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The Intrastate Exemption: Public Offerings and the Issue Concept

Sidney Sosin

INTRODUCTION

On July 12, 1961, the Securities and Exchange Commission issued Securities Act Release 4386¹ thereby casting doubt on the availability of the so-called "intrastate exemption" under the Securities Act of 1933² as to certain underwritten securities offerings, particularly those popular in Minnesota. Release 4386, the first general interpretative pronouncement by the Commission on section 3(a)(11) of the Securities Act since 1937, quickly became known as the "Minnesota Release." It was promptly followed by Release 4434³ which set forth a more comprehensive discussion of the elements and limitations of what appears to be at first glance a comparatively simple, straightforward statutory provision.

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However, practitioners of the black art of securities law have long recognized that practically nothing in the Securities Act is what it seems to be. The act is a deceptively simple statute with little case law upon which to rely, and many unforeseen hazards lurking in the interpretive shadows of the SEC. The intrastate exemption is no exception.

THE INTRASTATE EXEMPTION

Section 3(a)(11) provides an exemption from the registration and prospectus requirements of the Securities Act.

Any security which is a part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such

1. (July 12, 1961), CCH FED. SEC. L. REP. § 76,774 (1957-61 Transfer Binder).

2. 48 Stat. 75 (1933), as amended, 15 U.S.C. § 77c(a)(11) (1958). [The Securities Act of 1933, 15 U.S.C. § 77a-aa (1958) is hereinafter referred to as the Securities Act. The Securities and Exchange Commission will be referred to as the SEC or Commission.] Copies of the releases cited may be obtained free of charge from the public reference sections in the Washington or regional offices of the Commission.

3. SEC Securities Act Release No. 4434 (Dec. 6, 1961), 17 C.F.R. § 231.4434 (rev. ed. 1964).

security is a person resident and doing business within, or, if a corporation, incorporated by and doing business within, such State or Territory.⁴

It is clear from this language that in order to qualify for such an exemption the entire issue of securities must be offered and sold only to bona fide residents of the state where the issuer is resident or incorporated and conducts business operations. The legislative history⁵ of the Securities Act supports such a conclusion, and the SEC has consistently pointed this out⁶ in strictly construing section 3(a)(11). However, a number of promoters, just as consistently, continue to regard section 3(a)(11) as the "substantially intrastate" exemption, feeling that a few non-residents in a group of several hundred investors should be overlooked, possibly as a *de minimus* proposition. But, in 1958, a district court emphasized in *SEC v. Hillsborough Inv. Corp.*⁷ that the sale of only one share of an exempted security to a non-resident would destroy the exemption for the entire issue.

Related Problems

The principal problems under the intrastate exemption result from attempting to answer the following questions:

1. When is the distribution of a securities issue completed to the extent that the entire issue can be said to have "come to rest" in the hands of resident investors, allowing subsequent resales to non-residents to be considered as ordinary trading transactions?
2. Under what circumstances may two or more offerings of securities, simultaneous or separate in time, be deemed to be parts of a single issue?
3. When is a person resident within a state?
4. What amount or character of business operations within a state is sufficient?

This article is limited to the first two problems. They are of particular significance in broad public offerings of securities made without registration in reliance upon the intrastate exemption.⁸

4. 48 Stat. 75 (1933), as amended, 15 U.S.C. § 77c (1958).

5. H.R. REP. NO. 85, 73d Cong., 1st Sess. (1933).

6. SEC Securities Act Release No. 1459 (May 29, 1937), 17 C.F.R. § 231.1459 (rev. ed. 1964); SEC Securities Act Release No. 4434, (Dec. 6, 1964), 17 C.F.R. § 231.4434 (rev. ed. 1964); Professional Investors, Inc., 37 S.E.C. 173, 175 (1956); Petersen Engine Co., 2 S.E.C. 893, 903 (1937).

7. 173 F. Supp. 86 (D.N.H. 1958), *permanent injunction granted*, 176 F. Supp. 789 (D. N.H. 1959), *aff'd without consideration of the point*, 276 F.2d 665 (1st Cir. 1960).

8. For discussions of the remaining questions, see 1 LOSS, SECURITIES REGULATION 598-601 (2d ed. 1961); McCauley, *Intrastate Securities Transactions under the Federal Securities Act*, 107 U. PA. L. REV. 937 (1959). Basically, the Commission equates "residence" with "domicil," thus creating problems with respect to transient residents such as military personnel. Some issuers require submission of a voter's card or driver's license at the time of subscription. Although an issuer's business operations need not be confined to the state of incorporation, they

Offering size.—The SEC has, for many years, attempted to discourage the use of the exemption in broad public distributions. The view of the Commission appears to be that section 3(a)(11) contemplates only a “semi-private” offering — that underwritten and other widespread offerings do not fit within the restrictive confines of the exemption. In Release 4434, it was stated that an offering “may be so large that its success as a local offering appears doubtful from the outset,” and that section 3(a)(11) “can exempt only issues which in reality represent local financing by local industries as well as being carried out through local investment.”⁹ A former Chairman of the Commission depicted the exemption in the case of substantial offerings as being “loaded with dynamite.”¹⁰ Another commentator described it as affording, in all but the simplest cases, “more an opportunity for trouble than relief.”¹¹ The *Special Study* stated that the exemption “is typically available for the offering by a small businessman of a limited amount of securities to his friends, relatives, business associates, and others.”¹²

Many sizeable offerings have, however, been sold and continue to be sold under the exemption, both through underwriters and by issuers. The Special Study noted that, notwithstanding the general exclusory rule of the editors of financial manuals, one manual alone listed at least ninety offerings during 1961, all apparently made pursuant to the intrastate exemption. Fifteen of the ninety offerings were for amounts of at least \$1,000,000, and an equal number were in amounts ranging from \$500,000 to \$1,000,000.¹³ It is in such offerings that the question of distribution versus trading is of vital significance, not only to the issuer, but to underwriters and dealers alike.

must be substantial. See *SEC v. Truckee Showboat, Inc.*, 157 F. Supp. 824 (S.D. Cal. 1957); SEC Securities Act Release No. 4434 (Dec. 6, 1941), 17 C.F.R. § 231.4434 (rev. ed. 1964).

9. Such a view would appear inconsistent with the Commission's position, expressed in Release No. 4434, *ibid.*, that a secondary offering by a controlling person in the issuer's state of incorporation may be made in reliance upon section 3(a)(11), provided that the exemption would be available to the issuer for a primary offering in such state and irrespective of the residence of the controlling person. A secondary offering is usually solely for the benefit of the controlling person and certainly does not represent financing by local industry. Moreover, it is difficult to see how a secondary offering can constitute an issue, since the controlling person is only an issuer for purposes of defining an underwriter in section 2(11). A literal reading of the exemption would seem to require the secondary offering to be part of an original *prior* issue which was in fact exempt under section 3(a)(11). Such an interpretation, however, would lend substance to consideration of the section as a true securities exemption rather than as a transaction exemption. See note 38 *supra* and accompanying text. In any event, this is the only facet of the exemption liberally construed by the Commission.

10. Gadsby, *The SEC and the Financing of Small Businesses*, 14 BUS. LAW. 144, 148 (1958).

11. Garrett, *Federal Securities Act — An Introduction to Jurisdiction*, 1961 U. ILL. L. F. 267, 284.

12. Securities and Exchange Commission, *Report of Special Study of Securities Market*, H.R. Doc. No. 95, pt. 1, 88th Cong., 1st Sess. 570-71 (1963).

13. *Id.* at 573.

Background of problem.—The historical background of the Minnesota release¹⁴ is helpful in understanding the problem raised by these large intrastate offerings, as well as comprehending the serious concern of the SEC. Its genesis is traceable to the emergence of the Minneapolis-St. Paul area as an electronics and aerospace research and development center, and in particular to the success story of the Control Data Corporation located in that area. As the story is told,¹⁵ Control Data Corporation was formed in 1957 under the laws of Minnesota by a group of scientists and engineers. These men had been formerly in the employ of the Sperry Rand Corporation and had taken with them some excellent ideas in the field of computer technology. However, they were without sufficient funds necessary to put the ideas into operation. Consequently, the company offered and sold 600,000 shares of common stock at \$1.00 per share through its officers and directors acting as salesmen without commission. The offering was limited to Minnesota residents in reliance upon the intrastate exemption. Thereafter, a local over-the-counter market arose, and by the end of 1957 Control Data stock had tripled in price. In 1958, its shares hit a high of \$10.00; in 1959, \$33.75; and in 1960, \$69.50. At the present time, the company is listed on the New York Stock Exchange and its shares have sold as high as \$340.¹⁶

The aftermath.—From this overwhelming demonstration of market performance, "get-rich-quickitis" fever struck and quickly spread throughout the Twin City area. A rash of stock offerings appeared on behalf of new companies engaged or, more often, hoping to engage, in some glamorous-sounding technological pursuit. All were "best efforts" underwritings through local dealers who, in some cases, had been as recently and hastily formed as their issuer clients. For the most part, the offerings were limited to Minnesota residents in order to avoid the necessity of SEC registration. Curiously, each was priced at \$1.00 per share plus a 15 cent commission to the dealer, as though to do otherwise might break the charm.

The local investing public, looking for another Control Data, pounced upon each new issue enthusiastically. The sheer weight of demand, possibly assisted by a few judicious placements to insiders and dealer personnel,¹⁷ thrust "aftermarket" prices upward. Within the

14. SEC Securities Act Release No. 4386 (July 12, 1961), CCH FED. SEC L. REP. ¶ 76,774 (1957-61 Transfer Binder).

15. As the brokerage houses are fond of stating, this story was obtained from sources deemed reliable, but its accuracy cannot be guaranteed.

16. All figures are prior to adjustment for a three to one split.

17. This procedure is known as free-riding and is frowned upon with respect to dealers and their personnel by the National Association of Securities Dealers, which interprets it as a violation of its own rules of fair practice. See, e.g., *Interpretation With Respect to Free Riding and Withholding*, MANUAL REPRINT G-23-26 (July, 1963); SEC Securities Act Release

first days, and even within hours and minutes after release of the issues, immediate growth was evident. This phenomenon was intensified by the local practice of obtaining "indications of interest" from investors prior to the effective date of the state registration. These indications of interest were, in practice, a presale of the offered securities.

The cumulative effect of the Twin City "new issue market" boom became known to speculators in other states, who then placed buy orders with their local brokers for the "aftermarket" trading, resulting in interstate resales being made by Minnesota residents to non-residents. This occurred almost before the ink was dry on the prospectus which, it is interesting to note, almost always carefully stated that offers and sales were limited to bona fide residents who would acquire the securities for investment purposes, or in Commission parlance, before the securities "came to rest."

Coming to Rest Concept

In pointing up this situation, the Minnesota release was not blazing a new trail. The "coming to rest" theory was initially formulated in Release 201 issued July 30, 1934, by the Federal Trade Commission.¹⁸ Release 201 stated, in part:

The Commission pointed out that in order that the exemption of Section 3(a)(11) may be available for securities of any issue, it is clearly required that *the securities at the time of completion of ultimate distribution shall be found only in the hands of investors resident within the State.* Ultimate distribution, in the opinion of the Commission, was declared to consist not only in the delivery of the bonds from the issuer to the underwriters, and the delivery of the bonds from the underwriters to subunderwriters and to dealers, but also in the disposition of the bonds in the hands of investors in any secondary distribution which might take place pursuant to arrangements by the issuer or underwriters.¹⁹

Release 201 specifically related to an \$8,000,000 issue of Brooklyn-Manhattan Transit Corporation fifteen year sinking fund bonds which was sold to underwriting houses resident in New York State. Subsequently, the SEC held, in a formal opinion,²⁰ that the exemption was not available to BMT. There it was stated that the sales of securities of an issue to be taken into account in making such determination were the sales in connection with the distribution to the public. The Commission

No. 4150 (Oct. 23, 1959), CCH FED. SEC. L. REP. § 76,671 (1957-61 Transfer Binder); First California Co., 40 S.E.C. 768, 770-72 (1961).

18. The Federal Trade Commission administered the Securities Act prior to the creation of the SEC.

19. SEC Securities Act Release No. 201 (July 30, 1934), 17 C.F.R. § 231.201 (rev. ed. 1964). (Emphasis added.)

20. Brooklyn Manhattan Transit Corp., 1 S.E.C. 147 (1935).

also observed that the point at which a distribution to the public is completed is a question of fact to be determined in light of all the circumstances of the offering. However, the Commission suggested that a rebuttable presumption should be adopted to the effect that sales by a dealer within one year of a public offering are sales in the course of distribution.²¹ In an earlier Release²² involving section 5(c) of the Securities Act, the substance of which became section 3(a)(11) in the 1934 amendments to the Securities Act, the FTC had stated:

The conditions which must be met in order to secure the exemption . . . relate only to the original issue of the securities. The fact, therefore, that residents of the state subsequently resell to persons outside of the state does not have the effect of destroying this exemption. Of course, the conditions must be met in substance as well as in form. Sales cannot be made by the corporation to residents with a view to their distribution in other jurisdictions. If later, however, the purchaser resells outside of the state, the corporation will not be liable, as has been indicated, and the purchaser himself will not violate the Act in view of the exemption provided in the first clause of Section 4(1).²³

Any possible conflict between this Release and the BMT situation was resolved, or at least clarified, in Securities Act Release 1459²⁴ issued in 1937. After discussing the requirement that an entire issue of securities be sold to residents, and referring to the *BMT* case, the Release stated:

From these general principles it follows that if during the course of distribution any underwriter, any distributing dealer (whether or not a member of the formal selling or distributing group), or any dealer or other person purchasing securities from a distributing dealer for resale were to sell such securities to a non-resident, the exemption would be defeated. Moreover, since under Section 3(a)(11) the exemption is applicable only if the *entire issue* is distributed under the circumstances specified, any such sales to a non-resident in connection with the distribution of the new issue would destroy the exemption as to all securities which are a part of that issue. This is true regardless of whether such sales are made directly to non-residents or directly through residents who purchased with a view to resale and thereafter sold to non-residents; and it would furthermore be immaterial that the sales might be made without use of the mails or instruments of interstate commerce, or by persons themselves exempt from the registration and

21. The presumption was suggested by analogy to the one-year period then contained in the dealer's exemption afforded by the third clause of section 4(1) of the Securities Act, discussed in notes 34 and 35 *infra* and accompanying text.

22. SEC Securities Act Release No. 97, pt. 11 (Dec. 28, 1933), 17 C.F.R. § 231.97 (rev. ed. 1964).

23. *Ibid.* This clause exempts transactions by persons other than issuers, underwriters or dealers. The language of the Release implies the conclusion that such purchasers will not be underwriters for the issuer in that they have not purchased with a view toward distribution within the definition in section 2(11) of the Securities Act.

24. SEC Securities Act Release No. 1459 (May 29, 1937), 17 C.F.R. § 231.1459 (rev. ed. 1964) (opinion of the General Counsel of the Commission). See also Throop & Lane, *Some Problems of Exemption under the Securities Act of 1933*, 4 LAW & CONTEMP. PROB. 89 (1937).

prospectus requirements, and might therefore, as isolated transactions, involve no violation of the Securities Act.²⁵ Any such sales to non-residents, however few, and even though legal in themselves, would preclude compliance with the conditions of Section 3(a)(11), and would render the exemption unavailable for that portion of the issue sold to residents through use of the mails.

On the other hand, securities which have actually come to rest in the hands of resident investors—persons purchasing for investment and not with a view to further distribution or for purposes of resale—may be resold by such persons, whether directly or through dealers or brokers, to non-residents without in any way affecting the exemption of the issue. The relevance of any such resales to the existence or non-existence of the exemption would consist only in the evidentiary light which such resales might cast upon the question whether the securities had in fact come to rest in the hands of resident investors. If the securities were resold but a short time after their acquisition, this fact, although not conclusive, would strengthen the inference that their original purchase had not been for investment, and that the resale therefore constituted a part of the process of primary distribution; and a similar inference would naturally be created if the seller were a security dealer rather than a non-professional.²⁶

As previously noted, the Commission's next general pronouncement on the exemption was not made until the 1961 Minnesota Release²⁷ which contained the following language.

If any person, whether or not a professional underwriter or dealer, purchases the securities offered with a view to resale and does, in fact, resell them to non-residents, such person may be a statutory underwriter engaged in transactions forming a part of the distribution to investors. Where, as a result of such a chain of transactions, the process of distribution is not completed prior to the time the securities are acquired by non-residents, the exemption is not available to the issuer or to any person participating in the distribution.²⁸

This rather strict posture adopted by the Commission was mitigated in Release 4434,²⁹ issued less than five months later, where, in substantially restating the quoted section of Release 1459, it was said:

This is not to suggest, however, that securities which have actually come to rest in the hands of resident investors, such as persons purchasing *without a view to further distribution or resale to non-residents*, may not in due course be resold by such persons, whether directly or through dealers or brokers, to non-residents without in any way affecting the exemption.³⁰

25. What is actually meant here is that such persons would fall within the transaction exemption of section 4(1), mentioned in note 23 *supra*. The Securities Act in contrast to some state blue sky laws has no exemption for "isolated transactions," as such.

26. SEC Securities Act Release No. 1459 (May 29, 1937), 17 C.F.R. § 231.1459 (rev. ed. 1964). (Emphasis added.)

27. SEC Securities Act Release No. 4386 (July 12, 1961), CCH FED. SEC. L. REP. § 76,774 (1957-61 Transfer Binder).

28. *Ibid.*

29. SEC Securities Act Release No. 4434 (Dec. 6, 1961), 17 C.F.R. § 231.4434 (rev. ed. 1964).

30. *Ibid.* (Emphasis added.)

Resale to non-residents.—The phrase “without a view to further distribution or resale to non-residents” marks a significant departure from the position taken in Releases 1459 and 4386. There is no reference to purchasing for “investment,” and more importantly the words “further distribution or resale” are for the first time modified by the words “to non-residents.” The terms “holding for investment” and “view to further distribution” have acquired a much more complex and mysterious connotation for the securities lawyer since those relatively peaceful days of 1937, due to their association with the perils and pitfalls of the private offering exemption.³¹

Eventual resale.—From the new language of Release 4434, it may be inferred that although an investor may purchase with a view to future resale,³² he may nevertheless at some time resell to non-residents so long as such a resale was not originally intended. This provides no panacea, however, since the burden of proving the availability of an exemption always rests upon the claimant,³³ and short term resales would appear to cast the same evidentiary light as before. Nevertheless, it is important since neither an underwritten issue nor any other truly public offering of securities ever really “comes to rest” — and if it does, the underwriter has not properly carried out his function of continuing sponsorship and market-making. In most cases, an underwriter will attempt to place an offering as widely as possible, in addition to having a definite interest in after-market trading. This is no less true in the case of a public intrastate issue. In any public offering, there are a number of investors who will sell, by plan or circumstance, the same day they purchase, or soon thereafter. However, this depends in great measure upon the market action, or lack thereof, as to the particular security in question. In making resales, such investors are not concerned with geography, for in most instances the securities are sold to the same broker from whom the

31. See 1 LOSS, *op. cit. supra* note 8, at 653-96; Orrick, *Non-Public Offerings of Corporate Securities — Limitations on the Exemption under the Federal Securities Act*, 21 U. PITT. L. REV. 1 (1959); Victor & Bedrick, *Private Offering: Hazards for the Unwary*, 45 VA. L. REV. 869 (1959).

32. It is suggested that very few investors truly possess that ideal mental attitude required in “taking for investment purposes only.” Garrett, *Federal Securities Act — An Introduction to Jurisdiction*, 1961 U. ILL. L.F. 267, 293 n.85, presents an amusing and devastatingly accurate colloquy between counsel and client concerning the precise state of mind required for a valid investment representation.

The lawyer begins by saying that he must take for investment purposes, not for resale. And the dialogue runs: “Does that mean I can’t ever sell it?” “No.” “When, then?” “Only later when your reselling is consistent with your present investment intent.” “In 6 months?” “No.” “How long?” “Theoretically tomorrow if there is some change in circumstances — but don’t you dare try it!” “What is a change in circumstances?” “Something basic and unforeseen.” “Like needing the cash for a trip around the world?” “Do you expect to take a trip around the world?” And so on, ad infinitum.

33. SEC v. Ralston Purina Co., 346 U.S. 119, 129 (1953); SEC v. Hillsborough Inv. Corp., 173 F. Supp. 86, 88 (D.N.H. 1958); 1 LOSS, *op. cit. supra* note 8, at 712.

original purchase was made. However, state lines are generally crossed in the wholesale over-the-counter market between dealers. Controlling this market would therefore go a long way toward assuring compliance with the intrastate exemption.

Generally, all dealer transactions on a principal basis, both in registered and unregistered securities,³⁴ are made in reliance on a combination of two exemptive provisions in section 4(1) of the Securities Act. The first clause of this section covers transactions by a person other than an issuer, underwriter, or dealer. The third clause, which is a complicated piece of draftsmanship, in effect exempts all principal trading transactions by dealers, except those taking place during the first forty days after the commencement of a public offering and those involving an unsold allotment of or subscription for part of the distribution itself.³⁵ The third clause applies to both registered and unregistered securities; in fact, Professor Loss states that the specific alternate treatment was intentional in order that dealers might begin lawful trading after the requisite period in securities which had originally been illegally offered to the public.³⁶ Professor Loss also comments that, although the alternate phrasing is not limited in so many words to transactions following illegal public offerings, "the language in question could serve no other purpose, and

34. In addition to making unlawful the offer or sale of unregistered securities, section 5 of the Securities Act also requires the delivery of a statutory prospectus in connection with the sale of registered securities. Therefore, dealers must comply with the prospectus provision in trading transactions unless such transactions are exempt under section 4(1). Section 4(2) exempts agency transactions by brokers provided there is no solicitation of a buy order.

35. The syntax of the exemption has been clarified in the Securities Acts Amendments of 1964, Pub. L. No. 88-467, 88th Cong., 2d Sess. (Aug. 20, 1964). As amended, the clause presently reads as follows:

(3) transactions by a dealer (including an underwriter no longer acting as an underwriter in respect of the security involved in such transaction), except —

(A) transactions taking place prior to the expiration of forty days after the first date upon which the security was bona fide offered to the public by the issuer or by or through an underwriter,

(B) transactions in a security as to which a registration statement has been filed taking place prior to the expiration of forty days after the effective date of such registration statement or prior to the expiration of forty days after the first date upon which the security was bona fide offered to the public by the issuer or by or through an underwriter after such effective date, whichever is later (excluding in the computation of such forty days any time during which a stop order issued under section 8 is in effect as to the security), or such shorter period as the Commission may specify by rules and regulations or order, and

(C) transactions as to securities constituting the whole or a part of an unsold allotment to or subscription by such dealer as a participant in the distribution of such securities by the issuer or by or through an underwriter.

With respect to transactions referred to in Clause (B), if securities of the issuer have not previously been sold pursuant to an earlier effective registration statement the applicable period, instead of forty days, shall be ninety days, or such shorter period as the Commission may specify by rules and regulations or order.

36. 1 LOSS, *op. cit. supra* note 8, at 257.

the legislative history makes it clear that the purpose was as here described."³⁷

Effect on dealers.—Despite its position in the exempt securities section of the Securities Act, section 3(a)(11) is viewed as exempting a transaction.³⁸ If this view is correct, a dealer effecting interstate sales of securities distributed intrastate is in violation of the act even though he did not participate in, or have knowledge of, the original distribution. However, the rationale behind shifting the intrastate exemption from section 5(c) to section 3 appears to have been a deliberate effort to avoid or prevent such a situation.³⁹ The Commission's view has necessarily remained constant since 1934 in that dealers who may not be deemed underwriters can begin trading immediately where the intrastate exemption is available.⁴⁰ This raises a vital caveat for dealers: if for any reason the exemption is not available, there is no exemption for principal transactions by dealers during the forty day period following the commencement of the public offering. Consequently, all purchasers during this period could take advantage of the rescission provisions of section 12(1).⁴¹ This is true whether such transactions be interstate or intrastate, and whether the dealer is an underwriter.

Until 1954, the excepted period in the dealers' exemption was one year. However, it was subsequently reduced to forty days because the longer period was deemed unrealistic, particularly with respect to registered securities where dealers found themselves unable to obtain a prospectus for transmission to purchasers.⁴² As previously noted, the Commission suggested in the *BMT* situation that the one year period provided for in section 4(1) be adopted as a period in which a rebuttable presumption would exist for purposes of determining whether an issue was sold only to residents of a single state. Nonetheless, the Commission has never shown, to the author's knowledge, any inclination to substitute a forty-day rebuttable presumption period.

The new limitation period.—The recent Securities Act Amendments

37. *Id.* at 257, n.228.

38. *Id.* at 709; SEC Securities Act Release No. 4434 (Dec. 6, 1961), 17 C.F.R. § 231.4434 (rev. ed. 1964).

39. H.R. REP. NO. 1838, 73d Cong., 2d Sess. 40 (1934).

40. SEC Securities Act Release No. 97, pt. 7 (Dec. 28, 1933), 17 C.F.R. § 231.97 (rev. ed. 1964), issued by the FTC prior to the creation of the SEC, took this position and the 1934 shift of sections was a codification of that view.

41. Assuming, of course, that they could prove use of the mails or facilities of interstate commerce in the sales to them. Throughout this article, the required use of jurisdictional means has been largely ignored, because of the practical impossibility of avoiding such jurisdiction in the type of offerings under discussion. Dealers registered under the Securities Exchange Act of 1934 also would face the possibility of disciplinary action by the Commission.

42. H.R. REP. NO. 1542, 83d Cong., 2d Sess. 14 (1954).

of 1964⁴³ provides for a new ninety-day period in the dealers' exemption. This amendment is applicable to securities of issuers selling to the public for the first time through a registration statement. Conceivably, the Commission might now be more receptive to revising the rebuttable presumption by analogy to conform to the lengthened time period. It should be noted, however, that the presumption militates against the availability of the exemption. Nevertheless, issuers and underwriters would naturally convert the presumption into a positive implication that transactions taking place subsequent to the period constitute trading, rather than distribution. The likelihood of such a reversal may explain the Commission's reluctance to analogize the rebuttable presumption to the lengthened time period. Nevertheless, its adoption would also add a slight amount of certainty to a perilous and confusing situation.

Distribution and trading.—The difficulty in discerning the thin line between distribution and trading results in issuers relying on the intra-state exemption in public offerings being held at the mercy of dealers, their salesmen, and anyone else who might qualify within the statutory definition of an underwriter. Consistent with this appraisal, Professor Loss finds it "difficult to believe that Congress intended to make the issuer an absolute insurer of every offeree's residence (or, worse, his *animus manendi*) and of every salesman's integrity." He stated:

Unless the standard is one of due care — which includes reasonable supervision of all selling agents and may well require something more than an automatic acceptance of the buyer's representation — the exemption is virtually read out of the statute. Perhaps it should be. But that presumably is why Congress sits. Meanwhile, although it is usually impracticable to litigate with the Commission when an issuer is primarily interested in completing its financing,^[44] a seller against whom a claim is made for rescission or damages under §12(1) would be well advised to defend if he thinks he used reasonable care.⁴⁵

Professor Loss' advice respecting the defense of civil actions is especially appropriate, for example, in a claim against an issuer which is based on resales by resident investors or dealers having no connection with the issuer or the original distribution.

Since the connotation of the terms "taking for resale" and "holding for investment"⁴⁶ has, in connection with the private offering exemption, attained metaphysical proportions, the problem has been unduly magni-

43. Securities Acts Amendments of 1964, Pub. L. No. 88-467, 88th Cong., 2d Sess. (Aug. 20, 1964).

44. Professor Loss is referring to a situation where the issuer has filed a registration statement and the staff of the Commission takes the position that a prior intrastate offering was not exempt, insisting that appropriate disclosure of the contingent liability and, possibly, an offer of rescission be made. See note 41 *infra* and accompanying text.

45. 1 LOSS, *op. cit. supra* note 8, at 604-05.

46. See note 32 *supra* and accompanying text.

fied by semantics. Both Release 97 and the expressed legislative purpose as to the transfer of the intrastate exemption from section 5 to section 3 of the Securities Act, as amended, seem to contemplate public offerings and aftermarket trading. Enforcement action by the Commission in the courts has been limited almost wholly to cases where "dummy" residents have been used as conduits for distribution to non-residents.⁴⁷ It would seem that despite the sweeping language of the Commission releases, it is necessary, in order to charge an issuer with a violation, that a resale to a non-resident be accomplished by a person who is an underwriter as defined in section 2(11) of the Securities Act; or in the alternative, there must be some arrangement with the issuer or an underwriter approaching a conspiracy or subterfuge. It is further submitted, for example, that a public purchaser of 100 shares out of 300,000 shares involved in an issue is not an underwriter merely because he takes the stock with the intention of a short term resale.⁴⁸ "Resale," in the author's opinion, is not synonymous with "distribution," as the latter term is used in section 2(11). Distribution should connote a quantity of securities large enough to require a selling effort, or at least involve division among several purchasers. It would seem that a more reasonable distinction should be whether a purchaser is acquiring securities in good faith for his own account, regardless of his mental attitude toward long-term investing or speculation for short-term gain. Nevertheless, in the absence of judicial interpretation and in the light of the strict views of the Commission,⁴⁹ securities practitioners would be well advised to counsel issuer clients contemplating a public intrastate distribution of the perilous possibilities of an insurer's liability.

47. See *SEC v. Hillsborough Inv. Corp.*, 173 F. Supp. 86 (D.N.H. 1959); *United States v. Meade*, CCH FED. SEC. L. REP. § 90,951 (1957-61 Transfer Binder) (S.D. Ind. 1959).

48. Otherwise, such a purchaser of registered securities should also be an underwriter resulting in a ludicrous situation whereby a statutory prospectus describing his underwriting "arrangement" would have to be transmitted to the person buying from him.

49. The rigorous application of these views is illustrated by the *Whitehall Corporation* opinion, SEC Securities Exchange Act Release No. 5667 (April 2, 1958), 38 S.E.C. 259, CCH FED. SEC. L. REP. § 76,573 (1957-61 Transfer Binder). The Commission found the intrastate exemption unavailable to an issuer and consequently held that Whitehall had willfully violated the registration provisions of the Securities Act despite the fact that there was no evidence of a single physical offer or sale to a non-resident. Whitehall was a "best efforts underwriter" in a public distribution of stock in an insurance company. The stock was offered and sold on an installment plan under which purchasers paid 25 per cent down and the balance over a maximum of 24 months. Installment purchasers received an assignable interim certificate entitling the registered owner to receive stock in accordance with the installment payments made. The certificate incorporated by reference a subscription agreement which limited the stock offering to residents, but the certificate did not specifically state such limitation. The Commission found that the interim certificates constituted a continuing offering of the underlying stock, not limited by its terms to residents, and, therefore, that Whitehall had not sustained its burden of providing the availability of section 3(a)(11). There was no evidence, apparently, that any non-resident had presented an interim certificate for exchange or even that any attempt had been made to assign a certificate to a non-resident.

The Integration Concept

The concept of "integration" has caused serious and expensive problems for a number of issuers. In application, this term indicates that two or more securities offerings by an issuer, ostensibly separate, may actually be integral parts of a single issue. Under section 3(a)(11),⁵⁰ integration means that a subsequent or prior interstate offering may destroy the exemption for an intrastate offering on the basis that a single securities issue is involved which has not been limited to residents.

Mixed offerings.—Commonly, a company might attempt to raise \$250,000 in reliance upon the available intrastate exemption. The officers and directors feel that they will have no trouble selling the requisite amount of stock to residents within the boundaries of their state, but are over-optimistic. Typically, while the company's need for capital becomes more pressing, the securities offering loses its momentum: the officers and directors have exhausted their collective supply of friends, acquaintances, local suppliers, and customers. In the meantime, offers are received by the company from out-of-state purchasers which are necessarily refused. Ultimately, however, someone suggests that the company file a registration statement, or a "notification" under Regulation A⁵¹ for the unsold portion. At this point, it is learned that the first offer or sale to a non-resident, even though covered by an effective registration statement, or exempt through compliance with the Regulation, will relate back to destroy the exemption for all securities previously sold to residents. Since the entire issue does not meet the residence test, none

50. Integration is also involved in section 3(a)(9) of the Securities Act, which exempts securities exchanged by an issuer with its existing securities holders exclusively without payment of any commission. The word "exclusively" creates the problem. See 1 LOSS, *op. cit. supra* note 8, at 575-80.

Section 4(1) of the Securities Act, in exempting "transactions . . . not involving any public offering, implies an issue concept with its corollary integration questions because of the word 'involving.'" SEC Securities Act Release No. 4552 (Nov. 6, 1962), 17 C.F.R. § 231.4552 (rev. ed. 1964), states that what

may appear to be a separate offering to a properly limited group will not be so considered if it is one of a related series of offerings. A person may not separate parts of a series of related transactions, the sum total of which is really one offering, and claim that a particular part is a non-public transaction.

Under Regulation A, integration questions arise because of the \$300,000 limitation in any twelve month period. See note 51 *infra*.

51. The Regulation is comprised of Rules 251 through 263 of the General Rules and Regulations under the Securities Act, SEC Reg. A, 17 C.F.R. §§ 230.251-263 (rev. ed. 1964). Regulation A is the Commission's general exemption, promulgated under the delegated authority of section 3(b) of the act, and unlike the statutory exemptions, is not automatic. It requires the filing with the appropriate regional office of the Commission of various documents, including an offering circular which in its final form must be distributed to offerees much in the same manner as a statutory prospectus. As presently in effect and interpreted, Regulation A is more like a junior registration statement than an exemption, the chief items of relief being in the less strict civil liability for untrue and misleading statements and in the fact that unaudited financial statements, without detailed schedules, may be used. For a most complete exposition of the Regulation, see Weiss, *Regulation A Under the Securities Act of 1933 — Highways and Byways*, 8 N.Y.L.F. 3 (1962).

of it is exempt under section 3(a)(11). In other words, the intrastate exemption cannot be combined with a registration statement, or with another exemption, where a single issue is involved. This is particularly true with regard to the private offering exemption which has its own integration problems.⁵²

For instance, in the example cited above the company could receive an offer from a single large non-resident supplier to purchase for investment purposes the entire balance of the unsold securities. The company would be unable to accept the offer without a loss of the exemption for the whole issue. The point is that an offering under the intrastate exemption should not be attempted until it is clear that the entire issue will be sold, or that at least abandonment halfway through will not work a hardship on the issuer. Unfortunately, promoters and management are almost always positive that no trouble will be encountered — that the local public is surely awaiting their issue with anticipatory enthusiasm.

In practice, the “notification” under Regulation A or the registration statement is filed to cover not only the unsold balance, but the entire issue. This procedure does not automatically cure a potential violation and such filings cannot take effect retroactively. The company must make an offer of rescission to all prior purchasers explaining the circumstances and admitting its contingent civil liability under section 12(1) of the Securities Act.⁵³ The rationale behind this step is that an offer of rescission is actually an offer to rescind, or to affirm a prior sale. In fact, an affirmation involves a new offer and sale of the security. It is the new offer and sale which is being registered or covered by a “notification.”

Lapse of time between offerings.—A more complex and difficult situation is presented when the issuer completes an *intrastate offering*, and then subsequently makes either a new *interstate offering* in reliance upon the private offering exemption, or files a registration statement or “notification” under Regulation A. The question then arises as to when the two offerings are deemed to be integrated, if at all.

The only case to consider the definition of “issue” from the standpoint of section 3(a)(11) appears to have been *Shaw v. United States*.⁵⁴ In the *Shaw* case, the court rejected a claim by the defendant that shares

52. See note 50 *supra*.

53. This section, among other things, allows a purchaser of a security sold in violation of section 5 to obtain rescission (or damages, if the security has been resold) from the violator. Section 13 provides a short statute of limitations: one year from the violation, or three years from the commencement of the public offering, whichever expires earlier. Presumably, then, if the statute has expired, there should be no contingent liability disclosure required.

54. 131 F.2d 476 (9th Cir. 1942).

issued in payment for mining property comprised a separate issue from other shares apparently sold for cash. The defendant argued that California law required a permit for the former issuance and not the latter. The court held that the term "issue," as used in the intrastate exemption, was not to be determined by state law, but, on the other hand, encompassed "all the shares of common character originally though successively issued by the corporation."⁵⁵ This statement, standing by itself, would seem to equate "issue" with "class" and therefore preclude an issuer, once having chosen the intrastate route, from ever making an interstate offering without destroying the exemption for the initial offering, even though the interstate offering was remote in time and circumstance. Fortunately, there is no authority, judicial or administrative, for such an extreme conclusion.

SEC criteria for integration.—For a number of years, the SEC staff has used five criteria in determining whether two or more offerings should be integrated into a single issue. In Release 4434, the following criteria were officially adopted.

- (1) Are the offerings part of a single plan of financing;
- (2) Do the offerings involve issuance of the same class of security;
- (3) Are the offerings made at or about the same time;
- (4) Is the same type of consideration to be received; and
- (5) Are the offerings made for the same general purpose?

The Commission stated that any one or more of the foregoing factors might be dispositive of the question of integration.

It would seem that items (2) through (5) are in reality detailed statements of item (1). It is difficult to conceive of a situation where an issuer could claim that no single plan of financing was involved when the remaining factors are positive.⁵⁶ Further, it would appear that in order to avoid integration the issuer must prove a negative answer to at least two of the criteria, although a lapse of several years between offerings should be conclusive evidence of a separate plan of financing. In any event, lapse of an appreciable period of time will usually result in a change in the business and financial condition of the issuer. Thus, a "different purpose" may be convincingly argued.

With respect to item (2), it is probable that offerings of two substantially different classes of securities, even though simultaneous, would not be integrated. However, the author suggests that it would be much safer if a different purpose could also be shown. In *SEC v. Hillsborough Inv. Corp.*,⁵⁷ the court determined that the intrastate exemption was not avail-

55. *Id.* at 480.

56. It should be noted that the obverse is not true; a different plan of financing can be involved without all the other factors being negative.

57. *SEC v. Hillsborough Inv. Corp.*, 173 F. Supp. 86 (D.N.H. 1958).

able and thereupon entered a preliminary injunction prohibiting the offer or sale, without registration, of the company's Class B and Class C common stock, 6 per cent preferred stock, and 7 per cent registered term notes. At that point, the defendant issuer authorized "new" consolidated common stock and 7 per cent registered term notes, 1959 issue. A portion of these "new" securities were exchanged for securities held by residents and subject to the injunction; the remainder were to be sold to residents for cash. The district court found that the plan constituted "an open and calculated attempt to avoid" the preliminary injunction, and broadened the injunction to include the newly issued securities and entered a permanent decree

The question of whether two types of securities are sufficiently distinct depends upon the rights and preferences afforded to holders, particularly as to voting, dividends, and liquidation preferences. The clearest difference, of course, is between debt and equity securities. However, the *intrastate* offering of common stock and *interstate* offering of convertible debentures or convertible preferred stock is particularly dangerous. Under section 2(3) of the Securities Act, immediately convertible debentures involve a concurrent offering of underlying common; this could be interpreted to be a simultaneous interstate and intrastate offering of the same class. On the other hand, a straight bond or debenture offering made to a small number of institutional investors would appear to differ substantially from an intrastate equity security offering to the public, and hence no question should be raised either under section 3(a)(11) or under the private offering exemption under section 4(1).

Under this criterion, as in the others, the word "substantial" is the key factor. A time difference alone should not be relied upon, unless, as previously indicated, it is so great as to preclude the conclusion that a single plan of financing is involved. The most that can be said with respect to this point is that the issuer had better be able to provide negative answers to the other criteria, especially if the time difference is short. A good guide would appear to be the one-year period of limitation upon actions set forth in section 13 of the Securities Act.

With respect to item (4), the basic types of consideration generally accepted in the sale of securities are cash, property, services, and other securities. Again, it is dangerous to rely upon this criterion itself. When all the other factors are positive, merely selling to one person for cash and to another for property is not enough.⁵⁸ For example, the so-called exchange fund, wherein either cash or securities are accepted as payment for mutual fund shares, has become popular in the past few years. Certainly, the alternate payment does not create two issues in that

58. *Shaw v. United States*, 131 F.2d 476 (9th Cir. 1942).

case. However, this criterion was established primarily to provide a connection with the criterion of a "different purpose." An illustration of this "consideration-purpose" test might occur shortly after an intrastate stock offering for working capital when the issuer discovers an opportunity to acquire for stock a valuable piece of property from several owners, one of which is a non-resident.

The determination under the item (5) criterion involves another question: has there been an unforeseen change in the issuer's business which would indicate that a separate plan of financing is involved? In addition to the acquisition of working capital and the purchase of capital assets, there are many reasons for the issuance of securities. These may include employee incentive plans, mergers, consolidations and re-classifications,⁵⁹ payment of maturing long-term debt, and out-of-court arrangements with trade creditors.

From the foregoing discussion and examples it can be readily observed that there is a considerable interrelation among the criteria. The greater the number of positive answers, the safer the issuer will be in preserving its intrastate exemption.

INVESTMENT COMPANIES

In the first footnote of Release 4434, it is stated that the exemption of section 3(a)(11) "is not available for an investment company registered or required to be registered under the Investment Company Act" of 1940.⁶⁰ Although the Release is correct in its practical application, it is not conceptually accurate. Section 24(d) of the Investment Company Act provides in part as follows:

The exemption provided by paragraph (8) of section 3(a) of the Securities Act of 1933 shall not apply to any security of which an investment company is the issuer. The exemption provided by paragraph (11) of said section 3(a) shall not apply to any security of which a *registered investment company* is the issuer. . . .⁶¹

It is clear from the italicised language that the intrastate exemption is specifically denied only to registered investment companies.

59. Generally, Rule 133, 17 C.F.R. § 230.133 (rev. ed. 1964), under the Securities Act General Rules and Regulations defines such reorganizations, under certain circumstances, as not constituting a sale of securities for the purposes of section 5 of the act. Query: do they involve a sale for the purpose of section 3(a)(11), so as to be integrated with a cash intrastate offering, assuming all integration factors other than type of consideration to be positive? The writer suspects that the Commission would say "yes," on the basis of the statement in Release 4434 that the intrastate exemption

should not be relied upon for each of a series of corporations organized in different states where there is in fact and purpose a single business enterprise or financial venture whether or not it is planned to merge or consolidate the various corporations at a later date.

60. 54 Stat. 789 (1940), 15 U.S.C. § 80a (1958).

61. 54 Stat. 808 (1940), 15 U.S.C. § 80a-12 (1958) (Emphasis added.)

The term "investment company" is defined in section 3 of the Investment Company Act. This long and complex section begins with an extremely broad and sweeping general definition, followed by a series of specific exceptions. A detailed consideration of the definition is beyond the scope of this article; however, an idea of its breadth can be gleaned from section 3(a)(3) which encompasses any issuer that

is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis.⁶²

It should be noted that holding companies are included in this provision, unless they fall within one of the fifteen enumerated exceptions.

Section 6 of the Investment Company Act also provides for a number of exemptions from its coverage, in addition to delegating further exemptive powers to the Commission. Section 6(d) grants the Commission power to exempt small, intrastate, closed-end investment companies⁶³ whose total capital will not exceed \$100,000. However, the intrastate exemption in the Investment Company Act is not automatic and may be partial, total, or subject to conditions precedent.⁶⁴

Unless it is excepted from the definition in section 3, or exempted pursuant to section 6, section 7 of the Investment Company Act, among other things, prohibits any investment company from offering, selling or delivering after sale, through jurisdictional means, any security or interest therein, whether issued by the investment company or another person; from purchasing, redeeming, or otherwise acquiring, through jurisdictional means, any security, by whomsoever issued; from controlling any investment company doing any of the foregoing; and from engaging in any business in interstate commerce or controlling any company so engaged. Section 7 also prohibits a promoter and an underwriter for a promoter of a proposed investment company from making a public offering of preorganization subscriptions for such a company.

It is not difficult to see that the prohibitions of section 7 of the Investment Company Act are much more stringent than those of section 5 of the Securities Act. Further, section 47(b) of the Investment Company Act voids every contract made or performed in violation of any provision of that act. Therefore, a non-excepted, non-exempt investment company making a public intrastate offering can take little solace from the fact that section 3(a)(11) of the Securities Act is technically available — it has leaped from the frying pan into a blast furnace.

62. 54 Stat. 797 (1940), 15 U.S.C. § 80a-3 (1958).

63. A closed-end company is one which does not offer or have outstanding any security redeemable by its holder upon presentation.

64. 54 Stat. 800 (1940), 15 U.S.C. § 80a-6 (1958).

IMPACT OF THE 1964 AMENDMENTS

This year the Congress passed and the President signed into law the most comprehensive changes in the Securities Exchange Act of 1934⁶⁵ since its enactment. The new law will have a substantial impact upon issuers which have utilized the intrastate exemption of the Securities Act in order to "go public."

Basically, the amendments will impose upon the larger companies having securities traded in the over-the-counter market, filing and reporting duties comparable to those applicable to companies having securities listed on a national securities exchange. More specifically, the amendments require that all issuers having at least \$1,000,000 in total assets and 750 record shareholders⁶⁶ must file an initial registration statement⁶⁷ and subsequent reports,⁶⁸ and that such companies must file and furnish to shareholders proxy statements containing specified disclosures.⁶⁹ In addition, the amendments impose upon the officers, directors, and beneficial owners of more than ten percent of the securities so registered the same initial and subsequent ownership reporting duties and arbitrary short-swing profit liabilities as those previously applicable to persons similarly affiliated with listed companies.⁷⁰ Each company

65. Securities Acts Amendments of 1964, Pub. L. No. 88-467, 88th Cong., 2d Sess. (Aug. 20, 1964), and the SEC rules thereunder, amending the Securities Exchange Act of 1934, 48 Stat. 881 (1934), 15 U.S.C. § 78 (1958).

66. Beginning July 1, 1966, the number of stockholders required for application of the new requirements will drop to 500. The amount of assets and number of record holders is determined as of the end of an issuer's fiscal year. Securities Acts Amendments of 1964, Pub. L. No. 88-467, 88th Cong., 2d Sess. (Aug. 20, 1964), and the SEC rules thereunder.

67. Presently, SEC Form 10. The registration statement referred to here is not for the offer and sale of securities, but Form 10 requires disclosure of much the same information concerning the issuer's business operations, financial condition, management and capital structure, as is presently required by Form S-1 for such offer and sale under the Securities Act. The new registration requirements are set forth in section 12(g) of the Securities Exchange Act, as amended, Pub. L. No. 88-467, 88th Cong., 2d Sess. (Aug. 20, 1964), and the SEC rules thereunder.

68. The reports presently required are the annual report on Form 10-K, the semiannual report on Form 9-K, and the current report on Form 8-K. The last mentioned report is only required to be filed upon the happening of certain material events specified in the form. The reporting requirements are set forth in section 13 of the Securities Exchange Act, as amended, Pub. L. No. 88-467, 88th Cong., 2d Sess. (Aug. 20, 1964), and the SEC rules thereunder.

69. The proxy statement requirements are contained in section 14 of the Securities Exchange Act, as amended, Pub. L. No. 88-467, 88th Cong., 2d Sess. (Aug. 20, 1964), and the SEC rules thereunder. Regulation 14 of the General Rules and Regulations under said act presently governs proxy solicitation, and Schedule 14-A sets forth the information required in proxy statements for various stockholder actions. Rule 14a-11 and Schedule 14-B provide special requirements in the case of contested elections for directors.

70. Section 16 of the Securities Exchange Act, as amended, Pub. L. No. 88-467, 88th Cong., 2d Sess. (Aug. 20, 1964), and the SEC rules thereunder. Briefly, this section and the rules thereunder require the specified persons to file initial reports of beneficial ownership of all equity securities of the issuer involved and thereafter to file reports of any changes in such ownership; imposes civil liability against any such person, in favor of the issuer, for any profit made from a purchase and sale, or sale and purchase, of such securities within any calendar period of six months; and prohibits short sales and sales "against the box" by any such person.

having at least \$1,000,000 in assets and at least 750 shareholders is required to file its initial registration statement with the Commission within 120 days after the close of its first fiscal year following July 1, 1964. The date pertains to the close of the fiscal year and not to its commencement so that, theoretically, any company subject to the requirements having a fiscal year ending July 31, 1964, must file on or before November 28, 1964. At this writing, the Commission has not adopted any of the substantial number of rules and forms which will be necessary in order to implement this legislation, even though the amendments became law more than a month and a half following the effective date of July 1. Therefore, it can be expected that a liberal policy will be followed in granting extensions of time.

The new law represents a distinct stumbling block for the issuer which chose the easy road of the intrastate exemption for its public financing in order to avoid the onerous task of filing detailed audited financial statements and other items of full disclosure. There is no real intrastate out; jurisdiction is based on doing business in interstate commerce, doing business affecting interstate commerce, or having securities which are traded in interstate commerce. There are, indeed, few issuers who will today be able to escape the impact of such a broad jurisdictional base.

One of the items of information which must be included in the registration statement under the recent changes requires the disclosure of details regarding any securities issued by the registrant within the past three years, including any claimed exemption. It would not be surprising if the Commission were to also require the filing of any prospectus or other selling literature used in offerings claimed to be exempt under section 3(a)(11) as an exhibit or as supplemental information. In any event, the disclosure itself may provide a fertile field for Commission investigations.

CONCLUSION

It is submitted that the new registration provisions will likely have a substantial deterrent effect upon issuers contemplating sizeable intrastate public offerings. If so, there will be few tears shed at the SEC, for as previously noted, it has long taken a dim view toward reliance on section 3(a)(11) in such distributions. Nonetheless, the intrastate exemption has not been repealed and no doubt will still be used in some large offerings. From the positive side, its principal value to securities lawyers has been and will continue to be a backstop to the private offering exemption in situations where the number of offerees or purchasers, or their lack of sophistication or knowledge makes an attorney hesitant to render

an opinion as to whether the offering is really private in accordance with the tests enunciated in *SEC v. Ralston Purina, Inc.*⁷¹

In proposed public intrastate distributions, the lawyer must necessarily sound like an oracle of doom. If the client, after being fully apprised of the dangers involved, insists on utilizing the exemption, counsel is limited to providing as many safeguards as possible in the subscription agreement, tempering the client's selling enthusiasm as expressed in the prospectus, and fervently keeping his fingers crossed.

71. 346 U.S. 119 (1953).