

1972 WL 19628 (S.E.C. No - Action Letter)

(SEC No-Action Letter)

American-Standard

Publicly Available October 11, 1972

LETTER TO SEC

August 16, 1972

*1 Neal S. McCoy, Esq.

Chief Counsel

Division of Corporation Finance

Securities and Exchange Commission

500 North Capitol Street

Washington, D.C. 20549

Re: Rule 144

Dear Mr. McCoy:

I believe that, if anything, the need for clarification of some aspects of Rule 144 has increased since we last spoke. I enclose some material which is roughly in the form the American Society of Corporate Secretaries might elect to publish if you do not regard it as being in a significant way out of harmony with the thinking of the staff. We chose this approach because there is so much on which some kind of comment is needed, and I suspect the staff does not want to issue a formal ruling on so broad a spectrum of questions.

The most important issue, however—a matter of very practical concern to many companies—is the problem of who is an “affiliate”. We recognize that Rule 144 has not changed the meaning of the term “affiliate”, and that it is a factual question as to who may be an “affiliate” of a particular issuer. However, at a time when Rule 154 was still in effect it was ordinarily not necessary to find out if one was an “affiliate”. Now, with the disappearance of that Rule, executive officers and directors of large publicly-held companies, whose ownership is widely dispersed, have a very real problem. In this context we feel strongly that the Commission must give industry more guidance. This is not to dispute the conclusion that the question is a factual one. However, there must be scores of companies and hundreds of management personnel who, as things stand, are not in a position to know. As you can recognize, conceding to be an “affiliate” when one is not carried with it potential difficult consequences, and managements should not be forced into that position. Is it the Commission’s position that merely being an executive officer or director of a large, publicly-owned company where stock ownership is widely dispersed, executive officers and directors own in aggregate, say, less than 5% of the outstanding stock and there is no apparent family or founder group which is in control, nevertheless would be enough without more, to establish a presumption that any of such executive officers or directors is a member of a “controlling group”? Additionally, does the “controlling group” concept apply with respect to the term “affiliate” in Rule 144?

It would not seem unfeasible also to isolate a few other common fact situations and comment on them. Consider the following three examples:

1. Chief executive and Director. Public company. His own stock interest less than 1/10 of 1%. No “associates” own any stock. Large Board. Only two Directors out of 15 are “insiders”. Rest are independent except in the remote sense that two or three of them have employers who do business with the company regularly and at arms’ length.

*2 2. Vary the facts slightly and consider the case of a chief executive who, with his family, may have 1% of the stock, one of the largest but not the largest single holding. Assume also that the bulk of the Directors have been recruited by him but have very limited business relationships, if any, with the company.

3. Consider next an outsider Director, not related in any family way to the chief executive but who was at one time the chief executive of the company, who holds about 1% of the stock. Many of the other Directors were recruited by him but he has no particular close relationship except in a social sense with any of them.

In none of these cases do we believe the individual mentioned is an "affiliate".

We will be glad to do whatever we can to advance the discussion.

Very truly yours,

David A. De Wahl Vice President, General Counsel & Secretary AMERICAN-STANDARD
40 W 40th Street New York, New York 10018 (212) 484-5245

PROPOSED COMMENT ON RULE 144 TO BE PUBLISHED BY ASCS

Word has come in from several cities that a few brokers have been advised by counsel to insist on observance of Rule 144 formalities before handling sale of stock belonging to any Director of any issuer. To assist ASCS members in answering this problem and others arising under Rule 144, the Securities Committee of ASCS has formulated judgments about the Rule and its application, which judgments have been reviewed with, and in general received the informal concurrence of, a highly-placed lawyer in the Securities and Exchange Commission staff, as follows:

Revocation of Rule 154 of the SEC and adoption of Rule 144 have made it necessary for senior management (and brokerage firms) to focus closely on the question of whether and when directors of various issuers may be "affiliates" of their companies. Under SEC rules, "affiliate" is defined as a person who "directly or indirectly, through one or more intermediaries, controls, or is controlled by, or is under common control with, the issuer." Generally the SEC has regarded determination of who may be in control as purely a fact question in which many kinds of facts and circumstances must be considered. Among the factors to be considered in respect of the posture of any individual are his office or position in the organization of the issuer, the amount of stock owned by the individual, the amount owned by an entire group which must reasonably be considered as functioning in concert or together (including, but not limited to, a family group), the position of the individual and/or other persons in the group; relationships between the individual and directors of the organization, and other factors, the relevance of which will come from particular circumstances.

We have now been told that some brokerage firms have been advised by counsel to assume that for Rule 144 purposes, all directors are "affiliates" unless there is an opinion or factual demonstration to the contrary. This poses a dilemma for some directors. Despite disclaimer, to appear to concede by filing under Rule 144 that one is an "affiliate" could have adverse consequences.

*3 Each company must, of course, look at its own circumstances and decide what kind of opinion its counsel can give if the question arises.

[At this point we would interpose material based upon the response to our letter of August 16, 1972 to Mr. McCoy.]

Other observations about the Rule are as follows:

A. With the revocation of Rule 154, it would now appear that "affiliates" can lawfully sell stock in their companies only in a limited number of ways:

(a) In a manner satisfying Rule 144. (For this purpose, despite the literal language of the Rule, shares need not have been held for two years if the affiliate's acquisition transaction did not itself make them "restricted shares" as defined by the Rule, e.g. shares bought by an "affiliate" in the open market.)

(b) Pursuant to a public offering in which the securities are registered under the Securities Act of 1933 on a Form other than S-8.

(c) Contrary to the negative inference possible from the second clause of (b) of Rule 144, sale may be made over a national securities exchange without Rule 144 formalities if the shares are currently registered on Form S-8. (An S-8 registration apparently will not support sales over-the-counter.) This view is supported by the staff ruling in Delta Air Lines, Inc. [CCH Fed. Sec. Law Rep. ¶ 78,847]

(d) As a "small", exempt transaction. Under Rule 144, small amounts of stock (not more than 500 shares having an aggregate sale price not exceeding \$10,000 in any six-month period) may be sold without a formal filing on Form 144. We reason from this provision that casual sale of unregistered securities in such amounts is not to be deemed a public offering (that is, the sale is exempt under § 4(1) of the Act) and the seller will not be an "underwriter" by reason of such sale, even though the shares

are restricted and were held less than two years.

Exempt disposition of restricted stock by affiliates is, of course, also possible in certain other proper circumstances, for example, in certain circumstances in a merger or other reorganization transaction. (Rule 133 is relevant but its amendment is a pending proposal of the Commission.)

B. We believe bonus stock may still be sold outside Rule 144 by non-affiliates if the plan under which it was issued was such that no sale was involved in the issuance of shares to the recipients. This is by virtue of the language of the Securities Exchange Act itself. The Commission in its order postponing to June 1, 1972 the application of Rule 144 to such plans implied that all shares issued under such plans can after June 1, 1972 be sold only in accordance with that Rule. It is the belief of the Society that if the plans are truly such that there was no sale involved in the original issuance of shares to participants, Rule 144 does not apply, even at this time, to sales by non-affiliates.

There is some suggestion that the SEC is considering this matter further, and the staff has raised questions about the correctness of certain “no sale” rulings given in the past, e.g. where the employee is committed to earn out some or all of the bonus shares in order to keep them.

*4 We believe though that any new rules will be prospective only but may establish a requirement for S-8 registration of nearly all stock bonus plans.

1933 Act / s 4(1) / Rule 144

October 4, 1972
Publicly Available October 11, 1972

David A. DeWahl, Esq.
Vice President, General Counsel & Secretary
American-Standard
40 West 40th Street
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Dear Mr. DeWahl:

This is in response to your letter of August 16, 1972, regarding the operation of Rule 144 under the Securities Act of 1933.

The first matter you raise pertains to the question of who is an “affiliate” for purposes of Rule 144. In this regard, it is this Division’s position that a person’s status as an officer, director, or owner of 10% of the voting securities of a company is not necessarily determinative of whether such person is a control person or member of a controlling group of persons. His status as an officer, director or 10% shareholder is one fact which must be taken into consideration, but, as you recognize, an individual’s status as a control person or as a member of a controlling group is still a factual question which must be determined by considering other relevant facts in accordance with the test set forth in Rule 405 under the Act, which provides: “The term ‘control’ (including the terms ‘controlling,’ ‘controlled by’ and ‘under common control with’) means the possession, direct or indirect of 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.” This has been the test applied under Rule 154 prior to its repeal and will continue to be the test applied under Rule 144. In applying this test, as a matter of law, a person who claims that he is not an affiliate in order to use an exemption from registration has the burden of proving the availability of the exemption.

You further ask whether the “controlling group” concept applies with respect to the term ‘affiliate’ in Rule 144. A person who is a member of a controlling group is deemed to be an ‘affiliate’ for purposes of Rule 144. This does not mean, however, that sales of securities by all members of the controlling group must be aggregated under the rule. With regard to the question of aggregation, a reference to the Commission’s interpretation of Rule 154 will be helpful. In [Securities Act Release No. 4518 \(January 21, 1966\)](#) the Commission stated that Rule 154 did not provide an exemption for portions of a distribution being effected by a group of closely related persons.

If such a distribution was in progress, the offering by the group as a whole would have to be included in a single computation under Rule 154(b). Two provisions of Rule 144 reflect the extent to which this group aggregation concept has been carried over into Rule 144. First, subparagraph (a)(2) of the rule has the effect of aggregating sales of securities by an individual and certain of his associates because they are deemed to be the same “person” for purposes of the rule. Second, subparagraph (c)(3)(F) of the rule requires aggregation “when two or more affiliates or other persons agree to act in concert for the purpose of

selling securities of an issuer.” This provision would aggregate sales of securities by members of a controlling group only to the extent that such persons agree to act in concert in selling the securities. Except as reflected in these two subparagraphs, the “controlling group” aggregation concept has not otherwise been carried over into Rule 144.

*5 I am unable to comment on the specific examples you give of cases in which, in your view, the individuals mentioned would not be affiliates. As indicated above, this involves a factual determination which would turn on facts in addition to those you have set forth. As a general matter, however, it appears that your interpretation would lead to the conclusion that no person or group of persons would be deemed to be in control, and thus “affiliates,” of many large corporations for Securities Act purposes. If I correctly understand your view, I do not agree with it. The Act contemplates that some person or group of persons will be in control of every corporation.

With regard to your proposed release, I hope that the following observations will be helpful to you. First, I do not agree with the suggestion made in paragraph A(a) that the literal language of Rule 144 requires a two-year holding period for affiliates in all instances. The holding period provision of Rule 144 only applies to “restricted securities” and, securities acquired by an affiliate in open market trading transactions would not be “restricted securities” within the meaning of the rule.

Second, I do not find any negative inferences in the second clause of subparagraph (b) of Rule 144 which indicate that shares currently registered for resale on Form S-8 may not be made over a national securities exchange without Rule 144 formalities. The staff’s view is that if shares are registered for resale on a national securities exchange on Form S-8 and there is a current prospectus available for use in connection with such sales, such shares should be sold pursuant to the “live” prospectus and Rule 144 would not be available. To permit the use of Rule 144 under such circumstances would be inconsistent with the broad remedial purposes of the Act and with public policy which strongly supports registration. If it is contemplated that the Form S-8 prospectus will be used for resales of securities registered on Form S-8 on a national securities exchange by persons who may be deemed to be underwriters, a statement to this effect should be included on the cover page of the prospectus. If the Form S-8 prospectus is not available for such resales, for instance because it is not current or because the resales are to be made otherwise than on a national securities exchange and the prospectus has not been amended to include the additional information required by Undertaking C of Form S-8, Rule 144 would be available for such resales assuming all its conditions are met.

Third, your discussion concerning the “small” exempt transaction is an incorrect reading of the provisions of the Rule. The provision referred to merely relieves the seller of the obligation to file a Form 144 in certain small transactions; it does not exempt such sales from the other provisions of the Rule or from the registration provisions of Section 5 of the Act.

Fourth, I am unable to agree with your discussion of bonus stock on page 5 of the proposed comment. It is the Commission’s view that shares issued in bonus plans would be restricted securities as defined by the Rule and, as a result, must be sold pursuant to the provisions of Rule 144 or pursuant to some other applicable exemption.

*6 Finally, I do not understand the paragraph beginning at the bottom of page 4 and I am not clear what “no-sale” position is being referred to at the top of page 6.

If you wish to discuss the above comments further, please do not hesitate to get in touch with me. In writing your proposed release, you should feel free to cite such parts of this letter as you feel would be of benefit to your membership.

Sincerely,

Neal S. McCoy
Chief Counsel

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