Federal Securities Regulation

Professor Harrington

Outline by Syllabus

Material Taken From Notes, Jennings Text and Gilberts

Classes 1-4

Efficient Capital Markets Hypothesis

Reading: 1933 Act (emph on §§ 2, 4(1), 5-10).
Rules 134, 135, 137-139, 141, 174-176, 424, 427, 430, 430A, 431, 460, 461-464.

Overview

Different Securities Acts

- 1933 Act
  - Initial distribution (to public)
  - Follow up offerings, repeat offerings
- 1934 Act
  - Post distribution trading
  - Regulation of broker/dealer
  - Registration, periodic disclosure
- Trust Indenture Act
  - Public offering of debt
  - What kinds of conflict of interest is okay

- The SEC
  - Procedural rules (402, 403, etc.)
  - Interstitial rules (Congress asking SEC to do such and such)
  - Definitional rules
  - No action letters - SEC response to question is "if you do such and such, we will take no action."

- Blue Sky Laws
  - State security laws
  - Held constitutional
  - Congress expressly interpreted this (see § 18 of '33 Act, § 28 of '34 Act)

- Glass-Steagel Act

Forbids (certain) banks from buying corporate stock for own account
Forbids banks from underwriting, except for government issues
Forbids traders from taking deposits, acting as banks.
Resulted in creation of new kinds of banks - independently commerical or investment.

Chap. 1 - The Institutional and Regulatory Framework

1. Overview of Financial Markets
    A. The Structure of the Financial Markets
        1) Money Market
        2) Government Securities Market
        3) Municipal Securities Market
        4) Corporate Debt Market
        5) Derivative Products Markets
            Options
            Futures
            Swaps
    B. The Principal Players: A Scorecard
    C. New Financial Products
        1) Equity Derivatives
        2) Securitization
        3) "Unbundling"
    D. One Market, Multiple Regulators
        1) New Trading Strategies
        2) One Market Concept
        3) Responses to Market Volatility
        4) Continuing Division of Authority
    E. Internationalization: Causes and Consequences
2. The Equity Markets
3. Investment Banking and the Underwriting Process

Four Kinds of Underwriting
    A. Best Efforts
        1) underwriter is only an agent for the company
        2) underwriter acts on commission
        3) underwriter does not promise anything
        4) rarely done
    B. Bought Deal
        1) issuer gets commitment from bank to buy
        2) comes up more due to "shelf registration"
        3) also rare
    C. Stand-by Offering
        1) "strict underwriting", "old fashioned underwriting", "guaranteed underwriting"

2) Syndicate commits to buy whatever they cannot sell [at reduced price] (as opposed to buying all and trying to resell it)

D. Firm Commitment
1) "syndication", "fixed price"
2) most prevalent
3) underwriters buy it all, led by lead underwriter
4) underwriters get spread - buy low, sell high
5) typical spread is 6-10%

E. Syndication Misc
1) Managers sometimes hired fro 1% of price, 20% of spread
2) May form another tier--sellers group. This may achieve wider distribution than if syndicate does it alone. Sellers agree to sell/buy 1000 (or so) shares. Sellers get concession, 50-60% spread.
3) Underwriter commits to initial allotment. When underwriter keeps some, its called the "retention".
4) Lead underwriter can re-allot.
5) Liability is individual and several. Each underwriter agrees to buy its own allotment. If one defaults, the others are not liable. See § 11(e) of '33 Act - cap on any member's liability based on number of shares underwritten.

4. The Role of the SEC

Chap. 2 - The Basic Structure and Prohibitions of the Securities Act, the Underwriting Process

1. The Statutory Framework - Timeline

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                Filing Date              Effective Date
5(a)(1)         no | "sales" ---------------> |
5(a)(2)         no | "deliveries" ----------> |
5(b)(1)            | no "prospectus"          |
                  | (except § 10) --------->  |
5(b)(2)           |                           | no deliveries without
                  |                           | §10(a) prospectus
5(c)  no offers|                              |
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2. Prefiling Period
1. Company looks for lead underwriter, who will organize other underwriters as well
2. Documents are drafted (see below)

3. Housekeeping work: technicalities, etc.
4. Lead underwriter forms syndicate
[5. Filing]

3. Waiting Period (between 1st filing and SEC's declaration of effectiveness of filing)
    1. File amendments (SEC staff comments, disaster)
    2. File amendment on price (not fixed until later)
4. Post effective period

Underwriting Documents

Underwriters Agreement (UA)

1. parties identified, issuer, selling stockholders (insiders who tag along with the offering)
2. secondary offer (optional)
3. provision for "option shares" ("over-allotment shares"). This gives syndicate option to buy more if it oversells.
4. provisions for closing
5. conditions precedent to closing
    a. registration statement is effective that day (else sale is illegal)
    b. no stop-order be given effect
    c. no § 8(e) proceeding be instituted to order stop
    d. "market out" provision - no material adverse change in condition of issuer.

        Walk in Med. Center (fed case)
        FACTS: "market out" provision so broad that underwriter could walk out even for "adverse market condition." On day of issue, price fell 4 -> 6. UW walked.
        HELD: provision too broad.

        1st Boston (no action letter)
        FACTS: "market out" provision stated 1st Boston could walk if **they thought** market was bad.
        HELD: "market out" provision must be objectively related to outside events and the value of the security. Not being able to market the security is not enough a reason.

    e. [other stuff, missed this]
    f. [other stuff, missed this]

g. indemnity provisions (against SEC--SEC says this won't work)

Agreement Among the Underwriters (AAU)

1. Signed just before UA
2. Each underwriter makes general delegation of authority to lead underwriter
    a. set price
    b. re-allot shares
    c. manage ads
    d. take back shares for re-allotment
3. Each underwriter agrees that sales to public will only be made at selling price. U.S. v. Morgan says this is not impermissible price fixing, because Congress must have forseen it, impliedly created exception.
4. Authorize lead underwriter to stabalize prices during offering period (defense from short sells). This is prohibited by § 9 of '33 Act, except as permitted by SEC, and '34 Act Rule 10(b)(7) permits this stabilization.

Dealer's Agreement (DA)

1. short form of AAU
2. underwriter agrees to buy from syndicate certain number of shares at concession price

NASD (get notes on this?)

The Securities Act of 1933

Overview

§ 2 definitions
§ 3 exemptions
§ 4 exemptions
§ 5 main disclosure requirement
§ 9 judicial review of SEC orders
§ 11 absolute liability for false or misleading statements in registration
§ 12 general antifraud, explicit private action allowed
§ 14 makes agreement not to sue void
§ 15
§ 17 general antifraud (private action? open Q?)
§ 19 general authority for SEC to make rules
§ 20 general authority for SEC to make rules
§ 22 concurrent jurisdiction in fed and state courts

Persons Covered

Issuers, underwriters, and dealers.

Property Interests Covered (Securities)

1. Anything commonly known as a security
2. Instruments specifically mentioned in the Act
3. Investment contracts
   a. Howey - any scheme where person invests money in common enterprise to make profit from efforts of promoter.
   b. Modern trend - expanded to include situations where investors are not entirely uninvolved.

Transactions Covered - sales, generally (see § 5 in particular, *supra*.

Registration Statement

1. Preparation
   a. All material facts needeed by the investor must be included.
   b. Must complete Schedule A
   c. Recent financial statement (balance sheet)
   d. Misc stuff which may affect investment/company, such as big risk factors, cacts about the issuers, etc.
   e. No opinions unless labeled as such.
2. Processing the Statement
   a. Effective date - 20 days after filing, unless there is a problem (there usually are amendments).
   b. Review by SEC
   c. Formal SEC proceedings
      1) Refusal order - delays effective date, done before effective date.
      2) Stop order - stops selling of securities, can be done after effective date.
   d. Registration can be withdrawn with permission fromn SEC.
   e. Shelf registrations - for stocks to be offered in the future.
3. Amendments
   a.

§ 5 in detail

Unless registered, it is illegal to, in commerce, sell, transport, or carry securities.

Sales includes contracts to sell. Deliveries are also prohibited.

§ 5(b)(1) - no prospectus (written offer to sell securities, by radio and TV as well) until security conforms with §10.

§ 5(b)(2) - no deliveries without compliance with § 10(a) prospectus ("final" or "statutory" prospectus). This includes confirmation of sales.

§ 5(c) - no oral communication of potential deal (except for potential underwriters).

Chap. 25 - Regulations and Liability under State Securities Laws

Ch.3,5. Disclosure Policy and the Debate Over the Efficient Market

Classes 5-6

Reading: 1933 Act §§6-8.
Regulations S-K & C.
Rules 130, 415, 460-461, 470-79.
Forms S-1, S-2, S-3, S-18.

Chap. 3 - The Registration Process

§ 6(a): minimum signatures requirement
: under § 11(a), liability falls on signatories
§ 6(b): effective upon payment of fee
§ 7(a): must contain certain (32) terms
§ 8(a): After filing, "cooling off" period
: Unless SEC orders otherwise or consents to shorter period, its 20 days.
: "order otherwise" must happen within 10 days under 8(b), so it never happens.

Five Mechanical Developments

1. Administrative Innovation: "red herring" preliminary prospectus. This is for information only, allowed under §§ 5, 10(b).
2. "Comment Letter": written communication of problems

with disclosure, can even get conferenced up to bureau chief.

3. Technical problem: what if on day 19, staff has not finished review?

Technical solution: issuer puts statement in initial filing deeming the filing continously amended.

4. Rule 430A allows issuer to go effective without pricing amendment or pricing information, provided this information is filed within 5 days in an amendment.

5. Acceleration Power: Issuer is allowed to not commit to price which will not be effective for 20 days anyways. To avoid endless 20 day cycles, SEC may shorten (accelerate) the "cooling off" period.

SEC Criteria: SEC purports to use Rules 460 and 461 to decide who gets accelerated.

a. broad dissemination of red herring
b. readability of prospectus
c. appropriate recirc. of amendments
d. NASD clearance
e. whether any underwriter is subject to SEC investigation (since one of the bases for not accelerating is being under SEC investigation, SEC is omnipotent to stop issuance).

Indemnification Problem: How to get indeminification agreement past the SEC, so they will grant acceleration: (J&J formula): describe

a. explanation of agreement,
b. any applicable statute,
c. SEC view of the agreement,
d. statement that it will not honor agreement without judicial test of its legality.

(see Form S-1, items 12, 14 & 17, cross referencing to Regulation S-K items 510, 702, and 542(h))

§1. SEC's Integrated Disclosure System

A. §§ 7, 19 of '33 Act allow SEC to prescribe forms.
B. Choose a form
C. Regulation S-K: collects disclosure requirements from '33 anbd '34 Acts.

Form S-1: most disclosure (no incorporation)
S-2: middle (incorporate by delivery)
S-3: least disclosure (incorporate by reference)
: disclose deal (1-10), rest by reference to

Annual reports, 10Q's
: must report material changes

You can use S-3 if:
a. Company meets registration requirements
b. Must already be '34 Act reporting company
c. Must have timely filed all required filing for last 3 years
d. No major financial default in last year
e. Meet "float" transaction test: "Float" is the aggregate market value of all voting stock held by non-affiliates measured any time in last 60 days. "Float" must be $150 million or more, or $100 million with relatively high trading volume.

You can use S-2 if: meet S-3 issuer tests (a. - d.) but not "float" test (e.). There are two (really three) options:
1) full disclosure
2) fill in first 10 items as in S-3, then incorporate by <u>delivery</u> with prospectus, latest annual report (the glossy) and last 10Q
3) as 2), but you can also incorporate the 8 key items of the SEC annual report (as opposed to the glossy), as in proxy rules 14(a). This excludes all the garbage in the glossy.

Stuck with the S-1:
a. IPO
b. see p.281 in rulebook
c. all things cross-referenced to S-K forms

<u>Miscellaneous Disclosure Points</u>

§2. Preparation of Disclosure Statement

§3. Qualitative Disclosure

A. <u>In re Franchard Corp</u>

Facts: Glickman formed and controlled Franchard, and other corporations, and sold shares to the public. Glickman took personal loans from the corporations, got out of control, forced to resign. Glickman did not disclose this in registration statements.

Held: The facts that the management of these corporations was so bad was material and should have been disclosed.

Note: Other things that should be disclosed (from CaseNotes): restrictions on disposition of earned surplus, general risks in business, recent government regulations affecting business, etc.

954-67 B. Matthews (p.941)

Facts: Matthews, legal counsel for Southland, discovered dispersments he thought were bribes. He did not inform Southland, and was later accused of conspiracy. He was accused of not disclosing this fact under §14(a).

Held: NO disclosure is required, since no criminal conduct was charged (at the time). You do not have to disclose criminal activity (?).

§4. New Approaches to Disclosure

A. SEC now focuses on Management Discussion & Analysis (MD&A). See Reg. S-K, item 303.

B. Required in virtually all SEC filings

C. Must address three areas:

1) liquidity
2) capital status
3) results of operation

D. Projections (Soft Information)

1) SEC used to ban projections
2) SEC now encourages them where there is reasonable basis (Reg. S-K, item 10-13)
3) Rule 175 - "Safe Harbor" for projections: will be deemed not fraudulent unless there really was no basis or there lacked good faith.

§5. Disclosure Policy and the Debate Over the Efficienct Market

§6. Lowering the Barriers to Shelf Registration - Rule 415

A. SEC used to oppose shelf registration

B. Created series of six exceptions
[Rule 415(a)(1)(1-6)]

C. Seventh exception for shelf offerings which commence promptly (Rule 415 (a)(1)(ix)).

D. Action of Rule 415

1) Preserves 7 shelf offerings, adds 2 more (mortgage backed securities, securities issued in acquisitions)
2) Permits registration of securities that will

either be offered on a continuous or delayed basis
a. permitted for S-3 registrants only
b. only primary offerings
3) Amount Limitation - Rule 415(a)(2). Quantity is capped at amount expected to be sold in next 2 years after effective date.
4) Undertakings requirement - cross reference to S-K, item 512: amendments will be made, not supplements (keeps statute of limitations away, good for π's).
5) Permits "at the market" offerings (rare) - Rule 415(a)(4). "At the market" oferings are for trading price at time of sale. Conditions:
a. only equity securities
b. applies only to traded security
c. only primary offerings
d. must be done through named underwriters

§7. Post-Filing Review and Restrictions
§8. Penny Stocks and Blank Check Offerings

Classes 7-8

Interrellationship w/1934 Act

Reading: 1933 Act §§ 2(1).
1934 Act §§ 3(a)(10-12).
Rule 145.

Chapter 4 - Definitions of "Security" and "Exempted Security"
1. What is a Security
Statutory definitions
1) § 2(1) read together with § 3(a)(10)
2) § 2 gives "laundry list" - stock, bond, etc.
3) anything deemed to be a security
4) "contract clause"

Other things deemed to be sales of securities
1) internal issuer reclassification
2) sale merger or consolidation
3) sale of substantially all assets

Resale problem
1) All parties to the transaction are restricted
2) Also affiliates are restricted

3) Rule 144 shows how to do a resale

Reves
Held: Notes are securities.
Criteria:
1) Motive is investment, not commercial
2) "commonly traded" or sold to public
3) Public expects notes to be instruments
4) Absence of regulatory scheme (or of other risk proiducing factors)

Howey
Facts:
Held: Is a security.
Criteria:
1) Investment of money or even assets
2) Investment made in common enterprise

Koscot (272)
Facts: Pyramid investment scheme.
Held: Sale of security where:
1. Investment of money to buy distributorships
2. Common enterprise (return on investment depends on labor of others)
3. Success depends on management efforts by promoter.

Glen Turner (273)
Held: Critical inquiry is "whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise."

3) Expectation of profit

United Housing Fund v. Foreman
Facts: Plain vanilla security, but was share of stock in a cooperative.
Held: (Powell) Stock in a cooperative, even though "stock" is explicitly listed as a security, is not a security. Don't look at the name, look at the economic reality. This does not even have the normal indicia of "stock".
Note: Might have been different if the stock was relied upon to be a security. Here, this

thing had no dividends or voting rights, despite that it was called "stock". Also must look to motivation of investor.

Howey seemed to say do do economic analysis only when the paper is exotic. Foreman says do it all the time.

4) Profits are expected to be made "[solely] from the efforts of others"

from other cases: [5] Absence of regulatory scheme

Daniel (274)

Facts: Compulsory non-contributory plan.

Held: Not a security, because there was no investment of money, and ERISA handles it anyway (pensions).

Weaver (314)

Facts: Three part deal:

1. Guaranteed loan made by local bank to slaughter house next door.
2. Bought certificate of deposit for collateral to pledge, so sufficiently guaranteed
3. Between Weaver and slaughterhouse, Weaver would get $100/month + 50% profits, and right to use barn and pasture.

Claim: 10(b)(5) - bank lied by falsely stating that the loan would be used for some purposes and not others, and that Weavers were not only guaranteurs.

Issue: Is bank certificate of deposit a security, creating federal claim?

Held: CD's generally not securities. There is comprehensive federal scheme covering banking industry.

Note: Congress created exemptions from registration in the '33 Act. But they're still under anti-fraud statutes! In any case, there is no general exception for banks! Why, then, do the cases hold this way?

Gary Plastic v. Merril Lynch

Facts: Broker/dealer scours country for highest yielding CD's. Merril would find little banks offering 15%, and offer them as 14%, FDIC insured (falsely).
Claim (Δ) - "Hey, its a CD!"
Held: There was more here being offered. Merril offered to maintain a liquid market for the CDs. Investors relied on this. Its a security. ??

2. Sale of Business Doctrine

Idea: the transfer of stock incident to the sale of an ongoing business which the buyer would manage and control is not the sale of securities (for the Act)

Pro: Focus of Congress is at public distribution in '33 and '34 Acts.
Context clause - economic analysis not concerned here.
If not, too much would suddenly be regulated.

Landreth Timber Company v. Landreth (rejecting this)
Held: If something is called a stock, and it has the normal indicia of a stock, then it is a security, regardless of other economic realities.

This kind of kills the Forman test.

Note (Harrington disagrees):
1. Court misreads context clause. Court should not do economic analysis for all defintions!
2. "Context clause" means the context of the document, not the particular transaction!
3. Plain meaning of laundry list of exceptions is that the rest are broadly covered.
4. With remedial statute, scope of corrective measures should be interpreted broadly.
5. Opinion makes no sense - why give so much interpretive power to the courts?

3. Promisory Notes - When Not a Security?
Four tests used:
1. Was transaction primarily mercantile/commercial,, or for investment purposes? E.g. note used by bank as security is commercial, but as part of investment for

return, security.
2. Risk-Capital test (6th and 9th Circuits) - was primary intention of the transaction to make risk-capital available? If yes, its a security.
3. "Literal Approach" (2nd Cir. and D.C.) - if it has the common characteristics of a note, its a note.
4. "Strong Family Resemblence" test (p. 304) - once you're dealing with a promissary note, the burden of proof of showing that it is something else shifts to other side. See page 305 - notes which are not securities.

Chapter 8 - Reorganizations and Recapitalizations

1. Section 2(3) and the Theory of "Sale"
   What is a Sale?
   A. Sale requires despoition of value/interest. § 2(3)
   B. Pledge of securities is also sale. <u>Rubin v. U.S.</u> (relying on language of § 2(3)). Circuits are split for this under the '34 Act.

3. Reorganizations and Reclassifications: The "No Sale" Rule
   A. Stock dividends - no sale

7. Going Public by the Back Door
   A. Spinoffs & Shells - no sale
      1) Similar to stock dividend but corporation is taking stock of **another** corporation and distributing it as stock dividend to their shareholders.
      2) No deposition of value, no sale.
      3) Abused in 1960's - "shell game" - where shell corporation is created for this purpose. Release 4982 said that the first sales by this corporation would be "sales".

         <u>Dictronix</u>
         Facts: Δ, public corporation, K'd to distribute shares of other corporations to its sharholders. Δ took a portion of the stock for itself as fee.
         Held: 1) Δ had K to sell, so was an issuer.
            2) Because Δ kept value (shares) and thereby profited, there was a "sale" of securities for value.
            3) Δ took stock of the other companies

with the intent to sell, so it could be held liable as an underwriter.

B. Rule 145 - 3 kinds of transactions deemed to be "sales", so these must be registered.
   1. Internal Issuer Reclassification/ Reorganization
      a. any transaction in which securities of the same companies are exchanged into other securities of the same company.
      b. Exception - does not apply to transaction done simply to defend corporate domicile (???)
   2. Asset Sale
      a. Sale of substantially all assets of target company to the buyer in exchange for securities
      b. Intent is to distribute the securities to the shareholders of the target.
   3. Merger/Consolidation

C. Consequences
   1. Must register.
   2. Pick a form, and also file S-14.
   3. Re-sale problem - Rule 145 (c), (d)
      a. Applies to all parties to the transaction other than the issuer
      b. These parties are deemed underwriters with respect to the securities they receive.
      c. Three situations in which parties can resell
         1) comply with 144 (c),(e),(f),(g)
            a) currently available information
            b) quantity limits
            c) brokerage transaction
         2) hold for 2 years, and there is currently available information
         3) hold for 3 years, resell without restriction

Classes 9-10

Comemrical Paper
Private Placements
Intrastate Offerings
Small Issue Exemptions
Integration

Reading: 1933 Act §§ 3, 4.
Regulations D & A.
Rule 147.

Chap. 4.2 - Definitions of "Security" and "Exempted Securities"

A. Can be exempt due to security or due to issuer, or something particular to the transaction.
B. Exemption from § 12(1) and § 11 liabilities, generally not from § 17 or § 12(2) liabilities.

C. Securities v. Transactions
1. Exempt securities will never have to be registered no matter how sold
2. Exempt transaction - when attempting to resell security, will have to register it unless can find another exemption

D. Burden of proof is on person claiming the exemption.
Joyner
Ralston Purina

Exempted Securities: Section 3(a)(2) through 3(a)(8)

E. Primary Categories
3(a)(2) - securities issued or guaranteed by any domestic government or entity
- securities issued or guaranteed by a bank

3(a)(3) - Commercial Paper exemption
- for promissory notes with maturity of less than 9 months
- Congress here intended to ease market for raising short term money
- Conditions:
1. Paper must be prime quality and negotiable
2. Cannot ordinarily be purchased by the public
3. Must relate to current transactions
4. Must be eligible for discount at Federal Reserve Bank (made unneccesary by 1979 Letter; don't need discountability for 3(a)(3) exemption).
5. Can't be demand paper

Exempted Transactions
A. 3(a)(9) Voluntary Issuer Exchanges

1. Purpose - allow volume
2. 3 requirements
    a. identity of issuer - limited to exchnages of the securities by the issuer with its **own security holders**
    b. "exclusively" -
        - can exchange for securities only
        - no part of the existing securities can be offered to anyone but the holders of the company
    c. Company may make **no payments** for solicitation of the holders to make the exchange

B. Private Placements [4(2), 5(d)]
1. § 4(2) - Transfer by issuer not involving public offering. Focus is on number of offerees.

    SEC v. Ralston Purina

    Facts: Company offered its own stock broadly to "key" employees (virtually all employees qualified).

    Held: Does not qualify for 4(2) exemption, because this was not a private placement.

    Why?
    a. Mere number of offerees not dispositive
    b. Need access to registration information to get this exemption
    c. **Relevant question is whether this class of offerees needs the protection of the Act or whether they can fend for themselves**
    d. Burden of proof on party claiming the exemption.

2. SEC Release, 1962 - Guidelines - Factors
    a. Relationship between issuer and offerees
    b. nature of the offering - # of offerees
    c. Scope of the offer (identifiable class of offerees, or to diverse group)
    d. Size of the offering
    e. Type of offering - need for (or use of) investment bankers suggests its not a private placement
    f. Use of public advertising
    g. The offeree's association with and knowlege of the issuer

h. Redistribution - better not be two step distribution! Issuers must undertake three things:

1) get investment representation from each buyer
2) issue stop order instruction (agent handling these securities should not trade at this point)
3) investment legend on securities (sayig that they are for investment, not trading, and are not registered

<u>Gilligan, Will v. SEC</u>
Facts: Private placement, initially to 4 buyers only. Gilligan eventually (after some "holding" period) sold some.
Held: Issuer is responsible for the actions of the buyer as well. May not sell to one who will just resell. Δ became an underwriter.

i. Have securities come to a rest?

j. Holding period is not dispositive (see <u>Gilligan</u>)!

k. Changed circumstances doctrine (see <u>Gilligan</u>) - sometimes a buyer will legitimately resell, such as when buyer suffers sudden tragedy and needs quick cash.

l. Absence of an integration problem

1) Integration problem - series of small private placements that add up to "public" sale
2) Relevant factors
    a) single plan of financing?
    b) closely related in time?
    c) same class of securities offered?

3. Caselaw

<u>Hill York</u>
Facts: Small number of buyers, sophisticated, but they still had not been given all relevant information.
Held: Not private placement - not only does the information have to be given over, it must have been understood.

<u>Continental Tobacco</u>

Held: Where not all offerees in placement were given access to issuer, not considered private because they could not verify the information.

Duran
Held: Sophistication is not enough. There must be access to information. There are two ways to satisfy this:

1. Access based on relationship (employer/employee, family relation, having economic bargaining power)
2. Actual disclosure of information

4. Response to Uncertainty - Regulation D

Rules 501, 502, 503 - definitions, procedure
Rules 504-506 - substance

504, 505 small business placement, nothing to do with private placements

506 SAFE HARBOR (available to issuers only)
Conditions:
1. Reasonable belief that only 35 or fewer unaccredited "purchasers" (???)
2. Reasonable belief that immediately before the sale the non-accredited purchasers have knowlege and experience to evaluate the investment either alone or with representation (defined in rule 501)
3. Information requirements
    a. Issuer must furnish to any purchaser who are not accredited investors (see 502(d)(1)(i)).
    b. Kind of information: 502(b)
        - if non-reporting, must basically give info as in registration statement
    c. If accredited investors ask for certain info, must inform unaccredited investors and tell them the answers too.
    d. Must give all an opportunity to ask and receive answers
4. Issuer must take steps to prevent redistribution
    a. inquire as to redistribution intent
    b. make written disclosure that there are redistribution restrictions

c. put legend on the securities to this effect

General Comments on Rule 506

1. Any general advertising would ruin the safe harbor
2. Integration problem - okay if you don't sell a similar security within 6 months - see 502

C. Intrastate Offerings

1. The Section 3(a)(11) Exemption
   a. Not for issuers (? - see p.389)
   b. Criteria
      1) Issue criterion - all offers and sales must be made to residents of the State only. Entire issue must be made only in the state.
      2) Company must be incorporated and "doing business" in the same state

         Chapman v. Dunne
         Facts: Used funds from outside the state for operations.
         Held: Can't use intrastate exemption.

         SEC v. Truckee Showboat
         Facts: Proceeds of the offering were to be used primarily for unrelated business in another state.
         Held: Can't use intrastate exemption.

      3) Business in the state must be predominant and the one being funded.

      4) Resale - if there is a resale to nonresidents before the issue has "come to rest", will lose the eexemption.

   c. Same integration safe harbor of 6 months
   d. No cap on number of offerees, $ volume, etc.

2. Rule 147 Safe Harbor - How to get it
   a. Issuer test - issuer must be resident of the state
   b. Commission gives 4 tests for "doing business"

in the state (147(c)(2))

1)
2)
3)
4)

c. All offerees and purchasers must be residents

d. all resales must be to residents for 9 months after last sale

e. Usual issuer precautions must be taken (legend, representations, etc.)

D. Small Issue / Small Business

1. § 4(6) - self-operative transaction exemption
   a. up to $5 million
   b. accredited investors only
2. Form S-B2
   a. <u>not</u> an exemption
   b. new form of regulation for small business
   c. how to qualify as small business:
      1) any U.S. company with revenues less than $25 million and float of less than $25 million
   d. Actually is simplified S-1, less detailed
   e. allows general declarations, as opposed to specific ones
   f. Alllows GAAP for financial statement
3. Reg. A - Issued pursuant to §3(b)
   a. Encompasses Rules 251-263
   b. Bad reputation, associated with much fraud
   c. Structured to look like "mini-registration"
4. Rule 504 - very attractive alternative
   a. $1 million cap per
   b. no qualification requirement for investors
   c. no cap on nu ber of offerees or purchasers
   d. in information requirement [really?? does that make sense?]
   e. no restriction on ads or publicity (recent)
   f. securities are freely resellable (recent)
5. Rule 505
   a. hybrid between 504 and 506
   b. $5 million cap
   c. only 35 unaccredited

If underwriter or dealer, see 4(1) - must register. When is seller "statutory underwriter" or "dealer"?

A. Underwriter - definition - 2(11)

1. Anyone who purchases from an issuer to distribute
2. Anyone who offers or sells for an issuer with a view for distribution
3. Anyone who participates in the above

4. Note - for this purpose, a controlling holder is considered an issuer.

What about inadvertant distribution?

B. Examples of "purchase (etc.) with view to distribute"

1. <u>Gilligan-Will</u>
   Held: Court read 4(2) and 2(11) to mean same thing
2. Conventional underwriting
3. Best efforts underwriting

C. Examples of "anyone who participates

1. <u>Chinese Benevolent</u> (p.463)
   Held: Even though association never purchased any of the bonds, and was not in an agency relationship with the issuer of the bonds, it took on underwriter statuts because of its participation in <u>promoting</u> the bonds.
2. Presumptive underwriter doctrine (p.461)
   a. probably dead doctrine
   b. held that a purchaser in a registered offering of a large block (> 10%) of the securities was presumptively a statutory underwriter, and to resell, would have to come up with defense.

D. Restricted & Control Securities

1. If one purchases securities from a control person, one aquires control securities, and is therefore deemed an underwriter
2. Control securities = owned by an affiliate
3. Affiliate - someone in control relationship with issuer
4. Control - power to direct the management and policies of the issuer, whether by ownership if the

securities, contract, or otherwise

5. Consequences

   a. purchaser form control person doesn't have 4(1) exemption from registration because he bought in a transaction where an underwriter was present (himself)

   b. control person who sold has breacvhed § 5, not because he is an issuer, but because he is selling an unregistered securities without a 4(1) exemption

      Wolfson

   c. Resales by the buyer will also violate § 5 because they will be tranasctions by an underwriter (himself) who is selling unregistered securities, no 4(1) exemption.

E. Cases

Haupt (p.470)
Facts: Schulte family declared liquor dividends to sell stock, broker/dealer (Haupt) hired to sell the stock.
Held: Haupt acted as underwriter by selling for a control person (Schulte owned 90% of stock).

4(4) exemption for unsolicited brokerage transaction, when customer initiates call, never intended for someone with underwriter status.

Minority: 4(3) exemption not applicable for dealers.

Wolfson (p.484)
Facts: Controlling group unloaded holdings by going to various securities firms who did not know of the other sales.
Held: Innocent broker/dealer firms treated as underwriters in order to deny the 4 (1) exemption to Wolfson.

Sherwood (p.489)
Facts: Sherwood signed consent decree that provided that he would not resell in violation of registration provisions.
Held: Holding stock for 2 years means you can't say it was bought for redistribution.

F. Pledgee Problem

Guild Films

Facts: Bank made loan based on securities
Note: If bank gave loan, taking securities, knowing that borrower was bad credit risk, then did it take "with intent to distribute?" [duh - no.] Either way, upon resale, would bank be seen, regardless, as an underwriter?
Held: ??

G. Restricted Securities
1. Definition - securities taken from an issuer or a control person in a private placement or in a Reg. D transaction.
2. Problem - If placee sells too soon, might be deemed an underwriter, and will therefore be illegally selling securities.
3. How long must the securities be held? No clear rule.

H. Rule 144A
144(b) provides that anyone who sells restricted securities in compliance with 144 will be deemed not an underwriter
144(b)(2) anyone who sells securities for a control person is deemed not an underwriter (??)

Requirements
1. Current information must be publicly available
   a. if reporting company, must be current in filing its required reports to the Commission
   b. if non-reporting company, company can
      1) voluntarily register, or
      2) make information specified in Rule 15 (2)-(11) publicly available
2. Holding Period (144(d))
   a. 2 years
   b. 2 year period begins when securities are fully paid for
   c. Affiliate exception - if affiliate comes in, 2 years start all over again

3. Quantity limitation - securities shouldn't hit market all at once
   a. 1% of outstanding securities in class, or
   b. weekly average trading volume on all markets where trading

4. Resale must be made by broker/dealers
5. After 3 years, non-=affiliate may sell unrestricted (144 (k))
6. Must say you are using 144A.

(missed next two hours)

Classes 14-15

Liabilities and Remedies under 1933 Act

A. Section 11 - fraud or misleading statements in registration or prospectus

1. Persons Liable
   a. Everyone who signs the registration statement
   b. Every director of the issuer
   c. Every person about to become a director
   d. Every "expert" who certified the statement
   e. every underwriter
   f. control persons
2. Elements of a cause of action
   a. material mistatement or ommission
   b. [no reliance requirement generally]
   c. [no privity of contract required]
   d. [no causation requirement]
   e. damages
3. Defenses
   a. Alleged mistatements were true
   b. no material facts involved
   c. plaintiff knew and invested anyway
   d. Due diligence (not available to issuer)
      1) experts actualy believed statements to be true, and were reasonable in this belief, inveastigated as expert would
      2) non-experts actualy believed statements to be true, and were reasonable in this belief, conducted investigation as RPP would
      3) Nonexperts reviewing statements made by other nonexperts - same as own statement
      4) Nonexperts reviewing statements made by experts - no investigation need to have been made, only that nonexpert had no reason to believe there was a problem

      <u>Escott v. BarChris</u>

Held: 1. Accountants only liable for parts they were experts for.
2. Drafter (lawyer) only held expert as to legal questions, not drafting issues.

Fight v. Nisco

Leasco Case
Facts: Lawyer played key role in management, associated with company for 3 years.
Held: 1. Insider is virtual guarantor of statmnents. Not allowed defense of fue diligence.
Note on likely liability:

	More Liability		Less Liability
More			
↓	Speaker	v.	Reviewer
↓			
↓	Expert	v.	Non-expert
↓			
↓	Insider	v.	Outsider
↓			
↓	Underwriter		
Less			

e. Negative Causation - caused by other things exclusively

Collins v. Signetics Corp (p.1123)
Facts: Several Omissions of material facts with respect to issuing company. Defendant used expert to say the loss was all due to market drop.
Held: Even though there material omissions, no reward of damages to π.

f. Resgination defense - Δ publicly resigns, denies responsibility

4. Damages - price minus price

B. Section 12(1) - Liability for offers or sales in violation of Section 5

1. Direct privity is necessary
2. Statute of Limitations (1 year or 3 years from issue) can run out, leaving π out in cold
3. Must be in commerce
4. Must have some § 5 violation
5. No scienter required
6. Liability for

a. Sale of unregistered securities
b. Gunjumping
c. Sale without prospectus
d. Written offer during waiting period but not in form of prospectus

C. Section 12(2) - General Anti-Fraud Civil Liability of '33 Act

1. Elements
   a. Use of interstate commerce
   b. material untrue statement or omission
   c. Sale by prospectus or orally
   d. Defendant knew or should have known of the untrue statement
   e. registered or unregistered securities involved
   f. [no scienter]
   g. π did not know of falsehood
2. Defenses
   a. Lack of knowledge
   b. waiver or estoppel (π did not mind before)
   c. π knew
   d. no privity of contract (defendant was not involved in sale to plaintiff)

      Pinter v. Dahl
      Held: Issuer is not seller for these purposes. π who purchases from underwriter can only sue the underwriter, not the issuer.
      Test: Person is seller if
         a. person successfully solicited purchase of securities
         b. person was motivated to satisfy his own financial interests or those of the technical seller

      Croy
      Held: Lawyer not liable because he only gave tax advice.

      Junker
      Held: Lawyer held liable because he was a key part of the sale transaction.

      Davis
      Test: Was defendant "Substantial factor/Proximate Cause" of the sale?

   e. Statute of limitations has run
      1) 1 year from discovery or reasonable disovery of claimed violation

2) 3 years cap (running from first bona fide offering of that issue)

3. Should 12(2) be restricted to primary markets? IOW, if I buy Apple on the stock market based on Apple's misrepresentations, can I sue Apple?

<u>Ballay</u>
Held: No.

Professor Weiss agrees. § 12(2) should be restricted to IPO's:
1. Legislative history
2. Would undercut § 10(b) remedy, which would no longer get used, since it requires scienter and reliance.
3. § 12 is by § 11, IPO's.

Professor Loss disagree. § 12(2) should not be restricted to IPO's:
1. § 12 not limited by its own terms.
2. Caselaw misinterpreted by Weiss
3. <u>U.S. v. Naftalen</u> held that § 17(a) is applicable to non-IPO, and § 17 is similar to § 12.
4. Overlap of remedies does not mean statute should not apply.
5. When remedial statute is ambiguous, tilt to granting the remedy.

D. Odds and Ends
   A. No punitive Damages
   B. Aiding and Abetting liability can not be had under § 12 or § 11. (???)
   C. § 17(a) General Anti-Fraud Provision
      1. Private Cause of Action?
         a. Landes says there is none
         b. Professor Loss says there is none.
         c. Cases are half and half
   D. Arbitration
      1. Intertwining Clause Rejected
      2. Effective?
         <u>Wilko v. Swann</u>
         Held: Broker could not force buyer to take case to arbitration because under '33 and '34 waiver of rights is void, and this is waiver of federal jurisdictional rights.

Rodriguez overruled Wilko and allowed arbitration clause. Also:

McMahon
Held: '34 Act claims can be arbitrated.
Factors:
1. Honor party intent
2. Honor intent of arbitration act
3. Waiver of jurisdiciton is not same as waiver of substantive rights
4. Arbitration more respectable today
5. '33 Act is different

SEC Enforcement Proceedings.
1933 Act Evaluation

Reading: 1933 Act §§ 11, 12, 13, 15, 17, 19, 20, 22, 23, 24.
1934 Act §§ 15 (c) (4), 20, 21.
Rules 158, 176, 405, 436.

784-89 Private Right of Action, Borak
817-22 Landry v. All American Assurance Co.
911-23 Conduct Creating Liability
1056-59 Persons Entitled to Sue
1235-41 What is Reliance

Class 16
Regulating Securities Trading - THE '34 ACT

1. Purpose of '34 Act - protect interstate commerce, create fair market for trading securities
2. Registration and Reporting Requirements - § 12
   A. corporations required to register securities if
      1) they are traded on national exchanges, or
      2) assets of $5 million or more and class of equity securities held by 500 people or more
   B. Information required - like registration under '33.
      1) Annual report
      2) 10-Q quartely report
      3) Current 8-K (within 5 days of an extraordinary event)
      4) Important news - Carnation problem
         Facts [generally]: Merger negotiations ongoing, buyer says we'll buy, but if offer gets ut and price jumps, forget it. When asked,

corporation says "we don't know why prices are going up."

Held: SEC said this is material mistatement, courts said it was not, not violation of 10b. Why? No firm deal to disclse until price is agreed upon.

C. Registered companies must make periodic reports to SEC

D. SK integrates '33 and '34 requirments

3. Additional Registration requirements
   - A. National securities exchanges must register
   - B. brokers and dealers
   - C. information processors
   - D. transfer agents and clearing houses

4. Additional Reporting Requirements
   - A. purchasers of 5% or more
   - B. officers, directors, and 10% owners of a corporation
   - C. exchanges must report
   - D. institutional investors report

5. Other regulation
   - A. Proxy solicitation
   - B. tender offers

6. Express and implied remedies
   - A. § 18 Remedies
     - 1) for false statement in '34 registration
     - 2) no privity requirement
     - 3) π must show actual reliance
     - 4) π must not have known statement was false
     - 5) no scienter requirement, but Δ can show good faith and lack of knowledge as defense.

Reading: 1934 Act §§ 12, 13, 15, 18, 20. Text: re-read ch. 1; 531-37, 828-31, 923-72. Rules 12g-1, 12g-4. Regulations 12B, 13A, 15D. Forms 10-Q, 10-K, 8-K.

Class 17-18

Proxy Solicitation - § 14

A. Purpose
   - 1. Encourage full disclosure
   - 2. Prevent fraud
   - 3. Allow shareholder proposals

B. Disclosure Requirements
   - 1. Where proxies are solicited, proxy statement is required
   - 2. Where proxies are not solicited, information statement is required (same)

3. Annual report

Proxy Contests

A. Preliminary solicitation of proxies - before proxy statement, if opposing proxy already started

B. All solicitation after initial proxy statement

C. Contests for election of directors - participants must first file with SEC

D. Might have to provide shareholder list

Proxy Contests (v. Tender Offers)

A. More issue oriented

B. Economy down, so less tender offers

C. If there is anti-takeover statute, proxy contest can still work

D. Poison pills can stop tender offers, but can (generally) be revoked by board, so proxy contest is the way in

E. Rise of institutional power favors proxy contests

What You have to do

A. get lawyers, slate of new directors, proxy solicitors, PR advisors

B. create dissident shareholders committee

C. Participants must:

1. make a filing with SEC

2. disclose nature of security ownership

Tactics

A. Investigate target early

B. look for poor economic growth, undervalued stock, low earnings, integrity issues, public policy issues, high compensation, etc.

C. Profile the shareholders - long term or short term?

D. Get conrol of 15% common

E. Stick to timetable - need at least 4 months

F. Get shareholder list, written agreement as to form of list

G. Datagrams - ads to voters

Reading: 1934 Act § 14. Text: 789-92, 832-33, 900-910, 958-61, 967-71, 1067-76 (proxy aspects of <u>Cowin</u>), 1096-97, 1189-1216, 1226-41, 1483-85 (proxy aspects of <u>Dixon</u>). Regulations 14A, 14C. Schedules 14A, 14B, 14C. Rules 14a-9, 19c-4.

Allen Sragow, 1992

Tender Offers - Williams Act Amendments

A. When person gets 5% benficial stock (voting power, investment control), must disclose

B. Person = entities and groups as well.

<u>GAF v. Millstein</u>

Held: Once people agree (even orally) to act together, they are a group.

Held: Even if no purchase is made, formation of group counts as an acquisition, if together greater than 5%, must report

C. Must be registered equity

D. File with SEC, company and exchange

E. File Schedule 13-D

F. File within 10 calendar days

What is a Tender Offer - Factors

1. active and widespread solicitation for shareholder stock
2. solicitation for substantial % of issuer's stock
3. offer made at premium over market
4. terms are firm rather than negotiable
5. offer contingent on purchase of number of shares
6. offer open for limited time
7. owner pressured to sell
8. public announcements of purchasing program

<u>Hale</u>

Facts: hostile tender offer commenced at premium.

Held: no solicitation, therefore not a tender offer

Policy question: do the solicitees need the protection of the Act?

<u>Hanson Trust</u>

Facts: Solicitees were all arbs, only 6 out of 25000 sharholders were solicited

Held: Not a TO

Target Responses - What can you do?

1. spook the arbs - make them believe you will resist
2. accuse of inadequate disclosure under 13D
3. breach of state anti-takeover statutes
4. Poison pills - e.g. allwo sharholders to buy mnore

stock real cheap

10(b) - general securities antifraud provision

A. Securities covered - all securities transactions

B. Elements of a cause of action

   1. fraud, misrepresentation, omission or deception - in connection with purchase or sale of securities
   2. misrepresentation or deceptive omission of a fact
   3. materiality - material to investor's decision
   4. investor relied, actually believed
   5. actual saller or purchaser
   6. no privity requirment
   7. Scienter - actual intent, or maybe recklessness to defraud
   8. causation

C. Defenses

   1. element not proven
   2. Statute of limitation has run -
   3. laches
   4. π's lack of due diligence

Liabilities & Remedies

Issuer Repurchases, Self-Tenders & Going Private

Reading: 1934 Act §§ 13, 14. Text ch. 12, pp. 793-801, 833-36, 908-10, 1040-45, 1082-86, 1097-98, 1334-37. Regulations 14D, 14E, 13D-G. Schedules 14D-1, 14D-9, 13D. Rules 10b-18.

Classes 23-25

Securities Fraud
"Sue Fact Doctrine"
RICO
1934 Remedies
First Amendment

Reading: 1934 Act §§ 10, 18, 20-22, 25-27, 32. Text ch. 13-19 (as relates to §10(b) litigation other than insider trading issues), 1505-27. 18 USC §§1961-68.

Classes 26-27

Manipulaton & Stabilization

Allen Sragow, 1992

Regulation of Broker-Dealers & Markets
Conflicts with Anti-Trust Policy
SRO's

Reading: 1934 Act §§ 6, 9, 10, 11A, 15 (especially 15(c)(1)), 15A, 19. Text ch. 10 & 11. Rules 10b-6, -7, -8, -10, 15c-3-1, 15c-1-7, 19c-1, 19c-3.

Class 28

Lawyers' Roles, Responsibilities & Liabilities
Rule 2(e) Proceedings

Reading: 1934 Act §§ 23, 27. Text 1152-88, 1434-65. Rule 2(e).

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