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REDEFINING THE PRIVATE PLACEMENT MARKET AFTER SARBANES-OXLEY: NASDAQ'S PORTAL AND RULE 144A

Elena Schwieger*

Whereas many companies have bemoaned the costs of going public in the United States under the restrictions created by the Sarbanes-Oxley Act of 2002,¹ NASDAQ's PORTAL actually does something about it.² One research firm estimated that Sarbanes-Oxley compliance cost public companies \$6 billion in 2006, and would cost \$5.9 billion in 2007,³ while others estimated the cost to be \$1.4 trillion.⁴ These costs have given incentive to private companies to remain private while seeking alternative sources of financing.⁵ In expanding the liquidity and

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1. Nikki Swartz, *Is the End of SOX Near?*, INFO. MGMT. J., Mar./Apr. 2007, at 24, 24-26, 28 (noting many companies' negative opinion of the costs associated with the Act, and describing the actual cost of Sarbanes-Oxley compliance for public companies); Editorial, *Peekaboo Powers*, WALL ST. J., Feb. 8, 2006, at A16 (reporting that a 2005 study found that Sarbanes-Oxley cost public companies \$1.4 trillion, and that "[a] recent London Stock Exchange survey of 80 international companies that went public on its markets found that of those that had contemplated a U.S. listing, 90% decided Sarbanes-Oxley made London more attractive"). See generally Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

2. See NASDAQ's *Electronic Trading Platform for the 144A Private Placement Market Begins Operation*, PRIMENEWSWIRE, Aug. 15, 2007, available in LEXIS, Nexis Library, PRIZNE File [hereinafter *NASDAQ's Electronic Trading Platform*] (reporting NASDAQ's prediction that the new PORTAL system will encourage capital formation via the private placement market). With more companies listed and more shares traded on an average daily basis than any other U.S. equities exchange, NASDAQ is the largest such exchange in the nation. *Id.* The acronym PORTAL stands for "Private Offerings, Resales, and Trading through Automated Linkages." Order Approving a Proposed Rule Change that Establishes Procedures to Support the PORTAL System, Exchange Act Release No. 27,958, 55 Fed. Reg. 18,777, 18,777 n.2 (May 4, 1990).

3. Swartz, *supra* note 1, at 26, 28.

4. See Editorial, *supra* note 1. But see Lorraine Woellert, *The SEC Opens Up SarbOx*, BUSINESSWEEK, Dec. 5, 2006, http://www.businessweek.com/bwdaily/dnflash/content/dec2006/db20061205_761982.htm ("The now-infamous \$1.4 trillion cost of the law, a figure calculated by measuring the drop in stock market capitalization during July, 2002, when the legislation was passed, has been widely discredited.").

5. See William J. Carney, *The Costs of Being Public After Sarbanes-Oxley: The Irony of "Going Private"* 55 EMORY L.J. 141, 147-52 (2006) (providing data on the costs of

transparency of the private placement market, NASDAQ's PORTAL stands poised to take advantage of this growing trend of using cheaper, less intrusive methods of raising capital in an increasingly cost-conscious and regulation-wary environment.⁶ Companies concerned about the cost of going public will seriously consider NASDAQ's Web-based PORTAL because it minimizes many of the drawbacks of private placements while achieving most of the benefits associated with public offerings.⁷

The importance of PORTAL's recent move to a Web-based format becomes evident when considering its history.⁸ In 1999, Arthur Levitt, a former chairman of the Securities and Exchange Commission (herein referred to as the SEC or the Commission), called the advent of electronic trading the "change[] that will define the marketplace for the 21st century."⁹ Consistent with Levitt's vision, while the original

compliance with Sarbanes-Oxley regulations and the growth of "going private," or delisting from stock exchanges, among smaller issuers).

6. See *NASDAQ's Electronic Trading Platform*, *supra* note 2. Private placements are "transactions by an issuer not involving any public offering," that is, offerings made to the private rather than the public markets. See Securities Act of 1933 § 4(2), 15 U.S.C. § 77d(2) (2000). According to John Jacobs, executive vice president of NASDAQ, private placements are "'a fraction of the cost and a fraction of the time'" of a public offering. Ken Schachter, *NASDAQ's New Exit*, RED HERRING, May 28, 2007, at 5, 6. A PORTAL listing is likely to cost one-third as much as a NASDAQ initial public offering (IPO), which "might cost more than \$600,000 in entry, annual, and administrative costs." *Id.*

7. David Cho, *Nasdaq Gives High Rollers a Market Free of Regulation*, WASH. POST, Aug. 14, 2007, at A1 (quoting the comments of Howard S. Marks, the chairman of a private investment firm, that the private placement market makes it "'possible to gain most of the advantages of being public while sidestepping the disadvantages'"); Schachter, *supra* note 6, at 5-6; see also Laurie Kulikowski, *Nasdaq Hopes Portal Will Expand Global Reach*, THESTREET.COM, Nov. 12, 2007, <http://www.thestreet.com/newsanalysis/wallstreet/10389707.html> ("Private placements have become much more common as firms such as hedge funds and other generally tight-lipped companies are looking for access to capital but do not want to undergo the rigorous compliance necessary for public companies under Securities and Exchange Commission rules.").

8. See Order Approving Proposed Rule Change to Reestablish the PORTAL Market, Exchange Act Release No. 56,172, 72 Fed. Reg. 44,196, 44,196 (Aug. 7, 2007) (discussing the history of PORTAL, and noting that it "did not develop as anticipated" in part due to the "required use of cumbersome technology").

9. Arthur Levitt, Former Chairman, Sec. & Exch. Comm'n, Address at Columbia Law School: Dynamic Markets, Timeless Principles (Sept. 23, 1999), <http://www.sec.gov/news/speech/speecharchive/1999/spch295.htm>. Levitt observed that

We are at a unique moment in our markets' history – a point of passage between what they have been and what they will become. In the next few years, they will undergo a transformation like we have never witnessed before. . . . We have an opportunity today that we may not have again in our lifetime – to realize the vision for a true national market system – one that embraces our future as much as it honors our past.

Id.

PORTAL system in 1990¹⁰ was an important step in the development of the private placement market, PORTAL's transition to a Web-based format may indeed be "one of the most significant developments on Wall Street in decades."¹¹

The private placement market has been growing since the adoption of Rule 144A in 1990,¹² but the trend has become particularly noticeable in recent years.¹³ Although the private placement market has always been large, its size has tripled since 2002.¹⁴ In 2006, "more money was raised in the private placement market than on the AMEX, NYSE and Nasdaq, combined," as American companies raised \$162 billion through restricted securities.¹⁵ In the first six months of 2007, "global equity and debt capital raised [via private placement offerings] was almost \$1 trillion," which represents a forty-three percent increase over the amount raised in the same period of 2006.¹⁶ NASDAQ officials predict that the number of stock offerings on private markets will soon greatly exceed the number of offerings on public exchanges.¹⁷

Rule 144A is an extension of the traditional private placement exemption from section 5 of the Securities Act of 1933 (Securities Act).¹⁸

10. See generally Order Approving Proposed Rule Change Relating to the Operation of the PORTAL Market, Exchange Act Release No. 27,956, 55 Fed. Reg. 18,781, 18,781-82 (May 4, 1990) (describing the operation of the original PORTAL system).

11. Cho, *supra* note 7; see also Ivy Schmerken, *Nasdaq, Goldman Sachs Creating Electronic Trading Platforms for Private Equity*, ADVANCEDTRADING.COM, July 26, 2007, <http://www.advancedtrading.com/showArticle.jhtml?articleID=201202145> (contrasting PORTAL's faulty start in the 1990s with its significant current potential due to advances in technology). Robert Greifeld, the chief executive officer of NASDAQ, has stated that PORTAL's movement online "could be as significant to the capital markets as the founding of Nasdaq 36 years ago." Shanny Basar, *Nasdaq to Launch Private Placement Market*, FIN. NEWS ONLINE US, Aug. 1, 2007, <http://www.financialnews-us.com/?page=ushome&contentid=2348452360>. According to John Jacobs, the executive vice president of NASDAQ, "[t]he launch of NASDAQ's Portal trading platform is a milestone in the transformation of the capital raising process in the U.S." *NASDAQ's Electronic Trading Platform*, *supra* note 2.

12. Resale of Restricted Securities, Securities Act Release No. 6862, Exchange Act Release No. 27,928, Investment Company Act Release No. 17,452, 55 Fed. Reg. 17,933 (Apr. 30, 1990) (codified as amended at 17 C.F.R. § 230.144A (2007)). See generally Securities Act Rule 144A, 17 C.F.R. § 230.144A (2007).

13. Schachter, *supra* note 6, at 5-6.

14. *NASDAQ's Electronic Trading Platform*, *supra* note 2.

15. Schmerken, *supra* note 11; see also Cho, *supra* note 7.

16. Laurie Kulikowski, *Wall Street Joins in 144A Frenzy*, THESTREET.COM, Aug. 14, 2007, <http://www.thestreet.com/newsanalysis/wallstreet/10374200.html>.

17. Cho, *supra* note 7.

18. See, e.g., *SEC v. Ralston Purina Co.*, 346 U.S. 119, 124-25 (1953) (interpreting what is now the section 4(2) exemption from the section 5 Securities Act registration requirements). The Supreme Court stated in *Ralston Purina Co.* that application of the registration provisions of the Securities Act "should turn on whether the particular class of

The rule allows resales of eligible restricted securities made to large sophisticated institutions to escape registration requirements under the Act.¹⁹ Private offerings were traditionally structured under section 4(2) of the Securities Act or Regulation D.²⁰ Private resales of restricted securities were originally structured under the unofficial section 4(1½) or the original Rule 144 exemptions.²¹ The adoption of Rule 144A in 1990 simplified the offering and resale exemptions for private placement securities.²² Simultaneous with the approval of Rule 144A, the National Association of Securities Dealers, Inc. (NASD) launched the PORTAL market to facilitate electronic trading among eligible investors under Rule 144A.²³ The Web-based PORTAL, a new version of the quotation and trading functions for restricted securities, was approved by the SEC on July 31, 2007 and introduced by NASDAQ on August 15, 2007.²⁴

This Comment argues that the SEC must define four areas of the private placement market to ensure PORTAL does not transform the original scope of Rule 144A: (1) requirements for the Rule 144A

persons affected needs the protection of the Act. An offering to those who are shown to be able to fend for themselves is a transaction ‘not involving any public offering.’” *Id.* at 125. The ability of prospective purchasers to “fend for themselves” depends on the offerees’ knowledge and on the availability of information that would normally be disclosed in a registration statement. *Id.* at 126-27; *see also* Sara Hanks, *Rule 144A: Another Cabbage in the Chop Suey*, 24 GEO. WASH. J. INT’L. L. & ECON. 305, 323 (1990).

19. Securities Act Rule 144A, 17 C.F.R. § 230.144A (2007).

20. Securities Act of 1933 § 4(2), 15 U.S.C. § 77d(2) (2000); Securities Act Regulation D, 17 C.F.R. §§ 230.501-.508 (2007).

21. Christopher Dean Olander & Margaret Stevens Jacks, *The Section 4(1½) Exemption—Reading Between the Lines of the Securities Act of 1933*, 15 SEC. REG. L.J. 339, 349 (1988) (“The term ‘4(1½)’ originated because the SEC, in no-action letters and other statements, has required that private resales of restricted . . . securities meet certain of the requirements necessary in order to perfect an exemption under Section 4(1) and 4(2).”); *see* Securities Act Rule 144, 17 C.F.R. § 230.144 (2007).

22. *See* Resale of Restricted Securities, Securities Act Release No. 6862, Exchange Act Release No. 27,928, Investment Company Act Release No. 17,452, 55 Fed. Reg. 17,933 (Apr. 30, 1990) (codified as amended at 17 C.F.R. § 230.144A).

23. *See* Order Approving Proposed Rule Change to Reestablish the PORTAL Market, Exchange Act Release No. 56,172, 72 Fed. Reg. 44,196 (Aug. 7, 2007). When NASD started PORTAL in 1990, NASDAQ was still a wholly-owned subsidiary of NASD. *See* Application of the Nasdaq Stock Market LLC for Registration as a National Securities Exchange, Exchange Act Release No. 53,128, 71 Fed. Reg. 3550, 3551, 3553 (Jan. 23, 2006). When NASDAQ became an independent securities exchange in July 2006, it retained control of PORTAL. Order Approving Proposed Rule Change to Reestablish the PORTAL Market, 72 Fed. Reg. at 44,197 nn.13 & 15. The NASD no longer exists; in July 2007, its regulatory function merged with the NYSE to create a new entity, the Financial Industry Regulatory Authority (FINRA). Order Approving Allocation of Regulatory Responsibilities, Exchange Act Release No. 56,148, 72 Fed. Reg. 42,146, 42,147 (Aug. 1, 2007).

24. Order Approving Proposed Rule Change to Reestablish the PORTAL Market, 72 Fed. Reg. at 44,196-97; *NASDAQ’s Electronic Trading Platform*, *supra* note 2.

exemption, (2) the role of PORTAL in complying with those requirements, (3) PORTAL's relationship with other industry players in the private placement market, and (4) the scope of PORTAL itself. First, this Comment explores the Securities Act and its private placement offer and resale exemptions, as well as Rule 144A and the evolution of PORTAL. Second, this Comment analyzes the impact of PORTAL on both the private placement and public markets as well as the venture capital industry. Finally, this Comment proposes that the SEC address the growth of the private placement market and its impact on public markets and the venture capital industry, as well as define PORTAL's role in the context of Rule 144A. The SEC's attention to these matters is necessary to ensure that PORTAL does not extend beyond the scope intended by Rule 144A and does not transform the competition-based securities markets in the long term.²⁵

I. THE LEGAL AND OPERATIONAL EVOLUTION OF PORTAL

The importance of PORTAL becomes clear when considering the legal precedent that led to its creation, as well as its operational evolution since its establishment in 1990. After the enactment of the Securities Act, two issuance exemptions (section 4(2) and Regulation D) and two resale exemptions (section 4(1½) and Rule 144) promoted the development of a functional private placement and restricted securities market.²⁶ The adoption of Rule 144A provided a simplified alternative to these regulatory provisions.²⁷ PORTAL was launched simultaneously with the promulgation of Rule 144A in 1990, as it was intended to serve

25. See William H. Donaldson, Former Chairman, U.S. Sec. & Exch. Comm'n, Opening Statement at Commission Open Meeting of April 6, 2005 Regarding Regulation NMS (Apr. 6, 2005), <http://www.sec.gov/news/speech/spch040605whd-nms.htm>. When discussing Regulation NMS, former Chairman Donaldson emphasized the SEC's belief in the importance of encouraging competition in the securities markets:

Regulation can enhance competition, and regulation can impede competition. . . .

It is the Commission's continual duty to examine the rules and regulations that govern the markets and to ask whether they advance or inhibit competition. If we find that a rule inhibits competition for no good reason, then we must act to abolish or reform it. Reform is the appropriate course when we believe in the principles underlying the rule, and we can further those principles in a way that does not unnecessarily or heedlessly impinge on competition.

Id.

26. Securities Act of 1933 § 4(2), 15 U.S.C. § 77d(2) (2000) (exempting from section 5 reporting requirements "transactions by an issuer not involving any public offering"); Securities Act Rule 144, 17 C.F.R. § 230.144 (2007) (implementing the section 4(1) exemption); Regulation D Rule 506, 17 C.F.R. § 230.506 (2007) (implementing the section 4(2) exemption); Olander & Jacks, *supra* note 21, at 341 & n.12 (describing the unofficial section 4(1½) exemption).

27. See Securities Act Rule 144A, 17 C.F.R. § 230.144A (2007).

as an electronic system to facilitate Rule 144A issuance and trading of private placement securities.²⁸ PORTAL's recent move to a Web-based format inspired a strong industry reaction that demonstrates its importance to the operation of the private placement and restricted securities market.²⁹

A. *The Securities Act of 1933*

Congress enacted the Securities Act to protect investors by requiring issuers to provide current financial and other material information through registration with the SEC.³⁰ The registration requirement, which is integral to the Act's mission of investor protection, falls under section 5 of the Act.³¹ Section 5 forbids the use of any means of interstate commerce or the mails to sell or offer securities without having first filed a registration statement with the SEC.³² It also prohibits the delivery of any security registered under the Securities Act unless the security is accompanied or preceded by a prospectus meeting certain requirements.³³

The Act exempts from section 5 registration requirements "transactions by an issuer not involving any public offering," known as private placements.³⁴ Prior to the adoption of Rule 144A, such private placements were traditionally structured under section 4(2) of the Securities Act or Regulation D.³⁵ Resales of restricted securities were structured under the unofficial section 4(1½) exemption or the original

28. See Order Approving Proposed Rule Change to Reestablish the PORTAL Market, 72 Fed. Reg. at 44,196.

29. See *infra* Part I.D.2.

30. See J. William Hicks, *Securities Regulation: Challenges in the Decades Ahead*, 68 IND. L.J. 791, 798 (1993) ("One of the essential missions of the SEC is to ensure that investors are provided with material information and are protected from fraud and misrepresentation in the public offering, trading, voting, and tendering of securities."). Whereas the Securities Act regulates the initial distribution of securities by issuers to investors, the Exchange Act of 1934 regulates the continued updating of that information. See Securities Exchange Act of 1934 § 2, 15 U.S.C. § 78b (2000). The SEC was created as part of the Exchange Act of 1934, *id.* § 4(a), 15 U.S.C. § 78d(a), at the conclusion of the Senate Banking and Currency Committee's 1932-1934 investigation of stock exchange practices, which sought to determine the reason for the stock market crash of 1929 and to prevent future crashes. See generally FERDINAND PECORA, WALL STREET UNDER OATH 3, 287-88 (Augustus M. Kelley Publishers 1968) (1939) (chronicling one of the first SEC Commissioner's experiences as counsel to the U.S. Senate Committee on Banking and Currency from 1933-1934).

31. Securities Act of 1933 § 5, 15 U.S.C. § 77e (2000).

32. *Id.*

33. *Id.*

34. See *id.* § 4(2), 15 U.S.C. § 77d(2).

35. See Securities Act Rule 144A, 17 C.F.R. § 230.144A (2007); see also Securities Act of 1933 § 4(2); Regulation D Rule 506, 17 C.F.R. § 230.506 (2007).

Rule 144 exemption.³⁶ For a complete understanding of Rule 144A, it is important to consider these original private placement and resale exemptions.

B. Exemptions from the Securities Act of 1933

The Securities Act provides for a number of exemptions from registration under section 5, but the two main categories of private placement exemptions are issuance exemptions and resale exemptions. Issuance exemptions such as section 4(2) and Regulation D allow issuers to offer securities in the primary market without registering with the SEC. Resale exemptions, such as Section 4(1-½) and Rule 144, allow purchasers to resell those securities on the secondary market to other buyers after a certain holding period. As a result, both exemptions must work together to create a functional market for private placements.

1. Section 4(2) Issuance Exemption

Section 4(2) of the Securities Act exempts private placements from the scope of the securities laws.³⁷ The legislative history states that the remedial purposes of the securities laws are not served by requiring registration for “a specific or an isolated sale of [an issuer’s] securities to a particular person” when “there is no practical need for [the Act’s] application or where the public benefits are too remote.”³⁸ The Supreme Court relied on this legislative history when it was called on to interpret the meaning of “public offering” under section 4(a) in *SEC v. Ralston Purina Co.*³⁹ There, the Court established that the key factors to consider in determining whether an offering is public include the sophistication of the offeree, the offeree’s access to information, and the nature of the offering.⁴⁰ The Court concluded that the determination “should turn on whether the particular class of persons affected needs the protection of the Act. An offering to those who are shown to be able to fend for themselves is a transaction ‘not involving any public offering.’”⁴¹ As a result, private placements are not considered public offerings because

36. See Securities Act Rule 144, 17 C.F.R. § 230.144 (2007); Olander & Jacks, *supra* note 21, at 341.

37. 15 U.S.C. § 77d(2).

38. H.R. REP. NO. 73-85, at 5, 16 (1933).

39. 346 U.S. 119, 122, 125 (1953).

40. *Id.* at 124-27; see also Hanks, *supra* note 18, at 322-23 (noting that courts have considered such factors as “(1) offeree qualification; (2) availability of information; (3) manner of offering; and (4) absence of redistribution”). Additionally, the Court determined that the statute “would seem to apply to a ‘public offering’ whether to few or many.” *Ralston Purina Co.*, 346 U.S. at 125.

41. *Ralston Purina Co.*, 346 U.S. at 125.

they are offered in limited quantity to sophisticated investors with access to information about their purchases.⁴²

2. Regulation D Issuance Exemption

The adoption of Regulation D expanded issuers' ability to rely on the section 4(2) private placement exemption.⁴³ Rule 506 under Regulation D⁴⁴ exempts certain offers and sales made to an unlimited number of accredited investors, and up to thirty-five non-accredited investors,⁴⁵ without general solicitation or advertising.⁴⁶ Additionally, the issuer must exercise "reasonable care"⁴⁷ to assure that purchasers are not

42. See *id.* at 126-27.

43. See Revision of Certain Exemptions from Registration for Transactions Involving Limited Offers and Sales, Securities Act Release No. 6389, 47 Fed. Reg. 11,251, 11,251-52 (Mar. 16, 1982). Regulation D both clarifies the criteria of section 4(2) and acts as an independent safe harbor. See *id.* Failure to comply with the requirements of Regulation D does not preclude the use of traditional section 4(2) private placement exemption. *Id.*

44. Regulation D Rule 506, 17 C.F.R. § 230.506 (2007). Whereas Rules 504 and 505 of Regulation D were promulgated under section 3(b)'s exemptions for small offerings, see Regulation D Rules 504(a), 505(a), 17 C.F.R. §§ 230.504(a), .505(a), Rule 506 arose under section 4(2), Regulation D Rule 506(a), 17 C.F.R. § 230.506(a). The remainder of the rules—Rules 501 to 503, 507, and 508—provide definitions, general conditions, and other provisions that apply to each of the three exemptive rules. Regulation D Rules 501-03, 507-08, 17 C.F.R. §§ 230.501-.503, .507-.508 (2007).

45. 17 C.F.R. §§ 230.501(a), .501(e)(1)(iv), .506(a), .506(b)(2). Most institutions qualify as accredited investors, as do individuals meeting specified net worth or income tests. *Id.* § 230.501(a). In addition, each issuer must reasonably believe that "[e]ach purchaser who is not an accredited investor . . . has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment." *Id.* § 230.506(b)(2). Recently, the SEC proposed to increase the wealth requirement for individuals meeting the accredited investor standard from \$1 million to \$2.5 million. Revisions of Limited Offering Exemptions in Regulation D, Securities Act Release No. 8828, Investment Company Act Release No. 27,922, 72 Fed. Reg. 45,116, 45,118 (proposed Aug. 10, 2007); see also Stephanie Baum, *SEC Seeks to Boost Wealth Requirement For Investors*, FIN. NEWS ONLINE US, Oct. 10, 2007, <http://www.financialnews-us.com/?page=ushome&contentid=2448923443>.

46. 17 C.F.R. § 230.502(c). However, publication of a notice that meets the requirements of Securities Act Rule 135c is not considered to constitute general solicitation or advertising. *Id.* § 230.502(c)(2). A so-called tombstone advertisement is also not considered to be a general solicitation or advertisement for purposes of Regulation D so long as it meets the standards of Securities Act Rule 134 by stating only (1) the issuer's name, (2) the title of the security, (3) the amount offered, (4) the issuer's type of business, (5) the security's price, and (6) certain other limited information, and it is published after the private placement transaction is made. See Securities Act Rule 134, 17 C.F.R. § 230.134 (2007); Alma Securities Corp., SEC No-Action Letter, 1982 WL 29423, at *1 (Aug. 2, 1982).

47. 17 C.F.R. § 230.502(d). Regulation D provides a non-exclusive list of steps that, if followed, satisfy the reasonable care standard, including

(1) [r]easonable inquiry to determine if the purchaser is acquiring the securities for himself or for other persons;

“underwriters” and will not resell the securities to other investors without registration.⁴⁸ In addition, Regulation D requires that information about the issuer be furnished prior to sale if the purchaser is a non-accredited investor.⁴⁹ Finally, a notice of the offering on Form D, including a sales report, must be filed with the SEC.⁵⁰

3. Section 4(1½) Resale Exemption

The purchaser in a private placement offering cannot rely on the issuer’s private placement exemption under section 4(2) or Regulation D to resell those securities into the secondary market.⁵¹ Nor is the purchaser able to claim the exemption provided by section 4(1) for trading in the resale market, because that would make the purchaser an underwriter subject to the Act’s registration requirements.⁵² As a result, the industry began to use a combination of the section 4(1) and 4(2)

(2) [w]ritten disclosure to each purchaser prior to sale that the securities have not been registered . . . ; and

(3) [p]lacement of a legend on the certificate . . . stating that the securities have not been registered under the Act and setting forth or referring to the restrictions on transferability and sale of the securities.

Id.

48. *Id.* The Securities Act defines “underwriter” as any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors’ or sellers’ commission. As used in this paragraph the term “issuer” shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.

Securities Act of 1933 § 2(a)(11), 15 U.S.C. § 77b(a)(11) (2000). If a purchaser is deemed to have purchased the securities “with a view to their distribution” rather than with the “proper investment intent,” he may be considered an underwriter, thus requiring him to register with the SEC. Olander & Jacks, *supra* note 21, at 343; *see also* Kellye Y. Testy, Note, *The Capital Markets in Transition: A Response to New SEC Rule 144A*, 66 IND. L.J. 233, 251 (1990).

49. 17 C.F.R. § 230.502(b)(1). The extent of disclosure depends on the value of the offering. *Id.* § 230.502(b)(2)(i)(B).

50. *Id.* § 230.503(a).

51. *See* Securities Act of 1933 § 4(2), 15 U.S.C. § 77d(2) (2000); 17 C.F.R. § 230.506.

52. *See* 15 U.S.C. §§ 77b(a)(11), 77d(1). Section 4(1) exempts “transactions by any person other than an issuer, underwriter, or dealer.” *Id.* § 77d(1). This exemption for secondary trading is available to the purchaser, but an immediate resale without a holding period would make the purchaser an underwriter because the Securities Act defines the term “underwriter” so broadly. *See id.* §§ 77b(a)(11), 77d(1); *see also* Marc I. Steinberg & Joseph P. Kempler, *The Application and Effectiveness of SEC Rule 144*, 49 OHIO ST. L.J. 473, 474-75 (1988).

exemptions, the so-called section 4(1½) exemption for private resales.⁵³ Investors in restricted securities have relied on the section 4(1½) exemption to resell to institutional investors after a certain holding period by structuring the section 4(1) resale as a non-public offering within the meaning of section 4(2).⁵⁴ This technique, however, was never “officially sanctioned” by the SEC.⁵⁵

4. Rule 144 Resale Exemption

The other alternative available to holders of restricted securities before the adoption of Rule 144A was to resell them into the public market under Rule 144.⁵⁶ Rule 144 provides guidelines for the seller to ensure that he is not considered an underwriter under section 4(1) and therefore can escape registration requirements under the Securities Act.⁵⁷ Rule 144 generally requires, among other things, that the seller must have been the beneficial owner of the securities for at least one year prior to resale.⁵⁸ In addition, sales are subject to conditions on the manner of sale, amount of shares that can be sold, availability of public information about the issuer, and form of notice to be made.⁵⁹

C. Rule 144A Issuance and Resale Exemption

Rule 144A is the most recent private placement exemption.⁶⁰ The SEC explicitly promulgated this rule to remove uncertainties about the legitimacy of restricted security resales to institutional buyers.⁶¹ A review of both the goals and the mechanics of Rule 144A demonstrates the importance of this rule to the development of PORTAL.

1. Goals of Rule 144A

The purpose of Rule 144A was to enhance the competitiveness of the U.S. market in the international capital-raising arena “by making it more attractive to foreign issuers.”⁶² Increasing liquidity in the private

53. Olander & Jacks, *supra* note 21, at 349.

54. *Id.* at 349-50.

55. Testy, *supra* note 48, at 252; *see also* Olander & Jacks, *supra* note 21, at 341-42.

56. *See* Securities Act Rule 144, 17 C.F.R. § 230.144 (2007).

57. Olander & Jacks, *supra* note 21, at 345.

58. 17 C.F.R. § 230.144(c).

59. *Id.* § 230.144(c), (e)-(f), (h).

60. Resale of Restricted Securities, Securities Act Release No. 6862, Exchange Act Release No. 27,928, Investment Company Act Release No. 17,452, 55 Fed. Reg. 17,933, 17,933-34 (Apr. 30, 1990) (codified as amended at 17 C.F.R. § 230.144A (2007)).

61. Resale of Restricted Securities, Securities Act Release No. 6806, 53 Fed. Reg. 44,016, 44,022 (proposed Nov. 1, 1988).

62. Luis F. Moreno Treviño, *Access to U.S. Capital Markets for Foreign Issuers: Rule 144A Private Placements*, 16 HOUS. J. INT'L L. 159, 174 (1993). The Commission staff has

placement market by clarifying the regulatory framework for resales facilitates the purchase of foreign securities in the United States by institutional investors.⁶³ Rule 144A destroyed the illiquidity discount previously applicable to all private placements by eliminating any holding period for sales to qualified institutional buyers (QIBs),⁶⁴ and thereby ensured more accurate and efficient markets for restricted securities.⁶⁵

expressed its goal as “remov[ing] unnecessary impediments to transnational capital formation, while assuring that those buying securities in the United States capital markets are afforded the protection, intended by the Securities Act and the Securities Exchange Act.” STAFF OF THE U.S. SEC. & EXCH. COMM’N, REPORT TO THE SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS AND THE HOUSE COMMITTEE ON ENERGY AND COMMERCE ON INTERNALIZATION OF THE SECURITIES MARKETS, at III-312 (1987).

63. See Robert A. Barron, *Control and Restricted Securities*, 18 SEC. REG. L.J. 400, 400-01 (1991). During an SEC meeting on April 19, 1990, SEC Chairman Richard C. Breeden stated that “‘Rule 144A . . . will bring enhanced market liquidity and efficiency for investors in the burgeoning private placement market; together with direct access to foreign issues in the U.S. institutional capital markets. As such, it is a step toward a more liquid and efficient institutional resale market for unregistered securities.’” *Id.*; see also Resale of Restricted Securities, 53 Fed. Reg. at 44,022 (“Removing uncertainties as to the legitimacy of resales to institutional buyers by providing a safe harbor from registration could permit some transactions to take place that otherwise might not occur. . . . Providing a framework in which institutional resales could be made freely may increase the efficacy of the private placement market.”). At the time Rule 144A was proposed, the SEC felt overwhelmed by several factors, including the imminent threat of the European market’s unification, constant criticism both at home and abroad for maintaining conservative policies, and pressure exerted by domestic participants of the U.S. market. Michael P. Kelley, Comment, *Bringing the Euromarket Back Home: Attracting Japanese Debt and Equity Securities Through SEC Rule 144A*, 13 GEO. MASON U. L. REV. 347, 350 (1990). However, in considering Rule 144A, the SEC noted that the Securities Act registration process was intended to benefit the “investing public,” not institutions. Resale of Restricted Securities, 53 Fed. Reg. at 44,023 & n.101 (“References to investors in the legislative history of the Securities Act are to ‘the poor woman who ha[d] a little money to invest,’ ‘poor men and women who turned over their live [sic] savings,’ and ‘widows who owned Liberty bonds, having invested the accumulations of a lifetime,’ not to sophisticated institutions.” (citations omitted)).

64. See 17 C.F.R. § 230.144A(a)(1) (defining the term “qualified institutional buyer”).

65. John C. Coffee, Jr., *Re-Engineering Corporate Disclosure: The Coming Debate Over Company Registration*, 52 WASH. & LEE L. REV. 1143, 1177-78 (1995); see also Testy, *supra* note 48, at 252-53. Beyond the holding requirements under Rule 144, there is often a lack of liquidity as a result of limited demand, so institutions often wait years before exiting a position. See Schachter, *supra* note 6, at 5. As holding periods decrease, causing illiquidity discounts to shrink, private placements become more attractive. Cf. Coffee, *supra*, at 1177.

2. Mechanics of Rule 144A

Rule 144A provides an exemption from registration under section 5 for the resale of certain privately placed and restricted securities.⁶⁶ Rule 144A is available to any person other than an issuer, so issuers must still rely on one of the original private placement exemptions.⁶⁷ In addition, it does not apply to open-end investment companies, such as mutual funds, which continually re-issue their shares on a daily basis.⁶⁸ To fall within the safe harbor, Rule 144A requires at least four conditions to be met.

First, the securities must be “offered or sold only to a [QIB] or to an offeree or purchaser that the seller and any person acting on behalf of the seller reasonably believe is a [QIB].”⁶⁹ To qualify as a QIB, an entity must own and invest, on a discretionary basis, at least \$100 million in securities of companies having no corporate affiliation with the purchaser.⁷⁰

66. 17 C.F.R. § 230.144A. The underlying policy for allowing QIBs to trade without disclosure is that they are able to “fend for themselves” because they are financially sophisticated entities; therefore, the protection provided by the Securities Act’s registration and other requirements is not necessary. *See* Resale of Restricted Securities, 53 Fed. Reg. at 44,023-26.

67. *See* Resale of Restricted Securities, Securities Act Release No. 6862, Exchange Act Release No. 27,928, Investment Company Act Release No. 17,452, 55 Fed. Reg. 17,933, 17,934 (Apr. 30, 1990) (codified as amended at 17 C.F.R. § 230.144A).

68. *See* 17 C.F.R. § 230.144A(d)(3)(ii).

69. *Id.* § 230.144A(d)(1). There are several types of entities that may qualify as QIBs: insurance companies; registered investment companies or business development companies organized under the Investment Company Act of 1940; Small Business Investment Companies licensed by the U.S. Small Business Administration; employee benefit plans established and maintained by a state or municipality; employee benefit plans organized under the Employee Retirement Income Security Act of 1974 (ERISA); collective or master trusts used for the investment of employee benefit plan funds; nonprofit organizations organized under § 501(c)(3) of the Internal Revenue Code, corporations, partnerships, or business trusts; investment advisers registered under the Investment Advisers Act of 1940; registered securities broker-dealers; U.S. or foreign banks; and any entities of which all the equity owners are QIBs. *Id.* § 230.144A(a)(1).

70. *Id.* § 230.144A(a)(1)(i). In determining the aggregate amount of securities that an entity must own and invest on a discretionary basis, Rule 144A excludes “bank deposit notes and certificates of deposit; loan participations; repurchase agreements; securities owned but subject to a repurchase agreement; and currency interest rate and commodity swaps.” *Id.* § 230.144A(a)(2). U.S. banks and thrifts, in addition to the \$100 million threshold, must reflect an additional \$25 million net worth in their latest annual financial statement, which cannot precede the sale by more than sixteen months. *Id.* § 230.144A(a)(1)(vi). To be considered a QIB, any broker-dealer that is either “acting for its own account or the accounts of other [QIBs]” must own at least \$10 million of securities of issuers having no affiliation with the broker-dealer. *Id.* § 230.144A(a)(1)(ii). However, any broker-dealer acting as the agent of a QIB or as a principal in transacting for his own account need not meet any net worth test if he is engaging in a “riskless principal transaction.” *Id.* § 230.144A(a)(1)(iii). Rule 144A defines a riskless principal transaction as “a transaction in which a dealer buys a security from any person and makes

Second, the seller must “take[] reasonable steps to ensure that the purchaser is aware that the seller may rely on the exemption.”⁷¹ Rule 144A provides four non-exclusive methods to determine whether the prospective buyer meets the QIB requirements: (1) “[t]he prospective purchaser’s most recent publicly available financial statements,”⁷² (2) “[t]he most recent publicly available information appearing in documents filed by the prospective purchaser” with the SEC,⁷³ (3) “[t]he most recent publicly available information appearing in a recognized securities manual,”⁷⁴ or (4) “[a] certification by the chief financial officer . . . or other executive officer of the purchaser.”⁷⁵

Third, the securities must not be the same class of securities as those listed on a national securities exchange or quoted in NASDAQ.⁷⁶ This fungibility requirement ensures that there is no two-tiered market for the same security for institutions and retail investors.⁷⁷

a simultaneous offsetting sale of such security to a [QIB], including another dealer acting as riskless principal for a [QIB].” *Id.* § 230.144A(a)(5).

71. *Id.* § 230.144A(d)(2).

72. *Id.* § 230.144A(d)(1)(i). Financial statements must present information “as of a date within 16 months preceding the date of sale of securities under this section in the case of a U.S. purchaser and within 18 months preceding such date of sale for a foreign purchaser.” *Id.*

73. *Id.* § 230.144A(d)(1)(ii). If the information is not available at the SEC, it is permissible to use the records of “another U.S. federal, state, or local governmental agency or self-regulatory organization, or . . . a foreign governmental agency or self-regulatory organization.” *Id.*

74. *Id.* § 230.144A(d)(1)(iii). The same time limits apply for this type of information as apply to financial statements. *See id.*; *see also supra* note 72.

75. 17 C.F.R. § 230.144A(d)(1)(iv). The certification must specify “the amount of securities owned and invested on a discretionary basis by the purchaser as of a specific date on or since the close of the purchaser’s most recent fiscal year.” *Id.*

76. *Id.* § 230.144A(d)(3)(i).

77. Changes to Method of Determining Holding Period of Restricted Securities, Securities Act Release No. 6839, 54 Fed. Reg. 30,076, 30,078 (proposed July 18, 1989). Equity securities are considered the same class if they are “of substantially similar character and the holders thereof enjoy substantially similar rights and privileges.” Resale of Restricted Securities, Securities Act Release No. 6862, Exchange Act Release No. 27,928, Investment Company Act Release No. 17,452, 55 Fed. Reg. 17,933, 17,935 & n.23 (Apr. 30, 1990) (codified as amended at 17 C.F.R. § 230.144A) (explaining that this test is identical to the one found in section 12(g)(5) of the Exchange Act, and that the SEC would interpret both in the same manner). Preferred equity securities are “deemed to be of the same class if their terms relating to dividend rate, cumulation, participation, liquidation preference, voting rights, convertibility, call, redemption, and other similar material matters are substantially identical.” *Id.* at 17,935. Debt securities are of the same class “if their terms relating to interest rate, maturity, subordination, security, convertibility, call, redemption, and similar material matters are substantially identical.” *Id.* This fungibility requirement is less relevant for debt and preferred stock than common equity because few debt and preferred stock issues are listed or quoted on the public

Fourth, the issuer must provide certain “reasonably current” information to the seller and his prospective purchaser upon request.⁷⁸ If the issuer is a reporting company, foreign private issuer that has qualified for an exemption under Rule 12g3-2(b), or a foreign government, the issuer does not have to provide the information required by Rule 144A.⁷⁹ However, most issuers with restricted securities are private companies, so they nevertheless will need to provide a brief statement of the nature of the business of the issuer and its products and services⁸⁰ along with the issuer’s most recent financial statements.⁸¹

Finally, some securities practitioners also argue that “there is a fifth, unarticulated” requirement: “a prohibition on ‘general solicitation.’”⁸² There is no accepted definition of general solicitation in the context of Rule 144A.⁸³ However, the SEC stated that a “closed, screen-based

market. 1 EDWARD F. GREENE ET AL., U.S. REGULATION OF THE INTERNATIONAL SECURITIES AND DERIVATIVES MARKETS § 4.03[1][c] (8th ed. 2006).

78. 17 C.F.R. § 230.144A(d)(4)(i). Specifically, the information may be provided by the issuer, the seller, or an agent of either. *See id.* The information is presumed to be reasonably current if “[t]he balance sheet is as of a date less than 16 months before the date of resale,” the profit, loss, and retained earnings statements “are for the 12 months preceding the date of such balance sheet,” and the business description “is as of a date within 12 months prior to the date of resale.” *Id.* § 230.144A(d)(4)(ii).

79. *Id.* § 230.144A(d)(4)(i).

80. *Id.* This information is comparable to that required by Rule 15c2-11(a)(5) under the Exchange Act. Resale of Restricted Securities, 55 Fed. Reg. at 17,939.

81. 17 C.F.R. § 230.144A(d)(4)(i). The required financial information is the same as that called for by Rule 15c2-11(a)(5) under the Exchange Act. Resale of Restricted Securities, 55 Fed. Reg. at 17,939. The financial statements should be audited to the extent audited financial statements are reasonably available. Securities Act Rule 144A(d)(4)(i), 17 C.F.R. § 230.144A(d)(4)(i) (2007).

82. Hanks, *supra* note 18, at 338. Ms. Hanks points to comments on the subject of general solicitation made by Linda C. Quinn, a senior SEC official, at a Practising Law Institute conference on Rule 144A. *Id.* at 338 n.176. Despite the disclaimer that the speaker’s remarks do not represent the SEC’s rules, Hanks observes, “[t]he securities bar . . . is inclined to take seriously the views of such a senior official. In fact, Ms. Quinn’s remarks only confirmed the opinion already held by many lawyers and reflected in their documentation of rule 144A offerings – that general solicitation would ‘blow’ the offering.” *Id.*; *see also* J. WILLIAM HICKS, REALES OF RESTRICTED SECURITIES § 7:43 (2006) (“[I]nformal comments by a member of the SEC staff indicate that a person may not rely on Rule 144A if he directly or indirectly engages in general solicitation.”) (citing Hanks, *supra* note 18, at 338 n.176).

83. Hanks, *supra* note 18, at 340. In the context of regulation of foreign broker-dealers, solicitation includes any affirmative effort by a broker or dealer that is intended to induce transactional business for the broker-dealer or its affiliates. Securities Exchange Act Rule 15a-6, 17 C.F.R. § 240.15a-6 (2007). Under Regulation D, general solicitation includes: “(1) [a]ny advertisement, article, notice or other communication published in any newspaper, magazine, or similar media or broadcast over television or radio; and (2) [a]ny seminar or meeting whose attendees have been invited by any general solicitation or general advertising.” Regulation D Rule 502, 17 C.F.R. § 230.502(c) (2007); *see also*

information system” where “access to the transmission was limited to institutions that the Seller had confirmed were QIBs and a confidential password was assigned to the QIB” was permissible.⁸⁴ Concerns about general solicitation continue to play a role in proper application of the Rule 144A exemption.⁸⁵

D. The PORTAL Market

PORTAL’s development is rooted in Rule 144A. Just as Rule 144A represented the next evolution of the private placement market from a regulatory perspective, PORTAL was supposed to move it to the next level with regard to execution.⁸⁶ Prior to PORTAL, the resale market in restricted securities functioned like a traditional over-the-counter market, where issuers and investors negotiated directly without any centralized quotation or trade comparison systems.⁸⁷ As a result, many characterized the market as one that had not “realized its potential.”⁸⁸ The SEC believed that PORTAL would expand this market by enhancing its operational efficiency.⁸⁹ Although the NASD’s attempt to develop a more centralized trading platform for private placements and

HICKS, *supra* note 82, § 7:43 (“[T]he ban presumably relates to the selling efforts that are proscribed by Rule 502(c) of Regulation D.”).

84. Letter from Thomas P. Moran, Assoc. Gen. Counsel, NASDAQ, to Nancy M. Morris, Sec’y, U.S. Sec. & Exch. Comm’n 2-3 (July 23, 2007), available at <http://www.sec.gov/comments/sr-nasdaq-2006-065/nasdaq2006065-9.pdf> (citing Institutional Real Estate Clearing House, SEC No-Action Letter, 1996 WL 279164 (May 28, 1996); Net Roadshow, Inc., SEC No-Action Letter, 1998 WL 40252 (Jan. 30, 1998)).

85. See, e.g., *id.* at 2 (“Nasdaq believes that the dissemination by PORTAL Dealers and PORTAL Brokers of PORTAL Market quotations and last sale report information of other PORTAL Dealers and PORTAL Brokers to investors not qualified by Nasdaq could constitute a prohibited general solicitation of Rule 144A transactions, contrary to the SEC’s historical efforts to limit access to such information to investors that are qualified as QIBs by the system operator.”).

86. See Order Approving Proposed Rule Change Relating to the Operation of the PORTAL Market, Exchange Act Release No. 27,956, 55 Fed. Reg. 18,781, 18,781 (May 4, 1990); Resale of Restricted Securities, Securities Act Release No. 6862, Exchange Act Release No. 27,928, Investment Company Act Release No. 17,452, 55 Fed. Reg. 17,933, 17,947 (Apr. 30, 1990) (codified as amended at 17 C.F.R. § 230.144A).

87. R. Brandon Asbill, Recent Development, *Securities Regulation – Great Expectations and the Reality of Rule 144A and Regulation S; The SEC’s Approach to the Internalization of the Financial Marketplace*, 21 GA. J. INT’L & COMP. L. 145, 148 (1991).

88. Schmerken, *supra* note 11. According to NASDAQ, “[i]nvestors have long wanted to buy and sell private securities but often could not find people to trade with.” Associated Press, *NASDAQ to Launch “Private” Exchange*, ABCMONEY.CO.UK, Aug. 14, 2007, <http://www.abcmoney.co.uk/news/142007118628.htm>.

89. Asbill, *supra* note 87, at 148.

restricted securities met with mixed results in 1990, NASDAQ's recent Web-based efforts seem poised for success.⁹⁰

1. Operation of PORTAL

On the same day it approved Rule 144A, the SEC also approved the original electronic PORTAL, a computer system that used NASDAQ terminals and network facilities but operated independently of the NASDAQ system to facilitate both private placement offerings and restricted security resales.⁹¹ In addition to providing resale trading in private placement securities, the PORTAL system facilitated the initial issuance of such securities by carrying information about a proposed offering to all PORTAL-registered QIBs.⁹² PORTAL's move to a web-based format for restricted equity trading on August 15, 2007 comprised a password-protected system only available to QIBs, thereby potentially creating the first genuinely transparent secondary marketplace for trading in private placements and restricted securities.⁹³ Whereas the electronic PORTAL focused on private placement offerings, as well as

90. Jenna Michaels, *NASD's Global Fumble*, WALL ST. & TECH., July 1992, at 57. The original electronic PORTAL was not considered a success with an estimated seventy-five subscribers from a potential pool of over 3300 QIBs. *Id.* When the SEC approved the Web-based PORTAL in 1990, it stated that the PORTAL market did not develop as originally planned because the original rules required trade reporting, even though this was not required for privately-placed securities and because for reporting purposes participants had to use "cumbersome technology" in order to access the PORTAL computer system. Order Approving Proposed Rule Change to Reestablish the PORTAL Market, Exchange Act Release No. 56,172, 72 Fed. Reg. 44,196, 44,196 (Aug. 7, 2007).

Although the Web-based PORTAL does not have these problems, some securities commentators are skeptical about its potential success due to "the problems affecting both the sub-prime market and, more importantly, private equity." *NASDAQ Launches Major Change with a Private Stock Market*, ASCRIBE NEWSWIRE, Aug. 15, 2007, available in LEXIS, Nexis Library, ASCRBE File [hereinafter *NASDAQ Launches Major Change*] (quoting Chris Brummer, Assistant Professor of Law, Vanderbilt University). Others say that the market already exists and this will only simplify access and transparency through the use of technology. Schmerken, *supra* note 11. The positive predictions for the Web-based PORTAL are perhaps coming true: NASDAQ recently announced record operating results, which it attributed to many of its recent initiatives, including the launch of the PORTAL Market. *NASDAQ Announces Third Quarter 2007 Results*, PRIME NEWSWIRE, Oct. 24, 2007, available in LEXIS, Nexis Library, PRIZNE File.

91. Order Approving Proposed Rule Change Relating to the Operation of the PORTAL Market, 55 Fed. Reg. at 18,781-82.

92. *Id.* at 18,784-85.

93. See Order Approving Proposed Rule Change to Reestablish the PORTAL Market, 72 Fed. Reg. at 44,197; Basar, *supra* note 11 (reporting PORTAL's August 15, 2007 launch with equities trading). One goal of a Web-based PORTAL is "greater market transparency in PORTAL securities in the form of centralized quotations and last sale trade information." Notice of Proposed Rule Change to Reestablish the PORTAL Market, Exchange Act Release No. 55,669, 72 Fed. Reg. 23,874, 23,876 (May 1, 2007); see also Schmerken, *supra* note 11.

resales, the online PORTAL trading system facilitates resales exclusively.⁹⁴ Although PORTAL went through a number of revisions from its inception, this represents the most significant transformation since 1990.⁹⁵

The SEC described the operation of the new PORTAL trading system by focusing on five areas, all of which are very similar to its original electronic platform.⁹⁶ First, PORTAL-designated securities are those that are “initially sold to QIBs by a broker-dealer acting as initial placement agent or initial purchaser.”⁹⁷ Under the new system, “NASDAQ would continue to qualify [Rule 144] ‘restricted securities,’ and securities that are restricted pursuant to contract or through the terms of the security, for designation as PORTAL securities.”⁹⁸ The PORTAL rules also give NASDAQ the authority to “suspend or terminate the designation of a PORTAL security.”⁹⁹

Second, NASDAQ members can be designated “‘PORTAL Dealers,’” who trade for their own accounts, and “‘PORTAL Brokers,’” who trade as agents for their customers.¹⁰⁰ Once designated, the dealers and brokers may post “anonymous one- or two-sided indicative quotations,” negotiate openly or anonymously, and execute trades.¹⁰¹

Third, “institution[s] that execute[] a subscriber agreement, agree[] to comply with the PORTAL rules and meet[] the \$100 million and other standards in Rule 144A to be a QIB” may become “PORTAL Qualified Investors.”¹⁰² Although they cannot enter quotations or orders directly into PORTAL, these institutions can access the PORTAL Market through a “password protected linkage” to view quotations and to confirm transactions executed by their PORTAL Dealer or Broker.¹⁰³ Confirmed trades will be forwarded automatically to the Depository Trust & Clearing Corporation (DTCC) for settlement.¹⁰⁴

94. See Schmerken, *supra* note 11. NASDAQ’s John Jacobs stated that the original electronic PORTAL was “‘great for capital formation but not secondary market formation.’” *Id.* As a result, NASDAQ’s focus with the online PORTAL was improving the secondary, rather than the primary market. See *id.*

95. See Order Approving Proposed Rule Change to Reestablish the PORTAL Market, 72 Fed. Reg. at 44,196.

96. *Id.* at 44,197-98.

97. *Id.* at 44,197.

98. *Id.*

99. *Id.*

100. *Id.*

101. *Id.*

102. *Id.*

103. *Id.*

104. *Id.* Friedman, Billings, Ramsey & Co. (FBR), a prominent Washington, D.C. investment bank, raised its concern that because the new PORTAL system “will be the

Fourth, NASDAQ will provide PORTAL trade reports to TRACE (Trade Reporting and Compliance Engine Service) and the OTC Reporting Facility (formerly the Automated Confirmation Transaction Service).¹⁰⁵ In addition, NASDAQ will make these anonymous reports available to all PORTAL participants.¹⁰⁶ Due to the restricted nature of PORTAL, recipients are not allowed to disclose the PORTAL Market information they receive to any party outside the PORTAL Market trading system.¹⁰⁷ Similarly, NASDAQ will not disseminate PORTAL Market information to the public.¹⁰⁸

Fifth, FINRA will monitor all trade reports in PORTAL securities.¹⁰⁹ NASDAQ's MarketWatch Department will provide "[r]eal-time surveillance" of PORTAL quoting and trading activity.¹¹⁰ As a result, FINRA and NASDAQ will share supervisory responsibilities over PORTAL.¹¹¹

By the time the new PORTAL Market trading platform was launched on August 15, 2007, more than 1,700 equity and debt securities had been designated as PORTAL securities,¹¹² and about 1200 companies had registered to participate.¹¹³ Historically, the restricted security market

only system that currently satisfies the DTC[C] eligibility standard" and "DTC[C] eligibility is important to investors," issuers of Rule 144A equity securities "will be forced" to register their securities in PORTAL. Letter from William J. Ginivan, Gen. Counsel, Friedman, Billings, Ramsey & Co., to Nancy M. Morris, Sec'y, U.S. Sec. & Exch. Comm'n 6 (May 22, 2007), available at <http://www.sec.gov/comments/sr-nasdaq-2006-065/nasdaq2006065-3.pdf> [hereinafter May Ginivan Letter]. FBR argued that "[l]inking DTC[C] eligibility to PORTAL registration provides Nasdaq a steady stream of product." *Id.* However, NASDAQ has explained that "nothing in DTC[C]'s current rules or processes would preclude another [self-regulatory organization] from establishing and operating a system for Rule 144A securities and obtaining depository services for those issues," so NASDAQ does not believe its behavior is anticompetitive. Letter from Thomas P. Moran, Assoc. Gen. Counsel, NASDAQ, to Nancy M. Morris, Sec'y, U.S. Sec. & Exch. Comm'n 11 (June 28, 2007), available at <http://www.sec.gov/comments/sr-nasdaq-2006-065/nasdaq2006065-7.pdf> [hereinafter Moran Letter]. Rather, NASDAQ argues that this "provides an opportunity for innovation and competition." *Id.*

105. Order Approving Proposed Rule Change to Reestablish the PORTAL Market, 72 Fed. Reg. at 44,196-97.

106. *Id.*

107. *Id.*

108. *Id.*

109. *Id.* at 44,197-98.

110. *Id.* at 44,198.

111. *Id.*

112. *NASDAQ's Electronic Trading Platform*, *supra* note 2.

113. Andrew Ross Sorkin & Michael J. de la Merced, *Buyout Firm Said to Seek a Private Market Offering*, N.Y. TIMES, July 18, 2007, at C3. Companies that have raised funding through PORTAL this year and last include "Archer Daniels Midland Company, Adidas (Germany), Bank of China, Rosneft (Russia), Samsung (Korea), Telstra

has been ninety-five percent debt and five percent equity, but the equity portion has recently tripled to fifteen percent of the total market.¹¹⁴ PORTAL offers previously unavailable “trading, trade reporting, historical prices, last sales [prices] and tickers,” similar to a regular stock exchange.¹¹⁵ NASDAQ has also stated that it is working with third-party providers to create an “industry-wide shareholder tracking” system to ensure that no more than 499 shareholders invest in any single PORTAL equity at one time, which will prevent triggering registration obligations under the Securities Act.¹¹⁶

2. Industry Reaction to PORTAL

In order to address the demands of issuers in the securities industry, investment banks first responded to PORTAL by introducing their own private placement and restricted securities trading systems before collaborating with NASDAQ on creating an industry-wide platform. Goldmans Sachs launched GS Tradable Unregistered Equity OTC Market (GSTRUE) in May 2007.¹¹⁷ Five other Wall Street firms – Citigroup, Bank of New York Mellon, Lehman Brothers, Merrill Lynch, and Morgan Stanley – formed Open Platform for Unregistered Securities (OPUS-5) in August 2007 to provide a similar system for trading private placement securities.¹¹⁸ In September 2007, Bank of America, Credit

(Australia), and UTI Bank (India).” *NASDAQ’s Electronic Trading Platform*, *supra* note 2.

114. Schmerken, *supra* note 11.

115. *Id.*; see also Nissa Darbonne, *New NASDAQ Private Platform to Offer 144A Securities Trading*, OIL & GAS INVESTOR, July 2007, at 18, 18.

116. *NASDAQ’s Electronic Trading Platform for the 144A Private Placement Market is Approved by the SEC*, PRIMENEWSWIRE, Aug. 1, 2007, available in LEXIS, Nexis Library, PRIZNE File; see also Joseph Giannone & Dan Wilchins, *Five Banks Plan Private Stock Platform*, REUTERS, Aug. 14, 2007, available in LEXIS, Nexis Library, REUNWS File. This feature was projected to become available within six months of the August 15, 2007 launch date. Giannone & Wilchins, *supra*.

117. Schachter, *supra* note 6, at 6. However, Goldman Sachs emphasized that it created GSTRUE in response to client demand, not to compete with PORTAL. Schmerken, *supra* note 11. Goldman Sachs’ first client was “Oaktree Capital Management, which raised \$880 million through the sale of 15 percent of the firm.” *Id.* GSTRUE could be accessed using either REDIPlus (Goldman Sachs’ execution management system) or Bloomberg Professional Services, both of which are widely available to most institutions. *Id.* The system provided tracking of record holders for each security, and included on-screen customer interest indicators and last sale information. *Id.* Goldman Sachs “charge[d] a commission when it matche[d] a buyer and seller and use[d] its own capital to act as a market maker, if necessary.” Basar, *supra* note 11. Eventually, competitive pressures forced Goldman Sachs to give GSTRUE access to other investment banks, including JPMorgan Chase and Credit Suisse. See Sorkin & de la Merced, *supra* note 113.

118. *Banks Set Up Platform for Unregistered Securities*, FORBES.COM, Aug. 14, 2007, <http://www.forbes.com/markets/feeds/afx/2007/08/14/afx4017151.html>; Kulikowski, *supra*

Suisse, and UBS joined the OPUS-5 trading platform.¹¹⁹ JPMorgan Chase was also working on a private placement market called 144APLUS,¹²⁰ and Bear Stearns launched its own platform called Best Markets.¹²¹ Pequot Ventures, the venture capital arm of Pequot Capital Management, had also provided funding to Restricted Stock Partners, which is a subsidiary of broker Green Drake Capital, to establish a new platform called Restricted Securities Trading Network.¹²² In addition, Zealous ATS (ZATS), “a global electronic marketplace for restricted and illiquid securities,” announced in September 2007 that it would begin to offer trading and settlement of private placement securities on its Global Axess system.¹²³ Finally, NYSE Euronext, another stock exchange, was exploring the private placement business; however, it announced no immediate plans to set up a market individually or in partnership with another organization.¹²⁴

Although initially NASDAQ’s launch of a Web-based PORTAL stimulated the creation of six competing private placement markets, the most recent developments suggest that a consolidated industry platform will dominate private placement trading instead. In November 2007, most of the private placement market participants agreed to collaborate

note 16 (reporting that the banks forming the new trading system stated that “OPUS-5 ‘will support and enable an open platform with multiple market makers and is designed to provide broad liquidity to the U.S. private placement market and facilitate greater access to capital for issuers in the 144A equities market’”). Bank of New York Mellon was to act as the administrator of the system. Matthew Quinn, *Private Placement Market Gets Boost as Three More Big Banks Join New Platform*, FIN. WEEK, Sept. 12, 2007, <http://www.financialweek.com/apps/pbcs.dll/article?AID=/20070912/REG/70912006/>.

119. Quinn, *supra* note 118.

120. Sorkin & de la Merced, *supra* note 113.

121. Giannone & Wilchins, *supra* note 116. Best Markets was launched “in connection with [Bear Stearns’] role as initial purchaser of a \$140 million private placement by J.G. Wentworth, a buyer of illiquid insurance products.” *Id.*

122. Darla Mercado, *Pequot Backs Private Trading Platform*, INVESTMENTNEWS, Sept. 21, 2007, <http://www.investmentnews.com/apps/pbcs.dll/article?AID=200770921/REG/70921003/1094/INDaily03&ht=&template=printart>. The platform had been in beta testing since October 2005. *Id.* In the following two years, nearly four hundred transactions took place, which represents a transaction volume of over \$200 million. *Id.*

123. *Zealous ATS ‘ZATS’ to Facilitate Trading of Rule 144a Securities Creating a Centralizes Electronic Marketplace*, PR NEWSWIRE, Sept. 24, 2007, available in LEXIS, Nexis Library, PRNEWS File [hereinafter ‘ZATS’ to Facilitate Trading].

124. Anupreeta Das, *NYSE Euronext Mulls Private-Placement Market*, REUTERS NEWS, Sept. 18, 2007, available in LEXIS, Nexis Library, REUNWS File. Larry Leibowitz, Executive Vice President and Chief Operating Officer for U.S. Products at NYSE Euronext, has stated that “It’s something we’re looking at actively but we haven’t come to any firm conclusions on.” *Id.* Were NYSE Euronext to consider establishing a private placement market, Leibowitz indicated that “it would likely be in partnership with ‘some of the biggest participants in that market’” and that NYSE Euronext’s role would likely be to “provid[e] a venue or the required technology.” *Id.*

on a single platform operated by NASDAQ: the PORTAL Alliance.¹²⁵ Although the PORTAL Alliance is subject to execution of a definitive agreement and regulatory approvals, it “[wa]s expected to become operational in the first quarter of 2008.”¹²⁶ The PORTAL Alliance’s founding members include most of the original participants in the individual private placement systems: “Bank of America, Bear Stearns, Citi, Credit Suisse, Deutsche Bank, Goldman Sachs, JPMorgan, Lehman Brothers, Merrill Lynch, Morgan Stanley, NASDAQ, UBS and Wachovia Securities.”¹²⁷ This move will result in a “revamp” of the PORTAL system, incorporating the best of the technology the investment banks have developed for their own systems, while utilizing PORTAL’s trading functionality.¹²⁸ Although there has been some speculation that this was a move by PORTAL to dominate the private placement trading market, NASDAQ has denied these claims.¹²⁹ Most importantly, expanding the PORTAL system will bring much greater liquidity to the private placement market than would have been possible with a fragmented market,¹³⁰ and will also expand NASDAQ’s international reach.¹³¹

125. See Anupreeta Das, *Nasdaq, Wall St Firms Join Forces for 144a Market*, REUTERS NEWS, Nov. 12, 2007, available in LEXIS, Nexis Library, REUNWS File.

126. *Id.*

127. *The PORTAL Alliance to Create Facility for 144A Equity Securities*, PRIMENEWSWIRE, Nov. 12, 2007, available in LEXIS, Nexis Library, PRIZNE File [hereinafter *PORTAL Alliance to Create Industry-Standard Facility*].

128. Lynn Cowan, *Banks to Share Platform for 144a Trades*, WALL ST. J., Nov. 12, 2007, at C3 (noting that the new system will use “some of the technology the investment banks have incorporated in their own systems”); Ivy Schmerken, *Banks to Consolidate 144A Trading on Nasdaq Platform*, WALL ST. & TECH., Nov. 13, 2007, http://www.wallstreetandtech.com/blog/archives/2007/11/banks_to_consol.html (stating that PORTAL would provide “front-end” functionality while the investment banks are best positioned to provide the “back end” system).

129. Stephanie Baum, *NASDAQ to Standardize Private Placement Platforms*, FIN. NEWS ONLINE US, Nov. 12, 2007, http://www.financialnewsus.com/index.cfm?page=us_home&contentid=2449167972. NASDAQ’s Jacobs stated that “‘There was no single force behind this decision . . . There is no element of control here. All of us think this market has huge potential.’” *Id.*

130. See Cowan, *supra* note 128 (“By using a single system operated by Nasdaq, investors in these instruments will congregate at the same site, which should result in a more-liquid market.”). NASDAQ’s Greifield noted that collaboration was key to truly achieving greater liquidity in the private placement marketplace. *Id.* (“One of the key points of this alliance is that all the investment banks will be working together and trying to establish post-capital-raising liquidity in the 144a market.’ . . . ‘In order to have the best chance of making this a success, having the collective weight of everybody on board is critical.’”).

131. Kulikowski, *supra* note 7. This decision to collaborate occurred at the same time that NASDAQ was positioning itself for international expansion with possible deals

II. PORTAL'S IMPACT ON PRIVATE PLACEMENT AND PUBLIC MARKETS

Assuming that the Web-based PORTAL is successful,¹³² its impact on both the private placement market and the public market will be substantial. The increase in both liquidity and transparency resulting from the Web-based format will certainly fuel the already growing private placement market.¹³³ As a result, PORTAL may redefine the competitive landscape in the private placement market, transform the boundaries between the private and the public spheres, and transform the venture capital industry.

A. Expanding the Private Placement Market

The private placement market has always been large, but the trend in its growth has become particularly noticeable in recent years.¹³⁴ Given the expanding size of the private placement market, the role of PORTAL in the private placement industry remains unclear. When NASD launched the electronic PORTAL in 1990, other stock exchanges considered establishing similar services, but decided against it.¹³⁵ As the size of the private placement market has grown considerably since then, competition to become "the industry standard trading platform for unregistered US securities" also increased.¹³⁶ Some analysts predicted a merger of the Wall Street platforms to counter the prominence of PORTAL.¹³⁷ Other commentators argued that PORTAL had a strong lead to become the industry standard due to its status as the only market

involving the London Stock Exchange, Nordic exchange operator OMX, and Borse Dubai. *Id.*

132. See *supra* note 90.

133. See *supra* note 17 and accompanying text.

134. See *supra* notes 12-16 and accompanying text.

135. *NYSE Proposes Creation of New System for Buying, Selling Rule 144A Stocks*, 22 Sec. Reg. & L. Rep. (BNA) 1290, 1291 (Sept. 14, 1990). The American and New York Stock Exchanges considered developing competing systems to the electronic PORTAL: SITUS (System for Institutional Trading of Unregistered Securities) and NYSE System 144A, respectively. *Id.*; Jessica Sommar, *American Stock Exchange May Have Killed Situs, INV. DEALERS' DIG.*, May 6, 1991, at 23. However, neither pursued the project because officials concluded that it would not be profitable. Sommar, *supra*.

136. See Anuj Gangahar, *US Banks Create Trading System*, FIN. TIMES, Aug. 15, 2007, <http://search.ft.com/ftArticle?ct=0&id=070815000974>.

137. See, e.g., Roger Ehrenberg, *The Growing Threat of Private Exchanges*, SEEKING ALPHA, Sept. 17, 2007, <http://seekingalpha.com/article/47277-the-growing-threat-of-private-exchanges>. These analysts believe that if such a merger is successful, it would leave little to no role for PORTAL. *Id.*

to be sanctioned by the SEC.¹³⁸ With the development of the PORTAL Alliance, comprised of all investment bank private placement platforms and PORTAL, both of these predictions have proven incorrect. With PORTAL's relative size,¹³⁹ NASDAQ's expertise in electronic trading systems and private placement markets,¹⁴⁰ and the proprietary technology developed by the investment banks,¹⁴¹ this consolidated system stands to bring the best of both worlds and much greater liquidity to the private placement market.¹⁴²

Despite such promise, this conglomerate raises a number of concerns. Although the previous market was more fragmented, it offered investors a number of options for private placement trading that are now no longer available.¹⁴³ In addition, the PORTAL Alliance will require a high degree of integration between investment banks and NASDAQ, which raises concerns about conflicts of interest because NASDAQ has a strong financial interest in expanding this market¹⁴⁴ but is also responsible for regulating the conduct of investment banks.¹⁴⁵ Finally, there are companies with private placement platforms that did not announce any intention of becoming part of the PORTAL Alliance: Restricted Stock Partners and ZATS.¹⁴⁶ NYSE Euronext, which had considered exploring the private placement business, also declined to participate in the Alliance.¹⁴⁷ It is unclear whether those organizations will attempt to compete with PORTAL, try to become a part of the Alliance, or simply close down operation of their individual platforms as a result of

138. See Schmerken, *supra* note 11. Working through the SEC allows PORTAL to provide neutral third-party oversight for compliance, as well as DTCC clearance and settlement services. *Id.*; see also *supra* note 105.

139. See Paula Schaap, *Banks Pile On to Private Placement Platform*, FIN. NEWS ONLINE US, Sept. 12, 2007, <http://www.financialnews-us.com/?page=ushome&contentid=2448725376>; Sorkin & de la Merced, *supra* note 113; see also *supra* text accompanying notes 112-13. PORTAL's size is a considerable advantage compared to the bank platforms, because scale, which lowers costs, is key to a profitable and successful exchange. Schaap, *supra*; see also *NASDAQ's Electronic Trading Platform*, *supra* note 2 (listing companies that used PORTAL to raise capital in 2006 and 2007).

140. See *NASDAQ's Electronic Trading Platform for the 144A Private Placement Market is Approved by the SEC*, *supra* note 116; Schmerken, *supra* note 11.

141. Cowan, *supra* note 128; Schmerken, *supra* note 128.

142. See *supra* note 130.

143. See Cowan, *supra* note 128.

144. See *supra* note 130.

145. See Application of the Nasdaq Stock Market LLC for Registration as a National Securities Exchange, Exchange Act Release No. 53,128, 71 Fed. Reg. 3550, 3554 (Jan. 23, 2006).

146. See Mercado, *supra* note 122; 'ZATS' To Facilitate Trading, *supra* note 123; see also *PORTAL Alliance to Create Industry-Standard Facility*, *supra* note 127.

147. See Das, *supra* note 124; *PORTAL Alliance to Create Industry-Standard Facility*, *supra* note 127.

PORTAL's dominance. As the private placement market continues to grow, defining the role of the PORTAL Alliance with regard to its remaining competitors will become increasingly important.

B. Squeezing the Public Market

The prevalence of private placements has affected corporate perceptions of the public market as the primary vehicle for capital formation. Whereas many companies continue to use private placements as an intermediate step to a public offering, others have begun to consider private placements to be "the best way to raise capital in the [United States]."¹⁴⁸ Some companies have considered the private placement market because it allows them "to gain most of the advantages of being public while sidestepping the disadvantages."¹⁴⁹ Banks have indicated that they view the move toward private placement capital formation as a way to "reduce their dependency on traditional exchanges."¹⁵⁰ This may reduce the pressure to ever publicly list the stock in the future, making the private placement platform a destination rather than an intermediate market.¹⁵¹ Already, much of the behavior that is typical for public offerings has been replicated for private placement and restricted security resales.¹⁵²

Continuing migration to the private placement market may create a parallel market, which is similar to the two-tier or side-by-side market that regulators sought to avoid.¹⁵³ Rule 144A's fungibility exclusion

148. Gangahar, *supra* note 136. However, NASDAQ's Jacobs has stated that the increased use of private placements is unlikely to change the role of the private placement as an intermediate step on the way to going public. Megan Johnston, *Private Placements Find Their Place in the Sun*, FIN. WEEK, Sept. 24, 2007, <http://www.financialweek.com/apps/pbcs.dll/article?AID=20070924/REG/70920015> ("Mr. Jacobs predicted that in the future, eight out of 10 companies that choose to have an initial public offering will tap the private market before going public.").

149. See Cho, *supra* note 7.

150. Schaap, *supra* note 139.

151. Darbonne, *supra* note 115.

152. See Lynn Cowan, *Rival Bankers Teaming Up in Private Securities Sales*, WALL ST. J., Oct. 29, 2007, at A14. Although PORTAL and the industry platforms are competitors, the banks are collaborating because they are forced to participate in offerings that are listed on someone else's exchange. *Id.* This type of behavior is common in public offerings, where underwriters often collaborate with competitors when a customer demands such a relationship. *Id.*

153. See Changes to Method of Determining Holding Period of Restricted Securities, Securities Act Release No. 6839, 54 Fed. Reg. 30,076, 30,078 (proposed July 18, 1989). Professor Brummer has also identified some regulatory concerns:

"First, 144A, which allows unregistered securities to be traded, was not really envisioned to create securities traded on an exchange. The creation of a market will make these securities more attractive than regulators had in mind . . . and

prohibits companies from having a similar class of equity securities listed on a public stock exchange while at the same time issuing or trading those securities in the private placement market.¹⁵⁴ This restriction prevents the creation of “shadow private markets,” ensuring that institutional investors cannot buy in private markets and resell the same security at a possibly higher price in public ones.¹⁵⁵ Although the fungibility rule prevented the creation of two markets for the same security, the growth of the Rule 144A private placement market nevertheless creates a similar parallel market problem, because as companies migrate to the private placement market, institutional investors in Rule 144A securities may gain the variety, liquidity, and profitability that were once the hallmarks of the public markets.¹⁵⁶ As a result, certain types of investments will be available only to institutional investors, but not to retail investors.¹⁵⁷

will consequently increase the exposure of investment funds and the entire economy to these securities.”

NASDAQ Launches Major Change, *supra* note 90 (quoting Chris Brummer, Assistant Professor of Law, Vanderbilt University). He calls the money raised on PORTAL and the private placement market “dark pools of liquidity that could lead to fraud or poor investment decisions.” *Id.* (internal quotation marks omitted).

154. Securities Act Rule 144A(d)(3), 17 C.F.R. § 230.144A(d)(3) (2007). Fungible securities include securities that, when issued, are part of the same class as securities listed on a U.S. securities exchange or traded in an automated U.S. inter-dealer quotation system (which includes NASDAQ, but excludes the “pink sheet” market), and securities issued by a registered open-end investment company, unit trust, or face-certificate companies. *Id.*; Resale of Restricted Securities, Securities Act Release No. 6862, Exchange Act Release No. 27,928, Investment Company Act Release No. 27,928, 55 Fed. Reg. 17,933, 17,935-36 & n.22 (Apr. 30, 1990) (codified as amended at 17 C.F.R. § 230.144A). The fungibility exclusion, Professor Coffee notes, has “the paradoxical effect of permitting secondary trading among QIBs in non-public companies, about whom there is little current information publicly available, but precluding such trading in cases where precisely such information is available.” Coffee, *supra* note 65, at 1178.

155. Coffee, *supra* note 65, at 1178-79 (“Politically, it could embarrass the SEC if a class of securities could be purchased by QIBs at a lower price in private markets than the public investor could buy in the public markets.”). Professor Coffee argues that the concern that institutional investors will engage in such “short-term arbitrage” should not apply to the private placement context. *Id.* at 1182-83. He reasons that “[i]nstitutions do not exclude or ‘squeeze out’ individual investors from this context because individuals do not generally qualify to participate in private placements.” *Id.* at 1183. Further, because institutions “engage in often significant due diligence efforts before buying equity securities in private placements,” this puts them “in a position to play a gatekeeping role” for individual investors. *Id.*

156. See Schachter, *supra* note 6, at 5-6. As publicly traded companies move their shares to private placement platforms, there is decreased liquidity for public stock exchanges and individual investors. See Changes to Method of Determining Holding Period of Restricted Securities, 54 Fed. Reg. at 30,077; see also Coffee, *supra* note 65, at 1178 (observing that the stock exchanges have “opposed extending Rule 144A to publicly traded securities”).

157. Schmerken, *supra* note 11.

Currently, individual investors can only participate *indirectly* if their mutual fund purchases restricted securities; however, mutual funds often have “restrictions in their charters against investing in illiquid securities, limiting retail participation in the private equity market.”¹⁵⁸ Some commentators have argued that the Rule 144A resale exemption should be expanded to include not just QIBs but other “accredited investors,” which are allowed to purchase private placements under section 4(1) and Regulation D.¹⁵⁹ NASDAQ has also stated that it plans to create PORTAL composite and sub-index private placement products for retail investors.¹⁶⁰ Retail investor advocates worry that Rule 144A is another mechanism to transfer wealth from the public markets to the private sphere.¹⁶¹ If PORTAL continues to grow, retail investors may end up flocking to institutions such as mutual funds to ensure adequate exposure to the private placement market, so some progress must be made to provide limited visibility for individuals.¹⁶²

158. *Id.*

159. See, e.g., Hanks, *supra* note 18, at 341; Lawrence R. Seidman, Comment, *SEC Rule 144A: The Rule Heard Round the Globe—Or the Sounds of Silence?*, 47 BUS. LAW. 333, 348-49, 353 (1991). FBR also argued in its comment letter to the SEC regarding the new PORTAL Market that PORTAL “limit[s] an [a]ccredited [i]nvestor’s ability to sell shares” in favor of providing access solely to QIBs, and that this “place[s] PORTAL Brokers and PORTAL Dealers in conflict with their obligations to their [a]ccredited [i]nvestor customers.” May Ginivan Letter, *supra* note 105, at 5. Even though accredited investors can obtain restricted securities under Regulation D, NASDAQ has prevented accredited investors from using PORTAL to sell those securities. *Id.* In response to FBR’s concerns, NASDAQ stated that PORTAL has excluded Regulation D securities since the system’s creation in 1990, and that “[i]ntroducing Regulation D offerings would increase the complexity of the PORTAL system offering during its crucial initial roll-out.” Moran Letter, *supra* note 105, at 11.

160. Schmerken, *supra* note 11 (“[PORTAL] could bring in retail because it’s done through aggregation down the road.”) (quoting John Jacobs, Executive Vice President, NASDAQ).

161. See Cho, *supra* note 7; Mark Cobley, *Wealthy Investors Expect Shift to Alternatives*, FIN. NEWS ONLINE US, Oct. 24, 2007, <http://www.financialnews-us.com/index.cfm?page=ushome&contentid=2349025833> (reporting that high net worth individuals and institutions are migrating to alternative assets such as private equity, hedge funds, and commodities, rather than the public markets).

162. See Letter from James J. Angel, Assoc. Professor of Fin., Georgetown Univ., to Nancy M. Morris, Sec’y, U.S. Sec. & Exch. Comm’n 1-2 (May 24, 2007), available at <http://www.sec.gov/comments/sr-nasdaq-2006-065/nasdaq2006065-10.pdf>. Professor Angel demands that PORTAL information be available to the general public. *Id.* He argues that secrecy gave rise to other market scandals, and that there is no risk that individual investors will use the information to purchase privately placed securities because they are not eligible to do so under Rule 144A. See *id.* He further contends that making PORTAL information public would be a net positive decision for the securities markets. *Id.*

C. Transforming the Venture Capital Industry

The growth of the private placement market will also likely transform the venture capital industry, which represents an important source of capital for private companies today.¹⁶³ Because a public offering is often sought only as a liquidity event that creates a payday for venture capitalists who originally invested in the private company, a viable private placement market may offer an alternative to venture capital financing in the long term.¹⁶⁴ On the other hand, private companies may retain their dependence on venture capital firms, and PORTAL may offer the venture capital firms an alternative intermediate or end-game liquidity event in comparison to a public offering.¹⁶⁵ Thus, an expanded private placement market could cause the venture capital industry, which is relatively small in comparison to other areas of the securities industry, to face significant changes to the way it does business.¹⁶⁶

III. AREAS REQUIRING DEFINITION FROM THE SEC

Given the effects the Web-based PORTAL will have on the private placement and public markets as well as the venture capital industry, PORTAL's scope needs additional definition by the SEC to ensure that its development is consistent with Rule 144A. The SEC's recent approval of the Web-based PORTAL format and its proposal to increase the accredited investor standard under Regulation D hopefully demonstrates its intent to begin clarifying the regulatory and execution aspects of the private placement market.¹⁶⁷ The SEC must define four areas of the private placement market to ensure that it retains the scope

163. See National Venture Capital Association, *The Venture Capital Industry—An Overview*, <http://www.nvca.org/def.html> (last visited Feb. 24, 2008). The National Venture Capital Association explains that “[v]enture capital is money provided by professionals who invest alongside management in young, rapidly growing companies that have the potential to develop into significant economic contributors.” *Id.* Venture capital firms are usually “private partnerships or closely-held corporations funded by private and public pension funds, endowment funds, foundations, corporations, wealthy individuals, foreign investors, and the venture capitalists themselves.” *Id.* These organizations usually get involved in situations where traditional bank financing is not an option, such as before the formation of company (“seed investing”), in the company’s beginning stages of development (“early stage investing”), during one of the later critical stages of development (“expansion stage financing”), or immediately before the company seeks to initiate a public or private offering (“later stage investing”). *Id.*

164. See Schachter, *supra* note 6, at 5 (stating that “company founders could use PORTAL to sell a portion of their holdings” instead of turning to a venture capital firm).

165. *Id.* at 5-6.

166. *Id.* (reporting the concern of National Venture Capital Association president Mark Heesen and others that “the flood of cash from an active private placement marketplace could upset the venture capital ecosystem”).

167. See Baum, *supra* note 45.

intended by Rule 144A: (1) requirements for the Rule 144A exemption, (2) the role of PORTAL in complying with those requirements, (3) PORTAL's relationship to other industry players in the private placement market, and (4) the scope of PORTAL itself. Considering the amount of wealth concentrated in private placements¹⁶⁸ and the transformative stage of this industry segment, without further definition from the SEC this market will either self-destroy, as it did in 1990,¹⁶⁹ or veer in a direction inconsistent with SEC goals.¹⁷⁰

A. Requirements for the Rule 144A Exemption

The first area requiring attention from the SEC is defining the requirements for taking advantage of the Rule 144A private placement and restricted security resale exemption.¹⁷¹ Whereas the codified parts of the rule are developed and well-supported, the unarticulated fifth prohibition against general solicitation has become part of the lore associated with Rule 144A and needs to be explicitly included or excluded from the rule.¹⁷² Given the marketing possibilities for NASDAQ and other private placement platforms, a poorly developed prohibition on general solicitation in connection with a Rule 144A transaction can severely impede the development of this market.

B. Role of PORTAL in Complying with Rule 144A Requirements

The second area requiring definition is the role of PORTAL in ensuring compliance with Rule 144A regulatory requirements. Although NASDAQ has taken the position that its obligations as an exchange require it to determine whether or not an institution meets the qualification requirements of a QIB through its PORTAL registration process,¹⁷³ others have argued that the registration process is an attempt

168. See *supra* notes 12-17 and accompanying text.

169. See May Ginivan Letter, *supra* note 105, at 2-3.

170. See *supra* note 90.

171. See *supra* Part I.C.2.

172. See *supra* notes 82-85 and accompanying text.

173. Moran Letter, *supra* note 105, at 9; see also Letter from William J. Ginivan, Gen. Counsel, Friedman, Billings, Ramsey & Co., to Nancy M. Morris, Sec'y, U.S. Sec. & Exch. Comm'n 4 (July 18, 2007), <http://www.sec.gov/comments/sr-nasdaq-2006-065/nasdaq2006065-8.pdf> [hereinafter July Ginivan Letter]. FBR states in its July 2007 comment letter to the SEC that section 6(b)(1) "requires an exchange to be organized and have the capacity to carry out the purposes of the federal securities laws, and to have the ability to enforce compliance by its members with the federal securities laws and the exchange's rules." July Ginivan Letter, *supra*, at 4; see also Securities Exchange Act of 1934 § 6(b)(1), 15 U.S.C. § 78f(b)(1) (2000). FBR asserts that "[a]ccording to Nasdaq, Rule 144A, and thus [s]ection 6(b)(1), requires [NASDAQ] to prevent the disclosure of PORTAL market information to non-QIBs," and that NASDAQ believes this can only be accomplished if it is the "sole entity authorized to determine QIB status." July Ginivan Letter, *supra*, at 4. NASDAQ

by NASDAQ to create a monopoly for privately placed securities.¹⁷⁴ This process is not the same as the one originally mandated by the electronic PORTAL in 1990, and some commentators are concerned that it will limit the liquidity of non-NASDAQ-approved QIB trading.¹⁷⁵ These critics contend that buyers and sellers should be able to independently verify QIB status without NASDAQ's involvement.¹⁷⁶ Either way, the PORTAL system "does not itself create an exemption from registration."¹⁷⁷ Yet because NASDAQ has attempted to ensure that participation in its system does create the exemption, it is important that the SEC explicitly approve or disapprove of this approach.¹⁷⁸

justifies its position on the basis that "dissemination of the information beyond QIBs has the potential to confuse investors in . . . related non-PORTAL securities," and argues that it "strains credulity to argue that QIBs . . . will be unable to incur the modest financial and ministerial costs . . . associated [with] becoming a PORTAL Qualified Investor." Moran Letter, *supra* note 103, at 9.

174. See July Ginivan Letter, *supra* note 173, at 4-5; May Ginivan Letter, *supra* note 105, at 2-3. FBR argued that the concept of "Nasdaq-approved QIBs" creates a "hidden market" for those securities. May Ginivan Letter, *supra* note 105, at 2. In addition, the "Nasdaq only" QIB approval process exceeds what is required by Rule 144A, [and] limits options provided in Rule 144A for determining who is a QIB" because Rule 144A already "provides sellers several methods for forming a reasonable belief that a purchaser is a QIB" without PORTAL registration. July Ginivan Letter, *supra* note 173, at 4-5 & n.6; see also *supra* notes 72-75 and accompanying text.

175. See July Ginivan Letter, *supra* note 173, at 4-6; May Ginivan Letter, *supra* note 105, at 4-5. FBR points out that "[t]he original PORTAL system approved by the SEC did not confer on Nasdaq sole authority for determining QIB status," so "an investor could obtain PORTAL market information directly from Nasdaq, or indirectly from a third-party vendor, as long as a PORTAL dealer represented to Nasdaq that the investor was a QIB." July Ginivan Letter, *supra* note 173, at 6. With regard to the market impact of this rule, FBR also argues that if a non-NASDAQ-approved QIB "needs to liquidate its position immediately or wants to take advantage of breaking news about a company, it will have to wait until it obtains NASDAQ's approval before it can obtain quotes, indications of interest, and last sale information" on PORTAL. May Ginivan Letter, *supra* note 105, at 4.

176. July Ginivan Letter, *supra* note 173, at 6.

177. Seidman, *supra* note 159, at 345.

178. See Order Approving Proposed Rule Change to Reestablish the PORTAL Market, Exchange Act Release No. 56,172, 72 Fed. Reg. 44,196, 44,199 (Aug. 7, 2007). Thus far, the SEC has sanctioned NASDAQ's approach by agreeing that its PORTAL registration process ensures that it complies with its obligations as an exchange and facilitates trading in private placement securities. *Id.* In the release approving the Web-based PORTAL, the SEC found that the proposal was "designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to a free and open market and a national market system, and, in general, to protect investors and the public interest." *Id.* It further stated that "[i]n light of Nasdaq's procedures as described in the proposed rule change, PORTAL Participants may rely on Nasdaq's procedures for establishing a reasonable belief that a prospective purchaser is a QIB." *Id.*

C. PORTAL's Relationship to the Industry

The third area where the SEC needs to focus is defining the scope of NASDAQ's PORTAL as part of the PORTAL Alliance and the remaining private placement platforms. Because the PORTAL Alliance will require a high degree of integration between investment banks and NASDAQ, there may be conflicts between NASDAQ's financial interest in expanding the private placement market and its statutory responsibility over regulating the conduct of investment banks.¹⁷⁹ Defining PORTAL's relationship to its investment bank partners in the Alliance will be critical to ensure that these potential conflicts are minimized. In addition, although most of the PORTAL Alliance members include investment banks with their own private placement trading platforms, two companies, Restricted Stock Partners and ZATS, and another stock exchange, NYSE Euronext, did not participate in the Alliance.¹⁸⁰ If the remaining platforms try to compete with the PORTAL Alliance, they are unlikely to succeed given its dominance, but folding them into the Alliance or closing down their operations leaves investors to face a monopoly on private placement trading. To prevent the PORTAL Alliance from using its dominance in the private placement market to manipulate the current Rule 144A regulatory regime, the SEC must take steps to define the relationship it finds would be appropriate among the participants of the PORTAL Alliance and the remaining regulatory and industry platforms.¹⁸¹ Determining the role PORTAL should play with regard to its investment bank partners in the PORTAL Alliance as well as remaining industry players will be important in defining the relationship among the private placement market, public markets, and the venture capital industry.

D. Scope of the PORTAL System

Finally, the fourth area the SEC must consider is the scope of PORTAL itself. The SEC has stated that NASDAQ's rules for the Web-based PORTAL are consistent with the legislative goals of the Securities Act, but Rule 144A and the SEC's release approving its Web-based format do not provide any guidance about the role of PORTAL in the restricted securities market.¹⁸² It is unclear whether PORTAL is merely

179. See *supra* notes 131, 145 and accompanying text.

180. See *supra* notes 127, 146-47 and accompanying text.

181. Cf. Cowan, *supra* note 152 (reporting on the early trend of cooperation among competing investment banks).

182. See Order Approving Proposed Rule Change to Reestablish the PORTAL Market, 72 Fed. Reg. at 44,199; see also Resale of Restricted Securities, Securities Act Release No. 6862, Exchange Act Release No. 27,928, Investment Company Act Release No. 17,452, 55 Fed. Reg. 17,933 (Apr. 30, 1990) (codified as amended at 17 C.F.R. §

the first of many potential platforms to be sanctioned by the SEC, or whether the SEC intends to support the PORTAL Alliance's role as the single dominant player in the private placement market. The lack of clarity about PORTAL's role could be interpreted as being consistent with the SEC's goal of encouraging a market-based approach to securities regulation rather than a regulation-based approach.¹⁸³ However, the SEC has also emphasized its focus on decreasing fragmentation and standardizing information flow across markets, as it did when it established the National Market System,¹⁸⁴ so it is also possible that the SEC supports PORTAL becoming a mandated market for Rule 144A securities in order to encourage similar efficiencies in private placements. Given the development of the PORTAL Alliance, it is inevitable that PORTAL will become the dominant industry platform in the private placement market unless the SEC takes action to suggest otherwise.

IV. CONCLUSION

NASDAQ's Web-based PORTAL demands additional definition of the private placement market by the SEC. Given the growth in popularity of private placements, and the potential effect of PORTAL on the private placement and public markets as well as the venture capital industry, this segment of the securities industry requires further attention

230.144A (2007)). The SEC stated that the PORTAL system was consistent with Congress' intent for the development of a national market system under the Securities Act of 1933:

Essentially, Congress found that new data processing and communication techniques should be applied to improve the efficiency of market operations, broaden the distribution of market information, enhance opportunities to achieve best execution and promote competition among market participants. That provision stresses the importance of implementing communication enhancements that will advance the efficiency and effectiveness of a securities market in servicing the needs of investors. The Commission believes that the changes to the PORTAL Market contained in this proposed rule change should provide these benefits and help to enhance the efficiency of the market for Rule 144A-eligible securities.

Order Approving Proposed Rule Change to Reestablish the PORTAL Market, 72 Fed. Reg. at 44,199-200. In addition, pursuant to the section 3(f) "require[ment] that the Commission consider whether Nasdaq's proposal will promote efficiency, competition, and capital formation," and the SEC found that the NASDAQ proposal did meet those goals. *Id.* at 44,200-01.

183. See *supra* note 25.

184. See Regulation NMS, Exchange Act Release No. 51,808, 70 Fed. Reg. 37,496, 37,496-97 (June 29, 2005); Regulation NMS Rules 601-12, 17 C.F.R. §§ 242.600-612 (2007) (setting out equal access and trade through provisions for trading, as well as joint industry plans and rules for dissemination of market data, which sought to limit price differences and mandate efficient communication among U.S. markets).

from the SEC. Without softening of the PORTAL-friendly regulations, NASDAQ threatens to monopolize the private placement market with the PORTAL Alliance. The SEC's attention is necessary to ensure that the private placement market retains the scope intended by the adoption of Rule 144A, and does not transform the competition-based securities markets in the long term.