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# Guide to Structuring Resales of Restricted Securities Held by Control and Non-Control Holders Under Federal and Arkansas Law

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# GUIDE TO STRUCTURING REALES OF RESTRICTED SECURITIES HELD BY CONTROL AND NON-CONTROL HOLDERS UNDER FEDERAL AND ARKANSAS LAW

*John F. Griffee, IV\**

## I. INTRODUCTION

When an investor acquires ownership in a non-public company (e.g., stock, limited liability company interest, or other security), the investment documents (e.g., a subscription agreement, a stockholders agreement, an operating agreement, or an investor rights agreement, as applicable) and the certificate representing the security acquired will typically contain restrictions on transferring or reselling the security. In light of the consequences resulting from an unlawful resale of the acquired security, the company issuing the security (the “issuer”) generally insists on some degree of restriction on resales of the security; such restrictions are usually set forth in the investment documents and certificate representing the acquired security. Often, the issuer additionally—either through a provision in the investment documents or legend on the certificate representing the security—requires an opinion of counsel before the acquired security may be resold.<sup>1</sup> Under Section 12(a) of the Securities Act of 1933 (“Securities Act”), a resale of the acquired security that fails to satisfy federal or state securities laws could entitle the purchaser of that security to rescission and the return of the purchase price.<sup>2</sup> More importantly, even if the issuer perfectly complied with federal and state securities laws in its original offering of the securities, an unlawful resale could “destroy[] the exemption the issuer originally relied” upon when issuing the securities.<sup>3</sup> Consequently, such an unlawful resale transaction could subject the issuer to liability for rescission to every investor in its original offering.<sup>4</sup> Accordingly, in resale transactions, whether

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1. A legal opinion typically requires counsel to state that the proposed resale will satisfy exemptions under federal and applicable state securities laws.

2. See 15 U.S.C. § 77f(a) (2012).

3. JAMES D. COX, ROBERT W. HILLMAN & DONALD C. LANGEVOORT, SECURITIES REGULATION 345 (5th ed. 2006).

4. STEPHEN J. CHOI & A. C. PRITCHARD, SECURITIES REGULATION: THE ESSENTIALS 284–85 (2008). For offerings under Regulation D of the Securities Act, the issuer may avoid liability for unlawful resales of securities issued under Regulation D based on the substantial compliance defense in Rule 508, 17 C.F.R. § 230.508 (2013). However, Rule 508 does not

counsel to the issuer, counsel to the investor, or counsel issuing an opinion on the resale, certainty in compliance with federal and state securities laws is a primary concern.

This article is written to assist attorneys structuring resales of “restricted securities” (e.g., securities issued in a private placement) with compliance under federal and Arkansas securities laws. Additionally, this article provides some background and analysis intended to provide an understanding of federal and Arkansas resale exemptions. When used in this article, these capitalized terms mean the following: Resale Holder means an investor (e.g., stockholder, bondholder, limited partner, or limited liability company member) proposing to resell “restricted securities.”<sup>5</sup> Control Holder means a Resale Holder proposing to resell “control securities.”<sup>6</sup> Non-Control Holder means a Resale Holder who is not a Control Holder. Purchaser means a person or entity purchasing “restricted securities” or “control securities” in a transaction other than the original issuance of the security (in other words, Purchaser refers to the person or entity purchasing the securities from the Resale Holder).

## II. APPLICABILITY

Practitioners most frequently encounter securities laws issues relating to resales of securities when structuring resales of “restricted” corporate stock. The common scenario involves a non-public company issuing stock in a private placement (e.g., an offering under Regulation D or Section 4(a)(2) of the Securities Act).<sup>7</sup> Securities issued in a private placement are generally deemed restricted securities. Registration or exemption under both federal and state securities laws is required for lawful resale of such restricted securities, except that state registration or an exemption from registration is not required in resale transactions made under Section 4(a)(7).<sup>8</sup>

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extend to violations relating to dollar ceilings, numerical purchaser limits, or general solicitations. Regulation D; Accredited Inv’r & Filing Requirements, Securities Act Release No. 6825 (Mar. 14, 1989). See generally Carl W. Schneider, *A Substantial Compliance (“I&I”) Defense and Other Changes Are Added to SEC Regulation D*, 44 BUS. LAW. 1207 (1989) (providing an in depth overview of Rule 508).

5. See *infra* Part III (defining the term “restricted securities”).

6. “Control securities” generally refer to securities held by an affiliate of the issuer (e.g., directors, executive officers, and control shareholders in the case of a corporation). See *infra* Part IV.A.2 (defining the term “control securities”).

7. See Rutheford B. Campbell, Jr., *Resales of Securities Under the Securities Act of 1933*, 52 WASH. & LEE L. REV. 1333, 1340 (1995).

8. *Id.*; see also Carl W. Schneider, *Section 4(1-1/2)—Private Resales of Restricted or Control Securities*, 49 OHIO ST. L.J. 501 (1988). For a discussion regarding preemption of state registration requirements for resale transactions under Section 4(a)(7) of the Securities Act, see *infra* Part IV.B.3.

Although it is common to think of securities law compliance in the context of corporate stock resales, it is important to recognize that securities laws also generally apply to resales of interests in unincorporated entities, such as limited liability companies (LLC) and limited partnerships (LP).<sup>9</sup> Further, in Arkansas, securities laws can extend to resales of general partnership interests in certain instances.<sup>10</sup> When analyzing resales of any such non-stock interests, the threshold inquiry is whether the LLC, LP, or other non-stock interest is a “security,” as defined in the state or federal securities laws. Under federal securities law, the analysis generally centers on whether the interest constitutes an investment contract under the *Howey* test.<sup>11</sup> Under the *Howey* analysis, as applied to LLC and LP interests, the investor’s degree of passivity is often the key factor indicating whether a security exists.<sup>12</sup> Arkansas jurisprudence, while similar to *Howey* in some ways, inter-

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9. Determining whether an interest is a security is guided by the definition of “security” in the Securities Act. 15 U.S.C. § 77b(a)(1) (2012). The Securities Act definition enumerates several interests that are securities, such as stock, bonds, options, and investment contracts. *Id.*; see also ARK. CODE ANN. § 23-42-102(17)(A) (Repl. 2013) (defining “security” under the Arkansas Securities Act). After the definition in the Securities Act was composed in 1933, however, new entities, such as the limited liability partnership and limited liability company, emerged. As a result, the term “investment contract” set forth in the definition of “security” in the Securities Act has been interpreted by courts to encompass such new entity ownership interests.

10. *Casali v. Schultz*, 292 Ark. 602, 605, 732 S.W.2d 836, 837 (1987) (“The mere fact that an investment takes the form of a general partnership does not insulate it from the reach of the Arkansas Securities Act.”). Specifically, the court noted the following:

A general partnership or joint venture interest can be designated a security if the investor can establish, for example, that (1) an agreement among the parties leaves so little power in the hands of the partner or venturer that the arrangement in fact distributes power as would a limited partnership; or (2) the partner or venturer is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers; or (3) the partner or venturer is so dependent on some unique entrepreneurial or managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers.

*Id.*, 732 S.W.2d at 837–38 (quoting *Williamson v. Tucker*, 645 F.2d 404, 424 (5th Cir. 1981)).

11. *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298 (1946) (holding that an investment contract is an investment of money in a common enterprise with the expectation of profit derived solely, or predominately, from the efforts of others); see FRANCES S. FENDLER, PRIVATE PLACEMENTS AND LIMITED OFFERINGS OF SECURITIES: A GUIDE FOR THE ARKANSAS PRACTITIONER § 2.1 (2010) (detailing the interpretation of “security” under the Securities Act).

12. See 1 THOMAS L. HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 1.62 (6th ed. 2009). With respect to limited partnerships as commonly structured, general partnership interests typically do not represent securities while limited partnership interests typically meet the definition of a security. See COX ET AL., *supra* note 3, at 50; see also *In re Ace Payday Plus, LLC*, 2002 Ark. Sec. LEXIS 12 at \*5 (noting passivity is a factor when analyzing whether LLC units are securities); *Pro Pick LLC*, 1994 Ark. Sec. LEXIS 21 at \*2.

prets the definition of security more broadly than *Howey*, focusing on all of the facts surrounding the transaction to determine whether an investment contract or other instrument is a security under the Arkansas Securities Act.<sup>13</sup>

Additionally, it should be noted that restrictions on resales also arise in the resale of registered securities of public companies. Specifically, a resale by a Control Holder could violate federal registration requirements, even if the securities were originally sold in a registered public offering.<sup>14</sup> Also, public companies may occasionally issue restricted securities in private placement transactions under the exemption set forth in Rule 506 of Regulation D under the Securities Act. Unless specifically noted, this article focuses on resale of restricted securities issued by non-public companies.

### III. BACKGROUND

Section 5 of the Securities Act makes it unlawful to sell securities unless the sale is registered or exempt.<sup>15</sup> This commonly stated registration or exemption maxim under Section 5 of the Securities Act applies equally to resales and original issuances of securities.<sup>16</sup> As applied to resales, Section 5 of the Securities Act requires registration or exemption in the following two main instances: (1) resales of restricted securities; and (2) resales of control securities.<sup>17</sup> Securities originally issued in a private placement under an ex-

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13. See *Waters v. Millsap*, 2015 Ark. 272, at 13, 465 S.W.3d 851, 858 (holding that the *Shultz* test, requiring a review of all facts related to the transaction, is the proper test for determining whether an instrument is a security under the Arkansas Securities Act, rather than the five-factor *Smith* test). In 1979, the Court of Appeals of Arkansas decided *Smith v. State* and adopted the following five-factor test instructive in determining whether an investment contract, or other instrument, is a security:

(1) the investment of money or money's worth; (2) investment in a venture; (3) the expectation of some benefit to the investor as a result of the investment; (4) contribution towards the risk capital of the venture; and (5) the absence of direct control over the investment or policy decisions concerning the venture.

*Smith v. State*, 266 Ark. 861, 864–65, 587 S.W.2d 50, 53 (1979). Prior to *Smith*, the Supreme Court of Arkansas held “that the definition of a security within the meaning of the Arkansas Securities Act should not be given a narrow construction,” but should be determined “in each instance from a review of all the facts whether an investment scheme, or plan, constitutes an investment contract . . . within the scope of the statute.” See *Schultz v. Rector-Phillips-Morse, Inc.*, 261 Ark. 769, 781, 552 S.W.2d 4, 10 (1977). In its most recent pronouncement on the issue, the Arkansas Supreme Court stated that “[w]hile the *Smith* test remains instructive, we find that the all-inclusive nature of the *Schultz* test is better suited” for determining what is considered a security under the Arkansas Securities Act. *Waters*, 2015 Ark. 272 at 13, 465 S.W.3d at 858.

14. *CHOI & PRITCHARD*, *supra* note 4, at 351.

15. *Campbell*, *supra* note 7, at 1334–35.

16. *COX ET AL.*, *supra* note 3, at 345.

17. *See id.*

emption to the registration requirements of the Securities Act are generally considered restricted securities. Control securities generally refer to securities held by an affiliate of the issuer.<sup>18</sup> Control securities can be restricted securities (issued under an exemption from registration) or registered securities (issued under a registration statement filed with the U.S. Securities and Exchange Commission (SEC)). The Securities Act and the rules promulgated under the Securities Act contain exemptions available to Resale Holders proposing resales of control and restricted securities (e.g., Section 4(a)(1), Section 4(a)(7) and Rule 144).<sup>19</sup>

Similar to the federal registration or exemption maxim, Arkansas securities laws require that sales and resales of securities be either registered with the Arkansas Securities Department or exempt from registration (except for resale transactions that qualify for preemption of state securities laws under Section 18 of the Securities Act).<sup>20</sup> Specifically, Section 501 of the Arkansas Securities Act, which contains a similar registration or exemption requirement for offers and sales of securities, is the state's companion provision to Section 5 of the Securities Act.<sup>21</sup> Section 504 of the Arkansas Securities Act contains exemptions available to issuers and Resale Holders proposing sales and resales of securities.<sup>22</sup> Moreover, discretionary exemptions promulgated by the Arkansas Securities Department and contained in the Rules of the Arkansas Securities Commissioner (the "Rules") are available for resales of control and restricted securities.<sup>23</sup>

#### IV. FEDERAL REALE EXEMPTIONS

As discussed above, the Securities Act and the rules promulgated under the Securities Act contain exemptions available to Resale Holders proposing resales of control and restricted securities. Part A will discuss the federal Section 4(a)(1) exemption, and Part B will discuss the other federal exemptions, including the Rule 144 exemption, the Section 4(a)(1½) exemption, and the new exemption under Section 4(a)(7) of the Securities Act.

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18. See *infra* note 51 and accompanying text (defining affiliate under the Securities Act).

19. See discussion *infra* Part IV.

20. See FENDLER, *supra* note 11, at 27–28. For a discussion regarding preemption of state registration requirements for resale transactions under Section 4(a)(7) of the Securities Act, see *infra* Part IV.B.3.

21. ARK. CODE ANN. § 23-42-501(2) (Repl. 2013).

22. *Id.* § 23-42-504 (Repl. 2013); see discussion *infra* Part V.A.

23. 003-14-006 ARK. CODE R. 504.01 (LexisNexis 2013), <http://www.securities.arkansas.gov/page/347/rules>.

### A. Section 4(a)(1) Exemption

One common exemption for resale of restricted securities (and control securities under more limited circumstances as further described in Part IV.A.2 below) exists in Section 4(a)(1) of the Securities Act.<sup>24</sup> Section 4(a)(1) exempts transactions by those other than an issuer, underwriter, or dealer.<sup>25</sup> The key to applying the Section 4(a)(1) exemption is to understand the definition of “underwriter” set forth in the Securities Act.<sup>26</sup> For purposes of federal securities laws, the term underwriter is not limited to Wall Street investment banks that commonly underwrite initial public offerings. Rather, the definition of underwriter in the Securities Act is much broader and frequently implicates public resales of restricted securities, as well as public resales of a significant amount of the issuer’s securities by Control Holders (the individual making these resales that are implicated by the Section 2(a)(11) definition of underwriter is often referred to as a statutory underwriter because the individual is not a typical Wall Street underwriter).<sup>27</sup>

Section 2(a)(11) of the Securities Act defines underwriter as “any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security.”<sup>28</sup> Further, the Section 2(a)(11) definition of underwriter provides that a Control Holder is an issuer for purposes of determining whether the Purchaser is an underwriter or whether the transaction involves an underwriter (the Control Holder is commonly referred to as a 2(a)(11) issuer).<sup>29</sup> In other words, the definition of underwriter in Section 2(a)(11) implicates resales when a person, including a Resale Holder, does any of the following: (1) purchased from the issuer, or from a Control Holder as a 2(a)(11) issuer, with a view to distribution; (2) sold for the issuer, or for a Control Holder as a 2(a)(11) issuer, in connection with a distribution; or (3) participated in a distribution by the issuer.<sup>30</sup> If a Resale Holder is deemed to have purchased the security with a view to distribution, he or she will be an underwriter under the Securities Act.

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24. 15 U.S.C. § 77d(a)(1) (2012).

25. *Id.*

26. The definition of underwriter is critical because the Resale Holder seeking an exemption will generally not be considered an issuer or dealer, except where there is a resale of control securities a Control Holder is deemed an issuer under the second sentence of the definition of underwriter in Section 2(a)(11). See discussion *infra* Part IV.A.2. Thus, if the Resale Holder is not an underwriter, the resale transaction will be exempt from Section 5 of the Securities Act. The transactional nature of the Section 4(a)(1) exemption analyzes whether the entire transaction (from the issuance by the issuer to the resale to subsequent Purchasers) involves an underwriter.

27. See FENDLER, *supra* note 11, at 229.

28. 15 U.S.C. § 77b(a)(11) (2012).

29. *See id.*

30. J. WILLIAM HICKS, *RESALE OF RESTRICTED SECURITIES* 6:11 (2010).

The result of a resale transaction involving an underwriter is that a commonly relied upon exemption for public resales (i.e., Section 4(a)(1)) is unavailable for the transaction.<sup>31</sup> Accordingly, unless another federal exemption applies to the resale, the transaction will violate federal securities laws.<sup>32</sup> Stated differently, the Resale Holder's sale will violate Section 5 of the Securities Act, and the issuer could lose the exemption under which it originally issued the securities.<sup>33</sup>

### 1. *Resale Holder as an Underwriter*

As described above, based on the definition of underwriter in Section 2(a)(11) of the Securities Act, a Resale Holder will be an underwriter if he or she purchases from an issuer with a view to distribution. Whether a Resale Holder purchases securities from an issuer with a "view to distribution" is left undefined by the Securities Act.<sup>34</sup> The analysis generally focuses on (1) whether the Resale Holder acquired the securities with investment intent and (2) whether the resale is a distribution.<sup>35</sup>

The critical inquiry with respect to investment intent is the Resale Holder's holding period.<sup>36</sup> Generally, most practitioners believe a purchaser possesses investment intent if shares have been held for at least three years.<sup>37</sup> For holding periods less than three years, consideration may be given to the circumstances existing before and after the purchase.<sup>38</sup> A Resale Holder, other than a Control Holder,<sup>39</sup> who establishes investment intent, will not be deemed an underwriter.<sup>40</sup> Accordingly, a resale made by a Non-Control Holder with investment intent will be exempt under Section 4(a)(1) as a transaction not involving an issuer, underwriter, or dealer.<sup>41</sup>

31. GARY M. BROWN, SECURITIES LAW AND PRACTICE DESKBOOK, § 7:3.1, at 7-8 (6th ed. 2012).

32. *Id.*

33. *Id.* at 7-7.

34. *Id.* at 7-8.

35. See COX ET AL., *supra* note 3, at 353.

36. *Id.* at 354.

37. *Id.*

38. *Id.* The Resale Holder can establish investment intent if the resale "occurs after the [Resale] Holder's circumstances change in some fairly dramatic way." Campbell, *supra* note 7, at 1339.

39. See *infra* Part IV.A.2.b (discussing different analyses of Control Holder).

40. See *infra* Part IV.A.2.b.

41. There is no issuer involved because a resale transaction does not involve an issuance of securities. There is no underwriter involved because the Resale Holder established investment intent. There is no dealer involved assuming there is no party involved in the transaction that meets the definition of dealer under Section 2(a)(12). See 15 U.S.C. § 77b(a)(12) (2012). Thus, the resale transaction is exempt from the registration requirements of Section 5 of the Securities Act.



Assuming the Resale Holder cannot establish investment intent, the Resale Holder will be deemed an underwriter unless the resale does *not* constitute a distribution. A distribution is generally synonymous with a public offering but is more fully described as “the entire process by which in the course of a public offering the block of securities is dispersed and ultimately comes to rest in the hands of the investing public.”<sup>42</sup> A public offering has been interpreted by the courts in *Ralston Purina* and its progeny as an offering to investors who are unable to fend for themselves.<sup>43</sup> It may not be necessary, however, that all the criteria necessary to establish that there was a public offering (i.e., access to information and sophistication of all Purchasers) be present for the resale to *not* constitute a distribution.<sup>44</sup> Rather, the test for determining whether a distribution exists in the context of a Non-Control Holder resale when the Resale Holder lacks investment intent is whether the securities being resold will come to rest only in hands of those who would satisfy the exemption relied upon by the issuer. Therefore, the inquiry is whether the resale, when viewed together with the original purchasers and all subsequent purchasers as a single transaction, satisfies the exemption originally relied upon by the issuer.<sup>45</sup> If the resale satisfies the issuer’s exemption, there will *not* be a distribution.

For example, assume an Arkansas corporation issues securities only to Arkansas investors, as required under the intrastate offering exemption set forth in Section 3(a)(11) of the Securities Act. A Resale Holder acquiring such restricted securities could immediately resell the securities to another Arkansas resident. Such a resale would be exempt from the federal registration requirements under Section 4(a)(1) because the Purchaser acquiring the securities from the Resale Holder would satisfy the criteria of the intrastate exemption relied upon by the issuer.<sup>46</sup> Accordingly, even though the Resale Holder cannot establish investment intent in light of such a short holding period, no distribution would exist for purposes of Section 4(a)(1). The analysis similarly applies to a resale undertaken when the issuer issued securities under Rule 506 of Regulation D under the Securities Act. If the Purchaser acquiring the securities from the Resale Holder satisfies the criteria

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42. FENDLER, *supra* note 11, at 228 (quoting *In re Lewisohn Copper Corp.*, 38 S.E.C. 226, 234 (1958)); *see also* Campbell, *supra* note 7, at 1338.

43. SEC v. *Ralston Purina Co.*, 346 U.S. 119, 125 (1953). Key factors in whether a sale is a public offering include the following: “[1] the number of offerees, [2] the relationship of the offerees to each other and the issuer, [3] the manner of the offering, [4] information disclosure or access, and [5] the sophistication of the offerees.” SEC v. *Kenton Capital*, 69 F. Supp. 2d 1, 11 (D.D.C. 1998); *see also infra* Part IV.B.2.

44. COX ET AL., *supra* note 3, at 357.

45. *See id.*

46. *Id.* at 358 (citing Campbell, *supra* note 7, at 1352).

for an “accredited investor” as defined in Rule 501(a) of Regulation D<sup>47</sup> and the resale transaction otherwise satisfies the requirements of the Rule 506 exemption (for example, no general solicitation or general advertising), then the resale would not involve a distribution.<sup>48</sup>

If a Non-Control Holder makes a “distribution” of a restricted security and cannot establish investment intent, the Non-Control Holder will be deemed a statutory underwriter. As a result, the Section 4(a)(1) exemption will be unavailable for the resale. Accordingly, unless another federal resale exemption is available, the resale will destroy the exemption originally relied on by the issuer.<sup>49</sup> Consequently, the issuer’s original offering will violate the registration requirements of Section 5 of the Securities Act and the original issuer could become liable for rescission to all investors in its offering.<sup>50</sup>

## 2. Control Holder Resales

Based on the definition of underwriter in Section 2(a)(11) of the Securities Act, resales of securities by a Control Holder take on an added layer of complexity. Although not defined in federal securities laws, control securities are generally described as “securities held by an affiliate of the issuer.”<sup>51</sup>

47. Rule 501 of Regulation D under the Securities Act identifies several categories of persons, both natural persons and entities, who are “conclusively presumed [whether based on wealth, income, or position] to be able to ‘fend for themselves.’” See FENDLER, *supra* note 11, at 155. That is, such individuals are “accredited investors” as defined by Rule 501(a). With respect to natural persons, categories of accredited investors include anyone who: (i) has earned income that exceeded \$200,000 (or \$300,000 together with a spouse) in each of the prior two years, and reasonably expects the same for the current year, (ii) has a net worth over \$1 million, either alone or together with a spouse (excluding the value of the person’s primary residence) or (iii) is an officer, director, or general partner of the issuer. 17 C.F.R. § 230.501(a)(5)–(6) (2013). With respect to entities, categories of accredited investors include: (i) any corporation, limited liability company, partnership, or Internal Revenue Code § 501(c)(3) tax exempt organization with total assets in excess of \$5 million, (ii) institutional investors such as banks, registered brokers or dealers, investment companies, and certain employee benefit plans, (iii) any trust, with total assets in excess of \$5 million, not formed to specifically purchase the subject securities, whose purchase is directed by a sophisticated person, or (iv) any entity in which all of the equity owners are accredited investors. *Id.* § 230.501(a)(1)–(3), (7)–(8).

48. See COX ET AL., *supra* note 3, at 358.

49. See *id.*

50. *Id.*

51. Revisions to Rules 144 and 145, 72 Fed. Reg. 71,546, 71,547 (Dec. 17, 2007) (to be codified at 17 C.F.R. pts. 230 and 239). “An affiliate of [the] issuer is a person that directly[] or indirectly . . . controls, or is controlled by, or is under common control with, [the] issuer.” 17 C.F.R. § 230.144 (2012). Control (as defined in Rule 405 of the Securities Act) means to possess, directly or indirectly, “the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.” *Id.* § 230.405 (2014). Although this definition is set forth in Regulation C under

Control securities generally include, but are not limited to, securities held by a director, executive officer, subsidiary, or greater than ten percent shareholder in the case of a corporation.<sup>52</sup> With respect to other entities, control securities commonly include securities held by general partner(s) in the case of a partnership, manager(s) in the case of an LLC, and owners (i.e., partners, members, and other owners, as the case may be) with controlling ownership interests in the entity. Notwithstanding this rule of thumb, determining whether a person is a Control Holder involves a highly fact specific inquiry.<sup>53</sup>

Resale by a Control Holder can present particular problems for a practitioner. Under certain circumstances, resale of control securities will be analyzed in the same manner as resales by Non-Control Holders. In other circumstances, however, certain facts may require a completely different analysis.

- a. Resale by Control Holder under Section 4(a)(1) when issuer's offering has not come to rest

The analysis for resale of control securities is the same as that of a Non-Control Holder when the Control Holder cannot establish investment intent. Again, the test is whether the issuer's offering, when viewed in combination with all initial sales and subsequent resales, constitutes a distribution. In this instance, a Control Holder's resale must be able to satisfy the exemption originally relied upon by the issuer.<sup>54</sup> If the issuer's sales in combination with the Control Holder's resale satisfy the original exemption relied upon by the issuer, the Control Holder's resale is protected by the origi-

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the Securities Act and authoritative only under such regulation, which relates to registration of securities, it is considered persuasive in other contexts.

52. See HICKS, *supra* note 30, 4:38. A beneficial owner of ten percent or more of outstanding securities of the issuer is presumptively a Control Holder of the issuer. *Id.* The percentage of shares owned is not always determinative of control. See STEVEN MARK LEVY, REGULATION OF SECURITIES: SEC ANSWER BOOK § 13:7 (4th ed. 2003); Revision of Rule 144, Rule 145 and Form 144, 62 Fed. Reg. 9246, 9247 (Feb. 28, 1997) (to be codified at 17 C.F.R. pts. 230 and 239). The ownership of a substantial number of shares standing alone does not always lead to a finding of control. Revision of Rule 144, Rule 145 and Form 144, 62 Fed. Reg. at 9247. Conversely, control can be found with ownership of less than ten percent of an issuer's securities when that ownership is coupled with another significant relationship with an issuer. *Id.* The ten percent ownership level is a "crude rule of thumb" that must be considered in light of factors relevant to control such as the type of security and the concentration of the company's voting securities. Rutheford B. Campbell, Jr., *Defining Control in Secondary Distributions*, 18 B.C. INDUS. AND COM. L. REV. 37, 44 (1976).

53. See FENDLER, *supra* note 11, at 230.

54. COX ET AL., *supra* note 3, at 359-60.

nal exemption.<sup>55</sup> Otherwise, the Control Holder's resale to a Purchaser that fails to satisfy the requirements of the original issuer's exemption will constitute a distribution and cause the Control Holder to be an underwriter.<sup>56</sup> Consequently, the resale will cause the issuer and the Control Holder to violate Section 5.<sup>57</sup>

b. Resale by Control Holder under Section 4(a)(1) when issuer's offering has come to rest

The analysis for resale by a Control Holder is much different than the analysis for a Non-Control Holder when investment intent is established. With respect to a resale by a Non-Control Holder, establishing investment intent protects the resale under Section 4(a)(1) of the Securities Act because a Non-Control Holder with investment intent is not an underwriter. That is, the securities have come to rest in the hands of the Non-Control Holder; so, the Non-Control Holder can establish that there was no *view to distribution*. The analysis for the resale by a Control Holder under these circumstances, however, cannot end there.

A resale under Section 4(a)(1) where the Control Holder establishes investment intent is analyzed differently because of the second sentence in the definition of "underwriter" in Section 2(a)(11) of the Securities Act. Under Section 2(a)(11), a person who purchases securities from the Control Holder, sells for the Control Holder, or otherwise participates in a distribution for a Control Holder could be deemed an underwriter.<sup>58</sup> Specifically, Section 2(a)(11) provides that a Control Holder is an issuer for purposes of determining whether the Purchaser, or broker, or other person participating in the resale, is an underwriter under Section 2(a)(11) (i.e., the Control Holder is a 2(a)(11) issuer).<sup>59</sup> For example, if a Control Holder, as a 2(a)(11) issuer, sells securities to a Purchaser in a resale transaction, and the Purchaser takes the securities with a view to distribution, the Purchaser will be a statutory underwriter under Section 2(a)(11).<sup>60</sup> Similarly, if a Control Holder makes a distribution to a Purchaser through a broker, the broker will be deemed a

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55. *Id.* This result is based on the transactional nature of exemptions under the Securities Act. *Id.*

56. *Id.* at 360.

57. See BROWN, *supra* note 31, § 7:3.1, at 7-9 to -10.

58. 15 U.S.C. § 77b(a)(11) (2012).

59. *Id.*

60. See COX ET AL., *supra* note 3, at 360. The definition of underwriter in Section 2(a)(11) is one who acquires shares from an "issuer" with a view towards distribution. 15 U.S.C. § 77b(a)(11). Because the Control Holder is deemed an "issuer" under the second sentence in Section 2(a)(11), if the Purchaser acquires securities from the Control Holder with a view towards distribution, the Purchaser will be an "underwriter" based on the statutory definition of "issuer" in Section 2(a)(11). See *id.*

statutory underwriter under Section 2(a)(11) because the broker is selling for a Section 2(a)(11) issuer in connection with a distribution.<sup>61</sup> In either instance, if the Purchaser or broker is deemed an underwriter, the resale will violate Section 5 for failing to meet either the registration or exemption requirement. Consequently, the Control Holder could be liable to the Purchaser for rescission if the resale violates Section 5.<sup>62</sup>

## B. Other Federal Resale Exemptions

Because of the uncertainty surrounding whether restricted securities were acquired with a view to distribution, resale exemptions other than Section 4(a)(1) are critical for practitioners. For example, the three-year holding period generally required to establish investment intent under the Section 4(a)(1) exemption is impractical when the Resale Holder needs to liquidate his or her investment. Further, the ill-defined boundaries of the distribution concept make reliance on Section 4(a)(1) somewhat unsettling. Moreover, in closely-held corporations, the Resale Holder is often an affiliate of the issuer (i.e., the Resale Holder is a Control Holder); so, reliance on Section 4(a)(1) is more complex by virtue of the Control Holder's status as a 2(a)(11) issuer. From this backdrop, structuring the transaction at the federal level under the safe harbor provisions in Rule 144 or the generally accepted Section 4(a)(1½) exemption are common alternative approaches to relying solely on

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61. See FENDLER, *supra* note 11, at 235.

62. See generally *Ackerberg v. Johnson*, 892 F.2d 1328 (8th Cir. 1989) (illustrating issues of Control Holder resales). In *Ackerberg*, Johnson was a Control Holder by virtue of being the founder and largest shareholder of Vertimag, Inc. *Id.* at 1329. After holding his shares for at least four years, Johnson resold some of his Vertimag shares to Ackerberg (through a broker). *Id.* at 1336. The court held that Johnson's resale was exempt under Section 4(a)(1) (though the court did not expressly recognize the 4(a)(1½) exemption by name, its analysis essentially affirmed application of the 4(a)(1½) analysis in Control Holder resales). *Id.* at 1335 n.6. First, the court noted that Johnson established investment intent by holding his shares for four years. *Id.* at 1336. Next, and more importantly, for a Control Holder resale, the court held that the resale was exempt under Section 4(a)(1) because it did not involve a "distribution." *Id.* at 1337. The court applied the public offering criteria of Section 4(a)(2) to determine no distribution occurred: Ackerberg was a sophisticated investor and he was given full and complete information regarding Vertimag (the issuer). *Id.* Thus, no distribution was involved, and the resale was exempt because Johnson was not an underwriter. Also notable, the court found that even though Johnson used a broker to sell his shares to Ackerberg, the 4(a)(1) exemption was still available to exempt the transaction because, absent a distribution, no party to the transaction (including the broker) can be an underwriter. *Id.* at 1334 n.4. *United States v. Wolfson* also illustrates issues of Control Holder resales. 405 F.2d 779 (2d Cir. 1968). In *Wolfson*, the Control Holder and his immediate family owned forty percent of the stock of Continental Enterprises. *Id.* at 781. Wolfson sold approximately half of his shares through six brokers. *Id.* The court noted that the resales were underwritten transactions with Wolfson as the "issuer" and the brokers acting as "underwriters." *Id.* at 782. Thus, Wolfson was liable for rescission. *Id.*

Section 4(a)(1). Additionally, a new resale exemption codified at Section 4(a)(7) of the Securities Act provides an attractive exemption for private resales.

### *1. Public Resales Under the Rule 144 Exemption*

Rule 144, promulgated under the Securities Act, provides a critical safe harbor for a Control or Non-Control Holder seeking to publicly resell restricted securities.<sup>63</sup> Rule 144 operates to shield a Control Holder or Non-Control Holder from being deemed an underwriter under Section 2(a)(11) of the Securities Act.<sup>64</sup> Importantly, a Purchaser in a Rule 144 transaction receives securities that are not restricted (i.e., freely transferable) whereas a Purchaser in a Section 4(a)(1½) resale transaction or a Section 4(a)(7) resale transaction receives restricted securities.<sup>65</sup> Because the conditions in Rule 144 can be quite intricate in certain circumstances, particularly as Rule 144 relates to a Control Holder resale, it is usually advisable to review Rule 144 itself (and, when appropriate, SEC interpretations and other commentary on Rule 144) when structuring a resale under Rule 144.<sup>66</sup> The following provides only a very general outline of the extensive provisions of Rule 144.

Resales by Control Holders must satisfy a number of conditions to qualify for the Rule 144 safe harbor. Regardless of whether the issuer is a reporting (i.e., public) or non-reporting (i.e., private) company, a Control Holder must generally satisfy all the conditions of Rule 144.<sup>67</sup> First, the Control Holder must meet the requisite holding period of six months with respect to resale of securities of a reporting company and one year with respect to resale of securities of a non-reporting company.<sup>68</sup> Second, there is a limit on the amount of securities that may be sold during any three-month period.<sup>69</sup> Third, adequate current information about the issuer of the securities must be available.<sup>70</sup> Fourth, the resale must be consummated through an ordinary broker transaction.<sup>71</sup> Fifth, a notice on Form 144 must be filed with the SEC if the sale involves more than 5000 shares or the aggregate dollar amount is greater than \$50,000 in any three-month period.<sup>72</sup>

63. 17 C.F.R. § 230.144(d)(1) (2012).

64. See Revision of Rule 144, Rule 145 and Form 144, 62 Fed. Reg. 9246 (Feb. 28, 1997) (to be codified at 17 C.F.R. pts. 230 and 239).

65. 17 C.F.R. § 230.144, introductory note.

66. For a detailed description of the conditions under Rule 144, see HICKS, *supra* note 30, at §§ 4:1, 4:268.

67. See *id.* at § 4:80.

68. 17 C.F.R. § 230.144(d).

69. *Id.* § 230.144(e).

70. *Id.* § 230.144(c).

71. *Id.* § 230.144(f).

72. *Id.* § 230.144(h).

On the other hand, Non-Control Holder resales are much simpler under Rule 144. A Non-Control Holder need only comply with the holding period condition of Rule 144. A Non-Control Holder must have a holding period of six months for a reporting company and one year for a non-reporting company.<sup>73</sup> Additionally, if the issuer is a reporting company, it must be current in its periodic reporting.<sup>74</sup>

As described above, the holding period is a requirement for resales by both Control Holders and Non-Control Holders. In recent years, the SEC has recognized the need for greater flexibility with respect to holding periods. In particular, as a result of amendments to Rule 144 in 2007, a Non-Control Holder may resell securities after six months for securities of a reporting company and one year for securities of a non-reporting company, compared to the previous two-year holding period. Investors that cannot satisfy the holding period and that need immediate liquidity may seek to tack the holding period of a prior holder in hopes of shortening the holding period. Importantly, Rule 144 allows tacking when a holder acquires the securities from someone other than an affiliate of the issuer (i.e., acquires the securities from someone other than a Control Holder).<sup>75</sup> Also, a Non-Control Holder is permitted to tack the holding period of a Control Holder when the Control Holder gifts the securities to the Non-Control Holder.<sup>76</sup> Other instances where a Non-Control Holder may tack the holding period of a Control Holder include securities acquired under a bona fide pledge and securities acquired under a trust.<sup>77</sup>

## 2. *Private Resales Under the Section 4(a)(1½) Exemption*

When Rule 144 is unavailable to exempt a resale, the Section 4(a)(1½) exemption is often the federal exemption of choice for practitioners.<sup>78</sup> The

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73. *Id.* § 230.144(d).

74. *See Rule 144: Selling Restricted and Control Securities*, SEC.GOV, <http://www.sec.gov/investor/pubs/rule144.htm> (last visited Mar. 22, 2016).

75. 17 C.F.R. § 230.144(d)(3). If the shares are reacquired by a Control Holder within the one-year holding period (thus converting restricted securities into control securities), the Control Holder is not permitted to tack the holding period of any prior holder, and any subsequent resale by the Control Holder to a Non-Control Holder will begin a new holding period for the Non-Control Holder. *Id.* § 230.144(d)(1)(i); DOUGLAS L. HAMMER ET AL., U.S. REGULATION OF HEDGE FUNDS 286 (2005).

76. 17 C.F.R. § 230.144(d)(3).

77. *Id.* § 230.144(d)(3)(iv), (vi). Rule 144(d)(3)(vi) permits a trust to tack the holding period of an affiliate-settlor and permits a trust beneficiary to tack the holding period of the trust and an affiliate-settlor. Securities Act Rule 144(d)(3)(iv) permits tacking of securities acquired from a pledgor-affiliate under a bona-fide pledge agreement under which the pledgee has full recourse against the pledgor. *See also* HICKS, *supra* note 30, at §§ 4:154, 4:166.

78. Resale Holders typically will rely on the Section 4(a)(1½) exemption because Rule 144 imposes certain conditions on Resale Holders, and on the issuer in some instances, such

Section 4(a)(1½) exemption is a judicially and administratively created exemption designed to facilitate private resales.<sup>79</sup> The Section 4(a)(1½) exemption stems from interpretations of the Section 4(a)(2) exemption that make the Section 4(a)(2) exemption applicable only to sales by issuers. Because the Section 4(a)(2) exemption is only applicable to issuers, the Section 4(a)(1½) exemption is technically based on the Section 4(a)(1) exemption because Section 4(a)(1) can exempt private resales that do not involve an issuer. Accordingly, the Section 4(a)(1½) exemption is a hybrid exemption; while technically it is based on the Section 4(a)(1) exemption, it applies an analysis similar to private placements by issuers under the Section 4(a)(2) exemption.

Notably for practitioners, neither the SEC nor its staff have explained the parameters or conditions of the Section 4(a)(1½) exemption.<sup>80</sup> As a result, certainty of compliance is a risk that accompanies relying on the Section 4(a)(1½) exemption. Nonetheless, the Section 4(a)(1½) exemption is a commonly-used and well-recognized exemption in practice. The key inquiry related to the Section 4(a)(1½) exemption is whether the resale would result in a distribution of the securities.<sup>81</sup> As described in the above discussion of Section 4(a)(1), distribution is not defined in the Securities Act but is generally equated with a public offering.<sup>82</sup> As a result, the Section 4(a)(1½) exemption exempts private resales when the private resale, either by itself or as part of a larger transaction, does not involve a public offering.

Courts have found the interpretations of Section 4(a)(2) in *Ralston Purina* and its progeny instructive on whether a resale involves a public offering.<sup>83</sup> In *Ralston Purina*, the Supreme Court of the United States announced the parameters of a private offering by establishing the basic principle that the private offering exemption in Section 4(a)(2) of the Securities Act is available only for an offering made *exclusively* to someone able to fend for

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as holding periods in the case of Control and Non-Control Holders and public disclosure of information, volume limitations, and other conditions in the case of Control Holders. See *supra* Part IV.B.1.

79. The term Section 4(a)(1½) refers to the interpretation of Section 4(a)(1) using the Section 4(a)(2) analysis reflected in *Ralston Purina* (hence the term Section 4(a)(1½)). CHOI & PRITCHARD, *supra* note 4, at 351.

80. See HICKS, *supra* note 30, at § 6:12.

81. See FENDLER, *supra* note 11, at 248. In the context of most resales, the Section 4(a)(1½) exemption is available so long as neither the Resale Holder *nor* the Purchaser is an underwriter. Generally, a person is an underwriter if he acquires the shares with a view to distribution or participates in a distribution. If the resale does not involve a distribution, there is no underwriter.

82. See *supra* Part IV.A.1.

83. See FENDLER, *supra* note 11, at 235, 248–49.



themselves.<sup>84</sup> As described by the Court in *Ralston Purina*, the ability of an offeree to fend for oneself depends on the following: (i) the offeree's access to the same kind of information as that which would be included in a registration statement (e.g., information a company is required to file with the SEC in connection with an initial public offering) and (ii) the offeree's sophistication.<sup>85</sup> A private offering in the context of *Ralston Purina* "does not depend upon whether the offerees are few or many, and in theory it is possible that an offering to a single person may constitute a public offering."<sup>86</sup> Since the Court's decision in *Ralston Purina*, lower courts have elaborated on the private offering principles announced by the Court. The factors emphasized by lower courts include the following: (i) information,<sup>87</sup> (ii) sophistication,<sup>88</sup> (iii) manner of offering,<sup>89</sup> (iv) number of offerees,<sup>90</sup> (v) size of

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84. HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, *SECURITIES LAW HANDBOOK*, § 9:1 (2013) (citing *SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953)).

85. *Id.* ("Although the staff of the Commission, with some judicial support, has insisted at times that access to the required information necessitates some type of insider relationship, it seems apparent that the access requirement can be satisfied by economic bargaining power as well. On occasion, the courts have required that the offerees have exceptional business experience or the equivalent level of sophistication.").

86. *Id.* The Court in fact rejected the argument that the determinative factor should be the number of investors and announced that the exemption should be interpreted in light of the following purpose of the Securities Act: "to protect investors by promoting full disclosure of information thought necessary to informed investment decisions." FENDLER, *supra* note 11, at 135 (citing *Ralston Purina*, 346 U.S. at 124).

87. The "offering must be made only to persons who either know or have access to the information they need in order to fully evaluate the merits and risks of the investment." FENDLER, *supra* note 11, at 141. "An offeree who has [an insider] relationship with the issuer that [gives] him access to full and detailed information [has less need for] detailed disclosure." *Id.* at 142. A disclosure document (i.e., an offering circular or private placement memorandum) may be furnished to offerees who do not have such an insider relationship. *Id.* While the standard for access to information that courts often recite equates the information to be provided to offerees with the type of information which would be included in a registration statement, the standard in fact is more flexible and varies with the nature of the investment and sophistication of the offerees. *Id.* at 141–42.

88. The offeree must be able to understand and evaluate the information provided intelligently. *See id.* at 143. "Relevant factors in assessing investment sophistication include education, occupation, business experience [especially experience in the kind of business in which the issuer engages], investment experience, relationship with the issuer, . . . net worth . . . , and economic bargaining power." *Id.*

89. "General advertising and solicitations are inconsistent with a private offering exempt under section 4(2)." *Id.* For example, a newspaper publication of the offering or posting offering details on a website would likely constitute an offer to a wide segment of the public. *Id.* The offerees should be persons with whom the Resale Holder (or the broker or placement agent assisting the Resale Holder) has an existing relationship. *Id.* at 143–44.

90. Lower courts have generally looked to the number of offerees as relevant to, but not determinative of, whether an offering constituted a public offering, notwithstanding the Supreme Court's rejection of the SEC's numerical test in *Ralston Purina*. *Id.* at 144.

offering,<sup>91</sup> and (vi) limitations on resale.<sup>92</sup> Because a resale that constitutes a distribution, taking into account the investors in the issuer's original offering, cannot satisfy the Section 4(a)(1/2) exemption, cases interpreting what constitutes a distribution under Section 4(a)(2), such as *Ralston Purina*, are significant in defining the contours of the Section 4(a)(1/2) exemption.

Whether the resale is a distribution (i.e., a public offering) for purposes of the Section 4(a)(1/2) exemption involves much of the same inquiry conducted under Section 4(a)(2), *Ralston Purina*, and its progeny, as discussed above. The elements include Purchaser sophistication, number of Purchasers, method of solicitation, and disclosure, including access to information.<sup>93</sup> In applying the Section 4(a)(2) analysis under *Ralston Purina* and its progeny to resales under the Section 4(a)(1/2) exemption, commentators have suggested that the number of Purchasers, including remote buyers, should not exceed twenty-five Purchasers, plus an "unlimited number of accredited investors."<sup>94</sup> Purchasers should be solicited directly by the Resale Holder or through intermediaries, in some cases.<sup>95</sup> The Resale Holder should disclose material information to the Purchaser about the issuer to the extent the Resale Holder is an insider or has access to such information.<sup>96</sup> Apart from issuer-related disclosures, it is critical that the Resale Holder disclose that the securities acquired by the Purchaser will be restricted securities in the Purchaser's hands.<sup>97</sup> Further, the Purchaser should probably be sophisticated

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91. While irrelevant to whether an offeree can fend for himself, the value of the securities offered has been a factor mentioned by courts. *Id.* at 145.

92. Restrictions on resale are critically important to ensure the original investors are not mere conduits for a wider distribution of the securities. *Id.* These restrictions help ensure that an offering that is initially private is not converted to a public offering by resale made by original investors. *Id.*

93. See generally Schneider, *supra* note 8; see also Campbell, *supra* note 7, at 1346.

94. Robert B. Robbins, *Offers, Sales and Resales of Securities Under Section 4(a)(1-1/2) and Rule 144A*, AM. LAW INST. 1, 2, (2014), <https://www.pillsburylaw.com/siteFiles/Publications/OffersSalesandResalesofSecurities.pdf>. See *supra* note 47 for a description of "accredited investor" under Regulation D.

95. Robbins, *supra* note 94, at 2.

96. *Id.* The Resale Holder needs to provide enough information so that the Purchaser is in possession of all material information about the issuer, so as to avoid violations of section 17(a) of the Securities Act and Rule 10b-5 of the Exchange Act. See BROWN, *supra* note 31, at 7-22.

97. See Schneider, *supra* note 8, at 508. A Resale Holder should disclose in transaction documents that the securities to be acquired are restricted securities and may not be resold without registration or an exemption from registration under federal and applicable state securities laws. FENDLER, *supra* note 11, at 146-47. Additionally, a Resale Holder should get written representations from the Purchaser that (i) the Purchaser understands the securities are restricted and cannot be resold without registration or an exemption from registration under both federal and applicable state securities laws and (ii) the Purchaser is acquiring the securities for his own account and for investment purposes and not with a view towards distribu-

and able to fend for himself. An informal rule of thumb for Section 4(a)(1½) transactions is that resales of restricted securities following a private placement are protected by the Section 4(a)(1½) exemption when the issuer could have sold the securities directly to the Resale Holder and all other direct buyers from it as well as all of the Purchasers who purchase from the Resale Holder without losing its exemption. This takes into account the number of ultimate buyers, the manner of sale to each, and time period during which the sales occur. Additionally, the Resale Holder should disclose to the Purchaser(s) the material information about the issuer known to the Resale Holder and not known or available to the Purchaser(s).<sup>98</sup>

### 3. Private Resales Under New Section 4(a)(7) Exemption

On December 4, 2015, Congress provided practitioners an additional avenue to exempt resales under federal and state securities laws with the enactment of the Fixing America's Surface Transportation (FAST) Act.<sup>99</sup> Under Section 76001 of the FAST Act, Congress codified an additional exemption for certain resales of securities as new Section 4(a)(7) of the Securities Act. The FAST Act provides that any Section 4(a)(7) transaction will be deemed not to be a distribution under Section 2(a)(11) of the Securities Act.<sup>100</sup>

#### a. Requirements of the new Section 4(a)(7) exemption

In general, the Section 4(a)(7) exemption is available for private resales of restricted securities to "accredited investors" where no general solicitation is used and certain information concerning the issuer and the transaction is provided to the Purchaser. More specifically, in order for the resale transaction to be exempt from registration under the Section 4(a)(7) exemption, the transaction must meet the following requirements: (i) each Purchaser must be an "accredited investor," as such term is defined in Rule 501(a) of Regulation D under the Securities Act; (ii) neither the Resale Holder nor any person acting on the Resale Holder's behalf may engage in any form of general solicitation or general advertising; and (iii) in the case of an issuer that

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tion. *Id.* Also, any certificate(s) representing the securities in the hands of the Purchaser should bear an appropriate legend restricting transfer. *Id.*

98. See Schneider, *supra* note 8, at 513.

99. Fixing America's Surface Transportation Act, Pub. L. No. 114-94, 129 Stat. 1312, 1790 (2015) (to be codified at 15 U.S.C. § 77r(b)(4)(G)), <https://www.gpo.gov/fdsys/pkg/BILLS-114hr22enr/pdf/BILLS-114hr22enr.pdf>; 15 U.S.C. § 77d(a)(7), (d) (2015). The provisions of the FAST Act providing the Section 4(a)(7) resale exemption were effective upon enactment.

100. § 76001, 129 Stat. at 1789.

is not an SEC reporting company (issuers that are neither subject to the reporting requirements of Sections 13 or 15(d) of the Securities Exchange Act, nor foreign private issuers exempt from reporting pursuant to Rule 12g3-(b) thereunder, nor foreign governments eligible to register securities under Schedule B of the Securities Act), the Resale Holder and Purchaser must obtain from the issuer (i.e., the Resale Holder requests from the issuer and the Resale Holder makes available to the Purchaser) reasonably current information.<sup>101</sup> This information includes the following: (A) the issuer's exact name (as well as the name of any predecessor); (B) the address of the issuer's principal place of business; (C) the exact title and class of the offered security, its par or stated value, and the current capitalization of the issuer; (D) the name and address of the transfer agent, corporate secretary or other person responsible for stock transfers; (E) a statement of the nature of the issuer's business that will be presumed current if it is as of 12 months before the transaction date, (F) the issuer's officers and directors; (G) information about any broker, dealer, or other person being paid a commission or fee in connection with the sale of the securities; (H) the issuer's most recent balance sheet and profit and loss statement for such part of the two preceding fiscal years as it has been in operation, prepared in accordance with U.S. generally accepted accounting principles (GAAP) (or, in the case of a foreign private issuer, International Financial Reporting Standards (IFRS)); and (I) if the Resale Holder is a Control Holder, a statement regarding the nature of the affiliation accompanied by a certification from the Control Holder that it has no reasonable grounds to believe that the issuer is in violation of the securities laws or regulations.<sup>102</sup> Practitioners seeking to rely on the new Section 4(a)(7) exemption should consider updating their form equity purchase agreements used in resale transactions to add the following: (i) representations and warranties by the Purchaser confirming receipt of the specific enumerated items of information in Section 4(a)(7); (ii) representations and warranties by the Resale Holder and the Purchaser regarding the "bad actor" disqualifications (described below); and (iii) schedules or exhibits to the equity purchase agreement that will document and contain each disclosure required to be provided to the Purchaser.

The Section 4(a)(7) exemption is not available for certain issuers or where certain bad actors are connected with the transaction.<sup>103</sup> Specifically, the new Section 4(a)(7) exemption is not available if: (i) the Resale Holder is a direct or indirect subsidiary of the issuer; (ii) the Resale Holder or any person that will be compensated in connection with the resale transaction, such as a broker-dealer or finder, is subject to the "bad actor" disqualifica-

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101. *Id.* at 1787–89.

102. *Id.* at 1788–89.

103. *Id.*

tion provisions under Rule 506(d)(1) of Regulation D under the Securities Act or a disqualification described under Section 3(a)(39) of the Securities Act; (iii) the issuer is blank check, blind pool, shell company, special purpose acquisition company, or in bankruptcy or receivership; (iv) the transaction relates to a broker-dealer's or underwriter's unsold allotment; or (v) the security that is the subject of the transaction is part of a class of securities that has not been authorized and outstanding for at least ninety days prior to the date of the transaction.<sup>104</sup>

There are other considerations with respect to the Section 4(a)(7) exemption that may be important to consider depending on the facts and circumstances of the resale transaction. For example, the securities sold in a Section 4(a)(7) transaction will be restricted securities in the hands of the Purchaser,<sup>105</sup> requiring the Purchaser to register or have an available exemption to resell the securities. Also, securities sold in a Section 4(a)(7) transaction are "covered securities" under the provisions of Section 18 of the Securities Act, which preempts the registration requirements of state securities laws.<sup>106</sup>

#### b. Section 4(a)(7) compared to other federal resale exemptions

The FAST Act is clear that the Section 4(a)(7) exemption is not exclusive of other available exemptions.<sup>107</sup> The Section 4(a)(7) exemption does not replace the Section 4(a)(1½) exemption; however, the Section 4(a)(7) exemption is expected to generally supplant the use of the Section 4(a)(1½) exemption. In several respects, the elements of the new Section 4(a)(7) exemption are similar to the parameters of the Section 4(a)(1½) exemption (i.e., no general solicitation, Purchaser suitability, and access to information about the issuer and the securities being acquired). On the other hand, there are a number of important distinctions between the exemptions. For example, unlike the Section 4(a)(1½) exemption, which has evolved in practice without the benefit of official rule-making,<sup>108</sup> the new Section 4(a)(7) resale exemption and its requirements are codified in the Securities Act, thus providing a greater degree of compliance certainty. Furthermore, the Section 4(a)(7) exemption preempts the registration requirements of state securities laws, thereby removing the requirement to have an available exemption in each state having jurisdiction over the resale. In fact, for practitioners, preemption is potentially the most attractive aspect of the new Section

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104. *Id.*

105. *Id.*

106. § 76001(b), 129 Stat. at 1790.

107. *Id.* at 1789.

108. ANNA T. PINEDO & JAMES R. TANENBAUM, EXEMPT AND HYBRID SECURITIES OFFERINGS 3-17 (2d ed. 2014).

4(a)(7) exemption, particularly in transactions involving multiple Purchasers residing in different states. Accordingly, based on the codified requirements of the Section 4(a)(7) exemption and its preemption of state securities registration requirements, the Section 4(a)(7) exemption simplifies the analysis otherwise required in resales under the Section 4(a)(1½) exemption and provides a greater degree of compliance certainty.

Another advantage of Section 4(a)(7) is that a Resale Holder need only be concerned with its solicitation of Purchasers, whereas, in a Section 4(a)(1½) transaction, general soliciting or advertising by the issuer or other sellers of securities could potentially cause the Section 4(a)(1½) exemption to be unavailable. On the other hand, certain requirements of the Section 4(a)(7) exemption impose a more stringent compliance obligation on the Resale Holder compared to the more flexible, albeit ill-defined, parameters of the Section 4(a)(1½) exemption. For example, the new Section 4(a)(7) exemption requires that the Purchaser satisfy one of the enumerated categories of “accredited investor” whereas the Section 4(a)(1½) exemption has a more flexible “sophisticated” Purchaser element. For example, some Purchasers that would clearly qualify as “sophisticated” under the Section 4(a)(1½) exemption (such as certified financial analysts and other seasoned investment professionals) might not qualify as “accredited investors” as required under Section 4(a)(7). Also, the Resale Holder under Section 4(a)(7) is required to provide to the Purchaser certain specified disclosures about the issuer, some of which (such as financial information) might be unavailable or the issuer might be unwilling to provide to the Resale Holder. Additionally, Section 4(a)(7) imposes a “bad actor” disqualification on the Resale Holder and broker-dealers receiving sales compensation; such a “bad actor” disqualification is not contained in a Section 4(a)(1½) transaction analysis.

When compared to Rule 144, the new Section 4(a)(7) is particularly advantageous for Control Holder resales. In particular, under Section 4(a)(7), a Control Holder may resell securities without regard to the holding period, manner of sale, or volume limitations contained in Rule 144. Non-Control Holders also benefit from no minimum holding period under Section 4(a)(7) when compared to the applicable six month or one year holding period under Rule 144. Nonetheless, Rule 144 may be preferable to Section 4(a)(7) in some circumstances. In Rule 144 transactions, the securities acquired by the Purchaser are fungible and unrestricted whereas securities acquired in a Section 4(a)(7) transaction will be restricted securities. As a result, securities acquired in a Section 4(a)(7) transaction cannot be further resold by the Purchaser, unless such resale complies with Section 4(a)(7) or with another federal and state exemption.

Moreover, notwithstanding the addition of the Section 4(a)(7) exemption, the Section 4(a)(1) exemption will continue to be a widely used exemp-

tion in certain resale transactions. In particular, for Non-Control Holder resales where the securities have clearly come to rest in the hands of the Non-Control Holder (i.e., the Non-Control Holder has a holding period of at least three years in most instances), the Section 4(a)(1) exemption will typically be the preferred exemption. The Section 4(a)(1) exemption could be available and preferable in other Control and Non-Control Holder resale transactions; however, the uncertain distribution concept involved in a Section 4(a)(1) analysis might make compliance with the Section 4(a)(7) requirements more attractive in those instances.

Section 4(a)(7) was a much needed enhancement and refinement of the federal securities laws that will potentially be widely used to facilitate resales of restricted securities. However, because the Section 4(a)(7) exemption is fairly limited in scope and imposes certain specific requirements (i.e., accredited investor requirement, disclosure requirement, and restrictions on subsequent transfers of the securities acquired), the Section 4(a)(1½) exemption, the Rule 144 exemption, or the Section 4(a)(1) exemption might still be preferable to the Section 4(a)(7) exemption in some instances. Choosing the appropriate exemption will depend on several factors including holding period, volume of securities to be resold, identity of the issuer, plans regarding subsequent resale, and identity and number of Purchasers (e.g., sophistication, net worth, income, and location of Purchasers).

## V. STATE OF ARKANSAS RESALE EXEMPTIONS

The Arkansas and federal exemptions for resale are similar in many respects. Similar to the federal framework, absent preemption of state securities laws in the case of resale transactions structured under Section 4(a)(7) of the Securities Act, Arkansas requires resales of securities to be registered or qualify for an exemption from registration.<sup>109</sup> Also, like the federal exemptions, the availability of Arkansas exemptions may depend on whether the Resale Holder is a Control Holder. Assuming that Arkansas exemptions mirror the federal exemptions, however, is a potential pitfall. Though some exemptions are complementary of the federal law, there is some degree of variation between the Arkansas and federal exemptions, which may result in

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109. See COX ET AL., *supra* note 3, at 391. There is an exception to the registration or exemption requirement in Arkansas (and other states) for “covered securities.” ARK. CODE ANN. § 23-42-501 (2013) (requiring that the sale of a security must be (1) registered, (2) exempt, or (3) a “covered security”). That is, Arkansas does not require that the offer or sale of a “covered security” be registered or exempt. “Covered Securities” include those sold under Rule 506 of Regulation D. See 17 U.S.C. § 77r(b)(4) (2012).

a resale that violates Arkansas securities laws while still complying with federal securities laws.<sup>110</sup>

There are two sources of Arkansas law where a practitioner can seek to qualify a resale for exemption: (i) the Arkansas Securities Act<sup>111</sup> provides certain exemptions applicable to resales, such as the statutory non-issuer exemption,<sup>112</sup> and (ii) the Rules provide additional exemptions.<sup>113</sup>

#### A. Statutory Exemptions

Section 504(a)(1) of the Arkansas Securities Act provides an exemption for “any isolated nonissuer transactions, whether effected through a broker-dealer or not.”<sup>114</sup> While this provision provides a broad exemption applicable to many resales, the terms “isolated” and “nonissuer” in the exemption may cause some resales to fall outside the exemption.<sup>115</sup> With respect to the term isolated, Section 504(a)(1) of the Arkansas Securities Act provides that “repeated or successive transactions shall be prima facie evidence that the transactions are not isolated nonissuer transactions.”<sup>116</sup> Regulations promulgated under the Arkansas Securities Act provide additional guidance on whether a resale will be considered isolated. To be an isolated non-issuer transaction, there must be no more than three such transactions effected in Arkansas during any twelve-month period.<sup>117</sup> Accordingly, if a transaction contemplates multiple resales, the resales must be structured to comply with the volume and timing requirements of the exemption. Further, as described in more detail below, by virtue of the condition that the transaction involve a non-issuer, the exemption in Section 504(a)(1) is unavailable for resales by a Control Holder.<sup>118</sup>

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110. For example, Rule 504.01(A)(12)(m)(i) of the Rules of the Arkansas Securities Commissioner provides a state level exemption that mirrors the federal exemption for Control Holders who resell securities in compliance with Rule 144. *See* 003-14-06 ARK. CODE R. § 1-504.01(a)(12)(L)(i) (LexisNexis 2012). On the other hand, the Arkansas Securities Department has expressly declined to recognize the availability of the Section 4(a)(1½) exemption as a state exemption. Interpretive Letter No. 97-007, Ark. Sec. Dept., July 24, 1997, 1997 Ark. Sec. LEXIS 10 (applying the non-issuer exemption instead of the Section 4(a)(1½) exemption). Though the Section 4(a)(1½) exemption, by its name, is not available, Arkansas has exemptions comparable to the Section 4(a)(1½) exemption (*e.g.*, the non-issuer exemption in ARK. CODE ANN. § 23-42-504(a)(1) (2013) and the non-public resale exemption for Control Holders in Rule 1-504.01(a)(12)(L)(ii)).

111. ARK. CODE ANN. §§ 23-42-101 to -509 (2013).

112. ARK. CODE ANN. § 23-42-504(a)(1).

113. 003-14-06 ARK. CODE R. § 1-504.01(a)(1)(C).

114. ARK. CODE ANN. § 23-42-504(a)(1).

115. *See infra* Part V.C (providing guidance on the term “nonissuer”).

116. ARK. CODE ANN. § 23-42-504(a)(1).

117. 003-14-06 ARK. CODE R. § 1-504.01(a)(1)(C).

118. *See infra* Part V.C.



The exemption in the Arkansas Securities Act set forth in Section 504(a)(8)(B) provides an exemption for offers and sales to an institutional buyer.<sup>119</sup> Importantly, unlike many exemptions in the Arkansas Securities Act, which are limited to offers and sales by issuers only, this exemption is available to exempt offers and sales by issuers and offers and sales by Resale Holders alike.<sup>120</sup> One drawback of the exemption is the lack of certainty regarding whether a Purchaser qualifies as an institutional buyer. Neither the Arkansas Securities Act nor the Rules contain a definition for institutional buyer. Section 504(a)(8)(B), however, does specify relevant characteristics of an institutional buyer, including experience, knowledge, volume of securities transactions, and background in securities.<sup>121</sup> Notably, a Resale Holder may petition the Arkansas Securities Commissioner to issue an order that the Purchaser qualifies as an institutional buyer; however, the timing and other practicalities of the resale transaction (e.g., confidentiality of the transaction and identity of the parties) often preclude a Resale Holder from soliciting an order from the Commissioner. The Commissioner has issued orders deeming an investor to be an institutional buyer based on the investor's net worth, annual earnings, educational background, knowledge of finance, number of securities brokerage accounts, and knowledge and experience in buying and selling securities.<sup>122</sup> The Commentary to the 1956 version of the Uniform Securities Act, which was the model act for the Arkansas Securities Act, indicates that the exemption in Section 504(a)(8)(B) is for institutional, sophisticated buyers who do not need the protection of registration.<sup>123</sup>

In addition to the statutory non-issuer exemption in Section 504(a)(1) and the statutory institutional buyer exemption in Section 504(a)(8), Section

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119. ARK. CODE ANN. § 23-42-504(a)(8)(B) (2013).

120. *Id.* § 23-42-504(a).

121. *Id.*

122. *See* Ark. Dev. Fin. Auth., Order No. S-12-0263-12-OR01 (Ark. Sec. Dep't Nov. 26, 2012) (order declaring the petitioner an institutional buyer for a transactional exemption); Gus Blass, III, Order No. 05-80005749-OR009 (Ark. Sec. Dep't Sep. 19, 2005) (order providing a transactional exemption from registration).

123. *See* LOUIS LOSS, COMMENTARY ON THE UNIFORM SECURITIES ACT 123 (1976). Other states that, like Arkansas, have adopted the 1956 version of the Uniform Securities Act have a similar institutional buyer exemption. *See id.* A number of states have amended their versions of the "institutional buyer" exemption, adopted rules, or issued orders, interpretative releases, or opinions, confirming that certain types of entities are "institutional buyers." *See id.* For example, Rule 510 under the Delaware Securities Act defines the term "institutional buyer" for purposes of the exemption by cross-referencing certain categories of accredited investors in Regulation D of the Securities Act. *See, e.g.*, 6 DEL. ADMIN. CODE § 510 (2011). In Delaware, an institutional buyer includes: (i) "accredited investors" as defined in Rule 501(a)(1)–(4), (7) and (8) of Regulation D (but with an exclusion for certain self-directed employee benefit plans), (ii) "qualified institutional buyers" within the meaning of Rule 144A under the Securities Act, and (iii) entities with a net worth of at least \$5 million not formed for the purpose of acquiring the securities. *Id.* § 510(a)(1)–(3).

504(a)(9) of the Arkansas Securities Act provides a statutory exemption for resales.<sup>124</sup> Though the exemption is customarily used as an issuer exemption, the provision applies broadly to sellers, which could include a Resale Holder.<sup>125</sup> This exemption permits offers and sales to no more than thirty-five purchasers during any twelve-month period provided that purchasers have investment intent and commissions are paid only to registered broker-dealers.<sup>126</sup>

Rules promulgated pursuant to this exemption, however, make it unattractive to a Resale Holder.<sup>127</sup> In particular, the Rules require the seller to disclose certain detailed information about the transaction, including copies of organizational documents, financial statements, and any sales literature or offering circular used in the sale.<sup>128</sup> Further, Section 504(b)(1) requires the seller seeking an exemption under Section 504(a)(9) to file a proof of exemption with the Arkansas Securities Commissioner, pay a filing fee, and wait at least ten business days to consummate the transaction, which will likely deter a Resale Holder from utilizing the exemption.<sup>129</sup> Accordingly, the exemption in Section 504(a)(9) is intended, and much better suited, as an issuer exemption rather than an exemption for resales.

## B. Administrative Exemptions

In addition to the exemptions specifically set forth in the Arkansas Securities Act, the Arkansas Securities Department has promulgated several exemptions in the Rules. Section 504(a)(12) of the Arkansas Securities Act authorizes the Arkansas Securities Commissioner to formulate exemptions by rule or order for transactions where registration is not necessary to protect investors.<sup>130</sup> Rule 504.01(a)(12) of the Rules contains a number of such discretionary exemptions that exempt a variety of offers and sales from registration.

One notable exemption for resales in the Rules is the 100% Sale of Business exemption in Rule 504.01(a)(12)(K). Under this exemption, a Resale Holder may lawfully resell securities if the following occur: (1) 100% of the securities of the business are sold; (2) there are no more than seven Purchasers; (3) each Purchaser acquires the securities with investment intent

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124. ARK. CODE ANN. § 23-42-504(a)(9).

125. Several exemptions in the Arkansas Securities Act specifically exempt transactions by “issuers.” Accordingly, “sellers” should be interpreted broadly to include sales by a Resale Holder.

126. ARK. CODE ANN. § 23-42-504(a)(9).

127. 003-14-06 ARK. CODE R. § 504.01(a)(9) (LexisNexis 2016).

128. *Id.*

129. *See* ARK. CODE ANN. § 23-42-504(b)(1).

130. *Id.* § 23-42-504(a)(12).

and the certificates bear a restrictive legend; (4) each Purchaser has access to information concerning the issuer; (5) no commission is paid for soliciting Purchasers; and (6) all parties had the opportunity to consult with counsel.<sup>131</sup>

Other discretionary exemptions in the Rules that might be applicable, depending on the facts of the resale, include the following: (i) Rule 504.01(a)(12)(J), which exempts sales pursuant to a written stockholders agreement, and (ii) Rule 504.01(a)(12)(G), which exempts any transaction incident to a class vote by security holders or members pursuant to statute (e.g., statutory provision authorizing merger or share exchange) or organizational document.<sup>132</sup> Additionally, the Rules provide two important exemptions for Control Holder resales, Rules 504.01(a)(12)(L)(i) and (ii).<sup>133</sup> Notably, the aforementioned exemptions in the Rules are self-executing; therefore, no filing is required with the Arkansas Securities Department to satisfy the exemption.<sup>134</sup>

### C. Control Holder Resales

Certain exemptions in the Arkansas Securities Act and Rules are *unavailable* to Control Holders. For example, the commonly used statutory non-issuer exemption set forth in Section 504(a)(1) of the Arkansas Securities Act and discussed above is generally *unavailable* to a Control Holder.<sup>135</sup> As described below, a Control Holder is generally unable to rely on the statutory non-issuer exemption because the Control Holder is *not* considered a non-issuer (only non-issuers are entitled to the exemption). Under the Arkansas Securities Act, “[n]on-issuer” means not directly or indirectly for the benefit of the issuer.”<sup>136</sup> This definition of non-issuer in the Arkansas Securities Act is unclear as to whether a Control Holder would be considered a non-issuer; although, the definition is arguably broad enough to encompass a Control Holder.<sup>137</sup> Other than this definition of non-issuer, the Arkansas

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131. 003-14-06 ARK. CODE R. § 1-504.01(a)(12)(K).

132. *Id.* § 1-504.01(a)(12)(J), (G).

133. *See infra* Part V.C.

134. Note, however, that because Rule 504.01(a)(12)(L)(i) requires compliance with Rule 144, a Form 144 must be filed with the SEC to satisfy the exemption under Rule 504.01(a)(12)(L)(i).

135. *See* ARK. CODE ANN. § 23-42-504(a)(1).

136. *Id.* § 23-42-102(12) (2013).

137. Unlike the expansive definition of underwriter under Section 2(a)(11) of the Securities Act, *see* 15 U.S.C. § 77b(a)(11) (2012), Arkansas does not deem a Control Holder an issuer for the purpose of determining whether an underwriter is present in the resale transaction. The term “underwriter” is not defined under the Arkansas Securities Act. *See* ARK. CODE ANN. § 23-42-102. The definition of underwriter in the Rules does not include the last sentence of Section 2(a)(11) in the Securities Act relating to control persons. *See* 003-14-002 ARK. CODE R. § 102.01(46) (LexisNexis 2016).

Securities Act lacks specific guidance on whether the term non-issuer would exclude a Control Holder from relying on the statutory non-issuer exemption.

Although the Arkansas Securities Act is unclear on whether the isolated non-issuer exemption may be relied upon by a Control Holder, the Rules and other guidance issued by the Arkansas Securities Department demonstrate that a Control Holder is *not* able to rely on the statutory non-issuer exemption in Section 504(a)(1) of the Arkansas Securities Act. Specifically, Rule 504(a)(1) provides that an isolated non-issuer transaction includes a sale by a person “not in control of the issuer.”<sup>138</sup> Control is defined in the Rules to mean “the possession, directly or indirectly, of the power to direct or cause the direction of the management or policies of a person, whether through the ownership of securities, by contract, or otherwise.”<sup>139</sup> Under the Rules, a Resale Holder is presumed to be a Control Holder of the issuer if he or she is a director, partner, or executive officer of the issuer; “directly or indirectly has the right to vote twenty-five percent (25%) or more of the voting securities of the” issuer; “or is entitled to twenty-five percent (25%) or more of the profits of” the issuer.<sup>140</sup> Further, in addition to the Rules, Order No. 88-10-S issued by the Arkansas Securities Department provides that the isolated non-issuer exemption “may not be available[] where the seller of the securities is deemed to be a controlling person of the issuer.”<sup>141</sup> Accordingly, a Control Holder cannot rely on the isolated non-issuer exemption to exempt resales.

Because the statutory non-issuer exemption is not available to those who control the issuer, a Control Holder must look to other exemptions contained in the Rules to exempt resales. There are five main exemptions available to Control Holders in the Rules: (1) Rule 504.01(a)(12)(K), the 100% sale of a business exemption discussed above; (2) Rule 504.01(a)(12)(L)(i), the equivalent of federal Rule 144 discussed above; (3) Rule 504.01(a)(12)(J), the security holder agreement exemption; (4) Rule 504.01(a)(12)(G), the statutory merger and acquisition exemption; and (5) Rule 504.01(a)(12)(L)(ii), the equivalent of the federal 4(a)(1½) exemption.

The 100% sale of business exemption may be particularly useful for a Control Holder in the event the resale is in connection with a stock acquisition or a merger where the specific merger exemption in Rule 504.01(a)(12)(G) is unavailable. The Arkansas Securities Department, in no-action letters, has also permitted Control Holders to resell corporate stock

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138. 003-14-006 ARK. CODE R. § 504.01(a)(1)(A) (LexisNexis 2016).

139. *Id.* § 102.01(11).

140. *Id.*

141. M & M Rock Co., Order No. 88-10-S, 1988 Ark. Sec. LEXIS 39 at \*4 (Ark. Sec. Dep’t Apr. 21, 1988).

when 100% of the issuer's stock is being acquired.<sup>142</sup> Alternatively, the security holder agreement exemption may be useful to a Resale Holder when the Purchaser is also an existing holder of securities in the issuer and the issuer's stockholders agreement governs the sale.<sup>143</sup> The Arkansas Securities Department, in no-action letters, has permitted Control Holders to resell their securities pursuant to the security holder agreement exemption.<sup>144</sup>

In addition to the 100% sale of business and security holder agreement exemptions, the Rules provide important exemptions specific to Control Holders. In particular, Rule 504.01(a)(12)(L)(i) provides a parallel exemption to federal Rule 144 for Control Holder resales that comply with the conditions of Rule 144.<sup>145</sup> Though this exemption provides a great degree of certainty that the Control Holder's resale will be exempt, conditions imposed upon Control Holder resales in Rule 144 (e.g., volume limitations, current public information requirement, manner of sale requirement, and Form 144 filing) often practically prohibit the Control Holder from relying on the exemption, particularly when the issuer of the security being resold is a non-public company.

A separate, potentially simpler exemption for a Control Holder is provided in Rule 504.01(a)(12)(L)(ii). Rule 504.01(a)(12)(L)(ii) exempts Control Holder resales that do not involve a public offering and meet the following conditions: (1) the Purchaser must be solicited directly by the Control Holder; (2) each Control Holder is "limited to no more than three (3) transactions [with] the same security within a twelve (12) month period;" (3) the Purchasers must be given the type of disclosure found in a registration statement; (4) the Purchaser must be financially sophisticated; and (5) the Purchaser must purchase the securities with investment intent.<sup>146</sup> Upon a closer examination, this exemption set forth in Rule 504.01(a)(12)(L)(ii) is

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142. See, e.g., D, Mc & W, Inc., No-Action Letter No. 10-NA-0020 (Ark. Sec. Dep't June 29, 2010) (allowing two co-owners of a corporation to sell their shares in a 100% stock acquisition); Hughes Transport, Inc., No-Action Letter No. 98-010 (Ark. Sec. Dep't July 9, 1988) (allowing owner of two corporations to sell his shares in a 100% stock acquisition).

143. 003-14-006 ARK. CODE R. § 504.01(a)(12)(K) (exempting sales "among the security holders"). The language in this Rule exempting sales "among the security holders" permits such resales. *Id.*

144. See, e.g., Diva Nail Spa, LLC, No-Action Letter No. 10-NA-0019 (Ark. Sec. Dep't June 25, 2010) (permitting a fifty percent owner of a limited liability company to resell his interest to the other fifty percent owner); H.M.I. Recycling & Disposal, Inc., No-Action Letter No. 03-900000317-NA016 (Ark. Sec. Dep't Oct. 20, 2003) (permitting two twenty-five percent owners to transfer their fifty percent interest to the other two shareholders). The exemption is also available to exempt resales by Non-Control Holders. First State Banking Corp., No-Action Letter No. 02-007 (Ark. Sec. Dep't Sept. 6, 2002) (permitting an agreement with a put provision that would require Control Holders to repurchase shares of an existing holder).

145. See 17 C.F.R. § 230.144 (2015); 003-14-006 ARK. CODE R. § 504.01(a)(12)(L)(i).

146. 003-14-006 ARK. CODE R. § 504.01(a)(12)(L)(ii).

essentially based upon the federal Section 4(a)(1½) exemption discussed above.<sup>147</sup> For example, the key inquiry of the federal Section 4(a)(1½) exemption (i.e., that the Purchaser does not acquire the security with a view toward distribution) is embodied in condition (5) requiring the Purchaser to make investment representations.<sup>148</sup> Further, the requirements of Section 4(a)(2), from which the federal Section 4(a)(1½) exemption is partially derived, are embodied in conditions (3) and (4) of the Rule 504.01(a)(12)(L)(ii) exemption (i.e., access to information and sophistication).<sup>149</sup> One point of difference between the exemption in Rule 504.01(a)(12)(L)(ii) and the federal 4(a)(1½) exemption, however, is that the Arkansas exemption specifically limits the number of resales by a Control Holder in a twelve-month period.<sup>150</sup> This limitation would be problematic in instances where a single Resale Holder makes resales to multiple Purchasers. Also, the requirement to provide information equivalent to that contained in a registration statement could be burdensome depending on the transaction and creates some degree of uncertainty regarding the level of disclosure sufficient to satisfy the exemption.

## VI. JURISDICTIONAL ISSUES

Because both federal and state securities laws apply to resales, an important step in the analysis involving resales of securities is determining which state securities laws apply to the resale (i.e., does the law of the issuer's state of residence, Purchaser's state of residence, or Resale Holder's state of residence apply). The Uniform Securities Act of 1956, the model act for the Arkansas Securities Act and the securities laws of several other states, bases its jurisdiction not on residency, but on geography.<sup>151</sup> Specifically, the registration or exemption requirement governing resales in the Uniform Securities Act applies to "persons who sell or offer to sell when (1) an offer to sell is made in this state or (2) an offer to buy is made and accepted in this state."<sup>152</sup> To determine whether or not an offer to sell or buy is made in a state, the Uniform Securities Act provides the following:

For the purpose of this section, an offer to sell or to buy is made in this state, whether or not either party is then present in this state, when the

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147. See *supra* Part IV.B.2.

148. See *supra* Part IV.B.2.

149. See *supra* Part IV.B.2.

150. Although no specific limit is imposed under the federal 4(a)(1½) exemption, the restriction on the number of purchasers in Rule 504.01(a)(12)(M)(ii)(B) is consistent with the 4(a)(1½) exemption's emphasis on whether the resale constitutes a distribution.

151. See FENDLER, *supra* note 11, at 25.

152. UNIF. SEC. ACT § 414(a) (1956); ARK. CODE ANN. § 23-42-103 (Repl. 2014).

offer (1) originates from this state; or (2) is directed by the offeror to this state and received at the place to which it is directed.<sup>153</sup>

Accordingly, if the Resale Holder directs an offer of securities to a Purchaser located in Arkansas, the Arkansas Securities Act is applicable.<sup>154</sup> Moreover, in addition to the state law of the state where the Purchaser is located, the state law where the Resale Holder is located might also apply.<sup>155</sup> With respect to resale transactions satisfying the requirements of the Section 4(a)(7) exemption, state securities registration requirements will not apply to the transaction because the securities sold in a Section 4(a)(7) transaction are deemed “covered securities.”<sup>156</sup> Notwithstanding such preemption of state registration requirements under Section 4(a)(7), states having jurisdiction over the resale transaction may still enforce the anti-fraud provisions of their respective securities laws.<sup>157</sup>

## VII. CONCLUSION

The requirement to have an exemption in the resale of securities is an important analysis that is sometimes overlooked in transactions involving the sale of securities. Even more often overlooked is the requirement, absent preemption of state registration requirements, to have both a valid federal and state exemption for a resale. In light of the consequences of an unlawful resale of a security, both federal and state securities laws should be reviewed in any transaction involving a resale of securities to confirm that federal and state exemptions are available. Identifying the applicable exemption in advance of the resale is important because the structure of the transaction and the representations set forth in the transaction documents can either hinder or help the Resale Holder satisfy an exemption.

The best exemption to rely upon will depend upon the facts and circumstances of the resale transaction (e.g., holding period, number of Purchasers, and Resale Holder’s control of the issuer). Of the federal exemptions, the Rule 144 safe harbor provides the greatest degree of certainty for public resales; however, it does have a holding period requirement, and it places several conditions on Control Holder resales. On the other hand, the Section 4(a)(1½) exemption applicable to private resales provides greater flexibility but less certainty of compliance than the Section 4(a)(7) exemption. With respect to Arkansas resale exemptions, the statutory non-issuer

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153. UNIF. SEC. ACT § 414(c); ARK. CODE ANN. § 23-42-103(a)(3).

154. See PETER M. FASS & DEREK A. WITTNER, BLUE SKY PRACTICE, § 1:4 (2013).

155. *Id.*

156. See FAST Act, Pub. L. No. 114-94, § 76001(b), 129 Stat. 1312, 1790 (2015) (to be codified at 15 U.S.C. § 77r(b)(4)(G)).

157. 15 U.S.C. § 18(c)(1) (1996); 15 U.S.C. § 77r(c)(1).

exemption is generally available for Non-Control Holder resales. For a Control Holder, on the other hand, if the transaction involves the sale of all of the securities of the issuer, Rule 504.01(a)(12)(K) is a commonly relied upon exemption. Otherwise, Rule 504.01(a)(12)(L)(ii), Arkansas's companion exemption to the federal Section 4(a)(1½) exemption, might be preferable for a Control Holder in light of its flexibility.