



## Offers, Sales and Resales of Securities and General Solicitation under Section 4(a)(1-1/2), Rule 144A, and the New Section 4(a)(7)

.....



### Robert Robbins

is a Partner with Pillsbury Winthrop Shaw Pittman LLP, in Washington, D.C. He is the leader of the law firm's Corporate & Securities practice, which provides services from offices in New York, San Francisco, Washington, DC, Houston, Los Angeles, San Diego, London, Tokyo, Shanghai and Abu Dhabi. His practice involves the legal aspects of securities offerings, mergers, acquisitions and restructurings, investment management and private investment funds, and advisory services to boards of directors and committees of independent directors. Mr. Robbins is an adjunct professor of securities law at the University of Maryland Law School. He has published widely on securities law topics and has served since 1991 as co-chair of the annual three-day course of study, "Private Placements and Regulation D," sponsored by The American Law Institute Continuing Legal Education Group (ALI CLE) (formerly known as ALI-ABA). He also has served for many years on the faculty of the annual ALI CLE two-day course of study, "Fundamentals of Securities Regulation." He is a former chair of the steering committee of the DC Bar Section on Corporation Finance and Securities Law, and former chair of the Section's Committee on Broker-Dealer Regulation.

### Robert B. Robbins

**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, after 2012 the amendments to the 1933 Act, “4(a)(1-1/2”).

### **Resales of Restricted Securities under Section 4(a)(1-1/2)**

It is generally considered that for a resale to be private for purposes of section 4(a)(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(a)(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.<sup>1</sup>

**BACKGROUND OF RULE 144A** • While as a general matter practitioners may appreciate their ability to interpret section 4(a)(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(a)(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(a)(1) of the 1933 Act, thereby eliminating underwriter liability and making available the exemption from the registration

<sup>1</sup> See, e.g., *The Section ‘4(1-1/2)’ Phenomenon: Private Resales of “Restricted” Securities*, 34 Bus. Law. 1961 (1979); Christopher Dean Olander & Margaret Stevens 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); Patricia E. Lockary, Comment, *Reinterpreting the “Section 4(1-1/2)” Exemption from Securities Registration: The Investor Protection Requirement*, 16 U.S.F. L. Rev. 681 (1982); Carl W. Schneider, *Section 4(1-1/2)—Private Resales of Restricted or Control Securities*, 49 Ohio St. L. J. 501 (Spring 1988).

requirements of the 1933 Act provided by Section 4(a)(1) for transactions by any person other than an issuer, underwriter or dealer.<sup>2</sup>

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.<sup>3</sup> It was a thorough success. Hundreds of billions of dollars of securities are sold in 144A transactions each year.<sup>4</sup>

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).

## **OPERATIVE PROVISIONS OF RULE 144A**

- The operative provisions of Rule 144A are: Qualified Institutional Buyer, Reasonable Belief, Exclusion of Fungible Securities, Notification to Buyers, Provision of Information by Non-Reporting Issuers, General Solicitation, Integration,

### **Qualified Institutional Buyer**

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

<sup>2</sup> 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.

<sup>3</sup> Release No. 33-6862, 55 Fed. Reg. 17,933 (April 30, 1990) (“Release 6862”)

<sup>4</sup> 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.

to individuals cannot be made in reliance upon the Rule.<sup>5</sup>

### **Portfolio Test**

In determining whether an entity has a \$100 million portfolio of securities:

- Institutions may aggregate proprietary assets and discretionary assets under management;
- Investment companies that are part of a “family of funds” may aggregate the invested assets of the family;
- Companies with multiple subsidiaries that report on a consolidated basis may aggregate the securities of their wholly-owned subsidiaries;
- Entities formed solely for the purpose of satisfying the \$100 million test are eligible, as are entities all of whose equity owners are QIBs;
- 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; and
- An affiliate of a bank or a savings and loan is not subject to an additional net worth requirement.
- 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.

### **Reasonable Belief**

<sup>5</sup> 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(c).

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).

### **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.

### **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.

### **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.

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.

### **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.

In July 2013, the SEC adopted final rules under the JOBS Act removing the ban against general solicitation and general advertising in private offerings made in reliance on Rule 144A and Rule 506 of Regulation D. The amendments to Rule 506 permit an issuer to use general solicitation or general advertising, as long as all purchasers are accredited investors and the issuer takes “reasonable steps” to verify that the purchasers are accredited investors. The amendments to Rule 144A permit offers of securities to persons other than qualified institutional buyers (“QIBs”), provided that the securities are sold only to persons reasonably believed to be QIBs. 144A offerings may therefore be made to the public by means of public advertising or general solicitation, so long as sales are made only to QIBs.

While resales under 4(a)(1-1/2) and resales under Rule 144A may be similar in concept, there is no basis to believe that general solicitation can be employed in a 4(a)(1-1/2) offering. The SEC made clear, in permitting general solicitation in some Rule 506 offerings, that general solicitation is not permitted in other Rule 506 offerings, or in offerings made under 4(a)(2). Because a Section 4(a)(1-1/2) offering must be based on a good 4(a)

(2) offering, offerings under 4(a)(1-1/2) should be conducted consistently with a private offering that complies with Section 4(a)(2). As a result, Section 4(1-1/2) offerings should continue to rely on the procedures and restrictions consistent with Section 4(a)(2) offerings.

### **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.

### **Securities of Non-Reporting Foreign Issuers**

In SEC Release No. 33-6806, 1988 WL 1024389 (Oct. 25, 1988), 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).

### **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).

### **NEW STATUTORY EXEMPTION FOR PRIVATE REALES – SECTION 4(A)**

(7) • The so-called "Fixing America's Surface Transportation Act" or "FAST Act" was signed into law on December 4, 2015. The legislation included changes to the JOBS Act and the Securities Act of 1933 that, among other things, add a statutory exemption for private resales of restricted and control securities.

The FAST Act adds Section 4(a)(7) to the Securities Act, granting a statutory exemption for resale transactions in restricted and control securities subject to certain conditions. Up until now, affiliates of the issuer have lacked a clear exemption to permit unlimited resale transactions.<sup>6</sup>

<sup>6</sup> As noted above, Section 4(a)(1) exempts resale transactions by "any person other than an issuer, underwriter, or dealer." Section 4(a)(2) exempts transactions by "an issuer not involving any public offering." Because of the broad definition of underwriter, affiliates are often not covered by Section 4(a)(1), and they are excluded from Section 4(a)(2). Rule 144 under the Securities Act allows limited resales by affiliates (and non-affiliates) of the issuer subject to holding periods and other limitations. The "Section 4(a)(1½) exemption" has

The new statutory exemption under the Section 4(a)(7) will bring certainty to the resale transactions that up until now have been exempted under Section 4(a)(1½). The Section 4(a)(7) exemption will apply so long as the following requirements are met:

- Each purchaser must be an accredited investor (as defined in Rule 501(a) under the Securities Act);
- Neither the seller nor any agent of the seller can make any general solicitation or general advertising in order to offer or sell the securities;
- If the securities being sold are those of a non-reporting issuer (with limited exceptions, e.g. foreign governments), the seller must obtain, upon request to the issuer, and provide to the prospective purchaser, certain information, including:
  - the name of the issuer (and any predecessor);
  - the address of the issuer's principal executive offices;
  - the title and class of the securities;
  - the par or stated value of the securities;
  - the number of shares or total amount of the securities outstanding as of the end of the issuer's most recent fiscal year;
  - the name and address of the person responsible for transferring shares and stock certificates;
  - a statement of the nature of the business of the issuer, and the products and services it offers, made within 12 months before the transaction;
- the names of the officers and directors of the issuer;
- the names of any person acting as a broker, dealer or agent that will be paid any commission or remuneration for such person's participation in the offer or sale of the securities;
- certain financial statements of the issuer, including the issuer's most recent balance sheet and profit and loss statement for the two preceding fiscal years; and
- if the seller is a control person with respect to the issuer, a 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 securities laws;
- The sale cannot involve securities for which the seller is the issuer or a subsidiary, either directly or indirectly, of the issuer;
- The seller or any person that has been or will be paid any commission or remuneration for their participation in the offer or sale of the securities must not be subject to disqualification as a bad actor under Rule 506(d)(1) of Regulation D under the Securities Act or subject to disqualification under Section 3(a)(39) of the Exchange Act;
- The issuer must be engaged in business, must not be in the organizational stage, in bankruptcy or receivership, and cannot be a blank check, blind pool or shell company that is only to be used for a merger or an acquisition;
- The transaction does not involve a security that constitutes all or part of an unsold allotment to or subscription by a broker or dealer acting as an underwriter of the security or a redistribution; and
- The class of securities being sold has been authorized and outstanding for at least 90 days before the date of the transaction.

---

been accepted as allowing for limited resales of restricted securities in private transactions without the holding period requirement of Rule 144. This exemption rests on the theory that the resale of privately placed securities to an investor that could have been made under Section 4(a)(2) in the original private sale by the issuer should not be deemed a new distribution and should be exempt from registration if the new investor, who is purchasing the same securities from the original purchaser in a private transaction, will be subject to the same restrictions imposed on the original purchaser.

Securities sold under Section 4(a)(7) will be “covered securities” under the Securities Act and accordingly will generally be exempt from state “blue sky” regulation. Additionally, securities acquired under the Section 4(a)(7) exemption will be deemed to have been acquired in a transaction not involving a public offering and the transaction will be deemed not to be a distribution for purposes of Section 2(a)(11) of the Securities Act. This is particularly important for sellers or placement agents, who can avoid concerns about potential

underwriter liability. Finally, the securities sold pursuant to Section 4(a)(7) will be deemed restricted securities under Rule 144 under the Securities Act.

Section 4(a)(7) also makes clear that it is not the exclusive means of effecting a resale of a restricted security. Accordingly, resale transactions may continue to be undertaken under the Section 4(a)(1½) exemption set forth above, which may continue to be particularly useful in the case of resales of securities of private companies that lack sufficient financial information.

**To purchase the online version of this article—or any other article in this publication—go to [www.ali-cle.org](http://www.ali-cle.org) and click on “Publications.”**