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**Offers, Sales and Resales of Securities
Under Section 4[a](1-1/2) and Rule 144A**



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I. Resales of Restricted Securities under Section 4(1-1/2)

Section 4(a)(2) of the Securities Act of 1933 (the "Act") exempts from registration "transactions by an issuer not involving any public offering." It is section 4(a)(2) that permits an issuer to sell securities in a "private placement" without registration under the Act. Section 4(a)(2), however, is only available to the issuer, and not to persons who have acquired securities from the issuer and who want to resell the securities.

Section 4(a)(1) of the Act exempts from registration "transactions by any person other than an issuer, underwriter, or dealer." A holder of securities who is not an issuer or a dealer can therefore sell his securities in a private sale without registration if the holder is not an underwriter as "underwriter" is defined in section 2(a)(11). Generally, a person is an "underwriter" if he acquires securities with a view to "distribution" or is participating in a "distribution," which generally means an offering that is not a private offering.

A holder of securities that were issued in a private placement may resell the securities on a public trading market, after a holding period, pursuant to the SEC's Rule 144. Specifically, the seller who complies with Rule 144 is deemed not to be an "underwriter" under the Securities Act of 1933 and therefore may sell the restricted shares without registration. There is not, however, a similar rule for private resales of restricted securities. A holder of securities who wishes to resell them privately under section 4(a)(1) therefore must sell in a transaction that is sufficiently "private" to avoid his being considered an underwriter. Over time, the various restrictions on sale considered by the SEC and securities lawyers to permit a resale under 4(a)(1) has been referred to as "section 4(1-1/2)" (or, to keep it consistent with amendments to the 1933 Act, "4(a)(1-1/2)," but we will use the traditional name in this outline).

It is generally considered that for a resale to be private for purposes of section 4(1-1/2),

- it should be to a limited number of purchasers, certainly less than 25 purchasers;
- the securities should be offered without public advertising or general solicitation;

- the seller should provide the purchaser with such information about the issuer as is available to the seller, although a seller that is not affiliated with the issuer may not be able to provide anything like the disclosures that would be made in a private placement by the issuer;
- if the seller is affiliated with the issuer, purchasers generally should be limited to those who are sophisticated enough to be able to evaluate the risks of the investment;
- although no specific holding period is required before the resale of the securities, the seller must not have purchased the securities with a view to resale, and it generally is considered that a holding period of six months or more will evidence the seller's original investment intent; and
- the purchaser should represent that it is acquiring the securities for investment, and not for resale.

While the SEC has never attempted to provide more specific guidance under 4(1-1/2) (and most practitioners probably prefer the flexibility that the lack of a rule permits), there are several significant articles that have reviewed the available interpretations and that can be helpful to the practitioner.¹

II. Background of Rule 144A

While as a general matter practitioners may appreciate their ability to interpret section 4(1-1/2), institutional investors who acquire securities (for the most part, corporate debt) in private placements sought both liquidity and certainty of execution – that is, they wanted to be able to resell the securities they acquired as quickly and easily as possible, and to be certain as to their ability to execute the sales. Foreign issuers, in particular, who had limited access to the U.S. public markets, because of disclosure and liability concerns (and now, the Sarbanes-Oxley Act of 2002), obtained unfavorable pricing in private placements because of limitations on resale of the securities being offered. The SEC adopted Rule 144A in Spring of 1990 as a way of codifying section 4(1-1/2) for use by large institutional investors.

As a general matter, Rule 144A permits free resales of restricted securities to large institutional investors – Qualified Institutional Buyers, or QIBs (defined below). Rule 144A provides that any person, other than the issuer or a dealer, who offers or sells unregistered securities in compliance with Rule 144A's conditions shall be deemed not to be engaged in a distribution and therefore not an underwriter of such securities for purposes of Sections 2(a)(11) and 4(1) of the

¹ See, e.g., "The Section '4(1-1/2)' Phenomenon: Private Resales of 'Restricted' Securities, 34 Bus. Law. 1961 (1979); Olander & Jacks, "The Section 4(1-1/2) Exemption -- Reading Between the Lines of the Securities Act of 1933," 15 Sec. Reg. L. J. 339 (1988); "Reinterpreting the 'Section 4(1-1/2)' Exemption from Securities Registration: The Investor Protection Requirement," 16 U.S.F. L. Rev. 681 (1982); Schneider, "Section 4(1-1/2) -- Private Resales of Restricted or Control Securities," 49 Ohio St. L. J. 501 (Spring 1988).

1933 Act, thereby eliminating underwriter liability and making available the exemption from the registration requirements of the 1933 Act provided by Section 4(a)(1) for transactions by any person other than an issuer, underwriter or dealer.²

The adoption of Rule 144A brought about a new period of increased liquidity and efficiency in international capital markets. By reducing or eliminating holding periods and by reducing the transactional costs associated with lock-up provisions, Rule 144A increased access, particularly of foreign issuers, to U.S. private placement markets.³ It was a thorough success. Hundreds of billions of dollars of securities are sold in 144A transactions each year.⁴

Because Rule 144A applies only to resales, an issuer cannot utilize Rule 144A. However, Rule 144A has become so important to issuers because it permits a financial intermediary to buy unregistered securities from an issuer and resell them to an unlimited number of “qualified institutional buyers” (QIBs) in transactions that comply with Rule 144A. The liquidity provided by free resale has substantially reduced the discounts that historically were associated with unregistered offerings.

As was intended, Rule 144A altered the manner in which securities can be brought to market in the U. S. Dealers or investment banks now can purchase blocks of securities from issuers and underwriters and then, as riskless principal (if the block has been pre-sold to the ultimate purchasers) or as underwriter (if the block has not been pre-sold), resell those securities immediately to QIBs pursuant to Rule 144A in “underwritten private placements” or “Rule 144A offerings.”

Rule 144A offerings may permit resales of the securities only to QIBs under Rule 144A (known as “Rule 144A only” offerings) or may permit resales to QIBs under Rule 144A or to other investors under other available registration exemptions under the so-called Section “4(1½)” resale procedure (known as “Rule 144A eligible” offerings).

² The Rule also provides that a dealer who offers or sells unregistered securities in compliance with the conditions of Rule 144A shall be deemed not to be engaged in a distribution of such securities for purposes of Section 4(a)(3)(C) of the 1933 Act (which provides that transactions relating to securities that are part of the securities allotted to or subscribed by a dealer in connection with certain securities offerings are not exempt from the registration requirements of the 1933 Act under Section 4(a)(3) thereof), and such securities shall be deemed not to have been publicly offered within the meaning of Section 4(a)(3)(A) of the 1933 Act. As a result, such offers and sales are exempt from the registration requirements of the 1933 Act. Further, resales under Rule 144A are not considered for purposes of integrating prior or subsequent sales or resales by the issuer or any prior holder.

³ Release No. 33-6862, International Series 121, 54 Fed. Reg. 30,076 (April 23, 1990) (“Release 6862”)

⁴ U.S. issuers have used Rule 144A offerings primarily to sell investment grade debt. The Rule 144A debt offerings tend in many cases to resemble public offerings in terms of the information supplied and the manner in which they are brought to market.

III. OPERATIVE PROVISIONS OF RULE 144A

A. QUALIFIED INSTITUTIONAL BUYER

1. Definition. Securities eligible for the Rule 144A safe harbor may be offered or sold only to a “qualified institutional buyer” (“QIB”), defined generally as an institution with a portfolio of securities valued (at cost) (determined on a fiscal year-end basis) at more than \$100 million either owned or under its management, a registered broker-dealer with at least \$10 million in securities owned or managed, and a bank or savings and loan that both (i) owns, or invests on a discretionary basis in, at least \$100 million in third-party securities and (ii) has an audited net worth of at least \$25 million. Resales to individuals cannot be made in reliance upon the Rule.⁵
2. Portfolio Test. In determining whether an entity has a \$100 million portfolio of securities,
 - (a) Institutions may aggregate proprietary assets and discretionary assets under management.
 - (b) Investment companies that are part of a “family of funds” may aggregate the invested assets of the family.
 - (c) Companies with multiple subsidiaries that report on a consolidated basis may aggregate the securities of their wholly-owned subsidiaries.
 - (d) Entities formed solely for the purpose of satisfying the \$100 million test are eligible, as are entities all of whose equity owners are QIBs.
 - (e) A broker-dealer acting as a “riskless principal” in a transaction with a QIB, regardless of the size of its securities portfolio, is a QIB.
 - (f) An affiliate of a bank or a savings and loan is not subject to an additional net worth requirement.

⁵ In Release 6862, the commission also adopted amendments to Rules 144 and 145 to allow holders of securities to satisfy the holding period requirements of Rules 144 and 145 by “tacking” (or adding on) the period of time that prior holders of the securities in question who are unaffiliated with the issuer held those securities. This change was intended to increase the liquidity of the secondary markets for restricted securities by permitting Rule 144A securities traded by non-affiliates to be sold into the retail market sooner than had been permitted previously. In addition, resales of securities under Rule 144A are not included in determining the amount of securities that can be sold in compliance with the volume limitations of Rule 144(e).

- (g) Purchases by an insurance company for separate accounts that are not required to be registered under the Investment Company Act of 1940 are treated as purchases for the account of the insurance company.

3. REASONABLE BELIEF

The sellers and their agents need only possess a reasonable belief that the buyer is a QIB. Rule 144A permits sellers to rely, on a non-exclusive basis, on material filed with the Commission and information in financial statements or other material filed with any United States federal, state or local governmental agency, self-regulatory agency, or a foreign governmental agency or self-regulatory organization. Information contained in a “recognized securities manual” affords a per se reasonable basis for belief of eligibility of an institution for Rule 144A. Examples are S&P’s Corporation Records, Moody’s publications, and Best’s Insurance Reports. S&P now publishes a list of QIBs. See *Standard & Poor’s* (letter available July 8, 1991).

B. EXCLUSION OF FUNGIBLE SECURITIES

In order to prevent development of side-by-side public and private markets for the same class of securities, Rule 144A expressly excludes the offer or sale of (i) “fungible” securities that, when originally issued, were of the same class as securities listed on a national securities exchange or quoted in an automated inter-dealer quotation system (not including “pink sheet” quotations) or (ii) securities of open-end investment companies, unit trusts, and face-amount certificate companies registered or required to register under the Investment Company Act of 1940. Eligibility for resale is determined at the time of issuance, thereby retaining the eligibility of securities privately placed before an issuer went public. Any resulting side-by-side market, however, is limited by Rule 144(k), which permits privately placed securities to flow into the public market only two years after issuance.

C. NOTIFICATION TO BUYERS

The seller is required to take “reasonable steps” to ensure that the purchaser is aware that the seller is relying on Rule 144A to sell unregistered securities. This notice is usually given by placing disclosure in the confirmation of sale and in the offering memorandum (typically, on the cover page and in a section called “Notice to Investors” which provides transfer restrictions applicable to the securities), and by assigning a unique identifying number (called a CUSIP number) for the clearance and settlement of the Rule 144A securities to distinguish them from unrestricted securities and from other restricted securities that are not Rule 144A eligible, such as securities sold under Regulation S.

Although the use of restrictive legends is not required by Rule 144A, it is common to place restrictive legends on the securities stating that they are restricted securities and subject to resale restrictions, have not been registered under the Securities Act; and may not be offered or sold in the US without registration or an applicable exemption from registration.

Restrictive legends, however, may not provide the required notice if the securities clear, settle and trade in book-entry form in an electronic depository (such as The Depository Trust Company (DTC) in the US, and Euroclear and Clearstream in Europe) through which members (known as participants) trade their beneficial interests in the securities, since the QIB purchasers never see the actual securities.

D. PROVISION OF INFORMATION BY NON-REPORTING ISSUERS

If the issuer is not a reporting company under the 1934 Act, a foreign issuer exempt from 1934 Act reporting under Rule 12g3-2(b), or a foreign government issuer eligible to register securities under the 1933 Act on Schedule B, Rule 144A obligates the issuer to provide investors with certain reasonable, current, basic business and financial information – in effect, sponsoring its shares for Rule 144A eligibility. A holder and a buyer must have the right to request such information from the issuer upon their request. If the buyer requests the information, the buyer must actually have received the information at or prior to the time of sale. The issuer's obligation may be contractual (as part of the security or otherwise), or may arise under laws or the rules of self-regulatory organizations (*e.g.*, the NASD's rules for PORTAL).

This information requirement can make sellers and issuers reluctant to rely upon Rule 144A. Foreign issuers that have not previously submitted home country information to the Commission pursuant to Rule 12g3-2(b) or filed 1934 Act reports have been particularly slow to avail themselves of Rule 144A.

E. LIMITATIONS ON GENERAL SOLICITATION.

Prior to the adoption of the Jumpstart Our Business Startups Act ("JOBS Act"), Rule 144A was presumed, as a matter of practice, to prohibit general solicitation or advertising, to ensure that offers were not made to non-QIBs and to protect the issuer's private placement exemption for the initial offer and sale of the securities. Under the JOBS Act, the Commission is required to adopt rules that will permit general solicitation and public advertising in both Reg D and Rule 144A offerings, so long as the securities are sold only to persons who the seller reasonably believes are accredited (in a Reg D offering) or are QIBs (in a 144A offering). The Commission proposed rules on August 29, 2012 (Rel. 2012-170), but they have not been adopted as of the date of this outline.

F. INTEGRATION

Under the doctrine of integration, an issuer conducting a private placement under Section 4(a)(2) or Regulation D must consider whether concurrent or subsequent offerings are part of the same financing plan, which should be viewed together as one offering, in which case the Reg D exemption may be lost. However, Rule 144A(e) provides that a Rule 144A offering does not affect the availability of any exemptions for previous or subsequent offerings (whether made by the issuer or a holder of the securities). A 144A resale therefore will not impair the private placement exemption for the issuer's original issuance of the securities. In addition, Preliminary Note 7 of Rule 144A specifically contemplates that a buyer may purchase securities from an issuer for the purpose of reselling them under Rule 144A, and indicates that this will not affect the availability of the issuer's private placement exemption.

G. SECURITIES OF NON-REPORTING FOREIGN ISSUERS

In Release 33-6806, the Commission expressed concerns about securities of non-reporting foreign issuers flowing into the U.S. retail market without adequate information being publicly available. The Commission thus raised the possibility of repealing or modifying Rule 12g3-2(b), which is used by more than 1400 foreign issuers. The Commission's concern resulted in part because it also proposed in Release 33-6806 to revise Rule 144 to permit investors to "tack" (or add together) their holding periods for purposes of satisfying the holding period requirements of Rule 144. However, to date the Commission has not taken any action to repeal or modify Rule 12g3-2(b).

H. COMPLIANCE WITH OTHER LAWS

Rule 144A does not affect the need to comply with applicable state law, nor does it affect the applicability of federal and state anti-fraud or anti-manipulation laws. The Commission, however, has provided a blanket exemption from the anti-manipulation provisions of Rules 10b-6 and 10b-7 under the Securities Exchange Act of 1934 (the "1934 Act") for stabilization transactions conducted on certain markets in connection with international offerings by world class issuers involving a Rule 144A tranche, and has granted others relief on a case-by-case basis. See Securities Industry Ass'n. (letter available April 25, 1991).