

The Application and Effectiveness of SEC Rule 144

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INTRODUCTION

The purpose of this Article is to examine the effectiveness from both an analytical and public policy perspective of rule 144¹ promulgated by the Securities and Exchange Commission (SEC) under the Securities Act of 1933 (the Securities Act).² Generally, when the provisions of the rule are complied with, a safe harbor from liability exists under the registration provisions of the Securities Act,³ thereby permitting the public sale in ordinary trading transactions of limited amounts of securities⁴ owned by persons controlling, controlled by, or under common control with⁵ the issuer (*i.e.*, "affiliates"),⁶ and by other persons who have acquired "restricted securities" of the issuer.⁷ By confining its safe harbor in this manner, the rule may have the practical effect of limiting the development of public markets in securities of issuers when adequate public information is not available.⁸

Hence, rule 144 exempts from the Securities Act's registration mandates certain resale transactions that are engaged in by: (1) persons who have acquired securities from either the issuer or an affiliate of the issuer in a transaction not involving a public offering ("restricted securities"); (2) persons who are deemed to be "affiliates" of the issuer at the time they propose to resell any securities of the issuer; and (3) brokers who effect transactions in compliance with the rule.⁹ The safe harbor derived from rule 144 is useful to the functioning of the securities markets. Absent the availability of an exemption, all offers or sales of securities must be registered pursuant to section 5 of the Securities Act.¹⁰ The exemptions normally available in the resale context are section 4(1)¹¹ for sellers and section 4(4)¹² for brokers. The

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1. 17 C.F.R. § 230.144 (1987). For a comprehensive treatment of rule 144, see D. GOLDWASSER, A GUIDE TO RULE 144 (2d ed. 1978); 7B J.W. HICKS, EXEMPTED TRANSACTIONS UNDER THE SECURITIES ACT OF 1933 (1987) [hereinafter J.W. HICKS].

2. 48 Stat. 74 (1933) (codified as amended at 15 U.S.C. §§ 77a-77aa (1982)).

3. See Preliminary Note to Rule 144, 17 C.F.R. § 230.144 (1987).

4. For discussion of these requirements, see *infra* notes 69-84, 121-79 and accompanying text.

5. For the definition of the term "control," see 17 C.F.R. § 230.405 (1987); *infra* notes 212-17 and accompanying text.

6. See 17 C.F.R. § 230.144(a) (1987). Hence, rule 144 accords different treatment to affiliates as compared to nonaffiliates. See, *e.g.*, *infra* notes 15-30 and accompanying text.

7. For the definition of the term "restricted securities," see 17 C.F.R. § 230.144(a)(3) (1987).

8. See Preliminary Note to Rule 144, 17 C.F.R. § 230.144 (1987).

9. *Id.*

10. See 15 U.S.C. § 77e (1982).

11. 15 U.S.C. § 77d(1) (1982).

12. *Id.* § 77d(4). See also the § 4(3) exemption, *id.* § 77d(3).

application of these exemptions under a given set of conditions, however, may be problematic.¹³ By creating a safe harbor for perfecting these exemptions, rule 144 seeks to provide greater clarity in this area, without sacrificing investor protection.¹⁴

I. THE GENERAL APPLICATION OF RULE 144

The person who has acquired "restricted securities" from an issuer or an issuer's affiliate often has obtained the securities either pursuant to section 4(2) of the Securities Act, which exempts from the registration requirements "transactions by an issuer not involving any public offering,"¹⁵ or pursuant to rule 505¹⁶ or rule 506¹⁷ of regulation D.¹⁸ One problem is that when an issuer sells unregistered securities to one or more persons in a nonpublic transaction, it is possible that the transfer is in reality a disguised public offering—a two-step, indirect distribution in which the transferees function as "underwriters" for the issuer.¹⁹ An affiliate of the issuer faces a similar problem—because of his or her close connection with the issuer, an affiliate may be unable to invoke the section 4(1) exemption in any resale transaction involving securities of the issuer.²⁰

If a person is deemed to be an "underwriter," he or she cannot rely on the exemption from registration provided by section 4(1) of the Securities Act to protect the resale transaction. Generally, although section 4(1) exempts ordinary transactions such as a private resale of securities, it does so only with respect to "transactions by any person other than an issuer, *underwriter* or dealer."²¹ The dilemma for persons holding restricted securities of an issuer and for affiliates of an issuer comes into

13. See, e.g., *United States v. Wolfson*, 405 F.2d 779 (2d Cir. 1968), *cert. denied*, 394 U.S. 946 (1969); *SEC v. Guild Films Co.*, 279 F.2d 485 (2d Cir.), *cert. denied*, 364 U.S. 819 (1960); *Gilligan, Will & Co. v. SEC*, 267 F.2d 461 (2d Cir.), *cert. denied*, 361 U.S. 896 (1959); *In re Ira Haupt & Co.*, 23 S.E.C. 589 (1946).

14. See Pollock, *Resale of Restricted Securities (And Other Securities Owned by Affiliates) Under SEC Rule 144*, 46 C.P.S. (BNA) (1986); Fogelson, *Rule 144—A Summary Review*, 37 BUS. LAW. 1519 (1982).

15. 15 U.S.C. § 77d(2) (1982).

16. 17 C.F.R. § 230.505 (1987). Rule 505 was promulgated by the SEC pursuant to the § 3(b) exemption. See 15 U.S.C. § 77c(b) (1982).

17. 17 C.F.R. § 230.506 (1987). Rule 506 is a safe harbor for the § 4(2) private offering exemption. See 15 U.S.C. § 77d(2) (1982).

18. For discussion of regulation D, see Regulation D—Revision of Certain Exemptions for Transactions Involving Limited Offers and Sales, Securities Act Release No. 6389, [1981–1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,106 (Mar. 8, 1982); M. STEINBERG, SECURITIES REGULATION 118–39 (1986) (and sources cited therein) [hereinafter STEINBERG]. See also rule 701, 17 C.F.R. § 230.701, adopted by the SEC in Securities Act Release No. 6768, [1987–1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,231 (Apr. 14, 1988). In the release adopting rule 701, which provides an exemption from the Securities Act's registration requirements for offers and sales of securities pursuant to certain compensatory benefits plans or written contracts, the Commission stated:

To obviate any confusion that might result from a reference to the "non-public" offering exemption in a rule which permits public offerings, Rule 701 securities have been defined to be "restricted securities" for purposes of Rule 144 and may be resold if the terms of that rule are fully complied with, including the holding period, notwithstanding that the offering may not be a private placement. The issuer's obligation to ensure that no improper distribution of these securities occurs without registration or appropriate exemption is now specified in the text of the Rule. When an issuer becomes subject to the reporting provisions of the Exchange Act, shares acquired in Rule 701 transactions may be resold 90 days thereafter without compliance with paragraphs (c), (d), (e) and (h) of Rule 144 if the person is not an affiliate of the issuer or under Rule 144 without compliance with paragraph (d), if an affiliate.

19. See Preliminary Note to Rule 144, 17 C.F.R. § 230.144 (1987).

20. *Id.* See also Notice of Adoption of Rule 144, Securities Act Release No. 5223, [1971–1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,487 (Jan. 11, 1972) [hereinafter Securities Act Release No. 5223].

21. 15 U.S.C. § 77d(1) (1982) (emphasis supplied).

focus upon examining the statutory definition of “underwriter.” Section 2(11) of the Securities Act defines an “underwriter” to include any person who “has purchased” securities from an issuer “with a view to . . . the distribution of any security.”²²

Section 2(11) does not provide an objective standard for determining whether a person acquiring securities from an issuer is taking with a view toward investment or with a view toward resale.²³ For an affiliate or nonaffiliate holding restricted securities, a resale in reliance upon section 4(1) carries the risk that the seller will be deemed an “underwriter” within the meaning of section 2(11), and, therefore, be unable to claim the desired exemption.²⁴ For an affiliate who intends to sell publicly non-restricted securities of the issuer, the risk is that the section 4(1) exemption would be denied because the person who purchases from or sells for an affiliate with a view to distribute would be deemed a statutory underwriter. Moreover, the presence of a distribution necessarily renders the transaction-based section 4(1) exemption unavailable.²⁵ In sum, provided that the requirements of rule 144 are met, the rule provides a safe harbor under section 4(1) to persons disposing of restricted securities of an issuer and to affiliates of an issuer who seek to resell their non-restricted securities.²⁶

Generally, rule 144 treats similarly the two categories of prospective sellers covered by the rule. There are, however, two important differences. First, the rule applies to affiliates of an issuer regardless of whether the securities are restricted or unrestricted.²⁷ On the other hand, in order for a nonaffiliate to claim rule 144’s safe harbor, the securities at issue must be restricted.²⁸ Hence, rule 144 is not applicable to nonaffiliates who wish to sell unrestricted securities. As discussed later, however, it may well be that nonaffiliates may be permitted to sell unrestricted stock without limitation under the section 4(1) exemption.²⁹ The second difference is found in paragraph (k) of the rule which lifts certain restrictions on nonaffiliates only, provided certain specified conditions are met.³⁰

22. *Id.* § 77b(11).

23. See 7B J.W. HICKS, *supra* note 1, at § 10.01[1]; L. LOSS, *FUNDAMENTALS OF SECURITIES REGULATION* 252–68 (2d ed. 1988).

24. See T. HAZEN, *THE LAW OF SECURITIES REGULATION* 140–49 (1985).

25. See *SEC v. Holschuh*, 694 F.2d 130, 137–38 (7th Cir. 1982); *SEC v. Murphy*, 626 F.2d 633, 648 (9th Cir. 1980); *United States v. Wolfson*, 405 F.2d 779 (2d Cir. 1968); *In re Ira Haupt & Co.*, 23 S.E.C. 589 (1946). See also T. HAZEN, *supra* note 24, at 148–49.

26. Rule 144(b) provides:

Any affiliate or other person who sells restricted securities of an issuer for his own account, or any person who sells restricted or any other securities for the account of an affiliate of the issuer of such securities, shall be deemed not to be engaged in a distribution of such securities and therefore not to be an underwriter thereof within the meaning of section 2(11) of the Act if all conditions of this section are met.

17 C.F.R. § 230.144(b) (1987). Although rule 144 provides a safe harbor and is not exclusive, see *id.* § 230.144(j), it may be the case that “reliance on non-rule 144 precedent will impose ‘a strong burden’ on the person claiming the exemption.” T. HAZEN, *supra* note 24, at 153 (quoting Securities Act Release No. 5223, *supra* note 20).

27. See 17 C.F.R. § 230.144(b) (1987).

28. *Id.*

29. See *Resales of Restricted and Other Securities*, Securities Act Release No. 6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H (Aug. 2, 1979) [hereinafter *Securities Act Release No. 6099*]; see *infra* notes 218–30 and accompanying text.

30. 17 C.F.R. § 230.144(k) (1987). See *infra* notes 192–217 and accompanying text.

II. HISTORICAL BACKGROUND

Historically, a nonaffiliate who acquired securities pursuant to a section 4(2) private placement exemption was not thereafter precluded from reselling the securities.³¹ Yet, certain conditions were placed on these resales. For example, a nonaffiliate holding restricted securities possibly could resell the securities after a substantial holding period of two or three years. Moreover, nonaffiliates, who acquired restricted securities allegedly for investment, could resell them pursuant to section 4(1), notwithstanding a relatively recent acquisition date, if the seller could demonstrate a "change of circumstances."³² Nonetheless, since the burden of proving the perfection of an exemption is upon the seller,³³ prudent parties exercised utmost caution when disposing of their securities without registration.³⁴

The situation for affiliates and broker-dealers who executed orders to sell securities for the account of affiliates was even more onerous. As a result of the SEC's 1946 administrative proceeding in *In re Ira Haupt & Co.*,³⁵ it was difficult for a broker to determine whether an affiliate, when disposing of stock, was engaging in a "distribution" of the issuer's securities within the meaning of section 2(11).³⁶ The confusion that broker-dealers faced led the SEC to adopt rule 154 in 1951.³⁷ Unfortunately, rule 154 was of limited value because it was designed for brokers and offered no protection to those persons on behalf of whom the sale was executed.³⁸

After extensive analysis, the Wheat Report was issued in 1969.³⁹ The Report recommended a series of rules that sought to clarify the circumstances under which an affiliate or a nonaffiliate could rely upon section 4(1) for resale transactions.⁴⁰ In 1970, the SEC substituted a single proposed rule as an alternative to the series recommended by the Wheat Report.⁴¹ Proposed rule 144 was designed to continue the SEC's efforts to provide objective standards with respect to the availability of the

31. See, e.g., *Fuller v. Gilbert*, 244 F. Supp. 196 (S.D.N.Y. 1965), *aff'd sub nom. Righter v. Gilbert*, 358 F.2d 305 (2d Cir. 1966); *United States v. Sherwood*, 175 F. Supp. 480 (S.D.N.Y. 1959).

32. See *G. Eugene England Found. v. First Fed. Corp.*, [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,837 (10th Cir. 1973). In promulgating rule 144, the SEC sought to abolish the "change in circumstances" defense. See Securities Act Release No. 5223, *supra* note 20. One may question, however, whether the SEC has the authority to take this action, given that the defense has been judicially recognized. See *T. HAZEN*, *supra* note 24, at 146-47; *M. STEINBERG*, *supra* note 18, at 276-77.

33. See, e.g., *SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953); *Lawler v. Gilliam*, 569 F.2d 1283 (4th Cir. 1978).

34. See *M. STEINBERG*, *supra* note 18, at 272-92.

35. 23 S.E.C. 589 (1946).

36. See *M. STEINBERG*, *supra* note 18, at 290-92.

37. See Adoption of Rule 154, Securities Act Release No. 3421, 1 Fed. Sec. L. Rep. (CCH) ¶ 2985.66 (Aug. 2, 1951), as amended by Amendment of Rule 154, Securities Act Release No. 3525, 1 Fed. Sec. L. Rep. (CCH) ¶ 2985.61 (Dec. 22, 1954).

38. See 2 S. GOLDBERG, PRIVATE PLACEMENTS AND RESTRICTED SECURITIES § 7.1 (1982); 7B J.W. HICKS, *supra* note 1, at § 10.02[1].

39. See U.S. SECURITIES AND EXCHANGE COMM'N, DISCLOSURE TO INVESTORS—A REAPPRAISAL OF FEDERAL ADMINISTRATIVE POLICIES UNDER THE '33 AND '34 ACTS (1969).

40. See *id.* at 182-220. See also 7B J.W. HICKS, *supra* note 1, at § 10.02[2].

41. See Notice of Proposed Rule 144, Securities Act Release No. 5087, [1970-1971 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,909 (Sept. 22, 1970).

section 4(1) exemption.⁴² Finally, after lively debate and extensive public comments and suggestions, the final version of rule 144 was adopted in 1972.⁴³

III. STRUCTURE AND SCOPE OF RULE 144

Rule 144 consists of a Preliminary Note and eleven separate paragraphs, setting forth the terms and conditions of the rule. When a seller meets all of the conditions of the rule, he or she may dispose of securities without compliance with the Securities Act's registration requirements. Under these circumstances, a seller will not be deemed an underwriter, hence making available the section 4(1) exemption, and a broker will be able to invoke the section 4(4) exemption.⁴⁴

Rule 144, being a safe harbor to the exemptions in section 4(1) and section 4(4), is "transactional" in nature. Hence, the presence of a "distribution" necessarily renders any exemptions (and the safe harbor thereto) unavailable.⁴⁵ In the Preliminary Note to rule 144, the SEC discusses three factors that are to be considered in determining whether or not a person is engaged in a distribution. First, since a major policy of the Securities Act is to protect investors by assuring that their decisions are informed, adequate current public information concerning the issuer must be available before securities can be resold without compliance with the registration provisions of the Act.⁴⁶ Second, in order to insure that the person wishing to sell restricted securities is neither acting as an underwriter nor participating in a distribution, a holding period is required to guarantee that the person has assumed the economic risks of investment.⁴⁷ Third, to minimize the impact on the trading markets of a mass resale of an issuer's securities, volume limitation requirements are imposed.⁴⁸

Turning to the provisions of rule 144, paragraph (a) defines the terms "affiliate," "person," and "restricted securities" as used in the rule.⁴⁹ Paragraph (b) describes the two types of sellers that may rely upon the safe harbor of the rule: any person who sells restricted securities of an issuer for his or her own account, and any person who sells restricted or any other securities for the account of an affiliate of the issuer.⁵⁰ Paragraph (c) is particularly important. It states that adequate current public information about the issuer must be available before the rule can be used for resales of the issuer's securities. It distinguishes between reporting and nonreporting companies under the Securities Exchange Act of 1934 (Exchange Act)⁵¹ for purposes

42. *Id.* See also 7B J.W. HICKS, *supra* note 1, at § 10.02[2].

43. See Securities Act Release No. 5223, *supra* note 20.

44. See 17 C.F.R. § 230.144(b) (1987).

45. See cases cited *supra* note 25; Ash, *Resales of Restricted & Control Securities Under the Federal Securities Laws*, in 11 H. SOWARDS, *FEDERAL SECURITIES ACT*, § 6B.01 (1987); Gilroy & Kaufmann, *Rule 144*, in 2 A.A. SOMMER, *SECURITIES LAW TECHNIQUES* § 38.01 (1987).

46. See Preliminary Note to Rule 144, 17 C.F.R. § 230.144 (1987). The SEC has abandoned this requirement, however, for nonaffiliates who seek to sell restricted stock after a three-year holding period. See 17 C.F.R. § 230.144(k) (1987); see also *infra* notes 192-217 and accompanying text.

47. See Preliminary Note to Rule 144, 17 C.F.R. § 230.144 (1987).

48. See *id.*

49. *Id.* § 230.144(a).

50. *Id.* § 230.144(b).

51. 48 Stat. 881 (1934) (codified as amended at 15 U.S.C. §§ 78a-78kk (1982)). See also rule 15c2-11, 17 C.F.R.

of defining the information that must be available and also provides a way for the noncontrolling investor to rely on information of an issuer who is not willing to supply certain information.⁵²

Paragraph (d) requires restricted securities to be beneficially owned for a period of at least two years prior to the date of the resale transaction. If the restricted securities were acquired by a purchase transaction, full consideration must be given before the holding period begins to run.⁵³ Paragraph (e) limits the amount of securities that may be sold within a three-month period pursuant to the rule.⁵⁴ Paragraph (f) provides that the manner of sale must be a "broker's transaction,"⁵⁵ a term that is defined in paragraph (g).⁵⁶

When the number of securities to be sold exceeds 500 or the aggregate selling price will be greater than \$10,000, paragraph (h) imposes a filing obligation.⁵⁷ Paragraph (i) provides that any person filing under paragraph (h) must have a bona fide intention to actually sell the securities within a reasonable time after the date of filing.⁵⁸

Paragraph (j) states that rule 144 is not the exclusive method of resale for affiliates or nonaffiliates, and that the existence of the rule does not eliminate or otherwise affect the availability of any exemption for resales that is otherwise available.⁵⁹ Finally, paragraph (k) exempts certain sales of restricted securities by nonaffiliates from the requirements of paragraphs (c), (e), (f), and (h) of the rule when the securities to be sold have been beneficially owned for a period of three years or longer.⁶⁰

As discussed above,⁶¹ a nonaffiliate seeking to dispose of stock may sell only restricted securities pursuant to rule 144. The safe harbor of the rule is not applicable to nonaffiliates attempting to sell nonrestricted securities; they must find their exemption in section 4(1).⁶²

If a nonaffiliate wishes to utilize rule 144 for the resale of restricted securities, he or she must comply with the conditions found in paragraphs (c), (d), (e), and (f) as well as paragraphs (h) and (i) when applicable.⁶³

§ 240.15c2-11 (1987) (deeming it a fraudulent, manipulative, and deceptive practice for a broker or dealer, *inter alia*, to publish any quotation for a security or to submit any such quotation for publication in any quotation medium unless such broker or dealer has in its files the issuer's Exchange Act periodic and current reports).

52. 17 C.F.R. § 230.144(c) (1987).

53. *Id.* § 230.144(d).

54. *Id.* § 230.144(e).

55. *Id.* § 230.144(f).

56. *Id.* § 230.144(g).

57. *Id.* § 230.144(h).

58. *Id.* § 230.144(i).

59. *Id.* § 230.144(j). *But see supra* note 26.

60. *Id.* § 230.144(k). *See infra* notes 192-217 and accompanying text.

61. *See supra* notes 28-29 and accompanying text; *see also infra* notes 218-30 and accompanying text.

62. *See Securities Act Release No. 6099, supra* note 29, at item 11 ("[S]ince the seller is no longer an affiliate, the sale of non-restricted securities by him is not subject to Rule 144."); *see also infra* notes 218-30 and accompanying text.

63. 17 C.F.R. § 230.140(c)-(f), (h)-(i) (1987).

On the other hand, an affiliate of the issuer may use the rule for the sale of restricted or unrestricted securities. When an affiliate seeks to sell restricted securities, except for the application of paragraph (k), the sale is subject to the same conditions of the rule that govern a sale by a nonaffiliate.⁶⁴ When an affiliate wishes to rely upon rule 144 for the sale of nonrestricted securities, the holding period requirement of paragraph (d) need not be satisfied.⁶⁵

A. Definitions

Rule 144(a)(3) defines “restricted securities” for the purposes of the rule. It provides:

The term “restricted securities” means 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, or securities acquired from the issuer that are subject to the resale limitations of Regulation D under the Act, or securities that are subject to the resale limitations of Regulation D and are acquired in a transaction or chain of transactions not involving any public offering.⁶⁶

For purposes of rule 144, an “affiliate” of an issuer “is a person that directly or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such issuer.”⁶⁷ The critical moment for determining whether a prospective seller is actually an affiliate of the issuer is normally the time of the resale transaction.⁶⁸

B. Current Public Information

The availability of rule 144 generally is conditioned upon the existence of adequate current public information with respect to the issuer. This requirement, which is for the benefit of the investing public and thus may not be waived by the issuer or the prospective seller, can be satisfied in either of two ways.⁶⁹ First, an issuer, who has been subject to the periodic reporting requirements set forth in section 13 or section 15(d) of the Exchange Act for at least ninety days prior to a sale, must be current in certain specified filings.⁷⁰ Alternatively, an issuer who does not qualify

64. See Division of Corp. Finance's Interpretation of Rule 144, Securities Act Release No. 5306, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,000 (Sept. 26, 1972) [hereinafter Securities Act Release No. 5306].

65. See 17 C.F.R. § 230.144(d) (1987).

66. *Id.* § 230.144(a)(3).

67. *Id.* § 230.144(a)(1).

68. See 7B J.W. HICKS, *supra* note 1, at § 10.05[1][a]. Note that for purposes of rule 144(k), a nonaffiliate must have that status for at least three months prior to the sale. See 17 C.F.R. § 230.144(k) (1987); see also *infra* notes 192-217 and accompanying text.

Rule 144(a)(2), 17 C.F.R. § 230.144(a)(2) (1987), identifies those persons who, because of their close relationship with the prospective seller, are deemed to be the same “person” for the purposes of the rule. Included are: (1) certain relatives of the seller; (2) certain trusts and estates in which the seller and those relatives included in category (1) collectively own 10% or more of the beneficial interest; and (3) corporations or other organizations in which persons in categories (1) or (2), collectively, are the beneficial owners of 10% or more of the equity interest.

69. See Preliminary Note to Rule 144, 17 C.F.R. § 230.144 (1987); *id.* § 230.144(c); 7B J.W. HICKS, *supra* note 1, at § 10.07. But see 17 C.F.R. § 230.144(k) (1987), discussed *infra* notes 192-217 and accompanying text.

70. See 17 C.F.R. § 230.144(c)(1) (1987). See *supra* note 51. If the issuer is a reporting company under the Exchange Act, adequate current public information is deemed to be available if the following conditions are met:

The issuer has securities registered pursuant to section 12 of the Securities Exchange Act of 1934, has been

as an eligible reporting company under the Exchange Act must make certain specified information available to the public.⁷¹

Establishing that an issuer has duly filed all necessary reports under the Exchange Act may be viewed as burdensome for noncontrolling stockholders. Any such burden, however, is largely alleviated by two clauses in rule 144(c)(1).⁷² These clauses protect a seller who relies on a written statement from the issuer representing its compliance with the Exchange Act's reporting requirements during the preceding twelve months, or any such shorter period in which the issuer was required to file reports under section 13 or section 15(d). The statement may appear in "the most recent report, quarterly or annual, required to be filed and filed by the issuer,"⁷³ or elsewhere, such as in response to a specific inquiry.⁷⁴ When the seller in good faith relies on the issuer's representation, the protection of the rule may be invoked despite actual noncompliance with rule 144(c)(1) by the issuer.⁷⁵

If an issuer is a nonreporting company under the Exchange Act, rule 144(c)(2) requires the issuer to make available certain "other public information" in order for the exemption to be claimed.⁷⁶ On a practical level, however, it may be difficult for

subject to the reporting requirements of section 13 of that Act for a period of at least 90 days immediately preceding the sale of the securities and has filed all the reports required to be filed thereunder during the 12 months preceding such sale (or for such shorter period that the issuer was required to file such reports); or has securities registered pursuant to the Securities Act of 1933, has been subject to the reporting requirements of section 15(d) of the Securities Exchange Act of 1934 for a period of at least 90 days immediately preceding the sale of the securities and has filed all the reports required to be filed thereunder during the 12 months preceding such sale (or for such shorter period that the issuer was required to file such reports).

Id. Generally, for a first-time registrant's stock, rule 144 will be available 150 days after the filing of the registration statement. See R. HAFT, ANALYSIS OF KEY SEC NO-ACTION LETTERS 7-13 (1987-88 ed.) (and no-action letters contained therein), citing FilmTec Corp., SEC No-Action Letter (Apr. 12, 1982) (LEXIS, Fedsec library, Noact file); DuFour, Levy, Marx, Lucas & Osborne, SEC No-Action Letter (May 2, 1974) (LEXIS, Fedsec library, Noact file); American Recreation Servs., Inc., SEC No-Action Letter (Mar. 13, 1973) (LEXIS, Fedsec library, Noact file); Associates Int'l, Inc., SEC No-Action Letter (Mar. 9, 1973) (LEXIS, Fedsec library, Noact file). When an issuer obtains an extension of time for filing an Exchange Act report, it is deemed "current" for rule 144(c)(1) purposes once the filing is made. See Project 7, Inc., SEC No-Action Letter, [1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,506 (July 19, 1972); Tidal Marine Int'l Corp., SEC No-Action Letter, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,889 (June 15, 1972). Moreover, rule 144(c)(1)'s requirement may be met upon filing, even if there are subsequent SEC staff letters alleging deficiencies. See First United Financial Corp., SEC No-Action Letter, [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,080 (Nov. 22, 1974); Electronic Transistors Corp., SEC No-Action Letter, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,942 (June 30, 1972). On SEC no-action letter in general, see Lemke, *The SEC No-Action Letter Process*, 42 BUS. LAW. 1019 (1987).

71. See 17 C.F.R. § 230.144(c)(2) (1987); Securities Act Release No. 6099, *supra* note 29, items 17, 18.

72. The person for whose account the securities are to be sold shall be entitled to rely upon a statement in whichever is the most recent report, quarterly or annual, required to be filed and filed by the issuer that such issuer has filed all reports required to be filed by section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the issuer was required to file such reports) and has been subject to such filing requirements for the past 90 days, unless he knows or has reason to believe that the issuer has not complied with such requirements. Such person shall also be entitled to rely upon a written statement from the issuer that it has complied with such reporting requirements unless he knows or has reasons [sic] to believe that the issuer has not complied with such requirements.

17 C.F.R. § 230.144(c)(1) (1987).

73. *Id.*

74. See 7B J.W. Hicks, *supra* note 1, at § 10.07[1][d]. Forms 10-K and 10-Q require registrants to state whether they have filed all the reports required under § 13 or § 15(d) of the Exchange Act during the ninety-day period preceding the date of the annual and quarterly reports, respectively. See General Instructions to Form 10-Q, 4 Fed. Sec. L. Rep. (CCH) ¶ 31,031 (1982); General Instructions to Form 10-K, 4 Fed. Sec. L. Rep. (CCH) ¶ 31,102 (1987).

75. See 17 C.F.R. § 230.144(c)(1) (1987); Gilroy & Kaufmann, *supra* note 45, at § 38.02[1].

76. 17 C.F.R. § 230.144(c)(2) (1987). The term "publicly available" for purposes of rule 144(c)(2) means that

a prospective seller to force an uncooperative issuer to make public this type of information, especially a seller who does not own a controlling block of securities. Nonreporting companies, due to privacy and liability concerns,⁷⁷ understandably are reluctant to disclose information concerning their operations. Often, a minority shareholder, particularly one who is not an affiliate, does not have the leverage to induce the issuer to publicly disclose.⁷⁸ Hence, until fairly recently, a nonaffiliate who acquired restricted securities of a nonreporting company, without a contractual obligation on the company's part to disclose the information specified in rule 144(c), undertook the risk of being locked indefinitely into the investment.⁷⁹ Although the section 4(1) and section "4(1-1/2)" exemptions⁸⁰ were available, their uncertain application left the prospective seller with little comfort.⁸¹

In 1983 the SEC, implicitly viewing the current public information requirement for nonreporting companies as an undue impediment to capital formation,⁸² revised

"[t]he issuer should make the information available on an ongoing and continuous basis (e.g., through the issuance of annual and quarterly reports) to security holders, market makers, financial statistical services, and any other interested persons." Securities Act Release No. 6099, *supra* note 29, item 20. See also Pocon, Inc., SEC No-Action Letter (June 7, 1985) (LEXIS, Fedsec library, Noact file).

The "other public information," as mandated by rule 144(c)(2), is "the information concerning the issuer specified in subdivision (i) to (xiv), inclusive, and subdivision (xvi) of paragraph (a)(4) [sic] of [Rule 15c2-11]" under the Exchange Act. The information that must be disclosed consists of: (1) The exact name of the issuer and its predecessor (if any); (2) The address of its principal executive offices; (3) The state of incorporation, if it is a corporation; (4) The exact title and class of the security; (5) The approximate or stated value of the security; (6) The number of shares or total amount of the securities outstanding as of the end of the issuer's most recent fiscal year; (7) The name and address of the transfer agent; (8) The nature of the issuer's business; (9) The nature of products or services offered; (10) The nature and extent of the issuer's facilities; (11) The name of the chief executive officer and members of the board of directors; (12) The issuer's most recent balance sheet and profit and loss and retained earnings statements; (13) Similar financial information of the issuer or its predecessor for the two preceding fiscal years; (14) Whether the broker or dealer or any associated person is affiliated with the issuer; and (15) Whether the quotation is being submitted or published on behalf of the issuer, or any director, officer, or other person, who is the beneficial owner of more than 10% of the outstanding shares of any equity security of the issuer, and, if so, the name of that person, and the basis for any exemption under the federal securities laws for any sales of such securities on behalf of that person. See 17 C.F.R. § 240.15c2-11(a)(5)(i)-(xiv), (xvi) (1987). See also *supra* note 51.

77. For example, an issuer may not wish to disclose the financial information called for by paragraph (a)(5) of rule 15c2-11 or incur the risk of antifraud liability if a material misrepresentation were to be made. See generally M. STEINBERG, *SECURITIES REGULATION: LIABILITIES AND REMEDIES* (1987). The potential initiation of an SEC or state enforcement action also may be a concern. See generally A. BROMBERG & L. LOWENFELS, *SECURITIES FRAUD AND COMMODITIES FRAUD* (1983); M. STEINBERG & R. FERRARA, *SECURITIES PRACTICE: FEDERAL AND STATE ENFORCEMENT* (1985).

78. See M. STEINBERG, *supra* note 18, at 282-83; see also *infra* notes 212-17 and accompanying text.

79. Provided that a prospective investor has sufficient leverage when purchasing "restricted" securities, he or she will seek a contractual agreement for "piggy-back registration" or "demand registration." Under a demand provision, the holder of the securities has the right to compel the issuer to file a Securities Act registration statement. Under a "piggy-back" arrangement, the holder may include his or her stock (or a portion thereof) at the time that the issuer decides to file a registration statement. Normally, "controlling" persons are the ones who have the leverage to successfully bargain for these provisions. See M. STEINBERG, *supra* note 18, at 289.

80. The section "4(1-1/2)" exemption is an informal exemption premised largely on SEC no-action letters and other official pronouncements. The exemption seeks to protect sales of securities by affiliates as well as sales of restricted stock by nonaffiliates that occur in routine private transactions. See *Employee Benefit Plans*, Securities Act Release No. 6188, 1 Fed. Sec. L. Rep. (CCH) ¶ 1051, at n.178 (Feb. 1, 1980). For further commentary, see 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), also published in *CONTEMPORARY ISSUES IN SECURITIES REGULATION* 151 (M. Steinberg ed. 1988); ABA Committee Report, *The Section "4(1-1/2)" Phenomenon: Private Resales of "Restricted" Securities*, 34 BUS. LAW. 1961 (1979). See also Hicks, *The Concept of Transaction as a Restraint on Resale Limitations*, 49 OHIO ST. L.J. _____ (1988).

81. See Olander & Jacks, *supra* note 80, at 345-47.

82. See Revisions to Rule 144, Securities Act Release No. 6488, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,429 (Sept. 23, 1983) [hereinafter Securities Act Release No. 6488]. For discussion, see *infra* notes 192-217 and accompanying text.

rule 144(k).⁸³ As a result, if the requirements of rule 144(k) are satisfied (*i.e.*, the prospective seller is a nonaffiliate who has held the restricted securities for at least three years prior to the resale transaction), there need not be any current public information concerning the issuer in order for the prospective seller to effect the resale transaction.⁸⁴

C. Holding Period Requirement for Restricted Securities

If the objectives of the Securities Act are to be served, safeguards are needed against the use of private transferees as "underwriters" for the sale of securities to the public without registration. Section 2(11) of the Act defines the term "underwriter" to include any person who "has purchased" securities from the issuer "with a view to . . . the distribution of any security."⁸⁵ This statutory definition may be viewed as inadequate because: (1) it does not by its terms include nonpurchaser transferees; and (2) it does not provide an objective standard for determining whether a person acquiring securities from the issuer is taking with a view toward his or her own investment or with a view toward resale.⁸⁶

The SEC has cured the first purported deficiency by extending the definition to encompass nonpurchase transactions.⁸⁷ The second supposed shortcoming is addressed in rule 144(d), which imposes a mandatory holding period for securities acquired in a nonpublic transaction. During this period the transferee must be subject to the full economic risks of the investment. Significantly, the rule 144(d) holding period requirement applies only to restricted securities, and thus does not apply to affiliates of the issuer who resell nonrestricted securities.⁸⁸

Rule 144(d) contains four subparagraphs. Subparagraph (d)(1) states that restricted securities may be sold pursuant to the rule only if they have been beneficially owned, and, if previously purchased, full consideration has been given for at least two years prior to the sale.⁸⁹ The subparagraph distinguishes between transactions in which the restricted securities were acquired by purchase and those transactions not involving a purchase. If the person for whose account the securities are sold acquired the securities in a nonpurchase transaction, subparagraph (d)(1), subject to the "tacking" provisions contained in subparagraph (d)(4), requires that he

83. Securities Act Release No. 6488, *supra* note 82.

84. 17 C.F.R. § 230.144(k) (1987). *See infra* notes 192-217 and accompanying text.

85. 15 U.S.C. § 77b(11) (1982).

86. *See* Securities Act Release No. 5223, *supra* note 20.

87. *See* 17 C.F.R. § 230.144(a)(3) (1987).

88. *Id.* § 230.144(d). *See* Preliminary Note to Rule 144, *id.* ("[A] § 230.144 holding period prior to resale is essential . . . to assure that those persons who buy [restricted securities] have assumed the economic risks of investment, and therefore are not acting as conduits for sale to the public of unregistered securities, directly or indirectly, on behalf of an issuer.") Moreover, "innocent" holders, who acquired securities in "improper" private placements, such as a placement that failed to comply with the requirements of § 4(2) of regulation D, may nonetheless invoke rule 144. *See* Drilling Co., SEC No-Action Letter (May 18, 1978) (LEXIS, Fedsec library, Noact file); Fluid Power Pump Co., SEC No-Action Letter, [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,875 (Nov. 16, 1976); R. HAFT, *supra* note 70, at 7-8.

89. 17 C.F.R. § 230.144(d)(1) (1987). This two-year holding period requirement is applicable to resales of restricted securities except those by certain members of the following categories: (1) donees; (2) trust beneficiaries; (3) estates of deceased persons; and (4) beneficiaries of estates.

or she "shall have been the beneficial owner of the securities for a period of at least two years prior to the sale."⁹⁰ If the sale involves securities that the owner had previously purchased, subparagraph (d)(1) adds the additional burden of paying, at least two years prior to the sale, "the full purchase price or other consideration."⁹¹

As previously discussed,⁹² the purpose of mandating a two-year holding period is to ensure that the holder of the restricted securities, rather than acting as a conduit for an issuer, is subject to the full economic risks of the investment. This purpose would be seriously undermined if an acquiror of restricted securities could pay for them by a promissory note that did not provide for full recourse in the event of default. Thus, if restricted securities are purchased in exchange for a promissory note, other obligation, or installment contract, subparagraph (d)(2) provides a three-part test that must be satisfied before a purchaser is deemed to have given "the full purchase price or other consideration." Subparagraph (d)(2) of rule 144 states:

Giving the person from whom the securities were purchased a promissory note or other obligation to pay the purchase price, or entering into an installment purchase contract with such person, shall not be deemed full payment of the purchase price unless the promissory note, obligation or contract:

- (i) Provides for full recourse against the purchaser of the securities;
- (ii) Is secured by collateral, other than the securities purchased, having a fair market value at least equal to the purchase price of the securities purchased; and
- (iii) Shall have been discharged by payment in full prior to the sale of the securities.⁹³

A seller who fails to comply with any of the conditions of subparagraph (d)(2) will encounter serious difficulties. Subparagraph (d)(2) tolls the holding period for the time during which the holder does not experience the full economic risks of ownership. For example, if a purchaser of securities gives the seller a promissory note that does not comply with the conditions set forth above, the holding period for the securities will not begin to run until the conditions of subsections (d)(2)(i) and (ii) are satisfied. If the conditions are not satisfied during the life of the note, the holding period does not commence until the note is fully discharged. Moreover, even if both conditions are satisfied and the securities are then held for two years, subsection (d)(2)(iii) provides that the holding period requirement is not met until the note is fully discharged at a time prior to the resale transaction.⁹⁴ A noncomplying note may be cured in order to meet the requirements of subparagraph (d)(2), but the modification does not relate back to the date of the original sale. The holding period will commence when the promissory note, other obligation, or installment contract is modified to meet the requirements.⁹⁵

90. *Id.* § 230.144(d)(1), (d)(4).

91. *Id.* § 230.144(d)(1). *See infra* notes 103–09 and accompanying text. *See also* Securities Act Release No. 6099, *supra* note 29, items 21–36.

92. *See supra* notes 19–26, 48, 53 and accompanying text.

93. 17 C.F.R. § 230.144(d)(2) (1987).

94. *See* Securities Act Release No. 6099, *supra* note 29, item 24.

95. *See id.*, items 25, 28; Rusty Pelican Restaurants, Inc., SEC No-Action Letter (Feb. 25, 1986) (LEXIS, Fedsec library, Noact file); Brooktree Corp., SEC No-Action Letter, [1985–1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,139 (Aug. 22, 1985); McGrath Rentcorp., SEC No-Action Letter (July 9, 1985) (LEXIS, Fedsec library, Noact file); Tolerant Systems, Inc., SEC No-Action Letter, [1984–1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,940 (Apr. 5, 1985); Redken Laboratories, Inc., SEC No-Action Letter, [1972–1973 Transfer Binder] Fed. Sec. L. Rep. (CCH)

While subparagraph (d)(2) of rule 144 provides guidelines for ensuring that the full purchase price of the restricted securities is actually given pursuant to a promissory note or installment contract, the provision is not helpful in determining when other types of consideration will commence the running of the two-year period. For instance, the greatest difficulty has arisen for recipients of restricted securities issued in connection with transactions in which the consideration to be given includes personal services or restricted covenants.⁹⁶

Generally, when some or all of the consideration for the issuance of restricted securities consists of personal services, the two-year holding period does not commence until all of the services have been rendered.⁹⁷ The SEC, however, has altered this position with respect to employee benefit plan participants who receive restricted securities as part of the plan. In these situations, the holding period commences when the securities are allocated to the participant's account.⁹⁸ Unfortunately, it remains unclear whether the SEC's revised position also applies to persons who provide services as consideration for restricted securities not in connection with an employee benefit plan.⁹⁹

Likewise, a transfer of restricted securities might carry with it a restrictive covenant that would authorize the transferor to repurchase the securities from the recipient if the recipient engaged in certain activities. For example, a restriction on competition might require that the recipient forfeit his or her shares in certain circumstances. Such a restriction would cast serious doubt on whether the recipient had fully paid for the shares. On this issue, the SEC has taken the position that a covenant not to compete "standing alone would not constitute additional consideration for the purpose of determining whether the purchase price for the securities has been fully paid for the purposes of Rule 144."¹⁰⁰

Subparagraph (d)(3) of rule 144 serves as an additional means of rigorously enforcing the two-year holding period requirement. It is designed to preclude holders of restricted securities from avoiding the economic risks of ownership during the holding period through the use of a short sale, put, or option.¹⁰¹ Of course, once the holding period requirement has been met pursuant to the other provisions of rule

¶ 79,061 (Sept. 13, 1972). See generally R. HAFT, *supra* note 70, at 7-16 to 7-17; 7B J.W. HICKS, *supra* note 1, at § 10.08[3][a]; Gilroy & Kaufmann, *supra* note 45, at § 38.03[2].

96. See generally 7B J.W. HICKS, *supra* note 1, at § 10.08[2][c][iii].

97. See Ormont Drug & Chem. Co., SEC No-Action Letter (July 29, 1975) (LEXIS, Fedsec library, Noact file).

98. Securities Act Release No. 6099, *supra* note 29, item 22 ("The fact that the securities may not vest until some later date does not alter the result."). See also *supra* note 18.

99. See 7B J.W. HICKS, *supra* note 1, at § 10.08[2][c][iii][A].

100. *Id.* at § 10.08[2][c][iii][B] (quoting Great W. United Corp., SEC No-Action Letter, [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,132, at 85,160 (Jan. 6, 1975)).

101. See 7B J.W. HICKS, *supra* note 1, at § 10.08[4][a]. Paragraph (d)(3) provides:

In computing the 2-year holding period the following periods shall be excluded:

(i) If the securities sold are equity securities, there shall be excluded any period during which the person for whose account they are sold had a short position in, or any put or other option to dispose of, any equity securities of the same class or any securities convertible into securities of such class; and

(ii) If the securities sold are nonconvertible debt securities, there shall be excluded any period during which the person for whose account they are sold had a short position in, or any put or other option to dispose of, any nonconvertible debt securities of the same issuer.

144(d), a short position in, or any put or other option in, the securities would not affect the holding period.¹⁰²

Subparagraph (d)(4) of the rule aids the prospective seller by setting forth specific provisions for determining the period for which the securities have been held. The seven subsections of subparagraph (d)(4) are referred to as "tacking" provisions and can be divided into two categories.¹⁰³ One category, subsections (iv), (v), (vi), and (vii), permits a holder of restricted securities who cannot meet the two-year holding period requirement to tack the holding period of the transferor to his or her own holding period.¹⁰⁴ The rationale is that an identity of interest exists between certain transferors and transferees, such as pledgors and pledgees, donors and donees, settlors and trusts, and decedents and their estates; therefore, a pledgee, donee, trust, or estate should have the benefit of the transferor's holding period.¹⁰⁵ The benefit, however, carries with it a significant cost. Under corresponding subsections of rule 144(e), a person who satisfies the holding period requirements of subparagraph (d)(1) by tacking a holding period pursuant to subsections (iv), (v), (vi), or (vii) must aggregate his or her sales with the person whose holding period has been used.¹⁰⁶

The other category, subsections (i), (ii), and (iii), allows a person to tack the period of time he or she has held certain restricted securities to "related" securities that were subsequently acquired. The more recently acquired securities "are deemed to have been acquired when such other securities were acquired."¹⁰⁷ The theory is that since the new securities do not create a change in the holder's capital at risk and since the more recently acquired securities emanate from the older ones, the holding period for the more recent securities should relate back to when the older securities were acquired.¹⁰⁸ This category includes securities acquired from the issuer (i) as a dividend or pursuant to a stock split or recapitalization, (ii) for a consideration consisting solely of other securities of the same issuer surrendered for conversion, and (iii) as a contingent payment of the purchase price of an equity interest in a business, or the assets of a business, sold to the issuer or its affiliate.¹⁰⁹

102. See Securities Act Release No. 5306, *supra* note 64. See also R. HAFR, *supra* note 70, at 7-18 to 7-22.

103. See generally 7B J.W. Hicks, *supra* note 1, at § 10.08[5][a]; Ash, *supra* note 45, at § 6B.02[4][d].

104. 17 C.F.R. § 230.144(d)(4)(iv)-(vii) (1987).

105. See 7B J.W. Hicks, *supra* note 1, at § 10.08[5][a]. With respect to transfers of restricted securities between spouses arising out of divorce settlements, the SEC staff generally has permitted the acquiror to tack the transferor's holding period. See Diamond Hill Indus., SEC No-Action Letter, (June 16, 1986) (LEXIS, Fedsec library, Noact file); Saga Corp., SEC No-Action Letter, [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,997 (June 21, 1976). *But see* Citizens & S. Corp., SEC No-Action Letter, [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,072 (Aug. 11, 1981). Moreover, subsection (vii) of rule 144(d)(4) provides that when an estate "is not an Affiliate or if the securities are sold by a beneficiary who is not an Affiliate, no holding period is required." 17 C.F.R. § 230.144(d)(4)(vii) (1987). See also Gilroy & Kaufmann, *supra* note 45, at § 38.03[4][f], *relying on* Securities Act Release No. 6099, *supra* note 29, item 32.

106. See 7B J.W. Hicks, *supra* note 1, at § 10.08[5][a]; see also *infra* notes 134-35 and accompanying text.

107. Securities Act Release No. 5223, *supra* note 20. Note, however, that subparagraph (d)(4) of rule 144 does not allow tacking in successive private placements. See Gilroy & Kaufmann, *supra* note 45, at § 38.03[4] ("A purchaser of Restricted Securities from the former holder of the Securities cannot utilize the period of time the Seller held the Restricted Securities, but instead must hold for at least two years after purchasing the Securities before utilizing Rule 144.")

108. See 7B J.W. Hicks, *supra* note 1, at § 10.08[5][a].

109. 17 C.F.R. § 230.144(d)(4)(i)-(iii) (1987). Under subsection (iii), tacking is permitted "if the issuer or affiliate was then committed to issue the securities subject only to conditions other than the payment of further consideration for such securities." *Id.* § 230.144(d)(4)(iii). Moreover, an employment contract or non-competition agreement entered into in connection with the purchase is not deemed the payment of further consideration for the securities. *Id.*

Significantly, regardless of the manner in which a person acquires restricted securities, a prospective seller must be able to trace specific securities to their actual acquisition dates.¹¹⁰ For example, the holder of a single block of restricted securities may satisfy the holding period requirement for a portion of the block by tracing the particular securities to be sold even though with respect to the remainder of the shares it cannot be established that the purchase price had been fully paid for at least two years.¹¹¹ A holder can demonstrate compliance with subparagraph (d)(1) for the shares to be sold either through a purchase agreement, which specifies that full consideration was given for those shares on a certain date, or by mathematically allocating the purchase price that was paid to a specific portion of the holdings.¹¹² However, the securities alleged to be in compliance with subparagraph (d)(1) must not be pledged as collateral for the holder's obligation to make full payment for the remaining securities.¹¹³

In regard to the two-year holding period requirement, it should be emphasized that rule 144 is not the exclusive means by which a prospective seller may sell restricted securities. Paragraph (j) provides that a person may sell restricted securities outside rule 144 provided another exemption can be found.¹¹⁴ Thus, nonaffiliates who wish to resell restricted securities within two years¹¹⁵ may seek to invoke the section 4(1) and section "4(1-1/2)" exemptions.¹¹⁶ Rule 144 is solely a safe harbor. A shorter holding period may come within the section 4(1) exemption.¹¹⁷ Moreover, although the SEC has disregarded the "change of circumstances" concept¹¹⁸ as a basis for finding an exemption pursuant to section 4(1),¹¹⁹ the courts may reject the SEC's position. The change of circumstances doctrine is a judicially recognized concept that should not be eviscerated through administrative fiat.¹²⁰

110. See Securities Act Release No. 6099, *supra* note 29, item 21.

111. See NLT Corp., SEC No-Action Letter, [1973-1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,710 (Jan. 11, 1974).

112. *Id.*

113. See BBDO Int'l Inc., SEC No-Action Letter (Dec. 10, 1974) (LEXIS, Fedsec library, Noact file). See also 7B J.W. Hicks, *supra* note 1, at § 10.08[2][a][i].

114. See 17 C.F.R. § 230.144(j) (1987).

115. See *id.* § 230.144(d) (two-year holding requirement for restricted securities in order to come within rule 144's safe harbor). Note that this analysis similarly would apply to a seller who was outside rule 144's safe harbor because he or she wished to exceed the volume limitations on the amount of securities sold under rule 144(e).

116. For discussion of the section "4(1-1/2)" exemption, see authorities cited *supra* note 80.

117. But see Securities Act Release No. 5223, *supra* note 20:

[P]ersons who offer or sell restricted securities without complying with Rule 144 are hereby put on notice by the Commission that in view of the broad remedial purposes of the Act and of public policy which strongly supports registration, they will have a substantial burden of proof in establishing that an exemption from registration is available for such offers or sales and that such persons and the brokers and other persons who participate in the transactions do so at their risk.

This rhetoric appears to be somewhat overstated. See, e.g., *supra* note 80.

118. See Securities Act Release No. 5223, *supra* note 20.

119. 15 U.S.C. § 77d(1) (1982).

120. See authorities cited *supra* note 32.

D. Limitation on Amount of Securities Sold

As addressed previously,¹²¹ section 4(1) of the Securities Act is intended to exempt only ordinary trading transactions and not to exempt distributions.¹²² Thus, rule 144(e) sets forth objective criteria in an attempt to ensure that a person who complies with all of the conditions of the rule will sell securities "in such limited quantities and in such a manner so as not to disrupt the trading markets."¹²³

Rule 144(e) contains three subparagraphs. Subparagraph (e)(1) governs sales by persons who are affiliates of the issuer at the time of the proposed sale. It limits the amount of *restricted and nonrestricted* securities that can be sold for the account of an affiliate during any three-month period.¹²⁴ Subparagraph (e)(1) provides that "[i]f restricted or other securities are sold for the account of an affiliate of the issuer,"¹²⁵ the amount of securities sold must conform to certain prescribed limitations.¹²⁶

Subparagraph (e)(2) applies to sales by nonaffiliates. It limits only the amount of restricted securities that can be sold by a nonaffiliate within a three-month period.¹²⁷ However, if the prospective seller meets the requirements of rule 144(k), rule 144(e) does not apply. Thus, there are no volume limitations on a nonaffiliate selling restricted securities if the nonaffiliate has not been an affiliate during the three months preceding the sale and if he or she has beneficially owned the securities for at least three years prior to the sale as calculated pursuant to rule 144(d).¹²⁸ Of course, if the nonaffiliate is not exempted from rule 144(e) by rule 144(k), he or she may still rely on the exclusion provided by subsection (e)(3)(vii), which exempts securities sold pursuant to an effective registration statement, a regulation A exemption, or a section 4 exemption.¹²⁹

Subparagraph (e)(1) includes the specific test for determining the maximum amount of securities a person can sell in any three-month period.¹³⁰ This test is incorporated into subparagraph (e)(2).¹³¹ The volume limitation provides that an affiliate or nonaffiliate can sell, during any three-month period, an amount equal to the greater of (i) the average weekly trading volume reported on all national securities exchanges and NASDAQ (or reported through the consolidated transaction reporting

121. See *supra* notes 15-26 and accompanying text.

122. See Securities Act Release No. 5223, *supra* note 20.

123. Securities Act Release No. 5223, *supra* note 20.

124. Rule 144(e) permits the maximum amount of securities to be sold in several related transactions as long as no more than the maximum number of shares are sold in any three-month period. See Pic 'N Pay Stores, Inc. SEC No-Action Letter (July 17, 1978) (LEXIS, Fedsec library, Noact file).

125. 17 C.F.R. § 230.144(e)(1) (1987).

126. *Id.* All shares of restricted and nonrestricted securities must be included in the computation, unless otherwise exempted under subsection (e)(3)(vii), which excludes from all volume computations under the rule any securities sold pursuant to an effective registration statement or pursuant to a regulation A or § 4 exemption.

127. 17 C.F.R. § 230.144(e)(2) (1987).

128. *Id.* § 230.144(k). For further discussion, see *infra* notes 192-217 and accompanying text.

129. See *supra* note 126.

130. 17 C.F.R. § 230.144(e)(1) (1987). Although sales may be made in continuous three-month periods to the maximum amount permitted, "unused" amounts cannot be accumulated. See Astrophysics Research Corp., SEC No-Action Letter (Aug. 14, 1973) (LEXIS, Fedsec library, Noact file).

131. See 17 C.F.R. § 230.144(e)(2) (1987).

system) during the preceding four calendar weeks, or (ii) one percent of the outstanding securities of the class as shown by the issuer's most recent report.¹³²

The final subparagraph of rule 144(e) consists of seven subsections that are included for the purpose of determining the amount of securities specified in subparagraphs (e)(1) and (e)(2).¹³³ Subparagraph (e)(3) can be divided into two parts. The first, consisting of subsections (e)(3)(ii) through (e)(3)(v), contains provisions that relate to the aggregation of sales of restricted securities by various persons—that is, pledgor-pledgee, donor-donee, settlor-trust, and decedent-estate—who have shared a holding period pursuant to rule 144(d)(4)(iv), (v), (vi), and (vii), respectively.¹³⁴ A person who relies on the relevant tacking provision in rule 144(d)(4) must comply with the complementary volume limitation aggregation provision in rule 144(e)(3). The aggregation mechanism's purpose is to deter abusive practices (such as an unregistered distribution) that might be effectuated by a transferor through the medium of a pledge, gift, trust, or will.¹³⁵

The second focus of subparagraph (e)(3), consisting of subsections (e)(3)(i), (e)(3)(vi), and (e)(3)(vii), concerns sales of restricted and nonrestricted securities.¹³⁶ Subsection (e)(3)(i) specifies the method of determining the amount of securities that can be sold under subparagraphs (e)(1) or (e)(2) when the prospective sales include both convertible securities and the underlying securities.¹³⁷ Subsection (e)(3)(vi) of rule 144 provides for aggregation of sales by persons who agree to act in concert for the purpose of selling securities pursuant to rule 144.¹³⁸ It provides that when two or more persons agree to act in concert, all securities comprising the same class that are sold for the account of all such persons during any three-month period shall be aggregated for the purpose of determining the limitation on the amount of securities

132. *Id.* § 230.144(e)(1)–(2). There are several technical questions concerning the calculation of volume limitation under subparagraphs (e)(1) and (e)(2) that are beyond the scope of this Article. However, it is important to note the following: (1) an affiliate of the issuer must include his or her sales of both restricted and nonrestricted securities of the same class during the preceding three months, while a nonaffiliate need only include sales of restricted securities in computing the volume; (2) regardless of the seller's status, the volume limitation is calculated in terms of the amount sold "for the account of" the seller; and (3) the three-month period for measuring sales includes only the three months immediately preceding the date of sale at issue. *See* Securities Act Release No. 5306, *supra* note 64.

133. *See* 17 C.F.R. § 230.144(e)(3)(A)–(G) (1987).

134. *See* 7B J.W. HICKS, *supra* note 1, at § 10.09[1][b]. As stated by Professor Haft:

In each of these situations [subsections (e)(3)(ii)–(v)], if the transferor is not an affiliate at the time of the transferee's proposed sales and the transferor has not been an affiliate during the preceding three months and the restricted securities, if they had been retained by the transferor, could have been resold under the unlimited resale provisions of Rule 144(k) during the two-year period following the transfer, then aggregation is not required.

R. HAFT, *supra* note 70, at 7-26 to 7-27, *relying on* Securities Act Release No. 6099, *supra* note 29, item 47. *See also supra* note 105.

135. *See* Securities Act Release No. 5223, *supra* note 20. *See also* Intertherm, Inc., SEC No-Action Letter, [1972–1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,055 (Sept. 5, 1972) ("The definition of 'person' in Rule 144(a)(2) serves to aggregate sales of securities by the persons therein described but does not serve to permit tacking of holding periods among such persons. The only tacking provisions contained in Rule 144 are those in part (d)(4) of the Rule.").

136. *See* 17 C.F.R. § 230.144(e)(3)(i), (vi), (vii) (1987).

137. *Id.* § 230.144(e)(3)(i) ("the amount of convertible securities sold shall be deemed to be the amount of securities of the class into which they are convertible for the purpose of determining the aggregate amount of securities of both classes sold").

138. *Id.* § 230.144(e)(3)(vi).

sold.¹³⁹ There are two important considerations relevant to this subsection. First, there must be an express or implied agreement, orally or in writing, between two or more persons to act in concert. The mere knowledge by one person that someone else is about to make a contemporaneous sale of securities does not qualify as concerted activity. Nonetheless, under certain circumstances, an agreement to sell securities may be presumed to be entered into, even in the absence of a written document, because of a business or family relationship.¹⁴⁰ Such a presumption is based on factual circumstances and may be rebutted, or avoided entirely, by appropriate measures, including selling through different brokerage firms and avoiding any communication with respect to selling intentions.¹⁴¹ Second, the agreement must relate to the *sale* of securities, whether restricted or unrestricted, subject to rule 144.¹⁴² For example, agreements concerning how to vote certain shares of stock are outside the ambit of the subsection.¹⁴³ Moreover, the fact that persons purchased their securities together or in the same transaction does not necessarily mean that they intend joint decisions in the future sale of those securities.¹⁴⁴

Still, prospective sellers must be wary of the scope of subsection (e)(3)(vi). Significantly, the provision applies irrespective of the motives of parties who agree to act in concert.¹⁴⁵ For example, according to the SEC staff, a meeting of security holders "for the purpose of discussing and arranging" an orderly method for the sale of securities "would appear to fall within" the purview of the subsection.¹⁴⁶ Likewise, security holders who agree to sell their securities in accordance with a timetable, through a designated broker and with prior notice to the other parties, come within the provision.¹⁴⁷ However, as indicated by a number of SEC no-action letters, the presence of certain types of agreements among security holders is not of itself determinative that the parties are acting in concert.¹⁴⁸

139. *Id.* See SEC no-action letters cited in R. HAFR, *supra* note 70, at 7-37 to 7-38.

140. See Control Bancorp., Inc., SEC No-Action Letter (Dec. 10, 1974) (LEXIS, Fedsec library, Noact file).

141. See Goldfeld, Charak, Tolins & Lowenfels, SEC No-Action Letter, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,824 (May 1, 1972).

142. See 7B J.W. Hicks, *supra* note 1, at § 10.09[5][f].

143. See RSR Corp., SEC No-Action Letter (Nov. 24, 1975) (LEXIS, Fedsec library, Noact file). Similarly, an agreement requiring stockholders not to engage in sales of their securities for a certain period would not involve concerted activity for the purpose of selling securities. See Dynard, Inc., SEC No-Action Letter, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,769 (Apr. 13, 1972).

144. See Patents Int'l Affiliates, Ltd., SEC No-Action Letter (Apr. 5, 1973) (LEXIS, Fedsec library, Noact file). *But see* Robert A. Mulderrig, Jr., SEC No-Action Letter (Jan. 3, 1978) (LEXIS, Fedsec library, Noact file) (trusts could be viewed as acting in concert when trustee of the trusts makes a common decision to sell for the trusts, even if trustee's decision comports with its fiduciary duty).

145. See Damson Oil Corp., SEC No-Action Letter, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,763 (Apr. 10, 1972) [hereinafter No-Action Letter in Damson Oil Corp.].

146. Stroock & Stroock & Lavan, SEC No-Action Letter, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,774 (Apr. 12, 1972).

147. See No-Action Letter in Damson Oil Corp., *supra* note 145.

148. These agreements, for example, include: (1) a common voting arrangement (*i.e.*, pool or trust), *see* George E. Carmody, Jr., SEC No-Action Letter (Apr. 19, 1972) (LEXIS, Fedsec library, Noact file); (2) joint and several liability for the purchasers in connection with a purchase money note, *see* Welltech, Inc., SEC No-Action Letter (Jan. 28, 1976) (LEXIS, Fedsec library, Noact file); (3) an agreement establishing procedures for the exercise of registration rights, *see* Pillsbury Co., SEC No-Action Letter (Oct. 31, 1977) (LEXIS, Fedsec library, Noact file); and (4) an agreement that restricts the amount of securities that individual stockholders can sell during designated periods of time, *see* Carnation Co., SEC No-Action Letter (Oct. 3, 1979) (LEXIS, Fedsec library, Noact file). *See also* 7B J.W. Hicks, *supra* note 1, at § 10.09[5][f](ii).

Finally, subsection (e)(3)(vii) provides for the exclusion of certain sales from the volume limitation calculation.¹⁴⁹ Only three limited types of sales are contemplated by this particular exclusion: (1) “[s]ecurities sold pursuant to an effective registration statement under the Act”;¹⁵⁰ (2) securities sold “pursuant to an exemption provided by Regulation A under the Act”;¹⁵¹ and (3) securities sold “in a transaction exempt pursuant to Section 4 of the Act and not involving any public offering.”¹⁵² All other sales, even those made pursuant to other valid exemptions under the Securities Act, generally must be included in computing the volume sold.¹⁵³

Of course, if the prospective seller satisfies the requirements of rule 144(k) (*i.e.*, a nonaffiliate who has held restricted securities for at least three years), he or she may disregard the volume limitation requirements imposed by rule 144(e).¹⁵⁴ Such a seller may resell an unlimited amount of restricted securities pursuant to rule 144(k) without taking these sales into account in computing permissible sales under rule 144(e) of other securities of the same class held for less than three years.¹⁵⁵

E. Manner of Sale and Brokers' Transactions

Rule 144(f) provides for the manner in which a security holder can resell securities pursuant to the rule.¹⁵⁶ Paragraph (f) permits sales of securities that are

Hence, the SEC's position is far from crystal clear, leaving counsel with difficult issues when advising parties whether they may be acting “in concert” for purposes of subsection (e)(3)(vi). *See* Gilroy & Kaufmann, *supra* note 45, at § 38.04[2][b] (For example, “[c]an mere knowledge by two affiliates that they both propose to sell securities and that it is in their mutual interest to limit their sales so as not to flood the market be deemed as acting in concert if both act accordingly?”).

149. 17 C.F.R. § 230.144(e)(3)(vii) (1987).

150. *Id.* Note that a seller of securities under rule 144 may make concurrent sales outside the rule, pursuant to a registered offering, a regulation A or § 4 exemption, without violating the rule's volume limitations. *See* Securities Act Release No. 6099, *supra* note 29, item 41.

151. 17 C.F.R. § 230.144(e)(3)(vii) (1987).

152. *Id.* Because rule 144 applies to resales by nonissuers, the reference to § 4 is not to the § 4(2) exemption that applies solely to issuers. In SEC no-action letters, the staff has construed the language in subsection (e)(3)(vii) to exclude from the rule 144 volume limitations sales “in private transactions which are effected in a manner similar to private placements by issuers under Section 4(2). . . .” Harris, Beach & Wilcox, SEC No-Action Letter, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,773 (Apr. 14, 1972). *See also* Environmental Sciences Corp., SEC No-Action Letter, [1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,466 (June 28, 1973); R. HAFT, *supra* note 70, at 7-37; *see also supra* note 80.

153. *See* 17 C.F.R. § 230.144(e)(3)(vii) (1987). For instance, affiliate resales pursuant to the § 3(a)(11) intrastate exemption, 15 U.S.C. § 77c (a)(11) (1982), must be included in computing the volume sold. There are certain other exceptions. For example, pursuant to rule 144(k), a nonaffiliate is not subject to paragraph (e)'s volume limitations. *See infra* notes 154-55, 192-217 and accompanying text. Also, pursuant to subsection (e)(3)(v), no volume limitation applies “if the estate or beneficiary thereof is not an affiliate of the issuer.” 17 C.F.R. § 230.144(e)(3)(v) (1987). *See also id.* § 230.144(f); *see also supra* note 105, *infra* note 173.

154. *See* 17 C.F.R. § 230.144(k) (1987).

155. *See* Securities Act Release No. 6099, *supra* note 29, item 44. *See infra* notes 192-217 and accompanying text.

156. 17 C.F.R. § 230.144(f) (1987). Rule 144(f) provides:

The securities shall be sold in “brokers' transactions” within the meaning of section 4(4) of the Act or in transactions directly with a “market maker,” as that term is defined in section 3(a)(38) of the Securities Exchange Act of 1934, and the person selling the securities shall not (1) solicit or arrange for the solicitation of orders to buy the securities in anticipation of or in connection with such transaction, or (2) make any payment in connection with the offer or sale of the securities to any person other than the broker who executes the order to sell the securities. The requirements of this paragraph, however, shall not apply to securities sold for the account of the estate of a deceased person or for the account of a beneficiary of such estate provided the estate or beneficiary thereof is not an affiliate of the issuer; nor shall they apply to securities sold for the account of any person other than an affiliate of the issuer provided the conditions of paragraph (k) of this rule are satisfied. Thus, for those sales not specifically exempted, rule 144(f) imposes three important conditions:(1) Securities must

made "in 'brokers' transactions' within the meaning of section 4(4) of the Act"¹⁵⁷ or in transactions directly with a "market maker."¹⁵⁸ Section 4(4) provides an exemption from the section 5 registration requirements of the Securities Act for any broker-dealer who functions as a broker in "brokers' transactions executed upon customers' orders on any exchange or in the over-the-counter market but not the solicitation of such orders."¹⁵⁹ Rule 144(g) defines the phrase "brokers' transactions" as including transactions in which a broker, without solicitation and after making reasonable inquiry, does no more than execute a sell order as agent and receives no more than the usual and customary commission.¹⁶⁰

The manner of sale requirement set forth in rule 144(f) places a significant limitation on the prospective seller. Rule 144(f) is more than a mere requirement that a seller simply use a broker to effect a sale of securities. Importantly, the phrase "brokers' transactions" in rule 144(f), as used in section 4(4), imposes the additional burden that the broker-effected sale take place on an exchange or in the over-the-counter market.¹⁶¹ In this regard, application of the rule may compel a seller of securities to incur a commission that might otherwise be avoided.¹⁶² Moreover, because of the rule's mandate to procure the services of a broker,¹⁶³ a prospective seller cannot rely upon the rule if he or she sells the securities in a privately negotiated transaction, even when there is no solicitation of the purchaser and the issuer of the securities has made available to the public all current information about itself.¹⁶⁴

A person planning to rely on rule 144, moreover, cannot "solicit or arrange for the solicitation of orders to buy securities in anticipation of or in connection with such transaction[s]."¹⁶⁵ This would prohibit certain sales practices that some prospective sellers might employ to circumvent the rule. For example, a person cannot use an apparent brokerage transaction to finalize a previously negotiated final sale.¹⁶⁶ Nor can a person proposing to sell securities through his or her broker circulate that

be sold either in brokers' transactions within the meaning of section 4(4) of the Securities Act or in transactions directly with a market maker, as defined in section 3(a)(38) of the Exchange Act; (2) a seller cannot solicit buy orders; and (3) a seller cannot make any payment in connection with the rule 144 sale to any person other than the executing broker. See *infra* notes 156-79 and accompanying text.

157. 17 C.F.R. § 230.144(f) (1987).

158. *Id.* A market maker is defined as "any specialist permitted to act as a dealer, any dealer acting in the capacity of a block positioner, and any dealer who, with respect to a security, holds himself out (by entering quotations on an inter-dealer communications system or otherwise) as being willing to buy and sell such security for his own account on a regular or continuous basis." 15 U.S.C. § 78c(a)(38) (1982). See also Securities Act Release No. 6099, *supra* note 29, item 52 (defining "market maker" and "block positioner").

159. 15 U.S.C. § 77d(4) (1982). See also T. HAZEN, *supra* note 24, at 137-40; L. LOSS, *supra* note 23, at 401-06; M. STEINBERG, *supra* note 18, at 290-92.

160. See 17 C.F.R. § 230.144(g) (1987).

161. See 15 U.S.C. § 77d(4) (1982). See also Science Applications, Inc. & Bull, Inc., SEC No-Action Letter, [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,343 (Aug. 22, 1977).

162. See First City Nat'l Bank, SEC No-Action Letter (Feb. 28, 1977) (LEXIS, Fedsec library, Noact file).

163. The requirement also applies to a broker-dealer who wishes to use rule 144 to resell securities it purchased in a private transaction. Thus, its sale must be executed through another broker-dealer. See National Envtl. Controls, SEC No-Action Letter, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,183 (Nov. 24, 1972).

164. See Securities Act Release No. 6099, *supra* note 29, item 61; MoAmCo Corp., SEC No-Action Letter, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,040 (Aug. 28, 1972); 7B J.W. Hicks, *supra* note 1, at § 10.10[3].

165. 17 C.F.R. § 230.144(f) (1987). *Accord id.* § 230.144(g)(2).

166. See Alcolac, Inc., SEC No-Action Letter (Jan. 10, 1976) (LEXIS, Fedsec library, Noact file).

intention in an attempt to induce prospective purchasers to contact their brokers and thus consummate a "brokers' transaction."¹⁶⁷

Rule 144(f) also states that a person selling securities cannot "make any payment in connection with the offer or sale of the securities to any person other than the broker who executes an order to sell the securities."¹⁶⁸ This prohibition prevents the seller from paying a fee to a prospective buyer, hiring a third person to locate a buyer, or retaining the services of another to engage in the type of promotional activities usually associated with a public offering.¹⁶⁹

The provisions of rule 144(f), and the SEC's interpretation thereof, may be criticized in certain situations as imposing undue restrictions on the proposed seller.¹⁷⁰ The SEC, however, has attempted to justify this burden by arguing that the manner of sale requirement prevents

securities distributions under the color of the [section 4(1)] exemption . . . together with the potential impact of such distributions on the trading markets. As set forth in the Preliminary Note to Rule 144 . . . Section 4(1) was intended to exempt only routine trading transactions between individual investors with respect to securities already issued and not to exempt distributions by issuers or acts of other individuals who engage in steps necessary to such distributions. Therefore, to insure that Rule 144 is utilized only to exempt that type of transaction, a person attempting to resell securities under the Rule is required to sell the securities in the limited quantities established in paragraph (e) and in the manner established and defined in paragraphs (f) and (g) of the Rule.¹⁷¹

Certainly, the manner of sale requirements of rule 144 help to insure that resales of restricted securities are effected only in ordinary transactions, at least after the two-year holding period has been satisfied and before the three-year holding period of rule 144(k) has been met by a nonaffiliate. Stated differently, for resales of restricted securities by nonaffiliates, the manner of sale requirements of rule 144(f), the volume limitations of rule 144(e), and the current public information requirements of rule 144(c) are only in effect during the one-year period between rule 144(d) and rule 144(k).¹⁷² It may be argued, however, that if a prospective seller is able to negotiate a private sale of restricted securities within this time frame and such resale transaction meets all the other requirements of the rule, it would not do a disservice to the rationale underlying the section 4(1) exemption to allow this private resale. When viewed this way, the manner of sale limitations of paragraph (f) seem somewhat superfluous and overly restrictive.¹⁷³

The "brokers' transactions" requirement of rule 144(f) must be distinguished from the requirements with the same name in rule 144(g).¹⁷⁴ Rule 144(f) is one of

167. See *Treasure Salvors, Inc.*, SEC No-Action Letter (Nov. 5, 1975) (LEXIS, Fedsec library, Noact file).

168. 17 C.F.R. § 230.144(f) (1987). See also *id.* § 230.144(g)(1).

169. See 7B J.W. Hicks, *supra* note 1, at § 10.10[4].

170. See *infra* notes 172-73 and accompanying text.

171. *International Airport Hotels, Inc.*, SEC No-Action Letter (Aug. 11, 1972) (LEXIS, Fedsec library, Noact file).

172. See *infra* notes 192-217 and accompanying text.

173. Of course, paragraph (f) provides two limited exceptions from its manner of sale requirements. There are exceptions for (i) nonaffiliated estates and beneficiaries, and (ii) persons who qualify their sales under paragraph (k). 17 C.F.R. § 230.144(f) (1987).

174. See 7B J.W. Hicks, *supra* note 1, at § 10.10[2][a][i].

the conditions that must be met by a seller intending to rely on the rule.¹⁷⁵ If a prospective seller does not sell securities through a market maker or is not eligible for one of the exemptions enumerated in rule 144(f), the sale must be effected in a brokers' transaction.¹⁷⁶ The broker also must find an exemption for its role in the transaction. Rule 144(g), by defining the term "brokers' transactions"¹⁷⁷ and by delineating aspects of "reasonable inquiry" to be conducted,¹⁷⁸ greatly assists the broker in meeting rule 144's safe harbor and thereby to perfect the section 4(4) exemption.¹⁷⁹

F. Notice of Proposed Sale and Bona Fide Intention to Sell

Rule 144(h) provides that Form 144 must be filed with the SEC in connection with certain sales of securities.¹⁸⁰ Form 144 aids the SEC in monitoring the rule's

175. See *supra* notes 156-64 and accompanying text.

176. *Id.*

177. See *supra* note 160 and accompanying text.

178. See 17 C.F.R. § 230.144(g)(3) (1987). In addition to rule 144, the SEC has discussed a broker's "reasonable inquiry" to perfect the section 4(4) exemption on a number of occasions. The Commission has stated:

[A] dealer who offers to sell, or is asked to sell a substantial amount of securities must take whatever steps are necessary to be sure that this is a transaction not involving an issuer, person in a control relationship with an issuer or an underwriter. For this purpose, it is not sufficient for him merely to accept "self-serving statements of his sellers and their counsel without reasonably exploring the possibility of contrary facts."

The amount of inquiry called for necessarily varies with the circumstances of particular cases. A dealer who is offered a modest amount of a widely traded security by a responsible customer, whose lack of relationship to the issuer is well known to him, may ordinarily proceed with considerable confidence. On the other hand, when a dealer is offered a substantial block of a little-known security, either by persons who appear reluctant to disclose exactly where the securities came from, or where the surrounding circumstances raise a question as to whether or not the ostensible sellers may be merely intermediaries for controlling persons or statutory underwriters, then searching inquiry is called for.

Distribution of Broker Dealers of Unregistered Securities, Securities Act Release No. 4445, 3 Fed. Sec. L. Rep. (CCH) ¶ 22,753-59 (Feb. 2, 1962) [hereinafter Securities Act Release No. 5168] (quoting SEC v. Culpepper, 270 F.2d 241, 251 (2d Cir. 1959)). In a subsequent release, the Commission asserted:

While "the amount of inquiry called for necessarily varies with the circumstances of particular cases," all registered broker-dealers should establish minimum standard procedures to prevent and detect violations of the federal securities laws and to ensure that the firm meets its continuing responsibility to know both its customers and the securities being sold. There should be written supervisory procedures that cover sales as well as purchases. These must be made known to salesmen and be sufficient to reveal promptly to supervisory officials transactions which may, when examined individually or in the aggregate, indicate that sales in a security should be halted immediately pending further inquiry.

Sales of Unregistered Securities by Broker-Dealers, Securities Act Release No. 5168, 3 Fed. Sec. L. Rep. (CCH) ¶ 22,760, at 16,627 (July 7, 1971) (quoting Securities Act Release No. 4445, *supra*) (footnote omitted).

179. See 17 C.F.R. § 230.144(g)(3) (1987) (defining the term "brokers' transactions" to require, *inter alia*, that the broker, after conducting a "reasonable inquiry," "is not aware of circumstances indicating that the person for whose account the securities are sold is an underwriter with respect to the securities or that the transaction is a part of a distribution of securities of the issuer"). See also 7B J.W. Hicks, *supra* note 1, at § 10.11.

180. Rule 144(h) provides:

If the amount of securities to be sold in reliance upon the rule during any period of three months exceeds 500 shares or other units or has an aggregate sale price in excess of \$10,000, three copies of a notice on Form 144 shall be filed with the Commission at its principal office in Washington, D.C.; and if such securities are admitted to trading on any national securities exchange, one copy of such notice shall also be transmitted to the principal exchange on which such securities are so admitted. The Form 144 shall be signed by the person for whose account the securities are to be sold and shall be transmitted for filing concurrently with either the placing with a broker of an order to execute a sale of securities in reliance upon this rule or the execution directly with a market maker of such sale. Neither the filing of such notice nor the failure of the Commission to comment thereon shall be deemed to preclude the Commission from taking any action it deems necessary or appropriate with respect to the sale of the securities referred to in such notice. The requirements of this paragraph, however,

operation so as to detect and prevent abuses.¹⁸¹ Rule 144(h) generally provides that the filing is required if the amount of securities to be sold pursuant to the rule during any three-month period will exceed 500 shares (or other units) or will have an aggregate sale price in excess of \$10,000.¹⁸²

Form 144 must contain information as to each of the following items: (1) the issuer, (2) the person on whose behalf the securities are to be sold, (3) the broker who will execute the order, (4) the exchange, if any, where the sale will occur, (5) the approximate date of sale, (6) the securities to be sold, and (7) other securities of the same issuer sold during the past three months.¹⁸³ Also, by signing the Form, the seller warrants that he or she does not know of any material adverse information regarding the issuer's current and prospective operations that has not been publicly disclosed or disclosed to the particular buyers of the securities.¹⁸⁴

A prospective seller of securities pursuant to rule 144, however, may be exempt from the filing requirement of paragraph (h) for any one of the following three reasons: first, the amount of securities to be sold is less than the jurisdictional limits for filing the form;¹⁸⁵ second, the transactions may qualify for one of the SEC-created exceptions (examples within this exclusion include sales of securities acquired as underwriters' compensation¹⁸⁶ and sales of securities by foreign security holders who acquired the securities in an unregistered foreign offering that was made in reliance on Securities Act Release No. 33-4708¹⁸⁷); third, the seller may be a nonaffiliate who is able to take advantage of paragraph (k) of the rule and thereby qualify for an exemption from the filing requirements.¹⁸⁸

Rule 144(i)¹⁸⁹ is a companion provision to paragraph (h). Its objective is to preclude prospective sellers from filing notice under Form 144 "for the shelf."¹⁹⁰ It provides that a person who files the notice required by paragraph (h) must have a bona fide intention to sell the securities within a reasonable time thereafter. Thus, a person who has no immediate desire to sell, or a person who cannot presently sell due to holding period restrictions, cannot employ the rule to gain liquidity for the securities without filing repeated notices under paragraph (h).¹⁹¹

shall not apply to securities sold for the account of any person other than an affiliate of the issuer, provided the conditions of paragraph (k) of this rule are satisfied.

17 C.F.R. § 230.144(h) (1987).

181. See Securities Act Release No. 5223, *supra* note 20.

182. 17 C.F.R. § 230.144(h) (1987). See also Securities Act Release No. 6099, *supra* note 29, items 63-68.

183. See SEC Form 144, reproduced in 2 Fed. Sec. L. Rep. (CCH) ¶ 7411.

184. *Id.* Evidently, the SEC has never brought an enforcement action based upon the making of a false "warranty" in Form 144. See Gilroy & Kaufmann, *supra* note 45, at § 36.06[3][d].

185. See 17 C.F.R. § 230.144(h) (1987).

186. See Securities Act Release No. 6099, *supra* note 29, at 2819-7 n.8; Communications Properties, Inc., SEC No-Action Letter, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,573 (Mar. 13, 1978).

187. See International Income Property, Inc., SEC No-Action Letter (Nov. 12, 1980) (LEXIS, Fedsec library, Noact file); 7B J.W. Hicks, *supra* note 1, at § 10.12[5]. See also Registration of Foreign Offerings by Domestic Issuers, Securities Act Release No. 4708, 1 Fed. Sec. L. Rep. (CCH) ¶¶ 1361-63 (July 9, 1964).

188. See 17 C.F.R. § 230.144(k) (1987); see also *infra* notes 192-217 and accompanying text.

189. 17 C.F.R. § 230.144(i) (1987).

190. See Securities Act Release No. 5223, *supra* note 20.

191. See 17 C.F.R. § 230.144(i) (1987). See also Envirotech Corp., SEC No-Action Letter, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,191 (Dec. 27, 1972); Permian Basian Royalty Trust, SEC No-Action Letter (Mar. 5, 1986) (LEXIS, Fedsec library, Noact file). The current position taken by rule 144(i) has been subject to criticism. See

IV. THE UNIQUE NATURE OF RULE 144(k)

A. *Certain Sales by Nonaffiliates*

Paragraph (k) of rule 144 eliminates the current public information, volume limitation, manner of sale, and notice requirements for nonaffiliates who have not been affiliated with the issuer for the preceding three months and who have beneficially owned the restricted securities for at least three years prior to the resale.¹⁹² Thus, rule 144(k) effectively removes all restrictions for nonaffiliates who have held restricted securities for three years. Paragraph (k) was designed to ease some of the burdens that rule 144 places on the liquidity of restricted securities.¹⁹³

The SEC revised paragraph (k) of rule 144 in 1983 to include current public information requirements among its exceptions.¹⁹⁴ Hence, as rule 144 now stands, a person, who is not an affiliate and who has held the restricted securities for three years, can sell such securities to the public in any manner without any information whatsoever being available concerning the issuer. Consider this result with the SEC's assertion when it adopted rule 144 in 1972:

[T]he purpose and underlying policy of the [Securities] Act to protect investors requires . . . that there be *adequate current information concerning the issuer*, whether the resales of securities by persons result in a distribution or are effected in trading transactions. Accordingly, the availability of [rule 144] is conditioned on the existence of adequate current public information.¹⁹⁵

The SEC, with its amendments to rule 144, essentially has nullified the above rationale. One justification proffered is the deregulatory assertion that “[t]he purpose of the amendments is to relax restrictions on resales of securities that are more burdensome than necessary.”¹⁹⁶ But the SEC does not adequately explain why such restrictions are “more burdensome than necessary,” particularly in view of the investor protection concerns that are highlighted throughout the 1972 rule 144 adopting release.¹⁹⁷ Hence, rule 144, as revised, may be viewed as inconsistent with a major objective of the Securities Act, which is to protect investors by ensuring that their decisions are informed, and also as incompatible with a fundamental premise underlying the rule's adoption.¹⁹⁸

Gilroy & Kaufmann, *supra* note 45, at § 38.04[1] (urging the SEC to amend paragraphs (h) and (i) so as to require a seller to have only “a bona fide intention to sell securities of the type referred to in the Form 144”).

192. 17 C.F.R. § 230.144(k) (1987). In determining the period for which the securities have been beneficially owned, paragraph (k) provides that reference should be made to paragraph (d) of rule 144. *See supra* notes 85–120 and accompanying text.

193. *See* Securities Act Release No. 6488, *supra* note 82; Resales of Securities, Securities Act Release No. 6286, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,821 (Feb. 6, 1981) [hereinafter Securities Act Release No. 6286]. It has been asserted that issuers should not have an obligation to retain legends on securities that have met the three-year beneficial ownership period under rule 144(k). *See* Gilroy & Kaufmann, *supra* note 45, at § 38.05[1].

194. *See* Securities Act Release No. 6488, *supra* note 82.

195. Securities Act Release No. 5223, *supra* note 20, at ¶ 81,053 (emphasis supplied).

196. Securities Act Release No. 6286, *supra* note 193. *See* Securities Act Release No. 6488, *supra* note 82.

197. *See* Securities Act Release No. 5223, *supra* note 20.

198. Moreover, consistent with rule 144, the SEC has substantially relaxed the “resale” provisions of rule 145, thereby permitting parties (*i.e.*, persons who are affiliates of an entity acquired in a rule 145 transaction) much greater leeway in reselling securities without fear of underwriter status. The SEC has determined that such parties receiving

There is, of course, another side to this issue. In order to promote capital formation and induce investors to take a stake in start-up and similar enterprises, a nonaffiliate who holds restricted securities must have a way to resell those securities if he or she chooses. Rule 144(k) now provides such shareholders with an opportunity to resell their securities after holding them for three years. In this way, the revised rule meets prospective sellers' expectations and facilitates the flow of venture capital into the economy. The prospective purchaser is adequately protected, it may be asserted, by the application of the antifraud provisions.¹⁹⁹ Moreover, a prospective buyer is not compelled to purchase the restricted securities. The determination whether to acquire the securities without adequate current issuer information being available should be left to the prospective purchaser, and not foreclosed by government intervention. As a final point, a nonaffiliate who has held restricted stock for three years should come within the section 4(1) exemption, provided that the sales taking place are transactions rather than a distribution. A three-year holding period should preclude a finding of underwriter status.²⁰⁰

It may be asserted, however, that the 1983 revision of rule 144 goes too far in liberalizing certain restrictions, while other overly burdensome limitations of the rule have been virtually ignored by the SEC. If adequate information is not available concerning the issuer, a prospective nonaffiliated seller should not be permitted to unload unlimited quantities of restricted securities into the market. The prospective nonaffiliated seller should only be allowed to resell the restricted securities in limited volumes over a period of time. In this way, the prospective seller would not have to rely on the unwilling, nonreporting issuer for public information and would not be locked into the investment, while at the same time, he or she would not be able to dump unlimited amounts of restricted securities into the market. In other words, paragraph (k) should permit a prospective nonaffiliated seller to avoid the information

securities in registered business combinations and who subsequently transfer such securities will not be deemed underwriters if:

i. The securities are sold in compliance with the provisions of paragraphs (c), (e), (f), and (g) of rule 144;

or

ii. The party is a nonaffiliate of the issuer, has held the securities for at least a two-year period, and the issuer has complied with the current public reporting requirement of rule 144(c) (by either being an Exchange Act reporting company or by making adequate information available); or

iii. The party is a nonaffiliate of the issuer and has held the securities for at least three years.

Revisions to the Resale Provisions Applicable to Securities Acquired in Registered Business Combinations, Securities Act Release No. 6508, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,489 (Feb. 10, 1984).

Note the effect of the SEC's amendments to rule 145 (with respect to persons who were affiliates of an entity acquired in a rule 145 transaction). First, nonaffiliates of the issuer can dispose of all of their securities after two years if the issuer has maintained adequate current public information. Second, such nonaffiliates, after a three-year holding period, can sell all their shares even if the issuer is not making adequate current information available. The public policy assessments made by the SEC in adopting these revisions can be questioned on much the same basis as the assessments made with respect to the amendments of rule 144. Undoubtedly, the SEC's amendments to rule 145 are a victory for deregulation and capital formation. Unfortunately, however, the costs may be too great. Permitting nonaffiliates of the issuer to "dump" their securities on the investing public with no information available about the issuer deals a blow to two fundamental purposes underlying the federal securities laws, namely, to ensure the integrity of the financial marketplace and to enable investors to have adequate information before them so that they can make informed investment decisions.

199. See, e.g., § 17(a) of the Securities Act, 15 U.S.C. § 77q(a) (1982); § 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b) (1982). See also Securities Act Release No. 5223, *supra* note 20.

200. See, e.g., Fuller v. Gilbert, 244 F. Supp. 196 (S.D.N.Y. 1965), *aff'd sub nom.* Righter v. Gilbert, 358 F.2d 305 (2d Cir. 1966); United States v. Sherwood, 175 F. Supp. 480 (S.D.N.Y. 1959); M. STEINBERG, *supra* note 18, at 272-78.

requirements of paragraph (c) only if that seller is willing to conform to the volume limitation restrictions of paragraph (e).²⁰¹

By promulgating paragraph (k), the SEC appears to take the position that the unloading of all of a nonaffiliate's stock after a three-year holding period will never constitute a "distribution." Such a position is questionable. Given the substantial amount of restricted stock that a nonaffiliate can unload in the marketplace under certain conditions,²⁰² the SEC's blanket exemption spreads too far. A more sensible approach, which would accommodate the competing interests, would be to require a nonaffiliate to adhere to the volume limitations of rule 144(e).²⁰³

Moreover, the SEC's amendments to rule 144 are inconsistent with the disclosure approach of rules 505 and 506 of regulation D.²⁰⁴ If the Commission's objective is to ensure the provision of adequate information to "unsophisticated" investors of restricted securities, it should be irrelevant whether the investor purchased the securities from the issuer (pursuant to regulation D) or from a shareholder who is not affiliated with the issuer (by means of rule 144). In either case, the prospective purchaser's need for sufficient information to make an intelligent investment decision remains the same. Only in the rule 505 or rule 506 regulation D offering context, however, is the investor entitled to such information.²⁰⁵ In the rule 144 setting, by contrast, there is no mandated disclosure when the investor purchases restricted securities from a nonaffiliated party (who has held the stock for at least three years) of an issuer who fails to provide current public information.²⁰⁶

The adoption of rule 144(k) is one of a series of actions that the SEC has undertaken to promote capital formation²⁰⁷ and may cause one to inquire whether the SEC has impliedly adopted, without legislative authority, the recommendation of a former commissioner that the preambles of both the Securities Act and the Exchange Act be amended to elevate the promotion of the capital formation process as one of the SEC's specified objectives.²⁰⁸ While this is certainly a laudable objective, it is clear that Congress was far more concerned with the SEC's role in protecting the investing public and the integrity of the financial marketplace.²⁰⁹

201. See *supra* notes 69–84, 121–55 and accompanying text.

202. See *infra* notes 222–26 and accompanying text.

203. See *supra* notes 121–55 and accompanying text.

204. 17 C.F.R. §§ 230.505–.506 (1987).

205. This statement presumes that the rule 505 or rule 506 offering is not made solely to accredited investors. *Id.* See Warren, *A Review of Regulation D: The Present Exemption Regimen for Limited Offerings Under the Securities Act of 1933*, 33 AM. U.L. REV. 355 (1984).

206. See M. STEINBERG, *supra* note 18, at 302–04.

207. See M. STEINBERG, *CORPORATE INTERNAL AFFAIRS: A CORPORATE AND SECURITIES LAW PERSPECTIVE* 44–49 (1983) (discussing rule 506 of regulation D as an SEC action taken to enhance capital formation); see also *supra* note 198 (discussing "deregulatory" amendments to rule 145).

208. See R. KARMEI, *REGULATION BY PROSECUTION: THE SECURITIES AND EXCHANGE COMMISSION V. CORPORATE AMERICA* 297–305 (1982).

209. See Preamble to the Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (1933) ("To provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent fraud in the sale thereof, and for other purposes"); Preamble to the Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (1934) ("To provide for the regulation of securities exchanges and over-the-counter markets operating in interstate and foreign commerce and through the mails, to prevent inequitable and unfair practices on such exchanges and markets, and for other purposes"). Interestingly, when Congress amended the Securities Act in 1980, it urged "greater Federal and State cooperation in securities matters, including . . . minimum interference with the business of capital

Although the SEC may have unduly liberalized rule 144(k), another aspect of rule 144 may be more burdensome than necessary. Because paragraph (k) applies only to nonaffiliates, it may be appropriate for the SEC to provide additional relief for affiliates who seek to resell securities. Presently, affiliates are forever subject to all of the restrictions of rule 144, except that an affiliate selling unrestricted securities has no holding period requirement.²¹⁰ Of course, affiliates may attempt to resell securities outside of the safe harbor of rule 144 by relying upon the section 4(1) or section "4(1-1/2)" exemption,²¹¹ but an affiliate relying on these exemptions would have a substantial burden of proof in establishing a basis for an exemption.

Paragraph (a) of rule 144 defines an "affiliate" as a person that, directly or indirectly, controls, or is controlled by, or is under common control with the issuer.²¹² A person who clearly controls the issuer does not need the protection of paragraph (k) because he or she will be able to force the issuer to divulge public information to comply with paragraph (c). Moreover, a controlling person should not be entitled to the other advantages of paragraph (k) because there is the danger that such a person (or such person's broker) is acting as an underwriter.²¹³ Hence, a controlling person, absent registration, normally should be entitled to resell the securities only through strict compliance with all of the provisions of rule 144 or through perfecting a separate exemption.²¹⁴

The situation is somewhat different, however, for an affiliate who is controlled by or is under common control with the issuer. Looking at the practical realities, such an affiliate may not have the leverage to compel the issuer to divulge current public information. Thus, an affiliate, like a nonaffiliate, may be indefinitely locked into its investment, subject to the whims of the issuer for making current information public.²¹⁵

Accordingly, the burden of rule 144 should be eased for certain affiliates. Like nonaffiliates, affiliates who have held restricted securities for a three-year period and who do not clearly control the issuer, signifying that they do not possess the power to compel the issuer to effect registration,²¹⁶ should not be subject to the adequate current public information requirement of rule 144(c). Such affiliates, by having held the restricted securities for this significant period of time and having been subject to the economic risks of the investment, ordinarily should not be viewed as underwriters

formation. . . ." 15 U.S.C. § 78s(c)(2)(C) (1982). The term "interference" is far different from the terms "facilitating" or "encouraging," which Congress could have elected to employ.

210. See 17 C.F.R. § 230.144(d) (1987); see also *supra* note 65 and accompanying text.

211. For discussion of the section "4(1-1/2)" exemption, see *supra* note 80.

212. 17 C.F.R. § 230.144(a)(1) (1987).

213. See *supra* note 13.

214. This assertion implies that a control person is identified without difficulty. Yet this is frequently not the situation. See Sommer, *Who's "In Control"?*—S.E.C., 21 BUS. LAW. 559 (1966). Rule 405 defines control as "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." 17 C.F.R. § 230.405 (1987). It may be asserted that application of the rule 405 definition of control in this context is misplaced. Rather, the key criterion should focus on whether the person possessed the power to compel the issuer to register an offering. See Campbell, *Defining Control in Secondary Distributions*, 18 BOS. COLL. INDUS. & COM. L. REV. 37 (1976).

215. The discussion *supra* note 214 applies equally here. Moreover, due to the quantity limitations of rule 144(e), such an affiliate's concerns are not limited to restricted stock. See 7B J.W. HICKS, *supra* note 1, at § 10.09[2].

216. See *supra* notes 214-15.

or as effecting a distribution so long as they comply with the volume limitation, manner of sale, and notice requirements of rule 144.²¹⁷

B. *Nonaffiliates Selling Nonrestricted Stock*

As discussed earlier,²¹⁸ rule 144 does not cover a nonaffiliate's disposition of nonrestricted stock. Nonetheless, the SEC, by its promulgation of rule 144(k), appears to take the position that the sale of a nonaffiliate's stock is not a separate distribution.²¹⁹ Moreover, the assumption of underwriter status may no longer be a pitfall for nonaffiliates selling nonrestricted stock due to the apparent abandonment of the presumptive underwriter doctrine by the SEC staff.²²⁰ These developments may lead to the conclusion that a nonaffiliate can freely resell nonrestricted stock without limitation pursuant to the section 4(1) exemption.²²¹ The Commission, however, has declined to expressly address this issue.

If the above represents the SEC's position, it is misplaced. In certain circumstances, a nonaffiliate can hold a substantial percentage of nonrestricted stock. Permitting such nonaffiliates to freely liquidate their positions conflicts with both the definition of underwriter under section 2(11)²²² and the rationale underlying the section 4(1) transactional exemption.²²³ In short, persons who dispose of large percentages of securities are, in actuality, engaging in a distribution rather than a

217. The manner of sale and notice requirements should apply to such affiliates. These requirements help to ensure, by providing public notice of such anticipated sales and by triggering "reasonable inquiry" obligations on the part of the relevant broker, that a "distribution" is not taking place.

218. See *supra* notes 28–29 and accompanying text.

219. See *supra* notes 192–217 and accompanying text.

220. See Barron, *Control and Regulated Securities: The SEC Staff Finally Abandons the "Presumptive Underwriter" Doctrine*, 15 SEC. REG. L.J. 296, 298 (1987) (quoting statement made by Linda Quinn, Esq., Director of the SEC's Division of Corporation Finance). The presumptive underwriter doctrine generally stood for the proposition that a purchaser of more than 10% of the securities sold in a registered offering may be an underwriter unless the purchaser shows sufficient investment intent. See T. HAZEN, *supra* note 24, at 146–47; M. STERNBERG, *supra* note 18, at 273–74; Ahrenholz & Van Valkenberg, *The Presumptive Underwriter Doctrine: Statutory Underwriter Status for Investors Purchasing a Specified Portion of a Registered Offering*, 1973 UTAH L. REV. 773.

221. See M. STERNBERG, *supra* note 18, at 302–04. As elaborated upon, see *infra* notes 222–28 and accompanying text, the illogic of such a position may be understood in light of the following hypothetical: Company X, for investment purposes, purchases 19% of Company Y's "unrestricted" stock on the open market. Insiders of Company Y, who still retain majority ownership of the public company's stock and who are able to elect the entire board of directors, have no desire to share control. Company X, pleased with its investment, increases its ownership interest in Company Y's "unrestricted" stock during a five-year period to 37%. One year later, after the insiders reject Company X's request to have a seat on Company Y's board of directors, Company X elects to sell all of its stock in Company Y on the open market during a thirty-day period.

Under the above hypothetical, Company X is not an "affiliate" of Company Y. It is neither in a "control" relationship nor can it compel Company Y to file a registration statement. See *supra* notes 214–15. Being a nonaffiliate, its sales, by analogy to rule 144(k), do not constitute a "distribution." See *supra* notes 192–217 and accompanying text. Moreover, again in reference to rule 144(d) and rule 144(k), a six-year holding period, as reflected in the hypothetical, indicates that Company X, not being a control person, acquired and held the securities with investment intent, hence mitigating against the assumption of underwriter status. *But see infra* note 222. The policies of the Securities Act, however, demand that Company X, absent registration, not be able to unload its securities on the investing public.

222. This is particularly true if the nonaffiliate disposes of its stock after a short holding period. See also Preliminary Note to Rule 144, 17 C.F.R. § 230.144 (1987) ("It should be noted that there is nothing in section 2(11) which places a time limit on a person's status as an underwriter. The public has the same need for protection afforded by registration whether the securities are distributed shortly after their purchase or after a considerable length of time.").

223. *Id.* ("The larger the amount of securities involved, the more likely it is that such resales may involve methods of offering and amounts of compensation usually associated with a distribution rather than routine trading transactions."). See *supra* note 221.

transaction and, when they do so after a short holding period, are purchasing from an issuer with a view toward distribution.²²⁴ Support for this assertion may be premised on the fact that, if a substantial security holder were an affiliate, he or she would be subject to the volume limitation requirements of rule 144(e).²²⁵ Yet, status as an affiliate in this context should not be determinative. At times, an affiliate may have more leverage to induce the issuer to file a registration statement for the securities the affiliate wishes to sell.²²⁶ Nonetheless, the detrimental effect on the capital trading markets and the investing public are identical, irrespective of whether one has affiliate status when reselling large quantities of stock.

With the promulgation of rule 144(k) and the apparent abandonment of the presumptive underwriter doctrine,²²⁷ the SEC may have given the impression that nonaffiliates can resell nonrestricted stock without limitation.²²⁸ Nonaffiliates and their counsel, however, should not act with the same certainty as other parties and transactions that come within rule 144's scope. Because unlimited sales by nonaffiliates should not be permitted,²²⁹ the SEC should prescribe a safe harbor under the section 4(1) exemption for nonaffiliates selling nonrestricted stock. This pronouncement may be effected either by amending rule 144 or by promulgating a separate rule.²³⁰

CONCLUSION

This Article has analyzed rule 144's scope, its effectiveness as a safe harbor mechanism, and the public policy concerns implicated. Although the rule generally has served to ease the burdens of persons seeking to resell their securities without sacrificing investor protection, there remain a number of troublesome concerns. Of particular importance is the SEC's recent amendment of rule 144(k), which represents a retreat from the Commission's position of requiring the disclosure of adequate current information about the issuer as a condition of invoking the rule. The SEC should address the problems associated with rule 144(k) as well as the other issues discussed herein.

224. See *supra* notes 221–23 and accompanying text.

225. See *supra* notes 121–55 and accompanying text.

226. See *supra* notes 212–17 and accompanying text.

227. See *supra* notes 192–217, 220 and accompanying text.

228. See *supra* notes 221–23 and accompanying text.

229. *Id.*

230. In this regard, the SEC should impose a safe harbor volume limitation on nonaffiliates selling non-restricted stock, unless the requirements of the section “4(1-1/2)” exemption are met. See *supra* note 80. The precise volume limitations should be determined pursuant to the SEC rulemaking process.