

FREQUENTLY ASKED QUESTIONS ABOUT RULE 144A

Understanding Rule 144A

What is Rule 144A?

Rule 144A is a safe harbor exemption from the registration requirements of Section 5 of the Securities Act for certain offers and sales of qualifying securities by certain persons other than the issuer of the securities. The exemption applies to resales of securities to qualified institutional buyers, who are commonly referred to as “QIBs.” QIBs must be institutions, and cannot be individuals—no matter how wealthy or sophisticated. See “What is a ‘QIB’?” below.

The securities eligible for resale under Rule 144A are securities of U.S. and foreign issuers that are not listed on a U.S. securities exchange or quoted on a U.S. automated inter-dealer quotation system. See “What is the definition of a U.S. national securities exchange or automated inter-dealer quotation system for purposes of Rule 144A?” below.

Rule 144A provides that reoffers and resales in compliance with the rule are not “distributions” and that the reseller is therefore not an “underwriter” within the meaning of Section 2(a)(11) of the Securities Act. A reseller that is not the issuer, an underwriter, or a dealer can rely on the exemption provided by Section 4(1) of the Securities Act. Resellers that are dealers can rely on

the exemption provided by Section 4(3) of the Securities Act. See “Who may rely on Rule 144A?” below.

Who may rely on Rule 144A?

Any person other than an issuer may rely on Rule 144A. Issuers must find another exemption for the offer and sale of unregistered securities. Typically they rely on Section 4(2) (often in reliance on Regulation D) or Regulation S under the Securities Act. Affiliates of the issuer may rely on Rule 144A.

See Preliminary Note No. 7 to Rule 144A; Telephone Interpretation No. 5S of the March 1999 Supplement of the Division of Corporation Finance’s Manual of Publicly Available Telephone Interpretations.

What types of transactions are conducted under Rule 144A?

The following types of transactions often are conducted under Rule 144A:

- offerings of debt or preferred securities by public companies;
- offerings by foreign issuers that do not want to become subject to U.S. reporting requirements; and
- offerings of common securities by non-reporting issuers (i.e., “backdoor IPOs”).

An issuer that intends to engage in multiple offerings may have a “Rule 144A program.” Rule 144A programs are programs established for offering securities (usually debt securities) on an ongoing or continuous basis to potential offerees. They are similar to “medium-term note programs,” but they are unregistered, and the securities are offered only to QIBs. These programs often are used by financial institution and insurance company issuers to offer securities, through one or more broker-dealers, to institutional investors in continuous offerings. Among the advantages of using Rule 144A programs are (1) no public disclosure of innovative structures or sensitive information; (2) limited FINRA filing requirements; and (3) reduced potential for liability under the Securities Act.

What are the conditions that a reseller of restricted securities must satisfy to rely on Rule 144A?

There are four conditions to reliance on Rule 144A:

- The reoffer or resale is made only to QIBs (see “What is a ‘QIB’?” below) or to an offeree or purchaser that the reseller (and any person acting on its behalf) reasonably believes is a QIB (see “How does a reseller establish a reasonable belief that a person is a QIB?” below);
- The reseller (or any person acting on its behalf) must take reasonable steps to ensure that the buyer is aware that the reseller may rely on Rule 144A in connection with the resale (see “Reseller’s Reasonable Steps So Buyer is Aware of Rule 144A Reliance” below);
- The securities reoffered or resold (a) when issued were not of the same class as securities listed on a U.S. national securities exchange or quoted on a U.S. automated inter-dealer quotation system

(see “What is the definition of a U.S. national securities exchange or automated inter-dealer quotation system for purposes of Rule 144A?” below); and (b) are not securities of an open-end investment company, unit investment trust, or face-amount certificate company that is, or is required to be, registered under the Investment Company Act of 1940; and

- In the case of securities of an issuer that is neither an Exchange Act reporting company, or a foreign issuer exempt from reporting pursuant to Rule 12g3-2(b) of the Exchange Act, or a foreign government, the holder and a prospective buyer designated by the holder must have the right to obtain from the issuer and must receive, upon request, certain “reasonably current” information about the issuer. See “Informational Requirements” below.

Source: Rule 144A(d).

Must a reseller of restricted securities rely only on Rule 144A in making exempt resales?

No; Rule 144A is a non-exclusive safe harbor. A reseller may rely upon any applicable exemption from the registration requirements of the Securities Act in connection with the resale of restricted securities.

In addition, Rule 144A offerings often are effected side-by-side with an offering targeted at foreign holders in reliance on Regulation S. This permits an issuer to effect a multinational offering with a QIB tranche and a Regulation S tranche, and to sell to an initial purchaser outside the United States in reliance on Regulation S, even though the initial purchaser contemplates the immediate resale to QIBs in reliance on Rule 144A.

Typically, resellers that cannot rely on the safe harbor under Rule 144A will attempt to rely on the hybrid Section 4(1½) exemption. See “What is the Section 4(1½) exemption?” below. In addition, the holder of securities purchased under Rule 144A may rely on the provisions of Rule 144 to sell those securities.

Are securities resold under Rule 144A freely tradable after such resale?

No. Securities acquired in a Rule 144A transaction are deemed to be “restricted securities” within the meaning of Rule 144(a)(3) of the Securities Act. As a result, these securities remain restricted until the applicable holding period expires and may only be publicly resold under Rule 144, pursuant to an effective registration statement, or in reliance on any other available exemption under the Securities Act. Exempt resales of restricted securities may be made in compliance with Rule 144A, the so-called Section 4(1½) exemption, or Regulation S. See “What is the Rule 4(1½) exemption?” below.

Source: Preliminary Note No. 6 of Rule 144A.

What are the holding periods applicable to the sale of Rule 144A and other restricted securities?

In December 2007, the SEC amended Rule 144, effective February 2008, to, among other things, shorten the holding periods for restricted securities (subject to certain public information requirements).

For non-affiliate holders of restricted securities, Rule 144 provides a safe harbor for the resale of such securities without limitation after six months in the case of issuers that are reporting companies that comply with the current information requirements of Rule 144(c), and after one year in the case of non-reporting issuers. (Prior to the December 2007 amendments, the

holding period was one year.) In each case, after a one-year holding period, resales of these securities by non-affiliates will no longer be subject to any other conditions under Rule 144.

For a reporting issuer, compliance with the adequate current public information condition requires the issuer to have filed all required reports under Section 13 or Section 15(d) of the Exchange Act. For a non-reporting issuer, compliance with the adequate current public information condition requires the public availability of basic information about the issuer, including certain financial statements.

For affiliate holders of restricted securities, Rule 144 provides a safe harbor permitting resales of restricted securities, subject to the same six-month and one-year holding periods for non-affiliates and to other resale conditions of amended Rule 144. These other resale conditions include, to the extent applicable: (a) adequate current public information about the issuer, (b) volume limitations, (c) manner of sale requirements for equity securities, and (d) notice filings on Form 144.

Due to the shortened holding periods, it has become easier for Rule 144A securities to be acquired by non-QIBs once the restricted period has expired. Accordingly, the December 2007 amendments will decrease the incremental value that registration rights previously provided. See “Why do Rule 144A purchasers typically insist that the issuer register the securities issued in the Rule 144A transaction?” below.

Source: Preliminary Note No. 2 of Rule 144. With respect to the resale of restricted securities pursuant to Rule 144, see J. William Hicks, *Resales of Restricted Securities*, at 5-1 (West Group 2007).

What is the Section 4(1½) exemption?

The Section 4(1½) exemption is a case law-derived exemption that allows the resale of privately placed securities in a subsequent private placement.

The Section 4(1½) exemption is designed to permit sellers of securities to rely on Section 4(1) (which provides an exemption for non-issuers, underwriters, and dealers) to avoid underwriter status by implementing the same kinds of restrictions that would be required in the case of a Section 4(2) offering by the issuer itself.

The Section 4(1½) exemption typically is relied on in connection with the resale of restricted securities to accredited investors who make appropriate representations. Generally, if an accredited investor cannot qualify as a “QIB” under Rule 144A, the seller will seek to use the Section 4(1½) exemption for secondary sales of privately-held securities. See “What are the conditions that a reseller of restricted securities must satisfy to rely on Rule 144A?” above.

Section 4(1½) also is sometimes used to extend a Rule 144A offering to institutional accredited investors.

Source: The seminal case involving the so-called Section 4(1½) exemption was the Second Circuit Court of Appeals decision in *Gilligan, Will & Co. v. SEC*, 267 F.2d 461 (2d Cir. 1959). The Second Circuit intimated that a person purchasing restricted securities from an issuer is not an underwriter for purposes of Section 4(1) if the purchaser resells the restricted securities to persons who qualify as purchasers under Section 4(2) as described by the U.S. Supreme Court in *SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953), and who acquire the restricted securities in a private offering of the type contemplated by Section 4(2).

Eligible Purchasers

What is a “QIB”?

In general, a QIB is any entity included within one of the categories of “accredited investor” defined in Rule 501 of Regulation D, acting for its own account or the accounts of other QIBs, that in the aggregate owns and invests on a discretionary basis at least \$100 million in securities of issuers not affiliated with the entity (\$10 million for a broker-dealer). See “Can the amount of securities to be purchased in a Rule 144A offering be included in calculating the amount of securities owned or invested by a QIB?” below.

In addition to the qualifications above, banks and savings and loan associations must have a net worth of at least \$25 million to be deemed QIBs.

QIBs can be foreign or domestic entities, but must be institutions. Individuals cannot be QIBs, no matter how wealthy or sophisticated they are.

A broker-dealer acting as a riskless principal for an identified QIB would itself be deemed a QIB. To qualify as a riskless principal, the broker-dealer must have a commitment from the QIB that it will simultaneously purchase the securities from the broker-dealer. The commitment from the QIB must be effective at the time of purchase in the Rule 144A transaction.

A QIB may be formed merely for the purpose of investing in a Rule 144A transaction. See “Will an entity that is formed solely for the purpose of acquiring restricted securities in a Rule 144A transaction be deemed to be a QIB?” below.

How is the value of securities owned and invested by a QIB calculated under Rule 144A?

Typically, value is calculated on a cost basis (i.e., how much the securities cost when purchased). However, where the entity values securities on a fair market value basis for financial reporting purposes and no current information with respect to the cost of such securities has been published, the entity may use the fair market value basis for valuation. See “If a company reports both cost and mark-to-market values of the securities it holds, which values should be used to determine whether an entity is a QIB?” below.

In determining the amount of securities, an entity may include securities of its consolidated subsidiaries if such securities are managed by that entity. However, unless an entity is a reporting company under the Exchange Act, securities owned by a subsidiary may not be included if the entity itself is a majority-owned subsidiary that would be included in the consolidated financial statements of another enterprise. In addition, an entity must exclude securities issued or guaranteed by the United States or a U.S. instrumentality; bank deposit notes and certificates of deposit; loan participations; repurchase agreements; and currency, interest rate, and commodity swaps. See “Can the amount of securities to be purchased in a Rule 144A offering be included in calculating the amount of securities owned or invested by a QIB?” below.

Source: Rule 144A(a)(2), (3) and (4). For a detailed discussion of the securities that are included and excluded for purposes of determining whether a prospective purchaser is a QIB, see SEC No-Action Letter, UNUM Life Insurance Co. (available November 21, 1990).

If a company reports both cost and mark-to-market values of the securities it holds, which values should be used to determine whether that company is a QIB?

Only the cost valuation method should be used. The SEC staff has made clear its preference for cost valuation rather than market valuation when determining whether a prospective buyer is a QIB. This applies regardless of whether the company uses cost or mark-to-market financial reporting.

Source: The staff’s views are expressed in SEC No-Action Letter, UNUM Life Insurance Co. (available November 21, 1990).

Can the amount of securities to be purchased in a Rule 144A offering be included in calculating the amount of securities owned or invested by a QIB?

No. The amount of securities to be purchased in a Rule 144A transaction may not be included when calculating the amount of securities that are owned or invested on a discretionary basis by a prospective purchaser for purposes of determining whether the purchaser is a QIB eligible to participate in the offering.

Source: Telephone Interpretation No. 6 of the March 1999 Supplement of the Division of Corporation Finance’s Manual of Publicly Available Telephone Interpretations.

Will an entity that is formed solely for the purpose of acquiring restricted securities in a Rule 144A transaction be deemed to be a QIB?

Yes. Eligible purchasers under Rule 144A can be entities formed solely for the purpose of acquiring restricted securities, so long as they satisfy the qualifying QIB tests.

Source: SEC Release No. 33-6862 (April 23, 1990).

How does a reseller establish a reasonable belief that a person is a QIB?

The reseller (and any person acting on the reseller's behalf) may rely on the following, provided the information is as of a date not more than 16 months (18 months for a foreign purchaser) preceding the sale:

- the purchaser's most recent publicly available annual financial statements;
- information filed with (a) the SEC, another U.S. federal, state or local governmental agency, or a self-regulatory organization, or (b) a foreign governmental agency or foreign self-regulatory organization;
- information in a recognized securities manual, such as Moody's or Standard & Poor's; or
- a certification by the purchaser's chief financial or other executive officer specifying the amount of securities owned and invested as of a date on, or since, the end of the buyer's most recent fiscal year.

This list is not exclusive. See "Can a reseller of restricted securities rely on information other than that enumerated in Rule 144A for its belief that the prospective purchaser is a QIB?" below.

Source: Rule 144A(d)(1)(i)-(iv) and SEC Release 33-6862 (April 23, 1990).

Can a reseller rely on the information enumerated in Rule 144A even though more current information shows that the amount of securities owned by the prospective purchaser is lower?

Yes. The SEC has expressly stated so. However, a reseller cannot rely on certifications that it knows, or is reckless in not knowing, are false.

Source: SEC Release 33-6862 (April 23, 1990).

Can a reseller of restricted securities rely on information other than that enumerated in Rule 144A for its belief that the prospective purchaser is a QIB?

Yes. The bases for reliance enumerated in Rule 144A are non-exclusive; resellers may be able to establish a reasonable belief of eligibility based on factors other than those cited.

A reseller cannot rely on certifications that it knows, or is reckless in not knowing, are false. However, a seller has no duty of verification. In other words, unless the circumstances give a reseller reason to question the veracity of the information relied upon, the reseller does not have a duty to verify the information.

Source: Rule 144A(d)(1) and SEC Release No. 6862 (April 23, 1990).

Reseller's Reasonable Steps So Buyer is Aware of Rule 144A Reliance

Why must the reseller take reasonable steps to make the purchaser aware that it is relying on Rule 144A in connection with the resale?

The seller must make the purchaser aware that it is acquiring restricted securities since those securities may only be resold pursuant to an exemption from or registration under the Securities Act. The investor is entitled to know that the securities may be subject to reduced liquidity.

How does the reseller typically satisfy the requirement of making the buyer aware that the reseller may rely on Rule 144A in connection with the resale?

Typically, the warning is given by placing a legend on the security itself. For example, the note or stock

certificate representing securities resold under Rule 144A will include a legend (or a notation for electronic records) stating that the securities have not been registered under the Securities Act and, therefore, may not be resold or otherwise disposed of in the absence of such registration or unless such transaction is exempt from, or not subject to, registration.

In addition, the private placement memo or other offering memorandum used in connection with the Rule 144A offering typically will include an appropriate notice to investors, such as the following:

“Each purchaser of the securities will be deemed to have represented and agreed that it is acquiring the securities for its own account or for an account with respect to which it exercises sole investment discretion, and that it or such account is a QIB and is aware that the sale is being made to it in reliance on Rule 144A.”

The offering memorandum also will advise the purchaser that the securities to be acquired can only be reoffered and resold pursuant to an exemption from, or registration under, the Securities Act.

Finally, the resold securities will have a restricted CUSIP number.

Eligible Securities

What securities are eligible for exemption under Rule 144A?

Securities offered under Rule 144A must not be “fungible” with, or substantially identical to, a class of securities listed on a national securities exchange or quoted in an automated inter-dealer quotation system (“listed securities”). See “What is the definition of a U.S. national securities exchange or automated inter-dealer quotation system for purposes of Rule 144A?”

and “What happens if a security that was previously resold pursuant to Rule 144A is subsequently listed on a U.S. stock exchange or quoted on a U.S. automated inter-dealer quotation system?” below.

Common stock is deemed to be of the “same class” if it is of substantially similar character and the holders enjoy substantially similar rights and privileges.

American Depository Receipts (“ADRs”) are considered to be of the same class as the underlying equity security. See “Can a reseller rely on Rule 144A to reoffer or resell securities underlying ADRs?”

Preferred stock is deemed to be of the same class if its terms relating to dividend rate, liquidation preference, voting rights, convertibility, call, redemption, and other similar material matters are substantially identical.

Debt securities are deemed to be of the same class if the terms relating to interest rate, maturity, subordination, convertibility, call, redemption, and other material terms are substantially the same.

A convertible or exchangeable security with an effective conversion premium on issuance (which means at pricing) of less than 10%, and a warrant with a term less than three years or an effective exercise premium on issuance (at pricing) of less than 10%, will be treated as the “same class” as the underlying security. See “How is an effective conversion premium calculated?” below.

Source: Rule 144A(d)(3)(i) and SEC Release No. 33-6862 (April 23, 1990). Rule 144A(d)(3)(i) “invites a comparison of apparently different types of securities of the same issuer to determine whether in reality they should be considered the same class.” J. William Hicks, *Resales of Restricted Securities* at 7-18 (West Group 2007). The SEC has stated that privately-placed

securities that, at the time of issuance, were fungible with securities trading on a U.S. exchange or quoted in NASDAQ would not be eligible for resale under Rule 144A. In Release No. 33-6862 (April 23, 1990), the SEC stated that the test under Rule 144A to determine whether common stock will be deemed to be of the same class is the same as the test used under Section 12(g)(5) of the Exchange Act (which governs the requirement to register a class of securities under the Exchange Act) and will be interpreted by the SEC in the same manner.

How is an effective conversion premium calculated?

For a convertible security, by (a) taking its price at issuance, (b) subtracting from such price the aggregate market value of the securities that would be received on conversion, and (c) dividing the difference by the amount subtracted in (b).

For a warrant, by (a) taking its price at issuance, (b) adding to such price its aggregate exercise price, (c) subtracting from such number the aggregate market value of the securities that would be received on exercise, and (d) dividing the difference by the amount subtracted in (c).

For both of these calculations, the market value of the underlying securities is determined as of the day of pricing of the convertible security or warrant.

Source: Notes 25 and 26 of SEC Release No. 33-6862 (April 23, 1990) provide examples showing how to calculate the effective conversion premium and effective exercise premium.

Are restricted securities received upon conversion eligible for resale even though they are the same class as securities listed on a national securities exchange or quoted in an automated inter-dealer quotation system?

Yes, but only if no additional consideration is paid by the holder in connection with such conversion. Thus, restricted securities received upon conversion without payment of additional consideration by the holder, where the convertible securities are eligible for resale under Rule 144A, may be resold in reliance on Rule 144A.

Source: SEC No-Action Letter Debevoise & Plimpton (available July 23, 1990).

Can a reseller rely on Rule 144A to reoffer or resell securities underlying ADRs?

No. If American Depositary Receipts are listed on a U.S. national securities exchange or quoted on an automated inter-dealer quotation system, the deposited securities underlying the ADRs also would be considered publicly traded, and may not be resold in reliance on Rule 144A. See “What is the definition of a U.S. national securities exchange or automated inter-dealer quotation system for purposes of Rule 144A?” below.

Source: SEC Release No. 33-6862 (April 23, 1990).

What happens if a security that was previously resold pursuant to Rule 144A is subsequently listed on a U.S. stock exchange or quoted on a U.S. automated inter-dealer quotation system?

There is no effect on the eligibility of previously issued Rule 144A securities. Eligibility under Rule 144A is determined at the time of issuance, so securities of the same class that thereafter are listed on a U.S. national securities exchange or a U.S. automated inter-dealer quotation system will not affect the eligibility of the

securities under the rule. See “What is the definition of a U.S. national securities exchange or automated inter-dealer quotation system for purposes of Rule 144A?” below.

Source: In SEC Release No. 33-6839 (July 19, 1989), the SEC stated that “eligibility for resale [under Rule 144A] would be determined at the time of issuance in interest of certainty.” See also SEC No-Action Letter Shearman & Sterling (December 21, 1998).

What is the definition of a U.S. national securities exchange or automated inter-dealer quotation system for purposes of Rule 144A?

Only securities quoted on the NASDAQ Global Market and the NASDAQ Capital Market are deemed to be “quoted on a U.S. automated inter-dealer system” for purposes of Rule 144A. Securities quoted in these systems cannot be resold under Rule 144A.

Securities quoted on the NASDAQ Electronic Bulletin Board or in the Pink Sheets can be resold under Rule 144A.

Source: SEC Release No. 33-6862 (April 23, 1990), note 22. See also Telephone Interpretation No. 72 relating to Rule 144 of the Division of Corporation Finance’s Manual of Publicly Available Telephone Interpretations.

Informational Requirements

What type of information is required to be delivered to purchasers under Rule 144A?

To satisfy Rule 144A, if the issuer is not (1) a reporting company under the Exchange Act, (2) a foreign company exempt from reporting under Rule 12g3-2(b), or (3) a foreign government, the holder of the securities

and any prospective purchaser designated by the holder must have the right to obtain from the issuer, upon request of the holder, the following information:

- a brief description of the issuer’s business, products, and services;
- the issuer’s most recent balance sheet, profit and loss statement, and retained earnings statement (the financial statements must be audited if audited statements are “reasonably available”); and
- similar financial statements for the two preceding fiscal years.

The information must be “reasonably current” in relation to the date of resale under Rule 144A. See “What does “reasonably current” information mean in connection with furnishing disclosure to purchasers?” below.

This delivery obligation can continue for some time. See “When does the obligation to provide a buyer with the information cease?” below

In addition to this information requirement, in connection with an initial offering of Rule 144A securities, the issuer and the initial purchaser(s) typically will prepare an offering memorandum relating to the issuer and the securities. See “What type of documentation is typically involved in a Rule 144A transaction?” below. The disclosure in the offering memorandum, or incorporated by reference in the offering memorandum, will typically exceed the amount of disclosure that is required to be made available under Rule 144A. This is because the offering memorandum often is used as a marketing document, and because having robust disclosure of the issuer’s business, finances, and securities helps reduce the

potential liabilities of the issuer and the initial purchasers for violations of the U.S. securities laws. See “Are the antifraud provisions of the federal securities laws applicable to Rule 144A transactions?” below.

Source: Rule 144A(d)(4)(i).

What does “reasonably current” information mean in connection with furnishing disclosure to purchasers?

To be reasonably current:

- the business description must be as of a date within 12 months prior to the resale;
- the most recent balance sheet must be as of a date within 16 months prior to the resale; and
- the most recent profit and loss and retained earnings statements must be for the 12 months preceding the date of the balance sheet.

For a foreign issuer, if the required information meets the timing requirements of its home country or principal trading markets, such information will be presumed to be reasonably current. See “What type of information needs to be provided by an Exchange Act reporting company or a foreign issuer providing home country information?” below.

Source: Rule 144A(d)(4)(ii).

How is the purchaser’s “right to obtain” such information from the issuer established?

Rule 144A does not specify the manner by which the right to obtain information would arise. Typically, the issuer’s obligation to furnish information will be imposed by either:

- the terms of the security, such as a covenant in a paying agency agreement, form of note, or certificate of designations for preferred stock; or

- a purchase agreement or other contract between the issuer and the initial purchasers of the Rule 144A securities.

What type of information needs to be provided by an Exchange Act reporting company or a foreign issuer providing home country information?

An issuer that is subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act, or exempt from reporting pursuant to Rule 12g3-2(b) under the Exchange Act, is not subject to the requirement to furnish information under Rule 144A.

In the case of foreign private issuers (which are permitted to furnish home country information under Rule 12g3-2(b)), the requirement to be “reasonably current” will be satisfied if the required information meets the time requirements of the issuer’s home country or principal trading markets.

Source: Rule 144(d)(4)(ii)(C).

When does the obligation to provide a buyer with the information cease?

The obligation to provide information continues so long as the issuer is neither a reporting company nor a foreign issuer providing home country information.

What information is required to be provided to a buyer when a Rule 144A issuer’s securities are guaranteed by its parent company?

It depends on the status of the parent-guarantor. The information requirement does not apply if the securities are guaranteed by a parent company that would itself be exempt from the information requirement. If the parent-guarantor is not exempt, the information to be supplied is that of the parent-guarantor.

Source: The staff's position comes from the SEC No-Action Letters British Aerospace (available May 9, 1990) and Schering-Plough Corp (available November 21, 1991).

Rule 144A Trading Markets

Is there a trading market for Rule 144A securities?

Yes. Rule 144A securities may be traded on the PORTAL market, a private securities trading platform. PORTAL, which stands for "Private Offerings, Resale and Trading through Automated Linkages," is NASDAQ's screen-based automated trading system. In November 2007, NASDAQ and 12 leading securities firms announced their intention to form The Portal Alliance, an industry standard facility designed to trade Rule 144A securities, to replace PORTAL. See "What is the PORTAL Alliance?" below.

In practice, even though many underwriters require that Rule 144A securities be eligible to trade in the PORTAL market, relatively few securities are traded through it at present.

What is the PORTAL market?

The PORTAL market is a facility that was created for use in secondary trading of unregistered securities in transactions exempt from the registration and prospectus delivery requirements of the Securities Act pursuant to Rule 144A, and for primary placement of Rule 144A securities. The SEC has approved a rule change that permits Rule 144A securities that use alternative settlement processes to be quoted on the PORTAL system, which will facilitate the formation and operation of the PORTAL Alliance. See "What is the PORTAL Alliance?" below.

Source: SEC Release No. 34-27956 (April 27, 1990); SEC Release No. 34-56176 (July 31, 2007). The Rule 5300 series of the NASD Manual contains the regulations relating to the PORTAL market.

Who qualifies as a buyer on the PORTAL market?

Only qualified institutional buyers (see "What is a 'QIB'?" above.), dealers that are qualified institutional buyers, and certain NASD registered broker-dealers can be buyers on the PORTAL market.

An entity that is interested and eligible to use the PORTAL market must first register with the PORTAL market and demonstrate its qualifications. See "How do securities become eligible to trade on the PORTAL market?" below.

Source: See Rules 5338, 5339, and 5351 of the NASD Manual.

How do securities become eligible to trade on the PORTAL market?

Trading on PORTAL requires an application by a PORTAL market participant (with or without the issuer's consent) to determine if a security is eligible for deposit into the PORTAL market. As part of this process, the security must be deposited by the issuer or a PORTAL market participant. The deposited security must be in a negotiable form or eligible for deposit with a securities depository, and must not be subject to any restriction that would impose an unreasonable burden on any PORTAL market participant.

Source: See Rules 5321 and 5322 of the NASD Manual.

What is the PORTAL Alliance?

The PORTAL Alliance is a consortium of investment banks, in conjunction with NASDAQ, for trading unregistered securities on a single platform. These investment banks had either launched or were in the process of developing their own platforms for trading unregistered securities. The founding members of the PORTAL Alliance include Goldman Sachs, which launched its own platform (GStrUE) in 2007; Bear Stearns, which created Best Markets; JP Morgan, whose platform was called 144 Plus; and Wachovia Securities. The PORTAL Alliance also includes Opus-5 (The Open Platform for Unregistered Securities), a consortium formed by eight leading investment banks whose members include Bank of America, Citibank, Credit Suisse, Lehman Brothers, Merrill Lynch, Morgan Stanley, UBS, and Wachovia Securities.

The PORTAL Alliance is intended to be a closed trading market that limits trading to qualified institutions and established depository and clearance systems so that trades can only be made to other such institutions, or outside the United States, or pursuant to a registration statement or exemption from registration. As of March 17, 2008, this collaboration was subject to execution of a definitive agreement and regulatory approvals.

Source: SEC Release No. 34-56176 (July 31, 2007).

Conducting Rule 144A Transactions

How are Rule 144A transactions structured?

Typically, an issuer first sells restricted securities to a broker-dealer (often referred to as an “initial purchaser”) in a private placement exempt from

registration under Section 4(2) or Regulation D of the Securities Act. The broker-dealer then reoffers and resells the securities to QIBs using the exemption provided by Rule 144A. See What are the conditions that a reseller of restricted securities must satisfy to rely on Rule 144A? and “What is a ‘QIB’?” above

Rule 144A permits the broker-dealer to immediately reoffer and resell the restricted securities, even though it has purchased the securities with a view to their distribution. The availability of Rule 144A does not depend on how much time has expired since the securities were issued or on whether the reseller had an investment intent when it purchased the securities.

Resales under Rule 144A are completely separated from the issuer’s original offering—no matter how soon they occur or how inconsistent they are with the issuer’s exemption. In this regard, Rule 144A states that resales “shall be deemed not to affect the availability of any exemption or safe harbor relating to any previous or subsequent offer or sale of such securities by the issuer.”

Source: Preliminary Note No. 7 to Rule 144A, and Rule 144A(e).

What type of documentation is typically involved in a Rule 144A transaction?

The documentation used in a Rule 144A transaction is similar to that used in registered offerings, including:

- an offering memorandum;
- a purchase agreement between the issuer and the initial purchasers (i.e., broker-dealers);
- in some cases, a registration rights agreement between the issuer and the initial purchasers;
- legal opinions; and
- comfort letters.

The offering memorandum typically will contain a detailed description of the issuer, including its financial statements, and the securities to be offered. In the case of a publicly-traded issuer, the offering memorandum may incorporate by reference the issuer's Exchange Act filings instead of reproducing the disclosure.

The form, organization, and content of a purchase agreement for a Rule 144A offering often resembles an underwriting agreement for a public offering in many respects, but is modified to reflect the manner of offering.

In the case of a Rule 144A offering that is combined with a Regulation S offering, the Regulation S offering may be conducted using documents that are based on the country-specific practices of the relevant non-U.S. jurisdiction or jurisdictions. However, the disclosure documents in such a case generally will contain the same substantive information so that investors have the same "disclosure package."

In connection with offers of debt securities, it is very common to have a Rule 144A tranche offered to QIBs, and a Regulation S tranche offered to non-U.S. persons. See "What is a 'QIB'?" above. However, while Rule 144A securities generally have a restricted period of six months to one year, Regulation S debt securities have a restricted period of only 40 days. Therefore, these tranches are represented by separate certificates in order to help ensure their lawful transfer in the secondary market. In such a case, the Rule 144A global certificate with a Rule 144A restrictive legend is deposited with DTC, while the Regulation S global certificate with a Regulation S restrictive legend is deposited with a European clearing system. These two securities have different CUSIP numbers and other security identification numbers. The Rule 144A securities can be

re-sold to non-U.S. persons if the buyer certifies that it is not a U.S. person, and the sale otherwise complies with Regulation S. The Regulation S securities can be re-sold in the United States to QIBs if the resale complies with Rule 144A. In each such case, the registrar for the securities will make appropriate entries to reflect increases or decreases in the respective certificates.

Note: A registration rights agreement would only be applicable to Rule 144A transactions in which the issuer has agreed to register under the Securities Act the securities resold in the Rule 144A transaction. See "How are Rule 144A securities registered under the Securities Act?" below.

What is the offering process in connection with a Rule 144A transaction?

The Rule 144A offering process is often similar to the public offering process. The features of this process typically include:

- solicitation of orders using a "red herring" or preliminary offering memorandum;
- preparation and delivery of a final term sheet to investors to indicate the final pricing terms;
- confirmation of orders using a final offering memorandum;
- execution of the purchase agreement at pricing;
- delivery of the comfort letter from the issuer's auditing firm at pricing;
- delivery of legal opinions and other closing documents at closing; and
- closing three to five days after pricing.

See "What type of documentation is typically involved in a Rule 144A transaction?" below.

How does Rule 159 under the Securities Act impact the Rule 144A market?

Rule 159 was adopted by the SEC in 2005 as part of the SEC's "Securities Offering Reform" rules. Rule 159 restates the SEC Staff's traditional position that, for purposes of determining the adequacy of the disclosure in a prospectus, such adequacy would be evaluated as of the time that an investor formed a contract to purchase the securities.

In the U.S. securities market, the purchase contract usually precedes delivery of the final prospectus. Accordingly, after Rule 159 was adopted, a market practice developed in registered offerings—particularly debt offerings—under which the issuer or the underwriters provide to investors a final term sheet or similar document at the time of pricing that conveys to the investor the information that was not included in the preliminary prospectus. Typically, this information consists solely of pricing-specific information, such as the aggregate principal amount and the interest rate of debt securities. However, such a document could include other information, such as corrections to the preliminary prospectus or a description of recent developments in the issuer's business. (The document that contained this information would typically be a "free writing prospectus" under Securities Offering Reform rules.) The forms of legal opinions and officer certificates also were updated to refer to the adequacy of the so-called "disclosure package" as of the "initial sale time."

Technically, Rule 159 only applies in the context of a registered public offering. However, many practitioners became concerned that, if a court ever tested the accuracy of a preliminary Rule 144A offering memorandum as of the time of pricing, based upon the

principles set forth in Rule 159 and its rationale, the disclosure could be found deficient. Accordingly, some of the pricing practices in connection with registered offerings were adapted to the Rule 144A market, such as the delivery of term sheets, and required statements in legal opinions and officer certificates.

Why should initial purchasers conduct a due diligence investigation in connection with a Rule 144A offering?

A due diligence investigation is a critical component in an initial purchaser's decision whether to undertake an offering, enabling the prospective purchaser to evaluate the relevant legal, business, and reputational risks.

Rule 144A offerings do not subject the issuer and the initial purchasers to liability under Section 11 of the Securities Act. Accordingly, the initial purchasers are not entitled to the "due diligence" defense that may be established under Section 11. Nonetheless, a thorough due diligence investigation by lawyers, accountants, the issuer, and the underwriter generally will result in better disclosure and a lower risk of liability or potential liability for material misstatements or omissions.

What is the due diligence process for initial purchasers in connection with a Rule 144A offering?

The Rule 144A due diligence process is similar to that followed in connection with registered public offerings. Generally, the due diligence process is divided into two parts: (a) business and management due diligence, and (b) documentary, or legal, due diligence. In order to help establish their due diligence, the initial purchasers in a Rule 144A offering often will receive documents at closing that are similar to those used in an underwritten offering, including a comfort letter, legal opinions, and officer certificates.

Why do Rule 144A purchasers often insist that the issuer register the securities issued in the Rule 144A transaction?

Liquidity is the primary benefit that comes from holding freely tradable securities rather than restricted securities. See “Are securities resold under Rule 144A freely tradable after such resale?” above. In addition, certain state and federal laws prohibit some mutual funds and insurance companies from investing more than a certain percentage of their assets in restricted securities. Some investment partnerships and similar entities are subject to comparable restrictions under their organizational documents. Absent an issuer’s agreement to register Rule 144A securities, these entities would be severely limited in their ability to purchase securities in Rule 144A transactions.

Since the holding period under Rule 144 for securities issued by reporting companies was reduced effective February 2008 from one year to six months (see “What are the holding periods applicable to the sale of Rule 144A and other restricted securities?” above), there will be a shorter period of time after the contractual deadline in which non-affiliated investors will be restricted from selling the securities under Rule 144, which would generally decrease the need for registration rights and, as a consequence, limit the incremental value that registration rights previously provided.

How are Rule 144A securities registered under the Securities Act?

The two principal methods to register Rule 144A securities under the Securities Act are:

- “Exxon Capital” exchange offers (see “What is an Exxon Capital exchange offering?” below), and

- Shelf registrations under Rule 415 of the Securities Act. See “How are Rule 144A securities registered in a ‘shelf offering’?” below.

What is an Exxon Capital exchange offering?

An Exxon Capital exchange offering is a procedure under which securities are privately placed pursuant to Rule 144A and then promptly exchanged for similar securities that have been registered under the Securities Act. This is generally the preferred means for providing holders of Rule 144A securities with freely tradable securities.

From the issuer’s standpoint, an Exxon Capital exchange offer eliminates the need to continuously update a shelf registration statement over its lifetime if any of the investors in the Rule 144A offering are affiliates of the issuer. However, these exchange offers currently are permissible only with respect to non-convertible debt securities, investment grade preferred stock, and initial public offerings of common stock by foreign issuers conducted under Rule 144A. Moreover, affiliates of the issuer may not participate in an Exxon Capital exchange offer, and the SEC takes the position that broker-dealers also may not participate in these exchange offers. In addition, all exchanging holders will be required to represent that they acquired the securities in the ordinary course of their business and have no arrangements or understandings with respect to the distribution of the security that is the subject of the exchange offer. The SEC has indicated that it is unlikely to expand the permissible scope of these exchange offers beyond the current parameters. See “Why are shelf offerings not the preferable form of registering Rule 144A offerings?” below.

Source: The SEC staff's positions in this area come from a series of no-action letters: Exxon Capital Holding Corp. (available May 13, 1988); Morgan Stanley & Co. Incorporated (available June 5, 1991); K-III Communications Corporation (available May 14, 1993); and Shearman & Sterling (available July 2, 1993).

How are Rule 144A securities registered in a shelf offering?

Under Rule 415(a)(1)(i) of the Securities Act, issuers of Rule 144A securities may register the resale of the restricted securities that were sold in the Rule 144A transaction. Registered offerings under Rule 415 are known as shelf registrations.

Rule 415(a)(1)(i) permits either a delayed or continuous offering of securities "which are to be offered or sold solely by or on behalf of a person or persons other than the registrant" The persons covered by this rule would include resellers holding Rule 144A securities.

Although shelf registrations offer potential liquidity to buyers of Rule 144A securities, the securities remain restricted until they are resold under the shelf registration statement. In shelf registrations, the issuer should covenant to keep the shelf registration statement continuously effective for no less than one year in order to ensure the holder liquidity until the resale exemption under Rule 144 becomes available without any limitations on non-affiliates.

Why are shelf offerings not the preferable form of registering Rule 144A offerings?

If Rule 144A securities are held in book-entry form at The Depository Trust Company (known as DTC),

preparation of shelf registration statements can be extremely difficult from an administrative perspective.

The SEC requires that the prospectus contain a list of the beneficial owners of the restricted securities that will be resold pursuant to the shelf registration statement. However, when securities are uncertificated, it is virtually impossible to identify the beneficial owner for whom the registered holder (i.e., CEDE & Co., as DTC's nominee) holds the securities, especially after the securities have been transferred by their initial holders. As a result, an issuer typically will require that holders of Rule 144A securities notify it regarding any resales of the securities, and that new holders of the securities furnish a notice and questionnaire before they can be added to the registration statement.

Because of these administrative issues, Exxon Capital exchange offers are the preferred means for providing holders of Rule 144A securities with freely tradable securities. See "What is an Exxon Capital exchange offering?" above.

Use of the Internet to Conduct Rule 144A offerings

Can the Internet be used to make Rule 144A reoffers and resales?

The SEC has not expressly stated whether Rule 144A offerings may be made on the Internet. However, the SEC has permitted road shows in connection with a Rule 144A offering to be made over the Internet to QIBs. See "What is a 'QIB'?" above. Access to the road show must be password-protected, with a separate password for each offering. Passwords may be issued only to those potential purchasers the seller reasonably believes are QIBs, and the seller must not otherwise

have knowledge or reason to believe that any such potential purchaser is not a QIB.

The SEC has issued a no-action letter permitting sellers to rely on a third-party vendor's Internet-based list of QIBs, which must be certified by such vendor(s).

Source: SEC No-Action Letter, Net Roadshow, Inc. (Jan. 30, 1998); SEC No-Action Letter, CommScan, LLC (Feb. 3, 1999).

Other Issues

Are the antifraud provisions of the federal securities laws applicable to Rule 144A transactions?

Yes. Preliminary Note No. 1 of Rule 144A specifically states that the safe harbor provided by the rule relates solely to the application of Section 5 of the Securities Act and not to the antifraud provisions.

Because the antifraud provisions apply to Rule 144A transactions, an offering memorandum typically contains information comparable to what a prospectus for a registered offering would contain.

Is a Rule 144A security a "covered security" for purposes of Section 18 of the Securities Act?

It depends. Section 18 of the Securities Act exempts certain securities and securities offerings from state regulation relating to registration or qualification of securities or securities transactions. However, states may continue to require notice filings to be made in connection with exempt securities or offerings.

Section 18 will exempt Rule 144A transactions from state regulation if (i) the issuer of the securities being resold in the Rule 144A transaction has a class of securities traded on the New York Stock Exchange,

American Stock Exchange, or the NASDAQ Market System, and (ii) the securities being resold in the Rule 144A transaction are equal or senior to the issuer's securities that are listed on one of the above-referenced markets. For example, if an issuer has common stock traded on the New York Stock Exchange, and it offers senior debt securities in a Rule 144A offering, the debt securities will be "covered securities" under Section 18.

In addition, Section 18 will exempt from state regulation Rule 144A resales to a "qualified purchaser." In December 2001, the SEC issued a proposed rule to define the term "qualified purchaser" for purposes of Section 18, but the proposed rule was never adopted. The proposed definition mirrors the definition of "accredited investor" under the Securities Act, but since the SEC never formally adopted the definition, most legal practitioners are reluctant to advise their clients that they may rely on it or, consequently, on this provision of Section 18.

If Section 18 does not exempt the Rule 144A transaction from state regulation, then the transaction will be required to be registered with each state in which the Rule 144A resales occur or must otherwise be exempt from such state registration. Most state securities laws contain an exemption from registration for reoffers and resales made to QIBs within the meaning of Rule 144A. In states that do not have the specific exemption, Rule 144A sales often are exempt because Rule 144A purchasers would likely be deemed to be "institutional investors" for purposes of such states' analogous institutional investor exemption.

Source: Preliminary Note No. 5 of Rule 144A and SEC Release No. 33-6862 (April 23, 1990) state that nothing in Rule 144A removes the need to comply with any applicable state law relating to the offer and sale of

securities. See Section 18(b)(1)(C) with respect to the covered security exemption, and Section 18(b)(3) with respect to the “qualified purchaser” exemption.

Can an issuer that is not an Exchange Act reporting company be required to register under the Exchange Act in connection with a Rule 144A transaction?

Yes. Section 12(g) of the Exchange Act requires any issuer having 500 or more holders of record (and, in the case of a foreign private issuer, of whom 300 or more are U.S. residents) of a class of equity securities and more than \$10 million in assets at the end of its most recent fiscal year, anywhere in the world, to register the class of equity securities under the Exchange Act.

As a result, a non-reporting company that has sold equity securities in connection with a Rule 144A transaction may be required to register that class of equity securities. This may occur as a result of resales of the Rule 144A securities in the secondary market, other transactions that increase the number of holders, or, in the case of a foreign private issuer, a listing on NASDAQ. Companies that effect “backdoor IPOs” under Rule 144A must be careful to monitor the number of their equity holders.

Source: Rule 12g3-2(a). Preliminary Note No. 4 of Rule 144A and SEC Release No. 33-6862 (April 23, 1990) state that Rule 144A does not affect the securities registration requirements of Section 12 of the Exchange Act.

Are securities resold in reliance on Rule 144A included in determining the amount of securities that a person can resell in reliance on Rule 144?

No. Securities resold in reliance on Rule 144A need not be included in determining the amount of securities that can be resold in reliance on Rule 144.

Source: Rule 144(e)(3)(vii) and SEC Release No. 33-6806 (October 25, 1988).

May an issuer publish a notice about a proposed Rule 144A transaction?

Yes. An offering pursuant to Rule 144A is an unregistered offering within the meaning of Rule 135c of the Securities Act. An issuer that is subject to the reporting requirements of the Exchange Act or that is exempt from these reporting requirements under Rule 12g3-2(b) is entitled to rely on Rule 135c to publish a notice that it proposes to make, is making, or has made an offering of securities in a Rule 144A transaction. In addition, Rules 168 and 169 provide a safe harbor for regularly released factual business information, including information maintained on a company’s website.

By **Lloyd S. Harnetz**,
partner in the Capital Markets Group of Morrison &
Foerster LLP