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Rule 144, the SEC, and Restricted Securities

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RULE 144, THE SEC, AND RESTRICTED SECURITIES*

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Rule 144 (effective April 15, 1972) is one of the most interesting and potentially far-reaching of the rules recently promulgated by the Securities and Exchange Commission. Discarding outworn concepts such as fungibility and de-emphasizing the necessity of proving "investment intent," the rule, for *the first time, sets forth fairly definite limits within which a person acquiring stock in a section 4(2) private offering may sell that stock to the public without being deemed an underwriter. Harold S. Bloomenthal's article discussing Rule 144 and related SEC rules is an excerpt from chapter 4 of* Securities & Federal Corporate Law, *his recently released treatise. The first such work to be written in a number of years, Mr. Bloomenthal's treatise promises to become a standard reference work in every legal library. In this article, footnotes have been renumbered and changed to law journal form and cross-references have been altered; otherwise the text is substantially as it appears in the completed book.*

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* Excerpted by permission from H. BLOOMENTHAL, SECURITIES & FEDERAL CORPORATE LAW ch. 4 (1972) — Clark Boardman Co., Ltd. and Sage Hill Publishers, Inc. publishers.

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I. THE WHEAT REPORT AS A CATALYST — "LEGISLATIVE HISTORY" OF RULE 144

IN November 1967, the Securities and Exchange Commission organized a small internal study group charged with the task of reappraising disclosure policies under the Securities Act of

1933 and the Securities Exchange Act of 1934 and of recommending changes which could be accomplished within the Commission's existing power to adopt rules and regulations.[1] The Study Group saw as its goals:

(a) to enhance the degree of coordination between the disclosures required by the '33 and '34 Acts;
(b) to respond to the call for greater certainty and predictability; and
(c) to develop a consistent interpretative pattern which would help to assure that appropriate disclosures are made prior to the creation of interstate public markets in the securities of any issuer.[2]

In reporting in March of 1969 on what it observed with regard to the prior regulatory pattern to control leakage,[3] the Wheat Report, named after the chairman of the group, Francis M. Wheat,[4] commented on the fact that not only were prevailing notions relating to investment intent difficult to apply, but whether unregistered securities could be sold turned upon events wholly unconnected with the need of investors in that, among other things, the prevailing pattern failed to make the following pertinent distinctions:[5]

(1) Whether or not information is regularly available concerning the affairs of the issuer;
(2) Whether the quantity of securities being offered were "massive or modest";
(3) Whether or not a heavily compensated selling effort was involved.

The Wheat Report found it anomalous that under the prevailing pattern a controlling shareholder might sell a substantial block of stock under Rule 154,[6] but an employee having acquired a relatively few shares upon the exercise of his stock option would be precluded from selling such shares without registration.[7] Perhaps most significantly, the Study Group perceived that from a disclosure standpoint the resale of shares to the public of shares acquired in a private placement and the sale of shares by controlling shareholders both have much in common in that in both instances the means exist for compelling registration

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[1] SEC, DISCLOSURE TO INVESTORS, A REAPPRAISAL OF FEDERAL ADMINISTRATIVE POLICIES UNDER THE '33 AND '34 Acts (THE WHEAT REPORT) 3 (CCH ed. 1969) [hereinafter cited as WHEAT REPORT].

[2] *Id.* at 8.

[3] *See* H. BLOOMENTHAL, SECURITIES AND FEDERAL CORPORATE LAW § 4.10 (1972) [hereinafter cited as H. BLOOMENTHAL].

[4] Mr. Wheat was then a member of the Commission and is presently chairman of the Securities Investor Protection Corporation.

[5] WHEAT REPORT at 155-56.

[6] For a general discussion of Rules 154, see H. BLOOMENTHAL § 4.09.

[7] WHEAT REPORT at 156.

prior to resale.[8] The Report conceivably could have gone on and recommended the Rule 155[9] pattern generally which would have precluded any leakage of unregistered securities into the public securities markets. However, the Study Group opted for a limited and controlled amount of leakage, suggesting for the first time that sales of shares acquired in reliance on private placements and those being sold by controlling persons be treated in substantially the same manner for this purpose. Utilizing the Rule 154 experience as a guide, the Study Group drafted and recommended the adoption of a series of specific rules that are commonly referred to as the 160 series.[10]

In this context, respectable support can be gathered for a number of different approaches. There undoubtedly has always been a group within and outside of the Commission in favor from a policy standpoint of preventing leakage without registration completely. In their view, whenever registration is feasible it should be insisted upon before securities reach the interstate public securities markets. Registration is feasible whenever securities are being sold by the issuer or persons who control the issuer or who acquire their securities in a private placement directly from the issuer. This group, perhaps, had their one moment of triumph in the adoption of Rule 155. There have been others that would permit leakage, but essentially, in terms of the prior pattern, based upon the definition of a statutory underwriter and the investment-intent concept. This group, as the Wheat Report points out, has a stake in the existing lore which had developed and their special expertise; among some of the regulators it may have found favor because its ambiguities allowed considerable flexibility and administrative discretion. A third viewpoint and the one that ultimately prevailed placed some emphasis on the extent to which information concerning issuers is available outside of '33 Act disclosures; It recognized that the desire of controlling shareholders to sell limited amounts of the issuers' securities was not per se unlawful; the fact that private placements play an important role in the capital markets of America; and that conscientious counsel should not be penalized by their unwillingness to render opinions built on shifting legal sands.

The foregoing is recounted as an explanation of the struggle one can only presume went on within the Commission and among its staff as is reflected by what followed. In September

[8] *Id.* at 19-20.

[9] *See generally* H. BLOOMENTHAL § 4.10(5).

[10] WHEAT REPORT app. VI-1.

of 1969, the Commission proposed the adoption of Rules 160 through 164, being essentially the rules recommended by the Wheat Report.[11] The rules would have established as to securities of reporting companies acquired in private placements a one-year holding period and would have thereafter permitted resales of such shares as well as shares being offered by controlling persons essentially in accordance with the requirements of Rule 154 in terms of quantitative limits and manner of sale.[12] Generally, the proposed Rule 160 series was welcomed by the securities bar as providing definite and reasonable standards and eliminating subjective questions about "investment intent." However, on September 22, 1970, the Commission withdrew the proposed Rule 160 series and proposed in lieu thereof Rule 144[13] which in the original version made a number of significant changes including the following:

(1) Increased the holding period from twelve months to eighteen months;
(2) Instead of establishing reliable standards, merely created a "presumption" that an exemption is available;
(3) Changed the six-month period in which quantity limitations were to be determined to a twelve-month period, thus reducing the number of shares that could be offered;
(4) As to controlling persons placed an aggregate limit not only on what they could sell individually under .the rule during the appropriate period, but also on what they could sell collectively.

Rule 144 as initially proposed was widely criticized as restoring "subjectivity" and reflecting a staff desire to (1) keep the law in this area ambiguous, and (2) severely and unrealistically restrict leakage.[14] In November of 1971, reacting to the criticism, the Commission published a revised version of Rule 144 for comment which increased the holding period to two years, but otherwise liberalized the initial Rule 144 proposal.[15] On January 11, 1972, the Commission announced the adoption of Rule 144 effective April 15, 1972; the rule as adopted was essentially the version proposed in November of 1971 with some further liberalization, particularly with respect to aggregations for the purpose of determining the individual quantity limita-

[11] SEC Securities Act Release No. 4997 (Sept. 15, 1969), CCH FED. SEC. L. REP., Special Rep. No. 272.

[12] *See* H. BLOOMENTHAL § 4.09(1).

[13] SEC Securities Act Release No. 5087 (Sept. 22, 1970), [1970-1971 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,909.

[14] *See* Note, *Secondary Distribution and Broker's Transactions: The Withering of Wheat*, 37 BROOKLYN L. REV. 588 (1971); Morrow, *Investment Letter Dilemma and Proposed Rule 144: A Retreat to Confusion*, 11 SANTA CLARA LAW. 37 (1970).

[15] SEC Securities Act Release No. 5186 (Sept. 10, 1971), CCH FED. SEC. L. REP., Special Rep. No. 387.

tions.[16] To recount the variations in the various proposals may confuse more than enlighten; the Commission's vacillations are enumerated primarily for the purpose of illustrating the fact that contending viewpoints had to be resolved to reach the finalized version of the rule and to make one aware of the "legislative" history of the rule, as in some instances specific omissions or revisions may tend to give meaning to the rule as finally adopted. In adopting the rule, the Commission stated that it was "in the nature of an experiment" and will be observed closely to determine whether it appropriately protects investors.[17] Nonetheless, one suspects that the substance of the rule will remain with us for some time and that the whole area of restricted securities will be dominated by the Rule 144 philosophy for an indefinite period.[18]

II. RULE 144

A. *An Overview*

Rule 144 adopts essentially the approach of Rule 154 (which was concurrently rescinded) with various important modifications and applies it to securities issued in transactions not involving a public offering, as well as to securities sold by affiliates (controlling persons). No differentiation is made in this regard as between convertible securities and other securities; Rule 155 also being concurrently rescinded except as to convertible securities issued prior to April 15, 1972, which the holder resells other than in conformity with Rule 144.[19] Rule 144 is not applicable to securities issued in reliance on the intrastate exemption[20] nor to securities issued in a merger or other transactions subject to Rule 145[21] except that it may be applicable to

[16] SEC Securities Act Release No. 5223 (Jan. 11, 1972), [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,487. Rule 144 will become 17 C.F.R. § 230.144 and will hereinafter be cited as R. 144 with appropriate indication of the subdivisions thereof concerning which reference is made. The accompanying release (SEC Securities Act Release No. 5223) will hereinafter be referred to as Release 33-5223. Release 33-5223 is in some respects almost as important as the rule itself as it contains a general explanation of the relationship of the rule to other action taken at the same time by the Commission including the adoption of Rule 237; a statement of the "Background and Purpose" of the rule; and "Explanation and Analysis of the Rule"; a "Synopsis of the Rule"; a "Preliminary Note to Rule 144"; the rule; and Form 144.

[17] Release 33-5223, under caption "Operation of the Rule."

[18] *See* S. GOLDBERG, PRIVATE PLACEMENTS AND RESTRICTED SECURITIES (1972) for additional information on Rule 144.

[19] Release 33-5223. The effect of this should ordinarily be to induce reliance on Rule 144 since Rule 155 was more restrictive. *See* H. BLOOMENTHAL § 4.10(5).

[20] This follows from the definition of the term "restricted securities" to mean securities "acquired directly or indirectly from the issuer thereof, or from an affiliate of such issuer, in a transaction or chain of transactions not involving any public offering." R. 144(a)(3).

[21] This follows from the definition of the term "restricted securities." *Id.*

shares issued in such transactions which essentially are not public offerings.[22] It is not clear as to the extent to which Rule 144 is applicable as to securities issued in violation of the registration provisions.[23]

As with Rule 154, Rule 144 is not available for sales by the issuer.[24] It is available for the resale of shares ("restricted shares") acquired in reliance on the Section 4(2) exemption for transactions not involving a public offering and for sales for the account of a controlling person. However, it is applicable only to securities of issuers concerning which appropriate information is publicly available. Restricted shares sold in reliance on the rule must have been paid for and been held for a period of two years. Sales must be made in unsolicited brokerage transactions and cannot exceed a quantitative limit during any six-month period which is similar to, but not identical to, the old Rule 154 limitations. Except for limited situations, an appropriate notice must be transmitted to the Commission concurrently with the placing of the order to sell the shares. There are detailed attribution rules for determining the extent to which sales by various related persons and entities must be taken into account in determining the selling shareholders' quantitative limitations. There are also explicit rules as to the extent to which selling shareholders can tack the holding period of their predecessors in interest in the shares in question and the extent to which under such circumstances sales of the selling shareholder and his predecessor have to be aggregated for purposes of the quantitative limitations.

B. *The Conceptual Format*

Analytically, the rule provides that anyone acquiring securities pursuant to the Section 4(2) exemption for private transactions from an issuer (or controlling person) who resells them after a two-year holding period in unsolicited brokerage transactions and in limited amounts in conformity with the requirements of the rule is not a statutory underwriter. The rule further provides that anyone selling securities for a controlling person in conformity with the requirements of the rule shall

[22] The inapplicability of Rule 144 follows from the definition of the term "restricted securities." *Id.* For persons whose shares are subject to restrictions on resale under Rule 145, see H. BLOOMENTHAL § 4.15(1).

[23] *See* p. 312-13 & notes 46-50 *infra.*

[24] This follows from the fact that the exemption is in terms of determining circumstances under which a person is not an "underwriter" and, hence, makes the exemption of Section 4(1) available for transactions not involving an "issuer or underwriter." R. 144(b). In the event the transaction involves an "issuer," there can, of course, be no Section 4(1) exemption. *See* H. BLOOMENTHAL § 4.08.

not be deemed an underwriter.[25] This should be all that is necessary to take care of the conceptual rationalization for the rule since it appears to cover the position of the selling shareholders and executing broker. In the case of the person who is not a controlling person acquiring shares in a private placement, if such person is not a statutory underwriter under the rule with respect to the resale of shares, it would follow that a Section 4(1) exemption would be available for him, and no further exemption is necessary for the executing broker.[26] Similarly, the rule provides that a controlling person reselling shares held by him for the appropriate period in conformity with the rule is not an underwriter, and anyone selling shares for him is not an underwriter; hence, the Section 4(1) exemption would be available for both the controlling shareholder and the executing broker. Section 4(4) of the Act for unsolicited brokerage transactions, while an integral part of the rule in terms of prescribing the manner in which sales must be made, does not, as was the case under Rule 154, appear to be the conceptual basis for the availability of the exemption. To the extent it is operative as a separate basis for the exemption, it would appear to serve the limited purpose of making an exemption available to the executing broker in the event Rule 144 is not applicable because the shareholder is in fact engaged in a distribution,[28] and the broker innocently executed the order after making the inquiries and taking the other appropriate steps required of him.[29]

A minor conceptual problem relates to the defining of restricted securities to include securities acquired from an affiliate in a transaction not involving a public offering.[30] The nonpublic-offering exemption is applicable to transactions with an issuer;

[25] R. 144(b). Although the rule provides that one selling any securities for an account of an affiliate in compliance with the provision of Rule 144 is not an underwriter, the rule would not operate to exempt the sale of shares acquired by an affiliate from the issuer unless such shares were acquired in a private transaction as restricted shares and held for the required holding period. Absent such circumstances, the affiliate would be an underwriter as to such shares and the Section 4(1) exemption for transactions not involving an issuer or underwriter would not be available. Compare the interpretation of Rule 154 in this respect at H. BLOOMENTHAL § 4.09(2) n.178.

[26] *See* H. BLOOMENTHAL § 4.08(2)(a).

[27] *Id.* § 4.09(2) n.176.

[28] This could result from the selling shareholder exceeding the limitations of Rule 144 or as a result of the Commission's caveat that the rule is not available despite technical compliance to "any transaction which . . . is part of a plan . . . to distribute or redistribute securities to the public." Release 33-5223, under caption "Operation of the Rule." *See* p. 339 at note 138 *infra*.

[29] *See* p. 343-46 *infra*.

[30] R. 144(a)(3).

not to transactions with an affiliate.[31] This poses some nuances of interpretation that could be troublesome in contexts discussed at sections II, D, and II, I, 2, *infra.*

C. *Availability of Current Public Information*

Rule 144 is applicable only with respect to securities of an issuer which is a reporting company under the Exchange Act or which otherwise makes certain specified information publicly available.[32] If it is a reporting company, it must have filed the most recent annual report required to be filed thereunder. Presumably, if no annual report has become due (because, *e.g.*, it only recently registered under the Exchange Act), it is not by that fact precluded from being a qualified issuer for purposes of Rule 144.[33] However, it must have filed the reports required to be filed for a period of at least ninety days immediately preceding the sales which would require that the issuer have been subject to the reporting requirements for at least ninety days.

The issuer must have filed all annual, quarterly, and other reports which became due during the immediately preceding ninety-day period and must have filed the most recent annual report required to be filed. A report is not viewed as due for this purpose until the date upon which failure to file results in delinquency.[34] If during the preceding ninety days an annual report on Form 10-K became due, the filing of such report and the filing of any 8-K that may have become due during the period would ordinarily satisfy the requirement. If, on the other hand, a quarterly report on Form 10-Q became due during the prior ninety days, in order for an issuer who has been subject to the reporting requirements for some time to be current it must have not only filed such report as well as any 8-K report that may have become due during the ninety-day period, but the Form 10-K for the last fiscal year which would have become due sometime prior to the ninety-day period. Except as to such annual report, delinquency in the filing of reports (8-K's, for example) which became due prior to the immediately preceding

[31] Section 4(2) reads in terms of "transactions by an issuer not involving any public offering." 15 U.S.C. § 77d(2) (1970). Sales by affiliates and persons purchasing from an affiliate have depended upon the exemption provided for by Section 4(1) for "transactions by any person other than an issuer, underwriter, or dealer." 15 U.S.C. § 77d(1) (1970). *See* H. BLOOMENTHAL § 4.08(2)(c).

[32] R. 144(c). *See* H. BLOOMENTHAL § 3.11(1).

[33] Lancer Homes, Inc., SEC Div. Corp. Fin. No-Action Letter Apr. 13, 1972, [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,722.

[34] Morrison, Foerster, Holloway, Clinton & Clark, SEC Div. Corp. Fin. No-Action Letter (Mar. 21, 1972), [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,779.

ninety days apparently does not affect the situation, although the Commission's accompanying synopsis of the rule suggests that the reporting company must have filed all reports required by the Act.[35] The issuer must state in each quarterly and annual report whether or not it has filed all annual, quarterly, and other reports required to be filed during the prior ninety-day period, and, in addition, in the quarterly report whether it has filed the most recent annual report required to be filed. A selling security holder may rely on this representation in the latest 10-Q or 10-K or upon a written statement from the issuer that all such reports have been filed unless he knows or has reason to believe such is not the case. Since the 10-Q or 10-K representation relates to the ninety days preceding the date of the report and the relevant ninety days from the standpoint of requirements of the rule is the ninety days preceding the sale, it appears inevitable that there will be a hiatus which will not be covered by such representation.[36]

Issuers not subject to the reporting requirements may, nonetheless, be qualified corporations for the purpose of Rule 144 if they make publicly available specified portions of the information required by Rule 15c2-11,[37] the rule which specifies the information that must be available for nonreporting companies before their securities can be generally traded in the over-the-counter market.[38] The information includes among other things the number of shares of the class outstanding, the nature and extent of the issuer's facilities and the product or service offered, and financial information (which need not be

[35] "This provision is deemed satisfied if an issuer has been subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act for a period of at least 90 days immediately preceding the sale of the securities and has filed all reports required by that Act and the rules and regulations thereunder and in addition has filed the most recent annual report required to be filed thereunder." Release 33-5223, under the caption "Availability of Public Information." A recent interpretative release also insists that a present delinquency in the filing of any report makes Rule 144 unavailable. SEC Securities Act Release No. 5306, pt. VI(A)(3) (Sept. 26, 1972), CCH FED. SEC. L. REP. ¶ 79,000. However, deficiencies in reports actually filed do not affect the availability of Rule 144. Electronic Transistors Corp., SEC Div. Corp. Fin. No-Action Letter (June 30, 1972), CCH FED. SEC. L. REP. ¶ 78,942.

[36] The period covered by the representation is ninety days prior to the date of the filing of the report. If we assume an issuer on the calendar year and a selling shareholder proposing to sell on June 15, at the time the selling security holder files his Form 144 the most recent Form 10-Q on file would cover the period January 1 through March 31, which report would have been filed by April 15 leaving a hiatus for reports that may have been due for April and May. By August 15, there will be a 10-Q on file which will cover the period through June 30. A shareholder filing a Form 144 on August 16 will have no hiatus, but if he files after September 10 there will be a hiatus.

[37] R. 144(c)(2).

[38] *See* discussion at H. BLOOMENTHAL § 12.05(3).

certified) concerning the issuer including its most recent balance sheet and profit and loss statement which has to be reasonably current.[39] Since there are no definite standards by which to determine the adequacy of the information and whether or not it is publicly available, some risk may be involved in assuming that a nonreporting company has satisfied the foregoing requirements. The Commission has urged such companies to voluntarily register under the Exchange Act and has indicated that if it is not feasible to provide the certified statements required by Form 10 for the three prior fiscal years, the Commission may, under appropriate circumstances, waive such requirement.[40]

For convenience in exposition, we shall refer to reporting companies and those satisfying the requirements of Rule 15c2-11 as qualified companies and all other companies as nonqualified companies.[41] Selling shareholders cannot utilize Rule 144 with respect to shares of a nonqualified company. The circumstances under which shares of such companies can be sold by controlling persons or by persons acquiring such shares in a private transaction are discussed *infra*. In subsequent discussions of Rule 144, the assumption is generally made that the issuer is a qualified issuer except as may be otherwise indicated.

D. *Shares to Which Rule 144 Is Applicable*

Rule 144 is applicable to restricted securities defined as securities acquired directly or indirectly from an issuer or an affiliate of an issuer in a transaction not involving a public offering.[42] Rule 144 is applicable also to securities sold for the account of an affiliate (controlling person) whether or not such securities are restricted securities. The foregoing presumes that the issuer is a qualified issuer as previously outlined. Nothing in Rule 144 alters the fact that in situations in which reliance is placed on the nonpublic-offering exemption, the issuer will have to continue to comply with the requirements of *SEC v. Ralston Purina Co.*[43] Those purchasing the securities in such transactions can utilize Rule 144 so as to dispose of limited amounts of such securities after the appropriate waiting period discussed below. A question arises, however, in this type of situa-

[39] R. 15c2-11(a)(4), Cls. (1)-(14), (16).

[40] Release 33-5223, under caption "Availability of Public Information."

[41] This terminology is not employed in Rule 144 as adopted. Rather Rule 144(b) conditions the availability of the rule to companies concerning which there is "available adequate current public information" and then spells out the information which must be available to satisfy this provision.

[42] R. 144(a)(3).

[43] 346 U.S. 119 (1953). Discussed at H. BLOOMENTHAL § 4.05(3).

tion as to the impact of Rule 144 if no private-offering exemption is available because of the failure to conform to the *Ralston Purina* criteria. It would appear clear that such purchasers could bring an action under Section 12(1) against the issuer and rescind the transaction if timely brought,[44] or could bring an action for fraud if appropriate disclosures relating to the necessity for registration are not made.[45] The status of persons who have purchased securities sold in violation of the registration provisions in terms of their classification as "statutory underwriters" has never been definitively determined. In one instance, it has been unsuccessfully urged that such persons are not statutory underwriters and are free to resell the shares acquired to the same extent they would have been as if they had been publicly offered pursuant to a registration statement or Regulation A offering.[46] However, this particular decision can be explained by the fact that arguably the purchaser of the shares was (or should have been) aware of the fact that such shares were being sold to him in reliance on the nonpublic-offering exemption. One cannot predict precisely how this line will be drawn, but it would appear that in some instances one purchasing under some circumstances in which reliance is inappropriately placed on the nonpublic-offering exemption may be, and in other instances may not be, a statutory underwriter. Perhaps this line will be drawn on the basis of whether or not there was purported reliance on the exemption, which reliance was known to and acquiesced in by reasonably aware investors as in *Crowell-Collier,* and those in which the securities were sold in violation of the registration provisions to unaware investors.[47] In those instances in which the purchaser is subject to classification as a statutory underwriter in the event he resells the securities, it would appear consistent with the underlying purposes of Rule 144 to permit him to resell shares in conformity with the provisions of Rule 144. In such event, strictly speaking, the shares were sold in a transaction involving a public offering, but are restricted because, absent the rule, the resale will result in classification as an underwriter. In those situations in which the person acquiring shares sold to him in violation is not deemed a statutory underwriter, he is presumably free under

[44] *See* H. BLOOMENTHAL § 8.04.

[45] *See* p. 346-47 *infra.*

[46] Quinn & Co. v. SEC, 452 F.2d 943 (10th Cir.), *cert. denied,* 406 U.S. 957 (1972).

[47] Crowell-Collier Publishing Co., SEC Securities Act Release No. 3825 (Jan. 12, 1957), [1957-1961 Transfer Binder] CCH FED. SEC. L. REP. ¶ 76,539. *See* H. BLOOMENTHAL § 4.10(2). As to the unaware investor, *compare* Can-Am Petroleum Co. v. Beck, 331 F.2d 371 (10th Cir. 1964).

Section 4(1) to resell them without restriction and without compliance with the provisions of Rule 144.

Two staff interpretations raise some interesting questions concerning the appropriateness of the foregoing analysis and pose some additional problems. In one the staff took the position that securities acquired by an underwriter in connection with an offering underwritten by it as additional underwriting compensation could not be offered under Rule 144. The shares had been previously registered for the shelf, but had not been disposed of. The underwriter now proposed to dispose of the shares pursuant to Rule 144. The staff took the position that such shares were not restricted shares as they were acquired in a transaction involving a public offering and, hence, Rule 144 was not applicable.[48] This is consistent with the Commission's traditional position that shares acquired by an underwriter in connection with an offering are to be viewed as a part of the public offering.[49] The other interpretation involved shares acquired from an issuer, subsequently registered, but not sold and then deregistered. The staff took the position that Rule 144 is not available for shares that have been subject to a registration statement that has been declared effective.[50] This would suggest that shares acquired with a view to distribution (perhaps regardless of the circumstances) cannot be offered pursuant to Rule 144. In such event it might revive all the old "theology" about investment intent that Rule 144 was designed to eliminate.[51]

The term "restricted securities" is applicable not only to securities purchased directly from the issuer, but also those purchased indirectly. Thus, if the issuer sells securities in a private placement and a purchaser in the private placement

[48] Telecredit, Inc., SEC Div. Corp. Fin. No-Action Letter (Apr. 14, 1972), SEC. REG. & L. REP. No. 150:C-2 (May 3, 1972).

[49] *See* H. BLOOMENTHAL § 7.15.

[50] Technical Operations, Inc., SEC Div. Corp. Fin. No-Action Letter (May 15, 1972). *See also* remarks of Alan B. Levenson, Director, Div. Corp. Fin., quoted in SEC. REG. & L. REP. No. 157:B-2 (June 21, 1972).

[51] Since the text was written, the staff has changed its position so that securities may be withdrawn from a pre-effective registration statement and deregistered as to an effective registration statement and sold pursuant to Rule 144 provided, in the latter event, the registration statement is no longer current because the prospectus has become dated or misleading. If the registration statement is current, Rule 144 may not be utilized as to securities covered by the registration statement, but may be for other restricted securities not covered by the registration statement. SEC Securities Act Release No. 5306, pt. I (Sept. 26, 1972) CCH FED. SEC. L. REP. ¶ 79,000. However, at the same time the staff reiterated the position referred to at note 48 *supra* that an underwriter cannot utilize Rule 144 for securities received in connection with a public offering and placed securities received by a finder in the same category. Emphasis in this regard was placed on the fact that such shares are not acquired "in a transaction or a chain of transactions not involving a public offering." *Id.* at pt. II.

resells a portion of the securities to another person who meets the *Ralston Purina* requirements, the shares purchased in the latter transaction are also restricted securities.[52] Each person along the chain acquiring restricted securities in this manner has his own waiting period and is subject to his own separate quantitative limitation with respect to resales under Rule 144.[53]

Shares acquired from an affiliate of an issuer in a transaction not involving a public offering are also classified as restricted securities.[54] To the extent that such shares were acquired by the affiliate in a transaction not involving a public offering and are resold to a person meeting the *Ralston Purina* criteria, the situation is not essentially different from those resold by others who acquire shares from the issuer in a private placement as discussed in a previous paragraph. However, a controlling shareholder's shares acquired in the open market and resold to a person in a transaction not involving a public offering are also classified as restricted shares for the purpose of Rule 144. This raises a question as to whether the sale to such persons is itself a violation if they are not sophisticated and informed investors within the meaning of *Ralston Purina*. Presumably, absent fungibility, they do not have to be in this context as there has been no transaction by an issuer or an underwriter; it is the resale by the purchaser (resulting in his classification as an underwriter) that leads to a possible violation of Section 5.[55] Accordingly, a transaction not involving a public offering for this purpose would appear to be essentially one in which the purchaser from the affiliate has not acquired the shares for distribution. In such event, the purchaser, by holding shares for the required waiting period and by complying with the other requirements of Rule 144, can resell the shares in appropriate amounts without registration. However, out of an abundance of caution the controlling person should probably confine his sales to purchasers meeting the *Ralston Purina* criteria. The staff has indicated in a related context that although Section 4(2) is not literally applicable to the affiliate, its limitations will be applied by analogy.[56] In the event the controlling person sells shares to individual purchasers without regard to the registration provisions, the position of the purchasers presumably would be similar to that of individuals

[52] R. 144(a)(3).
[53] *See* p. 316 at note 63 *infra*.
[54] R. 144(a)(3).
[55] *See* H. BLOOMENTHAL § 4.08(2)(c).
[56] *See* p. 321 at note 79 *infra*.

purchasing shares sold to them in violation of the registration provisions by the issuer as discussed above.

E. *The Required Holding Period and Fungibility*

Restricted securities must have been beneficially owned for a period of at least two years by the selling shareholder before they can be sold under Rule 144.[57] In addition, if purchased, the full purchase price or other consideration must have been paid at least two years prior to the Rule 144 sale. Payments by promissory note or purchase under a contract pursuant to an installment arrangement constitutes payment for this purpose only if the obligation is secured by collateral other than the purchased securities equal in fair market value to the purchase price; the seller has full recourse against the purchaser and the obligation has been discharged by payment in full prior to the sale.[58] The extent to which holding periods can be tacked and the effect of separate holding periods is discussed *infra.*

Notions of fungibility have been discarded. The fact that one has acquired nonrestricted securities during the waiting period does not affect either the sale of the nonrestricted securities or the waiting period as to the restricted securities. Rule 144 does not expressly refer to fungibility, but the release accompanying Rule 144 makes it clear that it is not applicable.[59] In addition, Rule 144, as finally adopted, deleted a provision that would have regarded restricted securities fungible to the extent that if acquired in successive transactions the last acquisition would start the holding period running anew for all restricted securities.[60] There is some possibility that a version of fungibility may be applicable for limited purposes in relationship to sales by affiliates as discussed above. The rule is not explicit how securities acquired at various times are to be identified; presumably, it will be by delivery of identifiable certificates.[61]

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[57] R. 144(d)(1). A person becomes the beneficial owner of restricted securities under a stock option plan on the date he exercises the option by paying the exercise price; the staff has suggested that the date of mailing of the check in payment can be used for this purpose. *See* National Patent Dev. Corp., SEC Div. Corp. Fin. No-Action Letter (Apr. 13, 1972), [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,797.

[58] R. 144(d)(2).

[59] "For the purpose of the rule, the doctrine of 'fungibility' will not apply. That is, the acquisition during the two-year period of other securities of the issuer, whether restricted, or nonrestricted, will not start the holding period running anew." Release 33-5223, under the caption "Holding Period."

[60] Proposed R. 144(d)(2), SEC Securities Act Release No. 5186 (Sept. 14, 1971), CCH FED. SEC. L. REP., Special Rep. 387.

[61] An inquiry to the staff had suggested that so long as the selling shareholder sold securities in appropriate amounts, there should be no need to identify shares by certificates or otherwise. The staff replied that

The rule specifically provides that short sales or purchases of puts (or other option) to sell securities of the same class or convertible into securities of the same class toll the running of the waiting period for the period of the short position or the period of the put or option.[62] Thus, if *A* acquired shares of *XYZ* Corporation in a private offering and after holding them for one year and one-half, then purchased a six-month put to dispose of securities of the same class, not only would he be unable to cover the transaction by the delivery of his restricted stock but the existence of the put would extend the holding period an additional six months. Thus, he is precluded from buying a put exercisable at a price related to the current market price or selling short at current prices so as to hedge against the possibility that the market price of the stock may go down before the expiration of his holding period. This is consistent with the reason advanced by the Commission for establishing a holding period — to assure that purchasers in a private placement have assumed the economic risks of investment and are not acting as conduits for sale to the public of unregistered securities on behalf of the issuer.[63]

F. *The Holding Period and Tacking*

There are a number of situations in which tacking of holding periods is allowed so that the holder's holding period relates back to the date upon which his predecessor acquired the shares in question. However, there is one situation in which tacking is not applicable and that pertains to the acquisition of restricted shares in a series or chain of transactions in each of which reliance is placed on the private-offering exemption. Thus, if *A* acquired the shares in question in reliance on the private-offering exemption from an issuer and resold them in a private transaction to *B*, *B* would have a new holding period and a separate quantitative limit.[64] This would follow irrespective of whether transferred by *A* within or after the expiration of his two-year holding period. In the latter event, *A* could

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tracing and identification of certificates "would be necessary in order to prevent any questions being raised about the length of the holding period of the securities to be sold." National Patent Dev. Corp., SEC Div. Corp. Fin. No-Action Letter (Apr. 13, 1972), [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,797.

[62] R. 144(d)(3).

[63] Release 33-5223, under the caption "Explanation and Analysis of the Rule."

[64] This follows from the definition of restricted securities to include shares acquired indirectly from the issuer as the result of a chain of private transactions and from the fact that there is no provision for tacking in this situation. As to the definition of restricted security, see R. 144(a)(3), and as to the provisions for tacking, see R. 144(d)(4)(D)-(G).

have resold the shares in conformity with Rule 144, but if he chooses to sell them in reliance on the private-offering exemption, *B* is the one who has indirectly acquired restricted securities from an issuer and must satisfy his own two-year holding period.

The situations in which tacking is permitted for purposes of the holding period are a transfer into trust, a gift, a bona fide pledge with recourse after default, and securities held by an estate.[65] Although the rule is not explicit in this regard, it would appear that a trust has reference to inter vivos gifts and trusts and not to testamentary gifts and trusts which are handled through the rules relating to estates. In all of the foregoing instances, the holder's holding period commences with the date the shares in question were acquired by his predecessor — that is, the settlor of the trust, the donor of the gift, the pledgor as to a pledge, and the decedent as to an estate. In the event a trust or estate has distributed the shares in question, the beneficiary can similarly use the holding period of the settlor or decedent as the case may be. If the pledge is without recourse, tacking is not permitted. Where there are successive donees each donee's holding period relates back to the date his donor acquired the shares and not to the date of the initial gift. Thus, if a donee acquired shares which had been held for less than two years but which with tacking satisfied the holding period, and he were to make an immediate gift of the same shares, all his donee could tack would be the donor's short holding period. Whenever tacking occurs, certain aggregation rules also come into play as is discussed *infra*.

G. *The Holding Period and Stock Dividends, Splits, and Recapitalization*

Rule 144 expressly provides that securities acquired from the issuer as a dividend or pursuant to a stock split, reverse split, or recapitalization have a holding period measured from the date of acquisition of the security as to which the dividend is based or the stock split or recapitalization relates.[66] If there has been more than one stock dividend, the holding period goes back to the acquisition of the shares upon which the initial dividend was paid. Although under Rule 145 a recapitalization subject to approval of shareholders involves a sale and may

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[65] R. 144(d)(4), para. (D) as to a pledgee; para. (E) as to a donee; para. (F) as to a trust, and para. (G) as to an estate.

[66] R. 144(d)(4)(A).

require registration under the Securities Act,[67] the security received in the exchange is deemed the same security as the one surrendered for purposes of the two-year holding period. An affiliated person receiving such shares could utilize the date of acquisition of the surrendered security rather than the date upon which securities were received as part of the recapitalization.[68] However, as to such a recapitalization this provision appears superfluous since to the extent resales would otherwise result in classification as an underwriter under Rule 145(c), shares can be resold within the confines of Rule 144 without regard to the length of the holding period. Accordingly, this provision is applicable to a recapitalization which is essentially a nonpublic offering. There is no comparable provision with respect to securities issued in corporate combinations (other than recapitalizations) which are essentially private offerings.[69]

H. *Holding Period for Contingently Issued Securities*

Rule 144 contains a special provision relating to determination of a holding period with respect to securities the issuance of which is contingent upon some condition other than the payment of a further consideration. The provision is applicable to situations in which restricted securities are to be issued as payment of part of the purchase price of an equity interest in a business or the assets of a business purchased by an issuer or an affiliate of the issuer. This assumes a combination which is not subject to Rule 145 because the private-offering exemption is available. If the purchaser is committed to issue the securities upon the occurrence of an event other than the payment of a further consideration, the securities are deemed for the two-year holding period requirement of Rule 144 to have been issued as of the date of the commitment to contingently issue.[70] Contingencies of the type that would be embraced within this provision would include (1) the acquired business generates a specified profit within a specified period of time; (2) those receiving the shares will not compete with the issuer; and (3) those receiving the shares will remain in the issuer's employ for a specified period of time. If the issuance is contingent on a further pay-

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[67] *See* H. BLOOMENTHAL § 4.15(1) with respect to the application of Rule 145; Rule 144(d)(4)(A) with respect to determination of the holding period for securities surrendered in connection with a recapitalization.

[68] *Cf.* Communications Consultants, Inc., SEC Div. Corp. Fin. No-Action Letter (Apr. 13, 1972), [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,764.

[69] *See* H. BLOOMENTHAL § 4.15(1).

[70] R. 144(d)(4)(C).

ment by the person to receive the shares, this provision has no application.

The foregoing provision is applicable, however, only to transactions involving the acquisition of an equity interest in a business or the assets of a business. The staff has expressed the view that this provision is not applicable when the securities have been escrowed pending clearance of some of the requirements preliminary to closing the transaction.[71]

I. *The Quantitative Limitations*

1. The Basic Calculation

The amount of restricted securities of a qualified issuer that can be sold for the account of a person other than an affiliate and the amount of restricted or other securities of a qualified issuer sold for the account of an affiliate under the rule during any six-month period cannot exceed one percent of the outstanding shares (or other unit) of the same class if the security is not listed on a national securities exchange.[72] For listed securities, the quantitative limitation is the same one percent amount or, if less, the average weekly reported volume of trading for all exchanges during the four weeks immediately preceding the filing of the notice (if required) referred to at section II, M *infra*. If no notice is required, trading volume is determined for the four calendar weeks prior to the placing of the order with the executing broker. This represents a departure from Rule 154 which based the amount that could be offered on the largest aggregate rather than average reported weekly volume and measured the four weeks in all instances from the placing of the order with the broker.[73]

The six-month period is not a semiannual or other calendar period. It is a six-month period determined in reference to the six months preceding the sales being presently made in reliance on Rule 144.[74] Insofar as the individual selling shareholder is concerned, it has the effect of requiring the aggregation of all shares sold by him in reliance upon Rule 144 during *any* six-month period. However, for purposes of the immediate calculation, it is determined in relationship to the sales during the *preceding* six months. Thus, if one is about to rely upon Rule

[71] Communications Consultants, Inc., SEC Div. Corp. Fin. No-Action Letter (Apr. 13, 1972), [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,764.

[72] R. 144(e)(1)-(2).

[73] *See* H. BLOOMENTHAL § 4.09(1) with respect to Rule 154.

[74] R. 144(e)(1)-(2). *See also* p. 343 at note 160 for variations based on fluctuations in trading volume of listed securities.

144 he must take into account the sales he has made during the preceding six months; he does not at that time take into account sales to be made subsequently. However, when he makes the subsequent sales if made within six months he will be taking into account the shares previously sold. Accordingly, his sales under Rule 144 will be aggregated unless they are spaced six months apart and the effect of the rule in this context is to include sales during any six-month period. However, in some contexts the fact that the period is the *preceding* rather than any six-month period conceivably could make a difference. As is noted in the succeeding section, in determining quantitative limitations, the selling security holder has to include restricted shares sold in reliance on the intrastate exemption if such shares were sold during the preceding six months. If, however, he were to dispose of restricted shares under Rule 144 and then sell restricted shares under the intrastate exemption (assuming the availability of the exemption)[75] the subsequent sales would not affect the availability of Rule 144 for the prior sales as in this context aggregation is only in terms of what went before. We shall note at a later point that in the specific context in which the Rule 144 requires aggregation because of tacking of holding periods that for this purpose the appropriate measuring period is *any* six-month period.

2. Securities Included and Excluded

The quantity of securities that could be sold under Rule 154 was seriously limited in that all securities of the same class sold by the appropriate selling shareholder during the appropriate six-month period had to be taken into account including securities which may have been registered, sold in exempted transactions, or covered by a Regulation A filing.[76] Rule 144 explicitly provides that securities sold in reliance on the Section 4(2) exemption for transactions not involving a public offering and securities covered by a registration statement or a Regulation A filing do not have to be included in making the quantitative calculation.[77] However, securities previously sold during the appropriate six-month period in reliance on Rule 144, restricted securities sold in reliance on the intrastate exemption, and restricted securities sold in violation of the registration provisions do have to be included in determining the quantitative limitation. The exclusion of securities sold in reliance on

[75] *See* H. BLOOMENTHAL § 4.04.
[76] *Id.* § 4.09(2) at nn.179-81.
[77] R. 144(e)(3)(G).

Section 4(2) poses a conceptual problem from the standpoint of sales by an affiliate (controlling person) in reliance on Rule 144 since in many instances reliance is technically being placed on the Section 4(1) exemption inasmuch as Section 4(2) is literally applicable only to transactions by an issuer, and an affiliate is not an issuer for this purpose.[78] Presumably, in this context the transactions by the affiliate will be viewed as if they did involve an issuer; in such event it would appear necessary for the affiliate, if he wishes to have the shares excluded from the calculation, to sell the shares to purchasers who not only acquire for investment, but who also meet the *Ralston Purina* criteria. This appears to be the position of the staff.[79] No comparable problem exists as to the nonaffiliated person selling securities in reliance on Rule 144 as such person includes in his quantitative calculation only the prior sale of restricted securities. To the extent he has acquired securities in the open market from a nonaffiliate, he can sell such shares in reliance on the Section 4(1) exemption, and they are not included in the quantitative calculation as they are not restricted securities. However, an affiliate has to include all sales of securities of the appropriate class (whether restricted or not) in his quantitative calculation unless exempt under Section 4(2), registered, or covered by a Regulation A filing.

3. The Attribution Rules

In determining the quantitative limitations applicable to a person (selling security holder) selling securities in reliance on Rule 144, the attribution rules must be taken into account. The attribution rules function by defining the term "person" so as to include under certain circumstances one's spouse and the relatives of the person and spouse and specified associated legal entities. Identical attribution rules are applicable under Rule 237 and Regulation A.[80] The term "person" is defined to include in addition to the selling security holder any person who is his (her) spouse or a relative (without regard to consanguinity) of the selling security holder or of his (her) spouse. Also attributed to a selling security holder are sales by a trust or estate in which the person and any of the related persons living together as discussed above collectively own 10 percent or more of the total beneficial interests in the trust or estate, or as to which the

[78] *See* H. BLOOMENTHAL § 4.08(2)(c).

[79] Harris, Beech & Wilco, SEC Div. Corp. Fin. No-Action Letter (Apr. 14, 1972), [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,773.

[80] *See* H. BLOOMENTHAL § 5.05(2)(d) for detailed discussion of the attribution rules in the context of Regulation A.

selling security holder serves as a trustee or executor or in a similar capacity. Similarly, sales by any corporation or other organization (other than the issuer) in which the selling security holder and the related persons referred to above own beneficially collectively 10 percent or more of any class of equity interest or of the equity interest are attributed to the selling shareholder.[81] To illustrate the attribution rules in determining the one percent (or other appropriate) limit, a person would have to take into account the sales of the appropriate security during the appropriate period by his wife and son if they lived in the same home with him.

In some instances the attribution rules operate in both directions — that is, sales by both persons are attributed to each other so that their sales are always aggregated. This would be true with respect to a husband and wife living together, for example, and for the most part with respect to related persons living together in the same household. The husband as a selling security holder must take into account sales by his wife and she would have to take into account sales by her husband. If, however, the attributable person is a relative of a spouse living in the same household, the attribution rules work only in one direction. To illustrate: If the selling security holder's mother-in-law lives with him, he would have to take into account appropriate sales of his mother-in-law. However, if the mother-in-law is the selling security holder, she does not have to take into account the sales of her son-in-law although she would under similar circumstances have to take into account the sales by her daughter. The attribution rules as applied to sales by entities (trusts, estates, organizations) operate only in one direction; they are taken into account by the individual selling security holder but not by the entity. Thus, if the trustee is the selling security holder for his own account he must take into account sales made by the trust. On the other hand, the trust as a selling security holder does not have to take into account sales made by the trustee for his own account. In those instances in which attribution operates in only one direction, the sequence in which transactions take place can affect the availability of Rule 144. If, for example, in the situation described, the trust were to sell securities of the appropriate issuer in one month and the trustee in the following month, both sales would be aggregated under Rule 144. If, on the other hand, the trustee were to sell his

[81] The attribution rules under Rule 144 are found in Rule 144(a)(2). Para. (A) thereof relates to relatives; para. (B) relates to trusts and estates; and para. (C) relates to corporations or other organizations.

shares before the trust sold its shares, they would not be aggregated. This appears to follow from the fact that the shares that can be sold under Rule 144 in this context are calculated in relationship to those sold within the *preceding* six months.[82] If transactions were planned in this context so as to maximize the amount of securities that could be sold under Rule 144, the possibility exists that the sales would be aggregated under the rules relating to sales by persons acting in concert discussed at section II, I, 6 *infra*.

4. The Aggregation Rules

We have observed above that tacking of holding periods is permitted with respect to a gift, a transfer into trust, a bona fide pledge with recourse, and securities held by an estate.[83] If tacking of holding periods is allowed, the aggregation rules generally come into play; accordingly, if a trust, pledgee, donee, or an estate has relied upon tacking in determining the holding period, account must be taken of the aggregation rules. For this purpose, the appropriate sales of the tacking party and his predecessor must be aggregated if they take place during *any* six-month period occurring within the period (generally two years from the appropriate event) within which tacking is allowed.[84] The result is that both parties concerned (for example, the donor and donee) must take into account what the other has done. The rule is not a model of clarity in this respect and will undoubtedly confuse some because of its reference to the "same six-month period," the syntax of which appears to be the donee's six-month period[85] which for some purposes is a period related to the date upon which the donee sold shares. However, in this context the donee's six-month period is not the six months immediately preceding his sales but *any* six-month period during which the donee sold shares within the tacking period.

Assume that the donee within two years of the gift were to sell restricted shares in reliance on Rule 144 and the donor the following month also proposes to sell restricted shares under Rule 144. At the time of the donee's sales, he will have to take into account the sales made during the preceding six months by his donor in determining the quantitative limitations on his sales. If the donor's sales are also made within two years of the gift, he would have to take into account the sales made

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[82] *See* p. 319 and note 74 *supra*.
[83] R. 144(d) (4) (D)-(G).
[84] *Id.* (e) (3) (C)-(F).
[85] *Id.* (e) (3) (C).

by his donee within six months prior to the donor's sales. Although the donor's six-month period and the donee's six-month period are not the same, their respective sales occurred within a six-month period which is the same.

After tacking is no longer necessary, the aggregation rules are no longer applicable. Tacking ceases to be necessary two years after the occurrence of the appropriate event for a trust, donee, or pledgee. The appropriate event as to a trust and donee is the date of acquisition of the securities; in the case of a pledgee with recourse, it is the date of default of the collateralized obligation.[86] Although tacking continues to be necessary for an estate or a beneficiary of an estate for a period of two years, the maximum period of time during which there is any possibility of aggregation with prior sales of the decedent is six months for apparent reasons. The one situation, possibly an oversight, in which tacking is allowed without bringing into play the aggregation rules is the distribution of shares of a trust (but not an estate) to a beneficiary.[87] In that event, although the beneficiary's holding period relates back to the settlor's, there is no requirement that the settlor's sales be aggregated with the beneficiary's. In some instances the attribution rules may come into play, but not necessarily.[88] Although beneficiaries receiving shares from a trust or an estate can tack the settlor's or decedent's holding period, their sales are not aggregated with the sales of the trust or the estate as the case may be.[89]

5. The Interrelationship of Attribution and Aggregation

The interrelationship of the attribution rules and the aggregation rules is complex and probably best understood in the context of specific situations pertaining to trusts, gifts, and the like as will be presently discussed. However, the following general procedures may be helpful in applying the aggregation and attribution rules:

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[86] R. 144(e)(3)(C)-(D) for gifts and trusts; R. 144(e)(3)(B) as to pledged shares.

[87] Rule 144(d)(4)(F) provides that securities acquired from the settlor of a trust or acquired by a beneficiary from the trust are deemed to have been acquired when they were acquired by the settlor. On the other hand, Rule 144(e)(3)(D) requires the trust to aggregate shares sold for the account of the trust with those sold during the same six-month period for the account of the settlor, but includes no similar requirement as to the beneficiary of the trust.

[88] They would come into play if the beneficiary and the settlor are related and reside in the same home. R. 144(a)(2)(A).

[89] For tacking, see R. 144(d)(4)(F)-(G); for aggregation, see R. 144(e)(3)(D)-(E). However, the beneficiary receiving shares from the estate has to aggregate his sales with those of the decedent if aggregation is otherwise appropriate. R. 144(e)(3)(E).

(1) Determine if tacking has to be relied upon in order to establish a holding period.
(2) If tacking is being relied upon, apply the aggregation rules as appropriate.
(3) After applying the aggregation rules, or if the aggregation rules are not applicable, apply the attribution rules.

Thus, one would determine whether the securities being sold are being sold by a donee, trust, estate, or by one having received the shares in a distribution from an estate, by a pledgee (or, in some instances, a purchaser from a pledgee). Then determine whether the selling security holder has made a gift, transferred shares into trust, or pledged shares of the appropriate class. In either of the two situations, apply the aggregation rules. Then apply the attribution rules to determine, for example, whether the selling security holder's spouse has sold restricted securities during the appropriate periods. In the event the aggregation rules are not applicable because a donee, etc., is not involved or because tacking is no longer necessary, apply only the attribution rules. If, to illustrate the foregoing general procedures, a settlor has made a gift of restricted securities into trust, of which he is trustee and the trust within two years of the gift sells the restricted shares in reliance on Rule 144, it must take into account sales of restricted shares made in reliance on Rule 144 by the settlor of his own shares during the same six-month period. If, on the other hand, the sales were made by the trust after two years from the transfer into trust, the trust would not have to take prior sales of the settlor into account. Should the trustee-settlor make sales before or after the expiration of the two-year period, he would have to take the Rule 144 sales of the trust into account because so long as he is the trustee all of the sales of the trust are attributed to him. If the settlor were not a trustee and the beneficiaries of the trust were neither his spouse nor related to him nor his spouse, the attribution rules would not be applicable. In such event, the settlor in selling his own restricted securities within two years from the date of the transfer into trust would take into account sales made by the trust. If, however, he sold shares after the two-year period, he would not take into account prior sales by the trust.

The aggregation provisions come into play only at the time the donee or other appropriate party sells restricted shares relying on tacking, not with respect to other sales by the party.

If, for example, a donee resells shares within two years of the gift so that he has to rely on tacking, he must take into account and aggregate prior sales of restricted securities made by his donor during the immediately preceding six months. If within a month he sells additional restricted securities which he acquired directly from the issuer and has held for two years, he must take his own prior sale of the gift securities into account; but even if it is within two years of the date of the gift, he does not have to take into account the sales of the donor unless they are attributable to him under the attribution rules. Thus, if the donor were his father and they lived together, he would take them into account; if they did not live together, he would not take them into account.

6. Persons Acting in Concert

One of the serious limitations on the use of Rule 154 was the Commission's interpretation of who constituted a "person" for the purpose of computing the quantitative limitations. The Commission's release interpreting Rule 154 had stated in that regard that "consideration must be given not only to sales by the specified control person but also the question whether such sales are, or may be, a part of a distribution being effected by a group of closely related persons of which the particular individual is a member. . . . Rule 154 does not provide an exemption for portions of group distributions . . . the offering by the group as a whole would have to be included in a single computation."[90] The practical implications of this in terms of Rule 154 was often to impose the one percent (or other appropriate) limit on controlling persons as a group. The careful consideration given in Rule 144 as to the extent to which sales by related persons and the like must be aggregated, hopefully, if complied with should avoid problems in this regard. However, Rule 144 does provide, both with respect to sales by an affiliate and sales of restricted securities by others, that sales by persons who "agree to act in concert" shall be aggregated for the appropriate six-month period in determining the quantitative limitation.[91]

The staff has stated that the "in concert" provision "is generally intended to group all persons who agree to act together in order to sell securities." Specifically, they have suggested that a meeting of individuals for the purpose of discussing and arranging an orderly method of sale pursuant to Rule 144 would

[90] SEC Securities Act Release No. 4669 (Feb. 17, 1964), CCH FED. SEC. L. REP. ¶ 2920.

[91] R. 144(e)(3)(F).

appear to fall within the phrase.[92] Certainly any planning among two or more persons designed to maximize the availability of Rule 144 would fall within the phrase. While the staff has not raised any question concerning an agreement among shareholders to withhold shares from the market during a period in which a registered offering is being made by them, the implication is that any comparable agreement while shares are being offered under Rule 144 would be viewed as acting in concert.[93] While the traditional "underwriting" is not feasible in connection with Rule 144 transactions, an agreement by a group to channel their shares through a single broker could well constitute acting in concert.[94] Perhaps the best course to follow in this context would be for every shareholder who is a potential Rule 144 offeror to consult his own counsel, sell through his own broker, and scrupulously avoid any meetings or conversations with other similarly situated shareholders concerning their plans for the disposition of stock under Rule 144. This may pose a real problem to counsel who is accustomed to otherwise advising several members of the group.

J. *Rule 144 in Operation*

1. Sales by Nonaffiliated Persons

An individual who acquired restricted shares from a qualified issuer, but who is not an affiliated person of such issuer, must first take into account if he proposes to sell such shares under Rule 144 whether he has held and paid for the securities for the required two-year period. He would then take into account all sales of restricted securities of the same class of the same issuer made by him during the prior six months. He would also review the extent to which he has made a gift, transferred into trust, or pledged restricted securities of the same class and of the same issuer during the preceding two years (or longer with respect to a pledge). In the event such transactions have taken place, he would also have to determine the extent to which his donee, the trust, pledgee, or purchaser from the pledgee may have sold the restricted securities in reliance on

[92] Stroock, Stroock & Lavan, SEC Div. Corp. Fin. No-Action Letter (Apr. 12, 1972), [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,774.

[93] Damson Oil Corp., SEC Div. Corp. Fin. No-Action Letter (Apr. 13, 1972), [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,763; Dynarad, Inc., SEC Div. Corp. Fin. No-Action Letter (Apr. 13, 1972), [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,769.

[94] While not directly in point, the staff has suggested that a single broker engaged to effectuate a registered secondary distribution through an exchange would be deemed an "underwriter." Texas Int'l Co., SEC Div. Corp. Fin. No-Action Letter (Apr. 5, 1972), [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,792.

Rule 144. He would finally take into account sales of restricted securities of the same class of the same issuer made by persons whose sales are attributable to him under the attribution rules.

Assume that *A* acquired common shares from *XYZ* Corporation in a private placement which he has held for more than two years and now proposes to dispose of in conformity with Rule 144. *A* must take into account restricted shares of *XYZ* Corporation common that he has sold during the prior six months if sold in reliance on Rule 144 and restricted shares sold in violation of the registration provisions as well and aggregate such shares with those he proposes to presently sell. Assume further that *A* made a gift of a portion of his restricted securities to State University and that State University disposed of those shares in reliance on Rule 144 within the preceding six-month period. If the gift had taken place more than two years prior to *A*'s proposed sales, *A* could disregard such sales. If, on the other hand, less than two years has elapsed from the date of the gift, *A* must aggregate the sales made by State University. If the gift had been to *A*'s son rather than to State University even if two years had elapsed from the date of the gift, *A* would have to take his son's sales into account if the son lived with him but not otherwise if two years has elapsed.

2. Sales by an Affiliate

If *A*, a controlling person of *ABC* Corporation, intends to sell shares of *ABC* Corporation in reliance on Rule 144, he must take into account the prior sales that he has made of *ABC* Corporation in reliance on Rule 144 during the appropriate six-month period. He must take into account the prior sales and the proposed sales even with respect to securities which he may have acquired in the open market. A nonaffiliated person in the same context could disregard the sales of shares he acquired in the open market since his quantitative limitations take into account only the sale of restricted securities. Except for this fact and the greater probability that an affiliate may have sold shares in violation, the discussion relating to Rule 144 as applied to nonaffiliated persons (see prior section) would also be appropriate. As to sales made during the prior six months by an affiliate in reliance on the nonpublic-offering exemption, the affiliate has a conceptual problem in that technically he is relying on the Section 4(1) exemption rather than the Section 4(2) exemption.[95] The staff has expressed the view that if such transactions are effected in a manner similar to private placements

[95] *See* p. 314 at note 56 *supra*.

by issuers under Section 4(2), such shares can be excluded.[96] Accordingly, if an affiliate sells shares to persons meeting the *Ralston Purina* criteria, he does not have to take them into account in determining the amount he can sell under Rule 144. To illustrate: Assume that *A*, an affiliate, owns 100,000 shares of *ABC* Corporation of which amount he acquired 80,000 shares from the issuer, which hence are restricted shares, and 20,000 shares in the open market, the latter not being within the definition of restricted shares since neither acquired from an issuer nor an affiliate. If *A* were to resell a portion of his restricted shares to *B*, a person meeting the *Ralston Purina* criteria, the shares would be exempt as there has been no distribution; *A* is not an underwriter in this context and *B* has acquired restricted shares. In a comparable situation, *X*, a nonaffiliated person, having acquired restricted shares from *ABC* Corporation and reselling them to *B* in compliance with *Ralston Purina* would not be an underwriter and *B* would have indirectly acquired restricted shares from the issuer. If *A* were to resell a portion of the shares he acquired in the open market under similar circumstances to *B* who acquired the shares for investment, the transaction would be exempt under Section 4(1) rather than Section 4(2). However, for the reasons noted above they probably do not have to be included in *A*'s calculations and they are restricted shares to *B* as shares acquired from an affiliate in a transaction not involving a public offering. In the identical situation, *X*, a nonaffiliated person, could resell the shares he acquired in the open market without regard to Rule 144 as *X* includes only restricted shares in his quantitative calculations.

3. Sales by Donees

Prior to adoption of Rule 144, it was the position of the Commission's staff that a donee may be an underwriter with respect to the gift securities if acquired from an affiliate of the issuer or from one who had acquired such shares in a private placement.[97] The critical consideration in this regard is whether to effectuate the gift it is necessary or probable that the gift securities will be resold. Rule 144 appears to be deliberately drafted so as to assure that gift securities will be embraced by the rule in that, among other things, restricted securities are defined in terms of securities acquired from an issuer or affiliate of an issuer rather than in terms of securities purchased from

[96] Harris, Beech & Wilco, SEC Div. Corp. Fin. No-Action Letter (Apr. 14, 1972), [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,773.

[97] SEC Securities Act Release No. 4818 (Jan. 21, 1966), CCH FED. SEC. L. REP. ¶ 2925.

an issuer or affiliate.[98] The Commission also emphasized in its release announcing Rule 144 that one may be an underwriter despite the fact that he did not purchase with a view to distribution if he participates in a distribution.[99] Since the Commission also announced that Rule 144 is not the exclusive means for selling restricted securities, it is conceivable that in limited situations a donee might be able to resell unregistered securities without being characterized as an underwriter. However, the Commission cautioned generally as to those relying on an exemption other than Rule 144 in the resale of restricted securities that "they will have a substantial burden of proof in establishing that an exemption from registration is available."[100]

A donee about to sell restricted shares in reliance on Rule 144 would determine his holding period by the acquisition date of his donor. If he had acquired the shares from the donor within the preceding two years, he would take into account any sales made by the donor within the appropriate six-month period; if the gift took place more than two years previously he would take into account sales by his donor only to the extent the attribution rules are applicable. He would also have to take into account whether he had made a gift or transferred into trust, or pledged the gift securities or other restricted securities and, in such event, under appropriate circumstances whether his donee, the trust, or pledgee has utilized Rule 144 for resale of the shares in question. Finally, in addition to his own sales during the preceding six months, he would have to take into account sales made by persons whose sales are attributable to him under the attribution rules.

Assume that *B* proposes to sell restricted shares of *XYZ* Corporation acquired from *A*, his father, who is an affiliate of *XYZ* Corporation, as a gift twenty-six months previously. The two-year holding period is satisfied without tacking; accordingly, *B* need not take into account sales made by *A* unless the attribution rules are applicable which would depend upon whether he is living with his father. The situation would have been otherwise if the gift had been made twelve months previously as in that event *B* would have to rely on the tacking of *A*'s holding period in order to utilize Rule 144. Returning to our initial assumptions, assume further that *B*, eighteen months earlier, made a gift of a portion of the securities received from *A* to *C*,

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[98] R. 144(a)(3).
[99] Release 33-5223, under the caption "Background and Purpose."
[100] *Id.* at the introductory general explanation.

his girlfriend, which she has resold in reliance on Rule 144 one month earlier. *B* would have to take *C*'s sales into account under the aggregation rules since *C* would have had to rely on the tacking of *B*'s holding period. Assume that *B*'s grandfather who lives with him has also resold restricted shares of *XYZ* Corporation of the same class during the preceding six-month period under Rule 144; *B* would have to take his grandfather's shares into account under the attribution rules.

The aggregation rules do appear to allow a donor to leak a substantial number of restricted shares into the market without registration provided he can avoid the attribution rules. Thus, if we assume that *A*, an affiliate of *ABC* Corporation, has four adult children, all of whom reside in their own homes, and makes a substantial gift of shares of *ABC* Corporation which have been held by *A* for in excess of two years to each of them, each of the children could resell the shares immediately under Rule 144 without taking into account the shares sold by the other donees. Thus, each might sell up to one percent of the outstanding shares or collectively four percent of the outstanding shares during a six-month period. If the children and/or the donor act in concert, however, all of their shares would be aggregated.[101] Further, although not a specific part of the rule, the Commission has announced that the exemption provided for by the rule is not available despite technical compliance with the provisions of the rule if the transactions are part of a plan to distribute securities to the public.[102] The situation described may well come within the foregoing caveat.

The rules relating to trusts are substantially identical to those relating to gifts and, hence, the discussion of various trust situations immediately below may have relevance to similar gifts not made in trust and the discussion of donees may be applicable to a gift in trust.

4. Sales by Trusts

A trust can utilize the holding period of its settlor with respect to restricted securities.[103] Thus, if the settlor had held the shares for only twelve months at the time he created the trust, the trust would have to hold the shares for another twelve months prior to relying on Rule 144. The holding period of shares distributed by the trust to its beneficiaries is also determined in reference to the settlor's acquisition date.[104] If the

[101] R. 144(e)(3)(F).
[102] *See* p. 339-40 *infra*.
[103] R. 144(d)(4)(F).
[104] *Id.*

trust resells the shares received from the settlor within two years from the transfer into trust, it must take into account sales of restricted shares by the settlor during the preceding six months. By an apparent oversight, a beneficiary to whom shares are distributed does not similarly have to take into account sales by the settlor[105] except under the attribution rules. The settlor may have to take into account sales by the trust under both the aggregation and attribution rules, but will have to take into account sales by a beneficiary only to the extent the attribution rules are applicable. The attribution rules attribute sales of the trust to the settlor if the settlor is a trustee or if he and/or his wife, his relatives, and the relatives of his wife living with him collectively own 10 percent of the beneficial interest in the trust.[106] If the shares had been distributed to a beneficiary, whether attributed depends upon whether the beneficiary is related to the settlor or his wife and lives with them.[107]

If we assume a fairly common family trust, transfer of restricted securities in trust for the benefit of the settlor's wife and children, application of the aggregation and attribution rules may vary depending upon the circumstances. The extent to which the attribution rules come into play in connection with a trust depends in part on who is the trustee, the living arrangements of the beneficiaries, and whether or not the shares transferred into trust have been distributed to some or all of the beneficiaries. It is also conceivable that there may be some differences depending upon whether the settlor creates a single trust or multiple trusts.[108]

Assume the settlor transfers restricted shares which he has held for two years into trust for the benefit of his wife and children with an independent trustee (a bank, for example). Conceivably, if all the children reside in their own homes and the wife is beneficiary for life with remainder to the children, an immediate problem in terms of the attribution rules would involve determination of whether the wife owns 10 percent or more of the beneficial interest in the trust. This may involve valuations based upon her age and selection of an appropriate

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[105] *See* p. 324 at notes 87-89 *supra*.

[106] R. 144(a)(2)(B).

[107] *Id.* (a)(2)(A).

[108] While sales of affiliated trusts have to be attributed to selling shareholders under appropriate circumstances, there are no provisions requiring sales of various trusts to be attributed to each other. See, however, on technical compliance, the Commission's general caveat at p. 339 *infra*.

life expectancy and valuation table.[109] Assume alternatively that each of the beneficiaries has the same interest in the trust; does it make any difference whether it purports to be one trust with five separate beneficiaries or five separate trusts? If it is five separate trusts, each trust would have its own one percent or other appropriate limitation and would not have to take into account the sales by the other trusts. Conceivably, the use of different trustees and/or different terms of the respective trusts may determine whether they are to be regarded as one or five trusts.[110] None of the foregoing matters are specifically referred to in the rule although they are common questions in the estate planning area generally.

For purposes of simplicity, assume a transfer of restricted securities which have been held for two years into a single trust for the benefit of five children of the settlor. Assume, further, that the trust has distributed a portion of such securities to one of the beneficiaries in accordance with the terms of the trust upon his attaining the age of thirty-five which occurred shortly after the trust was created. If within two years of the transfer into trust, the trust sells the restricted securities in reliance on Rule 144, it must take into account any restricted securities sold during the prior six months by its settlor. If, on the other hand, the beneficiary to whom shares were distributed sold such shares, he would not have to take sales by the settlor into account if he does not live with the settlor.[111] Yet, if the settlor had made a gift of such shares directly to him, he would have had to take the settlor's sales into account under comparable circumstances.[112] If the settlor proposes to sell shares in reliance on Rule 144, after two years he will not have to take the sales by the trust into account unless he is the trustee or unless the beneficiaries living with him collectively own 10 percent of the beneficial interest in the trust.[113] In view of this

[109] While the approach suggested in the text appears reasonable, as might be expected the staff did not disagree with the suggestion that the remainderman's beneficial ownership be determined upon the basis of the number of shares to which he would be entitled upon the expiration of the life estate. Otterbourg, Steindler, Housten & Rosen, SEC Div. Corp. Fin. No-Action Letter (Apr. 14, 1972), [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,754. This is, of course, the most stringent possible test, and if this were intended, there appears little reason why the rule should not have expressly so provided.

[110] In the tax context, twenty separate trusts with the same trustee have been held to be separate trusts. Each was created by a separate instrument and separate records were maintained as to each. Estelle Morris Trusts, Nos. 401-410 v. Commissioner, 427 F.2d 1361 (9th Cir. 1970).

[111] R. 144(e)(3)(D).

[112] *Id.* (e)(3)(C).

[113] *Id.* (a)(2)(B).

fact, a settlor undoubtedly will be encouraged to use a bank or other independent trustee rather than act as trustee himself. If one of the children-beneficiaries is a trustee, that child upon selling restricted shares held by him will have to take into account shares sold by the trust even though neither he nor the children living with him own 10 percent of the beneficial interest in the trust.[114] If the beneficiaries are children and grandchildren of the settlor, the attribution rules may be applicable to some of the beneficiaries and not to others. Thus, if *A* and his children living with him collectively (but not individually) have a 10 percent beneficial interest in the trust, *A* in relying on Rule 144 must take into account sales of restricted shares by the trust during the preceding six-month period. On the other hand, if *B* and his children collectively (but not individually) have a 10 percent beneficial interest in the trust but *B*'s children do not live at home, sales by the trust would not be attributable to *B*. The possibilities in terms of attribution and aggregation in the trust situation are numerous.

5. Sales by an Estate and Beneficiaries of an Estate

Perhaps the most complex situation in this general context is that of an estate which includes restricted securities held by the decedent at the time of his death, or, if the decedent was an affiliate, other securities of the appropriate issuer held by the decedent at the time of his death. If the estate is not itself an affiliate, in itself a difficult question of fact,[115] the status of the decedent as an affiliate has limited relevance. It may be of some significance in determining whether the estate is to be viewed as an affiliate although obviously not conclusive on this issue. As to shares the decedent held which were not acquired from the issuer (and, hence, which were not restricted shares), it would appear that the estate should be able to sell such shares without registration and without regard to Rule 144. However, it is conceivable that the estate would be viewed as participating in a distribution by an affiliate (now deceased) if it were to sell such shares and as such it would be an underwriter.[116] As to restricted shares acquired by the estate from the decedent, the Commission does not in this situation view the death of the decedent as in itself changing the restricted character of the shares. Presumably, the justification for this is the fact that from the standpoint of investor protection, the shares were

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[114] *Id.*

[115] *See* H. BLOOMENTHAL § 4.09(3), and in particular at n.196.

[116] Compare the rationalization with respect to donees generally in *id.* § 4.09(4).

issued in a private transaction and have never been registered.[117] In this context, however, assuming that the estate is not itself an affiliate, no holding period is required and shares may be sold in unlimited amounts under Rule 144. Nonetheless, the other requirements of Rule 144, such as the giving of appropriate notice, selling in brokerage transactions and the like, are applicable.[118] Thus, holding shares until death does not establish investment intent in this context, but liberalizes the circumstances under which such shares may be resold without registration.

If the estate (or beneficiary to whom shares have been distributed) selling restricted securities acquired from the decedent is itself an affiliate, Rule 144 with certain qualifications applies as it would to the sale of any other shares by an affiliate. The estate (or beneficiary) under such circumstances determines its holding period in reference to the date of acquisition by the decedent[119] and must take into account the shares sold by the decedent during the prior six-month period.[120] If the securities were not restricted securities and hence no holding period is required, it would appear nonetheless necessary for the estate (or the beneficiary) to include in its sales securities sold by the decedent during the prior six months, since in this one instance the rule appears to require aggregation even in the absence of tacking.[121] If the beneficiary who is also an affiliate having received restricted shares from the estate sells restricted shares of the issuer, it appears that he must include sales made by the decedent during the prior six-month period even if he does not sell the shares received from the estate.[122] Further, even if the beneficiary had not received any distribution from the estate, in selling restricted shares in reliance on Rule 144 he would have to aggregate all sales of the decedent in reliance on Rule 144 during the preceding six months.[123]

Assume that *A*, the decedent, was a controlling person of the *ABC* Corporation and his estate includes a substantial block of restricted stock of *ABC* Corporation, and that the estate controls *ABC* Corporation. If the estate sells restricted securities of *ABC*

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[117] On the role of "investor protection" generally in the drafting of Rule 144, see Release 33-5223, under the caption "Explanation and Analysis of the Rule."

[118] R. 144(d)(4)(G), (e)(3)(E). *See also* Release 33-5223, under the caption "Holding Period."

[119] R. 144(d)(4)(G).

[120] *Id.* (e)(3)(E).

[121] *Id.*

[122] *Id.*

[123] *Id.*

Corporation within six months of *A*'s death, it must take into account any sales made by *A* during the preceding six-month period. For apparent reasons, after six months has elapsed from *A*'s death there is no further possibility of aggregation. If *B*, *A*'s son, is an affiliate of *ABC* Corporation and the executor of the estate but not a beneficiary and also holds restricted securities of *ABC* Corporation, he does not have to take into account under the attribution or aggregation rules any sales made by *A* during the preceding six months as he obviously, at the time of his sales is not living with *A*. He must, however, take into account in connection with his sales under Rule 144 the sales made by the estate of restricted securities of *ABC* Corporation during the preceding six months under the attribution rules.[124] Further, if he were a beneficiary and the estate had distributed restricted shares of *ABC* Corporation to him as a beneficiary and he resold these shares under Rule 144, he would have to take into account sales made by *A* during the preceding six months under the aggregation rules. As noted above, under the aggregation rules, he would also have to take into account if he were a beneficiary of the estate all sales made by *A* during the preceding six months even if the restricted shares sold by him were not those received from the estate and even though none had been distributed to him.[125]

There may be some situations in which, by planning, the extent to which Rule 144 can be utilized by an estate and the beneficiaries may be maximized. Thus, if the estate distributes some of the shares to beneficiaries, the estate and the individual beneficiaries will each have separate one percent or other appropriate limitations, provided the attribution rules do not come into play. The aggregation rules would be applicable to the individual beneficaries to the extent each would have to take into account sales made by the decedent during the prior six months. However, absent application of the attribution rules, the beneficiaries do not have to take into account the sales made by each other or by the estate. In many instances, however, the attribution rules will be applicable as some of the beneficiaries may be executors, or be part of a related group with a 10 percent beneficial interest in the estate or may be within the relationships to each other that result in attribution.[126] The possible variations relating to attribution and aggregation as to an estate are numerous. The "in concert" provisions conceivably

[124] *Id.* (a) (2) (B).
[125] *Id.* (e) (3) (E).
[126] *Id.* (a) (2).

may be applicable if the estate and the beneficiaries attempt to arrange their transactions so as to maximize the availability of Rule 144.[127] If the Rule 144 limits have been exhausted, an estate may wish to consider offering shares under Regulation A.[128]

6. Sales by Pledgees

A pledgee selling restricted shares pledged as collateral or shares pledged by an affiliate may be an underwriter.[129] Rule 144 specifies the circumstances under which such pledged shares may be resold without registration.[130] Rule 144 distinguishes between shares pledged with recourse and those pledged without recourse. It also assumes two applicable situations: one in which the pledgee has sold to a private purchaser, and the other in which upon foreclosure the securities are offered publicly.

If the restricted shares (or other shares in the case of an affiliate) are pledged with recourse and if the pledge is bona fide, the pledgee (or the private purchaser) for purposes of the holding period is deemed to have acquired the shares when acquired by the pledgor. It should be observed that the pledge must be bona fide; that is, presumably, with the intention to repay and reasonable probability of repayment of the collateralized obligation.[131] If not, presumably, the holding period would be calculated as in the case of securities pledged without recourse as discussed below. Any sales under Rule 144 by the pledgee or the private purchaser from the pledgee made within two years of the default, must take into account prior sales by the pledgor and by each other during the appropriate six-month period for purposes of the quantitative limitations.[132] Thereafter, sales by the pledgee or the private purchaser can be made under Rule 144 without regard to sales by the pledgor or those made by each other except to the extent the attribution rules are applicable which would seldom be the case. The pledgor, until expiration of the two-year period referred to

[127] *Id.* (e) (3) (F).

[128] *See* discussion in H. BLOOMENTHAL § 5.05(2) (c).

[129] *Id.* § 4.09(4).

[130] R. 144(d) (4) (D), (e) (3) (B).

[131] *Cf.* SEC v. Guild Films Co., 279 F.2d 485 (2d Cir. 1960).

[132] R. 144(e) (3) (B). However, if the pledgee (or the private purchaser) in reliance on Rule 144 sells the shares publicly in a brokerage transaction, the purchaser is free to resell the shares without restriction. If the pledgee sells in a private transaction, the private purchaser in effect steps into the pledgee's shoes in determining the application of Rule 144. *See* Valicenti, Leighton, Reid & Pine, SEC Div. Corp. Fin. No-Action Letter (March 28, 1972), [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,761.

above, must take into account sales made by his pledgee or the purchaser from the pledgee; thereafter, he may sell securities under Rule 144 without taking into account sales by the pledgee or purchases from the pledge.[133]

If the pledge is not bona fide or if the pledge is made without recourse, neither the pledgee nor the private purchaser can tack on the pledgor's holding period.[134] In such event, the holding period for the pledgee commences from the date of the pledge and for the private purchaser commences from the date of his purchase from the pledgee. Accordingly, neither the pledgee nor the private purchaser can sell the shares in reliance on Rule 144 for a period of two years from the date of the appropriate event.[135] Thereafter, each can sell in reliance on Rule 144 without taking into account sales by the pledgor except to the extent the attribution rules may be applicable, which would seldom be the case.

7. Sales by Organizations

A corporation, partnership, or other business entity holding securities of an affiliated issuer or restricted securities of another issuer, can utilize Rule 144 for the purpose of selling such securities. It must, of course, establish its own appropriate holding period with respect to the securities in question. It ordinarily does not have to take into account sales made by others, although certain related persons owning a 10 percent equity interest would have to take into account under the attribution rules sales made by the organization in reliance on Rule 144.[136] However, conceivably, the corporation or other organization may own 10 percent or more of an equity interest in an organization other than the issuer of the restricted securities which also owns restricted securities, in which event sales by such organization during the appropriate six-month period would have to be taken into account.[137] Assume, to illustrate, that *A* Corporation and *B* Corporation, *A* Corporation's wholly owned subsidiary, acquire shares of *XYZ* Corporation in a private placement. Assume that *A* owns in excess of 10 percent of the common stock of *A* Corporation and also owns restricted shares in *XYZ* Corporation. If *A* were to sell restricted shares of *XYZ* Corporation in reliance on Rule 144,

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[133] R. 144(e)(3)(B).
[134] *Id.* (d)(4)(D).
[135] *Id.*
[136] *Id.* (a)(2)(C).
[137] *Id.*

he would have to take into account sales of restricted shares of *XYZ* Corporation made during the prior six months by both *A* Corporation and *B* Corporation as he owns of record and beneficially 10 percent or more of the equity interest in *A* Corporation and he owns beneficially 10 percent of the *B* Corporation. If *A* Corporation sold shares of *XYZ* Corporation in reliance on Rule 144, it would have to take into account prior sales of *B* Corporation, but not of *A* during the appropriate six-month period. If *B* Corporation sold restricted shares of *XYZ* Corporation in reliance on Rule 144, it would not have to take into account prior sales by *A* or *A* Corporation.

K. *Technical Compliance and a Distribution*

The Commission has cautioned as follows:[138]

> In view of the objectives and policies underlying the Act, the rule shall not be available to any individual or entity with respect to any transaction which, although in technical compliance with the provisions of the rule, is part of a plan by such individual or entity to distribute or redistribute securities to the public. In such case registration is required.

Conceivably, this language (although not part of the rule itself) could be the basis for retreating from the liberality of the rule in the event those members of the Commission's staff having reservations about the adoption of the rule in the present form should dominate the regulatory scene at some future date. It is often easier for the bureaucracy to change the ground rules by interpretation than by amended rules. Although Rule 154 contained no limitation on utilizing it for sales within the confines of the rule within successive six-month periods, the staff interpreted such practices as constituting a distribution beyond the confines of the rule.[139] Presumably, the foregoing warning is not directed at that situation as the same release specifically states, "[T]he rule permits sales within successive 6-month periods, but no accumulation would be permitted."[140] We have noted that it is possible by making a series of gifts[141] and creating a number of trusts[142] for one to arrange in conformity with Rule 144 for large blocks of unregistered securities to leak into the market. Conceivably, this is the type of situation that the Commission had in mind. In any event, it suggests that

[138] Release 33-5223, under caption "Operation of the Rule."

[139] *See* H. BLOOMENTHAL § 4.09(2) at n.182. Generally staff interpretations to date as reflected by no-action letters do not appear to be unduly restrictive or to evidence an intention to frustrate the objectives of Rule 144.

[140] Release 33-5223, under caption "Limitation on Amount of Securities Sold."

[141] *See* p. 329-31 *infra.*

[142] *See* p. 331-34 *infra.*

considerable caution be employed in attempting to plan the utilization of Rule 144 on a large scale as a means of avoiding registration.

L. *Manner of Sale*

In the event reliance is placed on Rule 144, securities must be sold in unsolicited brokerage transactions[143] which in this context requires strict compliance with all of the following:

(1) The broker engaged for the purpose of effectuating the transaction must act as the agent of the seller who is relying on Rule 144. The "broker" cannot purchase the securities from the seller.

(2) The broker must be paid no more than the usual and customary broker's commission. The seller must compensate no one other than the broker in connection with the transaction.

(3) The seller must not solicit or arrange for the solicitation of orders to buy the securities.

(4) The broker must not solicit or arrange for the solicitation of orders to buy the security. This means, for example, that the broker cannot call one of his customers and ask him if he would be interested in buying the shares. It also means that he must not engage in any market-making activities with respect to the class of security since in that event he would be making offers (and soliciting offers) through the medium of the sheets or NASDAQ or otherwise. A provision in earlier versions of the proposed rule would have allowed the broker to continue to insert quotations in an interdealer quotation service.[144] These provisions were deleted from the rule as adopted and a Rule 144 transaction cannot be effectuated through a broker who is also a market-maker with respect to the security.[145]

(5) As with Rule 154, the broker can, however, make inquiry of other dealers who are market-makers. Under Rule 154, such inquiries could be directed only to dealers who during the previous sixty days had made a written bid or a written solicitation of an offer to sell the security. Under Rule 144, such an inquiry can be made of a dealer who has indicated interest in the securities within the

[143] R. 144(f)-(g).

[144] Proposed R. 144(g)(2). *See* SEC Securities Act Release No. 5087 (Sept. 22, 1970), [1970-1971 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,909.

[145] R. 144(g)(2). The Commission explained that to permit a market-maker to effectuate Rule 144 transactions "would raise questions of conflict with the anti-manipulative provisions of Rule 10b-6 under the Exchange Act and accordingly has been deleted." Release 33-5223, under caption "Manner of Sale" at n.6. Since the text was written, the staff has outlined a procedure under which the market-maker can withdraw from the market for a period (generally approximately 24 hours) and effectuate a Rule 144 transaction. Kindel & Anderson, SEC Div. Corp. Fin. No-Action Letter (June 5, 1972), CCH FED. SEC. L. REP. ¶ 78,921. The Commission has also proposed amended Rule 144(g)(2) which would permit a bona fide market-maker in the security to effectuate Rule 144 transactions as agent for a selling shareholder without discontinuing its market-making activities. SEC Securities Act Release No. 5307 (Sept. 26, 1972), CCH FED. SEC. L. REP. ¶ 79,001.

preceding sixty days[146] which is broad enough to include one who has placed quotations in the sheets,[147] over NASDAQ[148] or contacted the executing broker orally concerning the same security.[149] Unsolicited brokerage transactions can normally be effectuated through an exchange with respect to a listed security.[150]

(6) Nothing in the foregoing precludes the broker from soliciting the selling shareholder; that is, contacting him and suggesting he may want to sell his shares.[151]

In substance the typical Rule 144 transaction will be effectuated by the selling security holder contacting a broker-dealer who does not make a market in the security[152] and placing a brokerage order with him. Obviously, the selling security holder should instruct the broker-dealer that the transaction must be effectuated in accordance with Rule 144. The broker will then contact a known market-maker in the security after assuring himself that the market-maker has been in the sheets or otherwise made a market in the security during the past sixty days and will sell the shares to the market-maker as agent for the selling security holder. The broker will then confirm to the selling security holder and charge him the usual brokerage commission. Alternatively, the broker could wait until someone (a customer or other broker-dealer) contacted him offering to purchase the security. In view of the improbability of this occurring on any sort of predictable basis, this method will ordinarily be used, if at all, only with respect to securities as to which there is no real market-maker or market. Absent an active market-maker in a security, it will be difficult to effectuate a Rule 144 transaction which may be the case as to securities of many unseasoned companies.

M. *Filing of Notice and Intention to Sell*

If the selling security holder relying on Rule 144 does not propose to sell in excess of 500 shares (or other units) and the aggregate sale price does not exceed $10,000 during any period of six months, there is no need to file a notice.[153] Conceivably,

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[146] R. 144(g)(2).

[147] *See* H. BLOOMENTHAL § 12.03(3).

[148] *See id.* § 12.03(5).

[149] The executing broker may, for example, during the prior sixty days have sold unrestricted securities to a dealer who indicated an interest at that time in purchasing additional shares.

[150] *See* H. BLOOMENTHAL § 12.02.

[151] The prohibited solicitation is a "solicitation of customers' orders to buy the securities," not the solicitation of customers' orders to sell. R. 144(g)(2).

[152] For subsequent developments relating to market-makers, see note 145 *supra*.

[153] R. 144(h).

one might not have to file such a notice at the time of his initial sales, but, due to an increase in market price or a change of intentions might have to file such a notice before the expiration of an appropriate six-month period. Although the rule is not explicit, a person probably has to take into account the attribution rules in determining whether the quantitative limits that trigger the notice requirement are applicable.[154] If the selling security holder proposes to sell 500 or more shares (or other units) or irrespective of the number of units the aggregate sale price may exceed $10,000 during any six-month period, he must concurrently with the placing of his order with the broker transmit to the Commission's principal office in Washington, D.C. three copies of a "Notice of Proposed Sale" on Form 144 which is to be signed (manually at least as to one copy) by the person for whose account the securities are to be sold.[155]

The notice on Form 144[156] calls for information relating to the issuer's IRS identification number and SEC file number which ordinarily will have to be obtained from the issuer. It also calls for the number of shares to be sold, aggregate market value of the shares to be sold as of ten days prior to the filing, and the approximate date on which the securities are to be sold. He must include appropriate information relating to acquisition and payment for the shares designed to establish his holding period and he must include appropriate information as to all securities sold during the past six months by himself, by persons whose sales are attributable to him, and by persons whose sales are required to be aggregated with his sales. Finally, he must represent that he does not know any material adverse information relating to the issuer which has not been publicly disclosed.

The person filing the notice must have a bona fide intention to sell the securities covered by the notice within a reasonable time.[157] In the event securities covered by the notice remain unsold after ninety days, the selling security holder must file an amended notice.[158] Presumably, the information set forth in the amended notice would relate to proposed date of sale and prior sales by the appropriate persons which could differ to a degree from the original notice because of a new appropriate six-month period. The rule is not explicit as to whether the

154 *Id.*
155 *Id.*
156 *See* Form 144, Release 33-5223.
157 R. 144(i).
158 *Id.*

filing of an amended notice requires a redetermination with respect to a listed security of the average weekly reported volume of trading which is measured by reference to the four calendar weeks preceding the filing of the notice.[159] The staff has taken the position that a new determination is not triggered by the amended filing; the date of the initial filing controls the volume determination for all shares sold during the succeeding six months.[160]

N. *Brokers' Compliance Responsibilities*

A broker effectuating a Rule 144 transaction must, of course, be able to identify the situation as one involving the application of Rule 144. Presumably, in most instances the selling security holder will bring this fact to the broker's attention. However, the broker's responsibilities with respect to the sale of unregistered securities go beyond merely complying with Rule 144 after a selling security holder has called his attention to the fact that the shares are restricted or are being sold on behalf of an affiliate. A broker has the responsibility of determining that the securities he is selling can be sold without registration; if he fails to exercise appropriate care in this regard, the broker may be an underwriter and the sales made by him may be in violation. For a broker to sell securities in violation of Section 5 not only subjects him to the usual sanctions, civil and criminal, but to disciplinary administrative proceedings within the SEC, the consequences of which can be extremely serious.[161]

The Commission insists that each broker-dealer adopt written supervisory procedures known to its salesmen sufficient to assure prompt notice to supervisory officials that specific transactions in this context require scrutiny.[162] As part of this procedure, the broker-dealer in opening an account for new customers should insist that the account be opened by the cus-

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159 *Id.*

160 Dow, Lohnes & Albertson, SEC Div. Corp. Fin. No-Action Letter (Mar. 26, 1972), SEC. REG. & L. REP. No. 149:C-1 (APR. 14, 1972). Since the text was written the staff has reversed itself in this regard. The quantitative limit is determined at the time of the proposed sale notwithstanding that it is within the six months succeeding the filing of Form 144. Thus, if an increase in trading volume would now permit additional sales without exceeding the 1% limitation, the selling shareholder may by filing an amended Form 144 sell additional shares based upon the average volume for the immediately preceding four weeks. He would, of course, have to take into account the sales made during the prior six months pursuant to the original Form 144 filing. SEC Securities Act Release No. 5306, pt. VIII(A) (Sept. 26, 1972), CCH FED. SEC. L. REP. ¶ 79,000.

161 15 U.S.C. § 78o(b)(5) (1970).

162 SEC Securities Act Release No. 5168 (July 7, 1971), CCH FED. SEC. L. REP. ¶ 22,760.

tomer himself and not some third person.[163] The broker-dealer must also, through routine inquiry of the selling customer, determine the following:[164]

> Whether the customer has direct or indirect connections with any publicly owned company or with the issuer, what his financial condition is, whether the customer's securities were acquired on the open market, whether he is the true beneficial owner of them, whether he is currently selling or attempting to sell the same securities through other brokerage houses, and whether he has non-public information about the issuer.

The broker-dealer cannot rely on the fact that the certificate delivered does not include a restrictive legend.[165] The issuer may have failed to place an appropriate legend on the certificate or, in the case of a controlling person, the stock may have been purchased in the open market and held by him in street name. The amount of inquiry necessary depends upon the circumstances. The sale of a modest amount of a widely traded security by a customer known to the dealer whose lack of relationship to the issuer is well known to the dealer "may ordinarily proceed with considerable confidence."[166] However, securities of relatively obscure and unseasoned companies which appear in substantial blocks are particularly suspect.[167] The sudden appearance of optimistic information relating to the issuer from management in these and other situations as well as a change in control of management may be circumstances suggesting careful scrutiny before handling a transaction.[168]

A minimal determination that a broker-dealer can always make is whether the issuer has made a registered or Regulation A offering. If it has not, obviously reliance is being placed on an exemption from registration. However, the fact of a prior registered or Regulation A offering does not preclude the possibility that the specific securities were issued in an exempt transaction or are being offered by an affiliate. The Commission insists with respect to sales by possible affiliates that a broker-dealer is not justified in relying on an opinion of seller's counsel that no control relationship exists. The dealer must make his own investigation to determine who his seller is and whether a control relationship exists.[169]

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163 *Id.*

164 *Id.*

165 *Id.*

166 Distribution by Broker-Dealers of Unregistered Securities, SEC Securities Act Release No. 4445, SEC Securities Exchange Act Release No. 6721 (Feb. 2, 1962), CCH FED. SEC. L. REP. ¶ 22,755.

167 *Id.*

168 *Id.* ¶ 22,756.

169 *Id.*

If the broker-dealer fails to determine that he is selling restricted securities or securities for an affiliate, he inevitably will have violated the registration provisions.[170] Assuming that he has made such a determination and the transaction is to be handled in conformity with Rule 144, the broker has further responsibilities if his participation in the transaction is to be exempt. Presumably, these responsibilities become applicable only if the securities are not sold in conformity with Rule 144; if the Rule 144 exemption is available to the selling security holder, the inquiry obligations of the broker would not normally come into play. However, it is nonetheless essential that the broker establish compliance procedures to discharge the responsibilities imposed upon him under the rule. In that event, if Rule 144 is not available to the selling security holder, the broker's transaction exemption will be available to the broker.[171] The broker's responsibilities in this regard are to take reasonable steps to assure that Rule 144 is applicable to the proposed transaction. In this regard the broker is charged with knowledge of the information included in the Notice of Proposed Sales and the Commission suggests that the broker obtain a copy of such notice and retain it in his files. As a minimum, the rule requires the broker to inquire concerning the following:[172]

(1) The length of time the securities to be sold have been held by the person selling them.

(2) If practicable, the dealer should make a physical inspection of the securities. Presumably, he could rely on the date of issuance as shown, but as noted above he cannot rely on the fact the certificate contains no legend.

(3) The nature of the transaction in which the securities were acquired.

(4) The amount of securities of the same class sold during the prior six months by the appropriate persons. The appropriate persons for this purpose include not only the selling security holder, but all persons whose sales are attributed to him and all sales which must otherwise be aggregated with his sales.[173] To satisfy this requirement a broker-dealer will have to have someone knowledgeable in the intricacies of the rule review each Rule 144 transaction and in many instances interrogate the selling security holder.

(5) Whether the selling security holder has solicited or arranged for solicitation of orders or made any payment to any other person in connection with the proposed transaction.

(6) Whether the selling security holder intends to sell addi-

[170] *See* H. BLOOMENTHAL § 4.08.

[171] 15 U.S.C. § 77d(4) (1964); R. 144(g).

[172] R. 144(g)(3) and notes thereto.

[173] *See* Form 144, Instruction.

tional securities of the same class through any other means.

(7) The number of outstanding shares (or other unit) and the relevant trading volume.

In view of the extensive compliance burden imposed on brokers, it is probable that many brokers will refuse to handle Rule 144 transactions at least as to orders below a specified amount. In such event, the utility of Rule 144 will be significantly reduced for its effectiveness from the standpoint of the selling security holder depends upon both an active market in the security and the willingness of brokers to effectuate Rule 144 transactions. In all probability, most dealers will require that the selling security holder furnish the dealer with an opinion of counsel covering many of the items listed above.

O. *Issuers' Responsibilities*

The issuer has policing and disclosure requirements in connection with the issuance of restricted securities which are discussed at section IV. A. In the past, through the use of appropriate legends on certificates and stop transfers orders to the transfer agent, responsible issuers have attempted to assure that shares issued in reliance on the private-placement exemption were not resold in violation. This is not without risk to the issuer since the issuer may be exposed to liability if it improperly issues orders to the transfer agent to refuse to transfer the shares in question.[174] The typical legend requires that securities be registered or an exemption be available prior to their resale and has attempted to vest considerable authority in counsel for the corporation to determine whether or not an exemption is available. In many instances in the past, counsel would insist on a no-action letter from the staff before allowing restricted shares to be transferred in reliance on an exemption. The staff has made it clear that although the means employed for this purpose are to be determined by the issuer, it remains responsible for assuring that shares resold in reliance on Rule 144 are actually sold in compliance with the provisions of Rule 144.[175] This places responsibility on the issuer not unlike those

[174] UNIFORM COMMERCIAL CODE § 8-401; H. HENN, LAW OF CORPORATIONS § 177 (1970). *Cf.* Kanton v. U.S. Plastics, Inc., 248 F. Supp. 353 (D.N.J. 1965). In the few jurisdictions that may not have adopted the Uniform Commercial Code, the transfer agent may avoid liability if it acts pursuant to the instructions of its principal (the issuer). *See* Hulse v. Consolidated Quicksilver Mining Corp., 65 Idaho 768, 154 P.2d 149 (1944). However, Section 8-406 of the Uniform Commercial Code expressly refuses to follow this line of cases and imposes liability on the transfer agent as well as the issuer for a wrongful refusal to transfer.

[175] Otterbourg, Steindler, Housten & Rosen, SEC Div. Corp. Fin. No-Action Letter (Apr. 19, 1972), [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,754.

described in this context with respect to a broker-dealer in the immediately preceding subsection. As a minimum, it would appear that the issuer should insist prior to authorizing the transfer of restricted securities in reliance on Rule 144 that a copy of Form 144 be filed with the issuer. In addition, an issuer will probably also insist that the selling shareholder furnish the issuer with an appropriate opinion of counsel that Rule 144 was available in connection with the sale. Presumably, this would be the same opinion that counsel furnished to the broker if such an opinion was, in fact, furnished. The issuer will probably want to have such opinions reviewed by its own counsel and would ordinarily insist that it include sufficient information from which it could be determined whether the aggregation and/or attribution rules come into play. The procedure established in this regard may create some problems in terms of assuring delivery of certificates without a legend within the settlement date.

P. *Rule 10b-6 and Rule 144*

SEC v. Jaffee & Co.[176] severely restricts the extent to which a secondary distribution can be effectuated other than through the usual syndicated underwriting arrangement. If a distribution is involved, Rule 10b-6[177] precludes any market-maker from participating in a distribution. Since Rule 144 is predicated on the assumption that the shares will be purchased in most instances from the executing broker by the market-maker, the implications of *Jaffee* would suggest that such purchases violate Rule 10b-6 if a Rule 144 transaction is deemed to involve a distribution. However, the basic rationale of Rule 144 is that if securities are sold in compliance with the rule then the persons are deemed not to be engaged in a distribution and therefore are not underwriters.[178] Accordingly, it would appear that Rule 10b-6 has no application to such transactions. However, the term "distribution" is used in a variety of contexts under the federal securities laws and not necessarily always with the same meaning. It is, therefore, conceivable that the staff might take the view that such transactions, while not a distribution for the purpose of defining an underwriter, may be a distribution for Rule 10b-6 purposes. It is not believed that the staff is likley to do so since

[176] 446 F.2d 381 (2d Cir. 1971). Discussed at length in H. BLOOMENTHAL § 6.17.

[177] Rule 10b-6 is discussed at H. BLOOMENTHAL § 6.15.

[178] R. 144(b) However, the same was essentially true with respect to Rule 154, but the Commission, nonetheless, cautioned that a Rule 154 transaction could violate Rule 10b-6. *See* H. BLOOMENTHAL ¶ 4.09(2) n.177.

in conjunction with *Jaffee* it would severely restrict the application of Rule 144 and all indications are that the Commission intends the rule to operate fully within the confines of its own limitation.

Q. *Investment Intent After Rule 144; Is Rule 144 Exclusive?*

The Commission has put all persons on notice that in connection with restricted securities issued after April 15, 1972, the "change in circumstances" concept will no longer be deemed an appropriate factor in applying the term "underwriter."[179] However, with respect to the resale of restricted securities acquired before April 15, 1972, by a noncontrolling person, the Commission will continue to take the "change in circumstances" concept into account in determining whether such persons are statutory underwriters should they choose to sell such securities other than in conformity with Rule 144. The Commission's staff will continue to issue no-action letters in the limited situation in which a noncontrolling person proposes to sell restricted securities acquired prior to April 15, 1972. The staff will not issue no-action letters with respect to securities acquired after April 15, 1972, but will issue interpretative letters to assist persons in complying with the new rule.[180]

The Commission has avoided any argument as to whether it has authority to make Rule 144 the exclusive means through which restricted securities can be sold without registration or compliance with Regulation A or Section 4(2) by stating that "the rule as adopted is not exclusive."[181] One suspects, nonetheless, for most, if not all, purposes it is exclusive. The same release states that in determining whether one reselling restricted securities outside of the rule is an underwriter, the Commission will take into account the length of time the securities have been held but holding "for a particular period of time does not by itself establish the availability of an exemption from registration."[182] Further, the Commission has stated that the definitive

[179] Release 33-5223, at introductory general explanation. As to nonaffiliates, it may be preferable to rely on old notions of investment intent if the shares were issued prior to April 15, 1972. This would be true with respect to (1) shares of nonqualified companies, (2) in instances in which it is difficult market-wise to effectuate Rule 144 transactions, and (3) in instances in which the proceeds realized from transactions effectuated within the limitations of Rule 144 will be relatively small. To the extent reliance can be placed on the old doctrines, it may be that a three-year holding period will be sufficient to establish investment intent. *See* H. BLOOMENTHAL § 4.08(2)(d) n.155 & § 4.10(3) n.219. However, one suspects that the staff may in addition require a demonstration of changed circumstances in this context.

[180] Release 33-5223, under caption "Operation of the Rule."

[181] *Id.*, at introductory general explanation.

[182] *Id.*

two-year holding period provided in the rule "may be relied on only in connection with sales made pursuant to the rule."[183] The fact that Rule 237 was adopted to permit resales under limited circumstances outside of the rule for securities held for five years, as discussed at section III *infra*, suggests that holding for a five-year period does not in itself establish that the securities were not acquired with a view to distribution. Further, although an estate which is not itself an affiliate can sell restricted securities without regard to holding period or the quantitative limitations under Rule 144, it must nonetheless comply with the other provisions of Rule 144, suggesting that holding the securities until death does not establish that securities were not acquired with a view to distribution. If holding securities for five years and/or until death does not establish that securities were not acquired with a view to distribution, and if changed circumstances are not to be taken into account for this purpose, it is difficult to conceive of circumstances in which one would not be an underwriter if he sold restricted shares outside of the confines of Rule 144 or Rule 237.

The Commission's views in this regard are undoubtedly to be respected by counsel and can be expected to be persuasive with the courts. However, by shifting (quite appropriately) emphasis to the need for investor protection which, in the Commission's view, continues irrespective of how long the securities have been held,[184] and refusing to recognize changed circumstances as a factor, the language "with *a view to* distribution" (emphasis added) in the definition of the term "underwriter" is disregarded. The words "with a view to" appear to require something more than an awareness that at some future date under some unforeseen circumstances the investor may sell the shares in question. The language of the street with reference to investment stock — "one has to marry it" — suggests an appropriate analogy. One acquires a wife with the awareness that divorce is possible; however, under such circumstances one has not acquired a wife with a view to divorce.

The context in which counsel may be tempted to raise the issue if shares have been held for a long period of time and/or to death or in which there has been a bona fide change in circumstances (terminal illness, for example) will involve situa-

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[183] *Id.*, under caption "Holding Period."

[184] "The public has the same need for protection afforded by registration whether the securities are distributed shortly after their purchase or after a considerable length of time." *Id.*, under caption "Explanation and Analysis of the Rule."

tions in which Rule 144 is unavailable because the issuer is not a qualified company; or it is unavailable because the other persons attributable to the client have exhausted its limits; or it is realistically unavailable because the market in the security lacks sufficient depth; or because of the low price at which the stock sells the amount that can be realized under the quantitative limitations is insignificant. In this context, rather than meeting the Commission's postion head-on, counsel might argue that the Commission has said that Rule 144 is not exclusive; the securities have been held for a long period of time which is conceded to be a factor and the securities are being sold in relatively small amounts without special selling efforts if such arguments are appropriate.[185]

III. THE RULE 237 ALTERNATIVE

The Commission contemporaneously with the adoption of Rule 144 liberalized Regulation A in certain respects[186] and adopted Rule 237 as a conditional exemption from registration.[187] While Section 237 is available with respect to qualified issuers as well, it appears to have been adopted for the primary purpose of allowing limited amounts of securities of nonqualified issuers to be disposed of under limited circumstances without registration or compliance with the conditions of Regulation A. It is of very limited operation since it is applicable only to transactions not involving a broker-dealer.[188] Accordingly, sales would have to be made on a negotiated face-to-face basis although there is nothing in the rule that precludes advertising for or otherwise soliciting the purchaser. Conceivably a commission could be paid to an agent finding a purchaser, if that agent is not a broker-dealer, as the definition of a broker-dealer depends upon whether one is engaged in the business of acting as such.[189] However, for the most part sales under Rule 237 will be made to friends, relatives, associates, and the like. Rule 237

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[185] *Cf.* WHEAT REPORT at 156.

[186] *See* H. BLOOMENTHAL § 5.05(2).

[187] Discussed in detail at *id.* § 5.13(2).

[188] For the Commission's announcement and explanation of Rule 237, see SEC Securities Act Release No. 5224 (Jan. 10, 1972), [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,484. Rule 237 will be 17 C.F.R. § 230.237 and is hereinafter referred to by its rule rather than its code designation. The rule conditions the availability of the exemption on the securities being "bona fide sold in negotiated transactions otherwise than through a broker or dealer." R. 237(a)(4). However, assuming that the shares are sold in a bona fide negotiated transaction not involving a broker-dealer, the purchaser can resell the shares through a broker-dealer in an open-market transaction. *See* Otterbourg, Steindler, Housten & Rosen, SEC Div. Corp. Fin. No-Action Letter (Apr. 19, 1972), [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,754.

[189] 15 U.S.C. § 78c(a)(4) (1970).

purchasers, provided they are not mere conduits, may resell the securities without restriction through normal market channels.[190]

In order for Rule 237 to be available, the issuer must be a corporation organized in the United States with its principal business operations in the United States. It must be and have been during the past five years a going concern.[191] The restricted securities must be offered by someone other than an issuer or an affiliate (controlling person) of the issuer, although restricted securities acquired from an affiliate could be offered if the required holding period has been met. The exemption is also available for securities which were acquired from an issuer in an intrastate offering.[192] The selling security holder must have paid for and held the securities for a period of five years without any provision for tacking.[193] Payment is defined as it is with respect to securities being sold in reliance on Rule 144.[194] The amount of securities that can be sold under Rule 237 during any *twelve* month period is one percent of the outstanding securities of the same class or $50,000 in aggregate gross proceeds, whichever is the lesser. Such amount must be reduced by the amount of *any* securities sold during such year by the selling security holder under a conditional exemption (usually Regulation A) and the amount of securities of the *same class* sold by the selling security holder in reliance on Rule 144.[195] In determining securities sold for this purpose, the same attribution rules as those applicable to Rule 144[196] and Regulation A[197] must be taken into account.[198] The selling security holder must file with the regional office of the Commission in which the issuer's principal business operations are conducted three copies of a notice on Form 237 signed by the selling security holder and must also send a copy of such notice at the same time to the issuer.[199] The notice must be on file at least ten days (excluding Saturdays, Sundays, and holidays) prior to any sales.[200]

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190 R. 237(a)(2).

191 *Id.*

192 This follows from the fact that unlike Rule 144 it is not limited to "restricted securities," but is applicable to any securities of an appropriate issuer held for the required holding period. R. 237(a).

193 R. 237(a)(3).

194 *Id. See* p. 315 & notes 57-58 *supra.*

195 R. 237(b).

196 For discussion of the Rule 144 counterpart see p. 321-23 *supra.*

197 For discussion of the Regulation A counterpart see H. BLOOMENTHAL § 5.05(2)(d).

198 R. 237(d).

199 *Id.* (c).

200 *Id.*

If the issuer of the securities is a qualified issuer and, hence, Rule 144 is available, the selling security holder would normally rely on Rule 144. If the selling security holder is not an affiliate and he has held the securities for five years, there may be some situations in which he would rely on Rule 237. If, for example, there is no real market in the issuer's securities and, hence, it is necessary to solicit prospective purchasers, Rule 144 is not a realistic alternative. Under such circumstances, he may rely on Rule 237 so as to negotiate sales without the assistance of a broker-dealer by soliciting friends, associates, and others. This may be preferable to attempting to sell the securities in reliance on Section 4(2) which would require that the purchasers meet the *Ralston Purina* criteria and would start a new holding period running.[201] In other situations, it may be possible to effectuate some sales through Rule 144, but not up to the quantitative limit. In such event, after completing the Rule 144 sales the selling security holder might supplement them with sales under Rule 237. However, in that event, he would have to take into account his prior sales under Rule 144 if made within the appropriate one-year period in determining the extent to which he can sell securities under the quantitative limitations of Rule 237.

IV. EXEMPTED TRANSACTIONS AFTER RULE 144

A. *Private Offerings of Nonconvertible Securities*

There is nothing in Rule 144 that changes the basic requirement of the nonpublic-offering exemption in regard to the necessity that all offerees meet the *Ralston Purina* criteria.[202] William J. Casey, Chairman of the Commission, has promised that the Commission, having changed the underwriter concept from one of theology to one of mathematics, will in the immediate future attempt to provide ascertainable standards for private offerings, although he cautioned that essentially those seeking venture capital without registration can expect to have to continue to look primarily, if not exclusively, to those who have the sophistication and financial capability to assume the risk.[203]

The private-offering exemption is of significance to an issuer in four different contexts:

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[201] *See* p. 316 & note 63 *supra*.

[202] *See* H. BLOOMENTHAL § 4.05 for discussion of the private-offering exemption. Rule 144 is premised on the assumption that the shares with respect to which the rule functions were acquired in reliance on the exemption. *See* p. 307 *supra*.

[203] Speech of William J. Casey before the Association of the Bar of the City of New York, exerpts from which are quoted in SEC. REG. & L. REP. No. 149:A-16 (Apr. 26, 1972). *See also* Speech of Commissioner Hugh F. Owens before Annual Meeting of District No. 4, National Association of Securities Dealers, reproduced in SEC. REG. & L. REP. No. 152:G-1 (May 17, 1972). A rule, if adopted, apparently will be Rule 146.

(1) In the situation in which the issuer is utilizing the exemption as an alternative to registration or Regulation A. In this context, typically the offering will have to be confined to institutional investors if there is to be reasonable assurance of the availability of an exemption.[204]

(2) Situations in which the issuer in an isolated transaction is offering stock in exchange for a property or other assets.

(3) Situations in which the issuer is attempting to utilize the private-offering exemption as a means of obtaining preliminary or "seed" money, but ultimately expects to make a registered or Regulation A offering.

(4) Situations in which the issuer is attempting to acquire a close corporation or other closely held business by exchanging its stock for stock or assets.[205]

Rule 144 facilitates all of the situations in which reliance is being placed upon the private-offering exemption in that it permits assurance to be given to the purchasers of circumstances under which they can sell the securities they acquire from the issuer. It does not, however, assure the availability of the exemption; in addition to compliance with the *Ralston Purina* criteria, the issuer must take into account the fact that the integration concept discussed at section IV, D below may affect the availability of the exemption particularly with respect to preliminary financing. The Commission has reiterated its strong suggestion that issuers use an appropriate legend[206] on stock certificates issued in reliance on the private-offering exemption and give appropriate instructions to its transfer agent as a policing device.[207] It has also given notice that persons acquiring shares

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[204] *See* H. BLOOMENTHAL § 4.05(6)-(9).

[205] The business combination situation is discussed at *id.* § 4.15.

[206] For a specimen legend, *see* H. BLOOMENTHAL § 4.09, penultimate paragraph of specimen escrow agreement. For cases giving effect to such restrictions, see Short v. Soil Builders Int'l Corp., [1957-1961 Transfer Binder] CCH FED. SEC. L. REP. ¶ 91,188 (Tenn. Ct. App. 1962); General Dev. Corp. v. Catlin, 139 So. 2d 901 (Fla. Dist. Ct. App. 1962). In Prudential Petroleum Corp. v. Rauscher, Pierce & Co., 281 S.W.2d 457 (Tex. Civ. App. 1955), the court refused to give effect to an investment restriction because it was not on the face of the stock certificate as required by the Uniform Stock Transfer Act. In Altman v. American Foods, Inc., 138 S.E.2d 526 (N.C. 1964), the court permitted an employee to rescind his exercise of a stock option upon the insistence of the corporation that the stock certificate include an "investment legend." *See also* Kanton v. U.S. Plastics, Inc., 248 F. Supp. 353 (D.N.J. 1965). The noted cases demonstrate some reluctance to implement legends as a policing device in this context. However, all of the cases referred to were prior to the adoption of Rule 144 and reflect in part the same type of concern as that expressed by the Commission (*see* p. 254 at note 210 *infra*) concerning awareness of the purchasers of the restricted nature of the securities and dissatisfaction with the subjective criteria applicable prior to the adoption of Rule 144.

[207] SEC Securities Act Release No. 5226 (Jan. 10, 1972). [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,483. *See also* SEC Securities Act Release No. 5121 (Dec. 30, 1970), [1970-1971 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,943.

from an issuer (or an affiliate), if they desire to distribute them, should obtain a contractual commitment from the issuer to voluntarily register under the Exchange Act and become a reporting company.[208]

Contemporaneously with the announcement of the adoption of Rule 144, the Commission has announced that it will regard it as a deceptive act or practice (and hence subject to the anti-fraud provisions) for the issuer or a controlling person or any other person selling unregistered securities in a private transaction to fail to inform the purchaser as to the applicable limitations upon the resale of the securities by the purchaser.[209] The Commission stated in this regard as follows:[210]

> The seller should inform the purchaser that the securities are unregistered and must be held indefinitely unless they are subsequently registered under the Securities Act or an exemption from such registration is available. It should be pointed out that any routine sales of securities made in reliance on Rule 144 can be made only in limited amounts in accordance with the terms and conditions of that rule and that in the case of securities to which that rule is not applicable compliance with Regulation A or some other disclosure exemption will be required.

If the issuer has no contractual obligation to register the securities or comply with Regulation A, it will be regarded as a deceptive practice to fail to make that fact clear to the issuer.[211] If the issuer represents that it will register the securities or cover them with a Regulation A filing, it must inform the purchaser "specifically as to the time when and the circumstances under which such attempt to register will be made or compliance with such exemption will be effected."[212] The issuer should inform the purchaser that a legend will be placed on his certificate upon issuance and that a stop transfer order pertaining to the certificate will be issued to the transfer agent if such is to be the case.[213] The issuer should also advise the

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[208] SEC Securities Act Release No. 5223 (Jan. 10, 1972), [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,487.

[209] SEC Securities Act Release No. 5226 (Jan. 10, 1972), [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,483.

[210] *Id.*

[211] *Id.*

[212] *Id.* Such contractual commitment should be undertaken only with awareness of its implications. Failure to timely comply with a contractual commitment can result in a substantial liability being imposed on the issuer. *See* Kupferman v. Consolidated Research & Mfg. Corp. [1961-1964 Transfer Binder] CCH FED. SEC. L. REP. ¶ 91,197 (S.D.N.Y. 1962). In any event, the issuer should carefully limit its obligations in this respect by controlling the timing of the filing of the registration statement and the number of instances under which it becomes obligated to file same. On problems related to timing the filing of a registration statement, see H. BLOOMENTHAL § 7.07.

[213] SEC Securities Act Release No. 5226 (Jan. 10, 1972), [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,483.

purchaser as to whether it will furnish the purchaser with information needed in order to make routine sales under Rule 144.[214]

B. *Section 3(a)(9) Exemption, Convertible Securities, and Private Offerings*

Section 3(a)(9) of the Securities Act of 1933 exempts certain voluntary exchanges with the issuer's own security holders.[215] As to offers made pursuant to 3(a)(9) generally, Rule 144 probably will have little impact. If the offering is essentially a public offering, the Commission will probably apply the double-standard version of the definition of "underwriter"[216] so that securities acquired can be freely resold by nonaffiliated persons. If recipients are a small group so that essentially the 3(a)(9) offering is a private placement, the Commission may, as in the case of business combinations, treat it as a private placement which brings Rule 144 into play. This is the distinction that was made under the old Rule 155 as to convertible securities issued in reliance on the Section 3(a)(9) exemption.[217] An affiliate receiving securities in an exempt transaction under Section 3(a)(9) could rely on Rule 144 in connection with the resale of the securities. Whether such securities are restricted securities and, hence, whether they must be held for two years prior to resale would appear to depend upon whether the offering is essentially a private or public one. The integration concept discussed at section IV, D *infra* may affect the availability of the Section 3(a)(9) exemption.

Convertible securities issued in a private placement are subject to Rule 144 whether issued before or subsequent to April 15, 1972.[218] Rule 155 is retained for the limited purpose of requiring registration of convertible debentures issued prior to April 15, 1972, if they are offered publicly and Rule 144 is not complied with.[219] As to convertible securities, the holding period under Rule 144 is the date of acquisition (and payment) for the convertible security both with respect to the convertible security itself and the security underlying the conversion right in the event converted. This is a significant change which may encourage the use of convertible debt, but is consistent with the relaxation of the Rule 155 requirement which generally precluded

214 *Id.*

215 Noted at H. BLOOMENTHAL § 4.06.

216 Discussed at *id.* § 4.08(2).

217 Proposed Rule 155 Revised, SEC Securities Act Release No. 4248 (July 14, 1960), [1957-1961 Transfer Binder] CCH FED. SEC. L. REP. ¶ 76,710.

218 *See* p. 306 & note 19 *supra.*

219 *Id.*

public sale of convertibles without registration.[220] Rule 144, on the other hand, treats privately placed convertible securities on the same basis as other privately placed securities and regards for most purposes the security received upon conversion as standing in the same place as the convertible security itself.[221]

Determination of the quantitative limitations poses some special problems with respect to convertible securities.[222] If during the appropriate six-month period only the convertible security is sold, the limitation would be based on the amount (percent of outstanding or relevant trading volume) of the outstanding class of convertible securities. If the security is converted and only the converted security is sold, the limitation would be based upon the amount of the class of security into which the security is convertible. One cannot, however, sell up to the relevant limits treating the convertible and underlying securities as two separate classes during the same six-month period. This much appears clear. Beyond this, the rule as drafted is ambiguous. Under a literal construction, if both convertible securities and the securities into which convertible securities are sold during the same six-month period, the amount of the convertible securities sold are deemed to be the number of shares (or other units) of the class into which they are convertible and the quantitative limits are based upon that class. The rule, however, is not explicit as to whether the class outstanding is increased for this purpose by the number of shares underlying all outstanding conversion rights. In either event, since the class of securities into which convertible is often larger, by converting the restricted convertible securities as to even a few shares and selling such securities, the selling security holder could effectively increase the quantitative limitations. Another (and in the light of the purpose of the provision, perhaps, more reasonable) reading of this provision would be to impose a dual test and also determine whether the convertible securities sold exceed the quantitative limit viewing the convertible security as a separate class for this purpose.[223] It is even conceivable that the con-

[220] *See* H. BLOOMENTHAL § 4.10(5).

[221] R. 144(d)(4)(B).

[222] *See* S. GOLDBERG, PRIVATE PLACEMENTS AND RESTRICTED SECURITIES § 8.6[c] [1].

[223] Since the text was written the staff has taken the position that the conversion of debentures into a few of the underlying shares, which are sold for the purpose of enlarging the amount of the convertible security that can be sold under Rule 144, is a plan to circumvent the quantitative limitations and is not permissible under the Rule. SEC Securities Act Release No. 5306, pt. VIII(c) (Sept. 26, 1972), CCH FED. SEC. L. REP. ¶ 79,000.

version itself might be deemed a sale of the convertible security.[224] The foregoing problems arise not only in the context of the selling shareholder selling both the convertible securities and the securities into which convertible during the same six-month period, but also in combining sales made by such persons and others under the attribution and aggregation rules.[225] The complexities of the problem do not appear to have been thought out in drafting this provision.

C. *Intrastate Offerings*

The Commission has always talked in terms of the necessity for securities issued in reliance on the intrastate-offering exemption[226] to be found only in the hands of investors resident of the single appropriate state upon completion of the distribution.[227] Technically this is another way of saying that those who purchase the securities must not be underwriters except for the limited purpose of reselling to other residents of the single appropriate state. The Commission has cautioned dealers that to commence making a market in a security offered in reliance on the intrastate exemption shortly after the completion of the offering is virtually certain (particularly with respect to a "hot issue")[228] to destroy the availability of the exemption.[229]

Securities issued in reliance on the intrastate exemption are not restricted securities and purchasers could not utilize Rule 144 in connection with their resale.[230] An affiliate of such an issuer having acquired his shares in reliance on the private-offering exemption, conceivably could, after holding the shares for the prescribed period, resell his shares in reliance on Rule 144.[231] To do so he would have to avoid integration of his shares

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[224] Compare with this the § 16(b) situation discussed at H. BLOOMENTHAL § 10.08.

[225] *See* p. 321-26 *supra*.

[226] For an extensive discussion of the intrastate-offering exemption, see H. BLOOMENTHAL § 4.04.

[227] *See id.* § 4.08(2)(b) n.146.

[228] For discussion of hot issues generally, see *id.* § 6.16.

[229] Ruling on Intrastate Exemption, SEC Securities Act Release No. 4386 (July 12, 1961), [1957-1961 Transfer Binder] CCH FED. SEC. L. REP. ¶ 76,774.

[230] This follows from the definition of restricted securities as securities issued in transactions not involving a public offering. R. 144(a)(3). *See* p. 311 *supra*.

[231] While Rule 144(b) provides that a broker selling any securities of an affiliate in compliance with the conditions of the rule is not an "underwriter," if the affiliate acquired the securities from the issuer and failed to hold them for the required period, he would be an underwriter with respect to the resale of the shares irrespective of the fact that they were otherwise sold in conformity with the provisions of Rule 144. *See* p. 308 at note 25 *supra*.

with the public intrastate offering;[232] in such event, he could be in a better position than the public purchaser in this context. All of the foregoing raises a question as to whether the Commission's new interpretation of the term "underwriter," as espoused in conjunction with the adoption of Rule 144,[233] will be applied in the context of an intrastate offering. In the event it is so applied, it will have the effect of indefinitely restricting the trading market in such securities to the state in which initially offered. While it remains to be seen as to what attitude the Commission will take in this context, one suspects that as to companies concerning which Rule 15c2-11 information is available,[234] the coming-to-rest concept and the term "underwriter" in this context will be construed in a manner to permit the resale of shares acquired by members of the public in an intrastate offering after a respectable interval of, for example, one or two years. Certainly in the past, shares issued pursuant to the intrastate-offering exemption have made their way into the interstate market; in some instances, fairly rapidly and probably in violation of the Securities Act, but in other instances they have gradually seeped into the interstate trading markets over a period of years. The Commission has, however, established a basis for narrowly restricting trading in securities offered in reliance on the intrastate exemption if it chooses to do so. In limited situations such shares, if held for five years, could be reoffered pursuant to Rule 237 which, unlike Rule 144, is not restricted to shares issued in reliance on the private-offering exemption.[235]

If reliance is being placed on the intrastate exemption, the integration concept discussed in the following section must also be taken into account.

D. *The Integration Concept*

In a number of situations it becomes important to determine whether securities are to be viewed as part of the same single issue (offering); in the event they are so viewed, they are said to be integrated. This question arises in the context of the private-offering exemption since an issuer cannot separate portions of the same issue into transactions exempt under the private-offering exemption and other portions either not exempt or exempt

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[232] *See* p. 361 & notes 351-52 *infra*. If the securities are integrated, they have been sold in a public offering and are not restricted securities under Rule 144(a)(3).

[233] *See* p. 307-08 *supra*.

[234] *See* p. 310-11 & notes 37-40 *supra*.

[235] *See* p. 350-52 *supra*.

under another exemption.[236] Thus, two exemptions (*e.g.*, private offering and intrastate offering) cannot be combined in this context, and the issuer cannot avoid liability for the private portion of an offering if the securities are part of a single issue which overall constitutes a public offering.[237] The question of integration arises in conjunction with the availability of the intrastate offering exemption in several situations. If the promoters include nonresidents, there is a question as to whether their shares are to be integrated with the general public offering to residents and thereby destroy the availability of the exemption.[238] If an offeror is unable to successfully complete an intrastate offering, to now offer securities publicly pursuant to a registration statement may result in integrating the public offering with the prior intrastate offering and destroy the availability of the intrastate exemption.[239] An issuer having failed to comply with the intrastate exemption because of a sale to a single nonresident may find that integration precludes him from continuing the offering to residents, since if integrated with the prior offering the exemption will not be available for the subsequent sales.[240] An issuer relying on the intrastate-offering exemption for the purpose of preliminary financing may destroy the availability of the exemption by its subsequent public financing even if the latter offering is registered because of the integration doctrine.[241] A Section 3(a)(9) exemption for certain voluntary exchanges with the issuer's own security holders[242] is also dependent upon the offering being exclusively in exchange with its own security holders. Thus, if the issuer offers securities for cash pursuant to a private-offering exemption or even if the securities are registered, if they are deemed to be part of the same issue offered in the exchange, the Section 3(a)(9) ex-

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[236] "It has been and is the Commission's position that an issuer or an underwriter may not separate parts of a series of related transactions comprising an issue of securities and thereby seek to esablish that a particular part is a private transaction if the whole involves a public offering of the securities . . . ." Crowell-Collier Publishing Co., SEC Securities Act Release No. 3825 (Aug. 12, 1957), [1957-1961 Transfer Binder] CCH FED. SEC. L. REP. ¶ 76,539.

[237] *Id.;* Batkin & Co., 38 S.E.C. 436 (1958).

[238] *See* Peoples Sec. Co., 39 S.E.C. 641 (1960); Founders Preferred Life Ins. Co., SEC Div. Corp. Fin. No-Action Letter (June 16, 1971), SEC. REG. & L. REP. No. 106:C-1.

[239] *See* Texas Glass Mfg. Corp., 38 S.E.C. 630 (1958); Presidential Realty Corp., SEC Div. Corp. Fin. No-Action Letter (Feb. 19, 1971), [1970-1971 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,066.

[240] *See* (Hillsborough Inv. Corp. v. SEC, 276 F.2d 665 (1st Cir. 1960).

[241] Cameron Indus., Inc., SEC Securities Act Release No. 1459 (Nov. 1959). *Cf.* Texas Glass Mfg. Corp., 38 S.E.C. 630 (1958).

[242] *See* H. BLOOMENTHAL § 4.06; p. 355-57 *supra.*

emption is not available for the exchange.[243] There are also potential integration problems with respect to the quantitative limits of the Regulation A exemption, but these are provided for by rules which resolve most potential integration issues in this context.[244]

The Commission has said that the question of integration is one of fact to be determined by all of the surrounding circumstances.[245] This means there are no objective standards for determining whether securities are part of the same single issue. Although it appears to be a mixed question of fact and law involving the application of general standards to usually acknowledged facts, some courts have viewed the issue as a disputed issue of fact precluding summary judgment.[246] The general criteria that the Commission has established as being appropriate for determining the issue of integration are as follows:[247]

(1) The fact that the secuities are of the same class tends to suggest that the securities are part of the same single issue.

(2) The fact that the securities are offered for the same purpurpose tends to indicate a single issue.

(3) The fact that the securities are offered on the same general terms tends to indicate a single issue. Offering securities at different prices is not offering them on different terms.[248]

(4) The fact that the securities are being offered in an uninterrupted program of financing suggests a single issue. A general plan and/or uninterrupted program of financing may exist despite the fact there has been a lapse of time between "offerings."[249]

(5) Offerings to promoters are less likely to be integrated.[250]

Viewed from the standpoint of avoiding integration, the principal considerations are to separate the offerings in terms

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[243] Opinion of General Counsel of Commission, SEC Securities Act Release No. 2029 (Aug. 8, 1939), CCH FED. SEC. L. REP. ¶ 2140.

[244] *See* H. BLOOMENTHAL § 5.09 nn.124-31. *But see* Batkin & Co., 38 S.E.C. 436 (1958). *Cf.* Schertle Galleries, Inc., SEC Div. Corp. Fin. No-Action Letter (July 15, 1971), [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,372.

[245] Unity Gold Corp., 3 S.E.C. 618 (1938); SEC Securities Act Release No. 4434 (Dec. 6, 1961), CCH FED. SEC. L. REP. ¶ 2272. The Fifth Circuit has held that as a question of fact, it is inappropriate for the court to decide the issue of integration upon a motion for summary judgment. Jackson Tool & Die, Inc. v. Smith, 339 F.2d 88 (5th Cir. 1964).

[246] Jackson Tool & Die, Inc. v. Smith, 339 F.2d 88 (5th Cir. 1964).

[247] Herbert R. May, 27 S.E.C. 814 (1948); Unity Gold Corp., 3 S.E.C. 618 (1938); Non-Public Offering Exemption, SEC Securities Act Release No. 4552 (Nov. 6, 1962), CCH FED. SEC. L. REP. ¶¶2781-82.

[248] *See* Batkin & Co., 38 S.E.C. 436 (1958).

[249] Texas Glass Mfg. Corp., 38 S.E.C. 630 (1958).

[250] L. LOSS, SECURITIES REGULATION 689 (1961). *But see* note 252 *infra*.

of time; to offer different classes of securities; and to offer securities to promoters and other insiders. In fact, one might assume that an offering of securities of significantly different classes to individuals who are promoters or other insiders, particularly if separated in time from a public offering, would be conclusively presumed to be separate issues. There are some indications, however, that in those instances in which reliance is being placed on the intrastate-offering exemption, the Commission may view securities of a different class as being integrated[251] and securities offered to promoters and other insiders to be integrated with the public offering if the effect is to destroy the availability of the exemption.[252] Although in one instance, the Commission convinced a district court to integrate different classes of promissory notes having some but not substantial differences in their terms,[253] in another instance in the context of the intrastate exemption a district court rejected the integration argument finding 6 percent installment notes to be a different issue from 7 percent notes payable upon a fixed maturity date.[254]

In the event reliance is placed on the private-offering exemption and the offering is not successfully completed, Rule 152 specifically provides that a subsequent public offering will not destroy the availability of the exemption to the extent sales took place in reliance on the exemption if it were otherwise avail-

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[251] *See* notes 253-54 *infra*. For the basic notion that securities of different classes are not part of the same issue see Opinion of General Counsel of Commission, SEC Securities Act Release No. 2029 (Aug. 8, 1939), CCH FED. SEC. L. REP. ¶ 2140. However, in appropriate contexts, other considerations may be more relevant. Thus, although fractional interests in different oil properties would appear to be clearly separate securities, the Commission has indicated they may be integrated emphasizing the related-plan aspect. The Commission stated in this respect: "Thus, in the case of offerings of fractional undivided interests in separate oil or gas properties where the promoters must constantly find new participants for each new venture, it would appear to be appropriate to consider the entire series of offerings to determine the scope of this solicitation." Non-Public Offering Exemption, SEC Securities Act Release No. 4552 (Nov. 6, 1962), CCH FED. SEC. L. REP. ¶ 2782. Conceivably, emphasis on the related nature of a series of separate offerings might result in characterizing a series of separately negotiated acquisitions of properties for securities as a single offering. This contention was raised and rejected by one district court which for purposes of determining whether a preliminary injunction should be issued was unwilling to find "any single plan of distribution" on the basis of a series of acquisitions for stock made over a three-year period. Bowers v. Columbia Gen. Corp., [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 93,450 (D. Del. 1971). Other aspects of the *Bowers* case are discussed at H. BLOOMENTHAL § 4.05(10) at n.108.

[252] Peoples Sec. Co., 39 S.E.C. 641 (1960); Founders Preferred Life Ins. Co., SEC Div. Corp. Fin. No-Action Letter, SEC. REG. & L. REP. No. 106:C-1 (June 16, 1971).

[253] Hillsborough Inv. Corp. v. SEC, 276 F.2d 665 (1st Cir. 1960).

[254] SEC v. Dunfee, d/b/a Dunfee Sav. & Lease [1966-1967 Transfer Binder] CCH FED. SEC. L. REP. ¶ 91,970 (D. Mo. 1966).

able.[255] There is no counterpart to Rule 152, however, with respect to the aborted intrastate offering. Further, with respect to preliminary financing made in reliance on the private-offering exemption, Rule 152 is of no assistance as it is applicable only if the issuer subsequently decides to make a public offering and in this context the issuer presumably has decided to make a subsequent public offering at the time it undertakes its preliminary financing. It is not clear what the impact of Rule 152 would be in the event an issuer undertakes an offering in reliance on the private-offering exemption, but with a general awareness that it may have to make a subsequent public offering. The question would turn on whether under such circumstances the decision to make a public offering is a subsequent decision. Rule 152 precludes a subsequently decided upon unregistered public offering (for example, an intrastate offering) from integrating the subsequent sales so as to destroy the private offering. However, in the same context, it does not operate so as to preclude integration of the sales made in reliance on the private-offering exemption with the intrastate offering so as to destroy the availability of the intrastate exemption.

E. *A Suggested Procedure for Preliminary Financing and Integration*

The Commission's staff has applied the integration doctrine in a manner that makes it unreasonably difficult for issuers to raise limited amounts from reasonably sophisticated investors preliminary to filing a registration statement. It is one thing to apply the integration concept so that what starts out to be a private placement does not expand into an unregistered public offering.[256] It is another matter to apply integration so that no exemption exists for transactions with a small group that is capable of fending for itself merely because the issuer intends to subsequently make a registered or Regulation A offering. On the assumption that reliance on the intrastate exemption is to be discouraged, there may be more justification for the strictness of the integration concept in this context if the initial financing is preliminary to a public intrastate offering.[257] Hopefully, the Commission's promised modernized version of the private-of-

[255] 17 C.F.R. § 230.152 (1972).

[256] *Cf.* SEC v. Continental Tobacco Co. of S.C., Inc., 463 F.2d 167 (5th Cir. 1972). An even more extreme suggestion is the speculation of the Fifth Circuit that it may be necessary to show at the time of a claimed exemption that the issuer does not intend a future offering that may affect the availability of the exemption. Hill York Corp. v. American Int'l Franchises, Inc., 448 F.2d 680 (5th Cir. 1972).

[257] *Cf.* Peoples Sec. Co., 39 S.E.C. 641 (1960).

fering exemption will also take into account the impact of the current doctrines relating to integration.[258] While the integration doctrine operates in a particularly harsh manner with respect to preliminary financing, it also serves no purpose if applied to a sale to institutional investors of the same class of security as that being publicly offered made more or less contemporaneously with a public offering.[259]

The principal problem other than assuring that the requirements of the private-offering exemption are met in connection with preliminary financing is to avoid the offering from being integrated with a subsequent public offering. A suggested format for accomplishing this would be to issue in connection with the preliminary financing nonassignable convertible promissory notes. Out of an abundance of caution an effort should be made to rely on the intrastate exemption as well as the private-offering exemption in connection with such issuance. The promissory notes should be issued to promoters, organizers, officers, and directors, all of whom are in fact to be actively involved in corporate affairs and have access to the appropriate information. The notes should be convertible into common stock only during a specified period of time after the common stock has been registered or covered by a Regulation A filing or after such efforts have been abandoned. The promissory notes are a different security from the common stock and, hence, along with the fact that they are issued to insiders should not be integrated with the common stock offered to the public. The common stock underlying the conversion right is, of course, identical to the common stock to be offered publicly, but under the last sentence of the Section 2(3) definition of the term "sale" and "offer" there is no offer of the underlying stock until the conversion right becomes exercisable.[260] Accordingly, there will be no offering of the underlying common stock until a registration statement has become effective or a conditional exemption available under Regulation A. The fact that some of the offerees do not become actively involved would appear to be primarily relevant to the availability of the private-offering

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[258] *See* p. 352 & note 203 *supra*.

[259] *Cf.* Value Line Fund, Inc. v. Marcus, [1964-1966 Transfer Binder] CCH FED. SEC. L. REP. ¶ 91,523 (S.D.N.Y. 1965).

[260] 15 U.S.C. § 77b(3) (1970). *See also* H. BLOOMENTHAL § 7.15(2) nn.241-42. *Cf.* the staff view that it would raise no objection to issuance of options not exercisable until the underlying shares were registered if the options were issued without registration. Dayton Steel Foundry Co., SEC Div. Corp. Fin. No-Action Letter (Sept. 1, 1971), [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,443.

exemption.[261] Assuming that they are sophisticated investors and can satisfy *Ralston Purina,* the outlined format would still appear to be a reliable one; if, however, the offerees are in fact large in number, relatively unsophisticated, and have only a nominal association with the issuer, the private-offering exemption will not be available for the offering of the promissory notes irrespective of any question of integration.

If the format outlined above is utilized and the noteholders convert after registration, their holding period from the standpoint of Rule 144 would commence with the acquisition of the promissory note.[262] Accordingly, if they are affiliates, as they would be under the circumstances described, they could use the earlier date to establish their holding period in the event it should be necessary for them to rely on Rule 144 in connection with the resale of their shares. A variation of the foregoing format, and one that should largely avoid the integration issue, would be to provide that the nonassignable convertible promissory note cannot be converted for a period of two years. In that event, the noteholders would be relying on Rule 144 as the means of ultimately reselling a portion of their shares upon conversion and their holding period would commence with the acquisition of the notes as is discussed at section IV, B. Such noteholders need assurance that the issuer will become a qualified company by registering under the Exchange Act. The issuer also has an obligation to explain to them the special position that their shares will be in as is discussed at section IV, A. Presumably, if they have the appropriate sophistication to satisfy *Ralson Purina,* their understanding in this regard will be a knowledgeable one.

V. CONTROLLING SHAREHOLDERS AFTER RULE 144

Rule 144 is the dawn of a new day for the controlling shareholder. For the first time since the adoption of the Securities Act, he has reasonably reliable guides for determining the extent and circumstances under which he can resell securities of an issuer as to which he is an affiliated person. He can sell restricted or other securities irrespective of his holding period in transactions with purchasers meeting the requirements of *Ralston Purina.*[263] Irrespective of how long he has held the securities, such a transaction will start a new holding period

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261 *See* discussion at H. BLOOMENTHAL § 4.05(6)-(7).

262 R. 144(d)(4)(B). *See also* p. 315 *supra.*

263 15 U.S.C. § 77d(1) (1970).

for his purchaser and the securities will be restricted securities in the hands of the purchaser.[264] He can, within the quantitative limitations of Rule 144, sell securities (assuming a qualified issuer) in compliance with that rule and for the purpose of determining the quantitative limitation he does not have to take into account shares he has sold in reliance on the private-offering exemption.[265] He can make sales up to the Rule 144 limit within successive six-month periods.[266] He can also utilize Regulation A if the issuer files an appropriate notification, but only if the issuer has realized a net profit during one of its last two fiscal years.[267] He cannot utilize Rule 237 for the sale of his securities.[268]

The extent to which Rule 144 permits controlling persons to realize substantial proceeds from the sale of securities depends in part on the number of outstanding shares and the current market price. Given two issuers with approximately the same number of shares outstanding, the amount that can be realized within the quantitative limits during a six-month period is directly proportionate to their relative market prices. Thus, with a million shares outstanding and a market price of $1 a share, the amount that can be realized under the quantitative limit would be only $10,000, whereas for a company with the same number of shares outstanding and a market price of $10 per share, the amount that could be realized would be $100,000. This will generally mean that for the most part controlling shareholders in established companies with a history of earnings can sell more under Rule 144 dollar-wise than a relatively unseasoned company, although conceivably in certain situations speculative frenzy might drive up an unseasoned company's market price to a point where controlling shareholders could realize substantial amounts in Rule 144 sales. In short, the greater value the market places on the total value of the company (outstanding shares multiplied by market price), the more substantial the amounts dollar-wise that can be offered by controlling persons (or others for that matter) in reliance on Rule 144. In certain situations, this fact could sorely test the notion that Rule 144 is consistent with the needs of investor protection.

One situation not explicitly covered by Rule 144 involves

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[264] *See* p. 316 at note 64.

[265] *See* p. 320-21 & notes 76-79 *supra*.

[266] R. 144(e)(1). *See also* SEC Securities Act Release No. 5223 (Jan. 10, 1972), under caption "Limitation on Amount of Securities Sold," [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,487.

[267] *See* p. 352-55 *supra*.

[268] R. 237(a).

shares purchased by a controlling shareholder in connection with a public offering which is either registered or covered by a Regulation A notification. Such shares are not restricted shares since they were not acquired in a transaction not involving a public offering. In an analogous context, the staff has made it clear that the underwriter cannot utilize Rule 144 for the purpose of reselling shares acquired by it in connection with a public offering.[269] However, Rule 144 is applicable not only to restricted securities, but also to securities sold for the account of an affiliate. The rule provides in this regard that a person selling securities for the account of an affiliate shall not be deemed engaged in a distribution and, therefore, is not an underwriter.[270] Accordingly, it would appear that an affiliate could resell such shares under Rule 144 to the same extent that he can resell shares purchased in the open market. It is probable, however, that the staff would take the position that while the selling broker may not be deemed an underwriter in this context, the affiliate is, and no exemption is available to the affiliate. In a comparable context prior to the adoption of Rule 144, the staff advised the controlling persons to either (1) file a post-effective amendment to the registration statement covering the reoffering of their shares, or (2) hold the shares for two years and then sell them in accordance with Rule 154 which was then in effect.[271] This appears to be an appropriate situation in which to request a no-action letter.

VI. NONQUALIFIED COMPANIES AFTER RULE 144

Discussion up to this point, except where otherwise explicitly noted, has been based upon the assumption that the securities were issued by a qualified issuer; that is, a reporting company or one which otherwise makes publicly available the necessary information.[272] Shareholders who are affiliates of or hold restricted stock in a corporation which is not a qualified issuer are severely restricted by the Commission's new approach to the sale of unregistered securities. To the argument that it amounts to a virtual restraint on alienation, the Commission has answered that shares of such issuer can be registered when sold pursuant to Regulation A or after a five-year holding period under Rule 237 or in reliance on the private-offering exemp-

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269 *See* p. 313 & note 49 *supra.*

270 R. 144(b).

271 *See* H. BLOOMENTHAL § 4.09.

272 *See* p. 309 *supra.*

tion.[273] The latter alternative appears to be a dubious one since the purchaser would have to start a new five-year waiting period with respect to his use of Rule 237.

It is, of course, always possible for the issuer to become a qualified company, in which event Rule 144 would be available for the sale of restricted securities and for sales by affiliates provided there is a market in the security. If a nonqualified company is to become a qualified one, it has the alternative of voluntarily registering under the Exchange Act[274] or otherwise making publicly available the necessary information. The latter alternative leaves much to be desired as there is no established method for making such information publicly available, and there can be no assurance that the information made available is adequate.[275] In some instances, companies which are not qualified companies in the course of time will become such either as the result of a registered offering made under the Securities Act[276] or the fact that they are compelled to register under the Exchange Act because they now have 500 or more shareholders of a class of equity securities and $1 million in total assets.[277] In any event, one acquiring securities from a nonqualified issuer in a transaction subject to the private-offering exemption would be well advised to obtain a contractual commitment from the issuer to register under the Exchange Act and/or to file a registration statement upon request. In most instances, such transactions undoubtedly will occur during the initial stages of the corporation's existence; accordingly, the implications of Rule 144 for the future must be taken into account at that stage if the shareholder is to be adequately protected.

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[273] SEC Securities Act Release No. 5223 n.5 (Jan. 10, 1972), [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,487.

[274] *See* H. BLOOMENTHAL § 3.04.

[275] *See* p. 310-11 & notes 37-40 *supra.*

[276] *See* H. BLOOMENTHAL § 3.11(1).

[277] *See id.* § 3.03.