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A. A. Sommer Jr.

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Mergers, Consolidations, Sales of Assets—Rule 133

A. A. Sommer, Jr.

INTRODUCTION

It may be aptly said that the Securities Act of 1933[1] is a "seamless web," in that to explain or discuss any part of it either presumes some understanding of the entire act, or requires placing the particular section under discussion in context. Moreover, because the act is characterized, and deliberately so, by the presence of several broad and uncertain terms such as "underwriter" and "public offering," any discussion quickly becomes involved with concepts such as "purposes," "meanings in context," "legislative history," "evils sought to be remedied," and other refuges when a statutory text is less than crystalline.

THE AUTHOR (A.B., University of Notre Dame, LL.B., Harvard) is a practicing attorney in Cleveland, Ohio.

Rule 133 is no exception; in fact it may be the very paradigm. It was promulgated by the Securities and Exchange Commission in 1951 to perpetuate a policy adopted in 1934. That policy as first proposed, and Rule 133 as originally adopted, provided in substance that a proposal for merger or consolidation when submitted to the shareholders of a corporation did not constitute an offer or sale of securities to those shareholders within the meaning of "offer to sell," "sale," and related terms. Somewhat later, sales of assets in exchange for securities of another corporation, and reclassifications of securities were accorded similar treatment. Therefore, compliance with the registration and prospectus requirements of the Securities Act was not required.

Prior to the 1959 amendments,[2] Rule 133 was frequently made the subject of clinical diagnosis, harsh controversy, animated defense, and piercing criticism.[3] However, since 1959 the controversy has abated and

1. 48 Stat. 74 (1933), as amended, 15 U.S.C. §§ 77a-77mm [hereinafter referred to as Securities Act]. Securities and Exchange Commission's Rule 133 under the Securities Act of 1933, 17 C.F.R. § 230.133 (rev. ed. 1964) will be hereinafter referred to as Rule 133.

2. See pp. 21-22 *infra.*

3. See Committee on Federal Regulation of Securities of the Section of Corporations, Banking and Business Law of the American Bar Association [hereinafter cited as Committee Report], *Proposed SEC Rule 133 — Comments of Committee on Federal Regulation of Securities*, 14 BUS. LAW. 423 (1959); Cohen, *Rule 133 of the Securities and Exchange Commission*, 14 RECORD OF N.Y.C.B.A. 162 (1959); Orrick, *Registration Problems Under the Federal Securities Act — Resales Following Rule 133 and Exchange Transactions*, 10 HASTINGS L.J. 1 (1958); Purcell, *A Consideration of the No-Sale Theory Under the Securities Act of 1933*, 24 BROOKLYN L. REV. 254 (1958); Sargent, *A Review of the "No-Sale" Theory of Rule 133*, 13 BUS. LAW. 78 (1957); Throop, *In Defense of Rule 133 — A Case for Administrative*

it is reported that the Rule is working satisfactorily in its present form with minimal problems for the Commission. The purpose of this article is to examine Rule 133 as a permanent part — as permanent as such rules ever become — of the statutory scheme which centers around the Securities Act of 1933.

RULE 133 IN THE STATUTORY SCHEME

Prohibitions

Section 5 of the Securities Act of 1933 sets forth the basic prohibitions on the offering and sale of securities in interstate commerce. Thus, it is unlawful to use the mails or any other instrument of interstate commerce to: (1) *sell* a security unless a registration statement is effective with respect to it;[4] (2) *carry* a security for the purpose of *sale* or *delivery after sale* unless a registration statement is effective with respect to it;[5] (3) *carry a prospectus* pertaining to a security as to which a registration statement has been filed, unless it conforms to certain requirements;[6] (4) *carry a security* as to which a registration statement has been filed for sale or delivery after sale, unless accompanied or preceded by a prescribed prospectus;[7] and (5) *offer to sell or buy a security* unless a registration statement has been filed with respect to it.[8] It is difficult to understand these prohibitions without defining such terms as "sale," "offer to sell," and "sell." As a part of the Securities Act, Congress defined these terms as follows: "Sale" includes "every contract of sale or disposition of a security or interest in a security, for value;"[9] "offer to sell," "offer for sale," or "offer" includes "every attempt or offer to dispose of . . . a security or interest in a security, for value."[10]

Exemptions

In addition to the prohibitory sections, the Securities Act also includes certain exemptions from the registration and prospectus requirements.

Self-Restraint, 13 BUS. LAW. 389 (1958); Throop, *Recent Developments With Respect to Rule 133*, 15 BUS. LAW. 119 (1959); Note, *The SEC's No-Sale Rule and Exchanges of Securities Pursuant to Voluntary Reorganization*, 67 HARV. L. REV. 1237 (1954).

4. Section 5(a)(1), 48 Stat. 77 (1933), as amended, 15 U.S.C. § 77e (1958).

5. Section 5(a)(2), 48 Stat. 77 (1933), as amended, 15 U.S.C. § 77e (1958).

6. Section 5(b)(1), 48 Stat. 77 (1933), as amended, 15 U.S.C. § 77e (1958).

7. Section 5(b)(2), 48 Stat. 77 (1933), as amended, 15 U.S.C. § 77e (1958).

8. Section 5(c), 48 Stat. 77 (1933), as amended, 15 U.S.C. § 77e (1958). Prior to 1954 "sale" included offers to sell and the Securities Act contained no provision permitting an offer prior to effectiveness of the registration statement; hence, *offers to sell* were prohibited by the provision forbidding "sales" prior to the effectiveness of the registration statement. The 1954 amendments made lawful certain kinds of offers subsequent to the filing of the registration statement but prior to its effectiveness.

9. 48 Stat. 74 (1933), as amended, 15 U.S.C. § 77 (b)(3) (1958).

10. *Ibid.* This is the present text of § 2(3) of the Securities Act. 48 Stat. 74 (1933), as amended, 15 U.S.C. § 77b (1958). Prior to 1954, the definition of "sale" included an *offer* to sell. See note 8 *supra*. See 1 LOSS, SECURITIES REGULATION 186 (2d ed. 1961).

Thus, specific securities, such as government, bank and savings and loan securities may be offered and sold without compliance with the registration or prospectus requirements regardless of the nature of the transaction in which such securities are involved.[11] Also, certain kinds of security *transactions* are exempt regardless of the nature of the securities involved. For example, exchanges by an issuer of securities with its own security holders are exempt if certain conditions are met.[12] It should be noted, however, that although *any* security may be the subject of an exempt transaction, that exemption is not perpetual in that it forever frees the security from compliance with the registration and prospectus requirements. Another kind of transaction in the same security, or in other securities of the same class, may require some type of registration and use of the required prospectus.

In addition to these express exemptions, the Securities and Exchange Commission has limited and narrowly circumscribed power to fashion additional exemptions. The Securities Act provides that the Commission may

> by its rules and regulations and subject to such terms and conditions as may be prescribed therein, add any class of securities to the securities exempted as provided in [Section 3] if it finds that the enforcement of this [act] with respect to such securities is not necessary in the public interest and the protection of investors by reason of the small amount involved or the limited character of the public offering; but no issue of securities shall be exempted under this subsection where the aggregate amount at which such issue is offered to the public exceeds $300,000.[13]

The Commission also has authority "to make, amend, and rescind such rules and regulations as may be necessary to carry out the provisions of [the act] including rules and regulations . . . defining accounting, technical, and trade terms used in [the act] . . . ."[14] It is this statutory scheme which is the background of the controversy over Rule 133 and its predecessor Commission postures.

ANCESTRY OF RULE 133

Soon after passage of the Securities Act the question arose as to whether the registration and prospectus requirements applied to corporate reorganizations, mergers, consolidations, and exchanges of assets for stock. To some extent, the act itself dealt with these matters. Section 3(a)(9) exempted from the registration and prospectus requirements of the act "any security exchanged by the issuer with its existing security holders exclusively where no commission or other remuneration is paid or given

11. Section 3(a)(2), 48 Stat. 75 (1933), as amended, 15 U.S.C. § 77c (1958).
12. Section 3(a)(9), 48 Stat. 75 (1933), as amended, 15 U.S.C. § 77c (1958).
13. Section 3(b), 48 Stat. 75 (1933), as amended, 15 U.S.C. § 77c(b) (1958).
14. Section 19(a), 48 Stat. 75 (1933), as amended, 15 U.S.C. § 77s (1958).

directly or indirectly for soliciting such exchange . . . ."[15] Also, section 3(a)(10) exempted securities issued in exchange for bona fide outstanding securities and claims or property interests where the terms and conditions of the issuance and exchange are approved by a governmental authority after a hearing.[16] While section 3(a)(9) was confined to *intramural* exchanges, *i.e.,* exchanges within a family of shareholders, section 3(a)(10), although less parochial in permitting exchange of securities of one corporate entity for those of another, laid down narrow confines within which such exchanges were exempt.

Legislative History

The legislative history of the Securities Act referred to reorganizations as follows:

> *Reorganizations carried out without such judicial supervision possess all the dangers implicit in the issuance of new securities and are, therefore, not exempt from the act.* For the same reason the provision [section 3(a)(10)] is not broad enough to include mergers or consolidations of corporations entered into without judicial supervision.[17]

Although one writer has stated that this statement "squint[ed] pretty hard" in the direction of saying that mergers, consolidations, and other kinds of reorganizations are covered by the registration and prospectus requirements of the Securities Act,[18] Commission Chairman Cohen has suggested that this statement merely reflected late consideration of the problem and he therefore doubts its value as a guide.[19] This view is somewhat confirmed by the absence of any mention of this problem in the House of Representatives debate on the Securities Act.[20] However, the Federal Trade Commission which administered the Securities Act during the year prior to the creation of the Securities and Exchange Commission took the apparent hint of Congress and early declared that mergers and consolidations were subject to the registration and prospectus requirements.[21]

Advent of Rule 133

Shortly after the Securities and Exchange Commission assumed responsibility for administering the Securities Act, its first general counsel took the position that a merger did not involve a "sale" and therefore was

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

16. *Ibid.*

17. H.R. REP. NO. 85, 73d Cong., 1st Sess. 16 (1933). (Emphasis added.)

18. 1 LOSS, *op. cit. supra* note 10, at 519.

19. Cohen, *supra* note 3, at 171.

20. Note, *The SEC's No-Sale Rule and Exchanges of Securities Pursuant to Voluntary Reorganization, supra* note 3, at 1242-44 n.41.

21. Sargent, *supra* note 3, at 79.

not subject to the registration and prospectus requirements.[22] This position was formalized in September 1935, when the Commission adopted a Note to Rule 5 of Form E-1.[23] This Note declared that mergers, consolidations, and exchanges of assets for securities, which were not included among the exempt transactions in the Commission's general counsel's opinion,[24] were exempt from the prospectus and registration requirements "where, pursuant to statutory provisions or provisions contained in the certificate of incorporation, there is submitted to the vote of such stockholders a proposal for the transfer of assets of such corporation to another person in consideration of the issuance of securities of such other person, or a plan or agreement for a statutory merger or consolidation, provided the vote of a required favorable majority . . ." would operate to authorize the transaction and bind all stockholders of the corporation except for appraisal rights of dissenters.[25]

Although Form E-1 as well as Rule 5 and the Note were abolished in 1947, the Commission continued to follow the policy expressed in the Note by excluding mergers, consolidations, and sales of assets from the scope of section 5.[26] Then in 1951, the Commission promulgated Rule 133 which formally restated the position of the former Note and, in addition, added to the transactions not within "sale" "reclassifications" of securities. Rule 133 was born as a Commission interpretation of the

22. See SEC Securities Act Release No. 3762 (March 15, 1957), CCH FED. SEC. L. REP. ¶ 76,511 (1957-61 Transfer Binder).

23. SEC Securities Act Release No. 493(C) (Sept. 20, 1935).

24. Sargent, *supra* note 3, at 80. Although there may be uncertainty as to whether there is a "sale" of securities in a merger or consolidation, none exists in case of an exchange of assets of a corporation for stock of another corporation. This is clearly a sale of the securities with the assets constituting the "value" given therefore. Section 2(3), 48 Stat. 74 (1933), as amended, 15 U.S.C. § 77b (1958). The typical "sale of assets" transaction consists generally of the transfer by one corporation of its assets in bulk to another corporation (or the subsidiary of another corporation) which in turn issues to the transferor corporation securities in exchange for the assets, whereupon the transferor corporation liquidates and distributes the securities to its shareholders. This succession of transactions would probably be exempt from the registration and prospectus requirements of the Securities Act even without Rule 133: the transfer of assets in exchange for stock by a corporation would probably be an exempt transaction under § 4(2) of the Securities Act which exempts "transactions by an issuer not involving any public offering. . . ." 48 Stat. 77 (1933), as amended, 15 U.S.C. 77d (1958), as amended, Pub. L. No. 88-467, 88th Cong., 2d Sess. (Aug. 20, 1964), and the subsequent distribution to shareholders in liquidation would not constitute a "sale" under the terms of § 2(3) since there would not be a disposition for value. See 1 LOSS, *op. cit. supra* note 10, at 520 n.195.

25. SEC Securities Act Release No. 493(C), at 3 (Sept. 20, 1935).

26. The Commission continued this policy despite the fact that in 1941 the Chairman had stated to a committee of the House of Representatives that "this, then, is the present situation: The act as it stands is not clear as to whether the registration provisions apply to the types of transactions about which I have been speaking. The Commission has interpreted the act as not applying, and as a result many mergers, consolidations, and reorganizations have been effected without registration. *There can be no doubt that in many instances investors have suffered as a result.*" *Hearings Before the Committee on Interstate and Foreign Commerce on H. R. 4344, 5065, 5832,* 77th Cong., 1st Sess. 845 (1941). (Emphasis added.)

word "sale" and related terms contained in section 2(3), and was presumably made under the Commission's power to "make, amend, and rescind such rules as may be necessary to carry out the provisions of [the act] . . . ."[27] To reflect a change in the Internal Revenue Code, Rule 133 was extended in 1954 to include transfers of assets to a subsidiary in exchange for a parent's stock.[28]

In 1956, the Commission became concerned about the use of this Rule as a device to turn loose in the securities markets substantial amounts of securities without registration or use of a statutory prospectus. As the Chairman of the Commission expressed it the following year:

> It has been extremely disturbing for the Commission to encounter indications of widespread evasion of the anti-fraud provisions (section 17) and evasions of the registration requirements (section 5) of the Securities Act through reliance upon claimed exemptions or statutory constructions where the facts do not meet the statutory tests or the clear statutory intent.[29]

This statement echoed the self-doubt expressed in 1941 when the Commission was concerned with the effect of its Note to Rule 5 of Form E-1. In a report to Congress the Commission stated that "although the mechanism differs from that employed in the ordinary case in which one security is offered to the public in exchange for another, the net result is the same; the stockholder in effect is purchasing a new security and paying for it by turning in his old one."[30]

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27. James C. Sargent (then Commissioner Sargent) has discussed in a provocative fashion whether the enunciation of Rule 133 was an "interpretive" rule, in which case it must be shown that it was "necessary to carry out the provisions of the act" or whether it was a definition, in which case he questions the power of the Commission to define a term expressly defined in the Securities Act by Congress. Sargent, *supra* note 3, at 83-85. See also p. 28 *infra*.

28. The differences between a sale of assets which qualifies as a type "C" reorganization under § 368 of the Internal Revenue Code of 1954 and a sale of assets which qualifies under Rule 133 should be noted. To qualify under § 368 of the Internal Revenue Code substantially all of the assets (with a limited qualification) must be transferred, and the transfer must be solely in consideration for voting stock. Under Rule 133, however, the transfer need not be of substantially all of the assets and it is not necessary that only voting stock be issued. For that matter, it is not even required that the exchange be for stock since any securities may qualify. However, oddly, when Rule 133 was modified in 1954 to recognize the change made in the Internal Revenue Code which made possible a tax-free reorganization in which the assets were transferred to a subsidiary in exchange for a parent's stock, to qualify under Rule 133 it was required, as under § 368 of the Internal Revenue Code, that the parent's securities issued upon transfer of assets to a subsidiary be voting stock. This inconsistency between the securities required when the transfer is made directly to the issuing corporation and when it is made to a subsidiary of the issuing corporation probably reflects nothing more than careless draftsmanship.

29. SEC Securities Act Release No. 3762 (March 15, 1957), CCH FED. SEC. L. REP. ¶ 76,511 (1957-61 Transfer Binder). At this time the Commission estimated that over $100,000,000 in securities had been distributed to the public without registration under the Rule 133 umbrella.

30. S.E.C. REPORT ON PROPOSALS FOR AMENDMENTS TO THE SECURITIES ACT OF 1933 AND THE SECURITIES EXCHANGE ACT OF 1934, 24-25 (1941).

This self-doubt bore fruit in 1956 when the Commission released a proposal to reverse the Rule completely and make mergers, consolidations, sales of assets, and recapitalizations subject to the registration and prospectus requirements of the Securities Act.[31] This proposal, although later abandoned in favor simply of a tightening of the Rule, triggered an intensive reexamination of the whole theory underlying the Rule. Although most segments of the securities bar vigorously defended the existing Rule, the Commission's staff and the Commissioners themselves voiced determined repudiations.[32]

Basis for Rule 133

The Rule and its underlying theory are predicated upon two notions: first, that submission of a proposal for a merger, consolidation, sale of assets for securities, or a reclassification to a corporation's shareholders as a body is different from offering to those shareholders on an individual basis the option of exchanging their securities for others; second, that the consummation of the transaction, once approved, is essentially different from the sale of a security to an individual purchaser. The most comprehensive statement of the Commission's justification of the Rule is contained in its brief in *National Supply Co. v. Leland Stanford Junior University*.

> The essence of the Commission's construction . . . is that in such cases a proposed corporate act is submitted to stockholders as a class, *in their capacity as members of the corporate body*, and that such an act of submission involves no *offer to exchange* with any stockholder as an individual the new securities which may be created as a result of the vote of stockholders as a class. Even though the stockholder may participate in the vote which results in changing his rights as a stockholder, his action in so doing is the action of a member of the corporation exercising his franchise, rather than the action of a security holder choosing to accept an offer of exchange made to him as an individual. And obversely, the solicitation of his vote is a request for the exercise of his

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31. SEC Securities Act Release No. 3698 (Oct. 2, 1956). As would be expected, an alert student of the stage discerned a precedent in Sir William S. Gilbert's "Iolanthe" wherein a "serious legal problem" was resolved in much the same fashion:

> "QUEEN: . . . And yet *(unfolding a scroll)* the law is clear — every fairy must die who marries a mortal!
>
> LORD CHANCELLOR: Allow me, as an old Equity draftsman, to make a suggestion. The subtleties of the legal mind are equal to the emergency. The thing is really quite simple — the insertion of a single word will do it. Let it stand that every fairy shall die who doesn't marry a mortal, and there you are, out of your difficulty at once!"

Letter to S.E.C. from Committee on Administrative Law of the Association of the Bar of the City of New York, p. 1 (Jan. 11, 1957), S.E.C. Docket File No. S7-151-1-2, quoted in Purcell, *supra* note 3, at 279-80 n.78.

32. See note 3 *supra*.

franchise as a member of the corporation, not an offer of exchange or sale of new securities to him as an individual.[33]

Since the controversy abated when the Commission withdrew its proposal to undo the Rule in its entirety and instead tightened the existing rule, and since it appears that the modified Rule is functioning effectively, there is little point in a detailed review of the arguments which spiced the lives of securities lawyers for a period of three years.[34] Suffice to say that the defenders of the status quo pointed out some of the logical absurdities which would eventuate if mergers and consolidations were brought within the registration and prospectus requirements of the Securities Act. In the case of consolidation, the argument was raised as to who would sign the registration statement since there would be no issuer in existence when the proposal was submitted to the shareholders of the would-be constituent corporations.[35] Moreover, who among the shareholders of parties to the transaction would have the right to recovery under section 11 of the Securities Act? Should it be only those who voted for the proposal, or should the right also include those who voted against it? Should it perhaps extend to the shareholders of the surviving corporation in a merger?[36] The argument was also raised that the Commission should be barred from tampering with the Rule since Congress had amended the Act after adoption of the Rule without modifying the related definitions and thereby gave Congressional acquiescence to the correctness of the Rule.[37]

In addition to countering the specific arguments of the defenders of the status quo, the proponents of the proposed reversal argued that shareholders involved in mergers and the like could be swindled, and had been under the purported umbrella afforded by Rule 133. This could be done just as effectively as if they were buying securities for cash and they therefore needed the protection of the registration provision of the Securities Act just as much.[38] The proponents also questioned the original exercise of the Commission's power in interpreting the meaning of a term explicitly defined by Congress.[39] They argued that the Rule seriously undercut the

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33. Brief for the Commission, p. 9, 134 F.2d 689 (9th Cir.), *cert. denied,* 320 U.S. 773 (1943). This theory was expressed when the Note to Rule 5 of Form E-1 was promulgated. SEC Securities Act Release No. 493(C) (Sept. 20, 1935).

34. The controversy, unlike many, generated light as well as heat: most of the perceptive writing and analysis of Rule 133 was done during this period. See note 3 *supra.*

35. Throop, *In Defense of Rule 133 — A Case for Administrative Self-Restraint,* 13 BUS. LAW. 389, 396 (1958).

36. Purcell, *supra* note 3, at 285.

37. A.B.A.: Comment on SEC Securities Act Release No. 3698, Proposed Revision of Rule 133, pp. 5-6 (Nov. 25, 1956). SEC Docket File No. S7-151-1-2.

38. SEC Securities Act Release No. 3762 (March 15, 1957), CCH FED. SEC. L. REP. ¶ 76,511 (1957-61 Transfer Binder).

39. Sargent, *supra* note 3, at 82-85.

legislative policy set forth in sections 3(a)(9) and 3(a)(10) pertaining to certain exchanges and supervised reorganizations since it permitted transactions which lay outside the restrictions there stated with anomalous results. For instance, if section 3(a)(10) were repealed, court-supervised exchanges would not be exempt, while voluntary exchanges would be under the Rule.[40]

The Commission retreated from its proposed elimination of the Rule under this barrage of criticism and reaffirmed its position that mergers, consolidations, sales of assets for securities, and reclassifications did not involve sales.[41] In the process, however, it defined two situations in which the disposition of securities received in a reorganization would activate the registration and prospectus requirements of the Securities Act.[42]

THE ORIGINAL RULE

The original Rule 133 is preserved intact in paragraph (a) of the present Rule, and although not formally such, it is in effect a "transaction exemption."[43] The pre-1959 Rule related, and paragraph (a) of the present Rule relates, to plans or agreements pertaining to four types of corporate transactions: (1) statutory mergers, (2) statutory consolidations, (3) reclassifications of securities, and (4) transfers of assets to a corporation in exchange for its securities or voting stock of a parent which is, in substance, a type "C" reorganization under section 368 of the Internal Revenue Code.[44] The Rule provides that the submission of a plan or agreement pertaining to one of the above transactions is not an "offer to sell" or a "sale" if: (1) the submission is pursuant to the statutory provisions of the state of incorporation or pursuant to provisions contained in the certificate of incorporation;[45] (2) the vote of the required majority will operate to authorize the transaction so far as concerns the corporation whose shareholders are voting (except for approvals by directors[46] and compliance with filing requirements imposed by the

40. *Id.* at 84-85.

41. SEC Securities Act Release No. 3761 (March 15, 1957), CCH FED. SEC. L. REP. ¶ 76,511 (1957-61 Transfer Binder); SEC Securities Act Release No. 4077 (May 4, 1959), CCH FED. SEC. L. REP. ¶ 76,510 (1957-61 Transfer Binder).

42. SEC Securities Act Release No. 4115 (July 16, 1959).

43. See pp. 12-13 *supra*, with respect to "transaction" exemptions.

44. See note 24 *supra*.

45. Under Ohio Law, the directors of a corporation may in the course of winding up the corporation under a voluntary dissolution "sell its assets at public or private sale." OHIO REV. CODE § 1701.88(D). If the directors of a corporation may, when the assets are being sold incident to a dissolution, make a sale of substantially all assets without submission to the shareholders, is there compliance with this provision of Rule 133 in a liquidation sale for securities even if the directors determine that they will voluntarily submit the proposed sale of assets to shareholders? The transactions would probably be exempt on other grounds in any event. See note 24 *supra*.

46. In Ohio the required authorization of directors for a sale, lease, exchange, or other disposition of substantially all the assets of a corporation may come before or after approval of

state); and (3) the vote of the required favorable majority will bind all stockholders of the corporation except to the extent that dissenting shareholders may have rights under statute or under the certificate of incorporation to receive the appraised or fair value of their holdings. Thus, if these conditions exist, submission of the proposal for a merger, consolidation, reclassification, or exchange of assets for securities is not subject to the registration and prospectus requirements of section 5 of the Securities Act. While the terms of the Rule do not specifically so provide, the issuance and delivery of the securities issued in completion of the transaction are likewise exempt from those requirements.

Situations Not Under the Original Rule

Negotiated transactions.—The Commission declared the original Rule inapplicable in certain circumstances and since it makes up the core of the present Rule, the amended Rule may still be inapplicable in those circumstances. For example, under the original Rule the Commission distinguished transactions entitled to the benefits of the Rule from those which in fact constituted "negotiated" transactions,[47] *i.e.*, transactions in which submission to shareholders was merely a formality because one shareholder or a controlling group of shareholders was unquestionably able to vote the required approval. Thus, if the statutes of the state of incorporation required a majority vote to approve a merger, the Rule would be inapplicable if one shareholder held more than a majority of the voting stock. While somewhat unclear, a consequence of this appears to be that the minority shareholders might have a claim against the issuer for violation of section 12(1), which gives a right of rescission if section 5 is violated, as it might be if the exemption afforded by Rule 133 were not applicable. The minority shareholders would probably be able to dispose of the securities they received under section 4(1), which exempts transactions not involving an issuer, underwriter, or dealer. On the other hand, dominating shareholders would be unable for some time to dispose of the securities they received since they might be deemed underwriters and therefore without an exemption.[48]

Transactions requiring unanimous approval.—A second type of transaction to which the original Rule was considered inapplicable was one

the shareholders. OHIO REV. CODE § 1701.76(A). In the case of a merger or consolidation, however, the directors' approval must be prior to the submission to the shareholders. OHIO REV. CODE § 1701.79(A).

47. Great Sweet Grass Oils Ltd., 37 S.E.C. 683 (1957), *aff'd per curiam*, 256 F.2d 893 (D.C. Cir. 1958); Kroy Oils Ltd., *petition for review withdrawn*, D.C. Cir. No. 13, 920, Dec. 10, 1958; Purcell, *supra* note 3, at 275-76.

48. The Commission does not generally regard the ordinary investor as an "underwriter" even if he purchases the securities with a view to their redistribution. 1 LOSS, *op. cit. supra* note 10, at 642-43.

requiring unanimous approval, such as a sale of substantially all of a corporation's assets which, in the absence of a statute, requires unanimous shareholder approval.[49] The Commission felt that the underlying justification of the Rule was not apposite to such a transaction. Because each shareholder was individually capable of defeating the transaction, shareholder consent approached more closely the type of individual choice which was considered tantamount to the sale of a security than did the typical merger, consolidation, reclassification, or sale of assets.[50]

Shareholder option.—The third type of transaction was one in which the shareholders had a choice of receiving one of two or more securities, *i.e.,* where shareholders in a reorganization might choose between preferred and common stock. Again, the Commission apparently believed that the element of individual choice prevailed over the "corporate decision" justification of the Rule.[51]

Transactions pursuant to a pre-existing plan.—Finally, the Commission regarded transactions ostensibly under Rule 133, but which in truth were conducted pursuant to a pre-existing plan to distribute securities to the public, as outside the Rule. This was especially true where the issuer and the persons in control of the issuer were involved in post-merger, post-consolidation, or post-sale dealings in the securities, or where such persons had knowledge of the plans for distribution by recipients in the Rule 133 transaction.[52] Clearly these transactions were public offerings outside the underlying policy of Rule 133, and, therefore, were subject to the registration and prospectus requirements.

Effect of amendments.—The extent to which these limitations remain valid since the 1959 amendments is doubtful, especially since in a large measure the amendments codify them. Also, there is evidence that the Commission is now less concerned with the application of some of them.[53] The reason is apparent: the new Rule imposes strict limitations on the capacity of persons in control of the predecessor corporation to dispose of their securities. For example, it abolishes the would-be opportunity to use Rule 133 to "free up" stock in a negotiated transaction. Likewise, the possibility of relying on the Rule to effect a "pass through" of securities — using a Rule 133 transaction as a means to peddle securities to the public without registration — has been sharply curtailed. However, the

49. 1 HORNSTEIN, CORPORATION LAW AND PRACTICE, 467-68 (1959).

50. Purcell, *supra* note 3, at 277.

51. The Commission has been criticized for its inconsistency in refusing to apply Rule 133 to this option, while applying the Rule to an option between taking cash as a dissenter or accepting securities of the surviving corporation. Note, *The SEC's No-Sale Rule and Exchanges of Securities Pursuant to Voluntary Reorganization*, *supra* note 3, at 1239-40.

52. Purcell, *supra* note 3, at 277.

53. See PRACTICING LAW INSTITUTE, S.E.C. PROBLEMS OF CONTROLLING STOCKHOLDERS AND UNDERWRITINGS 126 (Israels ed. 1962).

status of the Commission's position on transactions requiring unanimous approval and those allowing a shareholder option is somewhat less clear since the amendments do not expressly deal with these situations.

THE 1959 AMENDMENTS

The 1959 amendments deal exclusively with the disposition of securities involved in a Rule 133 transaction after the completion of the transaction. The amendments, however, did not change the original Rule's mandate (paragraph (a) of the amended Rule) that Rule 133 transactions are not sales or offers to sell. Furthermore, even if the strictures in paragraphs (b) and (c) of the amended Rule ultimately require registration, the initial step by which the securities replaced the securities of a predecessor corporation remains outside the registration and prospectus requirements of section 5.

Misconceptions Under the Original Rule

The 1959 amendments grew out of a widely held misconception — one often deliberate and sometimes innocent. In stating that the submission of a proposal for merger, consolidation, reclassification, or sale of assets in exchange for securites did not constitute an offer to sell or a sale, and in implying that the subsequent delivery of securities did not constitute a sale or delivery after sale, the Rule invited the conclusion that a subsequent disposition of securities received in the course of a Rule 133 transaction enjoyed the benefits of another exemption under section 4(1). This provision exempts "transactions by any person other than an issuer, underwriter, or dealer. . . ."[54] Since transactions by a dealer are exempt unless they occur within certain relatively short time intervals and are related to a public offering, the exemption depended on whether an issuer or underwriter (by definition) was involved in the transaction. It was a simple matter to conclude that one receiving securities in a Rule 133 transaction and in turn selling those securities was not an issuer. Since under Rule 133 there was no sale involved in transferring securities to the shareholders of the predecessor corporation, it was easy to conclude that no underwriter was involved, since an "underwriter" is defined as one who *purchases* from an issuer with a view to the distribution of any security (how could there be a "purchase" if there was no "sale"?), or one who offers or sells for an issuer in connection with the distribution of any security (how could a shareholder of a predecessor company be offering or selling for the issuer?).[55] Thus, it became common to look

54. 48 Stat. 77 (1933), as amended, 15 U.S.C. § 77d (1958), as amended, Pub. L. No. 88-467, 88th Cong., 2d Sess. (Aug. 20, 1964).

55. See 48 Stat. 75 (1933), as amended, 15 U.S.C. § 77b(11) (1958).

upon Rule 133 as a device for distributing securities without concern for the stringencies of the registration and prospectus requirements of the Securities Act.

Why the Amendments

The *Great Sweet Grass Oils Ltd.* and the *Kroy Oils Ltd.* cases vividly illustrated the extent to which Rule 133 was improperly relied upon,[56] and unquestionably hardened the Commission's thinking on this problem. There the Commission secured withdrawal of the registration of Great Sweet Grass and Kroy Oils stocks listed on the American Stock Exchange. The Commission found that in several instances, some of which were clearly sham transactions, both corporations issued stock ostensibly in exchange for the properties of other corporations, after which the recipients distributed the stock to the public through securities dealers only properly describable as "boiler shops." Often the recipients were "dummies" for persons in control of the issuing corporation, and in one instance a dormant corporation was apparently revived to facilitate the transactions.

Among the grounds for withdrawal of the registrations, the Commission alleged that both corporations, in their current reports[57] filed with the Commission, misrepresented that the securities in question were issued pursuant to the exemption under Rule 133. In withdrawing the registration of Great Sweet Grass the Commission stated:

> However, this [the "no-sale" theory] does not mean that the stock issued under such a plan is "free" stock which need not be registered insofar as subsequent sales are concerned. Unless the Securities Act provides an exemption for a subsequent sale of such non-registered stock, registration would be required. Of course, subsequent casual sales of such stock by non-controlling stockholders which follow the normal pattern of trading in the stock would be deemed exempt from the provisions of Section 5 of that Act as transactions not involving an issuer, underwriter or dealer under Section 4(1) of the Securities Act. However, if the issuer or persons acting on its behalf participate in arrangements for a distribution to the public of any of the stock issued to stockholders or have knowledge of a plan of distribution by, or concerted action on the part of, such stockholders to effect a public distribution in connection with the transaction, a Section 4(1) exemption would not be available since an underwriting within the meaning of the statute would be involved . . . Where there is a pre-existing plan, as in this case, to use stockholders merely as a conduit for the distribution of a substantial amount of securities to the public, Rule 133 cannot be relied upon by the issuer . . . *In any event, where the persons negotiating an exchange, merger or similar transaction have sufficient control*

56. Great Sweet Grass Oils Ltd., 37 S.E.C. 683 (1957).

57. See Form 8-K upon which corporations listed on exchanges and issuers which have had offerings registered under the Securities Act and certain others report significant and material corporate events.

of the voting stock to make a vote of stockholders a mere formality, Rule 133 does not apply.[58]

While this case is demonstrative of the abuses of Rule 133 which moved the Commission to action, it also provided ammunition for the opponents of the proposed amendments. They argued that the Commission's adjudicative process could adequately deal with abuses of Rule 133, thus obviating the necessity of raising questions as to the Commission's power to make the suggested amendments.

Amendment Coverage — Underwriter Defined

The amendments were intended to deal with two situations: first, where the issuer, or an affiliate[59] of the issuer, arranges for the sale of securities received in a Rule 133 transaction; second, where a predecessor company or an affiliate of a predecessor company disposes of securities received in a Rule 133 transaction.

In formulating the amendments the Commission used the Securities Act's unique and flexible concept of "underwriter." This term derives much of its importance from its use in section 4(1) wherein "transactions by any person other than an issuer, underwriter, or dealer . . ."[60] are exempt from the registration and prospectus requirements of section 5. While the terms "issuer"[61] and "dealer"[62] are precisely defined, the term "underwriter" is very broad in scope; it includes anyone who: (1) purchases from an issuer with a view to the distribution of a security, (2) offers or sells for an issuer in connection with the distribution of a security, or (3) participates directly or indirectly in any such undertaking or in the underwriting of any such undertaking.[63] Anyone who does any of these is a statutory underwriter, regardless of whether he is engaged in the securities business.

The definition of "underwriter" concludes by stating that " 'issuer' shall include, in addition to an issuer [used here and later in this sentence in the conventional sense as one who issues a security], any person directly or indirectly controlling or controlled by the issuer, or any person

58. 37 S.E.C. 683, 690-91 (1957). (Emphasis added.)

59. "[A] person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified." Rule 405, 17 C.F.R. § 230.405 (rev. ed. 1964).

60. 48 Stat. 77 (1933), as amended, 15 U.S.C. § 77d (1958), as amended, Pub. L. No. 88-467, 88th Cong., 2d Sess. (Aug. 20, 1964).

61. "[E]very person who issues or proposes to issue any security. . . ." Section 2(4), 48 Stat. 74 (1933), as amended, 15 U.S.C. § 77b (1958).

62. "[A]ny person who engages either for all or part of his time, directly or indirectly, as agent, broker, or principal, in the business of offering, buying, selling, or otherwise dealing or trading in securities issued by another person." Section 2(12), 48 Stat. 75 (1933), as amended, 15 U.S.C. § 77b (1958).

63. See § 2(11), 48 Stat. 75 (1933), as amended, 15 U.S.C. § 77b (1958).

under direct or indirect common control with the issuer."[64] In effect, then, an underwriter is one who: (1) purchases from an issuer *or controlling person* with a view to distribution, (2) offers or sells for an issuer *or controlling person* in connection with a distribution, or (3) has a participation in any such undertaking. It is through this subtlety that distributions of securities by controlling persons are subjected to the strictures of the Securities Act. The key term "distribution" as used in the definition of "underwriter" is generally considered synonymous with a "public offering."[65] A public offering, then, actual or intended, is a prerequisite to the presence of an "underwriter."[66]

Rule 133 Underwriters

As noted previously, a recipient of a security in a Rule 133 transaction must look to some other exemption to dispose lawfully of the security without registration or use of a prospectus. The exemption most often used is found in section 4(1) which exempts transactions by any person other than an issuer, underwriter, or dealer. To thwart abuse of Rule 133, the Commission placed that section's exemption beyond the reach of certain persons in certain circumstances by designating two classes of underwriters. This designation effectively hindered ready distribution of securities issued in Rule 133 transactions if such persons were involved.

Contractual underwriters.—The first person designated as an underwriter under the amendment has been called a "contractual underwriter." He is characterized as one who purchases the securities of an issuer corporation from the security holders of a predecessor corporation with a view to distribution, or who offers or sells such securities for the security holders in connection with a distribution, *pursuant to a contract or arrangement made in connection with the Rule 133 transaction with the issuer, an affiliate*[67] *of the issuer, or someone who is himself an underwriter of such securities in connection with the transaction.*

This classification arose out of the type of situation described in the

64. *Ibid.*

65. Orrick, *Some Interpretative Problems Respecting the Registration Requirements Under the Securities Act*, 13 BUS. LAW. 369, 370 (1958). Doubt that the terms are synonymous has been expressed by Manuel F. Cohen, now Chairman of the Commission. Cohen, *Rule 133 of the Securities and Exchange Commission*, 14 RECORD OF N.Y.C.B.A. 162 (1959).

66. The so-called "private offering exemption," as stated in the Securities Act, is confined to *issuers*: "transactions by an issuer not involving any public offering. . . ." Thus, technically the Securities Act affords no private offering exemption to controlling persons. However, because the term "underwriter" is defined in terms of a "distribution" which is commonly regarded as tantamount to a public offering, an offering by a controlling person which is confined in the same manner in which a private offering would be made by an issuer, cannot involve an underwriter and therefore would be exempt under the exemption of § 4(1): "transactions by any person other than an issuer, underwriter, or dealer. . . ." 48 Stat. 77 (1933), as amended, 15 U.S.C. § 77d (1958), as amended, Pub. L. No. 88-467, 88th Cong., 2d Sess. (Aug. 20, 1964).

67. See note 59 *supra*.

Great Sweet Grass Oils Ltd. and *Kroy Oils Ltd.* cases.[68] To some extent those cases are somewhat unrepresentative since they involved chicanery, fraud, and sham which reach far beyond a simple misuse of Rule 133. The somewhat more typical misuse situation is where some or all of the shareholders of a merging or predecessor corporation wish to secure cash for their interests, with the acquiring corporation either not in a position to make a cash transaction or not desiring to do so. Often, tax considerations may also be pertinent where some shareholders prefer a tax-free transaction with a continuing equity in the surviving enterprise, while others prefer liquidation. In these circumstances, not infrequently the transaction would be cast in the mold of a Rule 133 transaction, but the issuer or those in control would arrange to dispose of the securities of those who preferred cash through securities dealers or others. The end result would be the same as if the issuer had offered and sold the securities for cash (transactions which would in many instances require registration), and paid the proceeds to some or all of the shareholders of the acquired corporation; the issuer would have the other enterprise, some or all of the shareholders of the precedessor would have cash, and the public would have securities which they had purchased. But — and here a significant difference exists — they would likely have them with the valuable protections afforded by the Securities Act.

The contractual underwriter designation goes beyond simply defeating fraud. It encompasses all transactions in which the issuer or a controlling person is involved in arrangements to dispose of the securities received in a Rule 133 transaction. Thus, the person who arranges with the issuer or its affiliate to dispose of the securities becomes a statutory underwriter and the section 4(1) exemption is unavailable; and absent another exemption, the securities are subject to registration under section 5.

It should be noted that the person from whom the contractual underwriter purchases or on whose behalf he distributes need not be in control of either the issuing or the disappearing or selling corporation. A purchase from a minor shareholder with a view to distribution, or an offering or sale on behalf of that shareholder may also render the transaction violative of section 12(1)[69] which affords a civil action for damages.

This result gives rise to various questions. For example, the selling security holder or the security holder on whose behalf the distribution is

68. Great Sweet Grass Oils Ltd., 37 S.E.C. 683 (1957).

69. Section 12(1) states that "any person who — (1) offers or sells a security in violation of Section 5 . . . shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security or for damages if he no longer owns the security." 48 Stat. 84 (1933), as amended, 15 U.S.C. § 77*l* (1958).

made is clearly not the issuer of the securities, and may not have a controlling interest in either the issuer or predecessor corporation; how then can one dealing with such a person be an "underwriter" when that definition requires involvement of the issuer or an affiliate, usually a person in control of or controlled by the issuer? Further, the amendment expanding the definition of "underwriter" was apparently adopted under the Commission's authority to define "accounting, technical, and trade terms" used in the Securities Act.[70] Does it constitute a proper exercise of this authority when the term is defined within the act itself? In other words, when Congress has defined a term, may the Commission extend or alter that definition?[71] In any event, the Commission justified its position on the ground that the application of paragraph (b) depends on the existence of a relationship between the putative underwriter and the issuer or an affiliate; therefore, the distribution is in effect made on behalf of the issuer or affiliate, even though the benefits may not accrue to either.[72]

Despite this and other possible difficulties the Commission's underlying approach was accepted by the securities bar.[73] However, at the bar's suggestion a sentence was added to indicate that the definition did not apply to arrangements made to match fractional shares, or to purchases and sales in connection with such matching.

Control underwriters.—Paragraph (c) of the amended Rule which states the second definition of underwriter was less kindly received by commentators.[74] This provision defined underwriter as any constituent corporation (defined as any corporation which is a party to a Rule 133 transaction other than the issuer) or affiliate of a constituent corporation who acquires securities of the issuer in connection with a Rule 133 transaction with a view to their distribution. At the behest of the American Bar Association's Committee on Federal Regulation of Securities,[75] the Commission amended the rule as originally proposed to exclude from the term "distribution" a distribution by a constituent corporation to its security holders upon a complete or partial liquidation. The excluded situation usually occurs in a sale of assets for stock when the corporation dissolves and distributes the proceeds (the securities) together with any retained assets to its shareholders.

70. Section 19(a), 48 Stat. 85 (1933), as amended, 15 U.S.C. § 77s (1958).

71. This is the same problem mentioned previously in connection with the Commission's narrowing of the definition of the term "sale" despite the fact that Congress defined it as part of the Securities Act. See pp. 23-24 *supra*.

72. 1 LOSS, SECURITIES REGULATION 234-35 (2d ed. 1961).

73. Committee Report, *Proposed SEC Rule 133 — Comments of Committee on Federal Regulation of Securities*, 14 BUS. LAW. 423, 426 (1959).

74. *Id.* at 429-31; Throop, *Recent Developments with Respect to Rule 133*, 15 BUS. LAW. 119, 122 (1959).

75. Committee Report, *supra* note 73, at 429.

In the typical situation arising under this paragraph, the controlling shareholders of the disappearing or selling corporation will receive some of the securities issued, either *immediately* as in a merger or consolidation, or *somewhat later,* as where the securities are issued in a sale of assets transaction to the selling corporation which in turn distributes them to its shareholders. If the securities are taken by controlling persons with a view to distribution, they become underwriters and their dispositions of securities are not exempt under section 4(1). However, absent a situation within the purview of paragraph (b), the section 4(1) exemption remains available to persons other than the constituent corporation and its controlling shareholders. This provision requires the issuer to exercise considerable caution to avoid an inadvertent violation of the Securities Act.[76] It also requires foresight by the putative controlling shareholders to avoid being "locked in" with a nonmarketable security.[77]

Problems of paragraph (c).—Paragraph (c) was in some measure a reflection of the Commission's previous refusal to apply the original Rule 133 to situations where shareholder approval was reduced to a formality by a controlling group. In other words, this occurs where the transaction, rather than being corporate action by the shareholders, was in truth simply a "negotiated transaction."[78] The provision, in effect, limits the marketability of securities received by the corporation and its controlling shareholders. It does not, however, restrict the submission to the shareholders and the issuance of securities to them.

The semantic problems raised by paragraph (c), and to some extent by paragraph (b), are illustrated by the conclusions of the Commission staff out of which the 1959 amendments grew:

> CONCLUSION I.
>
> We do not agree with the proposition that the transactions described in Rule 133 do not involve a "sale" within the meaning of that term as defined in section 2(3) of the Securities Act and that, therefore, the Securities Act has no application to such transactions . . . .
>
> CONCLUSION II.
>
> We believe that the Commission has the power to promulgate or to continue in effect rules of interpretation or rules of definition which

76. If a controlling person of a constituent corporation takes securities in a transaction otherwise within Rule 133 without the requisite investment intent, then, at least as to those securities, Rule 133 does not provide an exemption from the provisions of § 5. Therefore, the issuer may be deemed to have violated § 5(a)(1) by selling the securities without a registration statement being effective, § 5(a)(2) by causing the securities to be carried through the mails or by other means or instruments of interstate commerce for the purpose of sale or delivery after sale, and § 5(b)(2) by causing the securities to be carried through the mails or by other means or instruments of interstate commerce for the purpose of said sale or delivery after sale without their being accompanied by a statutory prospectus. 48 Stat. 77 (1933), as amended, 15 U.S.C. § 77e (1958).

77. See p. 39 *infra.*

78. See p. 20 *supra.*

> have the effect of declaring that transactions are not "sales" for purposes of sections 4 and 5 of the Act where the Commission concludes on the basis of its experience and the overall structure of the Act that the procedural and liability provisions of the Act as they affect issuers, underwriters and dealers would not operate reasonably and effectively in such transactions . . . .
>
> CONCLUSION IV.
>
> We believe that a stockholder acquiring a new security in a transaction falling within Rule 133 "has purchased" that security from an issuer within the meaning of section 2(11) and accordingly certain stockholders may be defined as underwriters if they acquire the security with a view to distribution, and that in many cases this result conforms to the structure and policy of the Act. We believe, however, that ordinary investors not in a control relationship with any corporation participating in the transaction should not be defined as underwriters, although participation by the issuer in resales by them should require registration by the issuer . . . .[79]

In effect, Conclusions I and II state that even though transactions such as mergers are sales within the meaning of the term "sale" as used in the act, the Commission may declare them to be otherwise. This seems to imply that the Commission may completely reverse Congressional policy by simply taking a position contrary to the express language of the statute. In mitigation of the apparent presumptuousness of the staff's position concerning the Commission's power, it should be noted that section 2, which defines such terms as "sale" and "sell," provides that "*unless the context otherwise requires. . . .*"[80] the definitions contained in the Securities Act must be followed; and the Commission is given the power to define "accounting, technical and trade terms" used in the Securities Act.

Relying upon the prefatory language of section 2, at least one court has carefully analyzed the wording of section 5(a)(1) and concluded that "sell" in that context is narrower in meaning than "sell" in section 12(2).[81] Also, one commentator has remarked upon the anomaly in the text of the Securities Act whereby agreements (including presumably sales) between issuers and affiliates and underwriters are excluded from the definition of "sell" and related terms in section 2(3), although they are clearly included within the meaning of "sell" in section 2(11), and although undoubtedly underwriters would regard themselves — and rightly so — as entitled to relief under section 12(1) which makes a seller liable to his buyer if he offers or sells a security in violation of section 5.[82] In any event, the question is still pertinent

79. SEC Securities Act Release No. 3965 (Sept. 15, 1958), CCH FED. SEC. L. REP. ¶ 76,609 (1957-61 Transfer Binder).

80. 48 Stat. 74 (1933), as amended, 15 U.S.C. § 77(b) (1958). (Emphasis added.)

81. Schillner v. H. Vaughan Clarke & Co., 143 F.2d 875 (2d Cir. 1943).

82. Cohen, *Rule 133 of the Securities and Exchange Commission*, 14 RECORD OF N.Y.C.B.A. 176-77 (1959).

as to whether limitations possibly implied by the context justify affirmative Commission intervention by means of definition to formulate a substantive policy when Congress has deliberately given the term a very broad meaning.

The staff reaches other interesting conclusions. While declaring that the Commission may define "sale" and related terms to exclude the submission to shareholders of a defined proposal and the vote thereon, nonetheless in some circumstances a shareholder receiving securities in a Rule 133 transaction may be regarded as having purchased the same securities which in the very same transaction were not sold, thereby bringing himself within the definition of underwriter, one who ". . . has purchased from an issuer. . . ." Regardless of the questionable semantic underpinnings of this paragraph (c), this is the rule and there may thus be in effect a one-sided coin.

Finally, paragraph (c) contains a further refinement in that not every recipient of securities in a Rule 133 transaction is considered to have purchased them. Rather, only constituent corporations and their *affiliates* are considered to be purchasers, while non-affiliated recipients are excluded. This result, no matter how questionable logically, is consistent with the Commission's position that ordinary investors who purchase securities, even with a view to distribution, are not included within the term "underwriter" and therefore may dispose of the securities at any time under the section 4(1) exemption.[83]

This anomaly forced the Commission to adopt a means of mitigating the rigors of a rule which allowed non-control persons to dispose of unlimited amounts of securities without registration, while barring controlling persons from disposing of any. Accordingly, the Commission recognized anew that the Securities Act of 1933 is principally concerned with the *distribution* of securities and is not intended to pose obstacles to normal *trading* activity in securities.[84] This basic distinction underlies the exemption afforded by section 4(4) (section 4(2) prior to the 1964 amendments) which exempts from section 5 "brokers' transactions, executed upon customers' orders on any exchange or in the over-the-counter market but not the solicitation of such orders."[85] After many administrative problems with this exemption,[86] the Commission codified the distinction in Rule 154 which permits limited dispositions of securities by controlling persons.

83. 1 LOSS, *op. cit. supra* note 72, at 642-43.

84. MCCORMICK, UNDERSTANDING THE SECURITIES ACT AND THE S.E.C. 99 (1948).

85. 48 Stat. 77 (1933), as amended, 15 U.S.C. § 77(d), as amended, Pub. L. No. 88-467, 88th Cong., 2d Sess. (Aug. 20, 1964). Professor Loss has remarked that pre-amendment § 4(2) was not a "model of clarity." 1 LOSS, *op. cit. supra* note 72, at 698.

86. Ira Haupt & Co., 23 S.E.C. 589 (1946).

Paragraphs (d) and (e)

Concessions to controlling interests.—To afford persons in control of constituent corporations at least some of the latitude given others in disposing securities, the Commission formulated two paragraphs of the amended Rule based on Rule 154 and thereby permitted limited trading activity by controlling persons. It must be carefully noted that paragraphs (d) and (e) are only applicable to paragraph (c); they do not affect the contractual underwriter under paragraph (b).

Subject to complete compliance with the restrictive provisions of paragraphs (d) and (e), a constituent corporation or affiliate may, without being considered an underwriter or involved in a distribution, within any six-month period sell, in the case of an unlisted security, approximately one percent of the shares or units of the security outstanding at the time the broker receives the order to execute the transaction, and, in the case of a listed security, the lesser of such one percent and the largest aggregate reported volume of trading in the security on securities exchanges during any one week within the four calendar weeks preceding receipt of the order. Thus, by complying with the other provisions of these paragraphs and by complying with the limitations contained in Commission policy not stated in the Rule, a controlling person otherwise subject to the restraints imposed by paragraph (c) may divest himself of some of the securities received in the Rule 133 transaction. However, it is important to note that the numerical limit is in terms of the securities of the issuing corporation outstanding at the time the broker receives the order. Thus, for instance, if the security issued is unlisted and the acquisition is small in terms of the percentage of shares issued to the predecessor corporation or its shareholders, a controlling person of the acquired company may be able to dispose of a substantial portion, and in some situations, all of the securities received by him.

Solicitation.—Other provisions of paragraphs (d) and (e) of Rule 133 must be meticulously observed. Neither the selling security holder nor his broker may directly or indirectly solicit or arrange for the solicitation of purchase orders in anticipation of, or in connection with, the transaction. This, of course, in the case of a security with a limited market, may make disposition difficult since it forbids any sales effort in disposing of the securities. Because of the specialist's function, the problem is considerably alleviated if the security is listed on an exchange since there is usually a buyer available (the specialist), though the offering of a large number of shares may drive the price down.

To some extent, the impact of this limitation is lessened by the further provision that an inquiry concerning a dealer's written bid for a security or his written solicitation of an offer to sell made within the previous sixty days is not considered a solicitation of an order to buy. Thus, a broker may go through the so-called "pink sheets"[87] for the preceding 60 days and inquire of the dealers who had bids listed.

The solicitation activity forbidden is solicitation of buy orders and not the solicitation of sell orders. Accordingly, a broker's initiative in approaching the controlling person of a constituent corporaton and seeking his order to sell does not bar reliance on this exemption.

Distribution.—The selling security holder may not make any payment in connection with the execution of an otherwise permitted transaction to any person other than his broker, and the broker may perform only the usual and customary broker's functions. The broker is prohibited from doing more than executing an order to sell as a broker and receiving more than the usual or customary broker's commissions. He must not be aware of any circumstances indicating that his principal is failing to comply with the provisions of paragraph (d).[88] These provisions are intended to preclude the activities generally associated with the distribution of securities as distingushed from those pertinent to *trading* in securities.

It is clear that this "out" for the controlling shareholder only contemplates dispositions in straight brokerage transactions, *i.e.*, transactions through persons engaged in the securities business who act as agents for the seller and do not purchase the securities on their own account for subsequent resale to customers.

Other limitations.—The Commission has insisted that the analogous Rule 154 pertaining to brokers' transactions exempts only the broker's participation in the transaction and not that of the controlling person who is selling the securities; he, according to the Commission, must look to sections other than section 4(4) and its explicative Rule 154 for insulation against liability.[89]

It does not appear that paragraphs (d) and (e) of Rule 133 protect only the broker. As noted earlier, exemption for a person who sells securities received in a Rule 133 transaction must be found elsewhere than in Rule 133. In general, the exemption applicable is found in section 4(1). Paragraph (c) intends to deny to constituent corporations and their affiliates who take with a view to distribution that exemption by designating them as underwriters. The beginning of paragraph (d) appears to restore that exemption by declaring that upon compliance with paragraphs (d) and (e) such a person "shall not be deemed to be an underwriter nor to be engaged in a distribution with respect to securities

87. Compendiums published daily by the National Quotation Bureau, Inc. which contain the quotations of dealers throughout the country with respect to virtually all securities traded actively over-the-counter.

88. This paragraph limits the amount of securities which may be sold and restricts the seller's solicitations and payments.

89. SEC Securities Act Release No. 4469 (1964); 1 LOSS, *op. cit. supra* note 72, at 697-98.

acquired in any transaction specified in paragraph (a). . . ."[90] Thus, paragraphs (d) and (e) apparently provide protection for both the broker and the selling security holder by making available to both the exemption in section 4(1), and to the broker the exemption in section 4(4) as well.

However, other limitations which the Commission has applied to Rule 154 appear to be equally applicable to paragraphs (d) and (e) of Rule 133. The Commission reads "person" in Rule 154 as more than a single individual; it construes it to mean groups such as members of an immediate family. Such a group may not, in the aggregate, exceed the numerical limit on the disposition of securities within a six month period.[91] The Commssion has not gone so far as to regard all members of a controlling group as a single person for purposes of Rule 154, and it has on one occasion indicated in a "no action" letter that each of three family groups which in concert controlled a company was a "person" for purposes of that Rule.

The Commission has regarded reliance upon Rule 154 in several successive or nearly successive six month periods, especially where the maximum amounts are disposed of each time, as indicative of a distribution rather than trading, and hence the exemption would not be available.[92] Presumably, the Commission has the same attitude with respect to such repeated reliance upon paragraphs (d) and (e) of Rule 133.

The numerical limits of paragraph (d) do not apply solely to securities disposed of under Rule 133. Rather, there must be included in determining whether a proposed disposition will exceed the six month limitation "*all other sales of securities* of the same class by such person or on his behalf within the preceding six months . . . ."[93] Thus, if a person makes a private placement, an offering under Regulation A, or even, for that matter, a registered offering of securities of the same class within the six month period, the amounts thus sold are charged against the maximum allowable in determining the amount which may be offered at a particular moment. The obvious implication is that a person may not use Rule 154 to dispose of the maximum allowable thereunder and during the same six month period rely upon paragraphs (d) and (e) of Rule 133 to dispose of a similar quantity.[94]

In summary, if the requirements of paragraph (a) of Rule 133 are met, the Rule permits, without the necessity of registration or use of a statutory prospectus, submission of merger, consolidation, reclassification, and sale of assets proposals to the vote of shareholders, the vote thereon

90. Rule 133(d).

91. PRACTICING LAW INSTITUTE, *op. cit. supra* note 53, at 115.

92. SEC Securities Act Release No. 4469 (1964).

93. Rule 133(d)(3). (Emphasis added.)

94. PRACTICING LAW INSTITUTE, *op. cit. supra* note 53, at 114.

by the shareholders, and the delivery of the securities after approval. By inference the Rule confirms the right of recipients to later dispose of securities received except in cases of dispositions arranged by the issuer or an affiliate, and dispositions by a constituent corporation or a person in control thereof if the securities were taken with a view to distribution. The strictures of paragraph (c) are tempered by a limited right of disposition in brokerage transactions under paragraphs (d) and (e).

FORM S-14

Original Form S-14

In connection with the amendments to Rule 133, the Commission also adopted a new registration form for securities issued in a Rule 133 transaction which the underwriters described in paragraphs (b) and (c) might wish to distribute (otherwise, for paragraph (c) underwriters, than through "brokerage" transactions under paragraphs (d) and (e) of the amended Rule).

The usefulness of Form S-14 was limited since its use was originally confined to registrants subject to the Commission's proxy rules (Regulation 14 under the Securities Exchange Act of 1934), for the most part corporations with securities listed on an exchange, which had solicited proxies under Commission rules in connection with the Rule 133 transaction. Also, it was the *issuer* of the securities which had to be subject to the proxy rules and use a conforming proxy statement, rather than the selling or disappearing corporation; thus, where the selling corporation was listed and utilized a conforming proxy statement and the issuing corporation was not subject to the proxy rules or did not use a proxy statement, Form S-14 was not available.[95] Obviously, Form S-14 would

95. Section 14(a) of the Securities Exchange Act and the rules promulgated by the Securities and Exchange Commission thereunder do not *require* a listed corporation (nor under the recent amendments an unlisted corporation) to solicit proxies with regard to any matter, although the New York Stock Exchange and other exchanges do. Rather, it is required that in the event proxies are solicited certain information must be furnished to the persons from whom solicited with respect to the issuer and the matters to be voted upon. The recently enacted amendments to the securities acts added § 14(c) to the Securities Exchange Act wherein the Commission is given authority to promulgate rules and regulations requiring an issuer to send to the holders of listed securities and the holders of certain securities of larger unlisted issuers, the same information required in proxy solicitations. This is true even if no solicitation is made.

While the Commission has not stated its position on this matter, it is probable that the disqualification from use of a Form S-14 registration statement because of failure of the issuer to use a proxy statement is now obsolete inasmuch as the information otherwise contained in a proxy statement may, after the regulations are promulgated, have to be submitted to shareholders anyway. It should be noted that the proxy regulations with respect to unlisted companies will apply only to registered securities, that is, securities which are held by more than 750 record holders (500 after a period of two years). While unlikely, the possibility exists that the securities for which proxy statements are sent will not be required to be registered, while other securities of the same issuer will be registered because of the number of holders. It would appear that in such circumstances Form S-14 would not be available since the issuer would not be *required* to solicit proxies nor to furnish to the security holders the information pursuant to such regulations as may be promulgated under the new § 14(c).

rarely be available in a sale of assets transaction since there generally would be no necessity or occasion for the acquiring corporation to seek shareholder approval for such a transaction; usually only director approval would be necessary, assuming sufficient authorized shares, to authorize the transaction for the buyer.[96] Those companies not subject to the proxy rules, or which though subject had not solicited proxies, were relegated to the use of some other form, principally Form S-1, which involved a somewhat more difficult and cumbersome procedure.

Form S-14 Under 1964 Amendments

Under the 1964 amendments[97] to the federal securities laws, for the first time the larger unlisted corporations became subject to the Commission's proxy rules and to the other statutory requirements previously applicable only to listed corporations. The 1964 amendments provided that within 120 days following the end of their first fiscal year ending after June 30, 1964,[98] unlisted corporations with more than $1,000,000 in assets and more than 750 holders of a class of equity security, must register the equity security with the Securities and Exchange Commission. Upon effectiveness of the registration they become subject, as to that class of security, to the proxy requirements of the Securities Exchange Act of 1934,[99] and thus presumably may use Form S-14 in connection with the distribution of securities issued in Rule 133 transactions.

Schedule 14A.—The core of a Form S-14 registration statement is the information required under Schedule 14A of Regulation 14 under the Securities Exchange Act of 1934 to be included in a proxy statement pertaining to the Rule 133 transaction. Hence, the starting point for a Form S-14 registration statement is usually the proxy statement distributed to shareholders of the acquiring corporation. Generally, the pages of the proxy statement containing notice of the meeting are eliminated and printed pages containing the information required by Form S-14 to be included in the prospectus in addition to that in the proxy statement are simply "wrapped around" the proxy statement, giving rise to the description of many prospectuses forming part of Form S-14 registration statements as "wrap around prospectuses." In effect, the prospectus por-

96. Shareholder approval is in some circumstances for Ohio corporations necessary under a recently enacted amendment to the Ohio General Corporation Law. See OHIO REV. CODE § 1701.84.

97. Pub. L. No. 88-467, 88th Cong., 2d Sess. (Aug. 20, 1964).

98. The time for filing such registration statement has been extended to April 30, 1965, for many corporations which would have had to file earlier and the applicability of the proxy requirements has been slightly deferred as to some companies: Rule 12(g)-1 under the Securities Exchange Act of 1934.

99. See note 97 *supra*.

tion of a Form S-14 registration statement is simply an expanded Regulation 14 proxy statement.

A Regulation 14 proxy statement for a Rule 133 transaction, and hence a Form S-14 registration statement, must, in common with all proxy statements under Regulation 14, include information concerning the revocability of a proxy, a description of dissenters' rights upon approval, if any, identification of those on whose behalf the proxy solicitation is being made, the interest of insiders in the transactions to be voted upon, and certain information with respect to the number of shares outstanding and the identity and holdings of shareholders of record or shareholders known to own beneficially more than ten per cent of the outstanding voting securities of the issuer.

Item 14 of Schedule 14A sets forth with particularity the information to be disclosed with respect to mergers, consolidations, acquisitions, and similar matters. Generally, this Item requires information concerning the business of the other parties to the transaction, the location and general character of their plants, dividend arrearages and defaults on securities, and the market prices of the parties' securities. In addition, specified financial statements must be furnished for both the company issuing the proxy statement and the other companies party to the transaction.

Form S-14 requires that in addition to the foregoing there must also be included in the prospectus the information concerning the officers and directors specified in Item 7 of Schedule 14 (information not ordinarily required in a proxy statement pertaining to transactions specified in Item 14 of Schedule 14A) such as their compensation, the rights of officers, directors, and principal shareholders under pension and profit sharing plans, their rights under any option arrangements, their indebtedness to the company, and any interest they may have had during the preceding year in material transactions with the company or which they may have in any proposed material transaction. There must also be included identification of those on whose behalf the securities are being offered and information about the underwriting and distribution arrangements. In addition, the prospectus must comply with certain other formal requirements applicable to all prospectuses forming parts of registration statements.

Part II of the registration statement, as distinguished from the prospectus or Part I (the portion distributed to the public) must contain certain information set forth in Form S-14 and there must be filed specified exhibits. The statement must be signed by certain officers and a majority of the board of directors of the registrant. It should also be noted that Part II, while not required to be furnished to offerees or buyers, is available for public inspection at the office of the Commission and copies may be secured.

"Undertakings" requirements.—The most unique aspects of Form S-14 are the "undertakings" requirements. Prior to the 1964 amendments, section 15(d) of the Securities Exchange Act of 1934 required each issuer that registered securities under the Securities Act of 1933 to undertake to file with the Commission certain periodic reports corresponding to those required to be filed by corporations listed on securities exchanges. To this extent the undertaking procedure had foundation in law. However, the Commission, in the course of developing its enforcement procedures, has administratively required the inclusion of various other undertakings which may not enjoy comparable or any legal sanction.[100]

Among these latter undertakings are those required to be included in a Form S-14 registration statement. As a part of a Form S-14 registration statement, the registrant must undertake, for the purpose of public offering and sale in the United States of the registered securities, that: (1) it will file a post-effective amendment or amendments so that, for a period of 24 months after the effective date of the registration statement, there will be available a current prospectus,[101] and (2) at the request of any security holder who is an underwriter under paragraphs (b) or (c) of Rule 133 and who proposes to make a public offering of any of the registered securities (other than on a national securities exchange or in transactions properly within the scope of paragraphs (d) and (e) of Rule 133) the registrant will file a post-effective amendment or amendments to the statement setting forth information regarding the offering security holders and the underwriting and distribution arrangements.

In addition, the form of undertaking contains an agreement by the registrant that for the purpose of determining liability under the Securities Act of 1933, the effective date of each amendment shall be deemed the effective date of the registration statement with respect to securities sold after the amendment becomes effective.[102] The purpose of this

100. Throop, *Recent Developments with Respect to Rule 133*, 15 BUS. LAW. 119, 127 (1959).

101. A "current" prospectus is one which does not contain information, including certified financial statements, older than 16 months, does not contain a materially false statement, and does not omit a material fact or one necessary to make the other statements in the prospectus not misleading. Section 10(a)(3), 68 Stat. 685 (1954), as amended, 15 U.S.C. § 77j (1958).

102. Section 8(c) provides that amendments filed after the effective date of the registration statement become effective "on such date as the Commission may determine, having due regard for the public interest and the protection of investors." Generally post-effective amendments become effective some time after their filing on the date determined by the Commission. However, it has been suggested that a post-effective amendment may have a broader scope and effect than generally realized: "A post-effective amendment which purports to make only minor changes may, nevertheless, have the effect of reaffirming other facts which were true when the registration statement originally became effective, but which have since become untrue. Accordingly, most lawyers have been reluctant to file post-effective amendments except where absolutely necessary." THOMAS, FEDERAL SECURITIES ACT HANDBOOK 90 (1959).

The undertaking required in a Form S-14 registration statement makes the effective date agreement is to avoid the running of the relatively short statute of limitations applicable to section 11 violations[103] and to preserve thereby the broad remedial rights of purchasers of registered securities.

The upshot of the undertakings is that the registrant must maintain the currency of the prospectus forming part of the registration statement for a period of two years following its effectiveness. If an offering is being made at the end of the two year period there is probably an obligation to continue keeping the prospectus and statement current until that offering is completed.[104] There is an implication in all of this, of course, that securities not offered by Rule 133 underwriters at the end of two years may be thereafter offered freely without registration or use of a prospectus.[105] However, this implication to date has no official Commission confirmation.[106]

Other forms.—If an issuer is not eligible to use Form S-14, in that it is not subject to the Commission's proxy rules or did not solicit proxies in connection with the Rule 133 transaction, the securities which should be registered because of paragraphs (b) and (c) of Rule 133 must be registered on another appropriate Form.[107] This will usually be Form S-1. While no official Commission pronouncement has so indicated, the registration statement must include undertakings comparable to those required in a Form S-14 registration regardless of the Form used.[108]

It has been suggested that any issuer which complies with the Commission's proxy rules and uses a proxy statement complying with Schedule

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of the entire registration statement as to securities sold thereafter the date upon which the post-effective amendment becomes effective. Obviously in such circumstances great care must be taken to insure that the entire contents of the registration statement are accurate and complete at the date the post-effective amendment becomes effective.

103. Section 13 of the Securities Act provides that no action may be brought to enforce liability under § 11 (which defines liabilities arising out of registration statements) "unless brought within one year after the discovery of the untrue statement or omission, or after such discovery should have been made by the exercise of reasonable diligence [and] in no event shall any such action be brought . . . more than three years after the security was bona fide offered to the public. . . ."

104. PRACTICING LAW INSTITUTE, *op. cit. supra* note 53, at 213.

105. Of course, if the "underwriter" is also a controlling person of the issuer he is under the same restrictions as any other controlling person in making an offering involving an underwriter.

Generally, only distributions involving issuers and controlling persons are subject to the registration and prospectus requirements of § 5 of the Securities Act, and distributions involving controlling persons are so subject only in the event that an "underwriter" as defined in § 2(11) is involved. Obviously in many situations one or more persons receiving stock in a Rule 133 transaction may upon completion of the transaction have become a controlling person of the issuer. See CAVITCH, OHIO CORPORATION LAW ¶ 20.2 (1964), with respect to distributions by a controlling person and the ascertainment of who are controlling persons.

106. Charles E. Shreve, who was at the time Chief Counsel of the Division of Corporation Finance of the Securities and Exchange Commission, in 1962 expressed doubt that the securities became free of registration and prospectus requirements at the end of two years. PRACTICING LAW INSTITUTE, *op. cit. supra* note 53, at 214.

107. *Id.* at 213.

108. *Id.* at 214.

14A, even though not technically required to so comply, should be permitted to use Form S-14.[109] Presumably in some measure the rationale of the Commission's confinement of Form S-14 principally to listed issuers is based on the fact that considerable information with respect to such issuers is generally available as a consequence of required filings with the exchanges and Commission. The suggested extension of Form S-14, while perhaps less urgent in the light of the recent amendments to the federal securities laws, nevertheless may still be worthy of consideration.

As previously noted, Form S-14 implies that at the end of two years from the effectiveness of the registration statement securities issued in a Rule 133 transaction still in the hands of paragraph (b) and (c) underwriters are free of the necessity of continued registration and use of the statutory prospectus. It has been suggested that the same result would be true with respect to securities registered on other forms used because of the unavailability of Form S-14.[110]

SAFEGUARDING RULE 133 TRANSACTIONS

The provisions of Rule 133 and the requirements of Form S-14 dictate safeguards to be followed in the negotiation and preparation of agreements for Rule 133 transactions.[111] Two considerations define the cautions to be followed.[112] Those who receive securities in a Rule 133 transaction desire to have freely marketable securities, but lacking that, they wish to be certain that in the event they desire to sell the securities received they will have such cooperation as they need from the issuer. On the other hand, the issuer is interested in avoiding any possible violation of the Securities Act as the consequence not only of its own conduct, but also of the conduct of recipients of its securities in a Rule 133 transaction.

In order to avoid a violation, the issuer must first determine the identity of the persons in control of the corporation whose assets are being acquired or which is being merged because the securities received by such persons will not be freely transferable. While it has been urged that the test of "controlling person" or "controlling group" should be the

109. Throop, *supra* note 100, at 119, 126.

110. PRACTICING LAW INSTITUTE, *op. cit. supra* note 53, at 213.

111. See Throop, *supra* note 100, at 128, for an excellent discussion of the safeguards which should be worked into the agreements pertaining to a Rule 133 transaction.

112. It should be borne in mind that often the exact form of the agreements with respect to the securities issued in a Rule 133 transaction will be a result of negotiations and the give-and-take of bargaining. Consequently, many agreements will not include provision for all of the described contingencies and will not contain agreements with respect to all of the matters discussed.

person or persons able to compel the Rule 133 transaction[113] (in effect a sort of "negotiated transaction" standard), the Commission in promulgating the amendments to Rule 133 clearly adopted the customary meaning of the term.[114] Although determination of control may be a subtle and involved problem, it is imperative that the issuer seek its solution. This may involve a careful scrutiny of the history of the corporation, examination of its record books, interviews with officers and directors, and any other procedures which may elicit the necessary information upon which an informed judgment should rest.

Once having determined the identity of the controlling persons, the issuer should secure agreement of such persons, or the agreement of the other party to the transaction that it will deliver such agreements as a condition of closing, to the effect that: (1) they take the securities for investment and not for the purpose of resale or distribution; (2) they consent to the placement of a legend on the certificates evidencing their securities stating that they have taken the securities for investment and not for resale or distribution, that such securities have been issued in reliance upon such representation, and that no transfer of the securities will be made unless either there has been secured the opinion of counsel for the corporation that registration is not required, or the securities have been registered;[115] and (3) they consent to the placement of a "stop order" on the transfer books of the issuer as a means of enforcing the restrictions on transfer.[116] In addition, the issuer would be wise to procure an agreement for indemnification against any liabilities it might be subjected to as a result of a violation of the agreement (the Commission might regard such an indemnification as contrary to public policy). If those who might be considered in control of the disappearing or selling corporation hesitate to sign investment representations, such indemnification would be imperative.

The above agreement would have the effect of "locking in" the erst-

113. Committee Report, *supra* note 73, at 429-30.

114. Throop, *supra* note 100, at 125.

115. OHIO REV. CODE § 1701.25(B), provides that no restriction on the right to transfer shares shall be effective against the transferee of such shares unless the terms of the restriction or notice thereof are set forth on the face or the back of the certificate. A suggested form of restriction to be placed on the face or back of the certificate evidencing the securities is as follows:

> These securities have been issued in connection with a transaction described in Rule 133 under the Securities Act of 1933 and have not been registered under said Act in reliance upon the representation of the recipient that they are received for investment and not with a view to distribution. They may not be offered or sold, and no transfer of them will be made by the Company or its transfer agent, unless (1) they are registered under the Securities Act of 1933, or (2) there is presented to the Company an opinion of counsel satisfactory to the Company to the effect that such registration is not necessary.

116. See Israels, *Some Commercial Overtones of Private Placement*, 45 VA. L. REV. 851, 861 (1959), for a lengthy discussion of restrictions on transfer.

while underwriter for at least two years and would, for all practical purposes, make future disposition of the received securities dependent upon the cooperation of the issuer. Thus, unless the controlling persons of the predecessor or selling corporation are willing to be so confined, or believe they can make any dispositions they may wish within the provisions of paragraphs (d) and (e) of Rule 133,[117] they should secure an agreement from the issuer to register the securities immediately or upon request.[118] Request for such an agreement will invariably be accompanied by the urgent suggestion of the issuer that the expenses of a registration be borne by the security holders. In this connection the issuer would also be wise to exact some agreement as to the frequency with which the "underwriters" may request the filing of post-effective amendments.

In the light of the provisions of Form S-14 the "underwriters" will probably want the issuer to agree to comply with the Form S-14 undertakings, including filing post-effective amendments and the furnishing of up-dated prospectuses. Likewise, the issuer will want the "underwriters" to agree to furnish the necessary information concerning themselves and the underwriting and distribution. Also, the parties will probably want cross-indemnifications under which the "underwriters" indemnify the issuer against liabilities arising out of information they supply and the issuer indemnifies the "underwriters" against liabilities arising out of the other information in the statement. The issuer will wisely limit its obligation to file amendments to the period of two years after the effectiveness of the statement unless an offering is then being made. Likewise the issuer will insist that the "underwriters" inform it when the offering of the securities is completed in the United States so that it may then file a final post-effective amendment de-registering the remaining shares, while the underwriters will want an agreement that at the end of two years or the end of the offering in the United States such a final amendment will be filed. Without this latter agreement the securities will remain registered indefinitely with a continuing obligation on the underwriters, even after two years, to comply with the prospectus requirements of section 5.[119]

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117. See p. 31 *supra*.

118. It is probably wise, if there is to be a registration, to have it sooner than later since the two year period for keeping the prospectus current starts from effectiveness of the registration statement.

119. Section 5(b)(1) makes it unlawful to transmit by the mails or other means of interstate commerce any "prospectus" pertaining to a security other than a prospectus provided for under § 10 of the Securities Act if a registration statement has been filed with respect to such security. Section 5(b)(2) makes it unlawful to carry such a security by the mails or other means of interstate commerce unless accompanied or preceded by a § 10(a) prospectus. These requirements become operative upon the filing of the registration statement and presumably continue in effect until such time as the distribution of the securities is completed or they have been de-registered, or, as to dealers, the 40 or 90 day period for use of the prospectus expires.

While the foregoing discussion is only in terms of Form S-14, obviously the same considerations have application if that Form is not available.

"No Sale" in Other Contexts

Rule 133 explicitly states that "For purposes only of section 5 of the Act . . ."[120] submissions of proposals for mergers and other described transactions do not constitute "offers to sell" or "sales." Inasmuch as the Commission has seen fit to remove these transactions from the definition of "sale" for purposes of this one section, should they also be excluded from the other sections of the Securities Act, specifically, section 12(2) which imposes civil liability on anyone who offers or sells a security by the mails or other interstate means through material misstatements or omissions, and section 17(a) which makes it unlawful to use fraudulent means or material misstatements or omissions in the offer or sale of a security through the mails or other interstate means?

The Commission, although intimating in its brief in *National Supply Co. v. Leland Stanford Junior Univ.*[121] that perhaps the exclusion extended to other sections of the Securities Act as well, has otherwise consistently contended that the exclusion is confined to section 5. This position has been for the most part confirmed by the courts,[122] although in at least one case a federal court held that solicitation of proxies for a merger was not for the purpose of effecting a purchase or sale of any security.[123]

As noted previously, the Securities Act in and of itself virtually compels the conclusion that within a single statute the same word can have different meanings, and the courts have had no difficulty in so determining.[124]

After an initial flirtation with the extension of the no-sale theory to other statutes which it enforces,[125] the Commission has retreated and now apparently takes the position that "sale" and related terms, in the context of other acts, includes mergers, consolidations, sales of assets and the like.[126]

Conclusion

The controversy which raged over Rule 133, particularly from 1956 through 1959, has abated. The quiet is perhaps recognition that the

120. Rule 133.

121. 134 F.2d 689 (9th Cir.), *cert. denied*, 320 U.S. 773 (1943).

122. SEC v. Anaconda Lead and Silver Co., Litig. Rel. 2059 (D. Colo. 1961).

123. Sawyer v. Pioneer Mill Co., 190 F. Supp. 21 (D. Hawaii 1960), *cert. denied*, 371 U.S. 814 (1962).

124. See p. 29 *supra*.

125. Phoenix Securities Corp., 9 S.E.C. 241 (1941).

126. E. I. duPont, SEC Inv. Co. Act. Rel. No. 1837 (Jan. 26, 1953), 34 S.E.C. 531 (1953).

revised Rule is serving its purpose and thwarting the abuses which nearly caused its complete demise. However, it is possible that the controversy may be revived by new and now unforeseen abuses, or by a judicial determination that the Rule is an improper exercise of the Commission's authority. In that event, it is likely that efforts would be made to secure enactment of legislation approximating the Rule. From all indications, however, there is little likelihood that the courts will be inclined to overturn the Rule. This is especially true since the Commission says the Rule is limited to sections 4 and 5 of the Securities Act.

Defendants charged with offenses under sections 12(2) and 17(a) of the Securities Act and under Rule 10b-5 of the Securities Exchange Act of 1934 occurring during mergers and other Rule 133 transactions will undoubtedly assert that a "sale is a sale is a sale" and that a transaction not a "sale" under section 5 is never a "sale" under the Securities Act. The likelihood of success of this contention is limited since courts are likely to continue finding that mergers, consolidations, and the like do entail "sales" when the problem is one of applying those provisions.

Peaceful acceptance is now the apparent lot of Rule 133. May it thrive in peace.