

SECURITIES AND EXCHANGE COMMISSION  
ADVISORY COMMITTEE ON  
SMALL AND EMERGING COMPANIES

Washington, DC 20549-3628

June 11, 2015

The Honorable Mary Jo White  
Chair  
U. S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-1070

Dear Chair White:

As you know, the Securities and Exchange Commission organized the Advisory Committee on Small and Emerging Companies to provide the Commission with advice on the Commission's rules, regulations, and policies with regard to its mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation, as they relate to the following:

- (1) capital raising by emerging privately held small businesses and publicly traded companies with less than \$250 million in public market capitalization;
- (2) trading in the securities of such businesses and companies; and
- (3) public reporting and corporate governance requirements to which such businesses and companies are subject.

On behalf of the Advisory Committee, we are pleased to submit the enclosed recommendation regarding formalizing the exemption commonly known as "Section 4(1½)." This recommendation was discussed at a meeting held on March 4, 2015 and unanimously approved by the members of the Advisory Committee present and voting at a meeting held on June 3, 2015.

We and the other members of the Advisory Committee are prepared to provide any additional assistance that the Commission or its staff may request with respect to this recommendation.

Respectfully submitted on behalf of the Committee,



Stephen M. Graham  
Committee Co-Chair



M. Christine Jacobs  
Committee Co-Chair

Members of the Committee

Charles Baltic  
David A. Bochnowski  
John J. Borer, III  
Dan Chace  
Milton Chang  
Stephen M. Graham  
Shannon L. Greene  
Sara Hanks  
John Hempill  
M. Christine Jacobs  
Richard L. Leza\*  
Sonia Luna  
Catherine V. Mott  
David J. Paul  
Timothy Reese\*\*  
Timothy Walsh\*  
Gregory C. Yadley

Official Observers

Michael Pieciak  
Javier Saade

\* Not present at the meeting held on March 4, 2015.

\*\* Not present at the meeting held on June 3, 2015.

Enclosure

cc: Commissioner Luis Aguilar  
Commissioner Daniel M. Gallagher  
Commissioner Kara M. Stein  
Commissioner Michael S. Piwowar  
Keith Higgins  
Elizabeth Murphy  
Sebastian Gomez  
Julie Davis

U.S. Securities and Exchange Commission  
Advisory Committee on Small and Emerging Companies

**Recommendation Regarding the “4(1½) Exemption”**

From the March 4, 2015 and June 3, 2015 Meetings

AFTER CONSIDERING THAT:

1. The Committee’s objective is to provide the U.S. Securities and Exchange Commission (the “Commission” or “SEC”) with advice on its rules, regulations and policies with regard to its mission of protecting investors, maintaining fair, orderly and efficient markets, and facilitating capital formation, as they relate to, among other things, capital raising by emerging privately held small businesses (“emerging companies”) and publicly traded companies with less than \$250 million in public market capitalization (“smaller public companies”).
2. Smaller public companies and emerging companies play a significant role as drivers of U.S. economic activity, innovation, and job creation. Their ability to raise capital in the private markets is critical to the economic well-being of the United States.
3. Private companies are better able to attract and retain talented employees when those employees are able to monetize at least part of their equity compensation. Making equity compensation more attractive to prospective employees will facilitate job creation and start-up growth.
4. With the enactment of the Jumpstart Our Business Startups (JOBS) Act of 2012, private companies have greater flexibility to defer an initial public offering, and many are choosing to remain private longer than in the past. As a result, shareholders and employees of these companies can face a longer wait time for public liquidity, a fact that negatively impacts private company capital formation and job creation.
5. Securities Act Rule 144 is a commonly-used safe harbor that allows selling securityholders to sell privately-issued securities subject to the conditions of the rule. However, there are situations under which employees and affiliates of the issuer may not be able to meet the conditions of Rule 144. One common example is an option holder seeking a “cashless” exercise of employee options. In this case, the holding period requirements in Rule 144 often prevent the holder from being able to resell shares immediately upon exercise in order to pay the exercise price and other costs of acquiring the shares underlying the options.
6. When the conditions of Rule 144 are not met, selling securityholders often rely on the so-called “4(1½) exemption,” a legal construct that has developed based on case law. The “4(1½) exemption” incorporates elements of exemptions available under Securities Act

Section 4(a)(1) for persons other than an issuer, underwriter or dealer, and Section 4(a)(2) for transactions by an issuer not involving a public offering.

7. The expenses involved in a “4(1½)” transaction can be significant. Generally, the selling securityholder engages legal counsel to provide a legal opinion confirming that the shares were sold pursuant to a valid exemption from registration. Current opinion practice with respect to “4(1½)” transfers requires that the transferee certify that he/she/it is an accredited investor. In addition, the parties to the transfer need to certify that they have otherwise complied with the requirements of a valid private placement, including that there was no general solicitation, and the new certificates are legended as “restricted securities”.
8. Each transaction must satisfy the blue sky laws of the state of residence of the potential buyer. State regulations relating to these transactions generally vary, which often adds significantly to the complexity and cost.
9. There have been bills introduced in Congress to formalize the “4(1½)” legal construct. While a statutory change would be effective, the SEC also has the authority to formalize the exemption through rulemaking.

THE COMMITTEE RECOMMENDS THAT:

The Commission formalize the “4(1½) exemption” to mimic existing opinion practice for resales of privately-issued securities by shareholders who are not able to rely on Securities Act Rule 144.