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SHOULD DIRECT PLACEMENTS BE REGISTERED?

AVERY B. COHAN*

A distinguished professor of law, Roscoe T. Steffen, has suggested that all direct placements should be registered with the Securities and Exchange Commission.[1] This suggestion would have a considerable effect on the efficiency of the capital markets and also on the well-being of the economy as a whole, and it cannot, therefore, be allowed to go unchallenged—despite the eminence of its author.[2] The purpose of this note is to examine Professor Steffen's suggestion critically.

I. BACKGROUND

But, first, what are direct placements and what place do they presently occupy in the capital market?

A. What Is a Direct Placement

A direct placement[3] is a new corporate issue sold for cash to a restricted number of investors, without public offering, of maturity of more than one year but *not* including either bank term loans (when commercial banks are the sole participants) or mortgages on business property. The meaning of this definition will perhaps be

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The author is indebted to Professors Gordon Shillinglaw and Ernest L. Folk, III, for their helpful comment on a preliminary draft of this note.

[1] Steffen, *The Private Placement Exemption: What To Do About A Fortuitous Combination in Restraint of Trade,* 30 U. CHI. L. REV. 211 (1963). See generally United States v. Morgan, 119 F. Supp. 621 (S.D.N.Y. 1953); COHAN, PRIVATE PLACEMENTS AND PUBLIC OFFERINGS: MARKET SHARES SINCE 1935 (University of North Carolina School of Business Administration Technical Paper No. 1, 1961); COHAN, COST OF FLOTATION OF LONG-TERM CORPORATE DEBT SINCE 1935 (University of North Carolina School of Business Administration Research Paper No. 6, 1961); COREY, DIRECT PLACEMENT OF CORPORATE SECURITIES (1951); HICKMAN, THE VOLUME OF CORPORATE BOND FINANCING SINCE 1900 (1953); U.S. SECURITIES AND EXCHANGE COMM'N, PRIVATELY PLACED SECURITIES—COST OF FLOTATION (corrected printing 1952).

[2] Roscoe T. Steffen is Professor of Law, Hastings College of the Law, and John P. Wilson Professor Emeritus of Law, University of Chicago.

[3] Often called, variously, private placements, private deals, direct deals, etc.

clearer if the two essential distinctions between a direct placement and a public offering are made explicit. These distinctions are:

First, in a direct placement "the corporate issuer and the institutional prospective ultimate investor deal directly with each other, with or without the aid of an intermediary, in establishing the terms of a security issue. . . ."[4] In a public offering, on the other hand, the ultimate purchasers are a widely scattered multitude of individual investors, and although the issuer may attempt to sense their wishes, he does not negotiate terms with them. He either sets the terms himself and then throws the issue on the market, as in the case of a competitively bid utility issue, or he negotiates terms with an intermediate purchaser (in effect with a wholesaler), usually an investment banker.

Second, in a direct placement all the prospective ultimate investors must be "sophisticated," which in practice means that their number tends to be "small."[5] In a public offering, on the other hand, the prospective ultimate purchasers are in fact the entire public-at-large.

Issues that satisfy these criteria—*i.e.,* which are negotiated *directly* with a *"small"* number of *"sophisticated"* lenders—are usually considered to be "not-public-offerings" under section 4(1) of the Securities Act of 1933 and, as such, exempt from registration.[6] It is the existence of this "loophole" that Professor Steffen finds so disquieting.

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[4] COREY, *op. cit. supra* note 1, at 3-4.

[5] Prior to 1953, the SEC described direct placements as "offerings" to a single investor or a small number of investors, the offering being handled directly by the company itself (*i.e.,* the issuer) or by an investment banker. The bulk of private (direct) placements are corporate securities exempt from registration under section 4(1) of the Securities Act of 1933, 48 Stat. 77 (1933), 15 U.S.C. § 77d(1) (1958). See U.S. SECURITIES AND EXCHANGE COMM'N, *op. cit. supra* note 1, at 2. Since 1953, however, doubtless as a result of the Supreme Court's decision in SEC v. Ralston Purina Co., 346 U.S. 119 (1953), the SEC has tended to refer to direct placements simply as issues exempt under section 4(1)—*i.e.,* issues "not involving any public offering"—without making clear what, in its view, constitutes a public offering. See SEC Rule 152, 17 C.F.R. § 230.152 (1964). "An offering to those who are shown to be able to fend for themselves is a transaction 'not involving any public offering.' . . . [T]here is no warrant for superimposing a quantity limit on private offerings as a matter of statutory interpretation." SEC v. Ralston Purina Co., *supra* at 125.

[6] 48 Stat. 77 (1933), 15 U.S.C. § 77d(1) (1958), which provides in part: "The provisions of section 77e [providing for registration] . . . shall not apply to any of the following transactions: (1) Transactions by any per-

B. *Growth of Direct Placements*

The growth of direct placements has been one of the most striking developments since the mid-thirties in the market for corporate long-term capital. In the thirty-four years 1900-1933, slightly more than one billion dollars of corporate debt were directly placed. In the thirty-nine years 1934-1962, some sixty-three billion dollars were directly placed. And whereas, in the period 1900-1933, direct placements were roughly three per cent of all corporate debt cash offerings, they were forty-two per cent in the period 1934-1962.[7] As Table 6 indicates, some equities are directly placed, but by far the largest portion consists of debt securities.

This growth is described in detail both in absolute terms and relative to the growth of public offerings in Tables 1 to 4. These tables indicate, *inter alia,* that industrials, utilities, and rails have contributed by no means equally to the total growth of direct placements:

(1) *Industrial* direct placements have grown by far the most both in absolute terms and relative to public offerings (Table 2) and in 1962 accounted for more than seventy per cent of all corporate direct placements (Table 5). Industrial direct placements have been as much as ninety-one per cent of all industrial cash debt offerings (Table 2) and in the twelve years 1951-1962 fluctuated between forty-six per cent (1958) and eighty-four per cent (1951) of all industrial cash debt offerings.

(2) *Public utility* direct placements have grown less than industrial direct placements, both in absolute terms and relative to public offerings (Table 3), and in the twelve years 1951-1962 fluctuated between twenty-one per cent (1962) and thirty-four per cent (1951) of all public utility cash debt offerings. Public utility direct placements represented on the average, over the twelve years 1951-1962, about twenty-eight per cent of all corporate direct placements (Table 5).

(3) *Rail* direct placements have been negligible both in dollar terms (Table 4) and relative to total corporate direct placements (Table 5).

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son other than an issuer, underwriter, or dealer; transactions by an issuer not involving any public offering; or transactions by a dealer . . . ."

[7] The figures for the earlier period were derived from data given in HICKMAN, THE VOLUME OF CORPORATE BOND FINANCING SINCE 1900, at 284-85 (1953).

TABLE 1

LONG-TERM CORPORATE DEBT ISSUES OFFERED FOR CASH IN THE UNITED STATES BY METHOD OF OFFERING, AND PER CENT DIRECTLY PLACED (millions of dollars)

	Public Offerings	Direct Placements	Total	Per Cent Directly Placed
1934	$ 280	$ 92	$ 372	24.7
1935	1840	385	2225	17.3
1936	3660	369	4029	9.2
1937	1291	327	1618	20.2
1938	1353	691	2044	33.8
1939	1276	703	1979	35.5
1940	1628	758	2386	31.8
1941	1578	811	2389	33.9
1942	506	411	917	44.8
1943	621	369	990	37.3
1944	1892	778	2670	29.1
1945	3851	1004	4855	20.7
1946	3019	1863	4882	38.2
1947	2889	2147	5036	42.6
1948	2965	3008	5973	50.4
1949	2437	2453	4890	50.2
1950	2360	2560	4920	52.0
1951	2364	3326	5690	58.4
1952	3645	3957	7601	52.1
1953	3856	3228	7083	45.6
1954	4003	3484	7488	46.5
1955	4119	3301	7420	44.5
1956	4225	3777	8002	47.2
1957	6118	3839	9957	38.6
1958	6332	3320	9653	34.4
1959	3557	3632	7190	50.5
1960	4806	3275	8081	40.5
1961	4706	4720	9425	50.1
1962	4487	4529	9016	43.2

Source: SEC Annual Reports.

II. CONSEQUENCES OF GROWTH

The growth of direct placements has had a great variety of consequences of which three are of primary relevance here:

(1) The growth of direct placements has substantially increased the degree of competition in the market for long term corporate

TABLE 2
INDUSTRIAL-FINANCIAL-SERVICE, TOTAL DEBT CASH ISSUES, PUBLICLY OFFERED AND DIRECTLY PLACED, AND PER CENT DIRECTLY PLACED, 1935-1962
(millions of dollars)

	Publicly Offered	Directly Placed	Total	Per Cent Directly Placed
1935	$ 577	$ 231	$ 808	29
1936	1050	139	1189	12
1937	327	249	576	43
1938	398	385	783	49
1939	390	230	620	37
1940	588	365	953	38
1941	378	355	733	48
1942	219	225	444	51
1943	159	232	391	59
1944	380	399	779	51
1945	544	711	1255	57
1946	845	1557	2402	65
1947	317	1706	2023	84
1948	271	2263	2534	89
1949	459	1493	1952	76
1950	165	1679	1844	91
1951	458	2502	2960	84
1952	1218	2886	4104	70
1953	1539	2250	3789	59
1954	968	2275	3243	70
1955	1622	2326	3948	59
1956	1925	2875	4800	60
1957	2078	2630	4708	56
1958	2544	2130	4674	46
1959	1150	2233	3383	66
1960	1724	2395	4119	58
1961	2252	3442	5694	60
1962	1222	3678	4900	75

Source: 1935-1947, estimated by the author.
1948-1962, SEC.

funds and, together with the introduction in 1941 of compulsory competitive bidding on utility issues,[8] was responsible for the sharp decline which occurred between 1935 and 1958 in the cost of flotation of *publicly offered* industrial and utility issues.[9]

[8] SEC Holding Company Act Release No. 2676 (April 8, 1941).
[9] COHAN, COST OF FLOTATION OF LONG-TERM CORPORATE DEBT SINCE

TABLE 3

PUBLIC UTILITIES, TOTAL DEBT CASH ISSUES, PUBLICLY OFFERED AND DIRECTLY PLACED, AND PER CENT DIRECTLY PLACED, 1935-1962
(millions of dollars)

	Publicly Offered	Directly Placed	Total	Per Cent Directly Placed
1935	$ 1104	$ 152	$ 1256	12
1936	1873	218	2091	10
1937	637	61	698	9
1938	908	299	1207	25
1939	745	457	1202	38
1940	724	391	1115	35
1941	853	438	1291	34
1942	246	190	436	44
1943	340	101	441	23
1944	1002	297	1299	23
1945	1877	290	2167	13
1946	1482	325	1807	18
1947	2298	529	2827	19
1948	2076	740	2816	26
1949	1518	957	2475	39
1950	1654	868	2522	34
1951	1580	821	2401	34
1952	1954	1017	2971	34
1953	2020	971	2991	32
1954	2596	1169	3765	31
1955	1969	960	2929	33
1956	1932	890	2822	32
1957	3697	1209	4906	25
1958	3552	1191	4743	25
1959	2255	1377	3632	38
1960	2888	862	3750	23
1961	2326	1229	3555	35
1962	3048	829	3877	21

Source: See Table 2.

(2) The growth of direct placements has meant also the development of quite new types of loans (*e.g.*, oil production loans, gas transmission loans, and loans guaranteed by leases)—loans in

1935, at 87-89 (University of North Carolina School of Business Administration Research Paper No. 6, 1961). But the cost of flotation of utility and rail issues would surely have declined *more* if competitive bidding had not been made compulsory.

TABLE 4

RAILS, TOTAL DEBT CASH ISSUES, PUBLICLY OFFERED AND DIRECTLY PLACED, AND PER CENT DIRECTLY PLACED, 1935-1962*
(millions of dollars)

	Publicly Offered	Directly Placed	Total	Per Cent Directly Placed
1935	$ 128	$ 4	$ 132	3
1936	686	16	702	2
1937	176	20	196	10
1938	29	8	37	22
1939	83	20	103	19
1940	181	9	190	5
1941	90	20	110	18
1942	10	6	16	38
1943	59	39	98	40
1944	434	91	525	17
1945	1352	20	1372	1
1946	570	35	605	6
1947	29	1	30	3
1948	190	5	195	3
1949	12	2	14	17
1950	280	12	292	4
1951	35	4	39	11
1952	201	52	253	26
1953	58	6	64	10
1954	267	39	306	15
1955	353	15	368	4
1956	35	12	47	35
1957	11	0	11	—
1958	78	1	79	1
1959	—	22	22	100
1960	34	18	52	35
1961	17	50	67	75
1962	71	23	94	24

*Excluding Railway Equipment Trust Certificates.
Source: See Table 2.

general which respond uniquely to the particular needs of individual borrowers. This, in turn, has meant that certain types of unconventional ventures have been able, rather readily, to obtain financing which would not have been so readily available, and perhaps might not have been available at all, elsewhere. The financial institutions have been able to provide this "custom tailoring" service because they enter the market as ultimate purchasers

TABLE 5

INDUSTRIAL, UTILITY, AND RAIL DEBT DIRECT PLACEMENTS AS PER CENT OF CORPORATE DIRECT PLACEMENTS, ANNUALLY, 1951-1962

	Industrials	Utilities	Rails	Total*
1951	75.2	24.7	0.1	100.0
1952	73.0	25.7	1.3	100.0
1953	69.7	30.0	0.2	100.0
1954	65.3	33.6	1.1	100.0
1955	70.5	29.1	0.5	100.0
1956	76.1	23.6	0.3	100.0
1957	68.5	31.5	—	100.0
1958	64.1	35.9	—	100.0
1959	61.5	37.9	0.6	100.0
1960	73.1	26.3	0.5	100.0
1961	72.9	26.0	0.1	100.0
1962	81.2	18.3	0.5	100.0
Total 12 years	71.3	28.2	0.5	100.0

*Due to rounding, will not always add to total.
Source: SEC.

(*i.e.,* they are not wholesalers, as are investment bankers), and they are free therefore to buy issues on the merits thereof and without regard to whatever fashions, traditions, or prejudices may tend to dominate the *public* securities market.

(3) And last, but perhaps not least, the growth of direct placements has meant that many small, relatively unknown firms, which would probably have found the cost of a public offering prohibitive, have been able to obtain long term debt financing at moderate cost.[10] The financial institutions are able to provide funds to such firms at moderate cost because they buy for their own portfolios and not, as do the investment bankers, for resale to the public-at-large. An investment banker would only rarely be able to buy a small issue (say, 500,000 dollars) from a small, little-known company without making a high, perhaps prohibitively high, charge to cover the cost of the selling effort such an issue would require.

In the light of the foregoing, the conclusion seems inescapable

[10] Between 1951 and 1958 the average size, annually, of industrial public offerings ranged between $28 million and $70 million. The average size of industrial direct placements ranged between $2 million and $3 million.

TABLE 6

DIRECT PLACEMENTS BY TYPE OF SECURITY, 1934-1962
(millions of dollars)

	Bonds and Notes	Equities*	Total	Equities as Per Cent of Total
1934	92	—	92	—
1935	385	2	387	0.5
1936	369	4	373	1.1
1937	327	3	330	0.9
1938	691	1	692	0.1
1939	703	4	706	0.6
1940	758	7	765	0.9
1941	811	2	813	0.2
1942	411	9	420	2.1
1943	369	3	372	0.8
1944	778	9	787	1.1
1945	1004	18	1022	1.8
1946	1863	54	1917	2.8
1947	2147	88	2235	3.9
1948	3008	79	3087	2.6
1949	2453	49	2502	2.0
1950	2560	120	2680	4.5
1951	3326	88	3415	2.6
1952	3957	45	4002	1.1
1953	3228	90	3318	2.7
1954	3484	185	3668	5.0
1955	3301	176	3477	5.1
1956	3777	109	3886	2.8
1957	3839	86	3925	2.2
1958	3320	169	3490	4.8
1959	3632	122	3755	3.2
1960	3275	221	3497	6.3
1961	4720	279	4999	5.6
1962	4529	113	4643	2.4

*Includes both common and preferred.
Source: SEC.

that direct placements have grown as much as they have because a large number of issuers (especially industrial issuers) have found direct placement to be the best alternative available to them—better than a public offering, a bank term loan, an SBIC loan, a mortgage, or whatever. And by "better" we must mean *cheaper,* all things taken into account. This does not mean, of course, that some placements have not carried "high" (whatever that means) interest rates. But all issuers, no matter how small or obscure, have had

available a variety of alternatives, and it would be absurd to presume that large numbers of them, typically and consistently, have acted in an irrational manner—*i.e.*, have, typically and consistently, chosen an alternative which, for their particular purposes, was something less than the best available. This, in turn, must mean that the direct placement, as a device, has responded to a genuine need.

To put the matter in a somewhat different way: the growth of direct placements has benefited everyone directly concerned, with the possible exception of the investment bankers (and whether, on balance, the latter have benefited or not, is really irrelevant).[11] Issuers have benefited because increased competition for their securities has reduced their effective cost of money. Life insurance companies and pension funds (and, indirectly, the public-at-large as policy holders and annuitants) have benefited because they have had a ready outlet for large quantities of investible funds at yields *higher* than those they would otherwise have been able to obtain. In short, issuers have paid *less* and lenders have earned *more* than would otherwise have been the case.[12]

III. Register All Issues?

Against this happy background of increased competition, innovation, and efficiency in the capital markets, Professor Steffen suggests that all direct placements of three million dollars or more be required to be registered with the SEC.[13] This suggestion raises two questions:

On what grounds does Professor Steffen justify his suggestion?

What would be the consequences if Professor Steffen's suggestion were adopted?

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[11] Investment bankers assist the issuer in roughly half of all direct placements. Their fees on this score, however, are much less than the fees they earn on typical public offerings. See U.S. Securities and Exchange Comm'n, *op. cit. supra* note 1, at 10.

[12] How can issuers pay *less* and lenders earn *more* on a direct placement than would otherwise have been the case? The answer lies, of course, in the high cost of flotation of public offerings. A $10 million issue with a coupon of 4% and cost of flotation of 2% (the issuer would receive only $9,980,000) would effectively cost the issuer about 4.10%. If such an issuer sold the same issue directly at 4.05% (cost of flotation negligible) his effective cost would be five basis points less, and the lender's yield would be five basis points higher than it would have been had he bought a public offering carrying a 4% coupon. In brief, in a direct placement, the wholesaler is eliminated and his commission is divided (although not necessarily equally) between the borrower and the lender.

[13] See Steffen, *supra* note 1, at 239.

Professor Steffen makes the following three arguments on behalf of his suggestion:

(1) The original intent of Congress in passing the Securities Act of 1933 was "full and fair disclosure" *for its own sake* and not, as I (and perhaps a few others) had always supposed, to "protect" the small, unsophisticated *individual* investor who, in the nature of things, cannot tell the difference between a balance sheet and a turnip tree. I wish to present Professor Steffen's views as accurately as possible and hence I quote at length:

> Consistently, the preamble to the act was couched in broad terms: "An Act to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof, and for other purposes." Surely the thrust here is for "full and fair disclosure," concerning substantially all securities that Congress had the power to reach. Moreover, by its very lack of specification, the act was designed to benefit whoever might be concerned: new buyers unable "to fend for themselves"; holders of previously issued securities put out by the same issuer; indeed, the whole business and investment community. The events of the decade culminating in the 1929 crash had shown that all were in much the same boat and, in a sense, unable to "fend for themselves."
>
> Even this account understates the ends Congress hoped to accomplish by "full and fair disclosure." Underwriting and distribution costs had come to be extremely high; therefore, the facts should be disclosed for all to see. Accounting procedures were often designed to hide facts, rather than to inform the investors; these should be corrected, thus helping existing security holders as well as buyers of new issues. Phony promotions had too often hampered or defeated "honest" business enterprise, and hence the existing shareholders, in the competition for funds. A House report stated the matter plainly: "Alluring promises of easy wealth were freely made with little or no attempt to bring to the investor's attention those facts essential to estimating the worth of any security. . . . Whatever may be the full catalogue of the forces that brought to pass the present depression, not the least among these had been this wanton misdirection of the capital resources of the Nation." In a word, "full and fair disclosure" was thought to be essential if the nation's economy was to be kept in order.
>
> It is against this background that the phrase, "not involving any public offering," must be construed. If congressional purpose is to be served, it would seem that any offering that is in a substantial amount, or made to more than a few persons, may be of

> such public concern as to call for registration. It may well be that large institutional investors have the ability "to fend for themselves"—though they are by no means infallible—but it does not follow that security purchases by them aggregating over three billion dollars each year do not involve "any public offering."[14]

In brief, Professor Steffen is saying that, because such large sums of money are involved, everyone has a "right" to know "what goes on," that it was in fact the original intent of Congress that everyone should know "what goes on," and hence any issuer who is considering negotiating a direct placement (of three million dollars or more) should be required to disclose such facts about itself and the proposed issue as the SEC, in its wisdom, deems relevant.[15]

(2) The direct placement market tends to be dominated, Steffen says, by the twenty largest insurance companies.[16] Steffen says:

> It has been the unhappy role of the small institutional investor, over the last quarter century, to stand on the sidelines and watch while great numbers of the top grades of private debt securities have gone directly to the big insurance companies.[17]
>
> . . . .
>
> Excluded entirely from dealing directly with the larger issuers, they [the smaller institutional lenders] must be content with such small pieces of an issue as one of the big placees may later decide to sell . . . . [T]his surely presents a state of facts deeply in conflict with the basic philosophy embraced by Congress when it adopted the Sherman Act.[18]

Presumably, Professor Steffen believes that if direct placements were required to be registered, one or the other of two consequences would ensue: either more issues would find their way into

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[14] *Id.* at 221-22. (Footnotes omitted.)

[15] There is a minor practical problem here which arises more from the form of Professor Steffen's suggestion than from its substance and which, hence, need not long detain us: An issue is not typically registered with the SEC until its terms—type of security, maturity, sinking fund provisions, restrictive covenants, if any, and so forth—have been fixed. In a direct placement, terms are not fixed until the process of negotiation between the issuer and the lender has terminated—*i.e.*, until the transaction is at the point of consummation. And it is not easy to see what purpose would be served by registration at such a time. But, conceivably, the issuer might "register" merely his intent to seek a certain number of dollars for a specified period of time.

[16] As a matter of fact, some sixty-odd life insurance companies, representing roughly 80% of the assets of all life insurance companies, are active in the direct placement market.

[17] Steffen, *supra* note 1, at 213. (Footnote omitted.)

[18] *Id.* at 230.

the public market (simply because the cost differential in favour of direct placements would have been reduced by the cost of registration) and would hence be available for purchase by small lenders, or issuers in general would be able to approach both large and small lenders without fear of running afoul of section 4(1). In brief, then, in Professor Steffen's opinion, registration of direct placements would enrich the portfolios of small companies and would enable issuers to "shop around" for better prices and terms.

But Professor Steffen does not commiserate merely with small lenders. He commiserates also with large issuers:

> There is no lack of direct precedent to show that the restraints existing in the private placement market are contrary to policy. It will suffice to cite one of the early cases, *Swift & Co. v. United States,* where the essential charge was that the defendant packing companies had *agreed* not to bid against each other in the purchase of livestock on the several midwestern markets. In the words of Mr. Justice Holmes: "The scheme as a whole seems to us to be within the reach of the law." If we substitute bonds for beef and assume that the large private placees have agreed to buy bonds only according to the restrictions necessary to get through the section 4(1) loophole, the two cases are on much the same footing. In effect the issuer receives, and may receive, only one price-offer for his securities, that of the first investor group which he approaches. Of course, the issuer is not compelled to accept this offer; he may draw back and later offer his securities publicly; but this does not alter the fact that he does not have free access to a free private placement market.
>
> Nor may it be said—if that ever is a justification—that the private placement market just grew the way it has, as a result of economic forces alone. Rodgers, in fact, says frankly that an issuer when seeking to sell his securities privately "must be guided by the necessity of strictly limiting the number of offerees in order to preserve the exempt character of the transaction." Thus, it happens that "the larger issues are naturally offered to a few companies," and, he might have added, are purchased with virtually no competition.[19]

He also states:

> The question is not one of guilt. It may be assumed that this is a situation of the sort referred to by Judge Hand in the *Alcoa* case, that is, the large placees may have "become monopolists by force of accident," or may have had their preferred position "thrust" upon them. The question, nevertheless, is whether there

[19] *Id.* at 230-31. (Footnotes omitted.)

are grounds for so exempting the private placement market from congressional policy.[20]

In brief, then, to put the matter in its simplest terms, Professor Steffen believes that registration of direct placements would have the following beneficial consequences:

(1) It would force "full disclosure" which, in his view, is desirable as such.

(2) It would enable issuers to "shop around" among financial institutions without fear of running afoul of section 4(1). This would mean that small financial institutions would have a better chance to participate in the larger direct placements—*i.e.,* if the larger issuers had no fear of running afoul of section 4(1), they would, presumably, be inclined to approach every likely lender including the smaller lenders.[21] Alternatively, for reasons mentioned above, some issues which would otherwise have been directly placed, would be publicly offered: if by administrative fiat the price of margarine were raised—by so much as a penny—some consumers would shift to butter.[22]

(3) It would break the "monopoly" over direct placements "held" by the large insurance companies, with the result that issuers would be able to sell their securities at better prices and subject to fewer and less constricting covenants.

Do these arguments have any merit?

(1) With respect to *full and fair disclosure,* few experts would argue—in fact, Professor Steffen apart, I know of none—that full disclosure is an end in itself. In any event, most large issuers (*i.e.,* those who would be likely to sell issues of three million dollars or more) publish annual reports and are listed in Moody's. Professor Steffen would perhaps be surprised at the amount of information which is available in these two sources on the details and terms of the larger direct placements—*i.e.,* those in which he manifests particular interest.

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[20] *Id.* at 230. (Footnotes omitted.)

[21] Any given small financial institution would doubtless be unable to take all of a large issue but it could, presumably, organize a group made up of other small financial institutions or of both small and large financial institutions.

[22] Those who, at the previously existing prices, had just found it worthwhile to buy margarine. And, of course, the larger the increase in the price of margarine, the larger the number of consumers who would shift to butter.

(2) It is true that registration would enable issuers to "shop around," wherever they chose, both in the private market and in the public market without fear of running afoul of section 4(1). But the cure is indeed somewhat worse than the disease: in order to avoid running afoul of section 4(1) and being required, as a consequence, *to register,* Professor Steffen suggests that issuers be required to register—*whether they wish to shop around or not!* And, of course, any issuer who wishes to do so may so register *now.* The fact that very large numbers of issuers do *not* now choose to do so speaks loudly indeed about the advantages to be obtained thereby.

(3) Monopoly is a nasty, emotional word, virtually devoid of content and, therefore, it should not be used loosely. The simple fact of the matter is that the degree of competition in the market for long-term corporate funds has increased substantially since the mid-thirties, thanks largely to the growth of direct placements. Professor Steffen's suggestion, if it were adopted, would make it more difficult for the financial institutions to compete with the public market—just as forcing the manufacturers of margarine to raise the price of their product would make it more difficult for them to compete with manufacturers of butter. For this reason, Professor Steffen's suggestion constitutes a gesture in the direction of the *status quo circa* 1935.

What would be the *specific economic* consequences if Professor Steffen's suggestion were adopted?

(1) Cost of flotation and, *ergo,* the cost of money would be raised by the cost of registration. There can be no doubt whatsoever about this. It is certain.

(2) If the cost of money were raised, even marginally, investment on the part of business would be less than it would otherwise be. The decrease might not be large, but it would occur. This is also certain. Projects which would have appeared worthwhile at a lower cost of money will now seem to be *not* worthwhile. This also is certain. And, of course, if investment were less, the economy as a whole would suffer.

(3) In return for incurring these additional costs, issuers would be able to engender greater competition among financial institutions—*i.e.,* issuers would be able to "shop around" freely with-

out fear of running afoul of section 4(1). This, Professor Steffen suggests, would lower their effective cost of money.

But this happy result seems unlikely to occur. It *would* occur only if "shopping around" among financial institutions had the effect of reducing interest costs by *more than* the increase in cost of flotation. As indicated above, issuers who are intent on a direct placement may register now if they choose to do so. But very few such issuers do choose to do so. Why? The answer must be that such issuers do not believe that registration would be worthwhile—*i.e.,* such issuers do *not* believe that the additional costs involved would be outweighed by lower interest charges. And why should issuers who are intent on a direct placement (having made what must be presumed to be a rational choice between the private and the public markets) and who do not believe registration would be worthwhile, be *forced* to register? Such issuers are surely at least as sensitive as Professor Steffen to the advantages and disadvantages of registration.

In brief then, it is difficult to see who would benefit by forced registration, except perhaps the investment bankers: they would benefit in exactly the same way as the butter manufacturers, were the price of margarine raised by fiat.

IV. Conclusion

Although Professor Steffen's proposed "cure" would surely make the patient worse, he has correctly diagnosed the disease. He says: "Plainly, the culprit is section 4(1)."[23] It would perhaps be more accurate to say that the culprit is the refusal of the SEC, with typical bureaucratic timidity, to put a *reasonable interpretation* on section 4(1). If the SEC did put a reasonable interpretation on section 4(1), we would in fact have the best of both possible worlds—more free "shopping around" by issuers among financial institutions *without* any adverse effect whatever on cost of flotation. The SEC, relying on the dictum in the *Ralston Purina* case,[24] would need merely to draw up and publish a list of lenders "able to fend for themselves."[25] Such a list would surely include all corporate financial institutions with assets in excess of one million dollars, *i.e.,* virtually all the 1500-odd life insurance companies in

[23] Steffen, *supra* note 1, at 231.
[24] SEC v. Ralston Purina Co., 346 U.S. 119 (1953).
[25] *Id.* at 125.

the United States, virtually all the banks (including their trust departments), and a large number of pension and other funds. This would be a vigorously competitive market indeed. In fact, it might well prove to be the single most competitive market in the country.

In addition, the SEC might also wish to include in such a list anyone who wished to be included in it. If someone considers himself "able to fend for himself," who is the SEC to say him nay?