From Securities Lore to Securities Law

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Duquesne Law Review

Volume 11, Number 1, Fall 1972

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A lawyer frequently has to deal with that discombobulating concept, the restricted security. As used in this article the term[1] means that its owner generally cannot "offer" the security to the public without first filing it for registration under the Securities Act of 1933.[2] The 1933 Act further provides that any "sale" of securities to the public before the registration statement is "effective" can be met with an injunction, a private suit for damages, or criminal proceedings.[3] The security may be restricted because of the way in which the holder purchased it; for example, he may have bought pursuant to section 4(2) of the 1933 Act which exempts a non-public offering.[4] He may have received stock in exchange for stock in a company he controlled, the transfer of which is exempt pursuant to rule 133,[5] which states that certain transactions are

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1. The term as used herein does not refer to the situation where the shareholder has agreed with the company or with the other shareholders that he will not sell without first offering it to the company or to them, nor does it refer to the situation where the holder cannot sell unless he remains with the company a certain number ot years.

2. 15 U.S.C. § 77a-aa (1970) [hereinafter referred to as 1933 Act].

3. 1933 Act §§ 5, 12, 20(b), 15 U.S.C. §§ 77e, 77*l*, 77t(b) (1970). Section 5 requires registration and sections 12 and 20(b) set forth remedies for violation of section 5.

4. 15 U.S.C. § 77d(2) (1970) [hereinafter referred to as private placement]. Other less frequently used transaction exemptions—which will not be explored in this article—are to be found in 1933 Act §§ 3(a)(9)-(11), 15 U.S.C. § 77c(a)(9)-(11) (1970); *Id.* § 4, 15 U.S.C. § 77d (1970).

5. 17 C.F.R. § 230.133(a) (1972):

(a) For purposes only of section 5 of the Act, no "sale," "offer to sell," or "offer for sale" shall be deemed to be involved so far as the stockholders of a corporation are concerned where, pursuant to statutory provisions in the state of incorporation or provisions contained in the certificate of incorporation, there is submitted to the vote not sales under the 1933 Act.[6] The security may be restricted because of his status; for example, if he can or does control the company issuing the stock.[7] There are other ways a security can be restricted, but these are the most common as well as the situations most affected by recently implemented Securities Act Rules. In each of the above situations, except where a control person may have purchased his securities in a registered transaction, only the selling transaction was exempt; the security itself was not exempt.[8] Because the 1933 Act generally requires the registration of any offer of securities the holder desires to sell, either the company registers the holder's securities (only the company can file the registration statement under the provisions of the 1933 Act),[9] or he must

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> of such stockholders a plan or agreement for a statutory merger or consolidation or reclassification of securities, or a proposal for the transfer of assets of such corporation to another person in consideration of the issuance of securities of such other person or securities of a corporation which owns stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of such person, under such circumstances that the vote of a required favorable majority (1) will operate to authorize the proposed transaction as far as concerns the corporation whose stockholders are voting (except for the taking of action by the directors of the corporation involved and for compliance with such statutory provisions as the filing of the plan or agreement with the appropriate State authority), and (2) will bind all stockholders of such corporation except to the extent that dissenting shareholders may be entitled, under statutory provisions or provisions contained in the certificate of incorporation, to receive the appraised or fair value of their holdings.

Thus, rule 133 is not an exemption but rather a construction of section 5 which states that sales require an effective registration statement.

6. 15 U.S.C. § 77e (1970) requires that registration must be in effect prior to the sale of securities. However, the decision by shareholders to merge or to sell the corporation's assets in return for another corporation's securities has for many years, by virtue of rule 133, not been considered a "sale" of stock by the acquiring corporation for purposes of section 5. Unlike section 368(a)(1)(B) of the Internal Revenue Code of 1954 (offer of stock to *each* holder of the target company's stock), there is no individual choice to purchase or not to purchase the securities of the acquiring corporation. Under a legal fiction, it has been called a corporate choice. This rule may soon be abrogated.

7. The concept of control is not limited to actual control. It is the power to control because of the shareholder's position with the company or because of the amount of his voting stock or otherwise. SEC Rule 405(f), 17 C.F.R. § 230.405(f) (1972), provides as follows:

> The term "control (including the terms "controlling," "controlled by" and "under common control with") means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.

8. *But see* 1933 Act § 3, 15 U.S.C. § 77c (1970). Such securities as United States Government Bonds, securities of common carriers, receivers' certificates, and insurance policies are exempt from the registration requirements of the 1933 Act.

9. 15 U.S.C. § 77f(a) (1970) states:

> Any security may be registered with the Commission under the terms and conditions hereinafter provided, by filing a registration statement in triplicate, at least one of which shall be signed by each issuer, its principal executive officer or officers, its principal financial officer, its comptroller or principal accounting officer, and the majority of its board of directors or persons performing similar functions (or, if there is no board of directors or persons performing similar functions, by the majority of persons or board having the power of management of the issuer), and in case the issuer is a foreign or Territorial person by its duly authorized representative in the United States; except that when such registration statement relates to a security

find an exemption for the sale. Absent an agreement with the company made at the time of purchase to register his securities, it is highly improbable that it will file a registration statement at his request, even if he is willing to pay the very substantial expenses entailed. The reasons it will not are: (1) it may not want to disclose its economic situation; (2) the registration process is inconvenient; and (3) its principal officers and directors can be liable for misrepresentations or omissions.[10] Even if the company is planning to register its own offering, it may not wish to register an individual's securities, as the incremental offering may not be easily absorbed by the market.

Neither an Issuer, Underwriter, or Dealer

Consequently, the holder must find an exemption for sale which ordinarily will be section 4(1) of the 1933 Act, which states:

> The provisions of Section 5 shall not apply to any of the following transactions: (1) Transactions by any person other than an issuer, underwriter, or dealer . . . .[11]

Since issuers and dealers are easily identifiable, the most frequent question is whether any one in the transaction is an underwriter. Section 2(11) of the 1933 Act defines an underwriter as follows:

> The term "underwriter" means any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with a distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwritings of any such undertaking . . . .[12]

Thus, the term underwriter applies not only to an investment banker but to anyone who comes within the above definition. Under the Securities and Exchange Commission's previous interpretation of section

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issued by a foreign government, or political subdivision thereof, it need be signed only by the underwriter of such security. Signatures of all persons when written on the said registration statements shall be presumed to have been so written by authority of the person whose signature is so affixed and the burden of proof, in the event such authority shall be denied, shall be upon the party denying the same. The affixing of any signature without the authority of the purported signer shall constitute a violation of this title. A registration statement shall be deemed effective only as to the securities specified therein as proposed to be offered.

10. *See* 1933 Act § 11, 15 U.S.C. § 77(k) (1970). *See also* Escott v. Barchris Construction Corp., 340 F.2d 731 (2d Cir. 1965), for a discussion of a director's liability.

11. 1933 Act § 4(1), 15 U.S.C. § 77d(1) (1970).

12. 1933 Act § 2(11), 15 U.S.C. § 77b(11) (1970).

2(11), or unwritten lore, in order to demonstrate that he was not an underwriter, a person who received stock in a private placement merely had to retain ownership for a sufficiently long period of time to show that he was purchasing for investment rather than effecting a distribution; his holding period would be reduced if he suffered a "material change of circumstances," unforeseeable to him at the time of his acquisition. This change, it was presumed, would justify the change of his investment plans. Examples of unforeseeable material changes were severe illness or death of the shareholder or someone in his immediate family; in most instances economic changes were deemed to have been foreseeable.[13] Moreover, under the doctrine of "fungibility," a later private purchase of securities, unless a *de minimus* amount, would begin the holding period of the initial acquisition again. Therefore, even if he held the stock he bought initially for a very long period of time, a later private purchase would mean that he could not sell the securities purchased initially until he had held the newly acquired securities long enough.[14]

A second situation where a holder of securities might have to demonstrate lack of underwriter status occurs when he takes stock in a rule 133 transaction. Rule 133 concerns reorganization transactions such as a statutory merger or where stock is received for assets as described in the Internal Revenue Code.[15] Although stock is being sold which, as has been stated, generally would require registration, the "A" or "C"[16] transaction is deemed by rule 133 not to be a sale and thus does not come within the prohibition of the 1933 Act. If the stock of the acquired company is widely-held, and the receiver of the stock was neither an officer, director, or large shareholder of the acquired corporation, generally he is free to sell[17] because the 1933 Act does not apply. If he was one

13. *See* SEC Securities Act of 1933 Release No. 4552 (Nov. 6, 1962), which states *inter alia* that economic changes are foreseeable.

14. The period has varied from one to three years for the purpose of obtaining a "no-action" letter; recently, it had been three years. Some courts held that a one year holding period evidences investment intent. Clearly, the purchaser of restricted securities could not be certain as to what his obligation would be.

15. INT. REV. CODE of 1954, § 368(a)(1)(A), (C).

16. *Id.*

17. But SEC Rule 133(b), 17 C.F.R. § 230.133(b) (1972), administratively reads underwriter into what is not supposed to be a sale from an issuer.

(b) Any person who purchases securities of the issuer from securtiy holders of a constituent corporation with a view to, or offers or sells such securities for such security holders in connection with, a distribution thereof pursuant to any contract or arrangement, made in connection with any transaction specified in paragraph (a), with the issuer or with any affiliate of the issuer, or with any person who in connection with such transaction is acting as an underwriter of such securities, shall be deemed to be an underwriter of such securities within the meaning of section 2(11) of the Act.

of the above, for reasons too complex to explore herein, the 1933 Act does apply and he may only sell within the dribble provisions of rule 133(d) which provides for small sales periodically.[18] Under a Commission interpretation of rule 133, if the number of shareholders in the acquired corporation is small, the rule does not apply, and if another exemption is not available, registration is required.

Proposed rule 145, which should take effect early in 1973, will abrogate rule 133 and require merger and stock for assets transactions to be registered.[19]

The underwriter issue can arise in another way. Even should the

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This paragraph does not refer to arrangements limited to provision for the matching and combination of fractional interests in securities into whole interests, or the purchase and sale of such fractional interests, among security holders of the constituent corporation and to the sale on behalf of, and as agent for, such security holders of such number of fractional or whole interests as may be necessary to adjust for any remaining fractional interests after such matching.

18. 17 C.F.R. § 230.133(d) provides:

Notwithstanding the provisions of paragraph (c) a person specified therein shall not be deemed to be an underwriter nor to be engaged in a distribution with respect to securities acquired in any transaction specified in paragraph (a) which are sold by him in brokers' transaction within the meaning of section 4(4) of the Act, in accordance with the conditions and subject to the limitations specified in paragraph (e) hereof, if such person—

(1) does not directly or indirectly solicit or arrange for the solicitation of orders to buy in anticipation of or in connection with such brokers' transactons;

(2) makes no payment in connection with the execution of such brokers' transactions to any person other than the broker; and

(3) limits such brokers' transactions to a sale or series of sales which together with all other sales of securities of the same class by such person or on his behalf within the preceding six months will not exceed the following:

(i) If the security is traded only otherwise than on a securities exchange, approximately one percent of the shares or units of such security outstanding at the time of receipt by the broker of the order to execute such transactions, or

(ii) If the security is admitted to trading on a securities exchange, the lesser of approximately (a) one percent of the shares or units of such security outstanding at the time of receipt by the broker of the order to execute such transactions or (b) the largest aggregate reported volume of trading on securities exchanges during any one week within the four calendar weeks preceding the receipt of such order.

In essence, rule 133(d) permits the persons who were in control of the acquired company to sell publicly up to one percent of the outstanding stock of the acquirer. If the stock of the acquirer is listed on a national securities exchange, they can sell publicly the lesser of one percent of the outstanding stock or the largest weekly traded amount of the company's stock in any one week of the last four. This rule is similar to rule 154, the difference being that it is one percent of the acquiring company's stock, not simply the acquired company's stock, that can be sold.

Since rule 133(d) may not provide him with enough liquidity, a control person of the acquired company in either an "A" or "C" transaction should bargain to require the acquiring company to register his securities should he decide to sell. The company can do this simply by wrapping around the merger proxy statement, if directed at the shareholders of the acquiring company, a registration cover pursuant to SEC Form S-14. Since that registration statement will contain an undertaking to keep current the enclosed material, the control person of the acquired company will later be able to sell his stock publicly by using the updated wrapped-around merger proxy as a prospectus.

19. See note 39 *infra*.

shareholder establish he is not an underwriter, if he does or could control the issuer and if he is effecting a distribution, his buyer, usually his stockbroker, will be an underwriter, destroying the section 4(1) exemption.[20] The reason for this result is that the definition of issuer for purposes of section 2(11) includes a "control person."[21] To demonstrate lack of control, he and his associates cannot by virtue of their stockholdings or position with the company control or have the power to control it.[22] A control person in the past could sell some of his stock because of the dribble provisions of rule 154[23] of the 1933 Act. The rule was similar to the above-mentioned rule 133(d); it permitted the sale in unsolicited transactions in a six month period of an amount not exceeding one percent of the issuer's outstanding stock. If the stock was listed on a national securities exchange, the amount was the lesser of the latter and the largest weekly volume of trades on the exchange in any one of the last four weeks prior to the sale. The amount that could be sold was reduced by any stock other control persons sold in brokerage transactions in that period. The control person could not sell in that manner every six months, as the sales would become a "rolling distribution." Although rule 154 was actually an exemption for brokers, the Commission took the position that if a control person sold in the limited quantities articulated in that rule, he was not effecting a a distribution. Therefore, he was selling in accordance with section 4(1).

RULES 144 AND 237

The resolution of the question of whether a transaction involves an underwriter depends on the totality of circumstances, including periods of time, number of persons, and quantity of stock. Under the Commission's previous interpretation of section 2(11), little or no information about the stock being sold had to be available and no limits were placed on what could be sold in order to qualify for the section 4(1) exemption. Thus, what should be the most important objective of the securities law—protection of the buyer—was not achieved. Consequently, a study of the problem was included in the *Wheat Report*.[24]

20. If a control person sells in a distribution, because of section 2(11) of the 1933 Act, his broker will be considered an underwriter.
21. United States v. Wolfson, 405 F.2d 779 (2d Cir. 1968), *cert. denied*, 394 U.S. 946 (1969).
22. Sommer, *Who's "In Control?"—S.E.C.*, 21 BUS. L., 559, 577 (1966).
23. 17 C.F.R. § 230.154 (1972).
24. Wheat, *Disclosure to Investors: A Reappraisal of Federal Administrative Policies Under the '33 and '34 Acts*, in WHEAT REPORT 202-03 (1969).

One of the report's conclusions would have enabled persons taking in private placements to sell in limited quantities, commencing *one year* from the purchase, if the stock was that of a qualified issuer; qualification had to do with information available concerning the company. If not qualified, the owner had to hold at least five years and could then sell only if the issuer had sales over $250,000 per year. For various reasons, rule 144,[25] then revised rule 144, and ultimately final rule 144[26] were proposed as replacements. On April 15, 1972, rule 144 became the exclusive law governing sales by control persons and private placees taking after that date.

Rule 144 has the effect of placing non-control shareholders who own large blocks of restricted securities in a category similar to control persons, on the premise that if a large quantity of securities is being sold, the disruptive effect on the market is the same. Now non-control as well as control persons are confined to selling within dribble limitations similar to rules 154 and 133(d).[27] The rule recasts the concept of underwriter to de-emphasize the time one holds and to emphasize the amount being sold and the information or lack thereof regarding the securities. The emphasis has shifted from the section 2(11) words "with a view to" to the section 2(11) word "distribution." Informational requirements have been administratively written into the statute.

It should be noted that the dribble provisions have changed some-

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25. Proposed SEC Rule 144, SEC Securities Act of 1933 Release No. 5186 (Sept. 10, 1971).

26. 37 Fed. Reg. 596 (1972).

27. SEC Rule 144(e), 37 Fed. Reg. 596 (1972), states:

(e) *Limitation on Amount of Securities Sold.* Except as hereinafter provided, the amount of securities which may be sold in reliance upon this rule shall be determined as follows:

(1) *Sales by Affiliates.* If restricted or other securities are sold for the account of an affiliate of the issuer, the amount of securities sold, together with all sales of restricted and other securities of the same class for the account of such person within the preceding six months, shall not exceed the following:

(A) If the securities are admitted to trading on a national securities exchange, the lesser of (1) one percent of the shares or other units of the class outstanding as shown by the most recent report or statement published by the issuer, or (2) the average weekly reported volume of trading in such securities on all securities exchanges during the four calendar weeks preceding the filing of the notice required by Paragraph (h), or if no such notice is required the receipt of the order to execute the transaction by the broker; or

(B) If the securities are not traded on a national securities exchange, one percent of the shares or other units of the class outstanding as shown by the most recent report or statement published by the issuer.

(2) *Sales by Persons Other than Affiliates.* The amount of restricted securities sold for the account of any person other than an affiliate of the issuer, together with all other sales of restricted securities of the same class for the account of such person within the preceding six months, shall not exceed the amount specified in subparagraph (1) (A) or (B) above, whichever is applicable.

what from those of rule 154 and rule 133(d). Whereas under those rules a person selling stock of a listed company could sell, in the alternative, the amount traded in any one week of the past four weeks prior to the sale, he now must sell the *average* traded in the past four weeks. The reason for the change is that block trades make the market substantially more volatile than it was when rules 154 and 133(d) were written. Unlike rules 154 and 133(d), rule 144 may be resorted to in *successive* six month periods. However, if a person does not sell in successive periods, he cannot cumulate what he has not sold. For example, if he sells one percent of the outstanding stock in one six month period and misses the next six month period, he cannot in the third six month period sell three percent.

Rule 144 mandates that the company be subject either to the reporting requirement of section 13 or section 15(d) of the Securities and Exchange Act of 1934[28] or that similar information to that required by these sections be available.[29]

The doctrine of fungibility which frequently rendered injustices has essentially been eschewed. If one purchases securities of a company in a private placement and later purchases more securities of the company in a like manner, he need not begin the holding period for the earlier purchase from the later acquisition. But if during the time he holds the securities he acquires an option to sell or sells short, the

28. 15 U.S.C. §§ 78a-hh (1964).

29. SEC Rule 144(c), 37 Fed. Reg. 597 (1972), states:

(c) *Current Public Information.* There shall be available adequate current public information with respect to the issuer of the securities. Such information shall be deemed to be available only if either of the following conditions is met:

(1) *Filing of Reports.* The issuer has securities registered pursuant to Section 12 of the Securities Exchange Act of 1934 and has filed the reports required to be filed by Section 13 of that Act for a period of at least 90 days immediately preceding the sale of the securities and in addition has filed the most recent annual report required to be filed thereunder, or has securities registered pursuant to the Securities Act of 1933 and has filed the reports required to be filed by Section 15(d) of the Securities Exchange Act of 1934 for a period of at least 90 days immediately preceding the sale of the securities and in addition has filed the most recent annual report required to be filed thereunder. The person for whose account the securities are to be sold shall be entitled to rely upon a statement in whichever is the most recent report, quarterly or annual, required to be filed and filed by the issuer that such issuer has complied with such requirements, unless he knows or has reason to believe that the issuer has not complied with such requirements. Such person shall also be entitled to rely upon a written statement from the issuer that it has complied with such reporting requirements unless he knows or has reason to believe that the issuer has not complied with such requirements.

(2) *Other Public Information.* If the issuer is not subject to Section 13 or 15(d) of the Securities Exchange Act of 1934, there is publicly available the information concerning the issuer specified in clauses (1) to (14), inclusive, and clause (16) of paragraph (a)(4) of Rule 15c2-11 under that Act or, if the issuer is an insurance company, the information specified in Section 12(g)(2)(G)(i) of that Act.

running of the holding period ceases.[30] The theory is that he must be "at risk of ownership" to fulfill the requirement of investment intent.

As has been the case in the past, stock dividends and splits relate back to the initial acquisition.[31] They do not start a new holding period. The holding of a converted security may be tacked on to the holding period of the underlying convertible.[32] Moreover, in an "earn out" situation (where the seller of the stock may receive more stock should the earnings of his former company rise), the receipt of the contingent securities also generally relates back to the initial acquisition.[33] This had been a matter of dispute in the past.

In distinction from past policy, if a person buys in a private placement, holds the security for a year, and sells it to a second private placee who holds it for another year, the second purchaser may not tack the two periods.[34] However, if a person buys pursuant to the private

30. SEC Rule 144(d)(3), 37 Fed. Reg. 597 (1972), states:

(3) *Short Sales, Puts or Other Options to Sell Securities.* In computing the two-year holding period the following periods shall be excluded:

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

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

31. SEC Rule 144(d)(4)(i), 37 Fed. Reg. 597 (1972), states:

(i) *Stock Dividends, Splits and Recapitalizations.* Securities acquired from the issuer as a dividend or pursuant to a stock split, reverse split or recapitalization shall be deemed to have been acquired at the same time as the securities on which the dividend was paid, the securities involved in the split or reverse split, or the securities surrendered in connection with the recapitalization.

32. SEC Rule 144(d)(4)(ii), 37 Fed. Reg. 597 (1972), states:

(ii) *Conversions.* If the securities sold were acquired from the issuer for a consideration consisting solely of other securities of the same issuer surrendered for conversion, the securities so acquired shall be deemed to have been acquired at the same time as the securities surrendered for conversion . . . .

This supercedes SEC Rule 155, 17 C.F.R. § 230.155 (1972), which was directed at issuers who sell a few large denominated securities under the guise of a private placement, after which the securities are converted into smaller denominated securities and distributed. The rule's blanket prohibition prevented anyone with an immediately convertible security purchased in a private placement from selling it publicly without registration.

33. SEC Rule 144(d)(4)(iii), 37 Fed. Reg. 597 (1972), states:

(iii) *Contingent Issuance of Securities.* Securities acquired as a contingent payment of the purchase price of an equity interest in a business, or the assets of a business, sold to the issuer or an affiliate of the issuer shall be deemed to have been acquired at the time of such sale if the issuer or affiliate was then committed to issue the securities subject only to conditions other than the payment of further consideration for such securities. An agreement entered into in connection with any such purchase to remain in the employment of, or not to compete with, the issuer or affiliate or the rendering of services pursuant to such agreement shall not be deemed to be the payment of further consideration for such securities.

34. SEC Rule 144(d), 37 Fed. Reg. 597 (1972), states:

(d) *Holding Period for Restricted Securities.* If the securities sold are restricted securities, the following provisions apply:

placement exemption and makes a gift of the securities to another person after he has held it for a year, the second person may tack the two holding periods.[35]

It is of interest to note that the old concept of a control group has changed. Under rule 154 a control person was limited in the amount he could dribble by that which others in control of the company had dribbled, whereas under rule 144, unless they are acting in concert, each can sell under the entire dribble limitation.[36] Since the seller must establish his exemption, he must show the absence of concert. Concert may be difficult to disprove. It would appear that if a ten percent shareholder, not active in the business, sells at the same time as the treasurer of the company, it is much easier to show the absence of concert than when the president and vice president make simultaneous sales.

Notice of an offering must be made to the SEC if a person is selling over 500 shares of stock or $10,000, whichever is less, and it must be made simultaneously with the placing of the sell order with the broker.[37]

Rule 144[38] affects only sections 4(1) and 4(2) and not sections 3(a)(9), 3(a)(10), 3(a)(11), 4(3), and 4(4), the transaction exemptions. However, rule 133 and its no-sale concept may soon be abrogated, thus mergers

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(1) *General Rule.* The person for whose account the securities are sold shall have been the beneficial owner of the securities for a period of at least two years prior to the sale and, if the securities were purchased, the full purchase price or other consideration shall have been paid or given at least two years prior to the sale.

35. SEC Rule 144(d)(4)(v), 37 Fed. Reg. 597 (1972), states:

(v) *Gifts of Securities.* Securities acquired from any person, other than the issuer, by gift shall be deemed to have been acquired by the donee when they were acquired by the donor.

36. SEC Rule 144(e)(3)(vi), 37 Fed. Reg. 598 (1972), states:

(vi) When two or more affiliates or other persons agree to act in concert for the purpose of selling securities of an issuer, all securities of the same class sold for the account of all such persons during any period of six months shall be aggregated for the purpose of determining the limitation of the amount of securities sold . . . .

37. SEC Rule 144(h), 37 Fed. Reg. 598-99 (1972), states:

(h) *Notice of Proposed Sale.* Concurrently with the placing with a broker of an order to execute a sale of any securities in reliance upon this rule, there shall be transmitted to the Commission, at its principal office in Washington, D.C., for filing three copies of a notice on Form 144 which shall be signed by the person for whose account the securities are to be sold; provided, that such notice need not be filed if the amount of securities to be sold during any period of six months does not exceed 500 shares or other units and the aggregate sale price thereof does not exceed $10,000. If all of the securities for which a notice is filed are not sold within 90 days after the filing of such notice, an amended notice shall be transmitted to the Commission concurrently with the commencement of any further sales of such securities. Neither the filing of such notice nor the failure of the Commission to comment thereon shall be deemed to preclude the Commission from taking any action it deems necessary or appropriate with respect to the sale of the securities referred to in such notice.

38. *See* SEC Securities Act of 1933 Release No. 5243 (April 12, 1972).

and asset sales will require registration or an exemption therefrom.[39]

The second rule promulgated is 237.[40] It deals with those companies in regard to which there is inadequate information available so as to preclude compliance with rule 144. The rule states that if the person who has bought the security is not an issuer or a control person of the issuer, and he has owned the security for at least five years, he can sell no more than an amount equal to the gross proceeds from the sale of one percent of the security outstanding or $500,000 in any twelve month period. He must give notice to the SEC ten days before the sale and can only sell in a negotiated transaction; and there are other conditions.[41] Thus, qualifying for rule 144 treatment by filing a voluntary registration under section 12 is recommended for any company desiring to finance or make acquisitions through the private placement route.

The Role of the SEC

Since the company will be violating the 1933 Act if the holder transfers when he should not, it will instruct the transfer agent to request an opinion of counsel that the security holder is not an underwriter or control person before permitting transfer.[42] Anyone participating

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39. *See* SEC Securities Act of 1933 Release No. 5246 (May 2, 1972).

40. SEC Rule 237, 37 Fed. Reg. 590 (1972).

41. SEC Securities Act of 1933 Release No. 5223 (Jan. 11, 1972) at 13-14 states:

> The Commission recognized that noncontrolling persons owning restricted securities of issuers which do not satisfy all of the conditions of Rule 144 might have difficulty in selling those securities due to circumstances beyond their control. Accordingly, in order to avoid unduly restricting the liquidity of such investments, the Commission has adopted Rule 237 under Section 3(b) of the Act. Under that rule any person satisfying the conditions of the rule will be permitted to sell an amount of securities not exceeding the lesser of the gross proceeds from the sale of one percent of the securities of the class outstanding or $50,000 during any twelve month period, reduced by the amount of any other sales pursuant to an exemption under Section 3(b) of the Act or Rule 144 during the period. Those conditions are:
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> 1. The person is not an issuer, an affiliate of the issuer or a broker or dealer;
> 2. The person has owned and fully paid for the securities for five or more years;
> 3. The issuer is a domestic organization which has been actively engaged in business as a going concern for at least the last five years;
> 4. The securities are sold in negotiated transactions otherwise than through a broker or dealer; and
> 5. The person files the required notice with the appropriate regional office of the Commission at least 10 days before the sale, indicating, among other things, his name, the name of the issuer, the amount of securities to be sold and the amount sold within the past 12 months.

42. Frequently a restricted security will bear a restrictive legend. The fact that the security bears a restrictive legend is simply a means by which the issuer in a private placement puts the transfer agent on notice to make certain the transfer of the shares to a buyer will not result in the company's effecting a distribution. In order to expunge the legend, in effect render the stock transferable, the transfer agent will require an opinion from counsel and in the past often a "no-action letter" from the staff of the SEC.

in an unregistered sale that involves an underwriter is violating the 1933 Act, notwithstanding his innocent intent. The company may also request the holder to obtain a representation from the Commission's Division of Corporation Finance that should he sell, the Division will not recommend to the Commission that any legal action be taken. The representation requested is popularly referred to as a "no-action letter." The Division's representation does not mean that an unhappy purchaser would be precluded from demonstrating in a civil action for damages that the seller was an underwriter.

When a request for no action arrives at the Division, the response is drafted by a staff attorney and reviewed by an attorney in the Division's chief counsel's office. Incoming letters and replies are available to the public so that similar factual situations may be examined. If the Division's response is favorable and if the required opinion of counsel is favorable both are given along with the securities to the transfer agent and the sale is implemented. No-action letters are no longer issued[43] for private placement purchases made after April 15, 1972. On questions of other exemptions and interpretation of rule 144, they continue to be issued. Since the private offering exemption constituted the overwhelming majority of requests for no action, this should markedly reduce the time for receiving the answers to other requests for no action.

SUMMARY

The new rules better protect both stock buyer and seller and should also be salutary to companies in search of venture capital. They protect the buyer and the market in general, by focusing on the quantity of stock being sold and information available as to that stock. They protect the seller because of the certainty they provide as to how long he must hold and because they do not penalize him for what his associates sell. Contrary to the opinion of many, they will also be beneficial to small companies raising funds in private placements, since the buyer is now certain as to the time he must hold and the amount he can sell

43. An attorney should be very careful when rendering his opinion to the shareholder in the above discussed situations since he will have no SEC comfort. If a transaction to which he opines is held by a court to be in violation of section 5 of the Securities Act of 1933, 15 U.S.C. § 77e (1970), or rule 10b-5 under the Securities Exchange Act of 1934, 17 C.F.R. § 240.10b-5 (1972), he may be sued by his client for malpractice, his right to practice before the Securities and Exchange Commission may be suspended or terminated, and he may even find himself as a defendant in a civil action instituted by the Commission.

and will thus be more willing to invest. In this regard, he can apply pressure on a company not qualified under rule 144 to voluntarily become a reporting company. Thus, the uncertainty of the "lore" has been replaced by the certainty of the "law."