Introduction

• Overview of Restricted Securities
• Rule 144
• Definition of Affiliate
• Distribution Issues
Restricted Securities

- Securities acquired in an unregistered private sale directly from the issuer or an Affiliate (to be defined below) of the issuer
  - Private Placements

- Restricted Securities cannot be resold without registration or an exemption from registration

- Restricted Securities usually contain legend reciting restrictions on public sales

- Rule 144 is a “safe harbor” exemption from registration
  - i.e. failure to comply with Rule 144 will not automatically result in a violation of law if another registration exemption is available
  - Non-exclusive exemption
Rule 144

• Rule 144 provides a “safe harbor” exemption from registration for sales to the public of securities acquired in private transactions

• General Requirements
  – Holding Period
  – Adequate Public Information
  – Manner of Sale
  – Filing with SEC
  – Volume Restriction
Holding Period

The applicability of Rule 144 restrictions depends on the period that the securities were held and the Affiliate status of seller:

- Less than one year – Rule 144 not available
- Between 1 and 2 years – Rule 144 is available but sale is subject to restrictions
- Seller is Affiliate – Rule 144 is available but sale is subject to restrictions
- At least two years and Seller is not Affiliate – Rule 144 is available without restrictions
  - No Affiliate status within 90 days of sale
Rule 144 Sale Restrictions

• Adequate Public Information
  – Generally, the issuer of Restricted Securities must be a reporting company under the Securities Act of 1933 or the Exchange Act of 1934 for at least 90 days preceding the date of sale

• Manner of Sale
  – Sales of Restricted Securities must be sold in “brokers” transactions and handled in the same manner as a routine trading transaction
    ‣ No extraordinary commissions
    ‣ No solicitation of orders

• Filing with the SEC
  – Seller of Restricted Securities must file Form 144 with SEC if sale involves more than 500 shares or sale is more than $10,000 in any three-month period
Rule 144 Sale Restrictions (cont.)

• Volume Restrictions
  – The number of shares of a class of Restricted Securities sold by any person during any three month period cannot exceed the greater of:
    ▶ One percent of the outstanding shares of the same class being sold or
    ▶ The average reported weekly trading volume of such securities during the four weeks preceding the filing of Form 144
**Affiliate**

- **Rule 144 Definition**
  - “An ‘affiliate’ of an issuer is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with such issuer”

- **Control**
  - “the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person”
  - It is the existence of the power to control rather than the exercise of the power to control

- **Facts and Circumstances Test**
  - Percentage ownership of securities of issuer
  - Board of Directors membership
  - Other commercial or contractual relationships
  - SEC guidance is very limited
Distributing Restricted Securities

• Assuming only “Marketable Securities” can be distributed to Limited Partners

• How does Fund determine that Restricted Securities can be resold by distributee partners under Rule 144?
  – Holding Period
  – Is the Fund an Affiliate of the issuer?
  – Is the Fund “Closely Held”? 
Distributing Restricted Securities (cont.)

• Securities held less than one year
  – Fund partners cannot use Rule 144 to sell distributed securities

• Securities held at least one year and less than two years
  – The Fund can distribute securities subject to the Rule 144 restrictions, including the volume restrictions

• Securities held at least two years
  – If the Fund is not an Affiliate of the issuer, the Fund can distribute or sell Restricted Securities without regard to Rule 144 Restrictions, including volume limitations
Tacking Requirements

• Distribution to partners is made on a pro-rata basis
  – Disproportionate distribution to General Partner to account for carry is permissible

• No consideration is paid by partners in connection with the distribution

• Partners are not acting in concert with respect to resales
Tacking of Holding Periods by Limited Partners

• Restricted Securities held by the Fund ≥ 1 year and < 2 years
  – If Fund is not an Affiliate of the Issuer
    ▶ Distributee partners may tack holding period (i.e. add the Fund’s holding period to their own)
    ▶ For purposes of volume limitation must aggregate their sales with sales by the Fund and all other distributee partners

• Restricted Securities held by the Fund ≥ 2 years
  – If Fund is not an Affiliate of the Issuer
    ▶ Nonaffiliate distributee partners may tack holding period and freely resell under Rule 144 without any Rule 144 restrictions
    ▶ Distributee partners that are Affiliates themselves may tack holding period but are still subject to restrictions of Rule 144 as Affiliates
Tacking (cont.)

• If Fund is an Affiliate of the Issuer and “closely held”
  – Distributee partners can sell under the same conditions as if the Fund were not an Affiliate

• If the Fund is an Affiliate of the Issuer and not “closely held”
  – No tacking of holding period permitted
  – New holding period begins on the date of distribution
  – Practical effect is that securities are not “marketable securities” under most Fund limited partnership agreements and securities cannot be distributed
Closely Held

• SEC has not defined or given clear guidance as to what constitutes a “closely held” limited partnership

• Less than 30 distributee partners seems to have support in no-action letters

• SEC has provided oral guidance that a fund will be deemed closely held for purposes of the Rule 144 tacking rules if the Fund falls within the exception from the definition of “investment company” provided by Section 3(c)(i) of the Investment Company Act of 1940 (100 beneficial owner test)

• There is no guidance to address treatment of funds using the Section 3(c)(7) exemption (Qualified Purchaser Test)
Closely Held Solutions

• Register Securities
  – Use registration rights to cause portfolio company to file registration statement

• Drop Affiliate status
  – Resign board seats
  – Reduce ownership of voting securities

• Sell Securities subject to volume limitations
## Summary Chart

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<th>At the date of distribution, the partnership is:</th>
<th>Combined holding period of partnership and distributee partner:</th>
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<td>&lt; 1 Year</td>
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<td>1 – 2 Years</td>
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<td>2 + Years</td>
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**Not an affiliate of issuer or Affiliate of issuer, but “closely held” (precise meaning of term unclear)**
- Securities may not be sold under Rule 144.
- Distributee partners may tack and resell under Rule 144, but for purposes of volume limitation must aggregate their sales with sales by the fund and all other distributee partners.
- Nonaffiliate distributee partners may tack and freely resell under Rule 144(k), without aggregation. There is no need for a nonaffiliate distributee partner who has not been an affiliate during the last 3 months to wait for an additional 3 month period from the date of distribution based solely on affiliate status of the distributing partnership before commencing sales under 144(k).
- Affiliate distributee partners may tack but are still subject to restrictions of Rule 144 as affiliates. For 1 year following date of distribution, affiliate distributee partners must also continue to aggregate their resales with resales by the partnership and by all other distributee partners, though not with any 144(k) resales by nonaffiliate distributee partners.

**Affiliate of issuer, not “closely held”**
- No tacking permitted. New holding period begins on date of distribution.
This presentation is intended only as a general discussion and should not be regarded as legal advice. For more information, please contact your Fund Services Group attorney.

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