com. v. Guild Films Co., 279 F.2d 485, 489 (2d Cir. 1960), *cert. denied subnom.*, Santa Monica Bank v. Securities & Exchange Com., 364 U.S. 819, 81 S. Ct. 52, 5 L. Ed. 2d 49 (1960).

²⁵⁴ Rule 144(d)(3)(iv).

²⁵⁵ *Id.*; Valicenti Leighton Reid & Pine, SEC No-Action Letter, 1972 SEC No-Act. LEXIS 1604 (April 14, 1972). It should also be noted that where a pledgor pledged restricted securities to secure a note, and the securities were there after reacquired by the pledgor after paying the note, the pledgor was deemed to have held the securities since his original acquisition. He was not treated as a new purchaser. Chemex Corporation, SEC No-Action Letter, 1982 SEC No-Act. LEXIS 2998 (November 12, 1982).

²⁵⁶ Jack H. Bookey, SEC No-Action Letter, 1973 SEC No-Act. LEXIS 2644 (June 4, 1973).

in an ordinary purchase situation is treated.²⁵⁷ In short, the purchaser's holding period commences upon his acquisition of beneficial ownership and payment of the purchase price, *i.e.*, normally at the time of purchase.²⁵⁸

This tacking provision and indeed the Rule 144 holding period requirement itself is relevant only where the pledged securities are restricted securities. If an investor, whether or not an affiliate of the issuer, transfers restricted securities in a private transaction to secure an obligation, those securities are also restricted in the hands of the pledgee.²⁵⁹ If a non-affiliate so pledges unrestricted securities, they remain unrestricted and are freely tradable by the pledgee on default.²⁶⁰

Where, however, an affiliate of the issuer transfers unrestricted securities to a pledgee, the application of Rule 144(d) and the tacking provision is less clear. Since the pledgee acquired the securities from an affiliate of the issuer in a private transaction, under a literal interpretation of the Rule 144(a)(3) definition of restricted securities, those previously unrestricted securities would become restricted in the hands of the pledgee.²⁶¹ Although unrestricted securities that are acquired from affiliates in nonsale transactions are not considered restricted securities because the transferees are regarded as simply standing in the shoes of the respective transferor affiliates,²⁶² a pledge is viewed as a sale rather than a nonsale transaction.²⁶³ As a result, it is difficult to argue that the pledged securities are unrestricted for purposes of free tradability under Section 4(a)(1) of the Securities Act. On its face, the language of paragraph (d)(3)(iv) would seem to allow a pledgee in such circumstances to tack the affiliate's holding period (even though the concept of a holding period is foreign to a holder of unrestricted securities). However, the SEC has stated that such sales may take place without regard to the Rule 144 holding period.²⁶⁴

[vi] Securities Acquired as Gifts. Paragraph (d)(3)(v) of Rule 144 permits a proposed seller of restricted securities who received them as a gift from an affiliate of the issuer²⁶⁵ to tack to his holding period the holding period of the donor for the

²⁵⁷ *Id.*

²⁵⁸ See § 6.05[5][c] *supra*.

²⁵⁹ See § 6.03[4][c] *supra*.

²⁶⁰ See § 6.03[4] *supra*.

²⁶¹ See Rule 144(a)(3), discussed in § 6.03 *supra*.

²⁶² See § 6.03[4][c] *supra*.

²⁶³ *Rubin v. United States*, 449 U.S. 424, 101 S. Ct. 698, 66 L. Ed. 2d 633 (1981); *Securities & Exchange Com. v. Guild Films Co.*, *supra* n.227. See also SEC Division of Corporate Finance, Compliance and Disclosure Interpretations, Question 132.03 (Jan. 26, 2009).

²⁶⁴ First Bank System, Inc., SEC No-Action Letter, 1997 SEC No-Act. LEXIS 777 (July 30, 1997).

²⁶⁵ If the donee receives restricted securities from the issuer, the tacking benefit is not available. Rule 144(d)(3)(v). That donee is in the same position, therefore, as a purchaser of restricted securities. Also, since a subsidiary of an issuer is viewed as that issuer for purposes of the availability of Rule 144, see § 6.05[3][d][vi] *supra*, it is likely that a donee who receives restricted securities from a subsidiary of the issuer will be treated as having received them from the issuer and therefore unable to benefit from the Rule

purpose of satisfying the rule's holding period requirement.²⁶⁶ The availability of this tacking provision depends solely upon the securities having been acquired in a gift rather than a sale transaction.²⁶⁷ A gift is simply a transfer for no consideration. The existence of consideration, money, services, or anything of value, is a factual issue. In general, transfers between entities with a business relationship are presumed to be for consideration of some sort rather than gifts.²⁶⁸

[vii] Securities Acquired by Trusts. Paragraph (d)(3)(vi) of Rule 144 permits a trust proposing to sell restricted securities that were donated to it by a settlor of the trust who is an affiliate of the issuer to tack to its holding period to the holding period of the settlor for purposes of satisfying the rule's holding period requirement.²⁶⁹ However, the staff has taken the view that the tacking benefit is not available for restricted securities purchased by the trust from the settlor,²⁷⁰ from a beneficiary of the trust,²⁷¹ or indeed from the issuer or any other holder of restricted securities,²⁷² because that purchase would result from an investment decision on the part of the trustee.²⁷³ The tacking benefit available to the trust is also available to any beneficiary of the trust who may regard any restricted securities distributed to him as acquired on the date of their acquisition by the settlor of the trust.²⁷⁴

[viii] Securities Acquired by Estates. Rule 144's express tacking provisions also provide that securities held by the estate of an affiliate of the issuer are deemed to be acquired when acquired by the deceased.²⁷⁵ This is a unique provision in that it exempts the sales of those restricted securities by an estate that is not an affiliate of the issuer (even if one or more of the estate's beneficiaries is an affiliate) from the holding

144(d)(3)(v) tacking provision. *See also* Division of Corporation Finance Compliance and Disclosure Interpretations, Question 132.16 (Jan. 26, 2009).

²⁶⁶ *See, e.g.*, R. E. Turner and the Turner Foundation, Inc., SEC No-Action Letter, 1993 SEC No-Act. LEXIS 489 (March 19, 1993); John J. Moores and the Moores Foundation, SEC No-Action Letter, 1991 SEC No-Act. LEXIS 991 (August 14, 1991).

²⁶⁷ Rule 144(d)(3)(v).

²⁶⁸ *See, e.g.*, Chemed Corporation, SEC No-Action Letter, 1983 SEC No-Act. LEXIS 2204 (April 15, 1983). *See generally* Dan Goldwasser, *A Guide to Rule 144* (2d ed. 1978) at 274–76.

²⁶⁹ Rule 144(d)(3)(vi).

²⁷⁰ Jesse M. Brill, Esq., SEC No-Action Letter 1979 SEC No-Act. LEXIS 3489 (September 24, 1979) at Item 4; Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(D), Question 31.

But see Chesapeake Corporation of Virginia, SEC No-Action Letter, 1978 SEC No-Act. LEXIS 1964 (October 6, 1978).

²⁷¹ Schlumberger, Ltd., SEC No-Action Letter, 1980 SEC No-Act. LEXIS 2769 (February 11, 1980).

²⁷² Rule 144(d)(3)(vi) relates to restricted securities acquired from the settlor of that trust only.

²⁷³ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(D), Question 31.

²⁷⁴ Rule 144(d)(3)(vi).

²⁷⁵ Rule 144(d)(3)(vii).

period and volume limitations requirements of Rule 144 altogether.²⁷⁶ Similarly, paragraph (d)(3)(vii) of Rule 144 also exempts any sales of those restricted securities by any distributee beneficiaries who are non-affiliates from the rule's holding period and volume limitations requirement.²⁷⁷ As to an estate and any beneficiaries that are affiliates of the issuer²⁷⁸ of the restricted securities proposed to be sold, the provision allows the estate to tack to its holding period the holding period of the decedent. It further allows the beneficiaries to tack to their holding periods the holding periods of both the estate and the decedent, in each case to satisfy the six-month or one-year holding period requirement of the rule, as applicable.²⁷⁹

The benefits of paragraph (d)(3)(vii) are available only for restricted securities that are acquired from the decedent, either directly through descent or bequest or indirectly through a partnership agreement or otherwise not involving any investment decision by the executor of the estate.²⁸⁰ Accordingly, those benefits are not available for the sale by the estate of restricted securities acquired by it through the exercise of options to purchase the same that it received from the decedent,²⁸¹ through an exchange for securities that it received from the decedent,²⁸² or otherwise in a manner involving an investment decision by the executor of the estate. The 2007 amendments removed paragraph (i) from the note to paragraph (d)(3)(vii), as paragraph (i) now pertains to shell companies, described later in this chapter.

[ix] Securities Acquired upon Reclassifications, Mergers and Sales of Assets. Rule 144(d)(3)(viii), added in 1990 and amended in 2007, provides that a new holding period will apply to restricted securities that are acquired in the case of any of the corporate transactions described in Rule 145(a), except as otherwise provided in paragraphs (d)(3)(ii) and (ix) of Rule 144.²⁸³ Rule 145(a) applies to transactions in which, pursuant to applicable law or the charter documents of an issuer, the security holders are called upon to vote or give their consent for one of the following:

- a reclassification of securities other than a stock split, reverse stock split, or change in par value, which involves the substitution of a security for another

²⁷⁶ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(D), Question 32.

²⁷⁷ *Id.*

²⁷⁸ See Rule 144(a)(1) for the definition of the term "affiliate of the issuer." For an analysis of when an estate is such an affiliate, see § 6.04 *supra*.

²⁷⁹ Rule 144(d)(3)(vii).

²⁸⁰ McDonald & Co., SEC No-Action Letter, 1983 SEC No-Act. LEXIS 2487 (June 24, 1983).

²⁸¹ SEC Division of Corporate Finance, Compliance and Disclosure Interpretations, Question 132.04 (Jan. 26, 2009); Gemco National, Inc., SEC No-Action Letter, 1982 SEC No-Act. LEXIS 3128 (December 8, 1982).

²⁸² Virginia National Bank, SEC No-Action Letter, 1980 SEC No-Act. LEXIS 3767 (October 2, 1980).

²⁸³ Rule 144(d)(3)(viii); § 6.05[5][d][ix] *supra*. But see JPMorgan Chase & Co., SEC No-Action Letter (March 17, 2008) (based on the "extraordinary circumstances" the staff did not recommend enforcement action if JPMorgan sold Bear Stearns securities prior to the execution of the merger agreement with JPMorgan without compliance with Rule 144 for a limited time). See discussion in § 6.02[5][d] *supra*.

security;

- a statutory merger or consolidation (unless the sole purpose is to change the issuer's domicile within the United States); or
- certain transfers of assets of the issuer in exchange for securities of another person.

Such transactions have historically been treated as purchases of new securities. Therefore, the Commission takes the position that the new securities are not mere economic equivalents of the surrendered securities, and a new holding period is needed to prevent an unregistered two-step distribution of securities.

However, a transaction that is effected only to create a holding company, where the former security holders of an operating company become security holders of the new holding company, is not treated as the creation of a new restricted security, but instead is analyzed as a recapitalization covered by Rule 144(d)(3)(ix).²⁸⁴ That means that the new securities of the holding company are deemed to have been acquired from the issuer or an affiliate on the date that the securities of the operating company were acquired, for purposes of determining when resales may be made in reliance on Rule 144.

Moreover, the staff has also agreed that the adoption of Rule 144(d)(3)(viii) did not prevent tacking in the cases where it has been allowed under paragraph (d)(3)(i) or (ii) of Rule 144, even if the transaction is of a type described in Rule 145(a).²⁸⁵ The 2007 amendments codified the position with respect to paragraph (d)(3)(ii) relating to conversions and exchanges of securities discussed in Section 6.05[5][d][iii].

[x] Securities Acquired in Divorce Settlements. The staff occasionally permits tacking in nonsale situations perhaps not contemplated when the rule was adopted, often by interpreting beneficial ownership to have actually begun prior to the date on which the proposed seller of restricted securities actually acquired restricted securities.²⁸⁶ One such situation involves marital separations or divorces. One effect of a separation or divorce is that each spouse is no longer the same person as the other under Rule 144(a)(2).²⁸⁷ Arguably, however, the spouse who acquires restricted securities from the other who is an affiliate of the issuer pursuant to a divorce settlement agreement has really been a beneficial owner of those securities since they were acquired by the transferor spouse. Based on the view that the acquired restricted securities represent the acquiring spouse's beneficial interest in the total assets of the marriage, prior to the adoption of changes to Rule 144 in 1990, the staff normally allowed such a recipient of restricted securities to tack to his or her holding period the

²⁸⁴ See discussion in § 6.05[5][d][ii] *supra*.

²⁸⁵ See The ARA Group, Inc., SEC No-Action Letter, 1990 SEC No-Act. LEXIS 1318 (December 19, 1990). See also Aether Systems, Inc., SEC No-Action Letter, 2005 SEC No-Act. LEXIS 558 (April 26, 2005); J.P. Morgan Capital Corp., SEC No-Action Letter, 1992 SEC No-Act. LEXIS 1087 (December 4, 1992).

²⁸⁶ See Rule 144(d)(1) and § 6.05[5][c][i] *supra*.

²⁸⁷ See Rule 144(a)(2)(i).

holding period of the transferor spouse.²⁸⁸ There appears to be no reason why this position should not be continued. If the transfer of restricted securities to a former spouse involves the payment of consideration or otherwise appears to be a sale rather than a transfer pursuant to a divorce settlement agreement, however, tacking is not permitted because the former spouse's payment of consideration evidences that he or she in fact had no prior beneficial interest in those securities.²⁸⁹

[xi] Securities Acquired from Closely Related Persons. Similarly, a holder of restricted securities, who acquired such securities privately from an affiliate of the issuer who is also so closely related to that holder that there was no shift in the economic risk of the investment, may tack to his holding period the holding period of that closely related transferor for purposes of satisfying the Rule 144 holding period requirement.²⁹⁰ For example, tacking is permitted where a corporation converts indirect ownership of restricted securities into direct ownership.²⁹¹ In addition, tacking has been permitted where an individual transfers restricted securities to a corporation in exchange for all of its outstanding stock because such a transaction would represent a change in form without any change in either control over, or risk of loss from, the restricted securities.²⁹² On the other hand, the staff has held that if an individual were to transfer restricted securities to a corporation in exchange for only some of its outstanding stock, there would be a shift in risk, resulting in a new holding period for the acquiring corporation without any tacking benefit.²⁹³

In sum, whenever restricted securities are acquired by an entity which is either under the control of a transferor affiliated to the issuer or under the control of the same persons who control that transferor, and in the same proportions, there is no real change in

²⁸⁸ Van Dusen Air Incorporated, SEC No-Action Letter, 1981 SEC No-Act. LEXIS 4130 (October 26, 1981); Jesse M. Brill, Esq., SEC No-Action Letter 1979 SEC No-Act. LEXIS 3489 (September 24, 1979) at Item 7.

²⁸⁹ Citizens and Southern Corporation, SEC No-Action Letter, 1981 SEC No-Act. LEXIS 4257 (November 16, 1981).

²⁹⁰ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(D), Question 33.

²⁹¹ Physica B.V. and Solvay S.A., SEC No-Action Letter, 2003 SEC No-Act. LEXIS 525 (April 8, 2003); CompleTel Europe N.V., SEC No-Action Letter, 2001 SEC No-Act. LEXIS 698 (August 20, 2001); Borg-Warner Corp., SEC No-Action Letter, 1991 SEC No-Act. LEXIS 1251 (November 7, 1991).

²⁹² See, e.g., Worthington Industries, Inc., SEC No-Action Letter, 1980 SEC No-Act. LEXIS 3394 (June 23, 1980). Similarly, where no shift in the risk of loss respecting the restricted securities occurs, tacking is permitted where they are transferred:

- from one partnership to another, Robert R. Barker & Co., SEC No-Action Letter, 1983 SEC No-Act. LEXIS 2488 (June 20, 1983);
- from a partnership to a corporation, Convergent Technologies, Inc., SEC No-Action Letter, 1982 SEC No-Act. LEXIS 2211 (March 23, 1982); or
- from a corporation to a partnership, J. H. Foster & Co. Ltd. Partnership, SEC No-Action Letter, 1980 SEC No-Act. LEXIS 3015 (March 17, 1980).

²⁹³ Walnut Street Capital Co., SEC No-Action Letter, 1983 SEC No-Act. LEXIS 2489 (June 17, 1983); Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(D), Question 33(a).

beneficial ownership of, or risk of loss from, the securities. Hence, there is no justification for beginning a new holding period. Accordingly, any such entity, individual, partnership or corporation proposing to sell restricted securities acquired from such a transferor that is in a control relationship with it presumably may tack to its holding period the holding period of that transferor for purposes of satisfying the holding period requirement of Rule 144. In light of the absence of any express authority for the above analysis, however, and the fact that the need for such tacking now only exists where the transferor is an affiliate of the issuer, it is advisable for proposed sellers of restricted securities in these often unique fact situations to obtain an interpretive letter to avoid the risk of improper reliance on the rule.²⁹⁴

[xii] Securities Acquired in Spin-Offs or Liquidating Distributions. Frequently, a partnership or a corporation that has acquired the securities of other issuers for investment or otherwise will distribute those securities pro rata to its partners or shareholders. Often the distributing entity simply wishes to spin-off, that is divest itself of, a particular holding or holdings in its portfolio. On other occasions, the distributing entity is distributing all of its holdings incident to its own liquidation.²⁹⁵ In either case, if the distributed securities were restricted securities in the hands of the distributing partnership or corporation, they may also be restricted securities in the hands of the partner or shareholder distributees.²⁹⁶ Where restricted securities are acquired in such a spin-off or liquidating distribution from an affiliate of the issuer, the partner or shareholder recipient may normally tack to his holding period the holding period of the distributing partnership or corporation for the purpose of satisfying the Rule 144(d) holding period requirement.²⁹⁷ Again, the basis for this implied tacking provision appears to be that these sorts of distributions that involve no additional consideration for the distributed securities involve no real change in their beneficial ownership.²⁹⁸ In

²⁹⁴ For examples of rather unique situations where the staff permitted tacking under this reasoning, see Micron Corporation, SEC No-Action Letter, 1983 SEC No-Act. LEXIS 1632 (January 17, 1983) and Concord Fabrics, Inc., SEC No-Action Letter, 1983 SEC No-Act. LEXIS 2203 (April 11, 1983).

²⁹⁵ For a discussion of spin-offs and liquidating distributions, see generally § 6.03[4][e][viii] *supra*.

²⁹⁶ *Id.*

²⁹⁷ See, e.g., Triad Guaranty, Inc. and Collateral Investment Corp., SEC No-Action Letter, 2005 SEC No-Act. LEXIS 686 (August 12, 2005); Ashland Inc., SEC No-Action Letter, 2005 SEC No-Act. LEXIS 669 (August 08, 2005); TB&C Bancshares, Inc., SEC No-Action Letter, 2001 SEC No-Act. LEXIS 664 (July 25, 2001) (shareholders receiving shares which were primarily asset of company permitted to tack); Hale & Dorr, SEC No-Action Letter, 1991 SEC No-Act. LEXIS 780 (June 12, 1991) (limited partners receiving distributions of restricted securities from partnership portfolio permitted to tack); First Southern Capital Corp., SEC No-Action Letter, 1982 SEC No-Act. LEXIS 2230 (April 1, 1982) (shareholder who acquired restricted securities in an ordinary spin-off permitted to tack) and Intercontinental Industries, Inc.

See also Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(D), Question 34(b).

²⁹⁸ See Lee Data Corporation, SEC No-Action Letter, 1983 SEC No-Act. LEXIS 2834 (September 26, 1983).

See also Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(D), Question 34, n.11.

light of the analysis, it is not surprising that the staff allowed a shareholder of a close corporation who received his one-third share of the corporation's restricted securities of another issuer upon his termination of employment to tack to his holding period the holding period of the distributing close corporation, even though he was the only shareholder to be so cashed out.²⁹⁹ Despite considerable evidence that the staff is now likely to permit tacking to persons who acquire restricted securities from affiliates in transactions similar to spin-offs or liquidating distributions that seem to involve no significant change in who bears the risk of economic loss, it is nevertheless advisable to secure an interpretive letter whenever the particular circumstances have not yet come before the staff of the Commission.

[xiii] Cashless Exercise of Options and Warrants. The Commission received several comments to the 1997 Proposing Release asking for the codification of the position that the securities acquired from a cashless exercise of options or warrants be deemed to have been acquired when the options or warrants were granted, even if the options and warrants as initially granted did not permit cashless exercises.³⁰⁰ The Commission proposed this revision in the 2007 Proposing Release and adopted new paragraph (d)(3)(x) in the final rule, as well as the two corresponding clarifying notes, which read as follows:

If the securities sold were acquired from the issuer solely upon cashless exercise of options or warrants issued by the issuer, the newly acquired securities shall be deemed to have been acquired at the same time as the exercised options or warrants, even if the options or warrants exercised originally did not provide for cashless exercise by their terms.

Note 1 to Rule 230.144(d)(3)(x). If the options or warrants originally did not provide for cashless exercise by their terms and the holder provided consideration, other than solely securities of the same issuer, in connection with the amendment of the options or warrants to permit cashless exercise, then the newly acquired securities shall be deemed to have been acquired at the same time as such amendment to the options or warrants so long as the exercise itself was cashless.

Note 2 to Rule 230.144(d)(3)(x). If the options or warrants are not purchased for cash or property and do not create any investment risk to the holder, as in the case of employee stock options, the newly acquired securities shall be deemed to have been acquired at the time the options or warrants are exercised, so long as the full purchase price or other consideration for the newly acquired securities has been paid or given by the person acquiring the securities from the issuer or from an affiliate of the issuer at the time of exercise.

[xiv] Section 3(a)(10) Securities. Securities that are acquired through an exchange transaction that is exempt from the registration requirements of the Securities Act by reason of the exemption contained in Section 3(a)(10) are normally not

²⁹⁹ International Clinical Laboratories, Inc., SEC No-Action Letter, 1982 SEC No-Act. LEXIS 2746 (August 20, 1982).

³⁰⁰ Even *de minimis* cash payments would preclude tacking. Division of Corporation Finance Compliance and Disclosure Interpretations, Question 132.13 (Jan. 26, 2009).

restricted securities,³⁰¹ even when the securities initially exchanged were restricted securities,³⁰² and thus tacking provisions are inapplicable.

[xv] Other Securities Subject to Tacking Provisions. Although the staff of the Commission has stated that the only tacking provisions available to a proposed seller of restricted securities are those contained in paragraphs (d)(3)(i) through (vii) (now (x)) of Rule 144, it has regularly permitted tacking in certain other situations, as discussed above.³⁰³ For example, as discussed in this chapter the Commission has codified additional positions with regard to tacking with the 2007 amendments.³⁰⁴ Occasionally, the staff will allow a proposed seller of restricted securities to tack the holding period of other securities or of another holder to satisfy the Rule 144(d) holding period requirement just “because of special circumstances and policy reasons,” even without the benefit of a reason necessarily deriving from the purpose of the holding period requirement.³⁰⁵ Accordingly, in a case involving unique circumstances or policy considerations, a proposed seller may obtain a favorable interpretive letter respecting the availability of tacking.

[6] Volume Limitation Requirement—Rule 144(e)

[a] Application to Affiliates. The 2007 amendments revised paragraph (e) so that it now only applies to sales of restricted or control securities by affiliates and raised the volume limitation for debt securities.³⁰⁶ Thus, the third requirement that must be complied with by an affiliate who proposes to sell restricted or control equity securities, is that the amount of securities to be sold pursuant to Rule 144, together with the amount of such securities already sold (by such affiliate or any person or entity that the affiliate aggregates with) during the three-month period preceding the date of the proposed sale, must be limited to the greater of one percent of the outstanding securities of the class being sold or the average weekly trading volume for the class during the four week period preceding the date of the proposed sale.³⁰⁷

The proposed affiliate seller must aggregate his sales of both restricted and unrestricted securities of the same class during the three-month period for purposes of determining the maximum amount of securities that may be sold within the rule’s volume limitation requirement.³⁰⁸ In either case, however, the proposed seller is not required to aggregate any sales of securities made pursuant to an effective registration

³⁰¹ See § 6.03[4][e][v] *supra*.

³⁰² St. Ives Holding Co., SEC No-Action Letter, 1987 SEC No-Act. LEXIS 2250 (July 22, 1987).

³⁰³ See § 6.05[5][d] *supra*.

³⁰⁴ Rule 144(d)(3).

³⁰⁵ Communications Investment Corp., SEC No-Action Letter, 1980 SEC No-Act. LEXIS 3811 (October 14, 1980).

³⁰⁶ Sec. Act Rel. No. 8869, 72 Fed. Reg. 71546 (Dec. 17, 2007).

³⁰⁷ Rule 144(e). The volume measure to be used is reported volume and would not include the issuance of additional common stock notified to the transfer agent but not reported. Division of Corporate Finance, Compliance and Disclosure Interpretations, Section 533.07 (Jan. 26, 2009).

³⁰⁸ Rule 144(e)(1).

statement or pursuant to the exemption provided by Regulation A or any private sales of securities made pursuant to Section 4 of the Securities Act or any sales made pursuant to Regulation S for purposes of determining compliance with the Rule 144 volume limitation requirement for the relevant three month period.³⁰⁹

[b] Basis for Conditions of Rule 144(e). At the time of the promulgation of Rule 144, the availability of the resale exemption contained in Section 4(a)(1) of the Securities Act depended on the proposed seller's not being a statutory underwriter, which in turn depended in part on whether the contemplated resale would constitute a distribution within the meaning of Section 2(a)(11).³¹⁰ In the Commission's view, any transaction involving a substantial amount of securities, that is, an amount large enough to have an impact on the trading markets, did constitute a distribution,³¹¹ and would likely cause the proposed seller to be an underwriter and therefore unable to rely on the resale exemption.³¹² That interpretation of the statutory format was consistent with the fact that Section 4(a)(1) was intended to exempt only routine trading transactions between individual investors as distinguished from distributions by issuers or others.³¹³ By including the volume limitation requirement in the version of Rule 144 that was adopted, the Commission simply reaffirmed its long standing view that a significant characteristic of a transaction that is not a distribution is that it involves an amount of securities that is limited enough to have little, if any, impact on the relevant trading markets.³¹⁴

[c] Amount of Limitations

[i] Equity Securities. To comply with the rule's volume limitation requirement, an affiliate proposing to sell restricted or control equity securities pursuant to Rule 144 must first calculate the maximum amount of securities of the same class that he may sell in the three-month period ending on the date of the proposed sale³¹⁵ and then subtract from that maximum amount the amount of any other such securities that he sold during that three-month period. The maximum amount of securities that may be sold in the particular period is the greater of the two figures. The one percent is simply one percent of the number of shares of the same class that is shown to be outstanding by the most recent report or statement of the issuer.³¹⁶ That figure does not include

³⁰⁹ Rule 144(e)(3)(vii); Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(E), Question 41.

³¹⁰ See Sections 4(a)(1), discussed in § 4.02 *supra*, and 2(a)(11), discussed in § 4.02[2] *supra*.

³¹¹ Ira Haupt & Co., 23 S.E.C. 589, 597-98 (August 20, 1946). See also Rule 154.

³¹² This interpretation is commonly referred to as the presumptive underwriter doctrine. For further information about that informal (and now defunct) doctrine, see § 6.02[5][c] *supra*.

³¹³ Sec. Act Rel. No. 33-5223, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,487 (1972).

³¹⁴ Preliminary note to previous Rule 144.

³¹⁵ The relevant three-month period is three full calendar months ending on the date of sale such as, for example, January 16 through April 15. Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(E), Question 37.

³¹⁶ Rule 144(e)(1)(i).

treasury shares or issued shares that are held by a wholly-owned subsidiary of the issuer,³¹⁷ and a proposed seller may rely on the issuer's most recent statement or report regarding the number of shares outstanding unless he is aware of an inaccuracy therein.³¹⁸ Where shares of a class of security are represented in the United States by depositary shares, the one percent figure is calculated on the basis of all shares of the underlying security outstanding on a worldwide basis, not on the number of depositary shares or the number of shares of the underlying security held in the United States.³¹⁹

The alternative maximum amount of securities that may be sold during the three-month period is essentially the average weekly reported volume of trading in the securities of the same class for the four calendar weeks preceding the date on which the Form 144 is to be filed.³²⁰ If no notice is required to be filed by Rule 144(h), then the measuring date is the date on which the broker receives the sell order or the date the transaction is executed by the market maker, as the case may be.³²¹ If the trading volume decreases subsequent to the filing of Form 144, but before the sale occurs, the proposed seller may nevertheless sell the amount "locked in" by that filing.³²² In the event the trading volume increases during that same period, the proposed seller may file a new Form 144 (not an amended Form 144)³²³ to obtain the benefit of the larger figure.³²⁴

After determining the maximum amount of securities that may be sold under the rule's volume limitation requirement for the three month period ending on the proposed sale date, the proposed seller must reduce that maximum amount by the amount of all securities of the same class that he has already sold during that period.³²⁵ For this

³¹⁷ Trust Company of Georgia, SEC No-Action Letter, 1979 SEC No-Act. LEXIS 2027 (January 11, 1979).

³¹⁸ Dan Goldwasser, *A Guide to Rule 144* (2d ed. 1978) at 300. Subsequent to the 2007 amendments, this is now only applicable to affiliates of the issuer.

³¹⁹ See Kyocera Corp., SEC No-Action Letter, 1990 SEC No-Act. LEXIS 662 (March 30, 1990).

³²⁰ Rule 144(e)(1)(ii) and (iii); Sec. Act Rel. No. 6099, *supra* n.42 at Section II(E), Question 38.

Only the volume on U.S. exchanges may be taken into account, and thus the volume on Canadian exchanges and over-the-counter systems may not be included. Division of Corporation Finance Compliance and Disclosure Interpretations, Questions 133.01 and 133.02 (Jan. 26, 2009). See also Sec. Act Rel. No. 5995, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,759 (November 8, 1978).

³²¹ Rule 144(e)(1)(ii).

³²² Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(E), Question 40.

³²³ Division of Corporate Finance, Compliance and Disclosure Interpretations, Section 536.03 (Jan. 26, 2009).

³²⁴ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979) at Question 39; Jesse M. Brill, Esq., SEC No-Action Letter 1979 SEC No-Act. LEXIS 3489 (September 24, 1979) at Item 5.

³²⁵ There is no need to include in the calculation of securities already sold securities sold pursuant to a registration statement under the Securities Act, see Chs. 7 and 7A *infra*, pursuant to the exemption provided by Regulation A, see Ch. 5 *supra*, or in an exempt transaction pursuant to Section 4 of the Act and not involving any public offering, see Ch. 4 *supra* or for sales effected pursuant to Regulation S, see § 6.09. Rule 144(e)(3)(vii). It should be recalled that short sales against the box and call options must be

adjustment, securities that are of the same class as those proposed to be sold are those that do not differ significantly in voting and liquidation rights or in historic market price.³²⁶ Although that determination is an issue of fact, it is apparently a proper subject for an interpretive letter. Finally, the amount of securities that a proposed seller may sell under the rule's volume limitations requirement is unaffected by the amount of securities, if any, sold by that person in any other three month period in that neither carry-forward nor accumulation is permitted.³²⁷

While the amount of convertible securities that maybe sold pursuant to Rule 144 is determined exactly as explained above, the alternative procedure set forth in paragraph (e)(3)(i) of the rule would be used where both convertible securities and the securities into which they are convertible are sold during the same three month period.³²⁸ In that case, the computation is made as if only the underlying securities are to be sold and the convertible securities are counted as the amount of underlying securities into which they are convertible. Where, however, the calculation made according to paragraph (e)(3)(i) would allow the seller to circumvent the volume limitations of Rule 144 the alternative calculation is not applicable.³²⁹

[ii] Debt Securities. While the 2007 amendments exempted non-affiliates from the volume requirements, as noted above, affiliates still remain subject to volume requirements for sales of equity securities and debt securities. For sales of debt securities, affiliates may use an additional volume test adopted by the 2007 amendments in the form of revised paragraph (e)(2), which aims to rectify concerns that the previous volume limitations prevented sales of debt securities due to the fact that debt securities are usually issued in tranches.³³⁰ Paragraph (e)(2) now reads as follows:

If the securities sold are debt securities, then the amount of debt securities sold for the account of an affiliate of the issuer, regardless of whether those securities are restricted, shall not exceed the greater of the limitation set forth in paragraph (e)(1) of this section

included for purposes of calculating the volume limitation at the time the short sale is made or the call option is written, respectively. Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(H), Questions 80 and 71(a), respectively. *See also* § 6.05[2][c][iii] and [iv] *supra*. Again, short sales against the box and call options must be included for purposes of calculating the volume limitation at the time the short sale is made or in the case of the call option at such time as the restricted securities are segregated to cover or are delivered. Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(H), Question 80 and 70, 71(b), 72, 73 and 74, respectively.

³²⁶ Revenue Properties Company Limited, SEC No-Action Letter, 1983 SEC No-Act. LEXIS 2745 (August 25, 1983). *See also* Gulf & Western Industries, Inc., SEC No-Action Letter, 1975 SEC No-Act. LEXIS 1177 (June 16, 1975) (Debentures treated as same class "considering the identity of terms, market price and market treatment.").

³²⁷ Sec. Act Rel. No. 5980, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,732 (September 20, 1978); Sec. Act Rel. No. 33-5223, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,487 (1972).

³²⁸ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(E), Question 46.

³²⁹ *Id.*; Associated Dry Goods Corporation, SEC No-Action Letter, 1983 SEC No-Act. LEXIS 2679 (August 12, 1983) (relating to the volume limitations of Rule 144(e)(1) and (2) as in effect at the time).

³³⁰ Sec. Act Rel. No. 8869, 72 Fed. Reg. 71546 (Dec. 17, 2007).

or, together with all sales of securities of the same tranche (or class when the securities are non-participatory preferred stock) sold for the account of such person within the preceding three months, ten percent of the principal amount of the tranche (or class when the securities are non-participatory preferred stock) attributable to the securities sold.

The Commission stated that this additional volume limitation would allow for more trading of debt securities (including non-participatory preferred stock and asset-backed securities) than the one percent limitation had previously allowed.³³¹

[d] Aggregation Provisions

[i] Principles. As explained above, a proposed seller of restricted or control equity or debt securities will satisfy the Rule 144(e) volume limitation requirement only if the amount of the securities proposed to be sold when added to the amounts of all restricted securities or control securities sold by that seller during the three-month period preceding the proposed sale do not exceed in the aggregate the maximum amount specified by paragraph (e)(2) or (e)(1), respectively. In other words, the proposed seller is required to aggregate the amount of all such securities that he sold with the amount proposed to be sold pursuant to the rule to determine whether the proposed sale will comply with the volume limitations requirement.

In addition, certain of the rule's provisions require the proposed seller to aggregate or count against the maximum amount that he may sell during the relevant three-month period the amount of restricted securities or control securities sold during that period by specified other persons. Those aggregation rules, which are apparently designed to prohibit the proposed seller from circumventing the volume limitations requirement by selling through others, are contained in the Rule 144(a)(2) definition of "person" and in the provisions of paragraph (e)(3) of the rule that require aggregation of sales by persons having certain relationships with the proposed seller, which relationships generally led to the tacking of such persons' holding periods being permitted before tacking became the general rule. Finally, the staff of the Commission has implied other aggregation principles that go beyond the provisions of the rule.³³²

[ii] Aggregation Through Definition of "Person." The Rule 144(e) volume limitation requirement is applicable to proposed sales of securities by persons who are affiliates of the issuer. For purposes of that requirement, Rule 144(a)(2) defines a person to include, in addition to the person for whose account securities are to be sold, the following:

- any relative or spouse of such person, or any relative of such spouse, any one of whom has the same home as such person;
- any trust or estate in which such person or any of the persons specified in paragraph (a)(2)(i) of this section collectively own 10 percent or more of the

³³¹ Sec. Act Rel. No. 8869, 72 Fed. Reg. 71546 (Dec. 17, 2007).

³³² See §§ 6.05[6][e][xi] and [x] *infra* and the corresponding tacking provisions described in § 6.05[5][d] *supra*.

total beneficial interest or of which any of such persons serve as trustee, executor or in any similar capacity; and

- any corporation or other organization (other than the issuer) in which such person or any of the persons specified in paragraph (a)(2)(i) of this section are the beneficial owners collectively of 10% or more of any class of equity securities or ten percent or more of the equity interest.³³³

In general, all sales of restricted securities or control securities made or proposed to be made by any one included in the rule's definition of a person must be aggregated for purposes of the rule's volume limitation requirement.³³⁴

The aggregation of sales required by paragraphs (e) and (a)(2) of Rule 144 is generally a two-way street. In other words, just as a mother must aggregate with her proposed sales any includable sales within the applicable three month period by her son residing in the same home, so must the son similarly aggregate her sales with his.³³⁵ A significant exception to that rule involves the case of a non-affiliate trust or estate that is administered by an affiliate trustee or executor. In that circumstance, the affiliate trustee or executor is required to aggregate with his sales all sales made during the relevant period by the trust or estate.³³⁶ Although Rule 144(a)(2)(ii) would also seem to require aggregation by a person who exercises responsibilities "in any other capacity" comparable to those of a trustee, the SEC has interpreted such "other capacity" narrowly, based on the similarity with a trustee or executor.³³⁷ The trust or estate, of course, would be not subject to the volume restrictions.³³⁸ In addition, while an entity that serves as trustee or executor for several trusts and estates must aggregate all sales by all of those trusts and estates with sales for its own account,³³⁹ the trusts and

³³³ Rule 144(a)(2).

³³⁴ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(A), Questions 3, 5 and 8; James Fogelson, *Rule 144—A Summary Review*, 37 Bus. Law. 1519 (1982) at 1532.

³³⁵ Jesse M. Brill, Esq., SEC No-Action Letter, 1979 SEC No-Act. LEXIS 3489 (September 24, 1979) at Item 3; Carolina Securities Corp., SEC No-Action Letter, 1979 SEC No-Act. LEXIS 3766 (November 23, 1979).

See also Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(A), question 8, indicating that aggregation of sales by a parent corporation and its subsidiary is also a two-way street.

³³⁶ Jesse M. Brill, Esq., SEC No-Action Letter 1979 SEC No-Act. LEXIS 3489 (September 24, 1979) at Item 2. *See also* Wells Fargo Bank, N.A., SEC No-Action Letter 1975 SEC No-Act. LEXIS 1998 (September 29, 1975), requiring aggregation with a trust by an affiliate 10% beneficiary of the trust.

³³⁷ *See* Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at 2819-6 Question 7; Gap, Inc., SEC No-Action Letter, 1992 SEC No-Act. LEXIS 928 (September 16, 1992); Turner Foundation, Inc., SEC No-Action Letter, 1993 SEC No-Act. LEXIS 489 (March 19, 1993); BMC Software, Inc., SEC No-Action Letter, 1991 SEC No-Act LEXIS 991 (August 14, 1991).

³³⁸ Jesse M. Brill, Esq., SEC No-Action Letter 1979 SEC No-Act. LEXIS 3489 (September 24, 1979) at Item 2.

³³⁹ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(A), Question 5. *But see* First Pennsylvania Corp., *supra* n.125, and NCA Corporation, SEC No-Action Letter, 1982 SEC No-Act. LEXIS 2996 (November 12, 1982). In addition, it should be noted that the directors of a charitable

estates are not required to aggregate with each other unless they are as a result of their common administration acting in concert for purposes of paragraph (e)(3)(vi) of Rule 144.³⁴⁰

[iii] Pledged Securities. Paragraph (e)(3)(ii) of Rule 144 expressly requires that a pledgee proposing to sell pledged securities, or a purchaser of pledged securities after a default,³⁴¹ must aggregate with those securities proposed to be sold the amount of all restricted securities of the same class as those pledged that were sold for the account of the pledgor during the relevant three month period.³⁴² Such aggregation is required of the pledgee or purchaser for a period of six months for a reporting issuer and one year for non-reporting issuers from a default in the underlying obligation.³⁴³

Since this aggregation provision is a two-way street, a pledgor proposing to sell restricted securities or control securities under the rule is also required to aggregate any sales of such pledged securities by the pledgee (or a purchaser from the pledgee) for as long as the aggregation provision is applicable. While the pledgor and the pledgee must aggregate all of their sales (including those of persons attributable to them under Rule 144(a)(2)), paragraph (e)(3)(ii) does not require horizontal aggregation, that is aggregation by pledgees with other pledgees of the same pledgor.³⁴⁴ The 2007 amendments codified this position in a note to paragraph (e)(3)(ii), which reads as follows:

Sales by a pledgee of securities pledged by a borrower will not be aggregated under paragraph (e)(3)(ii) with sales of the securities of the same issuer by other pledgees of such borrower in the absence of concerted action by such pledgees.³⁴⁵

Since a pledgor can render Rule 144 unavailable to a pledgee at any time simply by selling the maximum amount of securities of the type pledged that is permitted by the

organization are not viewed as trustees or executors or in a similar capacity for purposes of the Rule 144(e) aggregation rules.

³⁴⁰ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(A), Question 6; Wix Corp., SEC No-Action Letter, 1978 SEC No-Act. LEXIS 597 (February 20, 1978).

³⁴¹ A purchaser of pledged securities is required to aggregate his sales with those of the pledgee and the pledgor only if the securities were privately purchased rather than purchased in a Rule 144 sale by the pledgee, Valicenti Leighton Reid & Pine, SEC No-Action Letter, 1972 SEC No-Act. LEXIS 1604 (April 14, 1972).

³⁴² Rule 144(e)(3)(ii).

³⁴³ *Id.* See also Met-Pro Corporation, SEC No-Action Letter, 1976 SEC No-Act. LEXIS 1784 (August 22, 1976) (obligation in default for more than two years); Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(E), Question 47, relating to donated securities, but equally applicable to pledged securities. If the pledgee (or the purchaser) is an affiliate of the issuer of the securities proposed to be sold, the unlimited resale provision contained in Rule 144(k) will not be available. It is important to note that Rule 144(k) no longer exists following the 2007 amendments to Rule 144, but that an affiliate must resell in accordance with the applicable paragraphs of Rule 144 which do not permit unlimited resales by affiliates in any circumstance. In other words, sales by affiliates are always subject to the volume restrictions set forth in paragraph (e) of Rule 144.

³⁴⁴ Frost National Bank of San Antonio, SEC No-Action Letter, 1976 SEC No-Act. LEXIS 1182 (June 7, 1976).

³⁴⁵ Rule 144(e)(3)(ii).

volume limitation requirement, a proposed pledgee is advised to consider contractually restricting, at the time the pledge transaction is negotiated, the pledgor's right to sell any such securities of the same class as those pledged while the pledge is outstanding.

[iv] Securities Acquired as Gifts. Paragraph (e)(3)(iii) of Rule 144 requires a donee proposing to sell donated restricted securities or control securities pursuant to Rule 144 to aggregate those securities with any sales of such securities of the same class for the account of the donor during the relevant three month period for a period of six months for a reporting issuer and one year for non-reporting issuers.³⁴⁶ The rule does not distinguish between gift securities acquired from an individual and gift securities acquired from a corporation or charitable institution.³⁴⁷ Again, this aggregation provision is reversible.³⁴⁸ The donor, however, is required to aggregate with all of his donees, whereas the donees are not required to aggregate with other of the donor's donees for compliance with the Rule 144 volume limitation requirement.³⁴⁹

[v] Securities Acquired by Trusts. Paragraph (e)(3)(iv) of Rule 144 requires affiliate trusts and their beneficiaries proposing to sell securities acquired from the settlor of the trust to aggregate those securities with any sales of such securities of the same class during the relevant three-month period by the settlor. This aggregation provision, like those applicable to pledged and donated securities, is applicable until either six months or one year has elapsed (depending on the type of issuer as noted above) following the settlor's transfer.³⁵⁰ Similarly, the provision is reversible, and while the settlor must aggregate with the trust and all beneficiaries while the provision is applicable, the beneficiaries are not required to aggregate with each other.³⁵¹ Where a proposed seller of restricted securities or of control securities subject to volume restrictions is a trust or a beneficiary of a trust, it should be kept in mind that the sales of such securities of the same class by other persons may be attributable to the seller under the aggregation provision deriving from the definition of persons for the purpose of the Rule 144(e) volume limitation requirement.³⁵²

[vi] Securities Acquired by Estates. Paragraph(e)(3)(v) of Rule 144 permits an estate to sell restricted securities that it acquired as a result solely of the decedent's

³⁴⁶ Rule 144(e)(3)(iii); Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(E), Question 47.

³⁴⁷ See, e.g., Turner Foundation, Inc., SEC No-Action Letter, 1993 SEC No-Act. LEXIS 489 (March 19,1993).

Since paragraph (e)(3)(iii) of Rule144 is substantially the same as paragraph (e)(3)(ii) of the rule, see generally § 6.05[6][d][iv] *supra*.

³⁴⁸ Rule 144(e)(3)(iii).

³⁴⁹ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(E), Question 48.

³⁵⁰ Rule 144(e)(3)(iv).

³⁵¹ Equitable of Iowa Companies, SEC No-Action Letter, 1980 SEC No-Act. LEXIS 2808 (February 19, 1980).

³⁵² See § 6.05[6][d][ii] *supra*.

death without regard to the rule's volume limitation requirement, provided that the estate is not an affiliate of the issuer³⁵³ even if one or more of the beneficiaries of the estate are affiliates.³⁵⁴ In addition, Rule 144(e)(3)(v) exempts non-affiliate beneficiaries proposing to sell such securities from the volume limitation requirement.³⁵⁵ Therefore, an estate that is an affiliate of the issuer of the securities proposed to be sold is required to aggregate with the amount of the restricted securities received from the deceased the amount of any securities sold by the deceased during the three month period preceding the proposed sale.

Similarly, an affiliate beneficiary is required to aggregate with his proposed sale of such securities any sales of such securities of the same class by the estate or the deceased during the measuring period. Once again, even where the rule's aggregation provision is applicable to the estate or certain of the beneficiaries, horizontal aggregation is not required for compliance with the Rule 144(e) volume limitation requirement.³⁵⁶ Finally, as with a trust, the executor of an estate or a beneficiary with a ten percent or more interest in that estate and his counsel should not overlook the possibility that aggregation may be required as a result of the Rule 144(a)(2) definition of the term "person" for purposes of the volume limitations requirement.

[vii] Securities Sold by Persons Acting in Concert. The last of Rule 144's express aggregation provisions neither derives from the rule's definition of a person nor relates to the Rule 144(d) tacking provisions. Apparently included as a catch-all provision to be used if necessary to deter attempts to circumvent the rule's volume limitation requirement, paragraph (e)(3)(vi) of Rule 144 simply requires that affiliate holders of restricted or control securities who agree to "act in concert for the purpose of selling securities of an issuer" must aggregate their sales during the relevant three month period to determine whether the Rule 144(e) volume limitation requirement has been met.³⁵⁷

In general, simultaneous sales even by affiliates fall short of constituting acting in concert.³⁵⁸ The critical requirement is that the proposed sellers have reached some agreement, written or oral, about selling their shares. In other words, aggregation is required whenever there are concerted activities by any persons as to resales of securities covered by Rule 144. Often, but not always, an agreement by persons who receive the securities in the same transaction to limit their resales will necessitate aggregation of their sales.³⁵⁹

³⁵³ For analysis of the meaning of the term "affiliate," see generally § 6.03 *supra*.

³⁵⁴ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(E), Question 49.

³⁵⁵ Since the 2007 amendments, Rule 144(e) is no longer applicable to non-affiliates.

³⁵⁶ See *Equitable of Iowa Companies*, SEC No-Action Letter, 1980 SEC No-Act. LEXIS 2808 (February 19, 1980), containing a view equally applicable to estate beneficiaries.

³⁵⁷ Rule 144(e)(3)(vi).

³⁵⁸ Lewis D. Lowenfels, SEC No-Action Letter, 1972 SEC No-Act. LEXIS 2147 (May 31, 1972).

³⁵⁹ See, e.g., *AMP Inc.*, SEC No-Action Letter, 1981 SEC No-Act. LEXIS 3680 (June 22, 1981). *But*

The determination of whether parties are acting in concert for the purpose of selling securities is determined on a case-by-case basis and depends upon the particular facts and circumstances involved, including the relationships among the parties.³⁶⁰

Although the staff will frequently provide an interpretive letter, its view is generally that whether the activities of particular persons constitute “acting in concert” within the meaning of Rule 144(e)(3)(vi) is a factual matter best decided by the issuer, the proposed sellers and their counsel.³⁶¹

[viii] Securities Acquired in Divorce Settlements. Following a divorce, former spouses are no longer a single “person” for purposes of the Rule 144 aggregation provisions.³⁶² However, a spouse who receives restricted securities from the transferor spouse as part of a divorce settlement agreement was normally permitted to tack to his holding period the holding period of the transferor spouse for the purpose of satisfying the old Rule 144(d) (prior to the 1990 amendments) under which holding periods generally ran from the last sale of restricted securities, not from the last sale by the issuer or an affiliate.³⁶³ That tacking benefit raises the question of whether there should be a corresponding aggregation rule applied to the sales of former spouses either on the theory that their sales constitute acting in concert or otherwise. The staff’s later position was that sales by the transferee spouse of restricted securities received pursuant to a divorce settlement need not be aggregated with any other sales of restricted securities of the same class by the transferor spouse, provided the former spouses maintain independent homes and are not otherwise acting in concert.³⁶⁴

[ix] Securities Acquired from Closely Related Persons. A person who acquired restricted securities in a private transaction from another person so closely related to the transferee that there was in fact no shift in the economic risk of the investment was generally permitted to tack to his or her holding period the holding period of the transferor closely related person for purposes of Rule 144(d) prior to the 1990 amendments as explained above.³⁶⁵ Typically, the transferee is a corporation

see Carnation Co., SEC No-Action Letter, 1980 SEC No-Act. LEXIS 2742 (February 3, 1980), in which the staff viewed a shareholders’ agreement limiting the resale of shares distributed in a liquidation as applying individually to each shareholder and therefore not constituting an agreement to act in concert.

For other circumstances possibly indicative of acting in concert, see Carolina Securities Corp., *supra* n.342 (relatives not sharing the same home must aggregate if acting in concert); James Fogelson, *Rule 144—A Summary Review*, 37 Bus. Law. 1519 (1982) at 1530, n.87 (multiple pledgees, donees or beneficiaries required to aggregate horizontally if acting in concert).

³⁶⁰ The Gap, Inc., *supra* n.345.

³⁶¹ Lewis D. Lowenfels, *supra* n.366; Gap, Inc., *supra* n.345.

³⁶² *See* § 6.05[5][d][x] *supra*; Division of Corporation Finance, Compliance and Disclosure Interpretations, Section 533.02 (Jan 26, 2009).

³⁶³ *Id.*

³⁶⁴ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(A), Question 4.

³⁶⁵ *See* § 6.05[5][d][xi] *supra*.

under the control of the transferor.³⁶⁶ Just as the closely related entities were regarded as the same person (no change in beneficial ownership) under the Rule 144 holding period requirement, they should be and are still required to aggregate their sales of restricted securities or indeed control securities of the same class for purposes of the rule's volume limitations requirement. In virtually all cases, aggregation results because the closely related parties are considered the same person as defined by the rule.³⁶⁷ Aggregation has also on occasion been required on the ground that the securities were donated to the controlled corporation³⁶⁸ and could, of course, also be required under the rule's acting in concert aggregation provision.³⁶⁹

[x] Securities Acquired in Spin-Offs or Liquidating Distributions. Where restricted securities are received by the partners or the shareholders of a distributing partnership or corporation in a spin-off or liquidating distribution, the distributees could normally tack to their holding periods the holding period of the distributing entity for purpose of Rule 144(d) prior to the 1990 amendments, as explained above.³⁷⁰ Predictably, the Commission takes the position that where partners who receive restricted securities in such a transaction from the partnership utilize that implied tacking benefit, then all of the partners must aggregate their sales of such securities for the purpose of the rule's volume limitations until two years (presumably now six months or one year, depending on the type of issuer) have elapsed since the distribution or the unlimited resale provision is available, whichever is earlier.³⁷¹

Where the distributing entity is a partnership, this horizontal aggregation requirement appears applicable regardless of the number of partner distributees.³⁷² Where the distributing entity is a corporation, however, the shareholders receiving restricted securities are subject to this horizontal aggregation requirement for up to six months or one year, depending on the type of issuer, only if the distributing corporation is or was closely held.³⁷³ If the distributing corporation is or was other than closely held, then the

³⁶⁶ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(A), Question 8.

³⁶⁷ Rule 144(a)(2)(iii); Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(A), Question 8.

³⁶⁸ Continental Alliance Corporation, SEC No-Action Letter, 1974 SEC No-Act. LEXIS 126 (August 12, 1974).

³⁶⁹ Rule 144(e)(3)(vi) and § 6.05[6][d][vii] *supra*.

³⁷⁰ See § 6.05[5][d][xii] *supra*.

³⁷¹ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(D), Question 34 and Section II(E), Question 45; Sec. Act Rel. No. 33-5306, [1972–1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,000 (1972) at Section VII(A).

³⁷² Convergent Technologies, SEC No-Action Letter, 1983 SEC No-Act. LEXIS 1876 (February 24, 1983). *But see* Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(D), Question 34 and Section II(E), Question 45 (references to closely-held corporations).

³⁷³ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(D), Question 34 and Section II(E), Question 45. *See also* Abacus Investments Limited, SEC No-Action Letter (October 5, 2007).

distributee shareholders are required to aggregate with each other only if they are as a matter of fact facing in concert.³⁷⁴

Presumably, the dichotomy between the case of a distributing partnership and that of a distributing corporation results only from the fact that most, if not all, of the partnership cases have involved closely held partnerships. To impose this rule on widely held corporations or indeed widely held partnerships would be both unreasonable and unworkable. Whenever the number of distributees is substantial, horizontal aggregation can be logically justified only where the distributees are in fact, or can be rebuttably presumed to be, acting in concert. In light of the uncertainty of the applicability of this implied aggregation provision, however, partners or shareholders proposing to rely on Rule 144 for the sale of restricted securities distributed by a partnership or corporation, as the case may be, are advised to comply with this horizontal aggregation rule for purpose of complying with the volume limitation requirement in the absence of a favorable interpretative letter from the staff.

[e] Exemptions from Provisions of Rule 144(e). As previously stated, since the 2007 amendments, the volume limitations requirement need not be complied with by a non-affiliate holder of restricted securities.³⁷⁵ In addition, non-affiliate estates and non-affiliate beneficiaries of those estates who receive restricted securities as a result solely of the death of the decedent are completely exempt from the Rule 144(e) volume limitations requirement with respect to those securities.³⁷⁶

[7] Manner of Sale Requirement—Rule 144(f)

[a] General. The 2007 amendments to Rule 144 modified paragraphs (f) and (g), in the first amendments to the manner of sale requirements since 1978.³⁷⁷ The Commission stated that it had come to believe that it was time to alter the manner of sale requirements so that they could better reflect the present market.³⁷⁸

Paragraphs (f) and (g) of Rule 144 detail the role of the broker in transactions effected in accordance with Rule 144. Specifically, paragraph (f) details the way in which securities must be sold while paragraph (g) sets forth transactions that are included within the definition of brokers transactions³⁷⁹ for the purposes of Rule 144. The 2007 amendments amended paragraph (f) to permit sales in riskless principal transactions³⁸⁰ and added a new subparagraph to paragraph (g) covering the posting of

³⁷⁴ Carnation Co., SEC No-Action Letter, 1980 SEC No-Act. LEXIS 2742 (February 3, 1980) (76 shareholder distributees).

³⁷⁵ Sec. Act Rel. No. 8869, 72 Fed. Reg. 71546 (Dec. 17, 2007).

³⁷⁶ Rule 144(e)(3)(v). *See* discussion in § 6.05[5][d][viii] *supra*.

³⁷⁷ Sec. Act Rel. No. 8869, 72 Fed. Reg. 71546 (Dec. 17, 2007).

³⁷⁸ Sec. Act Rel. No. 8869, 72 Fed. Reg. 71546 (Dec. 17, 2007).

³⁷⁹ That is, within the definition of “brokers’ transactions” set forth in Section 4(a)(4) of the Securities Act.

³⁸⁰ *See* Rule 144(f)(1)(iii). A “riskless principal transaction” is defined as a principal transaction where, after having received from a customer an order to buy, a broker or dealer purchases the security as principal

bid and ask quotations in alternative trading systems that will also be deemed not to be a solicitation.³⁸¹ Further, due to the 2007 amendments, the manner of sale requirements are now only applicable to sales by affiliates of equity securities.³⁸²

After a proposed affiliate seller of restricted or control equity securities determines that the Rule 144 adequate current public information and volume limitations requirements and, if the securities proposed to be sold are restricted securities, the holding period requirement can be satisfied, then the proposed seller must arrange for the securities to be sold consistent with the rule's manner of sale requirement. The manner of sale requirement will be satisfied only if the securities are sold in brokers' transactions, in transactions directly with a market maker or in riskless principal transactions.³⁸³ In all three of the preceding circumstances, the seller is precluded from soliciting or arranging for the solicitation of orders to buy the securities proposed to be sold and from making any payments respecting the proposed sale to anyone other than the broker executing the order to sell the securities.³⁸⁴

[b] Basis for Conditions of Rule 144(f). At the time of the adoption of Rule 144, routine trading transactions were exempted from the Securities Act's registration provisions by Section 4(a)(1) and 4(a)(4). The seller relied upon Sections 4(a)(1),³⁸⁵ and the participating broker relied on Section 4(a)(4), which exempts "brokers' transactions executed upon customer's orders . . . but not the solicitation of such orders."³⁸⁶ By 1972, transactions that qualified as "brokers' transactions" as that term had been interpreted were viewed as too limited to be considered distributions.³⁸⁷ The Commission simply embodied that notion in Rule 144 by excluding from the term "distribution" only those sales that qualified as brokers' transactions. In 1978, after the Commission was apparently convinced that some relaxation of the rule's manner of sale requirement would be possible without abuse, it amended the rule to permit transactions directly with a market maker to also satisfy the Rule 144(f) requirement.³⁸⁸ In 2007, as previously discussed, the Commission added riskless principal transactions as an additional method of satisfying the Rule 144(f) requirements.³⁸⁹

[c] Brokers' Transactions. The Rule 144(f) manner of sale requirement is

in the market to satisfy the order to buy or, after having received from a customer an order to sell, sells the security as principal to the market to satisfy the order to sell; *see also* Note to Rule 144(f)(1).

³⁸¹ Sec. Act Rel. No. 8869, 72 Fed. Reg. 71546 (Dec. 17, 2007).

³⁸² Sec. Act Rel. No. 8869, 72 Fed. Reg. 71546 (Dec. 17, 2007). Rule 144(f) does not apply to sales by non-affiliates or sales of debt securities.

³⁸³ Rule 144(f).

³⁸⁴ *Id.*

³⁸⁵ *See* analysis contained in § 6.02[2] *supra*.

³⁸⁶ Section 4(a)(4) of the Act is also discussed in § 4.06 *supra*.

³⁸⁷ *See* In the Matter of Ira Haupt & Co., 23 S.E.C. 589, 597, [1945–1947 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 75,690. *See also* Rule 154.

³⁸⁸ *See* Sec. Act Rel. No. 5979, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,731 (September 19, 1978).

³⁸⁹ Sec. Act Rel. No. 8869, 72 Fed. Reg. 71546 (Dec. 17, 2007).

satisfied if the proposed sale is made through brokers' transactions within the meaning of Section 4(a)(4) of the Securities Act. The only issue, therefore, is the scope of the term "brokers' transactions." Essentially, brokers' transactions are routine trading transactions in an established market rather than transfers that would serve to create, expand, disrupt or even significantly influence the market in the securities being sold.³⁹⁰ The first requirement, therefore, for brokers' transactions is simply that there be an existing market that can be used by the broker to effect the sale.

A second requirement is that the transaction must be executed by a "broker," defined by Section 3(a)(4) of the Exchange Act as a person engaged in the business of effecting transactions in securities for the account of others.³⁹¹ Accordingly, a transaction executed by a bank trust department for its own account is not a brokers' transaction.³⁹² Neither is a transaction by a dealer³⁹³ or any other person in the securities business that is not functioning in the transaction solely as an agent for a customer.³⁹⁴ However, where the broker itself is not a market maker for the securities to be sold, it may execute the customer order with a market maker affiliated with the broker, and such transaction would still be treated as a brokers' transaction.³⁹⁵ In addition, use of a foreign broker may well disqualify the transaction unless such broker either directly or through an affiliated entity, is registered with the Commission under the Exchange Act.³⁹⁶

Where a proposed seller of securities under Rule 144 has engaged a qualified broker to sell those securities as his agent in the existing market, the sale or sales will constitute brokers' transactions, provided the broker limits its activities to those permitted by Rule 144(g), namely:

- it does no more than execute the order or orders to sell the securities as agent for the person for whose account the securities are sold;³⁹⁷
- it receives no more than the usual and customary broker's commission,³⁹⁸ though it may act for both the seller and the buyer and receive the amount from

³⁹⁰ Arthur M. Borden & Edward A. Fleischman, *The Continuing Development of Rule 144: Significant SEC Staff Interpretations*, 8 Inst. Sec. Reg. 91, 112 (1977).

³⁹¹ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(F), Question 61, n.28.

³⁹² *Id.*

³⁹³ A dealer acts as a principal rather than an agent. It buys for its own account and sells to customers from its own account, making a profit from the difference between the price it pays and the price it receives for the securities. *In re Ryan*, Exchange Act Release No. 18,617, 24 SEC Docket 1716 (April 15, 1982).

³⁹⁴ Rule 144(g)(1).

³⁹⁵ Merrill, Lynch, Pierce, Fenner & Smith, SEC No-Action Letter, 2001 SEC No-Act. LEXIS 586 (May 30, 2001).

³⁹⁶ Revenue Properties Company Limited, SEC No-Action Letter, 1983 SEC No-Act. LEXIS 2745 (August 25, 1983).

³⁹⁷ Rule 144(g)(1). Section 4(a)(4) of the Act, discussed in § 4.06 *supra*.

³⁹⁸ Rule 144(g)(2).

each of those customers;³⁹⁹ and

- it neither solicits nor arranges for the solicitation of customers' orders to buy the securities in anticipation of or in connection with the transaction.⁴⁰⁰

Despite these prohibitions, the broker is nevertheless permitted to contact other brokers or dealers who have indicated an interest in the securities to be sold within the preceding 60 days⁴⁰¹ and the broker's customers who have indicated an unsolicited *bona fide* interest in those securities during the preceding ten business days.⁴⁰² Persons who have indicated such an interest in the securities proposed to be sold are customers for purpose of Rule 144(g) even if they have not previously effected transactions with the specific broker now selling the securities under the rule.⁴⁰³ In addition, the broker will not be regarded as soliciting buy orders if it continues to issue its regular research reports containing information about the issuer of the securities proposed to be sold⁴⁰⁴ or if it continues to make a two-way market in these securities, provided it had been doing so to the extent of publishing *bona fide* quotations in an inter-dealer quotation system on at least 12 of the preceding 30 days with no hiatus of more than four consecutive business days and such publication is incident to the maintenance of a *bona fide* inter-dealer market for the securities⁴⁰⁵ or, as added by the 2007 amendments, the publication by the broker of bid and ask quotations for the security in an alternative trading system, provided that the broker has published *bona fide* bid and ask quotations for the security in the alternative trading system on each of the last 12 business days.⁴⁰⁶ Previously, prior to the 2007 amendments, if a broker structures a riskless transaction such as a series of installment sales, on behalf of the seller, to customers who have expressed an interest in such securities then it could not be regarded as a solicitation.⁴⁰⁷ The 2007 amendments added new paragraph (f)(1)(iii) to allow for the sale of securities through riskless principal transactions where trades are executed at the same price (without any commission equivalent, fees of any kind, markdown or markup), as the Commission believes riskless principal transactions to be the equivalent of agency

³⁹⁹ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(F), Question 59.

⁴⁰⁰ Rule 144(g)(3).

⁴⁰¹ Rule 144(g)(3)(i).

⁴⁰² Rule 144(g)(3)(ii). Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(F), Question 60.

The broker should maintain written records of all the unsolicited indications of interest when received. See Note to Rule 144(g)(3)(ii).

⁴⁰³ Investment Corp. of Virginia, SEC No-Action Letter, 1976 SEC No-Act. LEXIS 1712 (August 16, 1976).

⁴⁰⁴ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(F), Question 62.

⁴⁰⁵ Rule 144(g)(3)(iii).

⁴⁰⁶ Rule 144(3)(g)(iv).

⁴⁰⁷ Jeffries & Company, Inc., SEC No-Action Letter (November 29, 1982).

trades.⁴⁰⁸ The broker or dealer effecting the agency trade must meet all of the requirements of paragraph (g), except for paragraph (g)(1), as with agency trades.⁴⁰⁹

The fourth brokers' transactions requirement, contained in paragraph (g)(4) of Rule 144, is that the selling broker must make a reasonable inquiry respecting, and be unaware thereafter of, any circumstances indicating that the proposed seller is an underwriter or that the proposed sale is part of a distribution.⁴¹⁰ A reasonable inquiry must include ascertaining at least the following information:

- the length of time the securities have been held by the person for whose account they are to be sold, and if practicable, the inquiry should include physical inspection of the securities;
- the nature of the transaction in which the securities were acquired by the proposed seller;
- the amount of securities of the same class sold during the past three months by all persons whose sales are required to be aggregated;
- whether the proposed seller intends to sell additional securities of the same class through any other means;
- whether the proposed seller has solicited or made any arrangement for the solicitation of buy orders in connection with the proposed sale of securities;
- whether the proposed seller has made any payment to any other person in connection with the proposed sale of the securities; and
- the number of shares or other units of the class outstanding or the relevant trading volume.⁴¹¹

In addition, the broker is, of course, deemed to be aware of all the information contained in Form 144,⁴¹² and in the report or other statement from the issuer respecting the adequate current public information requirement.

[d] Transactions with a Market Maker. As mentioned above, an alternative method by which a proposed seller of restricted securities or of control securities may presently comply with the Rule 144(f) manner of sale requirement is to sell those securities directly to a market maker.⁴¹³ Often the choice between this alternative, the brokers' transactions alternative, and the riskless principal alternative is irrelevant to the seller and becomes that of the broker involved. If the broker qualifies as a market maker, it may either limit its sale to that of an agent and proceed to comply with all of

⁴⁰⁸ Sec. Act Rel. No. 8869, 72 Fed. Reg. 71546 (Dec. 17, 2007).

⁴⁰⁹ Sec. Act Rel. No. 8869, 72 Fed. Reg. 71546 (Dec. 17, 2007).

⁴¹⁰ Jeffries & Company, Inc., SEC No-Action Letter (November 29, 1982). Rule 144(g)(4).

⁴¹¹ Note (ii) to Rule 144(g)(4).

⁴¹² Rule 144(g)(4) and Note (i) thereto.

⁴¹³ Rule 144(f).

the rule's requirements applicable to brokers' transactions⁴¹⁴ or purchase the securities itself in compliance with all of the Rule 144(f) requirements applicable to a market maker, or sell the securities in a riskless principal transaction as permitted by the 2007 amendments.⁴¹⁵

A broker qualifies as a market maker for purposes of Rule 144(f) only if it falls within one of the following three classes of persons specified in Section 3(a)(38) of the Exchange Act:

- any specialist that is permitted to act as a dealer;
- any dealer acting as a block positioner; and
- any dealer that holds itself out as willing to buy and sell a particular security on a regular and continuous basis.⁴¹⁶

Only in the case of a sale of securities directly to a specialist is the transaction clearly with a market maker within the meaning of Rule 144(f).

Since the term "block positioner" is not defined in the Exchange Act, it is not always obvious that a dealer is functioning as such and that its Rule 144 purchases will constitute qualifying transactions under Rule 144(f). In general, the Commission's view is that a dealer who qualifies as a block positioner for purposes of Exchange Act Rules 17a–17(b)(1) and (3)⁴¹⁷ will also be a block positioner for Rule 144 purposes, provided that:

- the Rule 144 transaction involves securities with the same type of trading

⁴¹⁴ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(F), Question 51.

⁴¹⁵ *Id.* A sale to the parent of a market maker, and in fact an installment sale, was viewed by the staff as a transaction directly with a market maker satisfying the requirement of Rule 144(f). SBHU Holdings, Inc., SEC No-Action Letter (October 18, 1981). Sec. Act Rel. No. 8869, 72 Fed. Reg. 71546 (Dec. 17, 2007).

⁴¹⁶ Section 3(a)(38) of the Exchange Act, reprinted in the Securities Primary Law Sourcebook, Volume B, Part F (Matthew Bender 2008).

⁴¹⁷ Rule 17a–17(b) under the Exchange Act was rescinded in Exch. Act Rel. No. 20,121, [1983–1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,418 (August 26, 1983), effective September 1, 1983. At the same time, Exchange Act Rule 3b-8 was adopted; it provides in pertinent part that a qualified block positioner is

[a] dealer who is . . . registered pursuant to Section 15 of the [Exchange] Act, . . . is subject to and in compliance with Rule 15c3-1 . . . has and maintains minimum net capital . . . of \$1,000,000 and . . . meets all of the following conditions: (i) he engages in the activity of purchasing long or selling short, from time to time, from or to a customer . . . a block of stock . . . in a single transaction, or in several transactions at approximately the same time, from a single source to facilitate a sale or purchase by such customer . . . (iii) he sells the shares comprising the block as rapidly as possible commensurate with the circumstances.

The adoption of Exchange Act Rule 3b-8 was announced in Exch. Act Rel. No. 34-20,121, [1983–1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,418 (August 26, 1983). The Rules under the Securities Exchange Act of 1934 are reprinted in the Securities Primary Law Sourcebook, Volume B, Part G (Matthew Bender 2008).

characteristics as those the block positioner generally holds itself out as being ready and able to purchase;⁴¹⁸ and

- the amount of securities to be purchased by the block positioner from the Rule 144 seller constitutes a “block.”⁴¹⁹

While the term “block” is also not defined in the Exchange Act, the Commission has indicated in the past that a block transaction is a transaction in which the dealer, by reason of the size of the order in relation to the conditions in the exchange market, reasonably concludes that it is in the customer’s best interests to search and negotiate for a matching interest on the other side of the market rather than to attempt to execute the order in the ordinary course of the auction market.⁴²⁰

Where a proposed seller desires to satisfy the Rule 144(f) manner of sale requirement by selling to a dealer that falls within the third category of qualifying market makers, the seller must confirm that the dealer is not a so-called “instant” market maker. In other words, a dealer cannot become a market maker through the Rule 144 transaction itself.⁴²¹ Rather, the dealer qualifies only if it has previously held itself out, and is currently holding itself out, as being willing to buy and sell the security being offered in the Rule 144 transaction.⁴²² Rule 144(g)(3)(iii) provides an objective guideline for whether a dealer is in fact a bona fide market maker for purposes of the rule,⁴²³ a fact that the proposed seller should ascertain and document in his files.⁴²⁴

Similar to a broker executing brokers’ transactions for purposes of Rule 144(f), a market maker is also precluded from soliciting buy orders for the securities it intends to purchase in the Rule 144 transaction.⁴²⁵ The normal activities of a market maker, however, will not constitute such an impermissible solicitation, provided they are not altered as part of a special campaign to generate interest in the securities that the market maker anticipates purchasing.⁴²⁶ Once the Rule 144 transaction is completed, the securities are unrestricted in the hands of the market maker and maybe treated by the

⁴¹⁸ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(F), Question 52.

⁴¹⁹ *Id.* at Question 53. The block may consist of securities subject to Rule 144 and securities of the same class not subject to the rule.

⁴²⁰ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(F), Question 54.

⁴²¹ *In re Ryan*, Exchange Act Release No. 18,617, 24 SEC Docket 1716 (April 15, 1982).

⁴²² *See* Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(F), Question 55.

⁴²³ *Id.*

⁴²⁴ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(F), Question 55, n.20.

⁴²⁵ *See* SEC v. Aaron, 605 F.2d 612 (2d Cir. 1979).

⁴²⁶ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(F), Question 56.

market maker as any other tradable securities.⁴²⁷ In other words, the market maker, unless it is an affiliate of the issuer, may solicit buy orders for the securities that it purchased in a Rule 144 transaction after its purchase from the holder is completed.⁴²⁸

[e] Exemptions from Provisions of Rule 144(f). As previously mentioned, a non-affiliate seller of debt securities need not comply with the manner of sale requirement. In addition, non-affiliate estates and non-affiliate beneficiaries of those estates who receive restricted securities solely as a result of the death of the decedent are completely exempt from the Rule 144(f) manner of sale requirement for those securities.⁴²⁹

[8] Notice of Proposed Sale Requirement—Rule 144(h)

The final requirement that must be satisfied before a sale of restricted or control securities by an affiliate (since the 2007 amendments, Rule 144(h) no longer applies to sales by non-affiliates) may be made under Rule 144 is the filing of Form 144.⁴³⁰ Historically, copies were filed with the Commission, either a paper filing or via email, regardless of the issuer's status. Beginning April 2023, Forms 144 for reporting issuers will be filed by such selling affiliate on EDGAR, the Commission's e-filing portal. For non-reporting issuers, paper and email forms may still be filed with the Commission. The notice must be filed on EDGAR or placed in the mail or otherwise transmitted, as applicable, not later than either the placing of the sell order with a broker or the execution of the Rule 144 sale with a market maker.⁴³¹ As specified by the form, certain information about the issuer, the securities to be sold, and the seller's other sales (including the sales of other persons required to be aggregated) of those securities during the three month period preceding the date of filing must be included.⁴³² Form 144 must be signed by the person for whose account the securities are to be sold.⁴³³ Finally, the proposed seller must have, at the time of filing, a *bona fide* intention of actually selling the securities referred to in Form 144 within a reasonable time after the filing.⁴³⁴ Any amendments to Form 144, whether to change the selling broker,⁴³⁵ to increase the amount of securities to be sold in light of an increased trading volume⁴³⁶

⁴²⁷ *Id.* at Question 50. Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979).

⁴²⁸ Jim G. Rhodes, SEC No-Action Letter, 1980 SEC No-Act. LEXIS 3204 (January 17, 1980).

⁴²⁹ Rule 144(f).

⁴³⁰ Rule 144(h).

⁴³¹ *Id.* The Staff confirmed that “concurrently” in this context means on the same day as the placing of a sale order or the execution of the sale. Division of Corporation Finance, Compliance and Disclosure Interpretations, Question 136.09 (Mar. 4, 2011).

⁴³² See Form 144. Regarding the proper time to file Form 144 in the case of call options, see Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(H), questions 76 through 79, and for put options, see § 6.05[3][d][iv] *supra*.

⁴³³ Rule 144(h). In a proposed sale by a pledgee of securities following a default in the loan obligation, the pledgee may sign the Form 144. Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(G), Question 64.

⁴³⁴ Rule 144(i). Where a proposed seller filed a Form 144 but instructed his broker not to actually sell any of the securities for 65 days, the staff took the position that the proposed seller did not have the required

or for any other reasons,⁴³⁷ are subject to the same requirements as the original notice.⁴³⁸ The filing thresholds is either \$50,000 or 5,000 shares.⁴³⁹ A proposed seller need not consider the sales of persons with whom he may be required to aggregate for purposes of the Rule 144 volume limitation requirement in determining whether a Form 144 must be filed, unless he is acting in concert with another such person.⁴⁴⁰

Form 144 requires that a seller represent that as of the date that the Form 144 is signed that the seller “does not know any material adverse information in regards to the current and prospective operations of the issuer of the securities to be sold which has not been publicly disclosed.”⁴⁴¹ This representation presents a problem when it comes to a seller that is selling the shares pursuant to a Rule 10b5-1 trading plan. The Commission had previously indicated that a seller with an effective 10b5-1 selling plan in place can modify the Form 144 representation indicating that as of the date on which the plan was adopted or the trading instructions were given, the seller had no knowledge of material adverse information pertaining to the issuer.⁴⁴² The Commission adopted this position in the 2007 amendments.⁴⁴³

[9] Unavailability to Securities of Issuers with No or Nominal Operations and No or Nominal Non-Cash Assets

The 2007 amendments replaced previous paragraph (i),⁴⁴⁴ with language regarding the treatment of securities issued by reporting or non-reporting shell companies,⁴⁴⁵ codifying a previous interpretation by the Commission.⁴⁴⁶ Under paragraph (i), Rule

bona fide intention to sell within a reasonable time. Flight Safety International, SEC No-Action Letter, 1976 SEC No-Act. LEXIS 1233 (May 31, 1976).

See also Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(H), Question 76, regarding the intent of a person who files a Form 144 for securities to be used to cover a call option, but then delivers other securities.

⁴³⁵ Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(G), Question 65.

⁴³⁶ *Id.* at Section II(E), Question 39.

⁴³⁷ *See, e.g., Id.* at Section II(G), Question 66.

⁴³⁸ Sec. Act Rel. No. 5995, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,759 (November 8, 1978).

⁴³⁹ Sec. Act Rel. No. 8869, 72 Fed. Reg. 71546 (Dec. 17, 2007).

⁴⁴⁰ *See* Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section II(G), Questions 67 and 68.

⁴⁴¹ Form 144.

⁴⁴² *See* original position as set out in SEC Division of Corporate Finance Manual of Publicly Available Telephone Interpretations, Fourth Supplement at Rule 10b5-1 (May 30, 2001); Form 144, Interpretation No. 2.

⁴⁴³ Sec. Act Rel. No. 8869, 72 Fed. Reg. 71546 (Dec. 17, 2007).

⁴⁴⁴ Previous to the 2007 amendments, paragraph (i) required a seller to have a bona fide intention to sell. Previous paragraph (i) is now contained in paragraph (h).

⁴⁴⁵ Rule 144(i).

⁴⁴⁶ Sec. Act Rel. No. 8869, 72 Fed. Reg. 71546 (Dec. 17, 2007).

144 is not available for resales of the securities of reporting and non-reporting shell companies, or for resales of the securities of blank check companies,⁴⁴⁷ other than business combination related shell companies and asset-backed issuers. However, Rule 144 is available for sales of securities of a former shell company, provided that the shell company has been subject to the reporting requirements of Section 13 or Section 15(d) of the Exchange Act during the preceding 12 months (or a shorter period that it was subject to the reporting requirements) and at least one year⁴⁴⁸ has passed since the former shell company issuer filed the information known as “Form 10” information with the Commission demonstrating that it is no longer a shell company.⁴⁴⁹ The Commission further noted that Form 10 information is deemed to have been filed when the initial filing is made with the Commission, rather than when the Commission’s review is complete or the amended Form 10 is filed in response to comments from the Commission.⁴⁵⁰ By no-action letter, the staff extended this position to Canadian companies that had formerly been shell companies but had been subject to Canadian disclosure requirements for at least a year.⁴⁵¹ In light of the Commission’s acceptance of Canadian disclosure as providing an equivalent level of investor protection to that of the United States under the Multijurisdictional Disclosure System (“MJDS”), this position is unlikely to be extended to companies from any other jurisdictions; the MJDS is in effect only with respect to Canada.

[10] Procedures for Sales under Rule 144

[a] **General.** Although the promulgation of Rule 144 was intended in part to facilitate the sale of restricted securities and of control securities by basing the availability of the resale exemption on more objective standards,⁴⁵² it was initially avoided rather than embraced by prospective sellers because of the often cumbersome and nonuniform selling procedures imposed upon them by fearful issuers and brokers. As a result, delays in effecting the sales were common and the costs to the sellers sometimes prohibitive.⁴⁵³ Despite numerous requests for guidance from the staff for acceptable procedures and documentation that would ensure compliance with the rule’s requirements, the staff has consistently taken the position that these matters are the

⁴⁴⁷ Sec. Act Rel. No. 8869, 72 Fed. Reg. 71546 (Dec. 17, 2007); NASD Regulation, Inc., SEC No-Action Letter, 2000 SEC No-Act. LEXIS 42 (Jan. 21, 2000).

⁴⁴⁸ The 2007 Proposing Release initially suggested a 90 day requirement for the filing of Form 10 information. Sec. Act Rel. No. 8813, 72 Fed. Reg. 36822 (July 5, 2007).

⁴⁴⁹ Sec. Act Rel. No. 8869, 72 Fed. Reg. 71546 (Dec. 17, 2007) (“Form 10” information is equivalent to information that a company would be required to file if it were registering a class of securities on Form 10 or Form 20-F under the Exchange Act”). It is important to note that both restricted and control securities are subject to the one year requirement regarding the filing of Form 10 information.

⁴⁵⁰ Sec. Act Rel. No. 8869, 72 Fed. Reg. 71546 (Dec. 17, 2007).

⁴⁵¹ Certain Canadian Issuers, SEC No-Action Letter, 2013 SEC No-Act. LEXIS 456 (September 6, 2013).

⁴⁵² See generally § 6.05[2] *supra*.

⁴⁵³ See Dan Goldwasser, A Guide to Rule 144 (2d ed. 1978); Bernard Cedarbaum, *Executing Rule 144 Sales*, 5 Rev. Sec. Reg. 851 (October 19, 1972).

responsibilities of the parties involved.⁴⁵⁴ After many decades of working with sales pursuant to Rule 144, however, both brokers and issuers have gained considerable experience and are generally able to effect most Rule 144 sales with a minimum of expense and inconvenience for all concerned parties.

[b] Responsibilities of Sellers. Rule 144 places the responsibility for complying with all of the rule's applicable requirements on the proposed seller of securities pursuant to the rule. The seller is presumably the person most familiar with the facts relating to his purchase and ownership of the securities proposed to be sold and to his affiliate or non-affiliate status under the rule. The seller is, however, often not qualified to ascertain whether the rule is available and to satisfy each of the rule's sometimes rather technical requirements, as well as to satisfy the issuer's conditions for the transfer of the securities proposed to be sold and the broker's requirements for effecting the transaction in compliance with Rule 144(f).⁴⁵⁵

[c] Responsibilities of Sellers' Brokers. In the absence of counsel for the seller, the broker will assume the primary responsibility for effecting the proposed sale of restricted securities or of control securities pursuant to Rule 144. Assuming it is willing and able to participate, the broker will cause the proposed seller to complete its standard form cover representation letter designed to indicate:

- the nature of the seller's relationship, if any, with the issuer;
- the restricted character of the securities;
- the period since the shares were last held by the issuer of any affiliate of the issuer (giving effect to any applicable tacking provisions where these are necessary); and
- any sales of securities of the same class during the preceding three months by the seller (after giving effect to any aggregation provisions and excluding any securities not required to be included in the calculation).⁴⁵⁶

If the representation letter demonstrates that the securities may be sold free of all of the rule's requirements, (i.e., non-affiliate selling shares after holding the shares for a period of one year), the broker should contact the issuer to ensure that the issuer, upon receipt of the seller's representation letter, will instruct the transfer agent to process the transfer after the sale has been made and the duly executed certificates have been delivered. Since the purchasers will demand unlegended certificates,⁴⁵⁷ the broker

⁴⁵⁴ See, e.g., Union Bank, SEC No-Action Letter, 1979 SEC No-Act. LEXIS 2153 (February 5, 1979).

⁴⁵⁵ See Rule 144(f) and (g).

⁴⁵⁶ For examples of a typical representation letter, see Denis T. Rice and Charles P. Ortmeyer, 6 Securities Regulation Forms § 2:22 (Westlaw 2008); James Fogelson, *Rule 144—A Summary Review*, 37 Bus. Law. 1519 (1982) at 1547, Exhibit A; § 4.02[1] *supra*; Dan Goldwasser, *A Guide to Rule 144* (2d ed. 1978) at 381–97.

⁴⁵⁷ Legended certificates are not deemed good delivery under the rules of the self-regulatory agencies. National Ass'n of Securities Dealers, Inc., [1972–1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,808 (April 21, 1972).

should not actually effect the sale until the issuer either delivers clean certificates or agrees to issue them to the purchaser promptly following completion of the transaction.

If the results of the seller's representation letter to the broker indicate that Rule 144 is available for the proposed sale, the broker will make any further investigation it feels appropriate to satisfy its Rule 144(g) responsibility to make reasonable inquiry as to whether the proposed sale will involve a distribution.⁴⁵⁸ Where the rule appears available for the proposed sale, the broker should next contact the issuer to ascertain whether the issuer is current in its Exchange Act filings⁴⁵⁹ and to obtain the factual information necessary to assist the seller to complete and file Form 144. At that time, the broker should also verify exactly what documentation the issuer will require to instruct its transfer agent to process the transfer and deliver clean certificates to the purchaser.

Normally, the issuer will require the following documentation:

- a completed and executed copy of Form 144 and representation that copies were timely filed with the Commission and any required exchange;
- an executed copy of the seller's representation letter to the broker;
- a letter from the broker representing that the sale was completed either through a brokers' transaction in transactions directly with a market maker or in a riskless principal transaction, in each case in compliance with Rule 144(f);⁴⁶⁰ and
- duly executed certificates representing the securities to be transferred to the purchaser.

The broker should confirm that no opinion of seller's counsel will be required and that upon delivery of the required documentation, the transfer agent will be instructed to complete the transfer and deliver clean certificates promptly to the purchasers.

Finally, the broker will request a letter from the proposed seller to effect that he or she has made no attempts to solicit buy orders in violation of Rule 144(f). After having done all of the above, the broker will:

- file Form 144 as required for the seller;
- either execute the sell order or itself purchase the securities from the seller; and
- deliver the required documents to the issuer or its transfer agent for processing and delivery of the securities to the Rule 144 purchaser of purchasers.

[d] Responsibilities of Issuers. When an issuer sells securities pursuant to one of the private offering exemptions from registration under the Securities Act, it is

⁴⁵⁸ See Rule 144(g)(3).

⁴⁵⁹ If the issuer is not a reporting issuer under the Exchange Act, see § 6.05[3][c] *supra*.

⁴⁶⁰ In view of the logistical difficulties involved in settling a Rule 144 transaction two days after the trade ("T+2"), as required by Rule 15c6-1(a), the SEC permits "future tense" representation letters from brokers. Smith Barney, Inc., SEC No-Action Letter, 1995 SEC No-Act. LEXIS 549 (June 20, 1995) (previously the settlement cycle was "T+3").

required to take steps to prevent the public resale of those securities including;

- obtaining investment representations from the purchaser;
- legending the certificates; and
- issuing stop transfer instructions to the issuer's transfer agent.⁴⁶¹

Although the obligations are more explicit in the case of restricted securities, issuers are also concerned about aiding and abetting the unlawful resale of unrestricted securities by their affiliates.⁴⁶² Accordingly, in both cases the issuers of restricted securities and control securities shoulder the burden of policing resales of their securities made pursuant to Rule 144. Generally, the form of that policing is that counsel for the issuer will:

- set the requirements for documentation required from the seller and his broker;
- review all of the documentation; and
- issue instructions (usually in the form of an opinion letter) to the issuer's transfer agent to proceed with the transfer and issuance of clean certificates to the Rule 144 purchaser of purchasers.

Of course, if the availability of the rule is not clear, the issuer (and its counsel) may refuse to effect the transfer in the absence of either a favorable interpretive letter from the staff of the Commission or a favorable opinion letter from counsel of substantial reputation for the seller.

[e] Responsibilities of Transfer Agents. Although the Exchange Act regulates transfer agents,⁴⁶³ a transfer agent is essentially just that, a person performing a ministerial function pursuant to the issuer instructions. In order to process the transfer, transfer agents will commonly require a favorable opinion from reputable legal counsel to either the seller or the issuer.⁴⁶⁴

[11] Effects of Compliance with Rule 144

Rule 144 offers a safe harbor for the public resale of restricted securities and control securities under the resale exemption from registration contained in Section 4(a)(1) of the Securities Act. Accordingly, if all of the applicable requirements of the rule are complied with by the seller and broker, the transaction is exempt from the registration and prospectus delivery requirements of Securities Act. In other words, a Rule 144 seller is not in violation of Section 5 of the Securities Act, the issuer is not in danger of losing a private offering exemption,⁴⁶⁵ the broker is not in violation of the Securities

⁴⁶¹ See the requirements of Rule 502(d) of Regulation D, discussed in § 4.04 *supra*.

⁴⁶² See Dan Goldwasser, *A Guide to Rule 144* (2d ed. 1978) at 371.

⁴⁶³ Registration and regulation of transfer agents under Section 17 of the Exchange Act is discussed in Federal Securities Exchange Act of 1934, § 2A.03 (Matthew Bender 2008).

⁴⁶⁴ With respect to broader investor services plans administered by transfer agents, see Computershare Trust Company, N.A., SEC No-Action letter, 2010 SEC No-Act. LEXIS 444 (July 26, 2010) and Harris Corporation, SEC No-Action Letter, 1999 SEC No-Act. LEXIS 610 (June 30, 1999).

⁴⁶⁵ See § 6.02 *supra*.

Act and the purchaser receives freely tradeable securities under the Securities Act,⁴⁶⁶ unless of course, the purchaser is an affiliate of the issuer of those securities.

§ 6.06 Public Resales of Restricted Securities and “Control Securities” Outside Rule 144

[1] Availability of Resale Exemption

Although Rule 144 is the vehicle for most unregistered public resales of restricted securities and control securities that are sold today, it is nevertheless not the sole option for their lawful resale.

As a result of the safe harbor provided by Rule 144, the resale exemption contained in Section 4(a)(1) of the Securities Act is currently available for most resales of restricted securities and most resale of control securities that comply with all of the rule’s applicable requirements.¹ By its own terms, however, Rule 144 is not the only means by which holders of restricted and control securities can rely on the resale exemption provided by Section 4(a)(1) of the Securities Act.² At least in theory, such proposed sellers may rely upon Section 4(a)(1) outside of the Rule 144 safe harbor. In light of the Commission’s warning, however, that a seller and any participating broker will have a heavy burden of proving the availability of the resale exemption outside of the rule,³ such proposed sellers will most likely resort to this alternative only where one or more of the rule’s requirements cannot be satisfied. The proposed sellers will almost certainly encounter reluctance on the part of most issuer and brokers to effect transfers of restricted securities and deliver clean certificates to the purchasers, absent convincing opinion letters from both the seller’s and its own experienced counsel regarding the availability of the statutory exemption outside of Rule 144.⁴

Since the unlimited resale provision contained in Rule 144 was broadened to permit non-affiliate holders of restricted securities that have not been held by the issuer or any affiliate of the issuer during the holding period to resell those securities, free of all restrictions, it is only in the case of restricted securities that have been held for less than the availability of the resale exemption outside of the rule is relevant.⁵ In other words, where the specified holding period has elapsed since restricted securities were acquired from the issuer or an affiliate, those securities are now as freely tradable under Rule 144 as unrestricted securities under the Section 4(a)(1) resale exemption.⁶ While Rule 144

⁴⁶⁶ Grove Explorations, Ltd., *supra* n.185, Sec. Act Rel. No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (1979), at Section I, Question 1.

¹ *But see* exceptions discussed in § 6.05[3][d] *supra*.

² *See* Preliminary Note to Rule 144, reprinted in the Securities Primary Law Sourcebook, Volume A, Section C (Matthew Bender), and discussed in § 6.05[2] *supra*.

³ *See* § 6.05[2][d] *supra*.

⁴ *See* § 6.05[10][c] and [d] *supra*.

⁵ Rule 144. *See* analysis in § 6.05[4] *supra*.

⁶ Indeed the restricted securities are perhaps more freely tradable given the safe harbor protection of Rule 144 occurring without any affirmative action on the part of the seller, as well as the fact that there are some limitations on the tradability of unrestricted securities by non-affiliates.

in its present form has virtually eliminated the difference in tradability between unrestricted securities and restricted securities that have been so owned for the applicable holding period, it is likely to cause Rule 144 to become, by implication, the nearly exclusive method by which restricted securities may be publicly sold under the Securities Act's resale exemption.⁷

As explained above, the resale exemption was intended to permit only private resales and ordinary trading transactions without registration under the Securities Act.⁸ Although most resales of unrestricted securities by non-affiliates in less than substantial amounts are regarded as ordinary trading transactions rather than unlawful distributions, public resales of restricted securities are always presumed to involve a distribution.⁹ Accordingly, a proposed seller of restricted securities may not safely rely upon the resale exemption for public resales unless it can establish that:

- the original purchase was with investment intent rather than resale intent;
- the resale is other than a sale for the issuer; and
- the resale does not amount to a participation in a distribution.¹⁰

These arguments are difficult to make until a substantial period of time, probably close to the applicable holding period has passed, rendering the proposed use of this exemption as more theoretical than practical. Only where a proposed seller of restricted securities can convince the issuer, presumably through an opinion of counsel that the resale does not involve a distribution is the resale exemption outside of the rule a realistic possibility for the lawful resale of those securities without registration under the Securities Act.

In this light, the availability of the resale exemption outside Rule 144 for the sale of restricted securities is extremely limited. Accordingly, counsel is likely to feel comfortable rendering a favorable opinion letter respecting the resale of restricted securities only where there is substantial, though perhaps not literal, compliance with the rule's several requirements.¹¹ For example, a favorable opinion letter may be appropriate where a Form 144 was inadvertently filed late,¹² where public information has been available for only 80 days,¹³ where a holder who has held the subject securities for one year has been a non-affiliate for only two months,¹⁴ and where in each case where all of the rule's other requirements were or could be satisfied. In light of the disclosure philosophy underlying the whole of Securities Act and the staff's vigorous policy against taking a position on the availability of the resale exemption absent

⁷ See, however, discussion of sale of securities that have "come to rest" in §§ 6.06[2] and 6.08[3] *infra*.

⁸ See analysis in § 6.02[2] *supra*.

⁹ See analysis in § 6.02[3] *supra*.

¹⁰ *Id.*

¹¹ See James Fogelson, *Rule 144—A Summary Review*, 37 Bus. Law. 1519 (1982), at 1541–42.

¹² See § 6.05[6] *supra*.

¹³ See § 6.05[4][c][ii] *supra*.

¹⁴ See § 6.05[5] *supra*.

adequate current public information about the issuer, even for restricted securities acquired prior to the adoption of the rule,¹⁵ it should be exceedingly difficult to justify a favorable Section 4(a)(1) opinion letter in the absence of such adequate current public information.

In sum, the resale exemption outside Rule 144 is probably presently available for the public resale of restricted securities by non-affiliates only in circumstances that are substantially in compliance with all of the rule's requirements.¹⁶ If a proposed sale of restricted securities would deviate substantially from meeting any of the rule's requirements, other than perhaps the notice of proposed sale requirement, the proposed seller should consider a private sale, or another available exemption from the Securities Act's registration requirements rather than the Section 4(a)(1) resale exemption.¹⁷

[2] Availability of Other Exemptions

As stated above, both restricted securities and control securities may also be publicly sold without registration under the Securities Act where the transaction meets the requirements of one of the limited number of rather narrow transaction exemptions contained in Section 3 of the Securities Act. Those possibilities include the exemption provided by Regulation A pursuant to Section 3(b)¹⁸ and those contained in Sections 3(a)(10)¹⁹ and 3(a)(11) of the Securities Act.²⁰

Also, the possibility has arisen that restricted securities that have "come to rest" and are no longer in distribution may be resold publicly or privately without registration reliance on Section 4(a)(1). However, the circumstances in which such an exemption is available are more likely to be encountered in a private resale rather than a public one.²¹

¹⁵ See, e.g., American Uranium Corp., SEC No-Action Letter 1980 SEC No-Act. LEXIS 3804 (October 14, 1980).

¹⁶ See, e.g., General Automation, Inc., SEC No-Action Letter 1980 SEC No-Act. LEXIS 3783 (October 9, 1980).

Since the staff will generally not comment of the availability of Section 4(a)(1) outside of Rule 144 for the sale of restricted securities acquired after April 15, 1972, guidance is limited, Sec. Act Rel. No. 33-6253.

¹⁷ An exemption might be made for the sale of large amounts of debt securities to institutional investors. In that regard, see generally Study Group on Resales of Debt Securities, ABA Committee on Developments in Business Financing, *Resale by Institutional Investors of Debt Securities Acquired in Private Placements*, 34 Bus. Law. 1927 (1979). Even in that case, a private sale might be the more appropriate alternative to registration, see § 6.07 *infra*.

¹⁸ See § 6.03[4][b] *supra*.

¹⁹ See § 6.03[4][e][v] *supra*.

²⁰ See § 6.03[4][e][vi] *supra*. See also § 3.12 *supra*.

²¹ See § 6.08[4] *infra*.

§ 6.07 Private Resales of Restricted Securities and Control Securities to Qualified Institutional Buyers under Rule 144A

[1] Nature and Philosophy of Rule 144A

During the 1980's, the market for privately placed securities in the U.S. grew faster than the public offering market and became increasingly important.¹ Issuers saved a substantial amount of money and minimized their information disclosure obligations by arranging placement of their securities with institutional investors without any public offering, thereby avoiding the need for registration under the Securities Act. Foreign issuers especially were attracted to private placements because those placements provided access to the U.S. capital markets without making all the disclosures required for the registration of a public offering and periodic disclosure required thereafter under the Exchange Act.

The Commission decided to facilitate such private placements and encourage the participation of foreign issuers in the U.S. market by increasing the efficiency and liquidity of the secondary market for restricted securities.² It found that registration under the Securities Act was not intended to protect large institutional investors and that, given minimal procedural protections, such institutions were presumably able to fend for themselves in the securities market. It concluded that offering and selling to such institutions does not involve a distribution.³

The Commission adopted Rule 144A on April 23, 1990.⁴ The rule provides safe harbors under Sections 4(a)(1) (for ordinary investors) and 4(a)(3) (for dealers) of the Securities Act. If all the conditions of the rule are complied with, any holder of restricted securities other than the issuer, including affiliates,⁵ may resell restricted securities at any time without registration in reliance on the rule. The rule provides that such sales will be deemed not part of a distribution, the seller will be deemed not as underwriter, and securities will be deemed not offered to the public. Thus, ordinary investors may rely on Section 4(a)(1), which provides an exemption from registration for transactions by persons other than issuers, underwriters or dealers.⁶ Dealers may rely on Section 4(a)(3), which provides an exemption from registration for transactions

¹ Sec. Act Rel. No. 33-6806, [1988–1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,335 (1988), at 89,526–89,528.

² Sec. Act Rel. No. 33-6806, [1988–1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,335 (1988), at 89,533.

³ *Id.* at 89,539.

⁴ Sec. Act. Rel. No. 33-6862 (1990).

⁵ Division of Corporate Finance, Compliance and Disclosure Interpretations, Question 138.01 (Jan. 26, 2009).

⁶ Rule 144A(b). *See also* Ch. 4 *supra* and discussion of Section 4(a)(1) at § 6.02[2] *supra*. Section 4(a)(1) of the 1933 Act is reprinted in the Securities Primary Law Sourcebook, Volume A, Section B (Matthew Bender).

by dealers except in circumstances involving a distribution or within forty days of a public offering.⁷

Unlike Rule 144, Rule 144A requires no holding period. This facilitates firm underwriting of privately placed securities. An issuer may sell to an underwriter (using the term underwriter in its factual, not its statutory sense) in a transaction to which the registration provisions of the Securities Act do not apply either because it involves no public offering (in reliance on Section 4(a)(2) or Regulation D, including offerings under Rule 506(c) of Regulation D, which permits “non-public” offerings to be made by means of general solicitation)⁸ or is conducted outside the United States in compliance with Regulation S.⁹ The underwriter may immediately resell the securities to institutional investors, provided the requirements of the rule are satisfied. The Commission has stated explicitly that purchasing securities from an issuer with a view to reselling under Rule 144A does not affect the availability of the Section 4(a)(2) or Regulation D exemption for the issuer.¹⁰

The rule also increases the opportunities for every holder of restricted securities to resell those securities at any time, albeit to a limited universe of potential buyers. There is no explicit limitation on the means that can be used to solicit such sales, provided that sales are made only to “qualified institutional buyers” (“QIBs”) in compliance with the rule. Prior to the changes mandated by the JOBS Act in 2012, both *offers* and sales had to be limited to QIBs only. Until recently it was assumed that a general solicitation with respect to the resale transaction would have affected the availability of the Section 4(a)(2) exemption for the original private placement by the issuer, so all parties involved in reselling securities under Rule 144A tended to proceed on the basis that Section 4(a)(2)’s prohibition on general solicitation¹¹ probably applied to the resales.¹² The JOBS Act directed the Commission to amend Rule 144A to provide that offers were permitted to be made to persons other than QIBs under the Rule provided that sales were made only to QIBs.¹³ In 2013 the Commission adopted rules that implemented this change and moreover made it clear that general solicitation in the course of a resale under Rule 144A would not prevent reliance on Section 4(a)(2) for the original private placement by the issuer.¹⁴ The Commission has permitted Rule 144A offers to be made

⁷ Rule 144A(c). *See also* Ch. 4 *supra*.

⁸ *See also* Ch. 4 *supra*.

⁹ *See* discussion of Regulation S at § 6.03[4] *supra*.

¹⁰ *See* Preliminary Note 7 to Rule 144A.

¹¹ *See* Ch. 4 *supra*.

¹² *See* Hanks, *Rule 144A: Another Cabbage in the Chop Suey*, 24 GW J. Int’l L. & Econ. 305, 338–41 (1990).

¹³ Jumpstart Our Business Startups Act, Pub. L. No. 112-106 §§ 301–05 (codified in 15 U.S.C.), Section 201(a)(2).

¹⁴ Sec. Act Rel. No. 33-9415 (2013). The general solicitation may be undertaken by the issuer or by initial purchasers in the Section 4(a)(2) transaction or other distribution participants. Division of Corporate Finance, Compliance and Disclosure Interpretations, Question 138.03 (Nov. 13, 2013).

by means of Internet roadshows whose attendees are limited to QIBs for some time.¹⁵ This limitation would presumably no longer be necessary.

Like all other exemptions from registration, Rule 144A relates only to Section 5 of the Securities Act. It does not provide exemption from any other provision of the securities laws, including the antifraud provisions of the Securities Act and the Exchange Act.

[2] Conditions of the Rule 144A Exemption

[a] Overview of Conditions. The conditions of the exemption provided by Rule 144A are as follows:

- the seller must reasonably believe the buyer is a QIB;
- the seller must take reasonable steps to ensure that the buyer knows the sale may be made in reliance on Rule 144A;
- the securities resold may not be issued by certain investment companies, or be of the same class or convertible or exchangeable for securities of the same class as those listed on a U.S. securities exchange or quoted on a U.S. automated inter-dealer quotation system; and
- prospective buyers must have a right to receive certain specified information about the issuer.

[b] Reasonable Belief Buyer is a QIB

[i] Definition of QIB. Rule 144A applies only if the seller reasonably believes that the buyer is a “qualified institutional buyer.” The rule contains a very detailed and specific definition of “qualified institutional buyer.”¹⁶ Generally, a QIB is an entity falling into one of the categories listed in the rule that owns and has investment power¹⁷ over at least \$100 million of securities not issued by the entity or any affiliate of the entity. If the entity is a bank or savings and loan association, it must additionally have

¹⁵ See Net Roadshow, Inc., SEC No-Action Letter, 1998 SEC No-Act. LEXIS 107 (January 30, 1998). In 2005, the Commission adopted the Securities Offering Reform which has since expanded the scope of permitted communications relating to road shows in the registered offering context. See Securities Release No. 33-8591, § III(3)(b)(iii)(D)(4), 70 Fed. Reg. 44,722 (July 19, 2005).

¹⁶ Rule 144A(a)(1). There is a “catch-all” provision in the definition of qualified institutional buyer in Rule 144(a)(1)(H) that does not catch all possible types of institutional so others have been added through the no-action letter process. See, e.g., Alaska Permanent Fund, SEC No-Action Letter, 2011 SEC No-Act. LEXIS 450 (July 14, 2011); College Savings Plan Network, SEC No-Action Letter (Jan. 12, 2016).

¹⁷ While this provision may be read to imply that prospective QIB must have investment power over all the securities that it owns (thus disqualifying many large institutions whose assets are managed by other persons), current market practice is to read the provision as permitting prospective QIBs to aggregate assets over which they have investment power (but do not own) with those that they own (but do not have investment power over) in meeting the size test. There is, however, no written authority for this. Borrowed securities may not be included as being “owned”, while securities owned but lent out should be included. Division of Corporation Finance, Compliance and Disclosure Interpretations, Questions 138.06 and 138.07 (December 8, 2016). Short positions do not represent ownership of securities. Division of Corporation Finance, Compliance and Disclosure Interpretations, Question 138.08 (December 8, 2016).

an audited net worth of at least \$25 million. A dealer registered as such under Section 15 of the Exchange Act need own only \$10 million of securities. Dealers engaging in “riskless principal transactions” on behalf of QIBs and entities of which all the equity owners are QIBs are also defined as QIBs. Some types of securities, including certificates of deposit, swap contracts and securities subject to repurchase agreements are not counted as eligible “securities” for this test.¹⁸ In 1992, the SEC amended Rule 144A to permit the inclusion of U.S. government and similar securities in calculations of the amount of securities owned or invested by a particular institutional investor.¹⁹

In its adopting release, the Commission stated that it had considered including additional tiers of investors defined by less stringent criteria, but that it decided to begin with a narrow definition and consider changes in the future based on experience with the rule.²⁰

[ii] Basis for Reasonable Belief. The safe harbor of Rule 144A is available only if the buyer is a QIB or the seller and any person acting on behalf of the seller reasonably believe the buyer is a QIB. Although this is a question of fact, the rule provides that, with respect to the prospective purchaser’s ownership of and investment power over securities, prospective sellers and persons acting on their behalf may rely on any of the following: a recent publicly available financial statement; any document filed by the issuer with government agency or self-regulatory organization either in the United States or elsewhere; the current edition of a “recognized securities manual”;²¹ or a certification by the chief financial officer of the purchaser.²²

[c] Notice to Buyer of Reliance on Rule 144A. The safe harbor of Rule 144A is available only if the seller takes reasonable steps to ensure that the buyer is aware the seller may be relying on the exemption provided by the rule. The rule does not elaborate what would constitute reasonable steps. Presumably, the notice of possible reliance on the rule would be included in the original offering documents for the securities. In subsequent resales, the seller should give a notice directly to the buyer or cause such a notice to be given.

¹⁸ Rule 144A(a)(1). Investments that are within the Securities Act definition of a security and are not specifically excluded by Rule 144A(a)(2) and which represent undivided interests in a pool of mortgages or receivables count in determining the amount of securities owned for determination of QIB status. *See* UNUM Life Insurance Co., SEC No-Action Letter, 1990 SEC No-Act. LEXIS 1250 (November 21, 1990).

¹⁹ *See* Sec. Act Rel. No. 33-6393, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,202, adding Rule 144A(a)(1)(i)(F).

²⁰ *See* Sec. Act Rel. No. 33-6862, [1989–1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,523 (1990) at I.A.

²¹ “Recognized securities manuals” include Standard & Poor’s Corporation Records, the Moody’s manuals and Best’s Insurance Reports. The staff has explicitly approved S&P’s method of establishing and maintaining its list of QIBs. *See* Standard & Poor’s Corp., SEC No-Action Letter, 1991 SEC No-Act. LEXIS 847 (July 8, 1991). *See also* CommScan LLC, SEC No-Action Letter, 1999 SEC No-Act. LEXIS 116 (February 3, 1999) and Communicator Inc., SEC No-Action Letter, 2002 SEC No-Act. LEXIS 783 (September 20, 2002), approving similar commercially available lists of QIBs.

²² Rule 144A(d)(1).

This notice requirement is important because, although a legend is not required on securities sold in reliance on Rule 144A, such securities are deemed to be restricted securities²³ and purchasers need to be aware of that restricted status. Securities distributed through resales in reliance on Rule 144A frequently do contain a legend stating that the securities have not been registered under the Securities Act and that resales are limited to certain specified circumstances, including resales made in compliance with Rule 144A. However, whether such a legend by itself satisfies the notice requirement for a subsequent resale made in reliance on the rule is doubtful, especially in cases where the securities may not be seen by the purchaser (for example, where they are held in book-entry form).

[d] Eligible Securities; Fungibility Prohibition

[i] General. The safe harbor of Rule 144A is available only if the security being sold was not, when issued, fungible with any class of securities that are either listed on a U.S. securities exchange that is registered under Section 6 of the Exchange Act or quoted on an “automated inter-dealer quotation system.”²⁴ The purpose of this requirement is to prevent unregistered offerings of securities that can readily flow into a public market. However, in the case of securities that are mandatorily exchangeable for securities of an unrelated issuer, and those underlying securities are themselves eligible to be traded in the public market (whether because they are not restricted securities or because they are restricted securities eligible to be resold under Rule 144), Rule 144A is available for the overlying securities.²⁵ Securities of an open-end investment company, unit investment trust or face-amount certificate company each of which is, or is required to be, registered under Section 8 of the Investment Company Act, may not be sold in reliance on the rule.²⁶ All other securities are eligible to be resold under the rule.²⁷

[ii] Not of the Same Class. The adopting release states generally that securities should be considered of the same class if they entitle their holders to substantially similar rights and privileges, even if the securities have different names or designations.²⁸

²³ Preliminary Note 6 to Rule 144A; § 6.03[2] *supra*.

²⁴ Rule 144(d)(3). “Automated inter-dealer quotation system” at the time of adoption of 144A included NASDAQ but not the “pink sheet” over-the-counter market. Sec. Act Rel. No. 33-6862. Since 2006, NASDAQ has been regulated as a stock exchange. Exchange Act Rel. No. 34-54085.

²⁵ See Mandatorily Exchangeable Issuer Securities, SEC No-Action Letter, 1999 SEC No-Act. LEXIS 854 (October 25, 1999).

²⁶ Rule 144A(d)(3)(ii). See Ch. 7B *infra*.

²⁷ Securities received without additional consideration upon exchange of securities that could be resold under the Rule may also be resold under the Rule. Debevoise & Plimpton, SEC No-Action Letter, 1990 SEC No-Act. LEXIS 992 (July 23, 1990).

²⁸ Sec. Act Rel. No. 6862, [1989–1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,523 (April 23, 1990), text accompanying ns. 23–24.

Securities underlying American Depositary Shares (“ADSs”) are treated as being the same class of securities as ADSs.²⁹ Thus, if ADSs are listed on a U.S. securities exchange, the underlying securities may not be offered pursuant to Rule 144A.

[iii] Not Convertible or Exchangeable for Same Class. A security that was, at the time of issuance, convertible into or exchangeable for another security is considered fungible with that other security unless it was subject to a conversion premium of at least 10% at the time of issuance.³⁰ Warrants are considered fungible with the security that can be purchased upon their exercise unless, at the time of issuance, the warrant had a life of at least three years and an effective exercise premium of at least 10%.³¹ The adopting release contains an explanation of “effective conversion premium” and “effective exercise premium.”³² Contingent convertible capital securities, even though they have conversion features that may result in their being deemed to be of the same class as listed securities, having a conversion premium that may be unknown or less than 10%, may be treated as not being fungible under certain circumstances, the staff noting that:

- The contingent convertible securities would qualify as regulatory capital and would be issued solely for the purpose of satisfying regulatory capital requirements under relevant national standards.
- The contingent convertible securities would not be, when issued, of the same class as securities listed on a national securities exchange or quoted on a U.S. automated inter-dealer quotation system.
- The contingent convertible securities would automatically and mandatorily convert into common stock upon the occurrence of a trigger event outside the relevant issuer’s and securityholders’ control and such a trigger event would be due to a regulator’s assessment of the issuer’s viability and/or insolvency, and/or the issuer’s common equity tier 1 capital ratio falling below a specified percentage.
- Neither the issuer nor securityholders would have the option to convert the contingent convertible securities into common stock of the issuer.³³

[iv] When Issued. It should be noted that the prohibition on fungible securities applies at the time the securities are issued. If the securities were issued prior to a listing on a U.S. exchange or a NASDAQ quotation, the fungibility prohibition does not apply. Thus, where a private company issues shares to its founders, and

²⁹ *Id.* at n.26.

³⁰ *Id.* at n.25.

³¹ Rule 144A(d)(3)(i).

³² Sec. Act Rel. No. 6862, [1989–1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,523 (April 23, 1990) at n.25. The Commission stated that this rule is intended not to interfere with “common financing activities” and that the power to designate other securities as “not fungible” with listed or quoted securities is delegated to the Director of the Division of Corporation Finance. *Id.*

³³ Contingent Capital Convertible Securities (March 28, 2019).

subsequently becomes public and listed on a U.S. exchange, the founders may use Rule 144A to resell their securities privately. They may wish to do so, for example, to avoid adversely affecting the price of the publicly traded securities by a public resale pursuant to Rule 144.

[v] Not Issued by an Investment Company. Rule 144A is not available for resales of securities issued by an open-end investment company, unit investment trust or face-amount certificate company that is or is required to be registered under Section 8 of the Investment Company Act.³⁴

[e] Information Requirement

[i] General. Rule 144A is available for resales of securities only when prospective purchasers have a right to obtain information about the issuer. The Commission has taken the position that even substantial institutional investors need to be protected by a right to obtain some information, although not necessarily all the information they would be able to obtain if the sale of securities were required to be registered under the Securities Act or the issuer were required to make periodic disclosure under the Exchange Act. The Commission intended to lighten the burden of traditional disclosure for Rule 144A issuers while retaining a limited right of prospective securities buyers to have information about the issuer's affairs.

The information requirement does not apply to securities issued by foreign government eligible to register securities under Schedule B of the Securities Act,³⁵ or to debt securities issued by an agency or instrumentality of a foreign government eligible to use Schedule B under the Securities Act, if such securities are fully and unconditionally guaranteed by such foreign government.³⁶ If prospective purchasers have a right to obtain the specified information about the parent of the issuer and the parent unconditionally guarantees the debt securities of its wholly-owned subsidiary, the information requirement of the rule is satisfied.³⁷

In light of the role that asset-backed securities played in the financial crisis that began in 2007, the Commission has proposed significant changes to the information requirement as it applies to such securities. Rule changes proposed in 2010 (and still outstanding despite the adoption of other rules proposed at the same time)³⁸ would permit the use of Rule 144A for “structured finance products” only where the underlying transaction agreement for the securities grants purchasers, holder and prospective purchasers the right to obtain the information that would be required if the securities were registered under the Securities Act. In addition, the disclosure

³⁴ Rule 144A(d)(3)(ii). Note that Rule 144A would be available for resales of the securities of such entities *not* required to register under the Investment Company Act. *See* Ch. 7B *infra*.

³⁵ Rule 144(d)(4)(i).

³⁶ *See* Rule 144A, SEC No-Action Letter (May 30, 1990).

³⁷ *See* British Aerospace PLC, SEC No-Action Letter, 1990 SEC No-Act. LEXIS 793 (May 9, 1990).

³⁸ Securities Act Rel. No. 33-9638 (September 4, 2014).

requirements applicable to such securities upon registration (and subsequent periodic reporting) would be significantly expanded.³⁹

[ii] How Right May Be Ensured. The information requirement may be satisfied three ways:

- if the issuer is subject to periodic disclosure under Section 13 or Section 15(d) of the Exchange Act;⁴⁰
- if the issuer is entitled to the exemption from periodic reporting under Rule 12g3-2(b);⁴¹ or
- if the prospective purchaser otherwise has a right to obtain, at or prior to the sale, certain basic information about the issuer that is reasonably current.⁴²

The Commission stated that the obligation to provide current basic information may arise by contract, by applicable corporate law or by a rule of an applicable self-regulatory organization.⁴³

[iii] What Information Must Be Available. The information that must be available includes a very brief statement of the nature of the issuer's business, including the products and services it produces, and financial statements (balance sheet, profit and loss and retained earnings) for as much of the previous two fiscal years as the issuer has been in operation. With regard to timeliness, the financial statements must either meet the timing requirements of the issuer's home country or principal trading market or the following schedule. The balance sheet must be as of a date less than 16 months before the date of sale, the profit and loss and retained earnings statements must cover the 12 months preceding such balance sheet, and, if the balance sheet is as of a date more than six months prior to the resale, the profit and loss and retained earnings statements must be updated from the date of the balance sheet to a date no more than six months before the date of resale.⁴⁴

[3] Rule 144A Trading Markets

The Rule 144A exemption created the opportunity for development of quasi-public trading markets in restricted securities, in which would-be sellers can freely offer restricted securities for sale, provided the universe of offerees is limited to institutions that are QIBs. Almost simultaneously with the adoption of the rule, the Commission gave the FINRA authority to establish what was then designated as the "Private

³⁹ Sec. Act Rel. No. 33-9117 (April 7, 2010).

⁴⁰ See Federal Securities Exchange Act of 1934, Ch. 4 (Matthew Bender). The Exchange Act is reprinted in the Securities Primary Law Sourcebook, Volume B, Section F (Matthew Bender).

⁴¹ This exemption from reporting under the Exchange Act is available to a foreign private issuer makes available on its website the same information it furnishes to its home government or securities exchange (and which is made public) or to its securities holders.

⁴² Rule 144(d)(4)(i).

⁴³ Sec. Act Rel. No. 6862, [1989–1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,523 (April 23, 1990).

⁴⁴ Rule 144A(d)(4)(ii).

Offering, Resale and Trading Through Automated Linkages” system, generally known as the PORTAL market.⁴⁵ The PORTAL rules as approved by the Commission permit a system in which QIBs and brokers acting as agents for QIBs can electronically post quotations and bids for restricted securities and execute trades with confidence that all offers and sales will be to QIBs or will otherwise be exempt transactions. All securities that can be sold in compliance with Rule 144A can be declared PORTAL-eligible and then can be entered PORTAL by depositing the securities in a PORTAL participant’s specially designated account at a PORTAL depository institution.

Alternative 144A trading systems also emerged, such as Goldman Sachs’s GSTRUE (GS Tradable Unregistered Equity OTC Market) which opened in 2007. This and similar rival systems were eventually integrated into the PORTAL Alliance, an industry-wide trading platform with standard procedures for the trading, shareholder tracking and settlement of 144A equity securities.

§ 6.08 Private Resales of Restricted Securities and Control Securities Outside Rule 144A

[1] Availability of Exemption

The Securities Act was never intended to prohibit the private sale of securities in the absence of registration.¹ Private resales of both restricted securities and control securities in the absence of registration have always taken place with the tacit approval of the courts, the Commission and members of the securities industry and their counsel.²

[2] Section 4(a)(1 1/2) Phenomenon

[a] Legal Basis. Although even the staff of the Commission has on occasion implied that private resales of outstanding restricted securities are permitted by Section 4(a)(2) of the Securities Act,³ that exemption is available only to “transactions *by an issuer* not involving any public offering” (emphasis added).⁴ Instead, the proper statutory exemption for the private resale of all outstanding securities, including restricted securities and control securities, is once again the Section 4(a)(1) resale exemption. In other words, it permits both routine trading transactions and private resales, in each case as distinguished from distributions that are subject to registration

⁴⁵ Exch. Act Rel. No. 34-27,956, 55 F.R. 18781 (April 27, 1990). The system was later renamed simply “PORTAL.”

¹ See *The Section “4(1 1/2)” Phenomenon: Private Resales of “Restricted” Securities*, 34 Bus. Law. 1961, 1963–65 (1979); *Law of Private Placements (Non-Public Offerings) Not Entitled to Benefits of Safe Harbors—A Report*, 66 Bus. Law. 85 (2010).

² *The Section “4(1 1/2)” Phenomenon: Private Resales of “Restricted” Securities*, 34 Bus. Law. 1961 (1979), at 1962.

³ See, e.g., Whittaker Corporation, SEC No-Action Letter, 1976 SEC No-Act. LEXIS 1002 (April 30, 1976).

⁴ Section 4(a)(2) of the 1933 Act, reprinted in the Securities Primary Law Sourcebook, Volume A, Section B (Matthew Bender), is discussed in § 4.03 *supra*.

in the absence of an exemption other than that contained in Section 4(a)(1).

As explained above,⁵ Section 4(a)(1) permits the resale of all outstanding securities, provided that neither the seller nor any other participant in the transaction is an underwriter within the meaning of Section 2(a)(11) of the Securities Act. As the language of Section 2(a)(11) makes clear,⁶ it is never possible for the seller or any other participant in the transaction to fall into the category of statutory underwriter unless the transaction involves a distribution. In other words, if the transaction does not involve a distribution, neither the seller nor any other participant is an underwriter, and the resale exemption is available. Although the availability of the Section 4(a)(1) exemption under this analysis turns on the meaning of the term “distribution,” that term is not defined in the Securities Act and it has not been defined by the Commission other than in the context of Rule 144.

The so-called Section 4(a)(1 1/2) phenomenon (originally the Section 4(1 1/2) phenomenon)⁷ is the result of judicial construction of the term “distribution” for purposes of defining the scope of Section 4(a)(1) for private resales, particularly resales by holders of restricted securities and by affiliates of the issuer. Because of the relationship between Sections 4(a)(1) and 4(a)(2) of the Securities Act, i.e., that both Sections address private sales of securities, the courts have equated the Section 2(a)(11) term “distribution” with the Section 4(a)(2) term “public offering.”⁸ In other words, where a particular transaction would constitute a public offering for purposes of a Section 4(a)(2) exemption, it would also constitute a distribution. If a distribution exists, a proposed seller may possibly be an underwriter and is therefore unable to rely upon the Section 4(a)(1) exemption.⁹ Accordingly, where the transaction does not amount to a distribution, that is, a public offering under Section 4(a)(2) of the Securities Act, the restricted securities or control securities may be lawfully resold in reliance upon the Section 4(a)(1) resale exemption.

[b] When Available. Essentially, a proposed sale of securities is a private rather than a public offering whenever the offerees do not need the sort of protection provided by the registration process.¹⁰ Based on the several decisions that have focused on the availability of Section 4(a)(1) for private resales, a resale is clearly private where the persons purchasing the securities are:

- few in number;

⁵ See analysis contained in § 6.02[2] *supra*.

⁶ See Section 2(a)(11), discussed in § 4.02[2] *supra*.

⁷ See generally *The Section “4(1 1/2)” Phenomenon: Private Resales of “Restricted” Securities*, 34 Bus. Law. 1961 (1979). The exemption is less of a phenomenon these days than a generally accepted fact. See *Law of Private Placements (Non-Public Offerings) Not Entitled to benefits of Safe Harbors—A Report*, 66 Bus. Law. 85 (2010), at 117 (ABA’s Committee on Federal Regulation of Securities assuming availability of the exemption for resales of privately placed securities).

⁸ *Gilligan, Will & Co. v. Securities & Exchange Com.*, 267 F.2d 461, 466 (2d Cir. 1959), *cert. denied*, 361 U.S. 896 (1959).

⁹ See discussion in §§ 6.02[1] and [3] *supra*.

¹⁰ *SEC v. Ralston Purina Co.*, 346 U.S. 119, 73 S. Ct. 981, 97 L. Ed. 1494 (1953).

- sophisticated in investment matters;
- privy to (or have access to) the basic information relevant to the decision to purchase the offered securities; and
- purchasing with investment intent rather than resale intent.¹¹

Neither the amount of securities offered¹² nor the period of time during which the proposed seller has held the securities¹³ is relevant to whether the transaction is other than a distribution and therefore permitted by the so-called Section 4(a)(1 1/2) private offering exemption.¹⁴

While the staff has responded to relatively few requests for no-action positions concerning proposed private sales of restricted securities or of “control securities,” and has done so with little consistency, there is no question that it concurs that such resales are permissible under Section 4(a)(1) of the Securities Act.¹⁵ The staff is likely, however, to refuse to take a no-action position¹⁶ except in those cases where all of the requirements for private offering under the safe harbor of Regulation D are satisfied.¹⁷ Accordingly, in most cases, sellers proposing to effect private resales will be forced to secure a favorable opinion of counsel in order to cause the issuer to instruct its transfer agent to make the transfer to the purchaser of the securities sold.

As stated above, both affiliates and holders of restricted securities may sell their securities in private transactions under Section 4(a)(1). For most non-affiliate holders of restricted securities, the private sale alternative to relying upon Rule 144 is attractive only where the holder has not owned the securities for the applicable holding period. The private sale alternative is also appealing to pledgees who cannot rely on Rule 144 for one or more reasons and who, following a default, are required to sell those securities in a commercially reasonable manner under the applicable state law.¹⁸ In those cases, despite the fact that public notice of the forthcoming sale is given to a large number of offerees, the staff will normally take a no-action position provided that the

¹¹ See, e.g., *Neuwirth Investment Fund, Ltd. v. Swanton*, 422 F. Supp. 1187 (S.D.N.Y. 1975); *Fuller v. Dilbert*, 32 F.R.D. 60 (S.D.N.Y. 1962).

¹² See, e.g., *Value Line Fund, Inc. v. Marcus*, 1965 U.S. Dist. LEXIS 9464, [1964–1966 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,523 (S.D.N.Y. Mar. 31, 1965).

¹³ *Id.* Cf. discussion of securities that have “come to rest” at § 6.08[2] *infra*.

¹⁴ For a summary of the elements that various commentators have found necessary for a Section 4(1 1/2) (now Section 4(a)(1 1/2)) resale, see Hanks, *Rule 144A: Another Cabbage in the Chop Suey*, 24 G.W.J. Int'l Law and Ec. 305, 338–41 (1990), at n.75.

¹⁵ Rule 144 (e)(3)(vii); Sec. Act Rel. No. 33-6188, [Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 1051 (1980) at n.178.

¹⁶ See, e.g., *Hazel, Inc.*, SEC No-Action Letter, 1980 SEC No-Act. LEXIS 3206 (April 25, 1980).

¹⁷ *But see* *McJunkin Corporation*, SEC No-Action Letter, 1982 SEC No-Act. LEXIS 2866 (October 4, 1982) (all requirements met).

¹⁸ See *Hueter, The Plight of the Pledgee Under Rule 144*, 3 Sec. Reg. L.J. 111 150–51 (1975).

final purchasers are few in number, sophisticated, provided with information, and purchasing for investment rather than for resale.¹⁹

For affiliates of the issuer, on the other hand, the private resale option is tremendously appealing because it is normally the sole alternative to a sale that must be in compliance with the adequate current public information, the volume limitations, the manner of sale, the proposed notice of sale, and possibly the holding period requirements of Rule 144. As stated above, the unlimited resale provision even after the applicable holding periods is never available to affiliates,²⁰ and a public resale outside of Rule 144 under Section 4(a)(1) is difficult for affiliates.²¹ In light of the Commission's more restrictive attitude respecting the resale of control securities at a time when it appears more flexible with respect to the resale of restricted securities at least after a specified holding period, it is likely that the Commission would take a narrower view of the availability of Section 4(a)(1) for a private resale by an affiliate than for a non-affiliate seller of restricted securities.²² Accordingly, counsel for the affiliate sellers and counsel for the issuer of the securities proposed to be sold should give careful consideration to the availability of the exemption when rendering or reviewing favorable opinion letters.

[c] Effects of Use of Exemption. Where restricted securities or control securities are privately sold in proper reliance upon Section 4(a)(1), the seller and any agent will not be in violation of the Securities Act's registration requirements. Neither should the issuer's exemption in the case of restricted securities be affected. The purchaser, however, will receive in either case, restricted securities with all of the consequent restrictions on their lawful resale under the Securities Act.²³

[3] Section 4(a)(7)

[a] Statutory Exemption. On December 4, 2015, President Obama signed the Fixing America's Surface Transportation Act, a highway funding law with several unrelated securities law provisions tacked on at the end (the "FAST Act").²⁴ The FAST Act included a new statutory exemption for private resales of securities, Securities Act Section 4(a)(7).²⁵

[b] Overview of Requirements. Sales under Section 4(a)(7) must meet the

¹⁹ See, e.g., Capital Facilities Corporation, SEC No-Action Letter, 1982 SEC No-Act. LEXIS 2599 (July 8, 1982); American Security Bank, SEC No-Action Letter, 1980 SEC No-Act. LEXIS 3341 (May 29, 1980).

²⁰ See § 6.05[5] *supra*.

²¹ See § 6.05[2][d] *supra*.

²² See Hazel, Inc., SEC No-Action Letter, 1980 SEC No-Act. LEXIS 3206 (April 25, 1980).

²³ See, e.g., Bank of New Hampshire Corp., SEC No-Action Letter, 1981 SEC No-Act. LEXIS 3179 (March 4, 1981). See also analysis contained in § 6.03[3] *supra*.

²⁴ Fixing America's Surface Transportation Act, Pub L. No. 114-94 (2015).

²⁵ Section 4(a)(7) of the Securities Act of 1933.

following requirements:²⁶

- each purchaser must be an accredited investor;
- neither the seller nor any person acting on the seller's behalf may engage in general solicitation;
- if the issuer is not a reporting company or subject to certain exemptions as a foreign government or private issuer as discussed below, the seller must provide specified information;
- the seller may not be the issuer or a direct or indirect subsidiary of the issuer;
- neither the seller nor any broker may be a "bad actor" who would be disqualified under Rule 506(d)(1) under the Securities Act;²⁷
- the issuer may not be in the organizational stage of business, be in bankruptcy or receivership or be a blind pool or blank check company;
- the security may not be part of an unsold allotment to an underwriter, broker or dealer; and
- the security must be part of a class that has been authorized and outstanding for at least 90 days.

[c] Provision of Information. Specified information must be provided unless the issuer is a reporting company or exempt from reporting pursuant to Rule 12g3-2(b)²⁸ or a foreign government eligible to register securities on Schedule B.²⁹ The information that must be provided, which must be "reasonably current" as of the date of the resale transaction, includes:

- the issuer's (and its predecessor's) exact name; the address of its principal executive offices and the title, class and par value of the security;
- the number of shares outstanding as of the end of the issuer's most recent fiscal year;
- the name of the transfer agent, corporate secretary or other person responsible for transferring the security;
- a statement of the nature of business of the issuer and the products and services it offers;
- the names of the issuer's officers and directors;
- the name of any broker who will be paid a commission;
- the issuer's most recent balance sheet and other financial statements; and
- if the seller is a control person of the issuer, a statement concerning the nature of the seller's affiliation with the issuer and a certification that the seller has no

²⁶ Section 4(d) of the Securities Act of 1933.

²⁷ Rule 506(d)(1).

²⁸ Rule 12g3-2(b) under the Securities Exchange Act of 1934.

²⁹ Schedule B of the Securities Act of 1933.

reasonable grounds to believe that the issuer is in violation of the securities laws or regulations.³⁰

The financial statements must include balance sheet and profit and loss statement and “similar financial statements.”³¹ The financial statements must be prepared in accordance with U.S. generally accepted accounting principles or, in the case of a foreign private issuer, in accordance with the International Financial Reporting Standards issued by the International Accounting Standards Board. They must cover “such part of the 2 preceding fiscal years as the issuer has been in operation.” They will be deemed reasonably current if the balance sheet is of a date less than 16 months before the transaction date and the profit and loss statement is for the 12 months preceding the date of the balance sheet. If the balance sheet is more than six months before the transaction date, additional statements of profit and loss from the date of the balance sheet to a date less than six months before the resale transaction are required. The various financial disclosure requirements do not necessarily work together comfortably. Does the “2 preceding fiscal years” provision mean that transactions cannot take place in reliance on Section 4(a)(7) in the early portion of an issuer’s fiscal year, when financials for the preceding year are typically not available, or does it merely mean that financials covering two years (or the period since inception) are required? And under what circumstances would an issuer be producing profit and loss statements without a balance sheet? Some of these issues may yet be addressed in a technical amendment.

There are similar ambiguities with respect to the actual provision of information. The text of the exemption requires that “the seller and a prospective purchaser designated by the seller obtain from the issuer, upon request of the seller, and the seller in all cases makes available to a prospective purchaser”³² The repetition makes it appear as if the prospective purchaser must receive the information from both the issuer and the seller. In any case, it is clear that delivery of information, as opposed to mere availability of information upon request, is required.

Securities sold under Section 4(a)(7) are “covered securities” exempt from state law provisions with respect to registration of securities.³³

[d] Continuing Relevance of Section 4(a)(1 1/2). While Section 4(a)(7) will be useful in some circumstances where Rule 144 is not available, including some affiliate sales, not all transactions involving the private resale of restricted securities to accredited investors will meet the requirements of Section 4(a)(7). The appropriate financial information may not be available at the time the transaction is to be made, or the issuer may decline to provide it, in order to control the secondary market in its securities. The class of securities may have been relatively recently created and thus not outstanding long enough to meet the requirement that the class be outstanding for at

³⁰ Section 4(d)(3) of the Securities Act of 1933.

³¹ Section 4(d)(3)(J) of the Securities Act of 1933.

³² Section 4(d)(3) of the Securities Act of 1933.

³³ Section 18(b)(4)(G) of the Securities Act of 1933.

least 90 days. In such circumstances, the seller may need to rely on Section 4(a)(1 1/2) instead.

[4] Resales Outside Sections 4(a)(7) and 4(a)(1 1/2)

While the conditions for reliance on Section 4(a)(7) are relatively clear (and will hopefully be clarified further), in view of the fact that the conditions for reliance on Section 4(a)(1 1/2) are not clearly established, it may seem inconsistent to discuss resales “outside” Section 4(a)(1 1/2). However, there is a school of thought that holds that if securities have “come to rest,” i.e., if the holder can demonstrate that he did not buy with a view to distribution and was not making the resale for the issuer (which factors could best be established by a sufficiently long holding period), there should be no further restriction on the manner of sale.³⁴ This is not, of course, a private Section 4(1 1/2) sale, nor necessarily a Rule 144 sale, but rather a resale in reliance on the resale exemption of Section 4(a)(1) because the securities are no longer in distribution, which is why the holding period, not deemed relevant to a Section 4(1 1/2) transaction, is so important.

The American Bar Association (“ABA”) Committee on Federal Regulation of Securities also reached this conclusion—at least with respect to institutional resales.³⁵ The Committee’s report recognized the existence of an active institutional market for the resale of privately placed debt securities.³⁶ The ABA Committee concluded that such resales could be made in reliance on Section 4(a)(1).³⁷ The Committee noted that such sales were usually made on the basis of representations from the buyer as to investment intent,³⁸ and information was generally provided by the seller or dealer only where requested or where such information was not available to the purchaser from the

³⁴ See *The Section “4(1 1/2)” Phenomenon: Private Resales of “Restricted” Securities*, 34 Bus. Law. 1961 (1979), at 1975. The concept of coming to rest existed prior to the adoption of Rule 144 and the ABA Study Group that produced this report felt it had continuing validity. *Id.* Louis Loss has discussed a similar idea:

It follows that, if the person who bought from an issuer (or affiliate) has held the securities long enough to make credible his assertion that he did not take them with a view to distribution—so that, as it used to be said, the securities have come to rest in his hands . . . his later distribution should be exempted under § 4(1).

L. Loss, *Fundamentals of Securities Regulation* (Little, Brown & Co. 1988), at 375. See also Rutheford B. Campbell Jr., *Resales of Securities Under the Securities Act of 1933*, 52 Wash. & Lee L. Rev 1933 (1995) at 1339.

³⁵ Study Group on Resales of Debt Securities, ABA Committee on Developments in Business Financing, *Resale by Institutional Investors of Debt Securities Acquired in Private Placements*, 34 Bus. Law. 1927 (1979), at 1953; see also Schneider, *Section 4(1 1/2)—Private Resales of Restricted or Control Securities*, 49 Ohio St. L.J. 501-510-11 (1988).

³⁶ Study Group on Resales of Debt Securities, ABA Committee on Developments in Business Financing, *Resale by Institutional Investors of Debt Securities Acquired in Private Placements*, 34 Bus. Law. 1927 (1979), at 1931.

³⁷ *Id.* at 1958.

³⁸ *Id.* at 1930.

issuer.³⁹ The type of information given generally varied according to the amount of information about the issuer that was available to the market.⁴⁰ The Committee closely examined Rule 144, which, as discussed above, provides that resales of restricted securities made in accordance with its conditions are not distributions.⁴¹ The Committee noted that such institutional resales of privately placed debt securities met the four substantive conditions of Rule 144⁴² and consequently involved no distribution. Thus, where adequate current information concerning the issuer is available, where the securities have been held for long enough to ensure that the seller is not a conduit for an unregistered distribution (although not necessarily for a fixed period of time such as Rule 144's minimum applicable holding period), where the quantity of securities resold does not disrupt the market, and where the manner of sales similarly does not disrupt the market (although not limited to brokers' or market maker transactions as in Rule 144),⁴³ resales can be made without registration. That said, this report pre-dated Rule 144A, which addresses many of items described in the report.

§ 6.09 Resales Overseas

Restricted and control securities may also be resold overseas in reliance on Regulation S under the Securities Act.¹ Rule 904 of Regulation S permits securities of any kind to be resold outside the United States without registration provided that:

- the relevant offer or sale is made in an “offshore transaction”;² and
- no “directed selling efforts” are made.³

Directed selling efforts and “general solicitation” are differently defined, and deliberately so, although some selling activities might be both general solicitation and directed selling efforts. The Commission did not make any changes to the provisions of or interpretation of Regulation S in response to the JOBS Act's sanctioning of general

³⁹ *Id.* at 1935.

⁴⁰ *Id.* at 1949–50.

⁴¹ *Id.* at 1953.

⁴² In such circumstances, all the conditions of Rule 144, except the filing of a notice and the requirement that the seller have the intent to resell shortly after that filing, would be met. *Id.* at 1949–53.

⁴³ Study Group on Resales of Debt Securities, ABA Committee on Developments in Business Financing, *Resale by Institutional Investors of Debt Securities Acquired in Private Placements*, 34 Bus. Law. 1927 (1979). This type of market is generally not disrupted by resales of securities. *Id.* at 1932–33.

¹ See discussion of Regulation S at § 6.03[4][e][ix] *supra* and § 4.10.

² Rule 904(a). An offshore transaction for this purpose requires that no offer be made to a person in the United States and that either the buyer be physically located outside the United States at the time the buy order is originated, or that the transaction is executed through a “designated offshore securities market” (there are currently 20 such markets), without being prearranged in the United States. Rule 902(i).

³ Rule 904(b). Directed selling efforts means any activity undertaken for the purpose of, or that reasonably could have the effect of, conditioning the market in the United States for the securities offered overseas. Rule 902(b).

solicitation for some private offerings.⁴ Many initial offerings are made concurrently within the United States in reliance on Section 4(a)(2), Regulation D or Rule 144A and outside the United States in reliance on Regulation S. Despite the Commission's assurances that nothing has changed, there are challenges involved in ensuring that general solicitation activities in the United States do not contravene the prohibition on directed selling efforts. Since general solicitation is unlikely to be going on at the same time as resales are being made in reliance on Rule 904, the tension between general solicitation and directed selling efforts is less likely to be an issue for resales.

Additional restrictions are imposed on certain persons reselling securities that were originally sold pursuant to Regulation S.⁵ Equity securities of U.S. issuers sold pursuant to Regulation S are restricted, and the restricted securities of such issuers remain restricted even after resales pursuant to Regulation S.⁶ This is an exception to the general principle discussed above that a public sale of securities breaks the "chain" of private transactions.⁷

⁴ Division of Corporate Finance, Compliance and Disclosure Interpretations, Question 138.04 (Nov. 13, 2014).

⁵ See § 6.03[4].

⁶ Sec. Act Rel. No. 33-7505 (1998).

⁷ See § 6.03[4][e][ix].

FEDERAL SECURITIES ACT OF 1933

Volume 2

A. A. SOMMER, JR.

General Editor [1982–2002]

Originally Authored by Hugh L. Sowards

2024

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