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Resales of Securities Under the Securities Act of 1933

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Resales of Securities Under the Securities Act of 1933

Rutheford B. Campbell, Jr.*

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I. Introduction

In the 1972 release¹ that accompanied the adoption of Rule 145,² the Securities and Exchange Commission (the "Commission") patched up a small portion of the nearly nonsensical and fundamentally unprincipled rules regarding resales of securities under the Securities Act of 1933 (the "1933 Act").³ In that release, the Commission stated that the matter of resales under the 1933 Act should be considered more broadly.⁴

When considering the import of the Commission's statement, one would not be overly cynical to ask two questions: First, why did it take the Commission over forty years to reach that conclusion? Second, why in the twenty years following its 1972 pronouncement has the Commission done nothing except make matters worse?

To understand the breadth of the resales problem, some rather technical definitions and descriptions are necessary. The term "resales," as used throughout this Article, refers to any noncontrolling,⁵ nonissuer's sale of securities that the nonissuer (hereinafter a "Holder") originally purchased from an issuer or a controlling shareholder.⁶ These resales by Holders fall within the proscription of Section 5 of the 1933 Act,⁷ which

1. Notice of Adoption of Rules 145 & 153A, Securities Act Release No. 5316, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,015 (Oct. 6, 1972) [hereinafter Securities Act Release No. 5316].

2. 17 C.F.R. § 230.145 (1995). See *infra* notes 124-51 and accompanying text (discussing resale provisions under Rule 145).

3. 15 U.S.C. §§ 77a-77aa (1994).

4. See Securities Act Release No. 5316, *supra* note 1, at 82,198-199.

5. Control persons are constrained by special rules governing the sale of their securities. As matters of theory, policy, and practicality, sales by control persons differ from the resale problems treated in this Article and thus are excluded from further consideration herein.

Technically, the constraints on sales of securities by control persons work through the interplay among §§ 5, 4(1), and 2(11) of the 1933 Act. 15 U.S.C. §§ 77e, 77d(1), 77b(11) (1994). Essentially, any control person who utilizes the services of an "underwriter," as that technical term is defined in § 2(11) of the 1933 Act, becomes an "issuer" and thus loses its § 4(1) exemption from the general registration requirements of § 5.

Such limitations on sales by control persons do not have the breadth of application as do the matters discussed in this Article and thus have much less impact on capital formation.

6. In its purchase, the Holder may be in privity of contract with the issuer or control person, as is typically the case when the issuer or control person privately places securities or sells registered securities in a best efforts underwriting. Alternatively, the Holder may purchase through an intermediary, as is typically the case when an issuer utilizes the services of an underwriter or a broker in a firmly underwritten public offering.

7. 15 U.S.C. § 77e (1994).

makes it "unlawful for *any person*"⁸ to offer or sell a security unless the security is either the subject of a registration statement or exempt from the registration requirement.⁹ The term "any person" in Section 5 is defined broadly and easily includes Holders.¹⁰ Holders that wish to resell securities, therefore, may only do so if those securities are the subject of a registration statement or are exempt from the registration requirement.

In meeting the requirements of Section 5, a selling Holder is unable to rely on the issuer's original registration statement¹¹ or exemption¹² because the transactional exemptions and registrations legitimize only the original sales by the issuer¹³ but do not legitimize the further resales of the securities by other persons. As a result, each selling Holder must either

8. See *id.* (applying to "any person") (emphasis added). Although § 5 applies to "any person," § 4(1) of the Act, 15 U.S.C. § 77d(1) (1994), exempts any person other than an "issuer, underwriter, or dealer" from the 1933 Act registration requirements. Section 2(11) of the 1933 Act, 15 U.S.C. § 77b(11) (1994), which defines "underwriter," includes in the definition of "issuer," for purposes of § 2(11), "any person directly or indirectly controlling the issuer." Read together, these sections subject both issuers and controlling persons to the registration requirements of § 5.

9. Stated with more precision, § 5 of the 1933 Act, 15 U.S.C. § 77e (1994), contains a general prohibition against offers and sales of securities unless the securities are registered. Sections 3 and 4 of the 1933 Act, 15 U.S.C. §§ 77c, 77d (1994), provide exemptions from the registration requirement. Read as a whole, therefore, these sections prohibit any person from offering or selling securities unless the securities are either registered or exempt from the registration requirement.

10. See 15 U.S.C. § 77b(2) (1994) (defining "person" as any individual, corporation, partnership, association, joint-stock company, trust, unincorporated organization, or government).

11. See J. WILLIAM HICKS, EXEMPTED TRANSACTIONS UNDER THE SECURITIES ACT OF 1933 § 1.01[3] (1995) (stating that "investor's resale involves a separate transaction that must either comply with the requirements of Section 5 or be protected by an appropriate exemption"). This statement, however, is not entirely true. If, for example, the Holder consents to being named an underwriter in the registration statement, the Holder can resell under the original registration, provided that the Holder meets the prospectus delivery requirement and other requirements, such as the nine month prospectus requirements of § 10(a)(3) of the 1933 Act, 15 U.S.C. § 77j(a)(3) (1994). Similar rules apply to members of the retail selling group in a public offering. See 17 C.F.R. § 229.508 (1995) (requiring certain disclosures concerning dealers involved in registered offerings). As a practical matter, the foregoing is no help to most Holders who purchase a small part of a registered offering.

12. One exception to this statement comes immediately to mind. Specifically, if the issuer sold an exempt security, that exemption follows the security and thus exempts the Holder's resale. See HICKS, *supra* note 11, at § 1.01[3] (discussing exemptions). See generally 15 U.S.C. §§ 77c(a)(2)-77c(a)(8) (1994) (exempting certain securities from 1933 Act registration requirements).

13. Original sales by the issuer include, for example, all sales throughout the initial distribution chain in a firmly underwritten offering sold through dealer selling groups.

register the securities or establish its own exemption from the registration requirements.

Registration by a Holder, however, is normally impossible or impracticable, in significant part, due to the Holder's lack of access to information about the issuer. Even if the Holder had access to such information, the costs of registration relative to the typical size of such resales make registration unworkable.

With regard to exemptions available for reselling Holders, Section 4(1) is the exemption of choice.¹⁴ This exceedingly broad section exempts all offers and sales of securities from the registration requirements of the 1933 Act except those offers and sales made by an "issuer, underwriter, or dealer."¹⁵ Section 4(1) appears to operate without reference to the particular transactional authorization under which the Holder purchased its securities from the issuer. Instead, the availability of Section 4(1), at least on its face, is determined strictly by whether or not the Holder is included in the definition of "issuer," "underwriter" or "dealer."¹⁶

Working through the availability of Section 4(1) for a Holder's resales, one concludes quite easily that a Holder is almost always outside the definitions of "issuer"¹⁷ and "dealer."¹⁸ A Holder's status as an "underwriter," however, is much less clear and, indeed, the very nub of the resale problem.

One may become an "underwriter" under any one of the four independent definitions of underwriter contained in Section 2(11).¹⁹ The first of the

14. See 15 U.S.C. § 77d(1) (1994) (exempting all persons other than issuers, underwriters, and dealers from 1933 Act registration requirements). In fact, § 4(1) is probably the only exemption available in nearly all cases because most of the broadly available exemptions (other than the exemptions provided by § 4(1)) are limited to offers and sales by the issuer. The exemptions from registration provided by, for examples, § 4(2), Regulation D, and Rule 147 are also limited. See 15 U.S.C. § 77d(2) (1994); 17 C.F.R. §§ 230.501-.508 (1995); 17 C.F.R. § 230.147 (1995).

15. See 15 U.S.C. § 77d(1) (1994).

16. *Id.*

17. See 15 U.S.C. § 77b(4) (1994) (defining issuer to include only original issuers of securities).

18. See 15 U.S.C. § 77b(12) (1994) (defining dealer to include one who "engages either for all or part of his time as principal, in the business of offering, buying, selling, or otherwise dealing or trading in securities issued by another person"). Although it is possible that a Holder could be a "dealer," that is not the usual case and not the problem under consideration here. For a more complete definition of key terms, such as "all or part of his time" and "in the business," see HICKS, *supra* note 11, at § 1.01[2][d]; LOUIS LOSS & JOEL SELIGMAN, *SECURITIES REGULATION* 1134-36 (3d ed. 1993).

19. See 15 U.S.C. § 77b(11) (1994) (defining underwriter). The four separate defini-

Section 2(11) definitions of underwriter, however, is clearly the most troublesome for a reselling Holder that seeks to qualify its resale under the Section 4(1) exemption. Specifically, the Section 2(11) definition of an underwriter as one "who has purchased from an issuer with a view to distribution," especially when considered in light of the gloss applicable to the key terms in that definition, creates the significant risk of a wildly inclusive concept that broadly impairs the availability of Section 4(1) for Holders' resales.

Consider, for example, a Holder that purchases securities directly from an issuer in a registered offering. Conventional wisdom provides that the Holder has freely tradeable securities,²⁰ but can we be so sure? If the Holder's freedom to trade is based on the exemption provided by Section 4(1), which it must be, the Holder's resales on the market shortly after it acquires its registered securities seem to cause the Holder to fall squarely within the first definition of "underwriter" under Section 2(11). The reselling Holder seems to have "purchased from an issuer with a view to distribution."

More specifically, the reselling Holder in our example "purchased" its securities and the purchase was "from an issuer." The Holder's "underwriter" status is complete, therefore, if the Holder purchased with a "view to distribution."²¹ Under long-standing interpretations, it may be impossible

tions of "underwriter" under § 2(11) are: (1) "any person who has purchased from an issuer with a view to distribution"; (2) "any person who offers or sells for an issuer in connection with [a] distribution"; (3) "any person who participates or has a direct or indirect participation in any [distribution]"; or (4) "any person who participates or has a participation in the direct or indirect underwriting of any such [distribution]" *Id.*

20. This is an overly broad statement and should be considered in light of the subsequent discussion concerning resales of registered securities in Part II.B of this Article. *See infra* notes 53-71 and accompanying text.

21. In the event that the Holder purchases from an intermediary, such as an investment banker functioning as an underwriter or a dealer that is part of a selling group, the analysis is more complicated, but the result is essentially the same. The first definition of underwriter in § 2(11), one who "purchased from an issuer with a view to distribution," appears to require direct dealing between the issuer and the underwriter, i.e., the Holder in our case. This type of direct dealing is missing when investors such as Holders purchase their securities from an intermediary. The second definition of underwriter, one who "sold for an issuer in connection with [a] distribution," also appears to require direct dealing between the issuer and the underwriter (i.e., the Holder), but at least one old and confusing case, *SEC v Chinese Consolidated Benevolent Ass'n*, 120 F.2d 738 (2d Cir.), *cert. denied*, 314 U.S. 618 (1941), seems to indicate that a Holder could be considered as selling for an issuer even without direct contact between the two. In any event, it seems quite likely that a Holder that purchased its securities from an intermediary could be an "underwriter" under either the third or fourth definition of § 2(11). These definitions define an underwriter as a "participant" in an underwriting or as an "underwriter" of an underwriter. Because there is no policy basis

to conclude that a Holder who, for example, resells into the market three months after purchasing from the issuer lacked, at the time it purchased, a "view to distribution."²²

The term "distribution" is understood to have the same meaning as "public offering,"²³ which in turn is defined under the broad definition that traces its roots back through the U.S. Supreme Court's decision in *SEC v Ralston Purina Co*²⁴ As a result, a Holder's resales would likely involve a "distribution" or a public offering unless all of the offerees and purchasers are sophisticated and have available the same information that would be found in a registration statement.²⁵ If the Holder executes its sale on an exchange or the NASDAQ system, for example, its securities are unarguably being offered to persons that do not meet the strict criteria necessary to avoid inclusion in the definition of "distribution" or "public offering."²⁶ To belabor the point, one would never consider that an issuer could utilize Section 4(2) by selling through brokers on an organized market. The whole idea is antithetical to any notion of a nonpublic offering.

for distinguishing between a Holder that purchases directly from an issuer and a Holder that purchases from an underwriter or dealer, conditioning the definition of underwriter and thus the availability of § 4(1) on the existence or nonexistence of an intermediary would be an irrational interpretation. My assumption, therefore, is that a Holder would be considered a "participant" or an "underwriter" of the underwriter if it purchased from an intermediary with a view to distribution and thereafter made a distribution.

22. See *infra* notes 45-52 and accompanying text.

23. "Distribution" and "public offering" are considered synonymous. See DISCLOSURE POLICY STUDY GROUP, SECURITIES & EXCHANGE COMMISSION, DISCLOSURE TO INVESTORS — THE WHEAT REPORT 161-62 (CCH 1969) [hereinafter WHEAT REPORT]; LOUIS LOSS, SECURITIES REGULATION 665-73 (2d ed. 1961); Andrew D. Orrick, *Some Interpretative Problems Respecting the Registration Requirements Under the Securities Act*, 13 BUS. LAW. 369, 370 (1958).

24. 346 U.S. 119 (1953).

25. These concepts grow out of the private placement jurisprudence of § 4(2), 15 U.S.C. § 77d(2) (1994). For a discussion of these concepts in the context of the § 4(2) exemption for the issuer, see generally Stanley Schwartz, Jr., *Private Offering Exemption: Recent Developments*, 37 OHIO ST. L.J. 1 (1976); see also Carl W. Schneider, *The Statutory Law of Private Placements*, 14 REV. SEC. REG. 869 (1981) (providing somewhat different view regarding requirements for nonpublic offerings in § 4(2) context). For an interpretation of these requirements in the context of Holders' resales, see DAN L. GOLDWASSER, *THE PRACTITIONER'S COMPREHENSIVE GUIDE TO RULE 144* (1975); *The Section "4(1 1/2)" Phenomenon: Private Resales of "Restricted Securities"*, 34 BUS. LAW. 1961 (1979) [hereinafter *Section 4(1 1/2) Phenomenon*].

26. Securities sold through a broker into an organized market would involve an offer to all bidders. See LOUIS LOSS, *FUNDAMENTALS OF SECURITIES REGULATION* 280 (1983).

Assuming, then, that our Holder's market resales of its registered securities would involve a "distribution," the Holder could still avoid underwriter status and accordingly preserve the availability of Section 4(1) if the Holder's purchase from the issuer were made without a "view" to its subsequent distribution or, as it is often phrased, if the purchase by the Holder were made with an "investment intent." As with the definition of "distribution," the definition of "view" or "investment intent" is seated in the private placement jurisprudence.²⁷ Essentially, two doctrines have emerged to reconcile a Holder's subsequent distribution with an initial investment intent. First, the change of circumstances doctrine holds that a Holder's distribution is consistent with an initial investment intent if the distribution occurs after the Holder's circumstances change in some fairly dramatic way.²⁸ Second, a Holder can establish its initial investment intent by holding the securities for an appropriate period, perhaps three years.²⁹ The rationale for both of these doctrines is that the subsequent distributions are not inconsistent with an initial investment intent. In the case of the change of circumstances doctrine, the altered circumstances caused the Holder to change its mind. In the case of the extended holding period, the Holder changed its mind over the passage of time. In both cases, therefore, the Holder purchased the securities without a "view" to distribution.

This same analysis would seem to apply to securities purchased by a Holder under a transactional exemption, such as the intrastate exemptions provided by the common law of Section 3(a)(11) and Rule 147, Regulation A and Section 3(a)(9). The same analysis clearly applies to resales of securities purchased by the Holder from an issuer in transactions exempt under Regulation D or Section 4(2), where, in fact, the analysis described above had its genesis.³⁰ In all these cases, a Holder that proposes to resell securities taken in such exempt transactions would appear to meet the definition of "underwriter" and thus would be unable to rely on the exemption in Section 4(1) if, for example, the Holder makes a nonprivate resale of its securities after acquiring its securities from the issuer.

Although the foregoing analysis is theoretically compelling, the analysis obviously does not drive the major portion of the current or historic rules

27. See *infra* notes 29-30 and accompanying text.

28. Regarding the change in circumstances doctrine, see generally THOMAS HAZEN, *THE LAW OF SECURITIES REGULATION* § 4.24 (2d ed. 1990); WHEAT REPORT, *supra* note 23, at 166-70; LOSS & SELIGMAN, *supra* note 18, at 1478-88.

29. See *infra* note 48 and accompanying text (discussing appropriate holding period).

30. See *infra* notes 45-52 and accompanying text (discussing resales of Restricted Securities).

regarding resales. The analysis does seem, however, to underlie some of the present resale rules, such as the Commission's unctuous and ephemeral presumptive underwriter doctrine³¹ and its little known one percent rule under Rule 145³²

Part of the resale problem is that strictly applying this line of analysis throttles to some substantial degree the post-offering trading of the issuer's securities. If subjected to a strict application of the principles outlined above, Holders with registered securities would either have to utilize a current prospectus to effect sales, sell privately to sophisticated purchasers who have access to all information about the issuer, or hold the securities for an extended period of time. Similarly, Holders of securities acquired from an issuer in transactional exemptions also would be required, under such a strict analysis, either to register their resales, resell privately, or hold the securities for an extended period of time.

Such strict limitations on post-offering trading would generate significant costs, not the least of which would be the additional capital costs to the original issuer resulting from the limitations imposed on resales. If Holders are unable to disinvest easily, the issuer's securities will be at a competitive disadvantage compared to other investments that can be liquidated easily. As a result, the issuer will have to pay Holders a higher return to entice them to invest.

These are not simple problems for the Commission. Nevertheless, one should not be overly generous in evaluating the Commission's performance in this area. Substantively, the rules governing resales are unnecessarily complex and contradictory. Procedurally, many of the resale "rules" have been generated through no-action letters, a procedure that is ill-suited for the development of important Commission policy and thus directly related to the substantive deficiencies. In proceeding along the no-action route, the Commission failed to consider resales in an appropriately broad statutory and policy context. Instead, the Commission considered the limited factual situations presented in no-action requests, often with little regard for statutory language, theoretical consistency, or sound process. As a result, de facto regulations have been generated without any meaningful opportunity for public comment. In short, the Commission has dramatically reduced its own accountability by pursuing its rulemaking through no-action letters.

31. See *infra* notes 57-70 and accompanying text (discussing presumptive underwriter doctrine).

32. See *infra* notes 137-40, 146 and accompanying text (discussing one percent rule under Rule 145).

This Article explains the failings of the Commission in dealing with resales of securities and suggests an appropriate statutory and policy framework for a principled approach to the matter. Part II of this Article, therefore, describes the present situation regarding the law of resales. Part III of this Article offers a series of broad observations about resales under the 1933 Act, suggests an economic analysis for the registration provisions of the 1933 Act, and presents some more specific recommendations concerning resale rules.

II. *The "Law" of Resales*

Today's rules regarding resales of securities are generally an unqualified mess. The rules lack theoretical consistency and are confusing. As a result, the rules generate significant economic waste for corporations raising capital, for Holders attempting to resell their securities and, in turn, for society as a whole.

In order better to understand the broad problems of resales, this Part II reviews and offers criticism of the present law of resales.³³ The rules governing resales vary according to the legal authorization for the issuer's original sale of securities to Holders, and this discussion, therefore, is organized similarly

A. *Resales of Restricted Securities*

The rules governing Holders' resales of securities originally acquired from an issuer in a transaction exempt from registration under Section 4(2)³⁴

33. The overall purposes of this Article are to demonstrate the unprincipled treatment of resales under the 1933 Act, to suggest that responsibility for the situation belongs with the Commission, and to propose, at least broadly, appropriate solutions for the present state of the law of resales. I have chosen to make these points in the context of the resales of securities acquired by Holders in the most usual of settings and have omitted any detailed consideration of resales by certain Holders, such as Holders of securities taken in transactions under § 3(a)(10), § 4(6), or the common law of § 3(a)(11). My experience is that these latter three exemptions are rarely used by issuers and thus generate significantly fewer resale problems than do the more broadly available exemptions, such as Regulation D, Rule 147, Regulation A and § 4(2).

Interestingly, however, the Commission has issued a number of no-action letters regarding resales of § 3(a)(10) securities, and I will occasionally reference such letters. The Commission's treatment of resales of Rule 3(a)(10) securities is as unprincipled as its treatment of the resales of securities described in this Article and thus supports the theses of this Article. For a description of the Commission's position with regard to resales of § 3(a)(10) securities, see Loss & Seligman, *supra* note 18, at 1588-89, and Hicks, *supra* note 11, at § 3.06[1]-[5].

34. 15 U.S.C. § 77d(2) (1994).

or Regulation D³⁵ (such transactions are hereinafter referred to as "private transactions" and such securities are hereinafter referred to as "Restricted Securities") may be considered something of an exception to the general state of confusion described above.³⁶ Although one may have some philosophical disagreement about the content of the rules governing the resale of Restricted Securities, the rules are generally principled and sufficiently clear to provide general guidance to Holders wishing to resell Restricted Securities.

With regard to Holders' resales of Restricted Securities, the courts and the Commission are properly respectful of the transactional nature of the issuer's exemption and enforce the requirements for the availability of Section 4(1) in a theoretically sound fashion. In order to ensure the availability of the Section 4(1) exemption, Holders, therefore, must take steps to avoid being included in the definition of "underwriter." As stated previously, Holders are most vulnerable to the risk of inclusion in the first of the four underwriter definitions — one who "purchased from an issuer with a view to distribution." A Holder's unregistered resale of Restricted Securities, therefore, must be effected in a way that either negates a finding that the Holder took with a "view" to distribution or in a way that does not involve a "distribution."

Rule 144 is the best known of the Commission's actions dealing with the resale of Restricted Securities.³⁷ Although as originally enacted Rule 144 was unavailable to smaller issuers,³⁸ an asinine situation that the Commis-

35. 17 C.F.R. §§ 230.501-508 (1995).

36. Securities issued in a transaction exempt from registration under § 4(6), 15 U.S.C. § 77d(6) (1994), should also be included in these defined terms. The § 4(6) exemption, however, appears destined only to be a historical curiosity and thus deserves no serious attention in this paper.

37. 17 C.F.R. § 230.144 (1995).

38. It is unclear exactly how a nonreporting issuer, especially a genuinely closely held issuer, meets the terms of Rule 144(c), 17 C.F.R. § 230.144(c) (1995), which requires "available adequate current public information" about the issuer. The Commission has opined that the condition is met if periodic reports are provided to issuer's stockholders, financial servicers, dealers, and marketmakers. See Division of Corporate Finance's Interpretations of Rule 144, Securities Act Release No. 5306, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,000, at 82,157 (Sept. 26, 1972). Although the uncertainty created by the requirements of Rule 144(c) make that Rule less attractive and less available for small issuers, Rule 144, as originally promulgated, required that all sales under Rule 144 by Holders be made in brokers' transactions. This requirement was an utter impossibility for Holders of securities in small companies. See Ruthford B Campbell, Jr., *The Plight of Small Issuers Under the Securities Act of 1933: Practical Foreclosure from the Capital Market*, 1977 DUKE L.J. 1139, 1150-53. Specifically, defining "brokers' transactions" as prohibiting any "solicitation of orders to buy" eliminated Rule 144 as a basis for Holders' resales of securities

sion has somewhat ameliorated,³⁹ Rule 144 generally has been judged a huge success.⁴⁰ At a practical level, Rule 144 permits a limited amount of resales of Restricted Securities, provided that information about the issuer is publicly available, the Holder observes a holding period, and the sales are made in brokers' transactions.⁴¹ Alternatively under Rule 144, the Holder may resell essentially without restrictions after a three year holding period.⁴²

More important at this point in the discussion, however, is the theoretical underpinning for Rule 144. If resales of Restricted Securities by a Holder meet the requirements of Rule 144, the Rule provides that the transaction is not considered a "distribution."⁴³ As a result, the Holder does not become an "underwriter" under Section 4(1) and the availability of the Section 4(1) exemption is thereby preserved. All of this makes perfect sense within the construct of the 1933 Act. Accordingly, while one may disagree with the particular requirements of Rule 144, as I have done in the past,⁴⁴ the theoretical underpinnings of the Rule are solid.

Two separate common-law theories for the resale of Restricted Securities also developed. These theories are, like Rule 144, supported on an appropriate theoretical footing.⁴⁵ Under these theories, Holders of Re-

of closely held companies because the absence of an organized market for the closely held securities made it impossible for the Holder to resell without a solicitation of the buy order. See 17 C.F.R. § 230.144(f) (1995).

39 In 1981, the Commission amended Rule 144 to add § (k), 17 C.F.R. §230.144(k) (1995), which permits a Holder to resell after three years without complying with certain provisions of Rule 144, including the brokers' transaction requirements. These amendments were adopted in Resales of Securities, Securities Act Release No. 6286, [1981 Transfer Binder], Fed. Sec. L. Rep. (CCH) ¶ 82,821 (Feb. 6, 1981). Unfortunately, § (k) is not available for resales by Holders that are "affiliates," which significantly limits the availability of the section for Holders of securities of closely held companies. See Rutheford B Campbell, Jr., *The Plight of Small Issuers (And Others) Under Regulation D: Those Nagging Problems That Need Attention*, 74 KY. L.J. 127, 156-62 (1985-86).

40. See, e.g., JAMES D. COX ET AL., SECURITIES REGULATION CASES & MATERIALS 468 (1991) (stating that "Rule 144 is widely viewed as one of the Commission's most successful undertakings"). From the beginning, Rule 144 was considered successful. See, e.g., Martin Lipton et al., *Rule 144 — A Summary Review After Two Years*, 29 BUS. LAW 1183 (1974). For a more recent discussion of Rule 144, see James Fogelson, *Rule 144 — A Summary Review*, 37 BUS. LAW. 1519 (1982).

41. See 17 C.F.R. §§ 230.144(c),(d),(f) (1995).

42. See Fogelson, *supra* note 40, at 1519

43. See 17 C.F.R. § 230.144(b) (1995).

44. See Campbell, *supra* note 39, at 156-62.

45. See *supra* notes 27-28 and accompanying text (discussing change of circumstances

stricted Securities are able to preserve their Section 4(1) exemption by making sales in ways that do not cause them to fall within the first definition of "underwriter" as one that "purchased with a view to distribution."

One of these theories ("public resales outside Rule 144") preserves the availability of Section 4(1) for Holders who acquired securities without a "view" to distribution. Under this theory, even if the Holder makes a "distribution," the Holder does not become an underwriter if at the point of acquisition the Holder had no "view" (i.e., no intent or purpose) to make the subsequent distribution that in fact it made. This absence of a "view" is also referred to as an "investment intent."⁴⁶

A Holder can establish an investment intent either through the change in circumstances doctrine or by abiding by a suitable holding period requirement. Under the change of circumstances doctrine, subsequent public resales of the Holder's Restricted Securities, even if such resales are close in time to the Holder's acquisition, are considered not inconsistent with the Holder's having purchased with an initial investment intent because it is reasoned that an unanticipated change in the Holder's circumstances caused the Holder to change its mind with regard to its initial investment intent.⁴⁷ The other way a Holder can establish a proper investment intent is to hold its Restricted Securities for an extended period of time, perhaps three years.⁴⁸ In that case, the subsequent distribution does not indicate that the

and holding period doctrines). Despite Rule 144's solid theoretical foundation, the Commission has at times seemingly tried to muddy the water, or, even in one instance, has tried to eliminate a common-law theory by administrative terrorism. Notwithstanding that, when adopted, Rule 144 was practically unavailable to Holders of securities of small issuers, the Commission attempted to force all resales of Restricted Securities into Rule 144 transactions by declaring an elimination of the change in circumstances doctrine. In doing so, the Commission stated that holding securities for "a particular period of time does not by itself establish the availability of an exemption." The Commission also emphasized the "substantial burden of proof" that selling Holders have in establishing an exemption outside of Rule 144 and declared an end to no-action letters on such resales. See Adoption of Rule 144, Securities Act Release No. 5223, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,487 (Jan. 11, 1972).

46. See LOSS, *supra* note 23, at 665-73; Stephen R. Volk & Carl W. Schneider, *The Sale of Restricted Securities Outside of Rule 144*, *Eighth Annual Institute of Securities Regulation* 135-48 (1977); WHEAT REPORT, *supra* note 23, at 160-77

47. Regarding the change in circumstances doctrine, see *supra* note 28 and accompanying text.

48. While the exact required holding period is subject to some uncertainty, the clear weight of authority seems to establish that holding restricted securities for three years establishes an investment intent on the part a Holder. See GOLDWASSER, *supra* note 25, at § 12.02

Holder purchased with a "view" to distribute its securities but, instead, indicates that the "view" or intent to sell developed over the protracted holding period.⁴⁹

The second broad common-law theory for the resales of Restricted Securities is predicated upon such resales being made only in private transactions. As in the case of public resales outside Rule 144, this common law theory is also conceptually sound. Typically referred to as the "Section 4(1 1/2) exemption,"⁵⁰ the fundamental rule is that a Holder of securities acquired in a private transaction may sell its Restricted Securities at any time, so long as the resales do not constitute a distribution.⁵¹ Thus, if a Holder of Restricted Securities sells to one who is sophisticated and has access to all material information about the issuer,⁵² the sales will be exempt under

(stating that it was "firmly established through literally hundreds of letters that SEC staff requires a three year holding period" for Restricted Securities); Carl W. Schneider, *Acquisitions Under the Federal Securities Acts — A Program for Reform*, 116 U. PA. L. REV. 1323, 1337 (1968); *Section 4(1 1/2) Phenomenon*, *supra* note 25, at 1972; A.A. Sommer, Jr., *Considerations Leading to the Adoption of Rule 144*, 67 NW. U. L. REV. 65, 69 (Supp. 1972).

Two distinguished commentators remind us, however, that the Commission earlier seemed content with a one year holding period. See Sommer, *supra*, at 69; LOSS, *supra* note 23, at 671-72. Over time, the length of the holding period expanded, but commentators generally agree that it has settled around the three year mark.

In *United States v. Sherwood*, 175 F. Supp. 480 (S.D.N.Y. 1959), the court permitted a resale after two years, but the matter arose in a criminal prosecution and the prosecution had the burden of proving its case "beyond a reasonable doubt." In *Ackerberg v. Johnson*, 892 F.2d 1328 (8th Cir. 1989), the court easily concluded that a four year holding period was sufficient. In the course of the opinion, the court acknowledged that "[m]any courts have accepted a two-year rule of thumb to determine whether the securities have come to rest" (citing only *United States v. Sherwood* as authority) and that Professor Loss has "noted that a three-year holding period to be 'well nigh conclusive.'" *Id.* at 1336. In *Gilligan, Will & Co. v. SEC*, 267 F.2d 461 (2d Cir.), *cert. denied*, 361 U.S. 896 (1959), the Second Circuit held that a ten month holding period was insufficient to demonstrate an investment intent.

49. See *Section 4(1 1/2) Phenomenon*, *supra* note 25, at 1972 (stating that "existence of a relatively long holding period serves a dual function, both substantiating the seller's original investment intent and evidencing that any 'distribution' by the seller is not 'for the issuer'").

50. For descriptions of the so-called § 4(1 1/2) exemption for resales of Restricted Securities, see *Section 4(1 1/2) Phenomenon*, *supra* note 25, at 1961; Carl W. Schneider, *Section 4(1 1/2) — Private Resales of Restricted or Control Securities*, 49 OHIO L.J. 501 (1988), reprinted in 1 SELECTED ARTICLES ON FEDERAL SECURITIES LAWS 312 (Franklin E. Gill ed., 1991); Carl W. Schneider, *Section 4(1 1/2): A 1990 Update*, 1 SELECTED ARTICLES ON FEDERAL SECURITIES LAW 325 (Franklin E. Gill ed., 1991).

51. The term "distribution" is considered synonymous with "public offering." See *supra* note 23 and sources cited therein (discussing meaning of distribution).

52. The requirements of sophistication and access to all material information are the

Section 4(1). The Holder avoids inclusion in the first definition of underwriter because, even though the Holder purchased from an issuer and resold quickly, the Holder's sale did not constitute a "distribution."

All of this law governing Holders' resales of Restricted Securities is well known and, more importantly for this paper, well seated theoretically. These interpretations preserve the Section 4(1) exemption for the Holder by excluding the Holder from the definition of "underwriter." Because under Rule 144 or the common-law interpretations discussed above, the Holder is considered either to lack a "view" or, alternatively, not to be involved in a "distribution," the selling Holder is not considered to be one who "purchased from an issuer with a view to distribution."

B. *Securities Acquired in a Registered Offering*

Although it popularly may be considered that Holders of securities acquired from an issuer in a registered offering (such securities are hereinafter referred to as "Registered Securities") may freely resell those securities, such Holders, at least theoretically, appear to be in the same situation as Holders of Restricted Securities. The issuer of the Registered Securities utilized a transactional authorization for its sale, and thus Holders of the Registered Securities must find their own separate transactional authorization for their resales. The availability of Section 4(1) for public resales of Registered Securities appears problematic, however, because a Holder who, shortly after acquiring Registered Securities, resells publicly would seem to fit within the definition of "underwriter" in Section 2(11),⁵³ thereby destroying the availability of Section 4(1).⁵⁴

Such a strict interpretation of the concept of "underwriter" and the resulting limited availability of Section 4(1) may not, as a policy matter, be attractive due to the adverse impact on the post-distribution market for Registered Securities. Especially if one has some idea that the efficient market may be at work⁵⁵ and that the disclosures accompanying the issuer's

heart of the § 4(2) exemption for the issuer, as that exemption has developed through the common law. See Schwartz, *supra* note 25, at 17. For a somewhat different approach to the requirements of a § 4(2) exemption, see Schneider, *supra* note 25, at 869-83. Commentators are not in complete agreement about the requirements of the § 4(1 1/2) exemption and just how closely the requirements of § 4(2) must be followed in order to meet the § 4(1 1/2) exemption. Compare Section 4(1 1/2) Phenomenon, *supra* note 25, at 1976 with GOLDWASSER, *supra* note 25, at §12.07.2 and Campbell, *supra* note 39, at 147-51.

53. 15 U.S.C. § 77b(11) (1994).

54. 15 U.S.C. § 77d(1) (1994).

55. See Donald C. Langevoort, *Theories, Assumptions, & Securities Regulation: Market*

initial registration and the continuous reporting requirements under the Securities Exchange Act of 1934 (the "1934 Act")⁵⁶ may result in information being absorbed and appropriately priced by the market for the issuer's Registered Securities, one may be especially concerned about the costs of limited trading in the post-distribution market. Nonetheless, Section 4(1) and Section 2(11) create substantial conceptual problems for free trading by Holders of Registered Securities.

The Commission has a long and unimpressive record in dealing with resales of Registered Securities. The Commission has been unguided by principle and has been unconstrained by statutory language, changing its position with some frequency. Thus today, although it seems possible to approximate the word description for the Commission's rules governing the resale of Restricted Securities, one feels little confidence regarding the stability or actual meaning of the rules.

The popular view among commentators is that for years the so-called presumptive underwriter doctrine guided the Commission's policy regarding the resale of Registered Securities.⁵⁷ Under this doctrine, the Commission considered certain large purchasers of Registered Securities to be "underwriters" if such purchasers engaged in the public resale of their Registered Securities,⁵⁸ and, as a result, such Holders were unable to rely on the exemption provided by Section 4(1).⁵⁹

The Commission's criteria for presumptive underwriter status seemed to change over the years. Initially, the Commission appeared to apply a ten percent test, considering a Holder of Registered Securities to be a presumptive underwriter if the Holder acquired ten percent of the registered offering.⁶⁰ Commentators, relying principally on no-action letters, noted, however, that the Commission over time abandoned this simple ten percent test in favor of a multifactor test for presumptive underwriter status.⁶¹ Thus,

Efficiency Revisited, 140 U. PA. L. REV. 851 (1992) (discussing impact of efficient market theory as it relates to securities regulation).

56. 15 U.S.C. §§ 78a-78kk (1994).

57. See HICKS, *supra* note 11, at § 9.02[5][a] (discussing evolution of presumptive underwriter doctrine); LOSS & SELIGMAN, *supra* note 18, at 1112-16 (same); Robert A. Barron, *Control & Restricted Securities*, 15 SEC. REG. L.J. 296 (1987) (same).

58. See LOSS & SELIGMAN, *supra* note 18, at 1114 n.577

59. See *id.* at 1114.

60. See HICKS, *supra* note 11, at § 9.02[5][a].

61. See *id.* Professor Hicks states the following regarding the evolution of the presumptive underwriter doctrine:

Initially, the SEC staff's response was direct and certain. A person who acquired

in addition to the traditional percentage test for presumptive underwriter status, the Commission also considered such factors as the " (1) Nature of Issuer (2) Trading Volume (3) Number of Shares Outstanding (4) Quantity of Shares to Be Acquired (5) Nature of the Offering (6) Relationship Between Recipient and Issuer (7) Nature of the Security ¹¹⁶²

Overlaid on this entire analysis was the Commission's position that resales by a presumptive underwriter were permissible, provided that the resales met the requirements of sections (c), (e), (f) and (g) of Rule 144.⁶³ Broadly stated, this meant that resales by a presumptive underwriter could be made without registration if information about the issuer were publicly available, the resales did not exceed the one percent limitations of Rule 144, and the resales were effected only in brokers' transactions.⁶⁴ Unfortunately,

more than 10 percent of the securities included in an offering was deemed to be a statutory underwriter. Beginning in 1972, the SEC staff abandoned the 10 percent rule of thumb. At first, the SEC staff replaced the objective standard with an approach that varied with the nature of the issuer. Under this transitional interpretation of the doctrine, the 10 percent rule continued to apply where the issuer was going public for the first time. Where the issuer was already in a trading market for its securities, the staff's interpretation depended upon all of the circumstances, including the volume of trading in the issuer's securities.

Id. (footnotes omitted). Regarding the evolution of the presumptive underwriter doctrine, Professors Loss and Seligman state:

For a while, [the Commission] applied a rule of thumb in terms of 10 percent of the issue. Gradually, they began to consider percentage as simply one factor together with other circumstances such as the total amount of the issuer's securities outstanding, the size of the "float," and whether the issuer was a reporting company under the 1934 Act. And in recent years, no-action letters have tended simply to apply by analogy the volume figures in Rule 144: the greater of (1) 1 percent of the amount outstanding or (2) the average weekly reported volume of trading during the last four weeks.

LOSS & SELIGMAN, *supra* note 18, at 1114-15 (1993) (footnotes omitted).

62. HICKS, *supra* note 11, at § 9.02[5][b].

63. See, e.g., Equimark Corp., SEC No-Action Letter, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,131 at 76,594 (July 23, 1985); James River Corp. of Va., SEC No-Action Letter, 1979 WL 14308 (S.E.C.), at *1, *2 (Aug. 2, 1979); American Fin. Corp., SEC No-Action Letter, 1973 WL 9585 (S.E.C.), at *8, *9 (Nov. 2, 1973).

64. See 17 C.F.R. §§ 230.144(c), 230.144(e)-(g) (1995). Obviously, I speak without precision regarding the requirements of the particular sections of Rule 144. For example, the amount limitations of § (e) of the Rule are defined in terms of sales during a three month period. A Holder's sales cannot exceed "the greater of (i) one percent of the shares outstanding or (ii) the average weekly reported volume of trading in such securities" 17 C.F.R. § 230.144(e) (1995).

the Commission developed these "rules" as it developed nearly all of its "rules" regarding resales of Registered Securities, through its no-action responses, which, as observed earlier, subjected none of this to the comment process.

In 1983, however, the Commission in the *American Council of Life Insurance* no-action letter⁶⁵ apparently abandoned the presumptive underwriter doctrine, an abandonment subsequently confirmed by officials of the Commission.⁶⁶ To complicate matters further, the Commission is now reluctant to issue no-action letters on the resale of Registered Securities, proffering as its reason, not that such process is inappropriate for such rulemaking, but, instead, that such requests involve "facts and circumstances" decisions that can better be made by selling Holders than by the Commission.⁶⁷

Notwithstanding such an apparent reluctance on the part of the Commission to issue no-action letters, a number of no-action letters, beginning with the *American Council of Life Insurance* letter, establish that today the Commission will interpose no objection to a Holder's resales of significant amounts of Registered Securities, so long as such a Holder acquired its Registered Securities in the "ordinary course" of business and the Holder has "no arrangement with [the issuer or] any person to participate in the distribution of such securities."⁶⁸ The meaning of the "ordinary course" language

65. American Council of Life Ins., SEC No-Action Letter, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,526, at 78,692-93 (May 10, 1983).

66. See LOSS & SELIGMAN, *supra* note 18, at 1114-15 n.577. In November of 1986, the Director of the Commission's Division of Corporate Finance stated:

For many years, a concept known as the "presumptive underwriter" doctrine existed. That doctrine assumed that a purchaser of a relatively large amount of securities covered by a registration statement (at one point 10%) was buying with a view to distribution and, therefore, should be deemed a statutory underwriter. The theory was most subjective, most difficult of explication and presented considerable problems both in compliance, as well as administration. In 1983, in the *American Council of Life Insurance* letter the presumptive underwriter doctrine "was for all intents and purposes abandoned." Nothing in the Securities Act compelled the view that a person acquiring a substantial part of an offering should be treated differently from any other investor with a large position in the issuer, unless the purchaser becomes an affiliate as a result of the purchases.

Id. (quoting Quinn, Redefining "Public Offering or Distribution" for Today, Address to Fed. Reg. of Sec. Com. (Nov 22, 1986)).

67. See Mission Resource Partners, L.P., SEC No-Action Letter, 1988 WL 233680 (S.E.C.) at *4 (Jan. 21, 1988).

68. See K-III Communications Corp., SEC No-Action Letter, 1993 WL 166858 (S.E.C.), at *1, *5 (May 14, 1993); American Council of Life Ins., SEC No-Action Letter, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,526, at 78,693 (May 10, 1993);

is highly problematic, but the criterion grew out of the facts of particular no-action requests from institutional Holders,⁶⁹ such as insurance companies, in which instances the criterion is generally intelligible. On the other hand, the criterion seems unsuited for determinations of many noninstitutional Holders. Finally, under today's rules, any Holder that is potentially subjected to underwriter status under the Commission's present day criteria apparently may still effect resales with impunity if it complies with sections (c), (e), (f) and (g).⁷⁰

The Commission's rules regarding the resale of Registered Securities are, as will be developed subsequently in this Article, broadly typical of resale rules generally. The rules are confusing, ephemeral, poorly promulgated, and flout both the language of the 1933 Act and proper administrative procedure. As a policy matter, it may be that the Commission's criteria in this area are designed simply to separate Holders' resales that are "small potatoes" from Holders' resales that are "big potatoes,"⁷¹ but such is a mean undertaking for the Commission. The Commission has at its disposal

Terminal Data Corp., SEC No-Action Letter, 1992 WL 217852 (S.E.C.), at *6, *7 (Sept. 3, 1992); Epic Properties, SEC No-Action Letter, 1991 WL 216064 (S.E.C.), at *2, *6 (Oct. 14, 1991); Warnaco, Inc., SEC No-Action Letter, 1991 WL 209850 (S.E.C.), at *3, *4 (Oct. 11, 1991); Morgan Stanley, Inc., SEC No-Action Letter, [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,018 at 78,885-86 (June 5, 1991); Mary Kay Cosmetics, SEC No-Action Letter, [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,016, at 78,879 (June 5, 1991); Exxon Capital Holding Corp., SEC No-Action Letter, 1988 WL 234336 (S.E.C.), at *3 (Apr. 13, 1988); Mission Resource Partners, L.P., SEC No-Action Letter, 1988 WL 233680 (S.E.C.), at *3, *5 (Jan. 2, 1988).

Additionally, the Holder who is an affiliate of the issuer cannot freely trade in its Registered Securities because such a Holder can become an "issuer" within the meaning of § 2(11) if it resells publicly through an "underwriter," thereby losing its § 4(1) exemption.

69 See K-III Communications Corp., SEC No-Action Letter, 1993 WL 166858 (S.E.C.), at *1, *5 (May 14, 1993); American Council of Life Ins., SEC No-Action Letter, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,526, at 78,691-693 (May 10, 1993); Terminal Data Corp., SEC No-Action Letter, 1992 WL 217852 (S.E.C.), at *6, *7 (Sept. 3, 1992); Epic Properties, SEC No-Action Letter, 1991 WL 216064 (S.E.C.), at *2, *6 (Oct. 14, 1991); Warnaco, Inc., SEC No-Action Letter, 1991 WL 209850 (S.E.C.), at *3, *4 (Oct. 11, 1991); Morgan Stanley, Inc., SEC No-Action Letter, [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,018 at 78,885-886 (June 5, 1991); Mary Kay Cosmetics, SEC No-Action Letter, [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,016, at 78,879 (June 5, 1991); Exxon Capital Holding Corp., SEC No-Action Letter, 1988 WL 234336 (S.E.C.), at *3 (Apr. 13, 1988); Mission Resource Partners, L.P., SEC No-Action Letter, 1988 WL 233680 (S.E.C.), at *3, *5 (Jan. 2, 1988).

70. See *supra* notes 63-64 and accompanying text (discussing permissibility of resales that comply with Rule 144).

71. See LOSS & SELIGMAN, *supra* note 18, at 1114.

sufficient administrative tools to bring order and predictability to this area and to do so in a manner that is consistent with the statutory language and underlying policy of the 1933 Act. Unfortunately, the Commission has proceeded otherwise.

C. Securities Acquired in an Intrastate Offering

From an issuer's point of view (especially a small issuer), the intrastate offering exemption provided by Rule 147⁷² is one of the most attractive vehicles under the 1933 Act for the sale of securities by an issuer.⁷³ Rule 147 permits issuers to sell unlimited amounts of securities ("Intrastate Securities") to unlimited numbers of purchasers and imposes no prerequisite disclosure requirements. Rule 147 does, however, limit the general availability of the exemption by requiring issuers to be incorporated and doing business in the same state where the offerees and purchasers have their principal place of residence.⁷⁴ These requirements limit to a large extent the availability of Rule 147 for financings by larger corporations, but truly small

72. 17 C.F.R. § 230.147 (1995).

73. See Campbell, *supra* note 39, at 1167-72 (discussing improvements to intrastate exemption embodied in Rule 147). For years, Rule 147 was the most attractive exemption. Recently, however, the Commission has significantly relaxed the requirements of Rule 504, which is now probably the most attractive exemption for an issuer. See 17 C.F.R. § 230.504 (1995).

Prior to the adoption of Rule 147, the lack of predictability of the § 3(a)(11) exemption and the small amount of common law that had developed thereunder made the intrastate exemption unattractive. See Tom A. Alberg & Martin E. Lybecker, *New SEC Rules 146 & 147: The Nonpublic & Intrastate Offering Exemptions from Registration for the Sale of Securities*, 74 COLUM. L. REV. 622, 648 (1974) (stating that "[b]ecause of these risks, major underwriters have adopted a general policy of refusing to participate in intrastate offerings"); Robert S. Kant, *SEC Rule 147 — A Further Narrowing of the Intrastate Offering Exemption*, 30 BUS. LAW. 73, 74-75 (stating that it is "extremely dangerous to rely upon the exemption except under almost laboratory conditions"). Notwithstanding such lack of predictability and the resulting risks, the § 3(a)(11) exemption and the limited amount of common law that developed thereunder was widely used. See HOUSE COMM. ON INTERSTATE & FOREIGN COMMERCE, REPORT OF SPECIAL STUDY OF SEC. MKTS. OF THE SEC, H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 1, 572-73 (1963) (stating that there are "indications of the offer and sale of a substantial volume of securities to the investing public under the color of the intrastate exemption"). Section 3(a)(11) and the common law thereunder continue to be most unattractive for issuers and thus will receive no further specific attention in this paper.

74. See 17 C.F.R. § 230.147 (setting forth requirements for intrastate offering exemption); see also J. William Hicks, *Intrastate Offerings Under Rule 147*, 72 MICH. L. REV. 463 (1974) (describing Rule 147 exemption in detail); HICKS, *supra* note 11, at § 4.01 (discussing general applicability of Rule 147); LOSS & SELIGMAN, *supra* note 18, at 1294-1307 (same).

corporations may find the Rule 147 exemption available to a surprising degree.

In addition to the foregoing requirements, the availability of Rule 147 to the issuer is predicated on Holders abstaining from interstate resales for nine months.⁷⁵ During the nine month holding period, however, the Holder may make intrastate resales.⁷⁶ This requirement is designed to ensure that the securities come to rest in the hands of truly local investors.⁷⁷

The nine month holding period requirement, however, is relevant only with regard to the availability of Rule 147 for issuers and is not intended to provide an independent exemption for Holders' resales.⁷⁸ This interpretation, of course, is consistent with the transactional nature of Rule 147,⁷⁹ but for Holders it means that they must find their own exemptions for resales of Intrastate Securities. Conceptually, that requirement presents a tough problem.

The only exemption generally available for Holders of Intrastate Securities is, once again, Section 4(1), which exempts sales by persons other than issuers, underwriters and dealers. Because, as described earlier, the availability of Section 4(1) is entirely unrelated to the transactional authority for issuers' sales of securities to Holders, the logical statutory interpretation is that the rules regarding the resales of Restricted Securities under Section 4(1) also should apply to resales of Intrastate Securities.⁸⁰ Under such a regime, a Holder of Intrastate Securities, in order to avoid inclusion in the "underwriter" definition and the resulting loss of its Section 4(1) exemption for its resales, would be required to effect resales in a manner that is either consistent with an initial investment intent (i.e.,

75. See 17 C.F.R. § 230.147(e) (1995). Technically, Rule 147(e) restricts a Holder to intrastate resales "for a period of nine months from the date of the last sale by the issuer." *Id.* Thus, if the Holder were to purchase its securities in the early part of a protracted offering by the issuer, the Holder's holding period could be substantially in excess of nine months from the date of its purchase.

76. See *id.* (describing limitations on resales).

77. See Notice of Adoption of Rule 147 Under the Securities Act, Securities Act Release No. 5450, [1973-1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,617, at 83,653 (Jan. 7, 1974).

78. See *id.* at 83,654 (stating that Intrastate Securities held by Holders are "unregistered securities that [can] only be reoffered and resold pursuant to an exemption from the registration provisions of the Act.").

79. See *id.* at 83,650.

80. See *supra* notes 34-52 and accompanying text (discussing resales of Restricted Securities).

following an extensive holding period or a change in circumstances) or in a way that does not involve a "distribution" (i.e., through private resales).⁸¹

Although the foregoing analysis is conceptually attractive, such an interpretation would, as a practical matter, impose material costs on Rule 147 transactions. Free trading in the post-offering market for Intrastate Securities would be throttled to a significant degree. Additionally, the costs of raising capital through a Rule 147 offering would increase because Holders would have to be paid for the costs imposed on them by limited transferability.

Viewed otherwise, such a strict interpretation would also render Rule 147's nine month holding period superfluous, in that Holders of Intrastate Securities would be restricted much beyond the nine month holding period imposed by Rule 147. Instead, in order to qualify the resales for the Section 4(1) exemption, Holders of Intrastate Securities would face a three year holding period (or a change in circumstances or private resale requirement).

The Commission's response to the problems of resales of Intrastate Securities is to turn a benevolently blind eye to the matter by taking the position that Holders of Intrastate Securities may resell their securities with impunity after complying with the nine month holding period of Rule 147.⁸² The Commission has offered no explanation of or theoretical support for this position, which, again, is found only in the Commission's no-action letters.

To make matters worse, the Commission, as it is wont to do,⁸³ has carved out an unprincipled exception to this unprincipled basic rule. This exception, which also is found only in the Commission's no-action letters, provides that Holders that purchase their Intrastate Securities in a transaction that is essentially private will not be permitted unlimited sales after a

81. See *supra* notes 45-52 and accompanying text (discussing manner in which Holders may avoid inclusion in definition of "underwriter").

82. See Synbiotics Corp., SEC No-Action Letter, 1985 WL 55619 (S.E.C.), at *4, *7-*9 (July 22, 1985); Dinner Levison Corp., SEC No-Action Letter, 1983 WL 28805 (S.E.C.), at *11 (Oct. 19, 1983); Quail Corp., SEC No-Action Letter, 1979 WL 14781 (S.E.C.), at *2 (Dec. 11, 1978). At least one early author opined that holding intrastate securities for nine months would be sufficient to remove the Holder from the definition of "underwriter." See Robert S. Kant, *SEC Rule 147 — A Further Narrowing of the Intrastate Offering Exemption*, 30 BUS. LAW. 73, 93 (1974) (stating that effect of Rule 147 is that original purchaser will not be underwriter if he resells in accordance with paragraph (e)).

83. See *infra* note 141 and accompanying text (discussing Commission's one percent rule).

nine month holding period, but, instead, will be required to make sales in compliance with the resale restrictions of Rule 144.⁸⁴

As a conceptual matter, none of this makes sense. The basic rule that Holders' interstate resales of Intrastate Securities are exempt after a nine month holding period is entirely inconsistent with the rules governing resales of Restricted Securities. No statutory basis exists for the distinction. The basic rule merely sweeps under the carpet the fact that a public resale of Intrastate Securities, whether such resale is intrastate or interstate, appears to cause the Holder to fall squarely within the definition of an underwriter, indicating that the Holder purchased with a view to distribution, and thus eliminating the Section 4(1) exemption for such a Holder.

The basic rule's exception (that resales of privately placed Intrastate Securities must be made only under Rule 144) is troubling on various grounds. First, the scope of this exception is not entirely clear. Is the exception triggered only if the transaction in which the Intrastate Securities were taken meets the technical requirements of Section 4(2)? One assumes that technical compliance is not required for the applicability of the exception, but if that were the case, then the exception's limits become quite narrow.⁸⁵

Second, resale options for one caught by the exception are unclear. Can such a Holder of Intrastate Securities utilize only Rule 144, or can the Holder also sell publicly or privately pursuant to the common law of resales, i.e., outside Rule 144? Certainly the better position and, indeed, the only theoretically defensible position is that any Holder of Intrastate Securities subjected to the exception should be able to resell under the common law as well as Rule 144,⁸⁶ but, again, that is not clear.

84. See *Dinner Levison Corp.*, SEC No-Action Letter, 1983 WL 28805 (S.E.C.), at *3, *4, *11 (Oct. 19, 1983) (stating that individuals who received Rule 147 securities in § 3(a)(10) transaction and became affiliates of issuer must sell pursuant to Rule 144 but two-year holding period does not apply); *Acceleration Corp.*, SEC No-Action Letter, 1976 WL 10425 (S.E.C.), at *4, *5 (Nov. 12, 1976).

85. Some disagreement exists regarding the requirements for the issuer's exemptions in § 4(2) of the 1933 Act, 15 U.S.C. § 77d(2) (1994). I am convinced that the most fundamental criteria are that the offerees and purchasers be sophisticated and have access to all information that would be contained in a registration statement. See *Banco de Bilbao*, Application For Exemption 812-6497, 1987 WL 11637 (S.E.C.), at *3 (Jan. 13, 1987); *Doran v Petroleum Management Corp.*, 545 F.2d 893, 900 (5th Cir. 1977) (stating that "relevant factors include the number of offerees and their relationship to each other and the issuer, the number of units offered, the size of the offering, and the manner of the offering"). It seems unlikely that an issuer's sale of securities structured under Rule 147 would also meet the technical requirements of § 4(2).

86. Any limitation on the right of a Holder of Intrastate Securities freely to trade such

Finally, the exception is impossible to square with the Commission's basic rule. If under the basic rule a Holder does not become an underwriter when it publicly resells intrastate securities held for nine months, the outcome must be based on the theory that a nine month holding period establishes that the Holder acquired such securities without a "view to distribution" and thus is not an underwriter. This analysis is unchanged by the fact that the Holder took its Intrastate Securities in an essentially private transaction. The Holder's status (or nonstatus) as an underwriter is unaffected by the type of transaction in which the Holder acquired its securities.

At a pragmatic level, however, the Commission's position on all this may seem defensible, at least if one indulges in a couple of assumptions. If one assumes that most resales of Intrastate Securities generally tend to involve dollar amounts that are small, perhaps the Commission need not be too concerned about enforcing rigid resale rules. The Commission's current approach, therefore, makes some practical sense. On the other hand, the exception to the general rule of free tradeability may be based on the assumption that each of the limited number of Holders in a privately placed Intrastate Securities offering may own a proportionately significant share of the Intrastate Securities offering and thus resales by such Holders may involve not insignificant amounts of securities. In that case, the Commission may have more concern, due to the potential size of such resales, and thus conclude that some more stringent limitation on resales of these Intrastate Securities is required.

Even to ramble through this attempt at explanation shows just how deeply flawed such a line of analysis tends to be. The explanation obviously is based on numerous leaps of faith and is wildly general regarding its factual assumptions. Moreover, the Commission's action (or inaction) leaves significant theoretical and administrative problems untreated. Resales of Registered Securities and Restricted Securities create precisely the same conceptual problems under Section 4(1) as do resales of Intrastate Securities. If sound policy bases exist for treating the problems differently, the Commission should act pursuant to its legitimate rulemaking power to deal with the matter.

securities is based on the Holder's status as an underwriter and the resulting loss of the exemption provided by § 4(1). A Holder of such Intrastate Securities can avoid inclusion in the definition of underwriter by complying with the common law of private resales, which negates the existence of a "distribution," or by complying with the common law of public resales, which probably requires a three year holding or a change in circumstances. See *supra* notes 34-52 and accompanying text (discussing § 4(1) exemption).

D Securities Acquired in a Section 3(a)(9) Transaction

Section 3(a)(9) of the 1933 Act⁸⁷ provides a transactional exemption for an issuer that offers to exchange its new securities "with its existing security holders exclusively"⁸⁸ Subject to meeting certain conditions,⁸⁹ an issuer may utilize the exemption both in exchanges structured as corporate transactions⁹⁰ and in exchanges effected directly with its security holders.⁹¹ The policy basis for the exemption appears somewhat problematic when considered in light of the 1933 Act generally⁹² but may represent an attempt

87 15 U.S.C. § 77c(a)(9) (1994).

88. Like the statutory intrastate exemption contained in § 3(a)(11) of the 1933 Act, 15 U.S.C. § 77c(a)(11) (1994), the exemption provided by § 3(a)(9) of the 1933 Act, 15 U.S.C. § 77c(a)(9) (1994), is mislabeled in the 1933 Act as pertaining to "Exempted Securities." Clearly, however, § 3(a)(9) provides only a transactional exemption. See HICKS, *supra* note 11, at § 2.08 (stating that "[a]s a transactional exemption, § 3(A)(9) provides an exemption only once; it does not exempt the subsequent sale of the new securities once received").

89. See 15 U.S.C. § 77c(3)(9) (1994). The statute predicates the availability of the exemption on the fact that "no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange." *Id.* Other significant conditions imposed on the availability of the exemption include the application of the integration concept and a prohibition against any material consideration other than the issuer's outstanding securities flowing from the exchanging security holder to the issuer. See LOSS & SELIGMAN, *supra* note 18, at 1228-41.

90. See LOSS & SELIGMAN, *supra* note 18, at 1228-41. An example of such a transaction would be a recapitalization of an issuer effected through amendment to the issuer's articles of incorporation changing significantly the rights of preferred stockholders. As examples of such transactions, see *Bailey v. Tubize Rayon Corp.*, 56 F. Supp. 418, 419-22 (D. Del. 1944); *Western Foundry Co. v. Wicker*, 85 N.E.2d 722, 723-25 (Ill. 1949); *State ex rel. Weede v. Bechtel*, 31 N.W.2d 853, 856-60 (Iowa 1948), *cert. denied*, 337 U.S. 918 (1949); *Franzbau v. Capital Sec. Co.*, 64 A.2d 644, 645-46 (N.J. Super. Ct. Ch. Div. 1949); *Wessel v. Guantanamo Sugar Co.*, 35 A.2d 215, 216 (N.J. Ch.), *aff'd*, 39 A.2d 431 (N.J. 1944); *Kamena v. Janssen Dairy Corp.*, 31 A.2d 200, 201-02 (N.J. Ch. 1943), *aff'd*, 35 A.2d 894 (N.J. 1944).

91. An example of such a transaction is a situation in which the issuer offers each preferred stockholder the right to exchange his or her preferred stock for a subordinated debenture. In that instance, each preferred stockholder individually has the right to accept or reject the offer. For an interesting twist on these "voluntary" exchanges, see the old but instructive case, *Barrett v. Denver Tramway Corp.*, 53 F. Supp. 198, 199-201 (D. Del.), *aff'd*, 146 F.2d 701 (3d Cir. 1944).

92. Recapitalizations were historically perceived by many legal commentators to involve the opportunity, often exploited, to mistreat securityholders, principally preferred stockholders. See E. Merrick Dodd, Jr., *Accrued Dividends in Delaware Corporations — From Vested Right to Mirage*, 57 HARV. L. REV. 894, 898-99 (1944); E. Merrick Dodd, Jr., *Fair & Equitable Recapitalizations*, 55 HARV. L. REV. 780, 791-93 (1942); Norman D. Lattin, *A Primer on Fundamental Corporate Changes*, 1 W. RES. L. REV. 3, 13-27 (1949); E.R.

to balance the needs of the corporation's security holders-investors against the needs of the reorganizing corporation for an expeditious and economically efficient reorganization.⁹³

Regarding resales of securities taken in Section 3(a)(9) transactions (such securities are herein referred to as "Section 3(a)(9) Securities"), Holders of Section 3(a)(9) Securities have the same theoretical posture as Holders of Registered Securities, Restricted Securities, and Intrastate Securities. Specifically, Holders of Section 3(a)(9) Securities purchased securities from an issuer in an exempt transaction and, accordingly must resell pursuant to their own transactional authorization. Section 4(1), again, appears to be the only exemption generally available to such Holders, and the availability of that exemption, again, appears problematic in light of the fact that reselling Holders may be considered to have "purchased from an issuer with a view to distribution" and thus be underwriters.

The Commission's resale rules for Section 3(a)(9) Securities are shaped primarily by its approach to the Section 3(a)(9) exchange itself. Generally, the Commission appears to consider the Section 3(a)(9) exchange a neutral event. The new securities received by the Holder in the exchange are subject to the same resale limitations as the old securities that the Holder surrendered in the Section 3(a)(9) transaction. Accordingly, a Holder in possession of freely tradeable securities prior to the Section 3(a)(9) exchange will possess freely tradeable securities after the exchange. Conversely, if the Holder's old securities were restricted, the Holder's new Section 3(a)(9) Securities also will be deemed restricted.⁹⁴

Latty, *Fairness — The Focal Point in Preferred Stock Arrearage Elimination*, 29 VA. L. REV 1, 24-51 (1942); John F. Meck, Jr., *Accrued Dividends on Cumulative Preferred Stocks: The Legal Doctrine*, 55 HARV. L. REV. 71, 78-79 (1941); Note, *Protection for Shareholder Interests in Recapitalizations of Publicly Held Corporations*, 58 COLUM. L. REV. 1030, 1031 (1958); Note, *A Standard of Fairness for Compensating Preferred Stockholders in Corporate Recapitalizations*, 33 U. CHI. L. REV. 97 (1965).

93. See Allen E. Throop & Chester T. Lane, *Some Problems of Exemption Under the Securities Act of 1933*, 4 L. & CONTEMP. PROBS. 89, 97-98 (1937); see also LOSS, *supra* note 23, at 573 (noting that § 3(a)(9) exemption may represent nothing more than "horse-trade compromise").

94. See Auto Fin. Group, Inc., SEC No-Action Letter, 1991 WL 257229 (S.E.C.), at *4 (Dec. 3, 1991); Calton, Inc., SEC No-Action Letter, 1991 WL 199473 (S.E.C.), at *7, *19 (Sept. 30, 1991); J. Gregory Milmo, *Selected Issues in Restructuring Public Debt Securities*, in 224TH ANNUAL INSTITUTE OF SECURITIES REGULATION 1992 419, 427 (PLI Corp. Law & Practice Course Handbook Series No. B-793, 1992) (stating that "Section 3(a)(9) is considered to be a transaction exemption. The Staff has determined that New Securities acquired in a Section 3(a)(9) Exchange are subject to the same resale restrictions, if any, as the Old Securities. The securities retain the same character before and after the

Some commentators suggest an exception to the foregoing general rule regarding resales if the exchange in which the Holder received its Section 3(a)(9) Securities were essentially a private transaction. Specifically, these commentators suggest that the resale of Section 3(a)(9) Securities received in a fundamentally private exchange may be subject to restrictions, even though the old securities surrendered by the Holder were freely tradeable prior to the exchange.⁹⁵

It is not clear, however, that the Commission imposes such an exception to its general approach of considering the Section 3(a)(9) exchange a neutral event. The Commission's handling of no-action requests suggests that even in situations where the Holder received its Section 3(a)(9) Securities in a private transaction, the Commission follows its general rule that such securi-

exchange"); *see also* TV Answer, SEC No-Action Letter, [1993-1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,816, at 78,299-303 (Nov 19, 1993); Sports/Leisure, Inc., SEC No-Action Letter, 1992 WL 227959 (S.E.C.), at *12 (Sept. 11, 1992); Echo Bay Mines, Ltd., SEC No-Action Letter, 1992 WL 180224 (S.E.C.), at *6, *7 (July 27, 1992); Turner Broadcasting Sys., Inc., SEC No-Action Letter, 1991 WL 176765 (S.E.C.), at *2, *3 (June 24, 1991); Mr. Coffee Inc., SEC No-Action Letter, 1991 WL 178808 (S.E.C.), at *4-*6 (June 6, 1991); Attwoods, plc, SEC No-Action Letter, 1991 WL 176649 (S.E.C.), at *4, *5 (Jan. 28, 1991); Terminal Data Corp., SEC No-Action Letter, 1990 WL 304941 (S.E.C.), at *2, *3 (Nov 19, 1990); Superior TeleTec Inc., SEC No-Action Letter, 1990 WL 287003 (S.E.C.), at *4, *6 (Oct. 26, 1990); Saatchi & Saatchi Co., SEC No-Action Letter, 1989 WL 236227 (S.E.C.), at *3, *5 (May 18, 1989); Siliconix Inc., SEC No-Action Letter, 1988 WL 234289 (S.E.C.), at *2, *3 (Apr. 15, 1988); La Jolla Bancorp, SEC No-Action Letter, 1987 WL 108819 (S.E.C.), at *1, *2 (Nov. 24, 1987); Iomega Corp., SEC No-Action Letter, 1987 WL 108458 (S.E.C.), at *3, *4 (Oct. 12, 1987); Wedgestone Realty Investors Trust, SEC No-Action Letter, 1988 WL 233594 (S.E.C.), at *3, *5 (Sept. 16, 1987); Hooker Enters., SEC No-Action Letter, 1987 WL 108338 (S.E.C.), at *1, *2 (Sept. 3, 1987); Maxus Energy Corp., SEC No-Action Letter, 1978 WL 108351 (S.E.C.), at *6, *7 (Aug. 13, 1987); Financial Corp. of Santa Barbara, SEC No-Action Letter, 1987 WL 108244 (S.E.C.), at *3 (May 20, 1987); Timken Co., SEC No-Action Letter, 1986 WL 66503 (S.E.C.), at *3, *4 (Dec. 19, 1986); Dynallectron Corp. & DFC Inc., SEC No-Action Letter, 1986 WL 67375 (S.E.C.), at *2, *3 (Oct. 10, 1986); Waldorf Corp., SEC No-Action Letter, 1986 WL 67029 (S.E.C.), at *10-*12 (May 29, 1986); American Greetings Corp., SEC No-Action Letter, 1986 WL 66812 (S.E.C.), at *3 (Apr. 26, 1986); Southwest Bancorp, SEC No-Action Letter, 1986 WL 66822 (S.E.C.), at *5 (Feb. 19, 1986); Southwest Bancorp, SEC No-Action Letter, 1986 WL 65215 (S.E.C.), at *3 (Jan. 14, 1986); Lehigh Valley Indus., Inc., SEC No-Action Letter, 1985 WL 54512 (S.E.C.), at *9 (Oct. 17, 1985); Clevepak Corp., SEC No-Action Letter, 1984 WL 44974 (S.E.C.), at *3 (Feb. 23, 1984).

95. *See* LOSS & SELIGMAN, *supra* note 18, at 1586-88; HICKS, *supra* note 11, at § 2.08[2][b] (recognizing potential for § 3(a)(9) Securities to fall within restricted securities found in Rule 144(a)(3), but arguing correctly that reading "is neither consistent with the purpose of Rule 144, nor is it protective of the public"). It is also worth noting that this suggested possible exception sounds much like the exception to the generally free tradeability of Rule 147 Securities, as described in the immediately preceding section.

ties carry only the same (if any) resale restriction as did the prior securities held by the Holder and exchanged in the Section 3(a)(9) transaction.⁹⁶

The rules governing the resales of Section 3(a)(9) Securities are vulnerable to the same criticisms as those previously made regarding the resales of other securities. The Commission in this area continues to follow an unprincipled path. The resale rules are vague and confusing, which generates complexity and costs for society, problems exacerbated by the poor promulgation of the resale rules.

E. Securities Acquired in a Regulation A Offering

Regulation A,⁹⁷ a transactional exemption scheme enacted by the Commission under the statutory authority of Section 3(b) of the 1933 Act,⁹⁸ allows an issuer to raise up to \$5 million in an interstate, public offering.⁹⁹ Although Regulation A in a technical and legal sense is an exemption from the registration requirements of Section 5, a Regulation A offering looks much like a registered offering, because the availability of the Regulation A exemption is predicated on the issuer's filing an offering statement (analogous to a registration statement) with the Commission and delivering an offering circular (analogous to a prospectus) to each investor. The disclosure requirements under Regulation A, however, are less burdensome for the issuer than are the normal disclosure requirements for a registered offering. The availability of Regulation A also depends on the issuer's meeting certain other conditions, but those conditions generally do not tend to be particularly burdensome or exclusionary¹⁰⁰

96. See Calton, Inc., SEC No-Action Letter, 1991 WL 199473 (S.E.C.), at *1, *3 (Sept. 30, 1991) (raising no objection to resales of § 3(a)(9) Securities by five institutional investors who had received their securities in exchange with issuer involving only issuer and five institutions); Clevepak Corp., SEC No-Action Letter, 1984 WL 44974 (S.E.C.), at *3 (Feb. 23, 1984) (raising no objection to resales by investment advisor of § 3(a)(9) Securities that had been taken in exchange involving only issuer and investment advisor).

97. 17 C.F.R. §§ 230.251-.263 (1995).

98. 15 U.S.C. § 77d (1994).

99. See 17 C.F.R. § 230.251(b) (1995).

100. Generally regarding Regulation A, see THOMAS L. HAZEN, 2 THE LAW OF SECURITIES REGULATION § 4.15 (1990); LOSS & SELIGMAN, *supra* note 18, at 1319-38; HICKS, *supra* note 11, at §§ 5.01-.11, see also HAROLD S. BLOOMENTHAL, SECURITIES AND FEDERAL CORPORATE LAW §§ 5.04-.05 (1993); Robert S. Green & Dan Brecher, *Part 1. When Making a Small Public Offering Under Regulation A (with forms)*, PRAC. LAW., Mar. 1980, at 25; Robert S. Green & Dan Brecher, *Part 2: When Making a Small Public Offering Under Regulation A (with forms)*, PRAC. LAW., Apr. 1980, at 41, Roy L. Brooks, *Small Business Financing Alternatives Under the Securities Act of 1933*, 13 U.C. DAVIS L. REV

Regulation A, therefore, at least upon initial consideration, appears to have an important place in capital formation, because it is, except for Rule 504 (which has a relatively low ceiling amount),¹⁰¹ the only exemption of general applicability available to an issuer for an interstate public offering. Unfortunately, at least in recent years, Regulation A has been an inefficient vehicle for use by issuers in capital formation,¹⁰² due principally to the unfavorable treatment of Regulation A offerings under state blue sky laws.¹⁰³

Holders of securities issued in Regulation A transactions (such Holders are hereinafter referred to as "Regulation A Holders" and such securities are hereinafter referred to as "Regulation A Securities") that wish to sell their Regulation A Securities face exactly the same theoretical problem described in the preceding sections. Specifically, if such Regulation A Holders resell publicly they appear to meet the statutory definition of "underwriter" and thus lose their Section 4(1) exemption.

Research reveals no no-action letters dealing generally with resales of Regulation A Securities.¹⁰⁴ Broadly applicable Commission pronouncements

543, 561-66 (1980); James T. Glavin & Francis J. Purcell, *Securities Offerings & Regulation A — Requirements & Risks*, 13 BUS. LAW. 303 (1958); Gustav B. Margraf, *Does Securities Regulation Hinder Financing Small Business*, 11 LAW & CONTEMP PROBS. 301 (1945); Leland E. Modesitt, *Exemptions from Registration Under the Securities Act of 1933*, 27 NEB. L. REV. 43 (1947); Ezra Weiss, *Highways & Byways Revisited*, 15 N.Y.L.F. 218 (1969); Ezra Weiss, *Regulation A Under the Securities Act of 1933 — Highways & Byways*, 8 N.Y.L.F. 3 (1962); Note, *Federal Control Over Small Issues of Securities*, 70 HARV. L. REV. 1438 (1957).

101. See 17 C.F.R. § 230.504(b)(2) (1995) (\$1,000,000 ceiling).

102. See LOSS & SELIGMAN, *supra* note 18, at 1319 n.279 (presenting interesting statistics regarding use of Regulation A over past years).

103. For a discussion of the drawbacks to Regulation A, see HICKS, *supra* note 11, at § 5.11[1]. My own view is that the impact of state blue sky laws is the primary reason for the underuse of Regulation A. Because states generally have not permitted registration by coordination in Regulation A offerings, issuers utilizing Regulation A are often required to register by qualification in each state in which the Regulation A offering is made. This requirement eliminates the savings otherwise available to issuers utilizing Regulation A.

104. Two no-action letters deal with resales of Regulation A Securities acquired in Rule 145 transactions. The first of the letters, Orbanco, Inc., SEC No-Action Letter, 1975 WL 9537 (S.E.C.), at *1 (June 16, 1975), indicates that such Regulation A Securities are freely tradeable by Holders, unless under Rule 145(c) the Holder was an affiliate of the company acquired in the Rule 145 transaction, in which case public resales by the Holder would cause the Holder to become an underwriter. The letter goes on to state that the special resale provisions of Rule 145(d) are not available for such a Holder of Regulation A Securities. A later letter, Indian Head Banks Inc., SEC No-Action Letter, 1979 WL 14023 (S.E.C.), at *3 (May 29, 1979), essentially confirms the foregoing analysis, except the Commission indicates a change in its position regarding the availability of Rule 145(d) for

regarding the resale of Regulation A Securities are also essentially non-existent. The scant and indirect authority from the Commission on resales of Regulation A Securities and the general authority one may garner from analogies to the resale rules described in the preceding sections, however, support the conclusion that Regulation A Securities held by a Holder are normally freely tradeable.¹⁰⁵ Commentators also agree that in most cases Regulation A Securities are freely tradeable by Holders.¹⁰⁶

The difficult question remains, however. When, if ever, is this general rule of free tradeability for Regulation A Securities supplanted by an exception? Stated differently, in what circumstances is a Holder who publicly resells Regulation A Securities considered an underwriter and thus without its Section 4(1) exemption?

Answers to these questions are even more problematic because of the nature of Regulation A itself, which operates like a registered offering but in fact is an exemption. On the one hand, therefore, at least one distinguished commentator is attracted by the analogy to Registered Securities and thus suggests that Holders of Regulation A Securities may be subjected to the same resale rules as Holders of Registered Securities.¹⁰⁷ On a policy basis, such an approach can be justified if one has faith that a reasonably efficient market for corporate information usually operates with respect to Registered and Regulation A Securities.¹⁰⁸ Under this approach and in light of what seems to be today's rules for resales of Registered Securities, Regulation A Securities in the hands of Holders would be freely tradeable unless such securities are not acquired by the Holder in its ordinary course of business

resales by Holders who are affiliates of the acquired corporation. The Commission stated that such Holders may resell Regulation A Securities in reliance on Rule 145(d).

105. As described previously, except with regard to Restricted Securities, the general rule regarding resales of all securities acquired by Holders pursuant to transactional authorizations is that such securities are freely tradeable, subject, however, to certain exceptions. It seems quite unlikely that the Commission would apply a different general rule to the resale of Regulation A Securities than it applies to the resale of such other securities issued pursuant to transactional authorizations. But, this conclusion leaves unanswered the "difficult question" discussed in the next preceding paragraph of the text, which is the rule the Commission would apply regarding the exception (if any) to the general rule of free tradeability.

106. See *LOSS & SELIGMAN*, *supra* note 18, at 1321, *BLOOMENTHAL*, *supra* note 100, at § 4.08[2][e].

107. See *BLOOMENTHAL*, *supra* note 100, at § 4.08[2][e].

108. See *id.* (stating that "justification [comes from] the fact that the shares have been registered (or qualified under Regulation A) and appropriate disclosure has been made before the securities have reached the marketplace").

or unless some arrangement exists between the issuer and the Holder regarding the distribution of the Regulation A Securities.¹⁰⁹

On the other hand, one may consider the resale of Regulation A Securities more attractive than the rules regarding the resale of securities acquired by Holders in exempt transactions, but the distinct circumstances surrounding such exempt offerings and the weak theoretical support underlying the resale rules for such securities may make those resales poor models for Regulation A resale rules. For example, the analysis supporting the rules governing the resales of Restricted Securities, despite its conceptual attractiveness, has never been applied to resales of nonrestricted securities. The rules governing the resale of Intrastate Securities are dominated by the text of Rule 147 itself and its nine month holding period. These rules, once again, seem unsuited for expansion into the rules governing the resale of Regulation A Securities. Finally, the rules regarding the resale of Section 3(a)(9) Securities are dominated by the neutral event analysis and the central fact of the exchange, factors that appear to strain such rules if applied to the resale of Regulation A Securities.

As a result, the analogy to Registered Securities clearly is most compelling, and thus a Holder with Regulation A Securities should be able to expect the same resale rules as a Holder of Registered Securities. Registered Securities seem closest to Regulation A Securities both in the structural nature of the initial offerings by the issuer and in the probability that information about the offering and the issuer has been made available to the public and thus absorbed into the price of the securities. From a regulatory, legal, and policy point of view, however, all of this is once again unsatisfactory

F Securities Acquired in a Rule 145 Transaction

1 Generally

All the problems described heretofore are exaggerated in the case of the rules governing the resale of securities taken in a Rule 145 transaction. A

109 Professor Bloomenthal characterizes the situations in which Regulation A Securities may not be freely tradeable by a Holder as follows:

There are a few situations in which purchasers in a registered or Regulation A offering because of their association with the securities industry, the underwriter, or the issuer, or because the purchaser acquired a disproportionately large part of the offering may be deemed underwriters in connection with their resales.

Id.

brief look at Rule 145¹¹⁰ and its history is helpful to understand these resale rules and associated problems.¹¹¹

Rule 145 was enacted by the Commission in 1972¹¹² principally for the purpose of eradicating the mischief of old Rule 133.¹¹³ That old rule, the so-called "no-sale" rule, dealt with the issuance of securities in acquisitions and single company recapitalizations and provided that in most instances the securities issued in such transactions were not subject to the registration provisions of the 1933 Act. The essential fiction of Rule 133 was that an acquisition or recapitalization is a corporate transaction and thus the stockholders acquiring securities in such a transaction are not making any investment decision, but, instead, the acquired or reorganized corporation as an entity, as opposed to stockholders receiving newly issued securities, is making the investment decision. As a result, such a transaction did not involve a "sale" of securities to the stockholders of the acquired or recapitalized company, even though (and this, of course, was the nonsense of the no-sale rule) the stockholders of the acquired or reorganized company approved the transactions by their affirmative votes.¹¹⁴

Instead of just repealing Rule 133, however, the Commission through Rule 145 enacted a series of provisions dealing with the issuance and resale of securities acquired in corporate acquisitions and recapitalizations (such transactions are hereinafter referred to as "Rule 145 Transactions" and such

110. 17 C.F.R. § 230.145 (1995).

111. The administrative history of Rule 145 is both interesting and instructive as it concerns the points made in this section. Since its enactment, the Commission has only once addressed the interpretative problems created by the rule in a systematic fashion, and that occurred shortly after the Rule was adopted. See Division of Corporation Finance's Interpretations of Rule 145 & Related Matters, Securities Act Release No. 5463, 1 Fed. Sec. L. Rep. (CCH) ¶ 3058, at 3067-3 (Feb. 28, 1974). To a much lesser extent, the Commission dealt with some resale problems under Rule 145 in a more general 1979 interpretive release. See Resale of Restricted & Other Securities, Securities Act Release No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H, at 2819-3 (Aug. 2, 1979). Otherwise, the Commission has proceeded to interpret Rule 145 through no-action letters. At the date of this Article, the Commission had issued more than 887 no-action letters on Rule 145.

112. Rule 145 was first proposed in Notice of Proposed Adoption of Rules 145 & 153A, Securities Act Release No. 5246, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,753 (May 2, 1972), and was adopted in Securities Act Release No. 5316, *supra* note 1 at ¶ 79,015.

113. 17 C.F.R. § 230.133 (1971) (repealed by 37 Fed. Reg. 23,636 (1972)).

114. For a description of Rule 133, see LOSS, *supra* note 23, at 518-42; Andrew D. Orrick, *Registration Problems Under the Federal Securities Act — Resales Following Rule 133 & Exchange Transactions*, 10 HASTINGS L.J. 1 (1958-59); Securities Act Release No. 5316, *supra* note 1, at 82,198.

securities are hereinafter referred to as "Rule 145 Securities"). As a result, Rule 145 is different in scope and purpose from the more usual exemptive rules, such as the intrastate exemption provided by Rule 147¹¹⁵ or the essentially private placement or small offering exemptions provided by Regulation D¹¹⁶

Rule 145(a) provides, and correctly so, that a "sale" of securities occurs when stockholders of the acquired or recapitalized company vote to approve the transaction and accordingly to receive the newly issued Rule 145 Securities.¹¹⁷ This provision of the Rule accommodates the reality of the situation, which is, contrary to the fiction of old Rule 133, that stockholders voting to approve an acquisition or recapitalization in which they will exchange their old securities for new securities make a significant investment judgment. As a result, such investors have a valid claim for the protection of the registration provisions of the 1933 Act.¹¹⁸ Because Rule 145 merely

115. 17 C.F.R. § 230.147 (1995). See *supra* notes 72-79 and accompanying text (discussing Rule 147).

116. 17 C.F.R. §§ 230.501-.508 (1995). For an explanation and criticism of Regulation D, see Campbell, *supra* note 39; Manning G. Warren III, *A Review of Regulation D: The Present Exemption Regimen for Limited Offerings Under the Securities Act of 1933*, 33 AM. U. L. REV 355 (1984); Mark F. Donahue, *Regulation D: A Primer for the Practitioner*, 8 DEL. J. CORP. L. 495 (1983).

117 More specifically, Rule 145 provides that a sale occurs

so far as the security holders of a corporation are concerned where, pursuant to statutory provisions there is submitted for the vote or consent of such security holders a plan or agreement for (1) a reclassification of securities of such corporation, (2) a statutory merger or similar plan in which securities held by such security holders will be exchanged; or (3) a transfer of assets [by the security holder's corporation] in consideration of the issuance of securities, [provided the securities received by the corporation are distributed to security holders in certain fashions].

17 C.F.R. § 230.145(a) (1995).

118. An interesting and serious body of literature, of course, argues the neoclassical economists' point that saddling corporations with mandated disclosure requirements results in an economically inefficient allocation of information and thus is undesirable. For a discussion of this point of view, see RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 444-48 (4th ed. 1992). Purposefully, I avoid a discussion of this scholarship. Accordingly, the statement in the text that investors voting of mergers and recapitalizations have a "valid claim for the protection of the registration provisions of the 1933 Act" is based on a consistency argument. Such voting investors are making investment decisions (albeit collectively) and thus need the disclosure of the 1933 Act as much as individual investors. I leave for another day the question of whether the 1933 Act is efficient and, perhaps even more interestingly, whether the Act is nonetheless morally attractive, even if it generates a certain level of inefficiency.

defines Rule 145 Transactions as those involving sales of securities to the stockholders of the acquired or recapitalized company that receive Rule 145 Securities and because Rule 145 provides no exemption from the registration requirements of the 1933 Act, issuers of Rule 145 Securities must either register the Rule 145 Securities or qualify such securities for an exemption from the registration requirements.

Rule 145 also contains explicit rules regarding the resale of Rule 145 Securities, and these provisions are the principal focus of this part of this Article. The resale provisions of Rule 145 work definitionally, providing in section (c) that a Holder who publicly resells Rule 145 Securities will be deemed to be engaged in a "distribution," and thus an "underwriter," if such Holder were a control person of the acquired or recapitalized company prior to the Rule 145 Transaction (such a control person is sometimes herein referred to as a "Rule 145 Affiliate").¹¹⁹ The operational theory of this provision, of course, is that a Holder that is a Rule 145 Affiliate and engages in such public resales loses its Section 4(1) exemption because such a Holder is an "underwriter." On the other hand, a Holder who is not a Rule 145 Affiliate is apparently outside the definition of "underwriter" and thus may resell freely because the Holder qualifies for the Section 4(1) exemption.¹²⁰

119. The scope of Rule 145(c) is apparently much broader than my description in the text. Specifically, the public resale of Rule 145 Securities by any of the following persons is a "distribution" and thus causes the selling Holder to be considered an "underwriter": "any party to any [Rule 145] transaction , other than the issuer, or any person who is an affiliate of such party " 17 C.F.R. § 230.145(c) (1995). Practically, however, only control persons of acquired or reorganized companies are concerned about this limitation.

120. As is so often the case when dealing with Commission rules, unqualified statements are impossible. On the one hand, clear language in the Commission's no-action letters indicates that Holders of Rule 145 Securities that were not control persons of the acquired or recapitalized company may freely sell their securities. See Coastal Int'l, SEC No-Action Letter, 1980 WL 15023 (S.E.C.), at *3 (Dec. 24, 1980) ("securities received in a Rule 145 transaction by persons who are neither affiliates of the acquired company nor of the acquiring company are registered securities without restriction on resale"). On the other hand, the Commission has suggested the possibility that certain noncontrol persons facilitating mergers could become underwriters. See Division of Corporation Finance's Interpretations of Rule 145 & Related Matters, Securities Act Release No. 5463, 1 Fed. Sec. L. Rep. (CCH) ¶ 3058, at 3067-68 (Feb. 28, 1974). Also, as will be described subsequently, the Commission's one percent rule purports in certain instances to apply resale restrictions to Holders that acquire more than one percent of the company's stock in a Rule 145 Transaction even though such persons are not Rule 145 Affiliates. See *infra* notes 137-41 and accompanying text (discussing Commission's one percent rule). As a final example, not surprisingly, Rule 145 Securities issued in transactions exempt under § 4(2) or Regulation D and held by Holders who are not Rule 145 Affiliates are also subject to the resale restrictions. See *infra* notes 147-51 and accompanying text.

Rule 145, however, contains specially crafted resale provisions for a Holder that is a Rule 145 Affiliate. Section (d) of the Rule declares that public resales of the Rule 145 Securities by a Holder will not be considered a "distribution" and accordingly the Holder will not become an "underwriter" if the Holder's resales meet any one of the three prescribed sets of conditions contained in section (d) of Rule 145. The conditions are based on a combination of some parts of the Rule 144 resale conditions and/or a holding period.¹²¹ Again, Rule 145(d) operates definitionally, defining reselling Holders to be outside the definition of "underwriter" and thereby preserving the Section 4(1) exemption for Holders that are Rule 145 Affiliates.

The seeming relative simplicity and compactness of the resale provisions of Rule 145 are, however, grossly misleading.¹²² To demonstrate the confusion and extreme complexity of the rules governing the resale of Rule 145 Securities, it is helpful to consider separately the manner in which the general resale provisions of Rule 145(c) and (d), as outlined above, are applied to resales of: (1) Rule 145 Securities acquired in registered offerings (hereinafter "Registered Rule 145 Securities"); (2) Rule 145 Securities acquired in offerings exempt under Section 3(a)(9), Rule 147,¹²³ or Regulation A (hereinafter "Exempt Rule 145 Securities"); and (3) Rule 145 Securities acquired in offerings exempt under Section 4(2) or Regulation D (hereinafter "Restricted Rule 145 Securities"). The resale provisions applicable in each of these three situations differ from the other two situations. To make matters even more complex, the resale provisions applicable in each of the three situations also often differ from the resale rules applicable in the non-Rule 145 counterpart to each of the Rule 145 situations. Again, no statute or policy necessitates such complex differences.

121. Under Rule 145(d), resales are not considered to be a "distribution" and, therefore, the reselling Holder is not considered an "underwriter" if the Rule 145 Securities are: (1) sold "in accordance with the provisions of paragraphs (c) [the issuer has current information publicly available], (e) [sales in any three month period do not exceed one percent of outstanding stock], (f) and (g) [sales made only in brokers' transactions] of Rule 144"; (2) held for two years and current information is publicly available; or (3) held for three years. 17 C.F.R. § 230.145(d) (1995).

122. For an extensive discussion of the resale rules governing Rule 145 Securities, see Rutheford B Campbell, Jr., *Rule 145: Mergers, Acquisitions & Recapitalizations Under the Securities Act of 1933*, 56 FORDHAM L. REV 277, 315-38 (1987), reprinted in II SELECTED ARTICLES ON FEDERAL SECURITIES LAW 309 (Franklin E. Gill ed., 1990).

123. For purposes of this section, I again limit my discussion of the intrastate exemption to Rule 147 because I consider the common law of § 3(a)(11) to be so uncertain and risk laden as to be unworkable and thus unworthy of extensive discussion. See *supra* note 73 (discussing risks inherent in common law of § 3(a)(11)).

To the contrary, such differences are inconsistent with the language of the 1933 Act and are contrary to the policy underlying the 1933 Act as well.

2. Resales of Registered Rule 145 Securities

Consistent with the general language of Rule 145(c), as described above, a Holder of Registered Rule 145 Securities that resells publicly is within the definition of an "underwriter" if the Holder is a Rule 145 Affiliate.¹²⁴ The Commission, in its no-action letters, also has manifested its willingness to be bound by the negative implication of Rule 145(c) as it applies to the resale of Registered Rule 145 Securities. Thus, Holders of Registered Rule 145 Securities that are not Rule 145 Affiliates may resell freely, relying on their exclusion from the definition of "underwriter," which, in turn, preserves the availability of the Section 4(1) exemption for their resales.¹²⁵

Holders of registered Rule 145 Securities that are Rule 145 Affiliates and thus caught in Rule 145(c)'s definition of underwriter have several options to effect an exempt resale. Most obviously, Rule 145(d) is available for such resales. Also, such Holders may preserve their Section 4(1) exemption by reselling privately¹²⁶ (i.e., in a transaction that does not involve a "distribution")¹²⁷ or by reselling after a suitable holding period or change in circumstances, since, for the same reasons described in Part II.A, above, such resales would not cause a Holder who is a Rule 145 Affiliate to become

124. See 17 C.F.R. § 230.145(c) (1995) (stating that "affiliate" of "party to any [Rule 145 Transaction] who publicly offers or sells" Rule 145 Securities is considered to be involved in "distribution and therefore to be an underwriter").

125. See Securities Act Release No. 5316, *supra* note 1, at ¶ 79,015; Coastal Int'l, SEC No-Action Letter, 1980 WL 15023 (S.E.C.), at *3 (Dec. 24, 1980) ("[S]ecurities received in a Rule 145 transaction by persons who are neither affiliates of the acquired company nor of the acquiring company are registered securities without restriction on resale").

126. Authority for the permissibility of a private resale of Registered Rule 145 Securities can be found in the language of Rule 145(c), which defines Rule 145 Affiliates as "underwriters" only if they "publicly" resell the Registered Rule 145 Securities. More directly, no-action letters concede that resales of Registered Rule 145 Securities can be made privately. See Sidney Stahl, SEC No-Action Letter, 1981 WL 24892 (S.E.C.), at *2 (Mar. 23, 1981). For a more general discussion of the use of private resales as a technique for the seller to avoid inclusion in the underwriter definition and preserve his or her § 4(1) exemption, see *supra* notes 50-52 and accompanying text.

127. Although not defined in the 1933 Act, "distribution," as used in the § 2(11) definition of "underwriter" is considered to have the same meaning as "public offering" in § 4(2). See *supra* note 23 and accompanying text.

an underwriter, thereby, again, preserving the Section 4(1) exemption for the reselling Holder.

Significantly, the rules regarding the resale of Registered Rule 145 Securities differ from the rules regarding the resale of non-Rule 145 Registered Securities. For example, under today's rules, as described previously, a Holder of non-Rule 145 Registered Securities apparently is considered an "underwriter" by the Commission only if either the Holder's purchase of the Registered Securities was not in the ordinary course of the Holder's business or the Holder had some arrangement with the issuer to participate in the distribution of the securities.¹²⁸ On the other hand, a Holder of Registered Rule 145 Securities becomes an underwriter if it were a control person of the acquired or recapitalized company. Another difference in the two situations is that the special resale provisions of Rule 145(d) are unavailable to Holders of non-Rule 145 Registered Securities because Rule 145(d) is specifically limited to resales of Rule 145 Securities.¹²⁹

Finally, as will appear below, the rules regarding resales of Registered Rule 145 Securities differ from the rules regarding resales of Exempt Rule 145 Securities and Restricted Rule 145 Securities.

3. Resales of Rule 145 Securities Acquired in Transactions Exempt Under Sections 3(a)(9), Rule 147, and Regulation A

Holders of Exempt Rule 145 Securities (i.e., Rule 145 Securities originally issued under an exemption provided by Section 3(a)(9),¹³⁰ Rule 147,¹³¹ or Regulation A¹³²) are also subject to the definitions in Rule 145(c). As a result, a Holder that engages in a public resale of Exempt Rule 145 Securities is considered to be involved in a "distribution" and thus an

128. See *supra* note 68 and accompanying text.

129. The Rule specifically states that a Holder "shall not be deemed to be engaged in a distribution and therefore not to be an underwriter of registered securities *acquired in a transaction specified in paragraph (a) of [Rule 145]* if " 17 C.F.R. § 230.145(d) (1995) (emphasis added). In its no-action letters, however, the Commission has indicated that a Holder of registered non-Rule 145 Securities caught in the Commission underwriter criteria may resell pursuant to conditions that are the same as the conditions imposed by the first section of Rule 145(d). See *supra* note 70 and accompanying text.

130. 15 U.S.C. § 77c(a)(9) (1995). For an overview of § 3(a)(9) and a citation to works on the Section, see *supra* notes 87-93 and accompanying text.

131. 17 C.F.R. § 230.147 (1995). For a description of Rule 147, see *supra* notes 72-79 and accompanying text.

132. 17 C.F.R. § 230.251-.263 (1995). See *supra* notes 97-103 and accompanying text.

"underwriter," if the Holder is a Rule 145 Affiliate. In such a case, the Holder loses its Section 4(1) exemption for such resales.¹³³

The Commission, at least in most instances, also applies the negative implications of Rule 145(c) to resales of such Exempt Rule 145 Securities. Accordingly, public resales of Exempt Rule 145 Securities by Holders that are not Rule 145 Affiliates are not considered "distributions," and, as a result, such reselling Holders do not become "underwriters" and do not lose their Section 4(1) exemption.¹³⁴

133. With regard to resales of Exempt Rule 145 Securities acquired by a Holder under § 3(a)(9), § 3(a)(10), or Regulation A, see 1st United Bancorp, SEC No-Action Letter, 1995 WL 15077 (S.E.C.) (Jan. 13, 1995); National Security Ins. Co., SEC No-Action Letter, 1990 WL 286379 (S.E.C.) (Apr. 12, 1990); First NH Banks, Inc., SEC No-Action Letter, 1988 WL 234464 (S.E.C.) (June 27, 1988); First NH Banks, SEC No-Action Letter, 1987 WL 107497 (S.E.C.) (Dec. 24, 1986); Commerce America Corp., SEC No-Action Letter, 1985 WL 55695 (S.E.C.) (Nov. 15, 1985); Arizona Silver Corp., SEC No-Action Letter, 1985 WL 55565 (S.E.C.) (June 26, 1985); Metheus Dev Partners., Ltd., SEC No-Action Letter, 1985 WL 54034 (S.E.C.) (Feb. 27, 1985); Saver's Bancorp, SEC No-Action Letter, 1985 WL 52009 (S.E.C.) (Jan. 3, 1985); Merrill Lynch & Co., SEC No-Action Letter, 1977 WL 10873 (S.E.C.) (July 7, 1977).

With regard to resales of Rule 145 Securities acquired by a Holder in a Rule 147 transaction, see La Jolla Bancorp, SEC No-Action Letter, 1987 WL 108819 (S.E.C.) (Nov. 24, 1987); Hungry Tiger Inc., SEC No-Action Letter, 1982 WL 29446 (S.E.C.) (Aug. 12, 1982); United Virginia Bankshares, Inc., SEC No-Action Letter, 1978 WL 9785 (S.E.C.) (Feb. 13, 1978).

134. Regarding resales by a Holder of Rule 145 Securities acquired under § 3(a)(9), § 3(a)(10) or Regulation A, see Storage Equities, Inc., SEC No-Action Letter, 1983 WL 28393 (S.E.C.) (June 2, 1983) (§ 3(a)(9)); Fairway Land Co., SEC No-Action Letter, 1990 WL 286078 (S.E.C.) (Feb. 6, 1990) (§ 3(a)(10)); Commerce America Corp., SEC No-Action Letter, 1985 WL 55695 (S.E.C.) (Nov. 15, 1985) (§ 3(a)(9)); Federated Guar. Life Ins. Co., SEC No-Action Letter, 1988 WL 28162 (S.E.C.) (Mar. 21, 1983) (§ 3(a)(10)); Western Gulf Fin. Corp., SEC No-Action Letter, 1982 WL 29474 (S.E.C.) (July 26, 1982) (§ 3(a)(10)); North American General Corp., SEC No-Action Letter, 1982 WL 30018 (S.E.C.) (Dec. 9, 1981) (§ 3(a)(10)); Indian Head Banks, Inc., SEC No-Action Letter, 1979 WL 14023 (S.E.C.) (May 29, 1979) (noting that affiliates of acquired corporations may resell their Regulation A securities if they comply with Rule 145(d)); Orbanco, Inc., SEC No-Action Letter, 1975 WL 9537 (S.E.C.) (July 16, 1975) (Regulation A Securities received in Rule 145 transactions are freely tradeable by individuals not affiliates of acquired corporation).

The Commission stated in an interpretive release, however, that Rule 145(d) is available to Rule 145 affiliates for resales of Rule 145 Securities originally issued pursuant to Regulation A, § 3(a)(9), or § 3(a)(10). See Resale of Restricted & Other Securities, Securities Act Release No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H, at 2819-27 (Aug. 2, 1979) (indicating that securities purchased under any of those three exemptions are subject to resale rules of Rule 145); see also Physicians Clinical Laboratory, Inc., SEC No-Action Letter, 1992 WL 289096 (S.E.C.) (Oct. 13, 1992) (§ 3(a)(10)); National Security Ins. Co., SEC No-Action Letter, 1990 WL 286379 (S.E.C.) (Apr. 12, 1990) (§ 3(a)(10)); Amoco Canada Petroleum Co., SEC No-Action Letter, 1988 WL 234330 (S.E.C.) (Apr. 13, 1988)

Two notable exceptions to this broad application of the negative implication of Rule 145(c) exist, however. First, Holders of Intrastate Securities that are not Rule 145 Affiliates are nonetheless required to refrain from an interstate resale of their securities for at least nine months following the last offering by the issuer. Compliance with this restriction on resales is required by Rule 147(e) and thus, as a technical matter, is necessary to preserve the availability of the Rule 147 exemption *for the issuer*.¹³⁵ Accordingly, while the holding period requirement of Rule 147(e) has nothing whatsoever to do with the availability or non-availability *to the Holder* of the exemption for its resales provided by Section 4(1), the practical impact of section (e) is to limit the Holder to only intrastate resales during that nine month period.¹³⁶

The other exception to the broad applicability of the negative implication of Rule 145(c) is more complex and insidious. The Commission in a series of no-action letters developed its one percent rule, which it applies to limit the resales of certain Exempt Rule 145 Securities by Holders who are not Rule 145 Affiliates. Although the terms of the one percent rule are almost as vague¹³⁷ as they are unprincipled, the apparent impact of the rule is

(§ 3(a)(10)); Tamal Energy, Inc., SEC No-Action Letter, 1988 WL 233727 (S.E.C.) (Jan. 29, 1988) (§ 3(a)(10)); Provident Life & Accident Ins. Co., SEC No-Action Letter, 1987 WL 108063 (S.E.C.) (July 24, 1987) (§ 3(a)(10)); Rosenmon, Colin, Freund, Lewis & Cohen, SEC No-Action Letter, 1980 WL 15240 (S.E.C.) (Jan. 30, 1980); Pacwest Bancorp., SEC No-Action Letter, 1979 WL 14720 (S.E.C.) (Sept. 24, 1979) (§ 3(a)(9) and § 3(a)(10)); Orbanco, Inc., SEC No-Action Letter, 1975 WL 9538 (S.E.C.) (June 20, 1975) (no-action letter issued prior to Release No. 33-6099 which indicates Rule 145(d) may be available for Rule 145 Affiliates that originally took under Regulation A).

Regarding resales of Rule 145 Securities acquired by a Holder in a Rule 147 Transaction, see United Virginia Bankshares, SEC NO-Action Letter, 1978 WL 9785 (S.E.C.), at *1 (Feb. 13, 1978) (Commission left unchallenged statement in no-action request letter that "non-affiliates following the satisfaction of Rule 147(e) would be able to resell the securities acquired in the merger transaction without restriction"); BSD Bancorp., Inc., SEC No-Action Letter, 1982 WL 30450 (S.E.C.) (Apr. 9, 1982) (Rule 147 securities issued in 145 transaction to nonaffiliates may be freely resold after nine months).

135. See 17 C.F.R. § 230.147(e) (1995) (stating that availability of Rule 147 to issuer is predicated on fact that during nine month period following last Rule 147 sale by issuer, resales of Rule 147 Securities are made "only to persons resident within such state or territory"); see also *supra* notes 75-79 and accompanying text.

136. See Hungry Tiger, Inc., SEC No-Action Letter, 1982 WL 29446 (S.E.C.), at *2 (Aug. 27, 1982); United Virginia Bankshares, SEC No-Action Letter, 1978 WL 9785 (S.E.C.), at *1-*2 (Feb. 13, 1978).

137 For example, even the calculation method of the one percent is uncertain. Thus, it is uncertain whether the one percent threshold for the application of the rule is calculated as a percentage of the total outstanding shares, the total outstanding shares in the particular

to treat any Holder of certain Exempt Rule 145 Securities¹³⁸ as the equivalent of a Rule 145 Affiliate if the Holder acquired more than one percent of the issuer's outstanding securities in the exempt Rule 145 transaction (these Holders are hereinafter referred to as "One Percent Holders").¹³⁹ This

class, or the total shares issued in the Rule 145 offering. *Compare* Bank of Highland, SEC No-Action Letter, 1984 WL 45668 (S.E.C.), at *4 (Sept. 6 1984) (suggesting that one percent is calculated by reference to shares issued in Rule 145 transaction) and Mutual Trust Bank, SEC No-Action Letter, 1984 SEC No-Act. Lexis 2487, at *2 (Aug. 20, 1984) (same), with Hadson Petroleum Corp., SEC No-Action Letter, 1986 WL 65178 (S.E.C.), at *5 (Jan. 1986) (suggesting that one percent is not calculated by reference to shares in Rule 145 transaction) and Stampede Energy Corp., SEC No-Action Letter, 1982 WL 29990 (S.E.C.), at *6 (Dec. 4, 1981) (same) and Western Gulf Fin. Corp., SEC No-Action Letter, 1982 WL 29474 (S.E.C.), at *4 (July 26, 1982) (same) and Spencer R. Collins Charitable Trusts, SEC No-Action Letter, 1982 WL 29320 (S.E.C.), at *4 (June 4, 1982) (same).

138. Generally, the one percent rule has been used by the Commission in resales of Exempt Rule 145 Securities acquired by a Holder under § 3(a)(10). See Hadson Petroleum Corp., SEC No-Action Letter, 1986 WL 65178 (S.E.C.), at *5 (Jan. 8, 1986); Western Gulf Fin. Corp., SEC No-Action Letter, 1982 WL 29474 (S.E.C.), at *4 (July 26, 1982); Spencer R. Collins Charitable Trusts, SEC No-Action Letter, 1982 WL 29320 (S.E.C.), at *4 (June 4, 1982); Amoco Canada Petroleum Co., SEC No-Action Letter, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,704, at 78,003 (Apr. 13, 1988) (declining to decide whether one percent will make Holder an affiliate for purposes of resale).

For purposes of Rule 145, the Commission normally treats § 3(a)(9) and Regulation A similarly to § 3(a)(10). Therefore, I assume that the one percent rule would be applied to resales of Exempt Rule 145 Securities taken under those exemptions as well. See Campbell, *supra* note 122, at 324-31. Again, although the Commission has not addressed the applicability of the one percent rule in Rule 147 situations, the rule could be applied by the Commission in such cases. It seems highly unlikely that the Commission would apply the one percent rule in the case of Rule 145 Securities taken in either a § 4(2) private placement or a Regulation D offering, because those exemptions have well developed and quite onerous resale provisions. See *infra* notes 37-52 and accompanying text. This author's research revealed no instance of the Commission's applying the one percent rule to the resale of Registered Rule 145 Securities. Language from no-action letters seems to indicate that the Commission would not apply the one percent rule in such instances. See, e.g., Coastal Int'l, SEC No-Action Letter, 1980 WL 15023 (S.E.C.), at *3 (Dec. 24, 1980) (stating that "securities received in a Rule 145 transaction by persons who are neither affiliates of the acquired company nor of the acquiring company are registered securities without restriction on resale").

139 The most instructive no-action letters on the one percent rule include Hadson Petroleum Corp., SEC No-Action Letter, 1986 WL 65178 (S.E.C.) (Jan. 8, 1986); Pegasus Gold, Ltd., SEC No-Action Letter, 1984 WL 45555 (S.E.C.) (July 20, 1984); Western Gulf Fin. Corp., SEC No-Action Letter, 1982 WL 29474 (S.E.C.) (July 26, 1982); Spencer R. Collins Charitable Trusts, SEC No-Action Letter, 1982 WL 29320 (S.E.C.) (June 4, 1982); Bell Canada, SEC No-Action Letter, 1982 WL 29887 (S.E.C.) (July 2, 1982); HRS Indus., Ltd., SEC No-Action Letter, 1982 WL 29057 (S.E.C.) (Mar. 1, 1982); Stampede Energy Corp., SEC No-Action Letter, 1982 WL 29990 (S.E.C.) (Dec. 4, 1981); International Plasma

means, then, that any public resale by a One Percent Holder may cause the selling Holder, even though not a Rule 145 Affiliate, to become an underwriter¹⁴⁰ Obviously, this rule is inconsistent with the otherwise broad applicability of the negative implication of Rule 145(c), as described above.

Not surprisingly, the Commission in its no-action letters constructed an unprincipled exception to its unprincipled one percent rule. Specifically, the Commission concluded that the one percent rule is not applicable if the issuer in connection with its original issuance of the Exempt Rule 145 Securities made disclosures equivalent to those required of a reporting company under the 1934 Act and the issuer is subject to the periodic reporting requirements of the 1934 Act.¹⁴¹

Regarding Holders that are true Rule 145 Affiliates, the Commission takes the position that the resale provisions of Rule 145(d) are available for resales of Exempt Rule 145 Securities, even though the language of section (d) speaks only of "registered securities" sold under the terms of Rule 145(d).¹⁴² Additionally, Rule 145 Affiliates that are Holders of Exempt

Corp., SEC No-Action Letter, 1974 WL 10010 (S.E.C.) (July 31, 1974).

140. See Pegasus Gold, Ltd., SEC No-Action Letter, 1984 WL 45555 (S.E.C.), at *4-*7 (July 20, 1984); International Plasma Corp., SEC No-Action Letter, 1974 WL 10010 (S.E.C.), at *3 (July 31, 1974).

141. See Hadson Petroleum Corp., SEC No-Action Letter, 1986 WL 65178 (S.E.C.), at *4 (Jan. 1986); Pegasus Gold, Ltd., SEC No-Action Letter, 1984 WL 45555 (S.E.C.), at *4-*7 (July 20, 1984); Spencer R. Collins Charitable Trusts, SEC No-Action Letter, 1982 WL 29320 (S.E.C.), at *1-*2, *4 (June 4, 1982); Bell Canada, SEC No-Action Letter, 1982 WL 29887 (S.E.C.), at *4-*5 (July 2, 1982); HRS Indus., Ltd., SEC No-Action Letter, 1982 WL 29057 (S.E.C.), at *5-*7 (Mar. 1, 1982); Stampede Energy Corp., SEC No-Action Letter, 1982 WL 29990 (S.E.C.), at *5-*7 (Dec. 1981).

142. See First NH Banks, SEC No-Action Letter, 1987 WL 107497 (S.E.C.), at *3-*5 (Dec. 24, 1986) (supporting availability of Rule 145(d) resales of securities held by Rule 145 Affiliate that were originally acquired in transactions exempt under § 3(a)(10) and Regulation A); Hadson Petroleum Corp., SEC No-Action Letter, 1986 WL 65178 (S.E.C.), at *5 (Jan. 8, 1986); Methus Dev Partners, Ltd., SEC No-Action Letter, 1985 WL 54034 (S.E.C.), at *6 (Feb. 27, 1985); Saver's Bancorp, Inc. SEC No-Action Letter, 1985 WL 52010 (S.E.C.), at *4-*6 (Jan. 3, 1985); Old Stone Corp., SEC No-Action Letter, 1984 WL 45967 (S.E.C.), at *4 (Nov. 19, 1984); Western Gulf Fin. Corp., SEC No-Action Letter, 1982 WL 29474 (S.E.C.) (July 26, 1982); see also Resale of Restricted & Other Securities, Securities Act Release No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H, at 2819-27 (Aug. 2, 1979) (stating that Holder may rely on resale provisions of Rule 145(d) for sale of its Rule 145 securities originally acquired in transactions exempt under § 3(a)(9), § 3(a)(10), and Regulation A). It is interesting to note that in an earlier no-action letter, the Commission denied the availability of Rule 145(d) for resales by a Rule 145 Affiliate holding securities originally issued in a Rule 145 transaction exempt under Regulation A. See Orbanco, Inc. SEC No-Action Letter, 1975 WL 9537 (S.E.C.), at *4 (June 16, 1975). In subsequent no-action letters, the Commission indicated its changed position on the matter.

Rule 145 Securities should be able to execute private resales¹⁴³ and should be able to resell publicly after an appropriate holding period or a change in circumstances.¹⁴⁴ Meeting any of the foregoing requirements will, for the reasons discussed previously, cause the reselling Holder to fall outside the definition of "underwriter," thereby preserving its Section 4(1) exemption.¹⁴⁵

With regard to Exempt Rule 145 Securities held by a One Percent Holder, the Commission, through its no-action letters, indicates that such a Holder can resell only by meeting the requirements of sections (c), (e), (f) and (g) of Rule 144.¹⁴⁶ Notwithstanding such language of exclusivity, a One Percent Holder has other resale options. Because the theoretical effect of the one percent rule is to cause a One Percent Holder to become subject to inclusion in the status of "underwriter" and thus make Section 4(1) unavailable to such Holder, private resales and public resales after a suitable holding period or following a change in circumstances should certainly

See Indian Head Banks, SEC No-Action Letter, 1979 WL 14023 (S.E.C.), at *1-*3 (May 29, 1979).

With regard to resales of Rule 145 Securities acquired by a Holder in a Rule 147 transaction, see Hungry Tiger, Inc., SEC No-Action Letter, 1982 WL 29446 (S.E.C.) (Aug. 27, 1982); United Virginia Bankshares, SEC No-Action Letter, 1978 WL 9785 (S.E.C.) (Feb. 13, 1978); Resale of Restricted & Other Securities, Securities Act Release No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H, at 2819-27 (Aug. 2, 1979). The proper interpretation of this Commission pronouncement, however, is that the availability of the exemption for the issuer provided by Rule 147 is always dependent upon the Holder's meeting the nine month holding period requirement. This requirement is not supplanted by Rule 145(d). After the expiration of the nine month holding period of Rule 145(e), however, Rule 145 Affiliates holding Rule 145 Securities taken pursuant to Rule 147 should be able to rely on Rule 145(d) for resales.

143. *See* Beatrice Foods Co., SEC No-Action Letter, 1973 WL 20048 (S.E.C.), at *4 (Jan. 17, 1973); Sidney Stahl, SEC No-Action Letter, 1981 WL 24892 (S.E.C.), at *2 (Mar. 23, 1981) (stating that if persons wish "to privately resell the securities without compliance with the registration requirements of the 1933 Act, they may do so pursuant to any available exemption, including the one popularly known as the Section 4(1 1/2) exemption").

144. *See* Sidney Stahl, SEC No-Action Letter, 1981 WL 24892 (S.E.C.) (Mar. 23, 1981).

145. *See supra* notes 45-52 and accompanying text.

146. *See* Hadson Petroleum Corp., SEC No-Action Letter, 1986 WL 65178 (S.E.C.), at *3 (Jan. 8, 1986); Bank of Highland, SEC No-Action Letter, 1984 WL 47311 (S.E.C.), at *4 (Sept. 6, 1984); Mutual Trust Bank, SEC No-Action Letter, 1984 SEC No-Act LEXIS 2487, at *1 (Aug. 20, 1984); Pegasus Gold, Ltd., SEC No-Action Letter, 1984 WL 45555 (S.E.C.), at *4 (July 20, 1984); Western Gulf Fin. Corp., SEC No-Action Letter, 1982 WL 29474 (S.E.C.), at *3 (July 26, 1982); HRS Indus., Ltd., SEC No-Action Letter, 1982 WL 29057 (S.E.C.), at *7 (Mar. 1, 1982). These requirements, of course, are the requirements of Rule 145(d)(1). *See* 17 C.F.R. 230.145(d)(1)(1995).

be available for resales of Exempt Rule 145 Securities by One Percent Holders.

4. Resales of Restricted Rule 145 Securities

The rules regarding resales of Restricted Rule 145 Securities (i.e., Rule 145 Securities originally sold by issuers in transactions exempt under Section 4(2) or Regulation D) can be explained with brevity. Specifically, resales of Restricted Rule 145 Securities are subject to the same rules that govern resales of all restricted securities generally, which rules were described in Part II.A, above. Accordingly, neither the definition of underwriter in Rule 145(c) nor the special resale provisions of Rule 145(d) apply to the resales of Restricted Rule 145 Securities.¹⁴⁷

The reasoning behind the inapplicability of Rule 145(c) and (d) to resales of Restricted Rule 145 Securities is apparently founded on the need for consistency. Permitting Restricted Rule 145 Securities to be sold under Rule 145(c) and (d) would mean that Restricted Rule 145 Securities would be subject to significantly more generous resale provisions than the resale provisions available to non-Rule 145 Restricted Securities.¹⁴⁸ For example, if Holders of Restricted Rule 145 Securities were permitted to resell under the provisions of Rule 145(c) and (d), Holders that are not Rule 145 Affiliates could immediately make unlimited public resales of their Restricted Rule 145 Securities.¹⁴⁹ Even Holders that are Rule 145 Affiliates could make immediate public resales of their Restricted Rule 145 Securities, although such resales would be subject to the restrictions imposed by Rule 145(d)(1).¹⁵⁰ Holders of non-Rule 145 Restricted Securities, on the other hand, are subject to additional limitations on their resales, including, in many instances, a significant holding period.¹⁵¹

147. Direct authority for this proposition is thin. The Commission in a 1979 interpretative release did, however, refuse to allow Rule 145(d) to be used for the resale of Restricted Rule 145 Securities. *See* Resale of Restricted & Other Securities, Securities Act Release No. 33-6099, 1 Fed. Sec. L. Rep. (CCH) ¶ 2705H, at 2819-27 (Aug. 2, 1979) (refusing to allow Rule 145(d) to be used for resale of restricted Rule 145 Securities).

148. The interesting point, of course, is that the Commission seems unconcerned about such disparate treatment in other situations, such as the difference in resale treatment accorded intrastate securities acquired under Rule 145 as compared to the resale treatment accorded intrastate securities acquired outside Rule 145 Transactions.

149. The reason is that, under the negative implication of Rule 145(c), public resales by such Holders would not be considered a "distribution," the Holders would not be considered "underwriters," and the § 4(1) exemption for the resales would be preserved.

150. 17 C.F.R. § 230.145(d)(1) (1995).

151. *See supra* notes 48-49 and accompanying text.

5. Concluding Observations About Resales of Rule 145 Securities

Favorable comments about Rule 145's resale provisions are not impossible to make. First, the Commission initially proceeded publicly instead of proceeding in the dark and musty world of no-action letters.¹⁵² Second, the broad theoretical and mechanistic bases for the resale rules in Rule 145 are sound. Those resale rules operate properly within the definitional framework of the 1933 Act by defining particular conduct as falling within or without the concept of "distribution" and by defining particular Holders as within or without the concept of "underwriter." This approach appropriately protects the integrity of the 1933 Act. Finally, the resale provisions of Rule 145 represent an admirable, if less than successful, attempt to provide some clarity regarding resales by Holders.¹⁵³

The deficiencies of Rule 145's resale provisions substantially overwhelm the positive aspects of those provisions, however. First, the resale provisions of Rule 145 are inconsistent with other resale provisions. Neither sound

152. See Notice of Proposed Adoption of Rules 145 & 153A, Securities Act Release No. 5246, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,753 (May 2, 1972); Securities Act Release No. 5316, *supra* note 1, at ¶ 79,015.

153. Unfortunately, predicating the availability of the § 4(1) exemption on such a slippery concept as "control" of the acquired or recapitalized company is less than a satisfactory solution to the problems of ambiguity and uncertainty. "Control" is a broad and vague concept that may include anyone that either controls 10% or more of a company's voting stock, holds a significant management position with the company or has a significant business or family relationship with such owner or manager. See Rutheford B Campbell, Jr., *Defining Control in Secondary Distributions*, 18 B. C. IND. & COMM. L. REV. 37, 49 (1976) (indicating that availability of 4(1) exemption may be uncertain because such exemption is based upon "control," an ambiguous term). The following no-action letters, which deal with the question of whether persons associated with acquired companies constitute "affiliates" under Rule 145(c), generally support such an interpretation. See Galbo, Vincent A., SEC No-Action Letter, 1977 WL 11238 (S.E.C.), at *3 (Sept. 22, 1977) (stating that Division could not conclude that one who owned 3.8% of voting stock and was director and member of executive committee was not affiliate); Norton Simon, Inc. SEC No-Action Letter, 1976 WL 10567 (S.E.C.), at *5 (Oct. 8, 1976) (stating that Division could not conclude that one who owned 1.2% of company's stock and served as director, senior vice-president, and member of executive committee was not affiliate); Uniservice Corp., SEC No-Action Letter, 1976 WL 10565 (S.E.C.), at *1 (July 13, 1976) (stating that one who was director and owned stock, served as secretary to company and was member of law firm that was counsel to company "may be deemed to be an affiliate"); Great N. Nekoosa Corp., SEC No-Action Letter, 1976 WL 10561 (S.E.C.), at *2 (Apr. 20, 1976) (stating that person "may be deemed an affiliate" because she owned 10% and "her husband, children, and grandchildren and a trust created by her collectively owned approximately 30%"). *But see* South Carolina Nat'l Corp., SEC No-Action Letter, 1975 WL 9174 (S.E.C.), at *1 (Apr. 21, 1975) (stating that official policy of Commission is to not respond to no-action requests regarding existence of control).

policy nor the language of the 1933 Act support such differences. Second, the rules regarding the resale of Rule 145 Securities are needlessly complex.¹⁵⁴ Third, the resale rules of Rule 145 are gross and indirect. Essentially, what seems to concern the Commission here is the specter of a large quantity of securities being resold in a situation in which information about the company is not publicly available.¹⁵⁵ The theory seems to be that resales by persons that are, for example, Rule 145 Affiliates probably will involve a lot of securities and thus those persons should be denied the exemption of Section 4(1). The Commission, however, could and should deal with these concerns in a more precise and direct fashion. Finally, the Commission unfortunately retreated to no-action letters as a way to develop its resale rules. Predictably, the results have been unsatisfactory.¹⁵⁶

III. The Resales Solution

To begin with the obvious, the Commission is the appropriate institution to deal with the problems outlined above. Under the most basic of rationales for administrative solutions to problems, agencies, like the Commission, are often preferred over other institutions, such as courts or legislatures, because of the agency's expertise and the capability of the agency to fashion and monitor flexible remedies to complex problems.¹⁵⁷ Such a rationale for Commission action is applicable here.

Statutorily, the Commission is well equipped under the 1933 Act to deal with the problems of resales. Perhaps the most obvious statutory basis for dealing with the problems of resales is the Commission's power under Section 19(a) of the 1933 Act to define terms used in the 1933 Act.¹⁵⁸ Section 19(a) is the basis for many of the Commission's rules defining exempt transactions,¹⁵⁹ including transactions by Holders. The most apparent

154. See Campbell, *supra* note 122, at 317-36.

155. The fundamental tension here and elsewhere for the Commission when it deals with resales by Holders generally is, of course, the tension between the desire to facilitate active trading and the need for disclosure in connection with significant sales of securities. See LOSS, *supra* note 23, at 279-80.

156. See Campbell, *supra* note 122, at 338-43.

157. See 1 K.C. DAVIS, ADMINISTRATIVE LAW TREATISE § 1.05 (1958).

158. See 15 U.S.C. § 77s(a) (1995) (giving Commission power of "defining accounting, technical, and trade terms used in this title").

159. See Notice of Adoption of Rule 147, Securities Act Release No. 5450, [1973-1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,617 (Jan. 7, 1974); Securities Act Release No. 5316, *supra* note 1, Notice of Adoption of Regulation D, Securities Act Release No. 6389, [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,106 (Mar. 8, 1982).

example is Rule 144,¹⁶⁰ which defines certain sales by control persons and Holders of Restricted Securities as outside the definition of "distribution," thereby protecting the availability of Section 4(1) for such resales.

Section 3(b) of the 1933 Act, however, provides the Commission with even broader and less constrained authority to deal with the problems of resales. Essentially, that section permits the Commission to enact exemptions to the registration requirement if such exemptions are in the public interest and the offerings do not exceed \$5 million.¹⁶¹ As is the case with Section 19(a), the Commission has used Section 3(b) to provide registration exemptions for issuers¹⁶² and, to a lesser extent, for sales of securities by nonissuers.¹⁶³

The administrative latitude under Section 3(b) makes the section particularly attractive as a basis for Commission action on resales. Constrained in Section 3(b) only by the public interest and the amount criteria, the Commission could reexamine resales as a whole, free from what some may consider the unfortunate, limiting language of Section 2(11) and Section 4(1). By using Section 3(b) as a basis for constructing resale rules, the Commission could also step out from under the mess it has created through its uncharacteristic ineptness, as over the years it wrestled with resale problems involving securities taken in varying circumstances.

Whatever the basis for an administrative solution, any Commission action dealing with resales should be respectful of both the integrity of the 1933 Act and appropriate process. As the discussions in the first two sections of this paper indicate, the Commission in recent times has done poorly in these regards. For example, the examination proffered by Part II of this Article reveals a set of resale rules that vary according to the transactional authority for the issuer's original sale to the Holder. Thus, one finds that different rules apply to the Holder's resale depending on whether the Holder acquired its securities in a registered offering, a private placement, an

160. Notice of Adoption of Rule 144, Securities Act Release No. 5223, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,487 (Jan. 11, 1972).

161. More specifically, § 3(b) authorizes the Commission to enact rules that exempt securities from regulation if the Commission "finds that [registration] is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering [provided that the issue] offered to the public [does not exceed] \$5,000,000." 15 U.S.C. § 77c(b) (1994).

162. Regulation A, 17 C.F.R. §§ 230.251-.263 (1995), and Rules 504 and 505 of Regulation D, 17 C.F.R. §§ 230.504, 230.505 (1995), are examples.

163. Regulation A, 17 C.F.R. § 230.251(b) (1995), for example, permits resales by control persons.

intrastate offering, or an offering under Section 3(a)(9). These disparate rules are unsupportable by any rational interpretation of the 1933 Act. Instead, in all of those situations the clear language of the 1933 Act predicates the Holder's freedom to resell on the Holder's not being an "underwriter," a status that is entirely unrelated to the issuer's transactional authority for its original sale to the Holder.

Such lack of respect by the Commission for the integrity of the 1933 Act is unjustified, even if such disparate resale rules promote the overall policy of the 1933 Act. It is at this point that the Commission's lack of respect for the integrity of the 1933 Act blends into its lack of respect for process. Suppose, for example, that one is convinced that the Commission's present disparate treatment of resales of Registered Securities and resales of Restricted Securities is justified as a matter of policy. Operating under such an assumption, the Commission has legislatively approved ways to promote such policy and at the same time to respect both the integrity of the 1933 Act and sound procedures. Specifically, the Commission could act under Section 3(b) or Section 19(a) of the 1933 Act to formulate various and differing resale rules that promote the perceived policy of the 1933 Act. The Commission would, of course, have to act pursuant to its rulemaking authority, which would subject the Commission to the requirements of the Administrative Procedures Act.¹⁶⁴

The Commission, however, has chosen to proceed otherwise and in its course has flouted process and effectively established a series of resale rules that do significant damage to the integrity of the 1933 Act and are quite questionable as a matter of policy.

One may observe with interest that the Commission had a close call in the recent Cracker Barrel litigation. In the Cracker Barrel case,¹⁶⁵ the District Court for the Southern District of New York concluded that a particular no-action response amounted to rulemaking by the Commission and that, as a result, the Administrative Procedures Act required notice and comment on no-action letters.¹⁶⁶ On appeal, however, the Second

164. 5 U.S.C. §§ 551-612 (1994). Rulemaking by the Commission must comply with 5 U.S.C. § 553's requirements. This would involve notice of the proposed rulemaking, including a statement of the time, place, and nature of public rulemaking proceedings, reference to the legal authority under which the rule is proposed, and either the terms of the proposed rule or a description of the issues involved. After notice, interested persons must be given an opportunity to participate in the rulemaking.

165. *New York City Employee's Retirement Sys. v SEC*, 843 F. Supp. 858 (S.D.N.Y. 1994).

166. *See New York City Employees' Retirement Sys.*, 843 F. Supp. at 881 (concluding

Circuit disagreed and accordingly overruled the decision of the district court.¹⁶⁷

Whatever may be the outcome of the issues raised by the Cracker Barrel litigation and the legal limits of the Commission's power to proceed by no-action letters, the Commission should not be satisfied with regulatory work at the lowest legally acceptable level. Thus, even if it is not legally prohibited for the Commission to continue to develop its resale rules largely through an unprincipled patch work of rules promulgated in responses to no-action requests, the Commission should contain its urge to make significant law in that fashion. The process is poor and has given us a demonstrably poor set of rules.

Another goal of the Commission in connection with any reformation of the resale rules should be to establish a regime that is clear, predictable, and simple. Without these qualities, the deadweight costs of deals increase. Lawyers fees, accounting fees, consulting fees, and internal costs for the time of the issuer's staff all increase with uncertainty

Economists also remind us that uncertainty generates additional deadweight costs as risk adverse parties take less desirable and thus less efficient paths to their goals.¹⁶⁸ Assume, for example, that a desirable resale method for securities is judged by a Holder as carrying a thirty percent risk of illegality. A risk adverse Holder may choose an alternate method of resale because the present value of his or her risk of liability is an unacceptable cost. If the resale method most desired by the Holder is in fact legal, and

that certain SEC actions regarding Cracker Barrel Old Country Store, Inc. violated Administrative Procedure Act (APA)). In *New York City Employees' Retirement System*, the court considered whether a rule announced in the *Cracker Barrel* no-action letter "was in contravention of the notice and comment requirements of the APA." *Id.* at 872. The district court determined that the regulatory history of the rule, including the Agency's method and authority for rule-making, the rule's legal effect, and the Commission's reversal of its position, required a finding that the rule was legislative in nature. *Id.* at 881. Accordingly, the district court concluded that the promulgation of the rule should have followed the public notice and comment procedures contemplated by the APA. *Id.*

167 *New York City Employees' Retirement Sys. v SEC*, 45 F.3d 7, 14 (2d Cir. 1995).

168. Economists have made this argument most often in considering appropriate penalties for violations of society's rules. In that context the point is made that an increase in the harshness of penalties will cause risk adverse individuals to build a safety factor into their conduct to ensure against an unintended violation. Thus, citizens will forego unprohibited and thus assumedly beneficial conduct in order to eliminate the risk of an inadvertent violation of the rule that carries unusually harsh penalties. The loss of the beneficial conduct in such instances is properly considered by economists to be a loss in value to society generally. See POSNER, *supra* note 118, at 223-31.

thus we must assume considered to be beneficial conduct for citizens to undertake, economists argue, and rightly so, that the Holder's selecting the alternate, less desirable resale method generates an unnecessary cost to society

Finally, and clearly most importantly, any administrative solution to the problems of resales must be consistent with the broad policy foundations of the 1933 Act. My suggestion is that an analysis of the 1933 Act of the type undertaken by economic positivists¹⁶⁹ is helpful to point the way to a resale regime that promotes the policies of the 1933 Act.

The economic positivist would attempt to explain the 1933 Act in terms of economic efficiency. For the purposes of this discussion, economic efficiency is defined as a pattern of resource allocation in which resources are allocated to the person willing to pay most for the resource.¹⁷⁰ The "resource" in this case is the information about the issuer and the transaction (such information is hereinafter referred to as "stock information"). Thus, the economic positivist would explain the 1933 Act in terms of whether or not the act facilitates an efficient market in stock information. An efficient market in stock information is essential to trading in the underlying resource, the issuer's securities.¹⁷¹

The basic position of the neoclassical economist in all this is that the parties (the Holder and the purchaser from the Holder, for example) should be left unfettered to trade for as much stock information as the parties desire. Stock information is desirable to the parties because it reduces the risks associated with trading in the underlying commodity (i.e., the issuers' securities), but stock information is expensive to gather. In the view of the neoclassical economist, the parties should be free to bargain regarding this

169. Posner defines "the positive role of economic analysis of law [as] the attempt to explain legal rules and outcomes as they are rather than to change them to make them better." He goes on to state the typical conclusion of the economic positivists, which is that "especially but not only the great common law fields of property, torts, crimes, and contracts, bear the stamp of economic reasoning. The theory is that the common law is best (not perfectly) explained as a system for maximizing the wealth of society." POSNER, *supra* note 118, at 23.

170. See POSNER, *supra* note 118, at 11-15. For a discussion of other definitions of economic efficiency, see Jules L. Coleman, *Efficiency, Utility, & Wealth Maximization*, 8 HOFSTRA L. REV. 509, 512 (1980).

171. Predictably, much has been written by the proponents (and opponents) of the law and economics movement both on the mandated disclosure requirements of the 1933 Act, the 1934 Act, and generally on the securities laws. Two good collections of important readings on these matters are found in RICHARD A. POSNER & KENNETH E. SCOTT, *ECONOMICS OF CORPORATION LAW & SECURITIES REGULATION* 118-54, 315-81 (1980) and ROBERTA ROMANO, *FOUNDATIONS OF CORPORATE LAW* 301-28 (1992).

classic risk-return trade off. This freedom to trade is essential if the parties are to reach economic efficiency regarding stock information itself and ultimately the issuers' securities.¹⁷²

The regime of mandatory disclosures required by Section 5 of the 1933 Act limits the parties' discretion to bargain freely regarding the delivery of stock information and thus is inconsistent with economic efficiency. No longer are the parties free to fashion levels of disclosure that best suit their needs, but, instead, the government imposes mandatory terms regarding disclosure levels. The economic positivist often attempts to explain such governmental intrusions into free bargaining as responses to market failures. The imposition of mandatory terms on free bargaining can be explained as an attempt by society to reach an economically efficient result in situations in which the market, for whatever reason, is unable to function in a way that ensures the parties will be able to bargain efficiently or, perhaps, at all.

Applying this extremely general description of economic positivism to the 1933 Act is instructive. Generally, what one finds, perhaps somewhat surprisingly, is that the 1933 Act broadly utilizes a market solution regarding the matter of disclosure between buyers and sellers of stock. This becomes apparent when one considers that the 1933 act imposes mandatory disclosures in only a very small percentage of all securities transactions. In the vast majority of securities transactions, the exemptions from registration eliminate mandatory disclosure between buyers and sellers, and in such cases bargaining between the parties determines the terms of information disclosure.¹⁷³

Pursuing this line of analysis, then, the economic positivist may attempt to identify and explain in economic terms those situations in which Congress, through the 1933 Act, elected to replace free bargaining with a regime of mandatory disclosure. Essentially, Congress, at least as a general matter, imposed mandatory disclosure only if the following two conditions are *both* present: (1) The transaction generates a significant risk of a market failure with respect to stock information, either because bargaining between the parties to the transactions with respect to stock information appears difficult or because the purchaser otherwise appears disadvantaged or

172. See POSNER, *supra* note 118, at 9-15 (discussing trading and its importance to economic efficiency).

173. I would include here transactions "exempt" because of failure to meet the jurisdictional requirements of § 5. Generally, the mandatory disclosure requirements of § 5 are limited in applicability to offers and sales that "make use of any means or instruments of transportation or communication in interstate commerce or of the mails." 15 U.S.C. § 77e(1) (1994).

inefficient in obtaining stock information; and (2) The purchaser is not otherwise protected by a relatively efficient securities market that likely impounds substantially all material stock information in the price of the security. Stated alternatively, under the 1933 Act, Congress exempted from the mandatory disclosure requirements of Section 5 (and thus opted for a regime of free bargaining and market solutions) transactions in which either the market for stock information between the purchaser and seller at the time of the transaction is considered reasonably efficient or the purchaser generally is otherwise protected by a reasonably efficient market in the security that is the subject of the transaction.

Consider, for example, the intrastate exemption, which eliminates the requirement for mandatory disclosures in situations in which the issuer and the purchasers are all in the same state. In such cases, geographic proximity between the issuer and the purchaser may be considered sufficient to ensure that bargaining with regard to stock information is essentially unimpeded.¹⁷⁴ The private placement exemption can be explained similarly. If the purchaser under Section 4(2) is sophisticated and has access to all information about the issuer, definitionally the market for stock information is working and thus no need exists for imposing the mandatory disclosure requirements of the 1933 Act.¹⁷⁵

Explaining the economic basis for the exemption provided by Section 4(1) of the 1933 Act is a particularly interesting challenge. One may conclude, however, that in most face-to-face sales involving a seller that is not an issuer, underwriter, or dealer, bargaining between the purchaser and seller regarding stock information is relatively unimpeded. To make the economic case against mandated disclosure in those face-to-face situations even stronger, the purchaser of the securities may be at least as efficient in gathering stock information as the seller.

In non-face-to-face sales involving a seller that is not an issuer, underwriter, or dealer, however, the reliance on a market solution for levels of disclosure is impossible to explain in terms of ease of bargaining between the parties. On the other hand, the availability in such situations of the exemption from mandatory disclosure provided by Section 4(1) may be explained as based on the existence of a reasonably efficient securities market, which impounds in the price of the securities all material information. Although not all such non-face-to-face sales are made in reasonably efficient markets,

174. See Hicks, *supra* note 74, at 499 (explaining that geographic proximity to issuer is part of explanation for intrastate exemption for purchaser under § 3(a)(1)).

175. For a discussion of the requirements for the common-law exemption provided by § 4(2), see *supra* note 52 and accompanying text.

by volume most such sales certainly are made through such reasonably efficient markets, such as the New York Stock Exchange or the NASDAQ system.

This economic analysis, which is illuminating regarding the bedrock policies of the 1933 Act, leads to the conclusion that the case for extensive and rigorous mandatory disclosure obligations on a Holder is weak. In most instances, the purchaser from the Holder either is able to acquire stock information in a reasonably efficient manner (either by bargaining with the Holder or otherwise) or acquires its securities in or with access to a reasonably efficient securities market. The analysis, therefore, favors lenient resale provisions for Holders.

The inevitable possibility exists, however, that the issuer will utilize generous resale rules as a way of evading the mandatory disclosure requirements otherwise imposed on the issuer. Suppose, as an extreme example, all resales were unrestricted. The issuer could avoid registration by selling "privately" to five investment bankers, who could then resell the entire offering publicly without any disclosures whatsoever. Obviously, such a practice would eviscerate the 1933 Act. The Commission, rightfully so, will not allow that to happen.

Considering all the foregoing, my suggestion is that the Commission proceed under Section 3(b) to enact a clear, simple, and, to the extent possible, lenient and unified rule governing resales by a Holder. The rule should focus more on preventing the issuer from subverting the policy underlying its obligation of mandatory disclosures under the 1933 Act than on protecting the Holders' purchasers.

My specific proposal for consideration is a rule that exempts from registration resales by Holders that either acquire less than a particular amount of the issuer's offering (perhaps five percent) or that hold the securities (and are economically at risk for the securities) for a minimum of six months. I recommend this rule not necessarily as the ultimate definitive rule regarding resales but, instead, more as a framework or an example of a sensible approach to this difficult problem. It may be, for example, that the Commission would conclude that in light of the realities of economic pressures and exposure under the general antifraud provisions of the 1933 Act and the 1934 Act, the upper limit of the exception for resales of registered offerings could be ten percent. The Commission may also consider that the limits of the exemption should vary somewhat depending on particular facts, such as, for example, whether the issuer is a reporting company under the 1934 Act and the breadth of trading activity in the issuer's stock. However the Commission may resolve such details, the rule should be

simple, direct, easy to administer, and not subject over the years to redefinition through the no-action process. Instead, the Commission should monitor the new rule and make any significant adjustments through the normal administrative process.

IV Conclusion

The rules regarding resales of securities are essentially unprincipled and unnecessarily complex. The Commission must assume full responsibility for this unfortunate state of affairs.

One should dismiss the urge to be overly generous regarding this failure on the part of the Commission. Neither the conceptual and pragmatic difficulties involved in these problems nor the usual honorable and efficient work of the Commission excuses the Commission's failings. The Commission has at its disposal an effective array of administrative tools to deal with these problems. Instead of proceeding in a responsible manner, however, the Commission has elected to proceed through a series of disjointed and inefficient administrative actions, principally through no-action letters. The poor results could have been predicted.

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