

Chapter 7

Resales of Securities Under the Securities Act

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§ 7:1 Introduction

Section 5 of the Securities Act generally requires that any sale (including a resale) of a security be registered with the Commission, unless an exemption is available. The primary exemption for initial sales by issuers is section 4(a)(2), which is discussed in Chapter 6 and permits sales by issuers in transactions not involving a public offering. When a security is acquired in a private offering, it is considered a “restricted security.” The primary exemption for resales of securities is section 4(a)(1), which permits sales of securities by persons who are not issuers, underwriters or dealers. As detailed in section 7:2 below, broad interpretations of the term “underwriter” (which itself includes the term “distribution”) generally have operated to substantially

restrict the ability of purchasers of restricted securities in private offerings to resell (or hedge) those securities. In addition, because issuers can be held responsible for subsequent resale transactions that violate section 5 even when the issuer does not participate in those transactions, issuers in private offerings often impose contractual restrictions upon resales by purchasers.

To address some of the uncertainty around whether resales of restricted securities comply with section 5, the Commission has adopted two safe harbor rules permitting resales of securities issued in unregistered offerings—Rules 144 and 144A. Rule 144, as discussed in section 7:4, provides a safe harbor for resales by affiliates and by all persons holding restricted securities. Rule 144A, as discussed in section 7:5.1 below, provides a safe harbor from the registration requirements for resales of certain securities to “qualified institutional buyers,” or QIBs. Each rule has conditions and requirements that must be complied with in order to ensure that the resales are exempt from the registration requirements of section 5. For example, Rule 144A is not available for securities that were, when issued, “fungible” with listed securities, such as the common stock of most reporting companies. “Restricted securities” sold in a Rule 144A transaction remain restricted in the hands of the purchaser.

Historically, in circumstances in which a safe harbor rule is not available, resales of restricted securities have, from time to time, been effected under the so-called “section 4(a)(1½) exemption,” which is discussed in section 7:5.2 below. That is not a true exemption but is instead a reasoned set of procedures for resale transactions that embody the elements of an issuer section 4(a)(2) private offering. For example, under practices developed over many years, section 4(a)(1½) transactions may not involve any general advertising or general solicitation and typically are individually negotiated with a small number of purchasers who provide specific representations as to their sophistication, access to information and non-distributive intent.

On December 4, 2015, the Fixing America’s Surface Transportation Act (“FAST Act”)¹ was signed into law. Although the FAST Act deals primarily with transportation funding, it also added a new exemption from section 5’s registration requirements—section 4(a)(7) for private resales of securities by non-issuers to “accredited investors.” This new exemption will significantly facilitate certain resales of control and restricted securities. The new exemption was effective immediately.

It is easiest to determine the availability of certain of these resale exemptions, most notably section 4(a)(1) and Rule 144, when a preliminary question is answered first: Are the securities proposed to be sold control securities or restricted securities? (As noted in chapter 6,

1. Pub. L. No. 114-94 (2015).

securities sold under the intrastate offering exemption have their own resale limitations, which are discussed in that chapter. Those securities can be control securities, and they can become restricted securities in the hands of new owners if purchased from an affiliate of the issuer under circumstances discussed in this chapter.) Accordingly, the concepts of “control” and “restricted” securities will be discussed before discussing the particulars of any of the resale exemptions.

§ 7:2 Control and Restricted Securities

Control securities are securities owned by a person who is an affiliate of the issuer. To understand the concept of control securities, it is helpful first to look to Securities Act Rule 405, which contains definitions of terms. “Affiliate” and “control” are both defined:²

Affiliate. An “affiliate” of, or person “affiliated” with, a specified person, is a person that directly, or indirectly through one or more intermediaries, controls or is controlled by, or is under common control with, the person specified.

Control. The 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.

To understand the concept of “control,” one must understand what the Commission means by the “power to direct or cause the direction of . . . management and policies.” Familiarity with two theories concerning control aids in that understanding. One is the idea that the unexercised ability to control is control. When, for example, a shareholder owns sufficient stock in a corporation that management is likely to be responsive to the shareholder’s requests or demands, the Commission says the shareholder is an affiliate of the corporation. It is immaterial that the shareholder pays no attention to the management of the corporation. That leads to the question of how much stock is enough to control a corporation. There is no fixed answer, but 10% equity ownership is a rule of thumb. Obviously, many shareholders who

2. Technically, the definitions contained in Rule 405 relate to terms used in Securities Act Rules 400 through 494 or terms used in a Securities Act registration form. The definitions of “affiliate” and “control,” however, are reliable definitions for general Securities Act purposes. In connection with Securities Act Rule 144, discussed below in this chapter, note that the Rule 405 definition of “affiliate” is carried over into the definition of this term contained in Rule 144(a)(1).

own that percentage of stock, or even a much greater percentage, are not in control of a corporation. For example, a shareholder who owns a large minority interest may be excluded from power by a management that holds a majority interest. When a shareholder has a 10% interest, however, the Commission will probably consider the shareholder to be an affiliate, unless someone convinces it otherwise. Securities lawyers begin worrying about control when well below this percentage of stock is involved.

The other theory to understand is that of the control group. Under that theory, a person is in control if he or she is a member of a group that controls. That theory applies to shareholders who may be considered part of a control group. A family is a classic example. The theory also is used to bring corporate officers and directors under the concept of “control.”³

The concept of “restricted securities” is simpler in a way than that of “control securities.” A definition is contained in Rule 144(a)(3):

The term “restricted securities” means:

- (i) 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;
- (ii) Securities acquired from the issuer that are subject to the resale limitations of Regulation D or Rule 701(c);
- (iii) Securities acquired in a transaction or chain of transactions meeting the requirements of Rule 144A;
- (iv) Securities acquired from the issuer in a transaction subject to the conditions of Regulation CE;
- (v) Equity securities of domestic issuers acquired in a transaction or chain of transactions subject to the conditions of Rule 901 or Rule 903 under Regulation S;⁴
- (vi) Securities acquired in a transaction made under Rule 801 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 this paragraph (a)(3);

3. For a helpful, further introduction to the concept of control, see A.A. Sommer, Jr., *Who's “in Control”?*—S.E.C., 21 BUS. LAW. 559 (1966). It is an old article, but so is the concept, and this is the landmark article on the subject.

4. Regulation S is an interpretive regulation, discussed above in section 6:6.4, that details the circumstances under which offers and sales of securities outside the United States will not be subject to U.S. securities laws, including resales of the securities in the United States.

- (vii) Securities acquired in a transaction made under Rule 802 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 this paragraph (a)(3); and
- (viii) Securities acquired from the issuer in a transaction subject to an exemption under section 4(5)⁵ of the Act.

That definition is convoluted, but it is readily understandable with a little explanation. The best way to accomplish that explanation is to break the definition into eight parts, and then discuss each part in turn.

The first part of the definition relates to “Securities that are 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.” That part of the definition covers securities that: (1) at one point were sold by the issuer under a section 4(a)(2) nonpublic offering exemption (either in a statutory private placement or in a sale under Securities Act Rule 506)⁶ or a section 4(a)(5) limited offering exemption;⁷ or (2) at one point were sold by an affiliate of the issuer in a private resale using the section 4(a)(1) exemption (which is discussed below).⁸ The current holder may have purchased the restricted securities directly from the issuer or an affiliate of the issuer, or there may have been a chain of transactions that separate the current holder from one of those sellers. When there is such a chain of transactions, each intervening sale must be a private resale that uses the section 4(a)(1) exemption. Thus, the straightforward thrust of this part of the definition is that purchasers in transactions under section 4(a)(2) or 4(a)(5) buy restricted securities.⁹

The second part of the definition of restricted securities covers “Securities acquired from the issuer that are subject to the resale limitations of Rule 502(d) under Regulation D or Rule 701(c).” That phrase includes all securities purchased directly from an issuer in any

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- 5. Note that in the JOBS Act, section 4(5) was redesignated as section 4(a)(5).
 - 6. See section 6:2, “Private Placements: Section 4(a)(2).”
 - 7. See section 6:1.2[C], “Section 4(5).” The 2007 amendments to Rule 144 codified the staff position that securities issued in a 4(a)(5) offering are “restricted” securities. See Rule 144(a)(3)(viii). Note that the Dodd-Frank Wall Street Reform and Consumer Protection Act repealed the former 4(5) exemption relating to mortgage-backed notes and renumbered section 4(6) as 4(5). As indicated, it was redesignated as section 4(a)(5) in the JOBS Act.
 - 8. See *infra* section 7:5, “Private Resales of Control and Restricted Securities.”
 - 9. Securities acquired by gift, directly or indirectly from the issuer or an affiliate of the issuer, also meet the criteria for restricted securities.

transaction under Rule 701(c), or under Rule 505 or 506 of Regulation D, because all securities sold under those rules have resale restrictions.¹⁰ There is some overlap between this part of the definition and the part discussed above, because securities purchased directly from an issuer under Rule 506 of Regulation D are included under both parts.

The third part of the definition covers “Securities acquired in a transaction or chain of transactions meeting the requirements of Rule 144A.” Rule 144A is discussed at the end of this chapter. It relates to resales of securities by security holders to “qualified institutional buyers.”

The fourth part of the definition covers “Securities acquired from the issuer in a transaction subject to the conditions of Regulation CE.” Regulation CE exempts offerings and sales of securities that satisfy the conditions of section 25102(n) of the California Corporations Code, up to a total of \$5 million per offering. Regulation CE provides that all securities issued under the regulation are restricted securities.

The fifth part of the definition covers “Equity securities of domestic issuers acquired in a transaction or chain of transactions subject to the conditions of Rule 901 or Rule 903 under Regulation S.” As mentioned in a footnote accompanying the definition of “restricted securities” above, and in chapter 6, Regulation S relates to the offshore offer and sale of securities.

Like the fifth part of the definition of restricted securities, the sixth and seventh parts of the definition exemplify the Commission’s initiative to facilitate international securities transactions. The sixth part relates to cross-border rights offerings made in accordance with Rule 801 by foreign private issuers. The seventh part covers securities subject to cross-border exchange offers and business combinations made under Rule 802 by such issuers. Finally, as mentioned above, the 2007 amendments to Rule 144 added an eighth part that codified a staff position that securities issued in a 4(5) offering are restricted securities.

Before leaving the discussion of restricted securities, it will be helpful to introduce one further concept: fungibility. Under that concept, if a person owns both restricted and nonrestricted securities of the same

10. See chapter 6 for a discussion of Regulation D and Rule 701. Rule 502(d) of Regulation D states the resale restrictions of that regulation: “Except as provided in Rule 504(b)(1), securities acquired in a transaction under Regulation D shall have the status of securities acquired in a transaction under section 4(2).” Rule 701(c)(1) provides: “Securities issued pursuant to [Rule 701] are deemed to be ‘restricted securities’ as defined in [Rule 144]”; under Rule 144, all restricted securities have restrictions on resale. (Under Rule 701(c)(3), however, most resale restrictions are lifted for non-affiliates ninety days after the issuer becomes subject to the reporting requirements of the Exchange Act.)

class and from the same issuer, the nonrestricted securities take on the taint of restricted status. That occurs because, for some purposes, securities are considered to be fungible. In the release in which it adopted Rule 144, however, the Commission indicated that the concept of fungibility will not apply for the purposes of the rule.

§ 7:3 Public Resales Outside Rule 144

Rule 144, which the Commission adopted in 1972, provides a means for selling both control and restricted securities. However, Rule 144 is not exclusive, and sellers sometimes wish to sell outside the rule. Also, the rule often is of no use when lawyers are called in after the fact, since it has requirements that may demand advance planning. In addition, the rule is mechanistic rather than analytic, and it provides little help in understanding section 4(a)(1) and its place in the regulatory scheme. Without that understanding, some of the provisions of the rule are quite opaque. For these reasons, public resales of control and restricted securities outside Rule 144 are discussed at this point.

§ 7:3.1 Sales of Control Securities

As indicated at the beginning of this chapter, section 4(a)(1) provides the exemption that allows most security holders to resell securities without registration. To determine when that exemption is available, it is important to determine whether the proposed transaction is “by an issuer, underwriter or dealer.”¹¹ Here are the section 2 definitions of issuer and dealer:

The term “issuer” means every person who issues or proposes to issue any security. . . .¹²

The term “dealer” means any person who engages either for all or part of his time, directly or indirectly, as agent, broker, or principal, in the business of offering, buying, selling, or otherwise dealing or trading in securities issued by another person.¹³

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11. Securities Act § 4(a)(1).
 12. Securities Act § 2(a)(4). That portion of the definition covers typical situations. The definition goes on to provide exceptions in the case of specialized securities, such as voting-trust certificates, collateral-trust certificates, and equipment-trust certificates.
 13. Securities Act § 2(a)(12). In the usual situation, the Securities Act definition of “issuer” parallels the use of the term in corporate law generally, and means the company that originally sells the security. The term “dealer” refers to one type or other of securities professional, and not to an ordinary investor.

Except in an unusual situation, then, an investor who wishes to sell securities under section 4(a)(1) is neither an issuer nor a dealer.

The consequences of holding control securities are found in the definition of “underwriter.” In its most basic provision, section 2(a)(11) defines the term to mean “any 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.”¹⁴ For an affiliate who holds securities that are control securities and not also restricted securities,¹⁵ there would be little problem if the definition stopped there. It does not, however. The last sentence of section 2(a)(11) adds: “As used in this [section 2(a)(11)] 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”—the classic definition of an “affiliate.” In other words, the basic definition of “underwriter” should be treated as if it read: “The term ‘underwriter’ means any person who has purchased from an issuer or an affiliate¹⁶ of the issuer with a view to, or offers or sells for an issuer or an affiliate of the issuer in connection with, the distribution of any security.” “Distribution” is not defined in the statute, but it is understood essentially to be synonymous with “public offering.”¹⁷ For example, in an early case the Commission established that a distribution comprises “the entire process by which in the course of a public offering a block of securities is dispersed and ultimately comes to rest in the hands of the investing public.”¹⁸

Because of the way in which the term “underwriter” is defined, a securities firm that handles the sale of control securities in the public markets may be considered an underwriter. If it handles the sale as a dealer (as the term is used in the securities industry, that is, if it buys the securities itself with the idea of reselling them), it may be considered to have “purchased from an issuer with a view to . . . distribution.” If it handles the transaction as a broker (that is, if it merely sells the securities for the affiliate), it may be considered to have offered or sold “for an issuer in connection with . . . the

14. The basic provision also includes persons who “participate” in acts included within the definition.

15. There is nothing to prevent securities from being both control and restricted securities. In fact, that is quite common, since officers, directors, and major shareholders often acquire restricted securities from their companies.

16. See section 7:2, “Control and Restricted Securities,” *supra*. As can be seen, an “affiliate” is someone in one of the control relationships specified in the last sentence of section 2(a)(11).

17. See section 6:2, “Private Placements: Section 4(a)(2),” *supra*, for a discussion of the statutory opposite, the nonpublic offering.

18. *In re Okla.-Tex. Tr.*, 2 S.E.C. 764, 769 (1937).

distribution.” In either case, the series of transactions by which the securities pass from the affiliate to the public is considered to constitute one distribution that is partially “by” an underwriter.¹⁹ When that is the case, section 4(a)(1) is not available, and the registration requirement of section 5 is violated.

The typical sale in the trading markets by an ordinary investor is a transaction partially by a dealer (as defined in section 2(a)(12), where brokers and real-world dealers are lumped together as “dealers”) in the same sense that a similar sale by an affiliate is by an underwriter. Since section 4(a)(1) is not available when a transaction is by an issuer, underwriter, or dealer, it may seem that section 4(a)(1) is not available when an ordinary investor sells through a dealer. That is not the case, however.

There is in the Securities Act no exemption available to underwriters in any circumstance. There are, on the other hand, exemptions provided for dealers, both when operating as dealers in the ordinary sense of the term (section 4(a)(3)) and as brokers (section 4(a)(4)). It is clear that it would make little sense for the Securities Act to provide those exemptions to dealers, while not at the same time providing an exemption to the investor selling to or through the dealer. And, of course, there is no question but that the section 4(a)(1) exemption was designed to exempt most transactions by ordinary investors. Perhaps the way to think about such a transaction involving a dealer is that the investor is covered by section 4(a)(1) and the dealer by section 4(a)(3) or 4(a)(4). It may be argued that in a transaction involving an underwriter, section 4(a)(1) is not available because neither it nor any other exemption would cover the underwriter.²⁰

It may appear that securities would always have to be registered before an affiliate could sell them publicly, because it may seem that such a sale always would constitute a distribution. Considering the costs involved in registration, that would mean that it would not be economically feasible for an affiliate to sell control securities except in a transaction involving at least some hundreds of thousands of dollars. That result is not what was contemplated by the drafters of the Securities Act, and

19. See *supra* text accompanying note 14.

20. It should be noted that if a securities firm comes under the definition of “underwriter,” it cannot have the benefit of a dealers’ or brokers’ exemption even though its acts in a particular transaction are those of a traditional broker or dealer. The concept of “underwriter” can be thought of as overriding those of “broker” and “dealer.” See *In re Ira Haupt & Co.*, 23 S.E.C. 589, 600–04 (1946). In at least one unusual case, however, a court was backed into treating a firm both as a broker and an underwriter so as to give the firm a section 4(4) (now 4(a)(4)) brokers’ exemption (in accordance with now superseded Rule 154, with which the firm had complied) while denying a section 4(1) (now 4(a)(1)) exemption to the selling shareholders. *United States v. Wolfson*, 405 F.2d 779 (2d Cir. 1968).

the Commission has never taken that extreme position. Rather, the Commission has built some flexibility into the Securities Act by manipulating the concept of distribution.

As discussed above, the Commission in its early years of operation established that a distribution comprises “the entire process by which in the course of a public offering a block of securities is dispersed and ultimately comes to rest in the hands of the investing public.”²¹ Notwithstanding the expansive nature of that conception, prior to the mid 1940s the Commission allowed affiliates publicly to sell unregistered control securities in limited circumstances. Under administrative interpretations of the Commission’s staff and the implication of its orders in at least one case,²² the Commission considered no distribution to be involved when an affiliate sold control securities, on a stock exchange, in a transaction in which the selling broker limited its activities to the usual brokerage functions—and, most important, when the broker did not solicit any orders for the securities.²³ Under that rather generous interpretation of “distribution,” affiliates had a ready market for their securities, as long as the amount of securities involved in a particular sale was small enough to be salable, at a reasonable price, without one or more securities firms’ drumming up buyers.

The Commission’s generosity came to an end in a 1946 case heard by the Commission sitting in its quasijudicial capacity, *In re Ira Haupt & Co.*²⁴ In that case, affiliates sold during a five-and-one-half-month period of 1943, publicly, and through a broker, stock representing approximately 38% of their company’s common stock. The ability of the broker to accomplish that sale seems to have been related to two factors. First, the prosperity of the World War II years had created a hot stock market; one in which sales of large blocks were possible without any unusual sales effort. Second, the company announced that it was considering an unusual and apparently economically favorable plan under which it would sell its product, whiskey, at cost to its shareholders.²⁵

21. *Oklahoma-Texas Trust*, 2 S.E.C. at 769.

22. *In re United Corp.*, 21 S.E.C. 619 (1945).

23. *See Ira Haupt*, 23 S.E.C. at 604–05.

24. *Id.* at 589.

25. The plan appeared to be unusually favorable because World War II had made whiskey scarce and, at least in the usual channels of commerce, whiskey was subject to price controls. Largely because of the hope that the whiskey, or rights to purchase it, could be sold without price constraints, the stock’s price rose from 57% to 98¼. After the Office of Price Administration announced limitations on the negotiability of the whiskey purchase rights and maximum allowable profits, the stock’s price dropped precipitously to 30% within less than a month. *Id.* at 592–93.

By its finding that the *Haupt* facts constituted a distribution, the Commission made it clear that, although it was willing to allow control securities to trickle into the market, it would not allow a flood. That decision made the securities firm that handled the sales an underwriter, which caused the section 4(a)(1) exemption to be unavailable. In reaching that result, the Commission disregarded the contention of the securities firm that the brokers' exemption of section 4(a)(4), which exempts from the registration requirements of section 5 "brokers' transactions executed upon customers' orders . . . but not the solicitation of such orders," was available to protect its conduct. That exemption, said the Commission, is available only to brokers selling for ordinary investors and cannot be used by a firm that is an underwriter involved in a distribution.

The problem with that case was that its facts were too far from the garden variety sale of securities by an affiliate for securities firms to get much guidance from it. The firms knew they would be underwriters if they replicated the facts of *Haupt*, but they did not know where the Commission would draw its line separating allowable transactions from distributions. Particularly troubling was the fact that the Commission, while failing to give guidelines, overruled the prior staff interpretations that had allowed at least small-scale market sales by affiliates through brokers.²⁶

It was not until 1954, when it adopted Rule 154, that the Commission took definitive action on the questions left open in *Haupt*. That rule, which was later superseded by Rule 144, used the old Commission staff interpretations as a starting point and added a numbers test to determine the existence of a distribution. Under the rule, no distribution occurred when:

- (1) all sales were by a broker, who performed only ordinary brokers' functions and who received only the usual commission;
- (2) neither the broker, nor to the broker's knowledge the seller, solicited any orders;
- (3) the broker was not aware of circumstances indicating that the sales were part of a distribution; and
- (4) the amount of securities sold in six months did not exceed approximately one percent of the total outstanding securities of the same class.

That rule alleviated a good bit of the problem generated by *Haupt*. As discussed below, its concepts were carried over into Rule 144.

26. *Id.* at 605-06.

§ 7:3.2 Sales of Restricted Securities

Outside of Rule 144, there never has been a corollary to Rule 154 relating to the sale of restricted securities. There are, however, administrative interpretations that allow restricted securities to be sold publicly without the sale's being treated as a distribution. Before the adoption of Rule 144 in 1972, those interpretations had a great deal of vitality, and securities lawyers spent substantial amounts of time struggling with them. In Securities Act Release No. 5,223,²⁷ the release in which the Commission announced Rule 144, the Commission asserted that the rule is not exclusive. Subsequently, the Commission amended the rule to provide that explicitly.²⁸ It must be remembered, however, that the Commission almost certainly lacked the power to adopt an exclusive resale rule, and so its failure to do so tells little about its real desires in the matter. The language the Commission used in Release No. 5,223 is the best gauge of those desires, and it clearly discourages reliance on the pre-existing interpretations for sales of restricted securities, except for securities purchased before the effective date of the rule. The tone of the release accomplishes that discouragement, as do two statements in the release relating to restricted securities purchased after the effective date of the rule: (1) the change-of-circumstances doctrine (discussed below) would have no further effect and (2) the Commission's staff would no longer issue no-action letters in connection with resales. (The Commission later relented on the latter point and will give no-action letters on resale questions that are unusual.)

Still, Rule 144 is not exclusive for restricted securities purchased after its effective date, and there may be an occasion for a holder of such securities purposely to sell them publicly outside the rule. That rarely would be wise, however. The interpretations pre-existing Rule 144 are of much greater current importance for three other reasons:

- (1) they foster an understanding of the workings and effect of the rule,
- (2) they may be used freely in the case of securities purchased before the effective date of the rule, and
- (3) they may have to be relied upon in cases in which a holder of restricted securities, without proper planning, sells those securities publicly without following the requirements of the rule.

One interpretation relates to how long restricted securities are held before resale. That factor is important because it is thought that

27. Securities Act Rel. No. 5223 (Jan. 11, 1972).

28. Securities Act Rule 144, Preliminary Note 2.

the length of the holding period is objective evidence of the holder's investment intent, or the lack thereof, at the time of original purchase. A purchaser's investment intent is important because the opposite of investment intent is "view to distribution." And, under section 2(a)(11), purchasing with a view to distribution makes the holder an underwriter.

Alternatively, a person who sells restricted securities too soon after their purchase may be considered an underwriter under the theory that the sale is "for an issuer in connection with [a] distribution."²⁹ Reasoning to that conclusion starts with the idea that a distribution is not complete until the securities have come to rest in the hands of persons who are not "merely conduits for a wider distribution."³⁰ The argument may then proceed that:

- (1) the issuer knows or should know that some purchasers of restricted securities will want to resell fairly quickly after their purchase;
- (2) a purchaser is able to resell quickly only because the issuer does not take effective steps to prevent it (such as contractual provisions prohibiting the resale and legends on the certificates representing the securities);³¹ and
- (3) since the issuer is responsible for the resale, the resale will be considered as simply a part of a larger distribution of the securities, by the issuer, to the public through an underwriter.

Notice that from the point of view of the purchaser who has resold, the alternative theory is the more dangerous theory. Under the first theory, a purchaser may have a good chance of convincing a court that he or she did not purchase securities with a view to distribution, notwithstanding the shortness of the holding period. Under the second theory, however, the intent of the purchaser is irrelevant, as is the intent of the issuer.

The obvious question, of course, is how long a holding period is required to avoid these problems. It is clear that no holding period removes the taint of underwriter status from someone who has purchased with a distribution in mind. In the usual situation, however, a sufficiently long holding period dispels any notion that a reseller of restricted securities is an underwriter, and two years came to be viewed by securities lawyers as the minimum safe holding period of

29. This is another test for determining underwriter status under Securities Act § 2(a)(11).

30. See section 6:2, "Private Placements: Section 4(a)(2)"; see also text accompanying note 18, *supra*.

31. See text accompanying note 43 in chapter 6.

restricted securities before a public sale. *United States v. Sherwood*³² helped in that respect by declaring that the passage of two years between the purchase and resale involved in the case was an “insuperable obstacle” to a finding that the reseller was an underwriter. Before the passage of Rule 144, the Commission’s staff responded to a multitude of no-action letter requests in connection with potential resales of restricted securities. The staff freely granted no-action letters when restricted securities were held for three years, but was much less likely to do so in the case of a two-year holding period.

The other pre-Rule 144 interpretation that must be discussed is the change-in-circumstances doctrine. Since the Commission has asserted that the doctrine should no longer be relied upon in the case of securities purchased after the effective date of Rule 144,³³ a change in circumstances is of much less help to a post-Rule 144 purchaser than is a sufficiently long holding period. In fact, it has always been of less importance than the holding period. The thrust of the change-in-circumstances doctrine is that the inference of underwriter status that may accompany a too-short holding period can be avoided when the holder of restricted securities proves that the desire to resell arose because of changed circumstances. The Commission made it clear in Securities Act Release No. 4,552 that factors such as an advance or decline in a stock’s price or in an issuer’s earnings “are normal investment risks and do not usually provide an acceptable basis for a claim of changed circumstances.”³⁴ An examination of pre-Rule 144 no-action letter requests and responses shows little staff acceptance of change-in-circumstances arguments. Perhaps the usual effect of the doctrine in the pre-Rule 144 period was to give comfort to those involved in a transaction by a security holder who barely met a minimally acceptable holding period.

§ 7:4 Public Resales Under Rule 144

As indicated by the title of Rule 144, “Persons Deemed Not to Be Engaged in a Distribution and Therefore Not Underwriters,” the rule is designed to provide a mechanism for avoiding underwriter status. As is further discussed below, with Rule 144’s focus on what constitutes a distribution, the basic elements of the rule include a holding period for restricted securities, a limitation on the amount of securities that can be sold by affiliates during a specified period, a requirement that sales be

32. *United States v. Sherwood*, 175 F. Supp. 480 (S.D.N.Y. 1959).

33. A court, of course, is free to disagree with the Commission on this point. At least when the equities are clearly on the side of a purchaser who has resold, that is perhaps not unlikely.

34. Securities Act Rel. No. 4552 (Nov. 6, 1962).

made by affiliates in “broker’s transactions” and an information requirement. Since its adoption in 1972, the rule has been amended several times, primarily with respect to the holding period required prior to reselling restricted securities. The rule originally required a two-year holding period, which was subsequently reduced to one year. Additionally, over the years, special rules were added for non-affiliates who had held restricted securities for three years, later two years, and most recently six months (for securities of a reporting company), allowing them greater flexibility in reselling those securities.

In 2007, Rule 144 was further amended “to increase the liquidity of privately sold securities and decrease the cost of capital for all companies without compromising investor protection.”³⁵ The 2007 amendments further reduced the holding period for restricted securities and virtually eliminated the rule’s other requirements for sales by non-affiliates.

The best starting point for an examination of Rule 144 is section (b), which gives the effect of the rule:

- (1) *Non-affiliates.* (i) If the issuer of the securities is, and has been for a period of at least ninety days immediately before the sale, [an Exchange Act reporting company], any person who is not an affiliate of the issuer at the time of the sale, and has not been an affiliate during the preceding three months, who sells restricted securities of the issuer for his or her own account shall be deemed not to be an underwriter of those securities within the meaning of section 2(a)(11) of the Act if all of the conditions of paragraphs (c)(1) (current public information) and (d) (holding period) of [the rule] are met. The requirements of paragraph (c)(1) of this section shall not apply to restricted securities sold for the account of a person who is not an affiliate of the issuer at the time of the sale and has not been an affiliate during the preceding three months, provided a period of one year has elapsed since the later of the date the securities were acquired from the issuer or from an affiliate of the issuer.
- (ii) If the issuer of the securities is not, or has not been for a period of at least ninety days immediately before the sale, [an Exchange Act reporting company], any person who is not an affiliate of the issuer at the time of the sale, and has not been an affiliate during the preceding three months, who sells restricted securities of the issuer for his or her own account

35. Securities Act Rel. No. 8869 (Dec. 6, 2007).

shall be deemed not to be an underwriter of those securities within the meaning of section 2(a)(11) of the Act if the condition of paragraph (d) of [the rule] is met.

- (2) *Affiliates or persons selling on behalf of affiliates.* Any affiliate of the issuer, or any person who was an affiliate at any time during the ninety days immediately before the sale, who sells restricted securities, or any person who sells restricted or any other securities for the account of an affiliate of the issuer of such securities, or any person who sells restricted or any other securities for the account of a person who was an affiliate at any time during the ninety days immediately before the sale, shall be deemed not to be an underwriter of those securities within the meaning of section 2(a)(11) of the Act if all of the conditions of [the rule] are met.³⁶

With an understanding of control and restricted securities, and the theories by which sellers and brokers may be tainted with underwriter status,³⁷ that section of the rule should be decipherable. To the uninitiated, however, it is quite opaque.³⁸

Subsection (b)(1) relates to non-affiliates. If the issuer is a reporting company, and the securities have been held for more than one year, the shares can be resold freely. If the securities have been held for more than six months but less than one year, they may be resold freely so long as there is current public information available about the issuer—that is, the company is current in its Exchange Act reports. If the issuer is not a reporting company, the securities may not be resold until they have been held for one year, after which time they may be freely resold by a non-affiliate.

Subsection b(2) relates to affiliates. The first clause covers restricted securities and the second clause relates to control securities. Notice that the focus of the first clause is on the holder of securities, while in the second it is on the person who sells securities for the holder. That, of course, fits with the earlier discussions of how the taint of underwriter status arises differently in the case of restricted and control securities.

Notice also that neither section (b)(1) nor (b)(2) provides that when the rule is followed there will not be a distribution. Both sections provide that in that circumstance there will not be deemed to be a distribution. Through that technique, the Commission has structured a rule that, although accomplishing the Commission's desired ends, does not necessarily have to fit within general securities law theory and interpretations.

36. Rule 144(b).

37. See sections 7:2 and 7:3.1, *supra*.

38. See Table 7-1 at the end of this chapter for a “decision tree” that one can use to navigate Rule 144's requirements.

Rule 144 begins with definitions, the most important of which is that of “restricted securities.” That definition is discussed above.³⁹ The next most important definition is that of “person” when that term is used to refer to the seller of securities under the rule. Here the Commission has played a little drafting trick by including other people within the definition, such as certain relatives who share the same home. This has significant importance, including for the purpose of determining whether certain limitations in the rule are complied with.

Most of the rest of the rule sets forth the various categories of requirements:

- (1) current public information,
- (2) holding period for restricted securities,
- (3) limitation on amount of securities sold,
- (4) manner of sale, and
- (5) notice of sale.

The rule can be used by affiliates only when there is publicly available specified current information concerning the issuer.⁴⁰ Under the rule, it is theoretically possible for an issuer to meet that requirement simply by making public the required information. As a practical matter, it rarely is met other than by companies who are required to file reports with the Commission, usually as a result of having securities registered under the Exchange Act.⁴¹ Because of that, some companies that have not been legally required to register securities under the Exchange Act have done so to make Rule 144 available for use by their security holders.

Rule 144’s holding period itself depends upon whether the issuer of the restricted securities is a reporting company (six months) or a non-reporting company (one year). The holding period begins to run when the securities are bought and fully paid for, with provisions for adjusting the holding period (or doing away with it) in special situations, such as the creation of a holding company structure, cashless exercise of options and warrants, when securities are purchased on credit or from

39. See section 7:2, “Control and Restricted Securities,” *supra*.

40. Securities Act Rule 144(c). Note, as mentioned above, once a non-affiliate has held restricted securities of an Exchange Act reporting issuer for more than six months or of any other issuer for more than one year, the non-affiliate may make resales free of any other requirements.

41. See chapter 9, *infra*, for a discussion of what this involves. For example, satisfaction of the “current public information” condition does not require a company to have filed all Form 8-K reports during the twelve-month period preceding such a sale of securities.

a security holder who is not an affiliate of the issuer, or when they are held by a pledgee or by a donee of a gift or a beneficiary of an estate.⁴²

The generally applicable amount limitation for all securities sold by an affiliate is the greater of one percent of the class of securities outstanding or of the average weekly trading volume of the class of securities during the preceding four weeks, again with a number of provisions for special situations.⁴³ Generally, securities must be sold by an affiliate in a broker's transaction or directly to a market maker and no solicitation of buyers or extraordinary commissions is allowed.⁴⁴ Unless sales during a three-month period do not exceed 5,000 shares or other units of securities, or a total sales price of \$50,000, an affiliate usually is required to file a notice of sale with the Commission.⁴⁵ Form 144, which is a simple fill-in-the-blanks form, is used for that purpose.

Rule 144 is complex because it is detailed and covers a variety of circumstances, and also because it combines provisions relating to control and restricted securities. For those familiar with the rudiments of the section 4(a)(1) exemption, which is what compliance with the rule secures, understanding the rule presents no problem. Actually using the rule requires something else: a knowledge of the practices that have developed to effect its compliance. The typical task for a lawyer representing a seller, in addition to being personally satisfied that the rule is available, is determining what is required by the issuer's lawyers and by the securities firm that is to handle the sale. Many securities firms, transfer agents, and law firms have worked out a detailed set of requirements, sometimes even providing drafts of documents. Usual requirements, especially in the case of restricted securities, include letters or certificates attesting to the facts supporting Rule 144 compliance, along with an opinion of counsel that the requirements of the

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42. Securities Act Rule 144(d). When restricted securities are resold in a private transaction, the holding period of the new owner generally begins when the securities were purchased from the issuer or an affiliate of the issuer. *Id.* Some changes were made in 2007 that codified prior staff positions on certain issues with respect to calculation of the holding period. In the case of bona fide donees and pledgees and their ability to sell free of any holding period, see the Commission's Compliance and Disclosure Interpretations 129.03 (May 16, 2013) and 532.01 (May 16, 2013), respectively, available at *Securities Act Rules*, U.S. SEC. & EXCH. COMM'N, www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm (last updated May 16, 2013).
 43. Securities Act Rule 144(e). The volume limitations do not apply to resales of restricted securities by non-affiliates.
 44. Securities Act Rule 144(f), (g). These "manner of sale" restrictions do not apply to debt securities sold or certain "riskless principal transactions" by affiliates or to any resale by non-affiliates.
 45. Securities Act Rule 144(h)(1). The form may be, but is not required to be, filed electronically under the Commission's EDGAR system.

rule are met.⁴⁶ Handling all the details often takes some days, and legal fees typically run at least some hundreds of dollars. For those reasons, the rule is not so useful as it may at first seem for the sale of a relatively small amount of securities.

§ 7:5 Private Resales of Control and Restricted Securities

§ 7:5.1 Resales Under Rule 144A

Issuers frequently use private placements of securities to access the U.S. capital markets while avoiding the Securities Act's registration requirements. Prior to the adoption of Rule 144A, however, private placements generally were not as advantageous to issuers when compared to public offerings, principally due to the limitation on resale applicable to privately placed securities. Because a privately placed security is less liquid than a security registered with the Commission, issuers could expect to receive less competitive pricing when selling a privately placed security than when selling the same security in a public offering. Rule 144A was adopted in April 1990 to ease such resale restrictions.

Since its adoption, Rule 144A has greatly increased the liquidity of the securities affected. This is because the institutions can now trade these formerly restricted securities amongst themselves, thereby eliminating the restrictions that are imposed to protect the public.⁴⁷ One purpose of Rule 144A was to encourage foreign companies to sell securities in the U.S. capital markets—as a result, Rule 144A has become the principal safe harbor on which non-U.S. companies rely when accessing the U.S. capital markets. Rule 144A should not be confused with Rule 144 (discussed above), which permits public (as opposed to private) unregistered resales of restricted and controlled securities (within certain limits).

Rule 144A establishes a safe harbor for certain private resales of restricted securities, by providing that the seller in a transaction qualified under the rule will not be deemed to be an underwriter.⁴⁸ If the seller is a dealer, Rule 144A(c) provides also that the dealer will be deemed not to be a participant in a distribution of the securities covered by the rule. The rule is available only if the proposed buyer is a

46. For an early, but still helpful, article on Rule 144 compliance, see Green, *Selling Restricted Securities Under Rule 144—A Practical Guide*, PRAC. LAW, May 1972, at 13.

47. Since 1990, the NASDAQ Stock Market offers a compliance review process which grants Depository Trust & Clearing Corporation (DTCC) book-entry access to 144A securities. NASDAQ also launched an Electronic Trading Platform for 144A securities called PORTAL.

48. Securities Act Rule 144A(b).

“qualified institutional buyer” or an institution that the seller and any person acting on its behalf reasonably believe to be a “qualified institutional buyer” (QIB).⁴⁹ The rule is not available, however, for the resale of securities (1) that, at the time of their issuance, were of the same class of securities listed on a national securities exchange or quoted in a U.S. automated inter-dealer quotation system⁵⁰ or (2) that were issued by one of enumerated types of companies that are or are required to be registered under the Investment Company Act of 1940.⁵¹

What often is referred to as a “144A offering” or “144A deal” is in actuality a two-step process—the first, a primary offering of securities by an issuer to one or more financial intermediaries—generally referred to as the “initial purchasers”—in a transaction that is exempt from registration pursuant to Securities Act section 4(a)(2) or Regulation S.⁵² What then follows is the second step and the portion of the transaction truly covered by Rule 144A—the resale of those securities by the initial purchasers to QIBs. Prior to September 23, 2013, Rule 144A required that both offers and sales be made only to QIBs or those reasonably believed to be the QIBs. This restriction, coupled with the concern not to disqualify the first step of the transaction—the 4(a)(2) transaction between the issuer and the initial purchasers—effectively limited general solicitation in a 144A transaction.

As a result of lifting the ban on general solicitation under Rule 144A, the rule was revised to delete the references to “offers,” “offered,” or “offeree.” Because Rule 144A does not expressly prohibit general

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49. Securities Act Rule 144A(a)(1) basically provides that a “qualified institutional investor” is any of a list of institutions (such as certain insurance companies, investment companies, business development companies, employee benefit plans, trust funds, educational or charitable organizations, corporations, partnerships, business trusts, and investment advisers), “acting for its own account or the accounts of other qualified institutional buyers, that in the aggregate owns and invests on a discretionary basis at least \$100 million in securities of issuers that are not affiliated with the entity, plus certain dealers.”
50. Securities Act Rule 144A(d)(3). This part of the rule details special requirements for determining when securities are of the “same class.”
51. *Id.* As discussed in chapter 6, as required by the JOBS Act, the Commission lifted the decades-old ban on general solicitation and general advertising for offerings conducted under Rule 506 and Rule 144A, provided that Rule 506 sales are made only to investors who are “accredited” and Rule 144A resales are made only to investors who are “qualified institutional buyers” (or “QIBs”), as each of those terms is defined under the federal securities laws. *See* Securities Act Release No. 9415 (July 10, 2013); section 6:5.1[D][4], *supra*.
52. Regulation S is a “safe harbor” rule that, when its conditions are met, results in offers and sales of securities being deemed to take place outside the United States and, therefore, not subject to the registration requirements under the Securities Act. *See* section 6:6.4.

solicitation, these revisions allow sellers to rely on Rule 144A even if the securities are offered to non-QIBs and even if there has been general solicitation so long as all of the purchasers are either QIBs or persons that the seller and any person acting on behalf of the seller reasonably believe are QIBs. In the release in which the amendments were adopted, the Commission confirmed that the use of general solicitation in the second step will not affect the availability of the 4(a)(2) exemption for the issuer's initial sale.⁵³

For transactions to be covered by Rule 144A, the seller and any person acting on its behalf must take reasonable steps to ensure that the purchaser is aware that the seller may rely on the exemption from the registration requirements provided by the rule.⁵⁴ Also, in the case of securities issued by certain companies (basically those that are not subject to the reporting requirements of the Exchange Act), the rule provides that, upon request, the purchaser has a right to obtain from the seller, and the seller and the purchaser have a right to obtain from the issuer, certain basic information about the issuer.⁵⁵ The specified information, which must be "reasonably current," consists of "a very brief statement of the nature of the business of the issuer and the products and services it offers; and the issuer's most recent balance sheet and profit and loss and retained earnings statements, and similar financial statements for such part of the two preceding fiscal years as the issuer has been in operation (the financial statements should be audited to the extent reasonably available)." The rule also provides that the requested information must be received by the purchaser at or prior to the time of sale.⁵⁶

§ 7:5.2 Resales Under the "4(a)(1½) Exemption"

The section 4(a)(1½) exemption is a case law-derived set of procedures developed over time by the securities bar and accepted by the Commission.⁵⁷ The exemption allows the resale of privately placed

53. See Securities Act Release No. 9415 (July 10, 2013), at 55, n.172. That same footnote also confirmed that the general solicitation permitted in Rule 144A transactions will not affect the ability of an issuer to rely on Regulation S for the initial sale of securities to the initial purchaser. See also section 6:6.4. Accordingly, issuers will be able to participate in the initial purchaser's selling efforts like any other person acting on behalf of the seller to assist in the sales of securities, including through general solicitation.

54. Securities Act Rule 144A(d)(2).

55. Securities Act Rule 144A(d)(4).

56. *Id.*

57. The seminal case involving the so-called section 4(a)(1½) exemption was *Gilligan, Will & Co. v. SEC*, 267 F.2d 461 (2d Cir. 1959). In that case, the Second Circuit intimated that a person purchasing restricted securities

securities in a subsequent private placement when certain conditions are satisfied. The section 4(a)(1½) exemption is designed to permit sellers of securities to rely on section 4(a)(1) (which provides an exemption for sellers other than issuers, underwriters, and dealers) to avoid statutory “underwriter” status by implementing the same kinds of restrictions that would be required in the case of a section 4(a)(2) offering by the issuer itself. The section 4(a)(1½) exemption typically is relied on in connection with the resale of restricted securities to accredited investors who make appropriate representations. Generally, if an accredited investor cannot qualify as a “QIB” under Rule 144A, a seller may seek to use the section 4(a)(1½) exemption for secondary sales of privately-held securities. Section 4(a)(1½) also sometimes is used to extend a Rule 144A offering to institutional accredited investors.

The analysis in a potential 4(a)(1½) transaction proceeds in the same way that it does for the public resale of control and restricted securities. That analysis leads to the conclusion that, as in the case of a public sale, the troublesome question is whether an “underwriter” will be involved in a proposed transaction.⁵⁸ Also as with public resales, that question is answered by answering a more basic question: Will the transaction involve a distribution?⁵⁹ When there is no distribution, there is no underwriter, since the definition of “Underwriter” in section 2(a)(11) is tied exclusively to a distribution. When there is no underwriter involved in a sales transaction, the section 4(a)(1) exemption is available to any security holder other than the issuer or a dealer. Since “distribution” essentially is synonymous with “public offering,” the necessity for doing an exempt private resale of control or restricted securities is that the sale not involve a public offering. It is apparent that there is substantial learning available on the question of what constitutes a public offering and its statutory opposite, the section 4(a)(2) private placement.⁶⁰ What must be done,

from an issuer is not an underwriter for purposes of section 4(a)(1) if the purchaser resells the restricted securities to persons who qualify as purchasers under section 4(a)(2) as described by the U.S. Supreme Court in *SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953), and who acquire the restricted securities in a private offering of the type contemplated by section 4(a)(2). See discussion in section 6:2, *supra*. See also, e.g., In the Matter of John A. Carley et al., Securities Act Release No. 8888 (Jan. 31, 2008). Good starting points for work in the area are *The Section “4(1½)” Phenomenon: Private Resales of “Restricted” Securities*, 34 BUS. LAW. 1961 (1979), and Schneider, *Section 4(1½)—Private Resales of Restricted or Control Securities*, 49 OHIO ST. L.J. 501 (1988).

58. See section 7:3, “Public Resales Outside Rule 144,” and section 7:3.2, “Sales of Restricted Securities,” *supra*.
59. See section 7:3.1, “Sales of Control Securities,” *supra*.
60. See section 6:2, “Private Placements: Section 4(a)(2),” *supra*.

then, is an offering that, although technically under section 4(a)(1), has some of the basic characteristics of a section 4(a)(2) transaction. For those reasons, private resales of control or restricted securities often are referred to as “section 4(a)(1½) transactions.”

For private resales of restricted securities that fall outside Rule 144A, the seller must structure the transaction so that the seller is (1) not an underwriter and (2) cannot be made an underwriter by actions of the purchaser.⁶¹ Analytically, that would seem to involve offering and selling only to persons who can meet the requirements for purchasing in a private placement.⁶² It further involves structuring the transaction in such a way that the new purchasers cannot resell in a nonexempt transaction, since that will likely destroy the exemption or exemptions that supported sales earlier in the chain.⁶³ That mainly involves having the new purchaser agree to contractual restrictions, of the type used in private placements,⁶⁴ and ensuring that the certificates representing the securities that are sold are legended against resale without an exemption.

The situation is somewhat different in the case of control securities. In that case, the seller must ensure that the purchaser is not an underwriter. Theoretically, at least, it seems that the purchaser would not have to meet any requirements (such as investment sophistication), except those that go to the question of underwriter status. At a minimum, the seller would want to obtain a representation that the purchaser is not purchasing with a view to distribution and, in addition, would want to insist on the same type of contractual restrictions and legends on certificates that are needed in the case of restricted securities.

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61. Note that, under Rule 144 after a six-month/twelve-month (see section 7:4 above) holding period that depends upon whether the issuer is a reporting company, non-affiliates who have had that status for at least three months can sell restricted securities “publicly.” For example, the sale can be in a face-to-face transaction. An important consideration here is the fact that, upon such a sale, the securities cease to be restricted securities when they go into the hands of their new owner. *See, e.g.*, Republic Resources Corp., SEC No-Action Letter, [1987–1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,669 (Jan. 13, 1988).
62. But see, as a starting point, no-action letters cited in *The Section “4(1½)” Phenomenon: Private Resales of “Restricted” Securities*, *supra*, note 57, which show some flexibility in that respect. Those letters also disclose some ambiguity about the information that must be provided to purchasers in a section 4(1½) transaction.
63. *See* section 7:2, “Control and Restricted Securities,” *supra*.
64. It should be realized that because of restrictions contained in a contract between the issuer and the person who currently wishes to sell, the issuer typically will have to agree that there is an exemption available for a planned private resale.

§ 7:5.3 Resales Under Securities Act Section 4(a)(7)

On December 4, 2015, the Fixing America's Surface Transportation (FAST) Act,⁶⁵ amended the Securities Act and added a new section 4(a)(7), which exempts from the registration requirements of section 5 of the Securities Act resale transactions meeting the following requirements:

- The seller is not the issuer or a direct or indirect subsidiary of the issuer of the relevant securities.
- Each purchaser of the securities is an "accredited investor," as defined in Securities Act Rule 501(a).⁶⁶
- Neither the seller, nor any person acting on the seller's behalf, offers or sells the securities by any form of general solicitation or general advertising.
- The securities are of a class that has been authorized and outstanding for at least ninety days prior to the date of the transaction.
- The securities are not part of an unsold allotment to, or a subscription or participation by, a broker or dealer as an underwriter or a redistribution.
- Neither the seller, nor any person remunerated for offering or selling the securities, is subject to a "bad actor" disqualification under Rule 506(d)(1) of Regulation D under the Securities Act or a statutory disqualification under section 3(a)(39) of the Exchange Act.

Resales of securities of non-reporting issuers—issuers that are neither subject to the reporting requirements of sections 13 or 15(d) of the Exchange Act, nor foreign private issuers exempt from reporting pursuant to Rule 12g3-(b) thereunder, nor foreign governments eligible to register securities under Schedule B of the Securities Act—must comply with an additional information requirement. The seller and a prospective purchaser must obtain from the issuer, upon request of the seller, and the seller must make available to the prospective purchaser, reasonably current specified information about the issuer, including:

- the nature of the issuer's business, products, and services;
- the names of its officers and directors;

65. Pub. L. No. 114-94 (2015).

66. The Rule 501(a) definition covers persons that satisfy certain criteria, or that "the issuer reasonably believes" satisfies those criteria. Since the issuer will not be involved in section 4(a)(7) transactions, one interpretive question is whether the reasonable belief standard will nonetheless apply.

- the name of any registered broker, dealer, or agent being remunerated for participating in the offering;
- the issuer's most recent balance sheet and profit and loss statement for such part of the two preceding fiscal years as it has been in operation, prepared in accordance with U.S. generally accepted accounting principles (or, in the case of a foreign private issuer, International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board); and
- if the seller "controls" the issuer, a brief statement regarding the nature of the affiliation, and a statement certified by the seller that it has no reasonable grounds to believe that the issuer is in violation of the securities laws or regulations.

Section 4(a)(7) is not available for securities of certain issuers that are dormant, bankrupt or shell companies.⁶⁷ The FAST Act also provides that any section 4(a)(7) transaction will be deemed not to be a distribution for purposes of section 2(a)(11) of the Securities Act, and that securities acquired in such a transaction will be deemed to have been acquired in a transaction not involving any public offering and thus to be "restricted securities" within the meaning of Rule 144 under the Securities Act. In addition, securities sold in a section 4(a)(7) transaction are "covered securities" for purposes of the provisions of Securities Act section 18, which preempts the registration requirements of state securities laws. Finally, the FAST Act makes it clear that the section 4(a)(7) exemption is not exclusive of other available exemptions.

The implications of the new section 4(a)(7) exemption are potentially significant. The new section 4(a)(7) could largely to supplant and be available in a broader range of circumstances than the section 4(a)(1½) procedures for resale transactions that do not fall within the safe harbors provided by Rule 144 or Rule 144A. Less clear is whether and to what extent new section 4(a)(7) will move transactions out of the Rule 144A market, and whether marketplaces will develop to facilitate trading among "accredited investors" under section 4(a)(7). The greatest benefits of the new exemption will be for affiliates who must sell subject to Rule 144's volume and manner of sale limitations. Non-affiliate holders of "restricted securities," however, also could find that section 4(a)(7) increases the liquidity for "restricted securities" prior to

67. The issuer must be engaged in business, not be in the organizational stage or in bankruptcy or receivership and not be a blank check, blind pool, or shell company that has no specific business plan or purpose, or have indicated that its primary business plan is to engage in a merger or combination of its business with, or an acquisition of, an unidentified person.

the expiration of the applicable six-month or one-year holding period. The new exemption also could be helpful in hedging transactions because the ability to make outright sales will be greater. See Table 7-2 at the end of this chapter for a comparison of Rule 144A, the 4(a)(1½) exemption, and the new section 4(a)(7) exemption.

§ 7:5.4 **Other Related Issues**

There are issues about what information must be provided by a seller of restricted or control securities in a private resale. A seller needs to ensure that he or she does not violate Securities Act section 17(a) or Exchange Act Rule 10b-5 by selling while in possession of material inside information.⁶⁸ If an affiliate sells securities of an Exchange Act reporting company, no information should have to be disclosed, unless there is material information that the issuer has not disclosed publicly, at least so long as the seller does not know that the purchaser lacks knowledge of disclosed information.⁶⁹ If the seller is selling securities of a non-reporting issuer, there are specific information requirements in Rule 144A and under section 4(a)(7) that are described above. If the issuer has not publicly disclosed material information, an affiliate could sell privately by disclosing the inside information to the purchaser. In that case, the purchaser would want to obtain a nondisclosure agreement. If an affiliate sells securities in a privately held company, the seller needs to provide enough information so that the purchaser is in possession of all material information about the issuer, so as to avoid section 17(a) and Rule 10b-5 questions. If the purchaser is also an affiliate, of course, the seller usually would have to provide no or very little information. If the purchaser is not an affiliate, the only safe way to avoid liability is to make sure the purchaser has the kind of information that the purchaser would receive in a section 4(a)(2) private placement (or, in the case of institutional buyers, that they have access to the information). In any case where information is provided, care dictates that it be provided in writing.

There is still at least one important question to be answered here: what restrictions, other than contractual ones, are there on the further resale of securities involved in a private resale transaction? The answer to that question leads back to the beginning of this chapter. The first

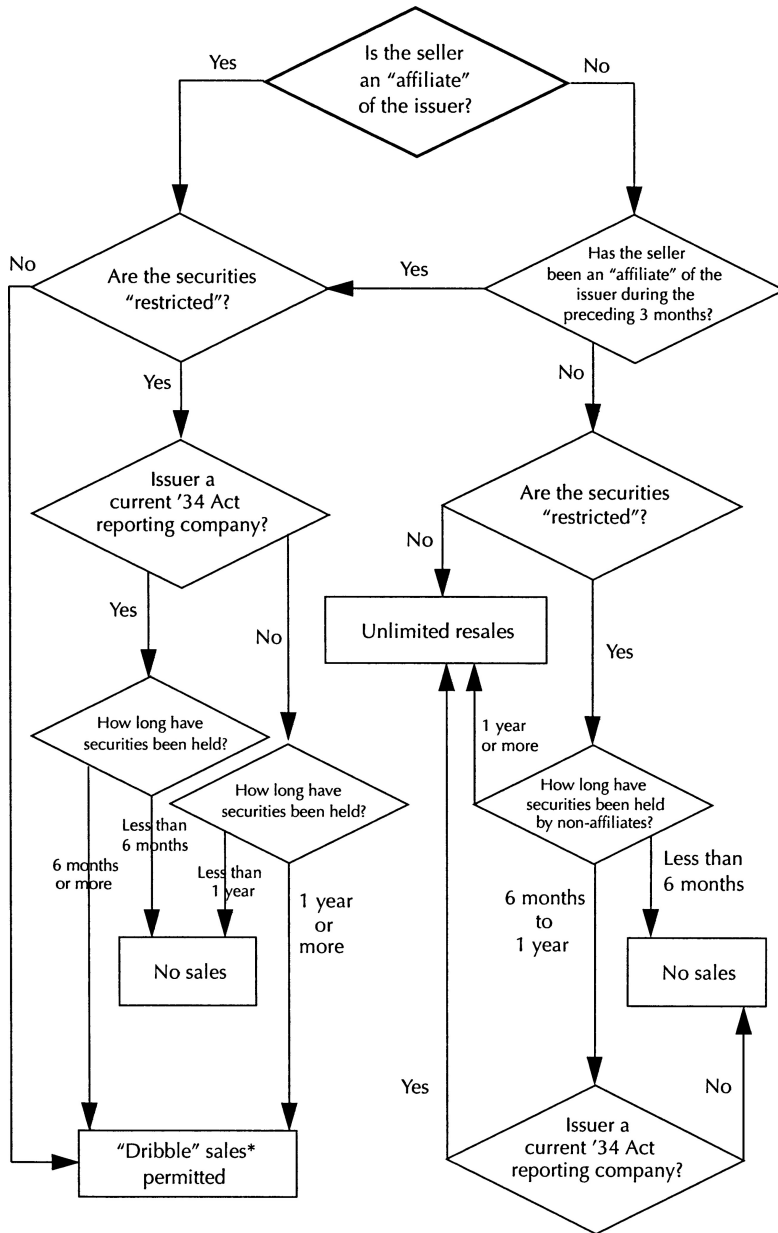
68. Section 17(a) is covered in chapter 8 and Rule 10b-5 in chapter 12.

69. The issue here is that “fraud” may at least be alleged if the seller knows that the purchaser has failed to learn of disclosed information. An affiliate would not want to get before a jury on the issue of fraud if it appears that he or she took advantage of a purchaser’s lack of knowledge.

inquiry is whether the securities are, in the hands of their new owner, either control or restricted securities. They are control securities when the new owner is an affiliate of the issuer. If the securities are control securities, they are subject to the resale limitations discussed elsewhere in this chapter. To determine when the securities are restricted securities, the definition in Rule 144(a) must be examined. Under the explicit language of that definition all securities purchased in a Rule 144A transaction, a 4(a)(1½) transaction, or pursuant to the 4(a)(7) exemption are restricted securities.

Many restricted securities sold in a private resale transaction outside Rule 144A are restricted securities in the hands of their new owner, since often these securities are acquired in a transaction that fits them within the definition of restricted securities in Rule 144(a). For example, they may be securities that are 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.

Table 7-1
Rule 144 Decision Tree



* "Dribble" sales refers to the ability to sell within the limits of Rule 144—e.g., volume limitations, manner of sale ("broker's transaction") limitations when required, filing of a Form 144, and the requirement that there be "current public information."

Table 7-2
Comparison of Rule 144A, the 4(a)(1½) Exemption and
Section 4(a)(7) for Private Resale Transaction

Exemption	Rule 144A	4(a)(1½)	Section 4(a)(7)
Restrictions on types of securities	May not be “fungible” with exchange listed securities and may not be securities of 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	None	Securities must be of a class that has been authorized and outstanding for at least ninety days; also may not be part of an unsold allotment
Holding period by seller	None	None	None
Volume limitations	None	None	None
General solicitation	Permitted	Practice is to ensure there is no general solicitation so as to avoid appearance of a “distribution”—media publicity by those other than the seller (e.g., the issuer) has raised concerns in 4(a)(1½) transactions	Neither the seller nor anyone acting on the seller’s behalf may engage in general solicitation

Exemption	Rule 144A	4(a)(1½)	Section 4(a)(7)
Bad actor disqualification	No	No	Yes
Issuer operating requirement	No; however, the requirement that in certain cases information about the issuer's business could imply otherwise	No	Yes—issuer must be engaged in a business—may not be a blank check, shell company without a specific business plan or a SPAC
Blue sky preemption	Only with respect to the securities of reporting issuers	No	Yes
Special conditions for resales by affiliates	No	No	For securities of a non-reporting issuer, the seller must provide a statement of the nature of the seller's affiliation and a statement certified by the seller that the seller has no reasonable grounds to believe the issuer is in violation of securities laws
Purchaser status	QIBs only	No specific requirement but practice is to require that purchasers be accredited investors	Accredited investors only
Representation of purchaser investment intent	None required	Practice is to require purchasers to make representation of investment intent so as to avoid appearance of a "distribution"	None required

Exemption	Rule 144A	4(a)(1½)	Section 4(a)(7)
Limit on number of purchasers	No	No specific limit but practice is to keep limited so as to avoid appearance of a "distribution"	No
Issuer information requirements	Right of purchaser to receive certain financial and other issuer financial information if securities are those of a non-reporting issuer	No specific requirement but practice is to obtain purchaser representation as to satisfactory access to information for purposes of an investment decision	If securities are those of a non-reporting issuer, seller must provide financial statements and certain other information specified in the exemption
Status of securities following transaction	"Restricted"	"Restricted"	"Restricted"

