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The Issuer Registration and Distribution Provisions of the Proposed Federal Securities Code

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The Issuer Registration and Distribution Provisions of the Proposed Federal Securities Code

*Kenneth J. Bialkin**

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I. INTRODUCTION

Perhaps the most difficult task in attempting to analyze and evaluate a portion of the proposed Federal Securities Code is establishing a proper initial perspective. In an effort to do so, I returned to the April 1967 issue of *The Business Lawyer,* which contains the transcript of the November 1966 proceedings of the Conference on

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Codification held in the medieval splendor of Lincoln Hall at the Northwestern University School of Law.[1] Rereading the transcript of the proceedings was a pleasantly nostalgic reminder of the deep intellectual stimulation and challenge one experienced when sitting through those sessions. It also brought back some of the confusion evident in discussing the proper objectives of a codification program—a subject upon which the participants never seemed to establish complete harmony. On the one hand, mere rewriting of the law and a straightening out of confusions would not have been worth the effort.[2] Conversely, codification could not attempt a thoroughgoing revision and rethinking of all problems in the securities laws, since that would have been an impossible task, tinged with political dispute and destined for conflict and, probably, failure.[3]

How then to measure the product? To those who called for a rethinking of fundamentals, the Code may fall short of the mark. For example, one commentator thoughtfully outlined the unchartered burgeoning of implied liability under the securities laws and called for some rationalization.[4] Other commentators doubted the utility of codification, arguing first that the SEC was possessed of sufficient administrative authority to undertake the necessary simplification and rationalization of the disclosure and registration procedures, and secondly, that a lengthy codification effort would tend to delay needed thinking about fundamental reform.[5] Perhaps the golden mean was expressed most aptly by Ralph Demmler, a former chairman of the SEC, whose remarks illustrated the problem by cataloguing current interpretive questions under the securities laws and reviewing the actions of the SEC in dealing with them. He concluded that:

> To me this indicates that something should be done to make it more nearly possible for a lawyer in general practice to read the statutes and have some idea what they mean, how to apply them to a particular situation and how to advise a client so that the client will understand what the lawyer is talking about. Everything practicable should be done to make the securities laws better understood because broad public understanding is the most effective aid to general public obedience of the laws. There lies the public interest in codification.[6]

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1. *Conference on Codification of the Federal Securities Laws,* 22 BUS. LAW. 793-925 (1967) [hereinafter cited as *Conference on Codification*].
2. *See, e.g.,* Remarks of William L. Cary, *id.* at 908-09.
3. *See, e.g., id.* at 809-10.
4. Henkel, *Codification—Civil Liability Under the Federal Securities Laws,* 22 BUS. LAW. 866 (1967).
5. *See* Remarks of A. Fleischer, Jr., *Conference on Codification, supra,* note 1, at 804-05; Remarks of Carl W. Schneider, *id.* at 808-09.
6. Demmler, *Codification,* 22 BUS. LAW. 832, 834 (1967).

Perhaps these remarks provide the standard for evaluation of the success of the ALI Federal Securities Code project. Does it achieve the expressed objective or does it tend to obscure and confuse? Does it provide a sounder basis upon which to build the regulatory structure, or does it provide for the wholesale elimination of practical solutions and established interpretations that would require several generations of new decisions and rule evolution to replace?

A codification project inevitably embodies reform as well. The draftsman of the Code had a particularly challenging and frustrating assignment, since he was charged with capturing a moving target. The ten years since commencement of the project have been times of ferment and swift development. Neither the courts, Congress, nor the SEC has delayed or even broken stride in the development of securities law matters and the reporter of the Code has had the task of reflecting these developments.

The issuer registration and distribution provisions of the Code, Parts IV and V, while perhaps not the best example of this evolution, illustrate the point. The central concept of the disclosure aspect of the Code, as will be discussed in greater detail below, is the requirement of registration of *companies* rather than of securities. Although procedurally different, this result had been advocated even prior to the impetus for codification provided by the Federal Regulation of Securities Committee of the American Bar Association in 1966. Prior to 1964, lawyers generally viewed the Securities Act of 1933[7] as concerned primarily with corporate disclosure in connection with the distribution of securities by issuers or by controlling persons. The Securities Exchange Act of 1934[8] was regarded mainly as a regulatory statute, concerned principally with the trading markets and imposing a more superficial disclosure burden upon those companies subject to the periodic reporting requirements applicable prior to 1964. The result was a somewhat accidental pattern of "full disclosure," which was provided only in the case of companies filing registration statements under the 1933 Act. This anomaly was visibly apparent and was commented upon by numerous observers, including the Special Study of the Securities Markets,[9] directed by Milton H. Cohen, and was articulated most force-

7. Securities Act of 1933 [hereinafter cited as 1933 Act], 15 U.S.C. §§ 77a-77aa (1970).

8. Securities Exchange Act of 1934 [hereinafter cited as 1934 Act], 15 U.S.C. §§ 77b-77e, 77j, 77k, 77m, 77o, 77s, 78a-78o, 78o-3, 78p-78hh (1970).

9. REPORT OF THE SPECIAL STUDY OF SECURITIES MARKETS OF THE SECURITIES AND EXCHANGE COMMISSION, H.R. Doc. No. 95, 88th Cong., 1st Sess. (1963).

fully by Mr. Cohen in a landmark law review article published in 1966.[10] The 1964 amendments[11] extended the full requirements of the 1934 Act from companies having securities listed and traded on national securities exchanges to most publicly owned companies having publicly traded equity securities.[12] Registration under section 12 of the 1934 Act is not company registration as such, but rather the registration of the equity securities of subject companies. The distinction, however, is technical only, and is mandated by the structure of the statute and the lack of authority by the Commission expressly to require company registration. For practical purposes, the effect is substantially the same.[13]

Thus the provision for company registration in the Code is the recognition of current reality. In its issuer registration and distribution provisions, the Code completes a process that the Commission began subsequent to 1964. The dichotomy between the full disclosure responsibilities of the 1933 Act and the less complete disclosure standards of the 1934 Act became increasingly anomalous. Prodded

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10. Cohen, *"Truth in Securities" Revisited,* 79 HARV. L. REV. 1340 (1966).

11. Securities Acts Amendments of 1964, Pub. L. No. 88-467, 78 Stat. 565.

12. The exceptions are set forth in section 12(g)(2) of the 1934 Act, 15 U.S.C. § 77l(g)(2) (1970).

13. The concept of company registration, as Professor Loss himself has noted, is not "a particularly radical idea." Loss & Blackstone, *Codification of the Federal Securities Laws,* 28 BUS. LAW. 381, 383 (1973). Indeed, the origin of the concept of company registration fairly can be said to lie in the 1934 Act. Aside from so-called "shelf registrations," the basic theory of the 1933 Act is to register only the actual quantity of securities proposed to be offered. The 1933 Act registration requirement was potentially applicable to any company, but only upon a public offering. The 1934 Act, on the other hand, required a registration of an entire class of securities by prohibiting any member, broker, or dealer from effecting a transaction in the security on a national securities exchange unless the securities were registered with such exchange. 1934 Act § 12(a), 15 U.S.C. 78l(a) (1970). The 1934 Act thus, in effect, imposed an early form of company registration for issuers desiring to have their securities listed on a national securities exchange. The 1934 Act registration requirement was not triggered by a public offering, as was the case under the 1933 Act.

In 1938 the reporting requirements of the 1934 Act were extended to cover issuers that had filed registration statements that became effective pursuant to the 1933 Act. Issuers that became subject to the reporting requirements of the 1934 Act in this manner, however, were not subjected thereby to the 1934 Act's registration requirement. Registration under the 1934 Act was not expanded significantly until the Securities Act Amendments of 1964, Pub. L. No. 88-467, 78 Stat. 565. The Amendments added subsection 12(g)(1) to the 1934 Act, which imposed a registration requirement on companies with 500 or more shareholders and more than $1,000,000 in total assets.

Significantly, the format of subsection 12(g)(1) did not follow the format of section 12(a) by prohibiting a broker or dealer from effecting any transaction in the securities of a particular class of an issuer. Subsection 12(g)(1), rather, was directly applicable to every issuer "engaged in interstate commerce, or in a business affecting interstate commerce, or whose securities are traded by use of the mails or any means or instrumentality of interstate commerce. . . ." Thus this subsection is the father of the Code's company registration requirement.

by Milton Cohen's 1966 article and by others, the Commission has substantially conformed the disclosure requirements of the 1934 Act to the 1933 Act standards. This process culminated in the now-familiar catechism that in adopting the 1933 and 1934 Acts, Congress intended to provide for an integrated and continuous disclosure process for publicly owned corporations.[14] While this, perhaps, attributes a hitherto unnoticed perspicacity to Congress, the result has been healthy and positive. The SEC has achieved real progress in upgrading the disclosure provisions of the 1934 Act, so that for all practical purposes they are fundamentally equivalent to 1933 Act disclosure requirements.[15]

As a result of Commission administrative action, it is not too much to say that the 1933 and 1934 Acts today do constitute a continuous disclosure system and that a corporation enters that system either through an initial public distribution of its securities or by the mere happenstance of meeting the requirements of shareholder participation and asset size specified in the 1934 Act.[16] Once entering the system, a company may not depart it unless it satisfies existing statutory standards that reflect the point at which the public interest no longer requires a corporation to undergo the expense of public reporting.[17]

How different, then, will life be under the Federal Securities Code? Will compliance with the Code involve any conceptual or substantive differences from compliance with today's practices and requirements? Have the procedures been markedly altered? Are the liabilities imposed upon participants significantly different? Will there be significant changes in the substance of the information provided to investors? What has happened to the level of investor protection? Is the entire process quicker? Is it cheaper or more expensive? Are there problems that have not been solved and that remain to vex? These are some of the important questions toward which all of the contributions in this Symposium are directed. They will serve to focus our inquiry, also, as we turn first to the issuer registration provisions.

14. SEC Securities Act Release No. 5487, 1 FED. SEC. L. REP. (CCH) ¶ 2710, at 2907-2 (April 23, 1974).

15. *See, e.g.*, SEC Securities Exchange Act Release No. 13,156 (Jan. 13, 1977); SEC Securities Act Release No. 5792, (Dec. 20, 1976); SEC Securities Act Release No. 5791, (Dec. 20, 1976). *See generally* Heller, *"Integration" of the Dissemination of Information Under the Securities Act of 1933 and the Securities Exchange Act of 1934*, 29 LAW & CONTEMP. PROB. 749 (1964).

16. 1934 Act § 12, 15 U.S.C. § 78l (1970).

17. 1934 Act § 12(g)(4), 15 U.S.C. § 78l(g)(4) (1970).

II. Issuer Registration

Under the Code, the term "registration statement" is used to refer to a permanent document to be filed by companies entering into the continuous disclosure process. The Code's "registration statement" thus provides the starting point for the continuous disclosure system that is the essence of the Code.[18]

A company may become subject to the registration requirement in one of three ways. First, a company with at least one million dollars of total assets and three hundred security holders must file a registration statement within 120 days after the first fiscal year-end at which it finds itself in this position.[19] Secondly, even if a company does not meet the assets and security holders criteria, it is required to file a registration statement if a "distribution"[20] of its securities is made. Thirdly, even if a company is not required to register under either of the preceding two tests, registration is required as a condition to listing on an exchange.[21] The Code further states that a company may register at its own option even if not otherwise required to do so.[22]

This basic company registration requirement will not be wholly unfamiliar to the securities law practitioner. Section 12(g)(1) of the 1934 Act is identified in the Code as a source for the Code's registration provision. The Exchange Act requires the registration of a class of equity securities if the company's total assets exceed $1,000,000 and the number of its record holders equals or exceeds 500.[23] Professor Loss in his Comment states that "[a]ny figures are, of course, arbitrary."[24] The Code's requirement of 300 security holders, Professor Loss goes on to suggest, "seems an appropriate cut-off point for the assertion of a federal interest to the extent of the registration and post-registration provisions. . . ."[25] Another significant change in the basic registration criteria is the counting of debt security holders in arriving at the total. Section 12(g) is limited to holders

18. The term "registration statement" under the 1933 Act has a different purpose. Its analogue in the Code is the "offering statement." *See* text accompanying notes 40-43, *infra*.

19. ALI Fed. Sec. Code § 401 (Reporter's Revision of Text of Tent. Drafts Nos. 1-3, 1974) [hereinafter cited as RD 1-3]. Unless otherwise indicated, all Code section references are to the Reporter's Revision.

20. RD 1-3 § 402.

21. ALI Fed. Sec. Code § 902 (Tent. Draft No. 5, 1976) [hereinafter cited as TD-5].

22. RD 1-3 § 401(d).

23. 1934 Act § 12(g)(1), 15 U.S.C. § 78l(g)(1) (1970).

24. ALI Fed. Sec. Code § 401, Comment (1) (Tent. Draft No. 1, 1972) [hereinafter cited as TD-1].

25. *Id.*

of a class of equity securities. As Professor Loss notes, however, "there seems to be no good reason why registration should not be required . . . whenever a company with $1,000,000 of assets has a debt security . . . held by as many as 300 persons. . . ."[26]

Section 403 of the Code provides that "[a] registration statement shall contain whatever information, financial statements, material contracts and other documents the Commission specifies by rule."[27] This complete legislative delegation to the Commission, in Professor Loss's view, "seems perfectly safe in the year 1972."[28] One need not criticize the Commission's competence in the disclosure area, however, to suggest that after some 35 years of experience with the securities laws a statute prescribing the basic disclosure items (similar to the 1933 Act's Schedule A) should be possible, as well as appropriate and desirable.[29] The wisdom of leaving the entire job to the Commission may be questioned. The contents of the Code's "offering statement" and "prospectus" also are left entirely to the Commission.[30] While conceding that the Commission has experience in devising disclosure requirements, and that the burdens imposed on registrants have generally been reasonable, clearer legislative guidelines to provide standards against which the Commission's requirements may be measured would seem appropriate. Doubts about the utility of increased disclosure have been expressed,[31] and the SEC has appointed a distinguished Advisory Committee to consider the role and appropriate scope of disclosure.[32] Further study of this issue hopefully will permit more authoritative guidance regarding the form of disclosure that best suits the needs of investors. This minor observation is perhaps illustrative of a broader concern that undoubtedly will be debated elsewhere in this Symposium—namely, whether the Code is unduly generous and sanguine in its delegation to the Commission of unresolved issues and problems. Instances of such delegation are frequent, and, on balance, seem to confer rather broader power on the Commission than it presently enjoys.

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26. *Id.*
27. RD 1-3 § 403.
28. TD-1 § 403, Comment (1).
29. 1933 Act Schedule A, 15 U.S.C. § 77aa Schedule A (1970).
30. *See* text accompanying notes 67-77, *infra.*
31. *See, e.g.,* Benston, *Required Disclosure and the Stock Market: An Evaluation of the Securities Exchange Act of 1934,* 63 AM. ECON. REV. 132 (1973). A different view was taken in Friend & Westerfield, *Required Disclosure and the Stock Market: A Comment,* 64 AM. ECON. REV. 467 (1975). The debate was continued in Benston, *Required Disclosure and the Stock Market: Rejoinder,* 65 AM. ECON. REV. 473 (1975).
32. SEC Securities Act Release No. 5673 (Feb. 2, 1976).

The Commission's plenary power to determine the contents of the registration statement renders impossible any prediction of its form or content. One can presume that it will resemble closely the Form 10 registration statement presently required under section 12(g) of the 1934 Act. The Code evidently contemplates that each company subject to registration will file a registration statement even if presently subject to the 1934 Act reporting requirements. The Commission should consider permitting companies to elect to adopt their most recent Annual Report on Form 10-K, or its equivalent, as their Code registration statement, thereby avoiding unnecessary paperwork and expense that would otherwise be involved in the transition to the Code system. If the Form 10-K is no longer reasonably current, a simple updating procedure would seem to suffice.

The Code provides that a registration statement becomes effective on the thirtieth day after filing of the registration statement or the last pre-effective amendment thereto.[33] Effectiveness is prevented automatically if a proceeding is pending under section 1506(d).[34] Additional provisions regulate the termination and withdrawal of registration statements.[35]

Once a company becomes a "registrant" by filing a registration statement, the company is subject to the continuous disclosure reporting requirements of Part VI of the Code for so long as such registration statement remains effective. The Code makes no provision for amending or updating the registration statement on a current basis.[36] It is not an offering document for the sale of securities that must be kept current by subsequent filings. Current information for the use of investors will be provided by an "offering" or "distribution" statement and by the reporting and disclosure requirements of Part VI of the Code, which contains the post-registration provisions, discussed elsewhere in this Symposium.

Our discussion of the post-registration provisions of Part VI will be limited to that which is necessary to complete our analysis of the issuer registration provisions of Part IV. Section 601 in general terms authorizes the Commission to require registrants to make whatever reports it deems necessary "to keep reasonably current the

33. RD 1-3 § 404.

34. *Id.*

35. *Id.* § 405.

36. Although the registration statement will not be updated on a current basis, its information will be revised and collected in one document periodically. *See* text accompanying notes 37-39.

information and documents contained in the registration statement or to keep investors reasonably informed with respect to the registrant."[37] In a Comment to this section, Professor Loss makes the following statement:

> It is contemplated that the Commission, with due regard to the burdens involved in the case of relatively small registrants particularly, will require the annual report at specified intervals to integrate the last previous registration statement and all subsequent reports.[38]

Thus a registrant's initial registration statement will survive only until the filing of its first "integrated" annual report.[39]

III. DISTRIBUTIONS

A. *Definition of Distribution*

The Code's system of permanent company registration and continuous disclosure has not dispensed with the need for a prospectus upon what Milton Cohen so felicitously has called the "special occasion" of a public offering. The Code "proceeds on the theory that there is still a role for some sort of special filing (the 'offering statement'), as well as the delivery of a prospectus, when there is a substantial distribution, with the extra selling pressure that is entailed."[40] In this respect the Code preserves the procedures familiar to lawyers and investment bankers engaged in securities distributions.

Section 501 of the Code, which relates to offerings by an issuer (primary distributions), provides:

> Except when section 509 applies . . . it is unlawful for any person in connection with a distribution by him or resulting from his offer (or for an underwriter, broker, or dealer in connection with a distribution by any person) to offer a security, or for a broker or dealer to offer to buy a security from an underwriter in connection with a distribution by or through the underwriter, (1) unless the issuer has filed an offering statement with respect to the distribution (either as a separate document if it is already a registrant or as part of its registration statement under section 402 if it is not), or (2) while an offering statement with respect to the distribution is the subject of a stop order under section 1506(d) or (before its effectiveness) a public proceeding under that section or a public investigation under section 1505(d)(1).[41]

37. RD 1-3 § 601.

38. TD-1 § 601, Comment (1)(b).

39. The reference in the Comment to the "last previous registration statement" is a minor oversight, which undoubtedly will be corrected in the final draft. Under the Code, every registrant will file one and only one registration statement. Indeed, a specific Code provision prohibits the Commission from requiring the filing of more than one registration statement by a registrant. RD 1-3 § 289(b).

40. TD-1 at xxi.

41. RD 1-3 § 501(a).

This structure will be recognized as a version of section 5(c) of the 1933 Act, which requires the filing of a registration statement before an offer can be made to purchase or sell a security. The Code's offering statement is thus the equivalent of the 1933 Act registration statement. Section 509 of the Code provides for somewhat different provisions in the case of secondary distributions. In the case of a secondary distribution of the securities of a one-year registrant, the offering document is called a "distribution statement."

At this point the conceptual similarities between the Code and present law diverge. First, the concept of "control" is abandoned and secondly, the determinant for the application of sections 501 or 509, which require the filing of an offering or distribution statement and the use and delivery of a prospectus, is whether a "distribution" is involved. Present law does not define the term "distribution," which has developed an impressive administrative and judicial superstructure.[42] The Code, however, does. A distribution is "an offering other than a limited offering or a trading transaction."[43] "Offering," "limited offering" and "trading transaction" are terms of art in the Code that must be considered separately.

(1) "Offering"

The use of the word "offering" rather than the perhaps more natural choice of "offer," is deliberate and is intended to serve two functions. First, the term "offering" is used rather than the term "issue" because the former applies to secondary as well as to primary offerings.[44] Secondly, the term is used to "make clear when the integration concept is to be applied."[45] Thus offering is defined in the Code as follows:

> "Offering" is used in the sense that (1) offers of securities of different classes are separate offerings, and (2) offers of securities of the same class by or for the account or benefit of the same person (whether the issuer or any person) are separate offerings only if they are substantially distinct on the basis of such factors as the manner, time, and purpose of the offerings, the offering price, and the kind of consideration.[46]

42. *E.g.*, Doran v. Petroleum Management Corp., [Current] FED. SEC. L. REP. (CCH) ¶ 95,844 (5th Cir. Jan. 20, 1977); 17 C.F.R. § 230.140 (1976); 17 C.F.R. § 230.146 (1976); *see* R. JENNINGS & H. MARSH, SECURITIES REGULATION 351-467 (3d ed. 1972).

43. RD 1-3 § 227(a).

44. TD-1 at xxiii.

45. *Id.* § 267, Comment.

46. RD 1-3 § 267.

(2) "Limited Offering"

The definition of distribution excludes "offerings" that are limited offerings. A limited offering is one that meets the following conditions:

(1) The initial buyers are either "institutional investors"[47] or thirty-five or fewer other persons, or both;

(2) Resales to persons other than institutional investors within three years[48] after the last sale to any of the initial buyers other than institutional investors do not result in more than thirty-five owners (excluding institutional investors and persons who become owners otherwise than by purchase) at any one time, unless the resales are pursuant to an offering statement,[49] a distribution statement,[50] or an exemption; and

(3) The original offeror or resellers comply with any rules adopted by the Commission relating to stock transfer restrictions.

As with other provisions of the Code, the proposed statute cannot provide a clear picture of the ultimate contours of the limited offering. This is a necessary concomitant of the Commission's power under the Code to "modify" the above conditions or to "impose additional conditions, considering (among other criteria) (A) whether the issuer is a one-year registrant, (B) the type of issuer and security, and (C) the kind of market if any."[51]

The limited offering is, of course, the Code's answer to the confusion caused by judicial interpretations of the statutory private offering exemption of section 4(2) of the 1933 Act.[52] Whether the limited offering provides an adequate answer is a separate question. It constitutes a significant loosening of the requirements of current law. More importantly, a much needed and welcome degree of certainty will be brought to an area of the law about which one leading and experienced practitioner has made the following observations:

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47. "Institutional investor" is defined in the Code to include a bank, insurance company, registered investment company, or parent of any such person. The Commission, however, is given very broad authority to enlarge, to contract, and otherwise to define precisely the term. RD 1-3 § 242.

48. The period is one year, instead of three years, if the issuer is a one-year registrant at the time of the particular resale. RD 1-3 § 227(b)(2).

49. *See* text accompanying notes 58-62 *infra.*

50. *See* text accompanying notes 102-109 *infra.*

51. RD 1-3 § 227(b)(3).

52. *See Section 4(2) and Statutory Law—A Position Paper of the Federal Regulation of Securities Committee,* 31 Bus. Law. 485 (1975) [hereinafter cited as ABA Committee].

> It would be satisfying to be able to say tbat §4(2) of the Securities Act of 1933 creating the private offering was born in sin, but it is probably fair only to say that it was not the child of much careful thought and planning. From the date of its birth, there has been uncertainty and controversy over why it was born and what it was supposed to do.[53]

Since June 10, 1974, a company seeking to raise money privately on the basis of the private offering exemption from registration under the 1933 Act has had two options availabile. First, under section 4(2) of the 1933 Act, a company safely may ignore the registration requirement of section 5 of the Act in connection with the sale of its securities, provided that the transaction is one "not involving any public offering." As all experienced corporate practitioners know, the extensive confusion surrounding the interpretation of the statutory language has rendered the availability of the exemption uncertain in all but the clearest cases.[54]

Partially in response to the perceived need for greater certainty in the area of private offerings, the Commission in 1974 promulgated rule 146.[55] Compliance with the rather stringent requirements of the rule provides an alternative avenue for effecting a private offering. So much has been written on section 4(2) and rule 146 that no useful purpose would be served by adding to the literature. Moreover, Professor Loss already has provided us with a comparison of the Code's limited offering and the 1933 Act's private offering.[56] Nevertheless, section 227(b)(3) appears to be sufficiently broadly written to permit the Commission, if the Code is enacted, to repromulgate rule 146 in its entirety. Although such action by the Commission would be theoretically possible, giving the wording of section 227 (b)(3), it would be wholly inconsistent with the spirit of the Code's welcome clarification and simplification of the law in this area.

(3) "Trading Transaction"

To complete the journey through the Code's sections for the purpose of defining a distribution, the definition of a trading transaction must be considered. A trading transaction is (a) a transaction through a broker or with or by a dealer (b) that meets the following conditions:

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53. Garrett, *The Private Offering Exemption Today,* in PLI FOURTH ANNUAL INSTITUTE ON SECURITIES REGULATION 9 (1973).

54. *See* ABA Committee, *supra* note 51.

55. 17 C.F.R. § 230.146 (1976).

56. Loss, *The "Limited Offering" under the American Law Institute's Federal Securities Code,* in PLI FOURTH ANNUAL INSTITUTE ON SECURITIES REGULATION 23 (1973).

(1) The transaction is not by or for the account or benefit of the issuer;

(2) The security was not the subject of a limited offering within a specified time period;

(3) The broker or dealer performs no more than his usual function;

(4) The broker or dealer receives no unusual compensation; and

(5) The total of all trading transactions originating with or for the account of the same person during a specified period does not exceed an amount to be specified by the Commission by rule.[57]

Thus all trading transactions, whether or not for the account of a "control" person, can be executed freely without the use of a prospectus.

B. Prohibited Activities

Section 501 prohibits three types of activities "unless the issuer has filed an offering statement with respect to the distribution." First, it is unlawful for any person in connection with a distribution by him or resulting from his offer to offer a security. The purpose of the limiting words "by him or resulting from his offer" is twofold. The language is intended "to avoid any inference that an ordinary resale of a security covered by an offering statement (a resale that is not itself a 'distribution') would be 'in connection with' the distribution covered by the offering statement."[58] The second reason for the limiting language is "to assure, conversely, that the section does apply to the buyer in a 'limited offering' whose improper resales result in a distribution."[59]

The second type of activity prohibited by Section 501 unless an "offering statement" is on file is an offer of a security by an underwriter, broker or dealer in connection with a distribution by any person. As a third proscription, unless an offering statement is on file it is unlawful for a broker or dealer to offer to buy a security from an underwriter in connection with a distribution by or through the underwriter.

These three prohibitions, whose provisions are the equivalent of current section 5(c) of the 1933 Act, do not apply in the case of

57. RD 1-3 § 227(c).
58. TD-1 § 501(a), Comment 2.
59. *Id.*

"a transaction incident to an offer or sale to an underwriter."[60] This exemption is necessary to allow the issuer to negotiate with the underwriting group during the prefiling period. The Code provision differs from its 1933 Act counterpart[61] in that the latter provides for the exemption by means of an exception from the definitions of "offer" and "sale," while the Code's exemption is transactional. Not only does the Code's formulation result in greater clarity, but, more importantly, it affords the underwriter as a buyer the benefit of the Code's antifraud provisions.[62]

The Code apparently does not contemplate any significant change in the duties or practices of underwriters and other participants in distributions. The stabilization rules in rule 10b-7[63] are carried forward in section 1309 of the Code. The reporter's Comment indicates that no substantial change is contemplated and, as is the case with other provisions, leaves the detail to Commission rule.[64] The same situation would seem to prevail regarding rules 10b-2[65] and 10b-6[66] which, generally speaking, govern the permitted activities of issuers, underwriters, and prospective underwriters who are participating or have agreed to participate in a distribution. Section 1308(d) of the Code simplifies and codifies the fundamental prohibitions presently found in rules 10b-2 and 10b-6, but does not codify the related exemptions in rule 10b-6. Thus the Code leaves to Commission rulemaking the exemption of conduct necessary to permit an underwriter to recommend the actual securities being distributed. The Comment indicates the Code's assumption that the Commission will adopt the traditional exemptions. We therefore can assume that the Commission will re-enact by regulation the existing provisions of rule 10b-6, but that event must await the ultimate preparation of rules under the Code. This approach seems undesirable in the case of the present rule 10b-6 situations, since the exemption in the rule seems to be an integral part of the regulation, and without the exemption the entire process of distributing securities simply will not work. It thus would seem advisable that the Code actually incorporate the more important exceptions presently contained in rule 10b-6, many of which are so fundamental that they are deserving of legislative recognition.

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60. RD 1-3 § 511(a).
61. 1933 Act § 2(3), 15 U.S.C. § 77b(3) (1970).
62. TD-1 § 511(a), Comment.
63. 17 C.F.R. § 240.10b-7 (1976).
64. TD-2 § 1309, Comment (1).
65. 17 C.F.R. § 240.10b-2 (1976).
66. 17 C.F.R. § 240.10b-6 (1976).

The content of the offering statement, like that of the registration statement, is left to the Commission to specify by rule.[67] Unless an administrative proceeding is pending with respect to an offering statement, it becomes effective on the thirtieth day after filing of the statement or the last pre-effective amendment,[68] subject to the Code's provisions for acceleration in section 1702(b).

C. *Communication of the Offer*

After an offering statement has been filed, the Code in section 502 provides the following six methods by means of which offers may be communicated:

(1) Orally;
(2) by a "prospectus";
(3) by a "summary prospectus";
(4) by a "preliminary prospectus" (before effectiveness only);
(5) by a writing that states from whom the prospectus, a summary prospectus, or a preliminary prospectus may be obtained and in addition does no more than state by whom orders will be executed and whatever other information the Commission permits by rule; or
(6) by any writing provided that it is accompanied or preceded by a prospectus current when the writing is used (after effectiveness only).

In setting forth in one place all the permissible methods of making offers from before filing until after effectiveness, section 502 of the Code represents an effort to clarify the procedures currently permitted under section 5(b)(1) of the 1933 Act and its related definition of "prospectus."[69] This formulation replaces the present system, which depends to a large degree on an expanded definition of the term "prospectus." The "concept of a 'prospectus' under the present § 2(10) as any written offer will be no more."[70] The Code's prospectus refers only to that document which contains so much of the registration statement and offering statement as the Commission may require.[71] Its content again is left to the Commission to prescribe by rule.[72] The Code requires only that the document be

67. RD 1-3 § 501(c).
68. *Id.* § 501(d).
69. 1933 Act § 2(10), 15 U.S.C. § 77b(10) (1970).
70. TD-1 § 502, Comment (3).
71. RD 1-3 § 504(a).
72. *Id.* § 504(b).

"current at the time of its use"[73] and specifically authorizes the Commission to permit the omission of "price, underwriting, and related information."[74] The content of the "summary prospectus" contemplated by the Code also is left to the discretion of the Commission.[75] It may omit in part or summarize information in the prospectus or the preliminary prospectus,[76] but it must be current at the time of its use.[77]

D. *Confirmation and Disaffirmance*

(1) Confirmation of Sale

Like its 1933 Act counterpart,[78] section 503(a)(1) of the Code makes it unlawful "to sell or confirm a sale of a security, deliver a security after sale, or accept payment for a security, unless an offering statement is in effect with respect to the distribution." The Code introduces a rather puzzling wrinkle regarding the confirmation of sales of securities. Section 503(a)(2) prohibits confirmation of a sale of a security, unless the buyer "has received a prospectus or preliminary prospectus not later than receipt of the confirmation." Subsection (a)(3) prohibits delivery of a security after sale or acceptance of payment for a security unless the buyer "has received a prospectus not later than receipt of the security or acceptance of payment, whichever first occurs." The net effect of these provisions appears to be that a sale may be confirmed on the basis of a preliminary prospectus but a security may not be delivered after a sale nor payment for a security accepted unless the buyer has received a final prospectus. Present law forbids confirmation of a sale using jurisdictional means without the final prospectus accompanying or preceding the confirmation (unless the unusual circumstances of rule 431 are present).[79] The reporter's Comment suggests that the Code's formulation is "designed to solve the 'California problem'—which is to say, the difficulty of getting prospectuses in time . . . ."[80] The utility of the Code's solution is somewhat difficult to see, since the final prospectus nevertheless must be delivered before payment may be accepted. Presumably, if the preliminary prospec-

73. *Id.* § 277.
74. *Id.* § 504(b).
75. *Id.*
76. *Id.*
77. *Id.* § 299.8.
78. 1933 Act § 5(a), 15 U.S.C. 77e(a)(1970).
79. 1933 Act § 5(b), 15 U.S.C. 77e(b)(1970).
80. TD-1 § 503(a), Comment (1).

tus varies in any material way from the final prospectus, or is otherwise incomplete, the legal significance of enclosing it with the confirmation is unclear.

The legal effect of the confirmation has been the subject of doubt and discussion among securities lawyers. When the broker is acting as a principal and sells to his customer from his inventory, the buyer is bound under section 8-319 of the Uniform Commercial Code by a legal contract as a result of receipt of the confirmation, unless he denies the existence of the contract or disputes its terms within the period of time specified in the Uniform Commercial Code as adopted in a particular state.[81] When the broker acts as agent for his customer, however, as is usually the case, the relationship does not involve a "contract for the sale of securities," and section 8-319 does not apply. Despite the more than forty years of operating under the Securities Act of 1933, the legal effect of such a confirmation has never been determined authoritatively by the courts.

(2) Disaffirmance of Purchase

In addition to the rather limited right provided by the Uniform Commercial Code to avoid the purchase of a security in certain cases, the Federal Securities Code would provide every buyer with a "privilege of disaffirmance" if the issuer is not a "one-year registrant" at the time of the sale.[82] In such cases "and in other cases in

81. New York, for example, which has adopted without change the 1962 Official Text of the Uniform Commercial Code, permits the buyer to object to "its contents" at any time within 10 days after receipt of the written confirmation. N.Y. U.C.C. § 8-319(c) (62-1/2 McKinney). Thus, upon receipt of a written confirmation relating to a purported sale of securities by the seller to tbe buyer, the buyer has 10 days within which to notify the seller if he either denies the existence of any contract or disputes the terms stated in the confirmation. *See* Lehman Gov't Sec., Inc. v. Commercial Mortgage Co., 16 U.C.C. Rep. Serv. (Callaghan) 1117 (N.Y. Sup. Ct. 1975). With respect to an objection on the former ground, U.C.C. § 8-319 does not provide an automatic 10-day right of rescission, but rather a means by which a buyer who received sucb a confirmation, either by mistake or under a dispute between the buyer and seller regarding whether the buyer had in fact agreed to buy, can register effectively his protest. Thus, as one court bas noted, "[i]t is not the purpose of Section 8-319(c) to give a purchaser of stock through a broker a period of ten days in whicb to repent of his purchase if the market goes down." DiJulio v. Digicon, Inc., 339 F. Supp. 1284, 1292 (D. Md. 1972).

If no objection is made by the buyer within the 10-day period, then tbe confirmation, although not itself a "contract," will be treated under the U.C.C.'s statute of frauds rule in section 8-319 as acceptable evidence of tbe existence of a contract on the terms contained therein. Moreover, if the confirmation "contains all of the essential elements of a contract, rather than being merely a skeleton memorandum, it sbould be treated as conclusive evidence of the existence of the contract, subject to attack only on the grounds on which a written contract may be attacked." Shpilberg v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 18 U.C.C. Rep. Serv. (Callaghan) 579, 583 (Ky. 1976).

82. RD 1-3 § 503(b).

which the Commission provides by rule or order, a sale . . . is not binding on the buyer if he proves that notice of disaffirmance was delivered to the seller's business address not later than five o'clock in the afternoon . . . of the second full business day after the buyer's receipt of a prospectus and notice of his right under this subsection."[83] This right of disaffirmance does not apply if the seller proves that a prospectus or *preliminary prospectus* current at the time of the sale was given to the buyer or delivered at his address not later than the second full business day before the sale.[84] The period for receipt of the notice of disaffirmance is reduced to the first instead of the second business day if the seller proves that the prospectus or preliminary prospectus (current at the time of sale) was given or delivered not later than the first full business day before the sale.[85] Thus, unlike section 8-319 of the U.C.C., section 503(b) would give the buyer, under limited circumstances, an absolute right to rescind his purchase, based presumably upon second thoughts induced by reading the prospectus.

The privilege of disaffirmance provided in the Code may be compared with the Commission's present policy of not accelerating the effectiveness of a new registrant's registration statement unless assurances have been received that copies of the preliminary prospectus will be sent to customers at least forty-eight hours prior to mailing of the confirmations.[86] With respect to existing as well as new registrants, rule 15c2-8 under the 1934 Act requires managing underwriters and dealers to take certain prescribed reasonable steps designed to assure that preliminary and final prospectuses are made available to customers who have been or are to be solicited to purchase the securities being distributed. Thus, the Commission, by rulemaking and accelerating policy, substantially has anticipated the requirement of the Code, albeit in a complex and circuitous way. The Code's direct handling of offering procedures, however, seems preferable.

E. The Prospectus Requirement

As earlier suggested, the principal conceptual innovation in the Code's handling of distributions is in the elimination of the control

83. *Id.*
84. *Id.*
85. *Id.* Measuring the two-day period from delivery of a current preliminary prospectus is somewhat confusing, since the preliminary prospectus is unlikely to be complete in all respects and the integration of this provision with the Uniform Commercial Code is unclear.
86. SEC Securities Act Release No. 4968 (April 24, 1969).

test with respect to whether secondary distributions must be registered. Aside from this basic conceptual change, the Code offering statement process is essentially the same as the 1933 Act's registration process. The 1933 Act's fundamental idea of providing advance notice of an offering of securities and of requiring the delivery of a prospectus to the purchaser has survived intact, but is rendered somewhat more simple and workable by the Code.

The prospectus delivery requirements of the 1933 Act have been subjected to criticism almost since the adoption of the statute in 1933.[87] Critics have complained that the prospectus often was received by the investor "as a momento of the transaction" and did not serve its purpose of assisting in formulating investment decisions. As the disclosure requirements of the 1934 Act became integrated more currently with 1933 Act disclosures, the Commission adopted a series of rules that dispense with the prospectus delivery requirement in various circumstances.[88] In addition, recognition of the increasing amount of continuous disclosure required of reporting companies has permitted the Commission over the years to reduce the information required to be disclosed in a public offering of the securities of a reporting company. This process has culminated in the most recent requirements for the contents of Form S-16 and the current proposal for further relaxation of the utilization of that form in connection with the proposed adoption of Form S-14A.[89] The SEC Advisory Committee on Disclosure is continuing to study the entire question of prospectus delivery, and proposals for further simplification of the process are expected. The Code provides for incorporation of this streamlining by simply providing that prospectuses shall include whatever information the SEC decides should be included.[90]

The Code, quite properly, does not enter the thicket of the current debate over the utility of retaining a prospectus delivery requirement. This issue has been posed squarely by Professor Homer Kripke in a recent article:

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87. *See, e.g.*, Cohen, *supra* note 10; Kripke, *The Myth of the Informed Layman*, 28 Bus. Law. 631 (1973); Kripke, *The SEC, the Accountants, Some Myths and Some Realities*, 45 N.Y.U.L. Rev. 1151 (1970); Mann, *Prospectuses: Unreadable or Just Unread? A Proposal to Reexamine Policies Against Permitting Projections*, 40 Geo. Wash. L. Rev. 222, 225-27 (1971).

88. *E.g.*, 17 C.F.R. § 230.174 (1976).

89. SEC Securities Act Release No. 5792 (Dec. 20, 1976); SEC Securities Act Release No. 5791 (Dec. 20, 1976).

90. Section 504 provides that the Commission by rule shall specify how much of the contents of the registration statement and offering statement shall be included in a prospectus.

> It is time to consider whether or not the 1933 Act, with its emphasis on the prospectus delivered to the prospective purchaser, is necessary and serves any purpose. This is particularly so in the case of a secondary distribution, in which price will in any event be determined by the existing market. Even on primary distributions where there will be some change in the capital structure and perhaps in the business of the issuer, there is a question as to whether or not the tension and the extensive prospectus effort of the Securities Act is needed in communicating the new facts to the prospective decision makers.[91]

Professor Loss has stated simply that the Code "proceeds on the theory that there is still a role for some sort of special filing . . . , as well as the delivery of a prospectus, when there is a substantial distribution, with the extra selling pressure that is entailed."[92] The writer is in general agreement with Professor Loss's observation. Notwithstanding the existence in the Commission's files of current information regarding an issuer, the distribution process still needs some type of offering document that (a) informs the securities markets of a coming distribution, (b) provides vital information with respect to the size of the offering, impact on the issuer's capitalization, if any, and describes proposed underwriting arrangements, and (c) provides in readable form the current information regarding the issuer not already provided in previous filings. The author also sees some utility in providing a reasonably concise summary of the company's business as well as a reference to sources of more detailed information. The Code is structured to permit such an approach. This approach also would coincide most nearly with the preference of underwriters and dealers in organizing a selling syndicate and in soliciting investors to purchase the distributed securities. Particularly in the case of conventional equity offerings, a solicitation period normally still is required, and investors as well as underwriters and dealers are likely to feel more comfortable with some type of summary selling document.

IV. Secondary Distributions

A. Introduction

Under current law, the questions of when and how a stockholder may sell all or some of his securities depend in large part upon his relationship to the issuer and the manner in which he acquired the securities. Thus, if the seller is not in a control relationship[93] with

91. Kripke, *An Unusual Opportunity For Rethinking Concepts on a Fundamental Level,* N.Y.L.J. December 13, 1976, at 27, 37.

92. TD-1 at xxi.

93. The 1933 Act exempts from registration "transactions by any person other than an issuer, underwriter or dealer." 1933 Act § 4(1), 15 U.S.C. § 77(d)(1) (1970).

the issuer and is not a statutory underwriter,[94] then he is free to sell any amount of securities in any manner.[95] If the seller, although not in a control relationship with the issuer, acquired the securities in a private offering, his ability to resell freely without the necessity of registration depends on compliance with rule 144 or otherwise demonstrating the availability of an exemption from section 5.[96] If the seller is in a control relationship with the issuer, however, then regardless of whether the securities he proposes to sell were acquired in the open market from another stockholder or from the issuer in an exempt offering, he is limited to (1) selling all or a portion of his holdings in a manner not involving a "distribution" (as the term is used in the 1933 Act), thereby qualifying for an exemption pursuant to section 4(1),[97] or (2) selling the quantity specified in rule 144 provided the other requirements of the rule are met.

Under the Code, the seller's relationship to the issuer is irrelevant. Only the amount and the manner of the offering are important. As Professor Loss put it, "[*a*]*ll* distributions, whether primary or secondary, are treated alike in that they are covered *prima facie*."[98] As will be seen, however, the Code does recognize the inherent differences between a primary offering by an issuer and a secondary offering by a stockholder.

B. Alternatives for Stockholders Selling Under the Code

The Code provides a stockholder with six ways by which to dispose of his securities. If the offering does not exceed 100,000 dollars, then an exemption from the offering statement requirement may be available.[99] Even if the amount is more than 100,000 dollars,

94. The selling shareholder himself would be deemed an "underwriter" if he purchased the shares from the issuer in an exempt offering with the intent to resell them. 1933 Act § 2(11), 15 U.S.C. § 77b(11) (1970).

95. This statement has been qualified somewhat by a series of no-action letters in which the staff of the Commission has taken the position that a proposed secondary offering may involve a "distribution" simply by reason of the quantity of shares proposed to be sold, regardless of whether the proposed seller is in a control relationship with the issuer or is a statutory underwriter. *E.g.*, International Foodservice Corp., 1933 Act § 2(11), available March 1, 1976. This administrative position, though without doctrinal foundation in the 1933 Act, apparently represents an administrative trade-off in determining whether a proposed seller may be a control person. The Commission traditionally has not been willing to take positions on the latter subject, and the staff position regarding distributions under these circumstances has been, generally speaking, that no enforcement action would be recommended against such a distribution if it were conducted substantially in compliance with the rule 144 limitations on volume and method of sale.

96. 2 S. GOLDBERG, PRIVATE PLACEMENTS AND RESTRICTED SECURITIES § 7.3 (1976 Rev.).

97. The transaction then would be one not involving an issuer, underwriter, or dealer.

98. TD-1 at xxiv.

99. RD 1-3 § 511(d); *see* text accompanying note 121 *infra*.

the selling stockholder may be able to achieve his purpose through the limited offering exemption.[100] He also may be able to dispose of his securities through "trading transactions."[101] If none of the foregoing methods is satisfactory or available, then the stockholder will be unable to dispose of his holdings without making some kind of filing. If the stockholder has the protection of a registration covenant, he only need make the appropriate demand upon the issuer. Under current law, the stockholder who could not avail himself of any of the four preceding alternatives would be "locked in."

The Code, however, provides two new methods by which a stockholder may dispose of his securities. If the issuer has been a registrant for at least one year (a "one-year registrant") and the security was not the subject of a limited offering during the one-year period specified in section 227(b)(2), then, as a fifth method of disposition, the stockholder may sell his securities pursuant to a "distribution statement."[102] As Professor Loss rightly observes, "[t]his is a radically new treatment of secondary distributions. . . ."[103] Section 509 provides a mini-registration procedure. In effect, the distribution statement is like a registration statement on Form S-16, except that it is filed by the selling stockholder and does not require the issuer's consent. The sixth alternative of a shareholder is to compel registration by demand upon the issuer under section 501. This provision, as discussed below, provides the "locked-in" shareholder of an issuer which is not a one-year registrant with a way to sell his securities on the public market.

(1) The Distribution Statement

Under section 509(b), unless the distributor has filed a distribution statement, it is unlawful for any person in connection with a secondary distribution (including underwriters, brokers, and dealers) to offer, sell, or confirm a sale of a security, to deliver a security after sale, to accept payment for a security, or for a broker or dealer to offer to buy a security from an underwriter in connection with the secondary distribution. Thus a distribution statement may be filed by the selling stockholder and does not require the issuer's cooperation.

The distribution statement apparently becomes "effective" immediately upon filing, since at this point completion of a sale no

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100. *See* text accompanying notes 47-56 *supra*.
101. *See* text accompanying note 57 *supra*.
102. RD 1-3 § 509.
103. TD-1 § 509, Comment (1).

longer is prohibited.[104] The offering statement becomes effective on the thirtieth day after its filing. The desirability of providing for the immediate effectiveness of a distribution statement may be questioned, since it would permit the distribution of a potentially large amount of securities without giving the market the chance to receive the information of a prospective offering and to evaluate its impact. This presents the policy question whether the market is entitled to any such notice. The answer may lie in the practical determination of the necessity for underwriters to undertake an offering period in order to successfully place the issue. Nevertheless, this question merits some further consideration.

The Code contemplates that the distribution statement will be a relatively simple document, containing whatever information the Commission requires by rule, but limited to information concerning the secondary distributor and the terms of the distribution.[105] The distribution statement must identify the most recent annual report and subsequent reports, but such reports need not be attached physically unless the issuer had less than 100,000 dollars of total assets and 1,000 holders of its securities as of its last two preceding fiscal year-ends, and if the Commission so requires by rule.[106] The distribution statement may contain additional information and must contain a certification by the secondary distributor that he is not aware of additional information that should be disclosed.[107] Thus, as Professor Loss notes, except for secondary distributions of securities of very small issuers, "all the required information might well appear on the confirmation."[108]

The distribution statement must be used in connection with written offers, and it is unlawful to confirm a sale of a security, to deliver a security after sale, or to accept payment for a security, unless the buyer has received a distribution statement not later than whichever of the foregoing events first occurs. The entire distri-

104. The apparently immediate effectiveness of the distribution statement is inconsistent with section 509(h), which provides that a distribution statement speaks as of its filing date unless an amendment has been filed. In that event it speaks as of the filing date of the distribution statement "until the amendment becomes effective and thereafter as of the effective date of the amendment." This would imply that a distribution statement amendment must he declared effective, an unusual implication since the statute provides no procedure by which the distribution statement itself is declared effective. The provision contemplating that an amendment to a distribution statement must be declared effective is a minor inconsistency that undoubtedly will be corrected.

105. RD 1-3 § 509(e).

106. *Id.*

107. *Id.*

108. TD-1 § 509, Comment (2).

bution statement, however, need not be delivered but only those portions that the Commission specifies by rule.[109] The privilege of disaffirmance provided in section 503(b) is not available in the case of secondary distributions, since as previously noted that privilege is available only in cases when the issuer is not a one-year registrant at the time of sale.

(2) Registration on Demand

Under section 501, the registration on demand provision, a stockholder, under certain circumstances, may compel the issuer to file a registration statement and an offering statement with respect to the securities that he wishes to sell, provided that he is willing to pay the expenses of the offering. The purpose of the section is to permit public sale by a stockholder who did not purchase from the issuer or otherwise did not protect himself by obtaining a registration covenant from the issuer. Thus, the right to demand registration does not apply "to securities held by a person who executed an express waiver of his rights under this subsection or who acquired the securities with knowledge that the person from whom he acquired them or a prior owner had executed such a waiver (except that knowledge need not be shown if the waiver is noted conspicuously on the securities)."[110] In addition, the demand for registration must be accompanied by an opinion of counsel stating that the proposed offering is subject to the Code's offering statement filing requirement.[111]

Once a proper demand for registration is made, two courses of action are open to the issuer. First, within sixteen months after the demand the issuer may file an offering statement, together with a registration statement if it is not already a registrant, and then must use its best efforts to ensure that the offering statement and any such registration statement become effective.[112] Alternatively, within thirty days after the demand the issuer may make a written offer to buy the securities that are the subject of the demand.[113] The offer must be at a cash price determined by the issuer to be the fair value of the securities, and certain other requirements also must be met.[114] The registration on demand procedure is given teeth by sec-

109. RD 1-3 § 509(f).
110. *Id.* § 501(b)(6)(A).
111. *Id.* § 501.
112. *Id.* § 501(b)(1).
113. *Id.* § 501(b)(6)(C).
114. *Id.* § 501(b)(7).

tion 1411, which provides that if the issuer fails without "substantial defense" to effect the filing, the stockholder may obtain specific performance, damages, or both, and in the event of specific performance, the issuer may be compelled to pay for the filing.

The concept of registration on demand is analytically and philosophically an important and interesting aspect of the proposed Code. It represents an attempt to strike a balance between equally strong but competing policy considerations. Abandonment of the control concept for the purpose of distinguishing between primary and secondary distributions will result, as Professor Loss notes, in "considerable expansion of coverage with respect to secondary distributions. . . ."[115] Accordingly, "without some right to demand registration, however limited, implementation of that idea might even create due process problems (at the very least it would be grossly unfair) in the case of a market buyer who could not have protected himself by a registration covenant."[116] On the other hand, there is "the principle of corporation law that permits reasonable restrictions on transfer and the idea that owners of a close corporation should have some control over whether it becomes public as long as they are careful not to issue shares that are freely transferable."[117] Of course, for the company that does not want to be forced into going public at the demand of a single shareholder, the easy solution is to offer to buy the shares itself, as contemplated by section 501(b)(6)(C). This solution, however, is a viable alternative only if the company happens to have the cash available at the time.

One may question whether it is a healthy development to empower one locked-in stockholder, however unfortunate his predicament, to force an issuer to become a publicly owned company and enter into the public disclosure process. The legal right to sell securities to the public does not provide any assurance of a strong and viable market. Further, the absence of a realistic trading market for securities in which significant investor interest is lacking may end up disappointing all parties—the seller because no one may purchase his securities and the issuer because of the expense and legal exposure implicit in the disclosure process. The question arises whether the proliferation of relatively small publicly owned companies that become such against their will is a good thing for the

115. TD-1 at xxiv.
116. *Id.* § 501, Comment (2).
117. *Id.*

United States' securities markets. In recent years our history has shown that many small companies simply are not suitable for public ownership, and many managements experience a type of "culture shock" when they realize the public expectation to which they have become subject.

V. The Transactional Exemptions

The offering statement and distribution statement requirements apply with respect to all distributions of a security.[118] A distribution, it will be recalled, is any offering other than a limited offering or a trading transaction. Thus limited offerings and trading transactions are two of the several transactional exemptions provided by the Code. They are the only two transactional exemptions that appear in the definitions part of the Code. The other transactional exemptions are set forth in Part V of the Code in sections 511 through 513. The Code's transactional exemptions for the most part do not differ significantly from the transactional exemptions currently afforded by the 1933 Act and the rules thereunder. Accordingly, the individual exemptions will not be discussed except to note that the Code's small offering exemption has a base amount of 100,000 dollars.[119] Section 3(b) of the 1933 Act authorizes the Commission to exempt from the registration requirements offerings in amounts up to 500,000 dollars. Pursuant to the authority conferred by this section, the Commission adopted Regulation A.[120] Regulation A exempts from registration offerings in amounts up to 500,000 dollars sold by or on behalf of the issuer or by the estate of a decedent who owned the securities at death. The amount is limited to 100,000 dollars in the case of offerings by other persons. The 100,000 dollar figure contained in section 511(d) of the Code, however, will not necessarily be the ultimate maximum amount. Comment (1) to that section states that the Commission could "and presumably would, as in Reg. A," raise the 100,000 dollar amount pursuant to the rather broad exemptive authority conferred upon it by section 302 of the Code.[121]

VI. Conclusion

In evaluating the issuer registration and distribution provi-

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118. The meaning of "distribution" already has been discussed. *See* text accompanying notes 42-57 *supra*. "Security" is defined in § 297 of RD 1-3.

119. RD 1-3 § 511(d).

120. 17 C.F.R. 230.251-63 (1976).

121. TD-1 § 511, Comment (1).

sions, several observations are in order. First, the ultimate formulation of the disclosure and other requirements imposed on issuers and underwriters is not entirely clear. The significant contours of many of the key provisions in Parts IV and V of the Code are left to the rulemaking process of the Commission. This broad discretion vested in the Commission, though perhaps advisable in view of the current rethinking of the proper role and scope of disclosure, as a practical matter will expand the Commission's authority in these areas. Secondly, during the period of drafting the Code, the Congress and the Commission both have been active in the process of codification and reform—especially, in the case of the Commission, in accelerating the process of integration of the 1933 and 1934 Acts.[122]

Although certain areas in the present statutory and regulatory firmament continue to harbor mystery and doubt, the passage of time and the efforts of the Commission to fill in the interstices have produced a system with which most securities lawyers, underwriters, and issuers are fairly comfortable. To reach this stage has required a tremendous proliferation of regulations, no-action letters, guidelines, and similar writing, which comprise the body of authority applicable to the registration and distribution of securities. Adoption of the Code, however, will not reduce the Commission's burden since the need for such regulations and guidelines to flesh out the extremely broad and vague standards of the Code will continue. The potential advantage of the Code lies in its completion of the integration of the 1933 and 1934 Acts and in its creation of a new statutory basis for the development of the law in the future. This is all to the good and should be encouraged, subject to the caveat that we will be writing on a clean slate so far as the underlying statutes are concerned. Old learning and interpretations no longer may apply, and a period of judicial construction and development probably will be necessary. The possible resulting uncertainty in the future interpretation and development of the new language introduced by the Code is the price that must be paid, at times, for progress. The bar and the public are indebted deeply to the Reporter for the Code, Professor Louis Loss, for his tireless dedication to the process of examining the securities laws and for his rethinking of their basic concepts. During the years of his efforts many of his ideas, sbared freely with the profession and the SEC, were snatched up and adopted by regulatory and legislative action. These ideas already are serving the needs of the expanding and dynamic securi-

122. *See* note 15 *supra*.

ties market. Professor Loss's many contributions to the development of the securities laws are enhanced further by the scholarship, sweep, and, yes, boldness of the concept of the Code, which only he even could begin to approach as a realistic project.