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li. The 140 Series Rules

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“common enterprise,” the courts should require a pooling of funds as was emphasized in *Howey*.¹³⁹ Where a modified reading of the *Howey* test seems justified, as in the modification of the “solely” requirement to “no managerial efforts,” the modification should be read narrowly. New types of analysis such as the “risk capital” approach should not supplant the *Howey* test. Thus, when such analysis is beneficial, it must be incorporated into the *Howey* formula.¹⁴⁰ Such an approach should effectuate the policy of limiting the scope of the Acts while still providing flexibility in those circumstances warranting extended coverage.

Gary S. Marx

II. THE 140 SERIES RULES

Section 5 of the '33 Act prohibits the use of interstate commerce or the mails to conduct transactions in securities unless those securities are registered¹ with the SEC.² The Act also establishes classes of securities and types of transactions that are exempt from the registration requirement of section 5. Among the exemptions provided are exemptions for securities issued in an intrastate offering,³ for transactions which do not involve a public offering,⁴ and for transactions conducted by a person other than an

¹³⁹ See text accompanying notes 89-106.

¹⁴⁰ See text accompanying notes 119-36.

¹ Registration of securities under the '33 Act is accomplished by filing a form with the SEC that contains the information specified in Schedule A of the Act. Securities Act of 1933 §§ 6 & 7, 15 U.S.C. §§ 77f & g (1976). Schedule A generally requires information about the directors and management of the company issuing securities, the character and size of the company's business, and recent property acquisitions by the company which were not in the ordinary course of business, in conjunction with disclosure of the interests of directors and managers in such property acquisition. In addition, the registration statement must reveal the pendency or existence of any legal proceedings. The statement also must indicate what use will be made of the proceeds of the securities offering. Finally, Schedule A requires extensive financial disclosure. The registrant must submit a balance sheet which was prepared within 90 days of the filing, income and expense statements for the three years preceding the filing, a summary of the company's earnings for the preceding five years, and additional historical information, including a description of the company's capital structure, for a period of ten years preceding the filing. Additionally, these financial statements must be certified. See Securities Act of 1933 Schedule A, 15 U.S.C. § 77aa (1976).

² 15 U.S.C. § 77e (1976).

³ Securities Act of 1933 § 3(a)(11), 15 U.S.C. § 77c(a)(11) (1976); see text accompanying notes 196-211 *infra*.

⁴ Securities Act of 1933 § 4(2), 15 U.S.C. § 77d(2) (1976); see text accompanying notes 9-106 *infra*.

issuer,⁵ underwriter,⁶ or dealer⁷ of securities.⁸ In order to define the scope of these exemptions the SEC enacted the 140 series rules.

A. Rule 146

Section 4(2) of the '33 Act exempts securities offerings that are not public offerings from the registration requirement of section 5.⁹ Judicial interpretation of section 4(2), however, has not created any comprehensible and uniform standard for determining whether, in a particular case, the exemption is applicable.¹⁰ Therefore, the SEC enacted Rule 146, which prescribes the requirements an issuer must satisfy to qualify his offering as a non-public offering.¹¹ The Rule, however, expressly is non-exclusive, thereby allowing offerings that fall short of Rule 146's requirements to qualify as a non-public offering if such offering satisfies the requirements imposed by the prevailing judicial interpretation of section 4(2).¹² A recent Fifth Circuit case expresses the requirements currently necessary to estab-

⁵ "[E]very person who issues or proposes to issue any security" is an issuer under the 1933 Act. Securities Act of 1933 § 2(4), 15 U.S.C. § 77b(4) (1976).

⁶ An underwriter is "any person who has purchased from an issuer with a view to . . . the distribution of any security. . . ." Securities Act of 1933 § 2(11), 15 U.S.C. § 77b(11) (1976).

⁷ The 1933 Act defines a dealer as "any person who engages either for all or part of his time, directly or indirectly, as agent, broker, or principal, in the business of offering, buying, selling, or otherwise dealing or trading in securities issued by another person." Securities Act of 1933 § 2(12), 15 U.S.C. § 77b(12) (1976).

⁸ Securities Act of 1933 § 4(1), 15 U.S.C. § 77d(1) (1976); see text accompanying notes 107-95 *infra*.

⁹ 15 U.S.C. § 77d(2) (1976). See text accompanying notes 1 & 2 *supra*.

¹⁰ See generally text accompanying notes 14-90 *infra*.

¹¹ 17 C.F.R. § 230.146 (1977) [hereinafter cited as Rule 146]; see SEC Securities Act Release No. 33-5487, 1 FED. SEC. L. REP. (CCH) ¶ 2710 (Apr. 23, 1974).

¹² Rule 146, Preliminary Note 1, 17 C.F.R. § 230.146 (1977), indicates that although an issuer must satisfy all the requirements of Rule 146 to qualify the securities offering for exemption under the Rule, Rule 146 is non-exclusive, and transactions failing to meet the requirements of Rule 146 may still be exempted by § 4(2). The Rule was adopted to provide guidelines for issuers seeking a non-public offering exemption. These guidelines were necessary because judicial interpretation of § 4(2) failed to establish criteria that an issuer could follow with reasonable certainty that his securities offering would qualify as a non-public offering. See ABA, Committee on Federal Regulation of Securities, Section of Corporation, Banking and Business Law, Position Paper, *Section 4(2) and Statutory Law*, 31 BUS. LAW. 485, 488-89 (1975) [hereinafter cited as Position Paper]. However, the Rule was not intended to constitute a restatement of judicial interpretation under § 4(2). See SEC Securities Act Release No. 5913, [1978-1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,532 at 80,172 (March 6, 1978). Portions of the Rule are more restrictive than the judicially imposed requirements of § 4(2), while certain provisions of the Rule are less restrictive than the requirements of § 4(2). *Id.*; see text accompanying notes 73-106 *infra*. Therefore, Rule 146 purposely was made non-exclusive. See [1978-1979 Transfer Binder] FED. SEC. L. REP. (CCH) at 80,172; Position Paper, *supra*, at 489. Although several state blue sky authorities have enacted rules that appear to condition the granting of a non-public offering exemption on the fulfillment of all of the Rule 146 requirements, the ABA has asserted that the authorities' actions are inappropriate and "overlook the sound policy reasons" for making Rule 146 non-exclusive. Position Paper, *supra*, at 490.

lish a non-public offering under section 4(2).¹³

In *Doran v. Petroleum Management Corp.*,¹⁴ the plaintiff had an opportunity to become a "special participant" in a partnership engaged in drilling activities.¹⁵ An offer to invest in the partnership also was extended to seven other individuals.¹⁶ The defendant provided Doran with drilling logs and technical maps of the drilling area and informed Doran that two of four wells already were completed.¹⁷ Doran agreed to become a special participant and was granted a partnership share in consideration for the payment of \$25,000 and the assumption of a note payable to a supply company.¹⁸ Initially, Doran received favorable production reports on the wells in operation, but these favorable reports were the product of the defendant's deliberate overproduction of the wells.¹⁹ Upon discovery of this overproduction, the Wyoming Oil and Gas Conservation Commission found that the defendant had violated production quotas and ordered the wells sealed.²⁰ When defendant resumed production and complied with production quotas the yields were necessarily smaller. Shortly after the resumption of operations, the note to the supply company became due and the defendant and Doran, as cosigner of the note, defaulted. The supplier sued on the note and recovered against Doran and defendant.²¹ Doran then instituted suit against the defendant for rescission of the participation contract alleging defendant's violation of section 5 of the '33 Act.²² The defen-

¹³ *Doran v. Petroleum Management Corp.*, 545 F.2d 893 (5th Cir. 1977). The Fifth Circuit is the circuit wherein the majority of important § 4(2) cases have been decided. *See, e.g.*, *Woolf v. S.D. Cohn & Co.*, 515 F.2d 591 (5th Cir. 1975), *vacated on other grounds*, 426 U.S. 944 (1976); *SEC v. Continental Tobacco Co.*, 463 F.2d 137 (5th Cir. 1972); *Henderson v. Hayden, Stone Inc.*, 461 F.2d 1069 (5th Cir. 1972); *Hill York Corp. v. American Int'l Franchises, Inc.*, 448 F.2d 680 (5th Cir. 1971).

¹⁴ 545 F.2d 893 (5th Cir. 1977).

¹⁵ *Id.* at 897. As a "special participant" in defendant's drilling scheme, an investor's financial contribution was used to pay tangible drilling expenses. The contributions of "participants" were used to pay intangible drilling expenses. *Id.* The importance of the distinction between special participant and participant is that the participant can take advantage of the tax deductions allowed for intangible drilling expenses. *See id.* at 897-98 n.2; I.R.C. § 263(c).

¹⁶ 545 F.2d at 898, 901. The record indicates that of the eight people offered the investment opportunity, four became "participants," Doran became a "special participant," and three investors declined the opportunity. *Id.* at 898.

¹⁷ *Id.* The record indicates that Doran was familiar with the oil and gas industries. He held a degree in petroleum engineering and his interests in 26 oil and gas ventures were worth approximately \$850,000. *Id.* at 902. Therefore, the technical data that the defendant gave Doran would be useful to him in making his investment decision.

¹⁸ *Id.* at 898. Doran cosigned a note, along with officers of the defendant corporation, for \$113,643 payable to a supply company. Doran also executed an agreement to hold the defendant and its officers harmless for any liability arising from the note. When this initial note came due, the parties were able to renegotiate the debt owing to the supply company and a second note was executed. *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

²² *Id.* Doran also claimed that overproduction of the wells constituted a breach of contract. *Id.* In rejecting his claim for damages resulting from the breach, the Fifth Circuit found

dant contended that its offer and sale of the special participant interest to Doran was a private placement²³ under section 4(2) and thereby exempt from section 5.²⁴ The district court agreed, relying on the fact that Doran was a "sophisticated investor who did not need the protection of the Securities Acts."²⁵ The Fifth Circuit, noting that investor sophistication alone is not sufficient to establish a section 4(2) exemption,²⁶ reversed and remanded the district court's ruling concerning section 4(2) for a determination whether Doran had been supplied sufficient information about the defendant and the drilling venture to make an informed investment decision.²⁷

The Fifth Circuit noted four factors which are relevant in determining the availability of a section 4(2) exemption.²⁸ An offering with a small number of securities involved is characteristic of a private placement. Additionally, the financial size of a private placement should be modest.²⁹ The manner of conducting the offering of securities to investors also is

that although deliberate overproduction of the wells constituted a breach of the partnership agreement between Doran and defendant, Doran was not damaged by the breach. In fact, the overproduction of the wells coupled with the reduced yields following resumption of operations, *see* text accompanying note 20 *supra*, produced greater yields than if the wells had produced continuously at the prescribed quota. 545 F.2d at 908-09.

In order for the 1933 Act even to be applicable, securities must be involved. Securities Act of 1933 § 2(1), 15 U.S.C. § 77b(1) (1976) considers ". . . fractional undivided interests in oil, gas, or other mineral rights . . ." to be securities for the purposes of the Act. Therefore, the Fifth Circuit considered the interest acquired by Doran in the drilling partnership to be a security. 545 F.2d at 899 n.4; *see* *Nor-Tex Agencies, Inc. v. Jones*, 482 F.2d 1093, 1098 (5th Cir. 1973), *cert. denied*, 415 U.S. 977 (1974). Because the defendant failed to register the securities in compliance with § 5, *see* text accompanying notes 1 & 2 *supra*, Doran brought suit under § 12(1) of the '33 Act. Securities Act of 1933 § 12(1), 15 U.S.C. § 77(l) (1976) enables a purchaser of securities to recover the consideration paid for those securities from the issuer if the issuer fails to register those securities in compliance with § 5 of the '33 Act.

²³ The term "private placement" is used interchangeably with "non-public offering."

²⁴ 545 F.2d at 899.

²⁵ *Id.* at 898-99. In *SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953), the defendant contended that its sale of unregistered securities to a diverse group of employees came within the § 4(2) exemption, since the sale was intra-company and therefore, not public. The Supreme Court refused the exemption, noting that "the applicability of [§ 4(2)] should turn on whether the particular class of persons affected needs the protection of the Act." *Id.* at 125. Under the Court's test, private placement investors must be able "to fend for themselves," *id.*, and must be distinguishable from the general investing public. *Id.* at 125-26; *see* Patton, *The Private Offering: A Simplified Analysis of the Initial Placement*, 27 *Bus. Law.* 1089, 1090 (1972). Because of Doran's background and investment experience, *see* note 17 *supra*, the district court considered him to be a "sophisticated investor." 545 F.2d at 898-99; *see* *Garfield v. Strain*, 320 F.2d 116, 119 (10th Cir. 1963) (prior investment experience is key to investor sophistication).

²⁶ 545 F.2d at 902; *see* note 33 *infra*.

²⁷ 545 F.2d at 909.

²⁸ *Id.* at 899-900. Although the *Doran* court considered four factors in determining whether the § 4(2) exemption was available, the court noted that the factors are only guidelines to aid a court in determining whether, in a particular situation, registration of securities is necessary for the protection of investors. *Id.* at 900.

²⁹ *Id.*; *see* *Hill York Corp. v. American Int'l Franchises, Inc.*, 448 F.2d 680, 687-89 (5th Cir. 1971).

important. A private placement usually involves a personal contact between the issuer and offerees.³⁰ Finally, the most critical factor in establishing a private placement is "the number of offerees and their relationship to each other and the issuer. . . ."³¹ Although an offering to a large or small group of investors can qualify as a non-public offering, a larger group of investors increases the likelihood that the offering is public.³² Furthermore, since the issuer has the burden of demonstrating that each offeree is a sophisticated investor,³³ a larger number of offerees will increase this burden and the probability that one of the offerees is not "sophisticated." Failure to prove that all of the offerees are sophisticated investors may preclude the existence of a private placement.³⁴

The *Doran* court found that Doran and each of the other seven offerees³⁵ were sophisticated investors.³⁶ The court also concluded that the small

³⁰ Hill York Corp. v. American Int'l Franchises, Inc., 448 F.2d 680, 687-89 (5th Cir. 1971); see 545 F.2d at 900. An issuer claiming a § 4(2) exemption cannot use public advertising or public intermediaries (investment banks or the stock exchange) to offer unregistered securities for sale. See 545 F.2d at 900; Rule 146(c) (forbidding any form of general advertising or general solicitation).

³¹ 545 F.2d at 900; see Hill York Corp. v. American Int'l Franchises, Inc., 448 F.2d 680, 687-89 (5th Cir. 1971).

³² 545 F.2d at 901; see SEC v. Ralston Purina Co., 346 U.S. 119, 125 (1953); Hill York Corp. v. American Int'l Franchises, Inc., 448 F.2d 680, 688 (5th Cir. 1971).

³³ 545 F.2d at 900-02. The issuer must prove that all purchasers and offerees of a particular offering are investors who can "fend for themselves." See note 25 *supra*.

³⁴ 545 F.2d at 902, 902 n.10. Even if an issuer can prove that each offeree is a sophisticated investor, courts are reluctant to find a § 4(2) exemption on the basis of investor sophistication alone. Instead, courts require that a sophisticated investor must be provided with or have access to information that a registration statement filed by the issuer would reveal. See *id.* at 902-03; Hill York Corp. v. American Int'l Franchises, Inc., 448 F.2d 680, 690 (5th Cir. 1971); United States v. Custer Channel Wing Corp., 376 F.2d 675, 678 (4th Cir.), *cert. denied*, 389 U.S. 850 (1967); see also text accompanying notes 40-65 *infra*. In *Doran*, the Fifth Circuit suggested that there might be situations where the court would find the § 4(2) exemption applicable despite the absence of investor sophistication. 545 F.2d at 902 n.10. The court noted that Rule 146 requires investors to be sophisticated and to receive or have access to the information necessary to make an informed investment decision. See note 77 *infra*. However, the court emphasized that the requirements necessary to establish a § 4(2) exemption are less restrictive than the Rule's requirements. 545 F.2d at 902 n.10; see *Woolf v. S. D. Cohn & Co.*, 515 F.2d 591, 611-12 (5th Cir. 1975), *vacated on other grounds*, 426 U.S. 944 (1976). Therefore, the *Doran* court implied that if the requisite information to make an informed investment decision was available, a securities offering could qualify for the § 4(2) exemption despite the fact that all offerees were not sophisticated investors. 545 F.2d at 902 n.10.

³⁵ See text accompanying note 16 *supra*.

³⁶ 545 F.2d at 902. Although two kinds of investment shares were involved, special participant and participant, the *Doran* court rejected the defendant's contention that because Doran was the only investor offered a special participant's share, the defendant only had to prove Doran's investor sophistication. *Id.* at 901-02. For the purpose of determining whether the securities offering was a non-public offering the *Doran* court refused to distinguish between a special participant's share and a participant's share. Since these shares were offered as part of a single investment scheme, offered at approximately the same time for similar consideration, and offered for the same purpose, i.e. drilling wells, the court required the

number of securities, modest financial size, and personalized manner of conducting the offering would aid the court in classifying defendant's offering as a private placement.³⁷ However, the district court's failure to consider the relationship of the offerees to each other and to the issuer³⁸ did preclude a finding of a private placement.³⁹ The importance of considering the relationship between offerees and the issuer results from the necessity that offerees have information which enables them to make an informed investment decision.

Sophisticated investors, lacking information about an issuer and his proposed business venture, can not evaluate properly the merits of investing in that venture.⁴⁰ Therefore, although a private placement is exempt from section 5 of the '33 Act,⁴¹ an issuer attempting to qualify a securities offering as a private placement is required to provide offerees with information or access to information which normally would be included in a registration statement.⁴² Providing each offeree with a document disclosing all relevant information enables an issuer to comply with the preceding requirement, but disclosure to each offeree may be expensive. As an alternative to disclosure, issuers can give offerees access to the relevant information. In order for this access to satisfy the preceding "information" requirement, each offeree who is provided access must be in a position to take advantage of his access.⁴³ Thus, courts require an issuer to show that each offeree who is provided access has an employment relationship with the issuer,⁴⁴ a family relationship with an employee of the issuer,⁴⁵ or sufficient economic bargaining power to obtain the needed information from the issuer.⁴⁶ Since the district court failed to consider whether each offeree had

defendant to prove that all the offerees of the drilling scheme were sophisticated investors. *Id.* at 901 n.9, 901-02.

³⁷ *Id.* at 900.

³⁸ See text accompanying note 31 *supra*.

³⁹ 545 F.2d at 903-04.

⁴⁰ *Id.* at 902-03.

⁴¹ See text accompanying note 9 *supra*.

⁴² See, e.g., *SEC v. Ralston Purina Co.*, 346 U.S. 119, 125 (1953); *Doran v. Petroleum Management Corp.*, 545 F.2d 893, 903 (5th Cir. 1977); *SEC v. Tax Serv., Inc.*, 357 F.2d 143, 144 (4th Cir. 1966); *Gilligan, Will & Co. v. SEC*, 267 F.2d 461, 466 (2d Cir.), *cert. denied*, 361 U.S. 896 (1959). See note 1 *supra* (information included in registration statement).

⁴³ *Doran v. Petroleum Management Corp.*, 545 F.2d 893, 904-05 (5th Cir. 1977).

⁴⁴ *Id.* at 903; see *Hill York Corp. v. American Int'l Franchises, Inc.*, 448 F.2d 680, 688 (5th Cir. 1971). In *Ralston Purina*, the Supreme Court noted that an offering of securities to a company's employees would qualify as a private placement if the offerees were key employees who because of their position have access to the requisite information. 346 U.S. at 125-26. In denying a private placement exemption in that case, the Court found that the class of employees who were offered securities was not composed of executives whose position in the company would afford them with access to the needed information. *Id.*

⁴⁵ *Doran v. Petroleum Management Corp.*, 545 F.2d 893, 903 (5th Cir. 1977); see note 44 *supra*.

⁴⁶ *Doran v. Petroleum Management Corp.*, 545 F.2d 893, 903 (5th Cir. 1977). An offeree who is not provided with the needed information and does not have a relationship with the company, see text accompanying notes 44 & 45 *supra*, must have sufficient economic bargaining power to "compel" an issuer to provide access to "appropriate files and records" and to

been provided the information that a registration statement would disclose or given access to such information, the Fifth Circuit reversed and remanded *Doran* to the district court for a determination of that issue.⁴⁷

Doran is one of a series of cases in which courts have considered the "disclosure or access" requirement. In *SEC v. Ralston Purina Co.*,⁴⁸ the seminal case regarding the section 4(2) non-public offering exemption, the Supreme Court noted that a sophisticated investor's ability to make an informed investment decision depends on his *access* to information that a registration statement would reveal.⁴⁹ The Court's holding, however, stated that the availability of the section 4(2) exemption "turns on the knowledge of the offerees."⁵⁰ Although the circuit courts generally have interpreted *Ralston Purina* disjunctively as requiring disclosure or access,⁵¹ the Fifth Circuit, in *SEC v. Continental Tobacco Co.*,⁵² appeared to adopt a requirement that both disclosure and access must be shown to establish a section 4(2) exemption. In *Continental*, the issuer complied with many of the requirements necessary to qualify the securities offering as a non-public offering.⁵³ Indeed, some of the offerees received a disclosure document from Continental.⁵⁴ Nevertheless, the court rejected the issuer's claim that the securities offering involved qualified as a non-public offering. The court stated that:

Continental did not affirmatively prove that all offerees of its securities had received both written and oral information concerning

require an issuer to answer questions concerning material information. 545 F.2d at 904. The necessity of having an employment or family relationship, or favorable bargaining power is recognized by Rule 146(e). Rule 146(e) notes that effective access to the information needed to make an informed investment decision depends on an offeree's position with respect to the issuer.

⁴⁷ 545 F.2d at 903-04.

⁴⁸ 346 U.S. 119 (1953).

⁴⁹ *Id.* at 127.

⁵⁰ *Id.* at 126.

⁵¹ See *Doran v. Petroleum Management Corp.*, 545 F.2d 893, 903-04 (5th Cir. 1977); *SEC v. Tax Serv., Inc.*, 357 F.2d 143, 144 (4th Cir. 1966); *Gilligan, Will & Co. v. SEC*, 267 F.2d 461, 466 (2d Cir. 1959). Compare *Lively v. Hirschfeld*, 440 F.2d 631, 633 (10th Cir. 1971) and *United States v. Custer Channel Wing Corp.*, 376 F.2d 675, 679 (4th Cir.), *cert. denied*, 389 U.S. 850 (1967), wherein those courts recognized access as a necessary requirement for establishing a private placement, but ignored actual disclosure as an alternate means of furnishing investors with needed information.

⁵² 463 F.2d 137 (5th Cir. 1972).

⁵³ The facts in *Continental* indicate that almost all of the investors had signed an instrument noting that they had received information from the company. In addition, the testimony of those *purchasers* who were called as witnesses indicated that they received information, had access to further information, and had personal contacts with the officers of the company. Those purchasers were sophisticated investors and knew the risks inherent in holding restricted stock. *Id.* at 157; see generally text accompanying notes 107-95 *infra* (restrictions on the sale of unregistered securities). Furthermore, the issuer was able to demonstrate that the stock had not been purchased with the intent to resell and the stock, in fact, had not been resold. 463 F.2d at 157; see note 73 *infra* (requirement of non-distributive intent).

⁵⁴ 463 F.2d at 157.

Continental, that all offerees of its securities had access to any additional information which they might have required or requested, and that all offerees of its securities had personal contacts with the officers of Continental.⁵⁵

Focusing on this language, commentators suggested that *Continental* abrogated the distinction between disclosure or access and, instead, required an issuer seeking a section 4(2) exemption to prove that all offerees have "insider" status.⁵⁶ Thus, even where the issuer provided each offeree with a comprehensive disclosure document, the section 4(2) exemption would not be available to the issuer unless all offerees had "insider" status. This insider requirement subsequently was rejected in *Woolf v. S.D. Cohn & Co.*⁵⁷ and *Doran*, wherein the Fifth Circuit suggested that *Continental* had been interpreted improperly.⁵⁸ As noted in *Doran*, since Continental's disclosure statement, which failed to reveal all of the information that a registration statement would reveal,⁵⁹ was distributed only to some offerees,⁶⁰ Continental could not satisfy the disclosure requirement.⁶¹ Therefore, it was incumbent on Continental to prove that all offerees had access to the requisite information and a relationship with Continental that would allow the offerees to take advantage of their access.⁶² Because Continental failed to prove access,⁶³ the non-public offering exemption was unavailable. Given the preceding analysis, *Doran* and *Woolf* asserted that the *Continental* court's language⁶⁴ only requires proof of the insider status of offerees when the issuer provides access to the information that a registration statement would reveal.⁶⁵

⁵⁵ *Id.* at 160. In seeking to qualify a securities offering as a private placement, issuers must prove that the criteria of § 4(2) are met, not only by purchasers, but by all offerees. *Id.*; see *Lively v. Hirschfeld*, 440 F.2d 631, 633 (10th Cir. 1971).

⁵⁶ See 2 S. GOLDBERG, PRIVATE PLACEMENTS AND RESTRICTED SECURITIES § 2.16[e] (rev. 1978); Schwartz, *The Private Offering Exemption—Recent Developments*, 37 OHIO ST. L.J. 1, 19 (1976) [hereinafter cited as Schwartz].

⁵⁷ 515 F.2d 591, 610, 612-13 (5th Cir. 1975), *vacated on other grounds*, 426 U.S. 944 (1976).

⁵⁸ 545 F.2d at 907-08; 515 F.2d at 610, 612-13.

⁵⁹ 545 F.2d at 907; see text accompanying note 42 *supra*.

⁶⁰ See text accompanying notes 53 & 54 *supra*.

⁶¹ See text accompanying note 55 *supra*.

⁶² See text accompanying notes 42 & 43 *supra*.

⁶³ See text accompanying note 55 *supra*.

⁶⁴ *Id.*

⁶⁵ 545 F.2d at 907-08; 515 F.2d at 610-13. Although the language in *Continental* is subject to differing interpretations, the language of the district court for the Southern District of New York clearly seems to adopt an "insider" requirement. In *SEC v. Universal Major Indus. Corp.*, [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,229 (S.D.N.Y. July 14, 1975), *aff'd*, 546 F.2d 1044 (2d Cir. 1976), the court stated that:

mere disclosure of the same information as would be disclosed in a registration statement to all persons offered unregistered stock would not, in the absence of showing that the offerees had the requisite relationship with the issuer and the ability to fend for themselves, suffice to form the basis for an exemption under [section 4(2)]. . . .

Id. at 98,211 (emphasis in original).

Recently the SEC scrutinized *Woolf* and *Doran*. While Rule 146 was enacted to establish guidelines for issuers seeking to qualify an offering as a non-public offering, the Rule is expressly non-exclusive,⁶⁶ thereby allowing an offering to be non-public if the requirements of section 4(2) are met.⁶⁷ In a recent SEC Release, the SEC criticized dicta in the *Woolf* and *Doran* opinions which tend to ignore the distinction between Rule 146 and

The Fourth Circuit recently considered a case involving the necessity for investors to have access to the type of information which a registration statement would reveal. In *Lawler v. Gilliam*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,277 (4th Cir. Jan. 9, 1978), Mower's trustee in bankruptcy, Lawler, brought suit against defendants alleging that defendants violated § 5 of the '33 Act by selling unregistered securities. See text accompanying notes 1 & 2 *supra*. Defendants Cocke and Gilliam participated with Johnson in a fraudulent "pyramid scheme." Under the pretense of operating a wine importation business, Johnson and defendants sold investment notes to a small group of investors and guaranteed a high rate of return on those notes. Additional notes were then issued to a larger group of investors and the proceeds of that sale were used to pay off the initial investors. At each level of the scheme a larger group of investors was included to pay off the investors at prior levels. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) at 92,788. Mower was solicited by defendants to invest in the scheme and he did so, investing his own funds and money obtained from other people. When Johnson's fraud was discovered, Mower brought suit against defendants under § 12(1) of the '33 Act which imposes liability on any person who offers or sells unregistered securities in violation of § 5. See note 22 *supra*. Mower never recovered any of the money which he invested and was adjudged a bankrupt in a separate proceeding. Lawler, as trustee for Mower, was substituted as plaintiff in the suit against Cocke and Gilliam. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) at 92,789. After determining that the investment notes were securities as defined by § 2(1) of the '33 Act, the district court held that the sale of the notes qualified as a non-public offering under § 4(2) and registration of the securities was not required. *Id.* at 92,790; see text accompanying note 9 *supra*. The district court found that Mower was a sophisticated investor who had the ability to ascertain the validity of the investment scheme. Furthermore, because Mower could have discovered the fraud through a reasonable investigation of Johnson's scheme, defendants were not withholding any information which was unavailable to Mower. The district court also considered Mower's investment transactions as isolated transactions apart from Johnson's transactions with other investors. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) at 92,790. Therefore, in order to substantiate a finding that § 4(2) was applicable, it was not necessary to prove that all of the offerees in Johnson's scheme were sophisticated investors. See text accompanying note 33 *supra*.

The Fourth Circuit found § 4(2) inapplicable because Mower was not provided with or given access to information which a registration statement would contain. Relying on *SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953); *Doran v. Petroleum Management Corp.*, 545 F.2d 893 (5th Cir. 1977); and *United States v. Custer Channel Wing Corp.*, 376 F.2d 675 (4th Cir. 1967), the Fourth Circuit stated that an offeree's sophistication was not a substitute for the offeree's possession of or access to the information which a registration statement would contain. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) at 92,791. Defendants also attempted to substantiate their § 4(2) claim by arguing that Johnson, if required to file, would have filed a fraudulent registration statement and Mower's receipt of the information normally disclosed by a registration statement would be worthless. The court, rejecting defendants' assertions, responded that "[e]xempting an issuer of fraudulent securities from registration because he probably would provide false data places a premium on fraud and defeats the purposes of the Act." *Id.* Thus, Mower was entitled to damages under § 12(1) of the '33 Act. *Id.* at 92,788; see note 22 *supra*.

⁶⁶ Rule 146, Preliminary Note 1, 17 C.F.R. § 230.146 (1977).

⁶⁷ See note 12 *supra*.

section 4(2).⁶⁸ Although the *Woolf* court recognized the non-exclusive nature of Rule 146, the court acknowledged that the Rule provides a "useful frame of reference . . . in assessing the validity of [section] 4(2) exemptions. . . ." ⁶⁹The *Doran* court characterized Rule 146 as a "serotine development" and noted that issuers seeking a private placement exemption probably will not "stray far from" the requirements of the Rule.⁷⁰ In response to the "creeping exclusivity" of Rule 146,⁷¹ as suggested by *Woolf* and *Doran*, the SEC reasserted the Rule's non-exclusivity.⁷² The importance of this non-exclusivity evolves from the stringency of Rule 146's requirements as compared with the requirements of section 4(2).

The factors used in determining whether a section 4(2) exemption is available⁷³ are guidelines rather than strict requirements which must be satisfied to qualify for the exemption.⁷⁴ Conversely, each requirement of

⁶⁸ SEC Securities Act Release No. 5913, [1978-1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,532 (March 6, 1978).

⁶⁹ 515 F.2d at 612; see *Casey*, *SEC Rules 144 and 146 Revisited*, 43 BROOKLYN L. REV. 571, 590-91 n.51 (1977) [hereinafter cited as *Casey*].

⁷⁰ 545 F.2d at 908; see note 75 *infra*.

⁷¹ See *Marsh*, *Who Killed the Private Offering Exemption? A Legal Whodunit*, 71 NW. L. REV. 470 (1976) ("tongue-in-cheek" description of the creeping exclusivity of Rule 146).

⁷² See SEC Securities Act Release No. 5913, [1978-1979 Transfer Binder] FED. SEC. L. REP. (CCH) at 80,172.

⁷³ Among the factors that should be considered in determining whether § 4(2) is applicable are offeree sophistication, the number of offerees, and the ability of each offeree to assume the risk of his investment. See *Position Paper*, *supra* note 12, at 499; see *generally* text accompanying notes 31-33 *supra*. In addition, offerees must be provided with or have access to the requisite information. See *Position Paper*, *supra* note 12, at 499; see *generally* text accompanying notes 40-65 *supra*. The issuer's manner of conducting a securities offering also is an important factor. See *Position Paper*, *supra* note 12, at 499; text accompanying note 30 *supra*. Finally, issuers should ascertain that offerees are purchasing securities for their private investment purposes. Thus, proof of the absence of redistribution and the absence of a redistributive intent is an important factor in establishing the availability of the private placement exemption. In *United States v. Custer Channel Wing Corp.*, 376 F.2d 675 (4th Cir.), *cert. denied*, 389 U.S. 850 (1967), the Fourth Circuit noted that the non-distributive intent could be evidenced by requiring offerees to sign an investment letter indicating that they knew the securities were purchased in compliance with the requirements of § 4(2) and that the securities were restricted. *Id.* at 679; see text accompanying notes 107-95 *infra*. In addition, to further restrict the sale of restricted securities by a purchaser of the securities, each stock certificate can be printed with a legend outlining the restricted nature of the security. 376 F.2d at 679. These precautionary measures alone are not sufficient to support a finding that the securities were sold in a non-public offering; however, taking these precautions does indicate the issuer's attempt to comply with the requirements of § 4(2). *Id.*; see *SEC v. International Scanning Devices, Inc.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,147 (W.D.N.Y. Apr. 6, 1977) (letters of non-distributive intent and restrictive legends are "essential element" of private placement).

⁷⁴ See *Doran v. Petroleum Management Corp.*, 545 F.2d 893, 900 (5th Cir. 1977). The determination of the availability of § 4(2) focuses on an evaluation of the whole offering and consideration of the various factors. See *generally* text accompanying notes 28-65 *supra*; note 73 *supra*. In *Doran*, the Fifth Circuit found that the number of offerees and their access to information were the most critical factors, *id.* at 900, see text accompanying notes 31-39 *supra*, and the issuer's failure to prove that each offeree had access to the requisite information was fatal to the issuer's claim of a § 4(2) exemption. 545 F.2d at 900.

Rule 146⁷⁵ must be complied with stringently.⁷⁶ While there are similarities between the requirements of section 4(2) and Rule 146,⁷⁷ certain provisions of the Rule make satisfaction of the Rule's criteria more difficult than satisfaction of the section 4(2) criteria. Under Rule 146, the number of purchasers of a non-public offering is limited to thirty-five,⁷⁸ while section

⁷⁵ Briefly, the requirements of Rule 146 are: (1) there must be no general solicitation or advertising of the offering; (2) the issuer must have reasonable grounds to believe that each offeree has the financial and business experience to evaluate the merits and risks of the investment or that an offeree is able to bear the economic risk of the investment; (3) if securities are sold to a person who can bear the economic risk but is lacking the requisite investment experience, the offeree must be represented by an offeree representative who has the requisite experience, *see note 77 infra*; (4) offerees must have access to or be provided with the same kind of information that would be contained in a registration statement; (5) there must be no more than 35 purchasers of an offering; and (6) the issuer must use reasonable care to ascertain that purchasers are not acting as underwriters, *see note 6 supra*, to redistribute the shares, *see note 73 supra*; text accompanying notes 107-95 *infra* (sale of restricted securities). *See* Rule 146(c), (d)(1), (d)(2), (e), (g), (h).

⁷⁶ *See* Rule 146(b).

⁷⁷ Both § 4(2) and Rule 146 require the issuer to conduct an offering in a non-public manner. *See* text accompanying note 30 *supra*; note 75 *supra* (Rule 146(c)). Additionally, § 4(2) and Rule 146 require that offerees be sophisticated and have access to or be provided with information that a registration statement would contain. *See* text accompanying notes 33, 40-65 *supra*; note 75 *supra* (Rule 146(d)(1), (d)(2), (e)).

Rule 146 is more flexible than § 4(2) in one aspect; Rule 146 recognizes the concept of an offeree representative. An offeree representative can represent an unsophisticated investor who is able to bear the economic risk of an investment. *See* Rule 146(d)(2). An offeree representative must have the financial experience necessary to evaluate the merits and risks of an investment, Rule 146(a)(1)(ii), and must not be an "affiliate, director, officer or other employee of the issuer . . ." of the securities. Rule 146(a)(1)(i); *see* Pension and Investment Assocs. of America, Inc., [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,405 (SEC Staff Reply Oct. 4, 1977) (a dealer of securities, *see note 7 supra*, considering participation as a partner in the private sale of certain securities, asserted that the dealer's "employees" were unsalaried and only received commissions on sales of securities; therefore, the dealer argued that its "employees" were independent contractors, not within the group proscribed by Rule 146(a)(1)(i), and that the "employees" could act as offeree representatives in the proposed private sale; the SEC disagreed, disallowing PIAA's attempt to qualify its employees as independent contractors and thereby precluding the employees from acting as offeree representatives). In addition, an offeree must acknowledge in writing that he is being represented by an offeree representative, Rule 146(a)(1)(iii), and the representative must disclose to the offeree the existence of any material relationship between the representative and the issuer. Rule 146(a)(1)(iii). Where a qualified offeree representative is involved in a transaction, the issuer of securities must furnish the representative with the information which a registration statement would disclose. In contrast, an offeree must be furnished with the requisite information or have access to it. *See* Rule 146(e)(1)(i) & (ii); 1973-74 Securities Law Developments, 32 WASH. & LEE L. REV. 730, 734 (1975); *see also* text accompanying notes 93-106 *infra* (proposed amendment to Rule 146(e) that would require less information to be furnished where small private offerings are involved).

⁷⁸ Rule 146(g)(1). For purposes of the 35 purchaser requirement and the other requirements of Rule 146 the definition of an offering is important. Rule 146(b)(1) provides that an offering does not include offers or sales which take place prior to the six month period preceding the offering in question or after the six month period following the offering. Offers and sales which occur within the six month period may be considered part of the offering in question. *See* Rule 146, Preliminary Note 3, 17 C.F.R. § 230.146 (1977). This aggregation of separate offerings may cause the combined offering to run afoul of Rule 146 if one of the

4(2) imposes no specific limit on the size of an offering as long as the manner of conducting the offering is appropriate⁷⁹ and the number of offerees and purchasers is not excessive.⁸⁰ The Rule also imposes mechanical requirements on issuers necessitating documentation and record-keeping.⁸¹ In addition, the SEC recently amended Rule 146 to require the filing of a disclosure statement by issuers attempting to qualify an offering for exemption under Rule 146.⁸² Prior to adopting Rule 146(i), the SEC lacked empirical data regarding the use of Rule 146 by issuers and also lacked the ability to perceive misuses of the Rule.⁸³ In an effort to correct these shortcomings, Rule 146(i) requires an issuer, who, in reliance on Rule 146, is offering more than \$50,000 worth of securities in a year, to file a report with the SEC at the time of the first sale in a particular offering.⁸⁴ This report must include basic information regarding the issuer, names and addresses of people facilitating the issuance of the securities, a description of the financial size of the offering, and an indication whether the issuer has previously filed reports with the SEC pursuant to Rule 146(i).⁸⁵ In the event of any material change in the facts accompanying an offering made pursuant to Rule 146, the issuer must file an amended report with the

component offers or sales does not meet the standards of Rule 146. Such aggregation may result in more than 35 purchasers being involved in a private offering, thereby violating the 35 purchaser requirement. Thus, in *The Shockey Cos.*, [1976-1977 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 80,924 (SEC Staff Reply Nov. 12, 1976), petitioner was concerned that a yearly offering of company stock to not more than 35 employees would have to be aggregated. The SEC held that such offerings did not have to be aggregated and were eligible for exemption under the criteria of Rule 146.

Rule 146(g)(2)(i) excludes certain persons from the 35 purchaser limitation. Rule 146(g)(2)(i)(d) provides that investors who purchase \$150,000 or more worth of securities for cash in a single payment or installments do not have to be included in the 35 total. In *Robert S. Sinn Securities, Inc.*, [1976-1977 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 80,905 (SEC Staff Reply Nov. 4, 1976), investors were going to purchase interests in a non-public offering. Certain investors were going to purchase \$150,000 worth of securities by paying \$75,000 cash and by issuing a non-recourse promissory note for the balance. Petitioner sought to have these investors excluded from the 35 total, but the SEC found that because a portion of the consideration paid was in the form of a non-recourse note, the Rule 146(g)(2)(i)(d) exception was inapplicable and the investors were includible in calculating the number of investors.

⁷⁹ See text accompanying note 30 *supra*. See also note 77 *supra*.

⁸⁰ See Position Paper, *supra* note 12, at 501.

⁸¹ *Id.* Rule 146(e)(3) requires the issuer to notify the offeree, in writing, of material relationships between the issuer and any offeree representatives, see note 77 *supra*, and of the restrictions on the sale of privately placed securities, see text accompanying notes 107-95 *infra*. The issuer also must place restrictive legends on the securities and obtain an agreement from purchasers that the securities will not be resold in violation of the '33 Act. Rule 146(h)(2) & (4); see note 73 *supra* (§ 4(2) precautionary measures).

⁸² SEC Securities Act Release No. 5912, [1978-1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,524 (March 3, 1978).

⁸³ *Id.* at 80,118.

⁸⁴ *Id.* at 80,119. The original proposal of Rule 146(i) required issuers to file a report with the SEC within 10 days after the termination of an offering and an annual report would have to be filed for any offering extending for more than a year. *Id.*

⁸⁵ *Id.* at 80,120. Information concerning previous filings will enable the SEC to determine the extent to which Rule 146 is used by particular issuers. *Id.*

SEC.⁸⁶ Rule 146(i), as adopted, is substantially less burdensome than the originally proposed rule.⁸⁷ Nevertheless, this additional burden, in conjunction with the previously mentioned limitations of Rule 146,⁸⁸ may force issuers to rely on the section 4(2) exemption. Thus, issuers who seek to avoid the expenses and burdens of registration⁸⁹ must suffer the burdens of Rule 146 or the uncertainty of section 4(2).⁹⁰

Critics of Rule 146 have indicated that both registration and Rule 146 are inappropriate for the small businessman.⁹¹ One proposed remedy has been to include a "substantial compliance" clause in Rule 146 that would foreclose a purchaser of unregistered securities who had received sufficient information to make an informed investment decision from rescinding a "sour deal" on the basis of the issuer's failure to comply with the technical requirements of Rule 146.⁹² Inclusion of a substantial compliance clause would create an intermediate ground between the uncertainty of relying on section 4(2) and the burdens imposed by absolute compliance with Rule 146. Thus, small businessmen would be able to avoid some of the burdens of Rule 146 and structure a non-public offering that would be protected from the opportunistic rescission claims of disillusioned investors.

The SEC also has proposed an amendment to Rule 146(e), which concerns the type of information that issuers must provide to offerees. Presently, Rule 146(e) provides that each offeree must have access to the kind of information that a registration statement would reveal about an issuer.⁹³ Alternatively, each offeree or his offeree representative⁹⁴ must be furnished with the requisite information by the issuer.⁹⁵ The information which must be disclosed under this alternative varies depending on the character of the issuer. If an issuer engages in public securities transactions and thereby is subject to the registration and reporting requirements of the '33 and '34 Acts, the issuer must disclose to offerees the information contained in a registration statement⁹⁶ and any information contained in a "definitive" proxy statement⁹⁷ or periodic report⁹⁸ which was filed with the SEC subse-

⁸⁶ *Id.* at 80,119-20.

⁸⁷ *Id.* at 80,119.

⁸⁸ See text accompanying notes 78 & 81 *supra*. See also note 75 *supra*.

⁸⁹ See note 1 *supra*.

⁹⁰ See Casey, *supra* note 69, at 591.

⁹¹ *Id.* at 592.

⁹² *Id.* at 594. The present strictness of Rule 146 allows an investor to take advantage of a technical failure to comply with all of Rule 146's requirements. The investor may be able to void the non-public status of an offering and escape the economic consequences of a "sour deal" despite the fact that the investor willfully entered into the original agreement to purchase the securities. *Id.* at 592.

⁹³ See Rule 146(e)(1)(i); note 1 *supra*.

⁹⁴ See note 77 *supra*.

⁹⁵ Rule 146(e)(1)(ii).

⁹⁶ See note 1 *supra*.

⁹⁷ See Securities Exchange Act of 1934 § 14, 15 U.S.C. § 78n (1976); Section V, Proxy Solicitation *infra*.

⁹⁸ Securities Exchange Act of 1934 § 13, 15 U.S.C. § 78m (1976) requires issuers of

quent to filing the registration statement.⁹⁹ In addition, a "reporting" issuer must supply offerees with a description of the securities which are being offered in reliance on Rule 146, the use to be made of the proceeds of the non-public offering, and any material changes regarding the issuer which are not disclosed in the documents filed with the SEC.¹⁰⁰ If, on the other hand, an issuer is not a "reporting" issuer, then such issuer must only provide offerees with the information that would be included on a registration statement.¹⁰¹

Proposed Rule 146(e)(1)(ii)(d) decreases the burden imposed by the extensive disclosure requirements noted above. Under the proposed Rule, issuers engaged in a non-public offering, the value of which does not exceed \$500,000, need to disclose only the information required by Schedule I of Regulation A.¹⁰² While the information required by Schedule I is similar to information that must be included in a registration statement,¹⁰³ documents prepared in compliance with Schedule I generally are briefer and less detailed than registration statements.¹⁰⁴ Furthermore, Schedule I does not require the issuer to prepare the extensive financial documents which accompany a registration statement. Under Schedule I, the issuer must provide offerees with documents disclosing the financial status of the issuer for the two years preceding the offering.¹⁰⁵ Because compliance with the requirements of Schedule I is less time consuming and less expensive, small businessmen would benefit from the enactment of the proposed Rule. Furthermore, the SEC has indicated that enactment of Rule 146(e)(1)(ii)(d) should encourage more issuers to take advantage of Rule 146 without compromising the protection afforded investors by effective disclosure of relevant information.¹⁰⁶

B. Rule 144

Securities sold pursuant to a private offering¹⁰⁷ are restricted securities¹⁰⁸ which can only be resold by an investor in compliance with Rule 144 or section 4(1) of the '33 Act. Prior to the adoption of Rule 144,¹⁰⁹ the resale

securities to file periodic reports with the SEC to supplement information in a registration statement.

⁹⁹ Rule 146(e)(1)(ii)(a)(1).

¹⁰⁰ Rule 146(e)(1)(ii)(a)(2); see text accompanying notes 96-99 *supra*.

¹⁰¹ Rule 146(e)(1)(ii)(b).

¹⁰² See Proposed Rule 146(e)(1)(ii)(d); 43 FED. REG. 10704 (1978); 17 C.F.R. § 239.90 (1977).

¹⁰³ See note 1 *supra*.

¹⁰⁴ See Burge, *Regulation A: A Review and a Look at Recent Developments*, 46 L.A. BAR BULL., 290-94, 308-20 (1971).

¹⁰⁵ *Id.*; cf. note 1 *supra* (more extensive financial disclosure required under Schedule A).

¹⁰⁶ See SEC Securities Act Release No. 5913, [1978-1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,532 at 80,173 (March 6, 1978).

¹⁰⁷ See text accompanying notes 9-106 *supra*.

¹⁰⁸ Rule 144(a)(3), 17 C.F.R. § 230.144(a)(3) (1977).

¹⁰⁹ 17 C.F.R. § 203.144 (1977) [hereinafter cited as Rule 144]. See Securities Act Release No. 5223, [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 78,487 (Jan. 11, 1972).

generally was accomplished by reliance on section 4(1) of the '33 Act.¹¹⁰ Section 4(1) exempts public sales "by any person other than an issuer,¹¹¹ underwriter,¹¹² or dealer"¹¹³ from the registration requirements of section 5.¹¹⁴ Originally, the availability of the section 4(1) exemption for the sale of restricted securities depended on an investor's intent regarding the resale of restricted securities at the time they were purchased,¹¹⁵ the length of time that the investor held the securities, and the impact of any unforeseeable changes in circumstances.¹¹⁶ Consideration of these factors was necessary to determine whether a purchaser of restricted securities had assumed the economic risk of holding unregistered securities or whether the investor merely was acting as a conduit for the sale of such securities.¹¹⁷

Rule 144 codified this analysis, attempting to establish a standard for the resale of restricted securities. Although Rule 146 is non-exclusive,¹¹⁸ the SEC did not indicate that Rule 144 is non-exclusive. Therefore, an investor seeking to resell restricted securities must comply with all of the requirements of Rule 144.¹¹⁹ The alternative to compliance with Rule 144 is registration of the securities¹²⁰ prior to resale or imposition of liability on the investor for the sale of unregistered securities.¹²¹ Generally, Rule 144 requires an investor to hold unregistered securities for a period of two years in order to qualify those securities for resale.¹²² A resale of securities must be executed through a "brokers' transaction."¹²³ In addition, the investor/seller must have a bona fide intent to sell,¹²⁴ current information concerning the issuer must be available,¹²⁵ the investor/seller must provide notice of the proposed sale to the SEC,¹²⁶ and the resale must comply with

¹¹⁰ Securities Act of 1933 § 4(1), 15 U.S.C. § 77d(1) (1976).

¹¹¹ See note 5 *supra*.

¹¹² See note 6 *supra*.

¹¹³ See note 7 *supra*.

¹¹⁴ See text accompanying notes 1 & 2 *supra*.

¹¹⁵ See note 73 *supra* (importance of non-distributive intent).

¹¹⁶ See Linden, *The Resale of Restricted and Control Securities Under SEC Rule 144: The First Five Years*, 8 SETON HALL L. REV. 157, 162-63 (1977) [hereinafter cited as Linden].

¹¹⁷ See Rule 144, Preliminary Note, 17 C.F.R. § 230.144 (1977).

¹¹⁸ See text accompanying note 12 *supra*.

¹¹⁹ Rule 144 has been interpreted as allowing the sale of restricted securities under § 4(1) by satisfaction of the requirements which administrative and judicial decisions have incorporated into § 4(1). See Linden, *supra* note 116, at 240-41. Nevertheless, exclusivity may be a moot issue since the administrative and judicial guidelines closely resemble Rule 144. *Id.* at 241.

¹²⁰ See text accompanying notes 1 & 2 *supra*.

¹²¹ See Securities Act of 1933 § 12(1), 15 U.S.C. § 77(l) (1976). Although an issuer of restricted securities may escape liability for the sale of unregistered securities by qualifying for an exemption, see text accompanying notes 9-106 *supra* and text accompanying notes 196-211 *infra*, the purchaser of the unregistered securities may subject himself to liability by reselling the securities in violation of § 4(1) or Rule 144.

¹²² Rule 144(d); see text accompanying notes 152-79 *infra*.

¹²³ Rule 144(f) & (g); see text accompanying notes 128-51 *infra*.

¹²⁴ Rule 144(i). See generally text accompanying notes 186-91 *infra*.

¹²⁵ Rule 144(c); Linden, *supra* note 116, at 191.

¹²⁶ Rule 144(h). See generally text accompanying notes 185-91 *infra*.

the volume limitations imposed by Rule 144.¹²⁷

Specifically, Rule 144(f) requires that restricted securities be resold in a brokers' transaction.¹²⁸ Rule 144(g) defines brokers' transaction as a transaction in which a broker¹²⁹ does not solicit customers' orders to buy the restricted securities¹³⁰ and does no more than execute the sales order as an agent for the investor selling those securities.¹³¹ In addition, the broker must make a reasonable inquiry to ascertain whether the investor seeking to resell the securities is acting as an underwriter.¹³² Finally, the broker must not receive more than his usual and customary broker's commission for executing the sale of the restricted securities.¹³³

The impact of Rule 144(f) and (g) is apparent in *SEC v. E. L. Aaron & Co.*¹³⁴ Aaron & Co. (the company) was a broker-dealer¹³⁵ which conducted securities transactions for the Lawn-A-Mat Chemical & Equipment Corp. (LAM).¹³⁶ Two directors of LAM owned a portion of LAM's unregistered securities. Desiring to purchase some of these securities on its own account, the company approached the two directors of LAM concerning the sale of the securities held by the directors.¹³⁷ The directors did not know that the company was purchasing the securities for its own account.¹³⁸ The company attempted to structure the sale of the unregistered securities in compliance with Rule 144. In so doing, the company arranged for another broker-dealer to act as an intermediary for the sale of the securities. At the company's direction, the securities were sold by the directors to the intermediary, and the shares were then sold by the intermediary to the company.¹³⁹ At the same time that these transactions were occurring, the company was involved in selling LAM's registered securities.¹⁴⁰ In connection with these sales some of the company's representatives made false and misleading statements concerning the registered securities.¹⁴¹ The actions

¹²⁷ Rule 144(e); see text accompanying notes 180-91 *infra*.

¹²⁸ Rule 144(f).

¹²⁹ A broker is a person who buys and sells securities for the account of others. Securities Exchange Act of 1934 § 3(a)(4), 15 U.S.C. § 78c(a)(4) (1976).

¹³⁰ Rule 144(g)(2); see note 133 *infra*.

¹³¹ Rule 144(g)(1).

¹³² Rule 144(g)(3); see note 6 *supra* (defining underwriter).

¹³³ Rule 144(g)(1). Section 4(1) and Rule 144 are designed to exempt routine trading transactions from the requirements of registration. See Rule 144, Preliminary Note, 17 C.F.R. § 230.144 (1977). Since solicitation of customers' orders and payment of additional compensation to brokers are characteristic of a distribution of securities rather than routine trading transactions, such activities preclude exemption under Rule 144. *Id.*

¹³⁴ [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,043 (S.D.N.Y. May 5, 1977).

¹³⁵ A broker-dealer operates as both a broker and a dealer. See notes 7 & 129 *supra*.

¹³⁶ [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) at 91,681-82.

¹³⁷ *Id.* at 91,683.

¹³⁸ *Id.*

¹³⁹ *Id.* at 91,683-84.

¹⁴⁰ *Id.* at 91,682.

¹⁴¹ *Id.* at 91,682-83. The company's representatives told prospective purchasers that the company was undertaking the manufacture of a new type of small car and a tractor. In fact,

of these representatives prompted the SEC to bring suit against the company alleging violations of the antifraud provisions of the '33 and '34 Acts,¹⁴² and the SEC also alleged that the company's purchase of the unregistered securities was in violation of section 5 of the '33 Act.¹⁴³ Section 5(c) prohibits the use of the mails or interstate commerce to offer to sell or buy an unregistered security.¹⁴⁴ Regarding the purchase of the unregistered securities, the company argued that the requirements of Rule 144 were complied with and therefore the transaction was exempt from the prohibitions of section 5(c).¹⁴⁵

The court found that the unregistered securities were not sold in a brokers' transaction and that the Rule 144 exemption was not available to the company.¹⁴⁶ The company did not act merely as the agent for the seller of the securities,¹⁴⁷ but purchased the securities for its own account. Furthermore, the company was soliciting customers' orders to purchase the unregistered securities after the company had purchased the securities from LAM's directors. The court held that such solicitation violates Rule 144(g)(2) and prevents the company's actions from qualifying as a brokers' transaction.¹⁴⁸ The company also could not comply with Rule 144 by purchasing the securities from an intermediary broker-dealer. If the broker-dealer had acted as a selling agent for the LAM directors, the company could have purchased the securities and the sale would have complied with Rule 144.¹⁴⁹ However, because the company arranged the entire transaction, the court characterized the participation of the intermediary broker-dealer as a sham.¹⁵⁰ Therefore, the company's actions violated the registration requirement of section 5.¹⁵¹

Rule 144 also requires that restricted securities must be held for a period of two years prior to resale¹⁵² and the Rule imposes volume limitations on the amount of securities which may be resold at any one time.¹⁵³

the company had no such plan. In addition, the company's representatives made false statements concerning the financial condition of the company.

¹⁴² *Id.* at 91,680. See Securities Act of 1933 § 17(a), 15 U.S.C. § 77q(a) (1976); Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (1976); Rule 10b-5, 17 C.F.R. § 240.10b-5 (1977).

¹⁴³ [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) at 91,681.

¹⁴⁴ 15 U.S.C. § 77e(c) (1976).

¹⁴⁵ The company asserted that the sale of the securities by LAM's directors complied with Rule 144. [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) at 91,685. Although as a purchaser the company can make that assertion, the company's actions as broker for the transaction foreclose the availability of the Rule 144 exemption. See text accompanying notes 146-51 *infra*. See also text accompanying note 120 *supra* (alternative to exemption is registration).

¹⁴⁶ [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) at 91,685-86.

¹⁴⁷ Rule 144(g)(1); see text accompanying note 131 *supra*.

¹⁴⁸ [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) at 91,685.

¹⁴⁹ See *id.* at 91,685-86.

¹⁵⁰ *Id.*

¹⁵¹ *Id.* at 91,686.

¹⁵² Rule 144(d).

¹⁵³ Rule 144(e).

The effect of these requirements on the operation of an employee stock ownership plan (ESOP)¹⁵⁴ was examined in *Lanchart Industries, Inc.*¹⁵⁵ Lanchart established an ESOP wherein all qualified employees automatically participated.¹⁵⁶ The company contributed securities and cash to the plan in amounts determined by the Board of Directors, and participants were not allowed to make contributions to the plan.¹⁵⁷ The plan provided that contributed stock was to be held in the name of the trustee of the plan and all acquisitions of stock for the plan were to be made in compliance with section 4(2),¹⁵⁸ thus making registration of the stock unnecessary.¹⁵⁹ The trustee would allocate shares according to a fixed formula and keep records of each participant's beneficial ownership in the fund.¹⁶⁰ The plan provided that thirty percent of accrued benefits would vest after three years of service, and that the percentage of benefits vesting would increase until fully vested after ten years of service.¹⁶¹ Interest in the plan also would become fully vested and distributable upon death, retirement or permanent disability of an employee.¹⁶² Upon distribution of a participant's share he was given the option of requiring the company to repurchase the stock.¹⁶³ The company presented these facts to the SEC and requested the SEC to indicate what rights participants had to resell the stocks in compliance with Rule 144.¹⁶⁴

Rule 144(d)(1) requires that restricted securities be held by an investor for a period of two years before those securities can be resold.¹⁶⁵ In response to the company's request in *Lanchart*, the SEC indicated that the holding period would begin to run, from a participant's standpoint, when the participant's interest in the plan was fully vested and not subject to forfeiture.

¹⁵⁴ An ESOP is essentially a deferred employee benefit. The employer normally makes contributions of "employer securities" (e.g. the common stock of the company) to individual employee accounts. The employee receives the stock as a benefit while the employer is allowed a tax deduction under I.R.C. § 404(a)(3)(A). See Canan, *Employee Stock Ownership Plans*, 61 A.B.A.J. 880, 880 (1975); see generally Givner, *ESOPS and the Federal Securities Laws*, 31 BUS. LAW. 1889 (1976) [hereinafter cited as Givner].

¹⁵⁵ [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,173 (SEC Staff Reply March 2, 1977).

¹⁵⁶ To qualify for participation in the ESOP, an employee must have at least one year of experience with the company or must be at least 25 years of age. *Id.* at 88,022.

¹⁵⁷ *Id.*

¹⁵⁸ See text accompanying notes 9-106 *supra*.

¹⁵⁹ [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) at 88,022-23.

¹⁶⁰ *Id.* at 88,023.

¹⁶¹ *Id.*

¹⁶² *Id.* Although a participant's share became fully vested after ten years of service, his share was not distributable until the termination of employment. *Id.*

¹⁶³ *Id.* The repurchase option given to employees under the plan had no expiration date. *Id.* at 88,020.

¹⁶⁴ Parties undertaking a securities transaction may request the SEC to provide interpretive legal advice with respect to the effect of a statute, rule, or regulation upon the transaction. In essence, a "no action" letter requests the SEC to indicate whether, given a particular set of facts, the transaction involved would violate a statute, rule, or regulation and cause the SEC to take enforcement action. 17 C.F.R. § 200.81 (1977).

¹⁶⁵ Rule 144(d)(1).

That the trustee still held the shares did not affect the commencement or running of the holding period.¹⁶⁶ Since an employee's share in the plan vested gradually over a period of ten years the running of the holding period was staggered. After three years of employment an employee had a thirty percent vested share in the plan and such share would increase ten percent for each additional year worked until an employee's share was one hundred percent vested after ten years of service.¹⁶⁷ Each year the holding period would begin running for that additional ten percent interest in the plan that had vested during that year.¹⁶⁸ The staggered running of the holding is important because of the impact that the repurchase option¹⁶⁹ has on the holding period.

Under Rule 144(d)(3), the period during which an investor can exercise a repurchase option must be excluded from the holding period.¹⁷⁰ Because the repurchase option in *Lanchart* became exercisable upon distribution of an employee's share¹⁷¹ and had no specific time of expiration,¹⁷² the entire period after distribution must be excluded from calculation of the holding period. Thus, if at the time of distribution the holding period had not run for any portion of an employee's vested share, then the employee would be prevented from ever selling that portion of his share in compliance with Rule 144.¹⁷³

¹⁶⁶ [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) at 88,019; *accord*, Crowley Maritime Corp., [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 80,443 (SEC Staff Reply Jan. 27, 1976); *see* Rule 144(d)(1) (employee is beneficial owner of vested share). *See generally* Givner, *supra* note 154, at 1892-96.

¹⁶⁷ [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) at 88,023.

¹⁶⁸ *Id.* at 88,026. *But cf.* *Roto Am. Corp.*, [1970-1971 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 78,026 (SEC Staff Reply Feb. 19, 1971). *Roto* concerned the pre-Rule 144 doctrine of fungibility. Stock of a single class was considered fungible. Thus, where an investor acquired securities periodically, each acquisition required the holding period to start anew for all stock of the same class as that acquired. The doctrine of fungibility has since been rejected by the SEC. *See, e.g.*, *NLT Corp.*, [1973-1974 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 79,710 (SEC Staff Reply Jan. 11, 1974).

¹⁶⁹ *See* text accompanying note 163 *supra*.

¹⁷⁰ Rule 144(d)(3) requires exclusion from the running of the holding period of any period during which a purchaser of securities has a short position, put, or option to "dispose of any equity securities of the same class or any securities convertible into securities of such class . . ." *See, e.g.*, *Familian Corp.*, [1976-1977 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 80,614 (SEC Staff Reply Apr. 1, 1976) (option to resell at guaranteed price must be excluded from holding period); *Telarent Leasing Corp.*, [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 80,445 (SEC Staff Reply Jan. 28, 1976) (12 month repurchase option under ESOP must be excluded from running of holding period); *Crowley Maritime Corp.*, [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 80,443 (SEC Staff Reply Jan. 27, 1976) (12 month repurchase option under ESOP must be excluded).

¹⁷¹ *See* text accompanying note 162 *supra*.

¹⁷² *See* note 163 *supra*.

¹⁷³ Assume that an employee completes six years of service before becoming permanently disabled. Although his share becomes fully vested at that time, the holding period would only have run for a 40% vested share. Because the repurchase option has no termination date the period after distribution must be excluded from the holding period. Therefore, the two year holding period will never run for 60% of the employee's vested share. Thus, the employee only

Compliance with the two year holding requirement is aided by the concept of "tacking." In certain transfers of restricted securities the transferee is able to treat the holding period for such securities as beginning at the time the holding period began to run for the transferor.¹⁷⁴ In situations involving a gift of restricted securities, the donee can treat his holding period as having started when the donor's began.¹⁷⁵ Additionally, "tacking" of holding periods is allowed where a group of securities is converted, for example, in an exchange of preferred stock for common stock.¹⁷⁶ In *Lanchart*, a question arose concerning calculation of the holding period for a beneficiary of an employee's share.¹⁷⁷ The SEC indicated that if the beneficiary acquired the employee's interest as a gift the beneficiary would be able to tack the employee's holding period.¹⁷⁸ If, however, the beneficiary acquired the employee's share for consideration, the beneficiary could treat the holding period as beginning when he had acquired a nonforfeitable interest in securities vested in an employee's account.¹⁷⁹

Rule 144 also imposes limitations on the volume of securities which can be resold pursuant to the Rule's requirements. If registered securities¹⁸⁰ are traded on a national exchange, then the amount of restricted securities that can be sold by an investor during a six month period is "the lesser of . . . one percent of the shares . . . outstanding"¹⁸¹ "as shown by the most recent report or statement published by the issuer, or . . . the average weekly reported volume of trading in [registered] securities on all securities exchanges . . . during the four calendar weeks preceding the filing of . . ." the notice which must be filed with the SEC.¹⁸² If registered securities¹⁸³ are not traded on a national exchange, the amount of restricted

can resell 40% of his acquired stock in compliance with Rule 144. The remaining 60% can be resold only if the shares are registered.

¹⁷⁴ Rule 144(d)(4).

¹⁷⁵ Rule 144(d)(4)(v). See Paine, Webber, Jackson & Curtis, [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 80,554 (SEC Staff Reply Apr. 16, 1976).

¹⁷⁶ Rule 144(d)(4)(ii). See, e.g., Tymshare, Inc., [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 80,569 (SEC Staff Reply Apr. 28, 1976); Kasper Instruments, Inc., [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 80,431 (SEC Staff Reply Feb. 26, 1976). Where conversion of stock is involved, the holding period may be tacked if the old stock is the only consideration given in exchange for the converted stock. National Am. Corp., [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 80,446 (SEC Staff Reply Feb. 11, 1976). *But cf.* Energy and Environmental Cos., [1976-1977 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 80,906 (SEC Staff Reply Nov. 15, 1976) (individuals acquired stock upon dissolution of corporation; SEC applied rule that individuals cannot tack onto corporation's holding period for purpose of Rule 144).

¹⁷⁷ [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) at 88,019.

¹⁷⁸ *Id.* at 88,019-20.

¹⁷⁹ *Id.*

¹⁸⁰ Although Rule 144 deals with the sale of unregistered securities, the Rule recognizes that a company may trade registered securities on an exchange as well as issue unregistered securities in compliance with § 4(2).

¹⁸¹ The number of outstanding shares includes both the registered and unregistered shares.

¹⁸² Rule 144(e)(1)(i) & (2). See text accompanying note 185 *infra* (notice requirement).

¹⁸³ See note 180 *supra*.

securities which can be sold by an investor during a six month period is limited to one percent of the outstanding shares.¹⁸⁴

Calculation of the volume limitation can affect not only the quantity of restricted securities sold, but also the manner in which those securities are sold. Rule 144(h) requires an investor to file a notice with the SEC indicating that the investor plans to sell restricted securities in reliance on Rule 144.¹⁸⁵ In addition, Rule 144(i) provides that an investor filing notice under Rule 144(h) must have a bona fide intent to sell the restricted securities within a reasonable time after the notice is filed.¹⁸⁶ The interaction between these sections and calculation of the volume limitation is apparent in *Flight Safety International, Inc.*¹⁸⁷ Petitioner owned restricted stock which could not be resold until June 6, 1976. The issuer of the restricted stock also traded registered stock on national exchanges, but the trading volume of that stock was small and the "lesser of" requirement of Rule 144(e) would have prevented petitioner from selling large amounts of his restricted stock.¹⁸⁸ On March 2, 1976 an extraordinarily large volume of the issuer's registered stock was traded on exchanges. If this large sales volume could be included in calculating the average weekly volume, the "lesser of" rule would permit petitioner to use the volume limitation of one percent of the outstanding shares.¹⁸⁹ Since the one percent limit was significantly larger than the normal weekly trading volume, the petitioner could sell a larger amount of his restricted stock. Therefore, on April 1 the petitioner filed notice with the SEC of his intent to sell restricted securities.¹⁹⁰ This notice was filed even though the securities could not be sold until June 6.

¹⁸⁴ Rule 144(e)(1)(ii) & (2). The impact which the volume limitation has on the number of securities which an investor can sell in compliance with Rule 144 is supplemented by the Rule 144(e)(3) requirement that certain transactions must be aggregated in determining whether the volume restrictions have been violated. For example, Rule 144(e)(3)(iii) provides that "[t]he amount of securities sold for the account of a donee thereof during any period of 6 months within 2 years after the donation, and the amount of securities sold during the same 6 month period for the account of the donor, shall not exceed, in the aggregate," the applicable volume limitation as calculated by Rule 144(e)(1)(i) & (ii). See *Lanchart Indus., Inc.*, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) at 88,020 (in the absence of concerted action between participants and company to disrupt market for company's securities, no aggregation of sales by participants and company required).

¹⁸⁵ Rule 144(h) requires that notice of a sale made in compliance with Rule 144 be filed with the SEC unless "the amount of securities to be sold during any period of six months does not exceed 500 shares . . . and the aggregate sale price thereof does not exceed \$10,000."

¹⁸⁶ Rule 144(i).

¹⁸⁷ [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 80,563 (SEC Staff Reply Apr. 30, 1976).

¹⁸⁸ See text accompanying notes 180-82 *supra*.

¹⁸⁹ [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) at 86,453; see text accompanying notes 180-82 *supra*.

¹⁹⁰ [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) at 86,453; see Rule 144(h). The petitioner waited as long as possible before filing his notice with the SEC. By waiting until April 1 to file his notice the petitioner still was able to take advantage of the high trading day of March 2 since the four weeks preceding April 1 were March 1-5, 8-12, 15-19, and 22-26. If petitioner had not filed until April 5, the week of March 1-5 would no longer be included in the four weeks preceding the notice required by Rule 144(e)(1)(i).

The SEC disallowed petitioner's attempt to include the March 2 trading volume in his calculations. The SEC stressed that the sixty-five day lapse between the filing of the notice and the time the shares were eligible for sale was not within the scope of reasonable time allowed by Rule 144(i).¹⁹¹

A major problem with Rule 144 is that investors must hold restricted securities for two years before the securities can be resold. Because this holding period ties up an investor's capital, investors may confine their investments to registered securities or the restricted securities of established companies where little risk is involved in holding an asset for two years.¹⁹² Small companies may be forced to register their issues since investors will be unwilling to assume the risk of holding the restricted securities of these "unsecure" companies. Yet, the cost of registering securities is particularly burdensome on these smaller companies.¹⁹³ It has been suggested that the private offering¹⁹⁴ only can become a viable alternative to registration by amending Rule 144 to provide for a larger volume of sales after an investor has assumed the risk of an investment by meeting the holding requirement.¹⁹⁵

C. Rule 147

Rule 147¹⁹⁶ parallels section 3(a)(11) of the '33 Act which exempts intrastate offerings from registration.¹⁹⁷ The rule principally requires that the issuer be doing business within the state¹⁹⁸ and that the offering be "genuinely local in character."¹⁹⁹ To be doing business, an issuer must derive at least eighty percent of its gross revenues "from the operation of a business or of real property located in or from the rendering of services within such state . . .,"²⁰⁰ have at least eighty percent of its assets located within the state,²⁰¹ intend to use and use at least eighty percent of the proceeds of the intrastate offering within the state,²⁰² and have its princi-

¹⁹¹ [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) at 86,453; see text accompanying note 186 *supra*.

¹⁹² See Casey, *supra* note 69, at 595.

¹⁹³ *Id.* at 575.

¹⁹⁴ See text accompanying notes 9-106 *supra*.

¹⁹⁵ See Casey, *supra* note 69, at 597-98.

¹⁹⁶ 17 C.F.R. § 230.147 (1977) [hereinafter cited as Rule 147]. See SEC Securities Act Release No. 33-5450, 1 FED. SEC. L. REP. (CCH) ¶ 2340 (Jan. 7, 1974).

¹⁹⁷ Securities Act of 1933 § 3(a)(11), 15 U.S.C. § 77c (a)(11) (1976).

¹⁹⁸ Rule 147(c).

¹⁹⁹ The SEC notes that an issue which is genuinely local in character is one "which in reality represents local financing by local industries, carried out through local investment." Rule 147 Preliminary Note 3, 17 C.F.R. § 230.147 (1977).

²⁰⁰ Rule 147(c)(2)(i). The 80% requirement is calculated for the principal industry and all subsidiaries. *Id.* Thus, a company with stores in numerous states may not be able to qualify for the Rule 147 exemption. Even if a company does qualify under this subsection it may fail to meet the other criteria necessary to be considered doing business in a state. See text accompanying notes 201-02 *infra*.

²⁰¹ Rule 147(c)(2)(ii). The calculation of the share of a company's assets within the state must take all subsidiaries into consideration.

²⁰² Rule 147(c)(2)(iii). The proceeds must be used "in connection with the operation of a

pal office within such state.²⁰³ These criteria are interpreted rigorously.

In *Berkeley and Co.*,²⁰⁴ the company had assets located in Iowa, Canada, and Taiwan. Seventy-nine point eight percent of its assets were located in Iowa. The SEC refused to allow the use of Rule 147 because the eighty percent requirement had not been met. The SEC also refused to allow the company to use a fair market valuation of its assets where such accounting method would bring the share of assets in Iowa to eighty-three point five percent.

In conjunction with the eighty percent requirement, offerings must also be local in character.²⁰⁵ In *Western Credit Association, Inc.*,²⁰⁶ petitioner proposed the sale of short term notes to California residents. Those notes could be placed with a California bank as a contribution toward the purchase of an annuity from a Maryland insurance company which did over fifty percent of its business in California. In denying the offering exempt status under Rule 147, the SEC noted that the participation of the Maryland insurance company foreclosed the offering from being genuinely local in character.²⁰⁷

Although Rule 147 expressly states that it is non-exclusive,²⁰⁸ critics suggest that judges and the SEC will look to Rule 147 as providing the guidelines for determining whether an offering is intrastate within the meaning of section 3(a)(11).²⁰⁹ These guidelines can "be expected to 'spill over' . . . until they have preempted the field."²¹⁰ Thus, issuers who cannot fulfill the requirements of Rule 147 "should not look to the intrastate offering exemption as a method of raising capital in the future."²¹¹

Conclusion

Although Rules 144, 146 and 147 were enacted to establish standards for determining the availability of various exemptions under the '33 Act, the requirements of each Rule must be strictly complied with. Recently, the SEC has expressed concern that the stringent requirements of the Rules are preventing issuers and investors from taking advantage of the Rules. Therefore, the SEC has proposed an amendment to Rule 146 which

business or of real property, the purchase of real property located in, or the rendering of services within such state. . . ."

²⁰³ Rule 147(c)(2)(iv).

²⁰⁴ [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 80,356 (SEC Staff Reply Sept. 16, 1975).

²⁰⁵ See note 199 *supra*.

²⁰⁶ [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 80,439 (SEC Staff Reply Feb. 26, 1976).

²⁰⁷ *Id.* at 86,159.

²⁰⁸ Rule 147 Preliminary Note 1, 17 C.F.R. § 230.147 (1977).

²⁰⁹ See Alberg & Lybecker, *New S.E.C. Rules 146 and 147: The Non-Public and Intra-state Offering Exemptions from Registration for the Sale of Securities*, 74 COLUM. L. REV. 622, 653 (1974).

²¹⁰ *Id.* at 653.

²¹¹ *Id.*