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Resales of Restricted Securities under Section 4(1-1/2)

Section 4(a)(2) of the Securities Act of 1933 (the “Act”) exempts from registration “transactions by an issuer not involving any public offering.” It is section 4(a)(2) that permits an issuer to sell securities in a “private placement” without registration under the Act. Section 4(a)(2), however, is only available to the issuer, and not to persons who have acquired securities from the issuer and who want to resell the securities.

Section 4(a)(1) of the Act exempts from registration “transactions by any person other than an issuer, underwriter, or dealer.” A holder of securities who is not an issuer or a dealer can therefore sell his securities in a private sale without registration if the holder is not an underwriter as “underwriter” is defined in section 2(a)(11). Generally, a person is an “underwriter” if he acquires securities with a view to “distribution” or is participating in a “distribution,” which generally means an offering that is not a private offering.

A holder of securities that were issued in a private placement may resell the securities on a public trading market, after a holding period, pursuant to the SEC’s Rule 144. There is not, however, a similar rule for private resales of restricted securities. A holder of securities who wishes to resell them privately under section 4(a)(1) therefore must sell in a transaction that is sufficiently “private” to avoid his being considered an underwriter. Over time, the various restrictions on sale considered by the SEC and securities lawyers to permit a resale under 4(a)(1) has been referred to as “section 4(1-1/2)” The SEC has never attempted to provide more specific guidance under 4(1-1/2).

It is generally considered that for a resale to be private for purposes of section 4(1-1/2),

- it should be to a limited number of purchasers, certainly less than 25 purchasers;
- the securities should be offered without public advertising or general solicitation;
- the seller should provide the purchaser with such information about the issuer as is available to the seller, although a seller that is not affiliated with the issuer may not be able to provide anything like the disclosures that would be made in a private placement by the issuer;

If the seller is affiliated with the issuer, purchasers generally should be limited to those who are sophisticated enough to be able to evaluate the risks of the investment;

Although no specific holding period is required before the resale of the securities, the seller must not have purchased the securities with a view to resale, and it generally is considered that a holding period of six months or more will evidence the seller’s original investment intent; and the purchaser should represent that it is acquiring the securities for investment, and not for resale.