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## Securities Law

### **Sale Of Restricted Shares By Non-Affiliates Under Federal And Florida Securities Laws**

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1. In securities offerings that are exempt from the registration requirements of the Securities Act of 1933 (the "33 Act"), purchasing shareholders receive *restricted* securities; that is, shares that may not be resold by an investor unless the shares are either registered under the 33 Act or are resold pursuant to an exemption under the 33 Act.
2. To facilitate resale of restricted securities by an investor, it is imperative that, when an issuer first sells its securities to the investor in an exempt transaction, the issuer obtain a written representation from the investor that the investor is purchasing the shares for investment only and not with a view to "distribution".
3. The 33 Act does not define the word "distribution" but it is commonly understood to mean a public offering. In other words, purchasing shareholders must represent that they are not buying shares from the issuer to, in turn, offer the shares to the public in an unlawful public offering.
4. The 33 Act, and the rules promulgated under it, permit the **resale** of restricted securities by an investor, but only under certain circumstances.
  - a. Section 4(1) of the 33 Act provides that the requirement that shares be registered with the SEC does not apply to sales by any person other than an issuer (i.e. the company issuing the shares), underwriter or dealer.
    - i. The pitfall in the foregoing section is that, if the purchasing shareholder originally purchased his shares from issuer with a view to "distribute" them, he will be deemed an "underwriter".
    - ii. Normally, whether or not one is deemed to be an underwriter is determined by the amount of time he has held the stock. The general rule of thumb is that if one has held his stock for two years, it is a good indication of an intent to hold the stock for investment and not an intent to

purchase the stock for "distribution". The SEC has never adopted this bright line test for Section 4(1), maintaining that the question is a factual one to be determined on a case by case basis. (However, see the discussion on Rule 144 below.)

- b. In 1972, the SEC adopted Rule 144 to provide a "safe harbor" for the resale of restricted stock. It was adopted to provide clear guidance on Section 4(1).
  - i. The rule provides different requirements for restricted stock depending upon the length of time held and upon the relationship of the investor to the company.
  - ii. **If the investor is an "affiliate" (i.e. director, executive officer or control person - usually a person holding 10% or more of the stock), additional requirements, some of which are rather onerous, apply.**
  - iii. Under Rule 144, if a shareholder is not an affiliate and he has held the stock for more than 2 years, the shareholder can sell as many shares as he wishes to as many people as he wishes.
    1. There are no limitations on the shareholder's ability to sell his restricted shares after two years. This is true even if there is no publicly available information on the company.
    2. In turn, the investor who purchases shares from a shareholder selling under Rule 144 receives **unrestricted** securities. In other words, the new investor is free to sell his newly purchased shares however and whenever he wishes.
5. Florida law provides an exemption from its state securities registration requirements provided the resale of restricted securities is an "isolated" sale and the seller holds the shares for his own account. Further, Florida provides that if the sale is in compliance with Section 4(1) of the 33 Act discussed above, then the sale will be deemed exempt.
6. One qualification: the anti-fraud provisions apply to every sale of securities. This is true whether the securities are restricted or unrestricted, whether the sale is private or public, and whether the sale is by the company or by an investor. The seller (whether the company or an investor) must disclose to the buyer all material information in the seller's possession and the seller must not fail to disclose any material information known to the seller.
7. Sample Legend for Restricted Securities:

"The securities represented by this certificate have not been registered under the Securities Act of 1933, as amended, or under any state securities laws. Such shares have been acquired for investment purposes only and not with a view to the distribution thereof. They may not be sold, offered for sale, transferred or otherwise disposed of in the absence of an effective registration statement under the Act or compliance with the requirements of any applicable state securities laws, or an opinion of counsel satisfactory to the corporation that such registration or compliance is not required."

This outline summarizes and highlights the relevant Federal and Florida statutes and regulations governing the sale of restricted securities by non-affiliates. The date of this outline is February

1998. Readers should refer to the Federal and Florida Statutes and regulations as the definitive source of the contents of these statutes and regulations. The contents of this outline should not be construed as legal advice. Readers should not act upon information presented herein without individual professional advice.

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