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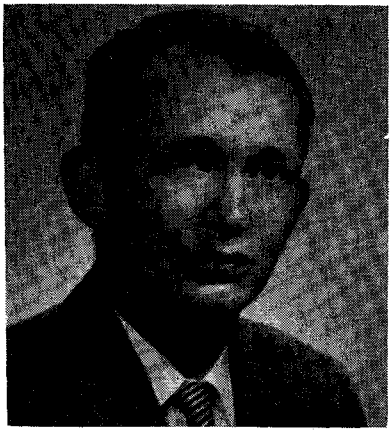

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INTRODUCTION

Regulation A is the general exemption from the registration requirements of the Securities Act of 1933, as amended, promulgated by the Securities and Exchange Commission pursuant to the statutory authorization of section 3 (b) of that act.[1] That subsection permits the Commission to exempt, by rule and regulation, securities that are part of an issue offered to the public for an aggregate amount not in excess of $300,000.

To qualify for the regulation A exemption it is necessary to file with the Commission a notification and copies of the offering circular (which must be used in making the offering), and certain other exhibits. The notification must be prepared in accordance with Form 1-A and should contain information enabling the Commission to determine whether or not the exemption is initially available. The offering circular must include the information required by schedule I of Form 1-A and such other information as is necessary for the investor to make an informed investment decision.

The attorney and others connected with the regulation A offering should constantly bear in mind that it is not a "self-contained" regulatory device, but merely a body of rules subordinate to an extensive background of both statutory and case law. Basically, if the terms and conditions of regulation A are met, only an exemption from the registration requirements set forth in section 5

1 48 Stat. 76, as amended, 15 U.S.C. § 77c(b) (1958). SEC Reg. A, 17 C.F.R. §§ 230.251-62 (Supp. 1959) in its present general form became effective on March 6, 1953, and was thereafter revised on July 23, 1956. For an article discussing the exemption as it existed after the 1953 change from the earlier much different version, see Krakover & Mehler, *Some Aspects of the Securities Regulation Law: Regulation 'A' and its Revision*, 32 *DICTA* 71 (1955). For an article discussing regulation A in its present revised form, see Hertz, *Federal Securities Act of 1933: Revised Regulation A*, 33 *DICTA* 307 (1956). For a general discussion of this exemption, see Loss, Securities Regulation 380 (1915), and Loss, Securities Regulation 165 (Supp. 1955).

of the Securities Act of 1933, as amended[2] is available. The reader is reminded that section 5 makes it unlawful to use any of the means of interstate commerce to offer to sell or buy a security unless a registration statement has been filed with the Commission, or to sell or deliver a security after sale unless a registration statement is in effect as to that security.

The purpose of this article is to discuss and analyze a few of the problems that arise either in connection with the preparation of the material to be filed under regulation A, or during the course of the offering pursuant to the regulation. The following discussion is presented with the observations on the limitations noted above in mind, and with the ever-present thought that each case presents different facts in different surroundings, thereby limiting the conclusiveness of any offered solutions.

I

If the issuer is in the promotional stage (basically, this is determined by whether or not it has had a net income from operations), the special provisions of rule 253 apply.[3] The most important provisions are those contained in paragraph (c) of rule 53 which sets forth the requirement that certain securities in addition to those being directly offered to the public must be included in computing the amount of securities being offered, unless "effective provision is made, by escrow arrangement or otherwise, to assure that none of such securities or any interest therein will be reoffered to the public within one year after the commencement of the offering."[4] This is significant in light of the statutory ceiling of $300,000 on the amount of any public offering under regulation A. The word "effective" apparently contemplates an irrevocable agreement with an independent person.

Specifically included in the computation of the amount being offered are: (1) all securities issued to and held by "any director, officer or promoter of the issuer, or . . . any underwriter, dealer or security salesman," whether or not they were issued for services,

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

3 SEC Reg. A, 17 C.F.R. § 230.253(a) (Supp. 1959): "The following provisions of this section shall apply to any offering under . . . (this regulation) of securities of any issuer which—

(1) was incorporated or organized within one year prior to the date of filing the notification required by § 230.255 and has not had a net income from operations; or

(2) was incorporated or organized more than one year prior to such date and has not had a net income from operations, of the character in which the issuer intends to engage, for at least one of the last two fiscal years."

In summary those following provisions are: (b) requirements for certain issuers incorporated or organized in Canada or those proposing to conduct their principal business operations in Canada, (d) the provisions are unavailable to persons other than issuers, and (e) rule 257, which sets certain minimal requirements for offerings not in excess of $50,000, shall not be available for any offering if the issuer is subject to this rule. Subsection (c) is discussed in text.

4 SEC Reg. A, 17 C.F.R. § 230.253(c) (Supp. 1959): "In computing the amount of securities which may be offered hereunder, there shall be included, in adition to the securities specified in § 230.254—

(1) all securities issued prior to the filing of the notification, or proposed to be issued, for a consideration consisting in whole or in part of assets or services and held by the person to whom issued; and

(2) all securities issued to and held by or proposed to be issued, pursuant to options or otherwise, to any director, officer or promoter of the issuer, or to any underwriter, dealer or security salesman;

Provided, that such securities need not be included to the extent that effective provision is made, by escrow arrangements or otherwise, to assure that none of such securities or any interest therein will be reoffered to the public within one year after the commencement of the offering hereunder and that any reoffering of such securities will be made in accordance with the applicable provisions of the act."

property or cash, and (2) all securities issued to any person for property or services, if presently held by the person to whom issued. One problem may arise over the meaning of the words "issued to and held by" or "presently held by the person to whom issued." After a brief consideration of the provisions of the rule one might mistakenly conclude that they could be easily circumvented. To avoid including securities in the $300,000 amount allowed, it would appear one could transfer the securities to a non-officer not reimbursed in securities for services or property, with the transferor retaining control over the securities; or, alternatively, all stock for either the officers or those persons who are to be reimbursed in stock for services or property, might be "issued to" one party and then have him transfer the securities to the planned holders. Obviously, the rule was not meant to be illusory. The answer lies in the reasonable interpretation of the language used. "Held by" would comprehend control as well as record ownership of the securities by the person subject to the rule. For instance, an officer could not transfer record ownership to his wife and avoid the rule, at least not absent a showing that the transfer was in good faith and that the securities are no longer subject to his control. Also, an attorney paid with securities for his services, could not transfer record title to his law firm to avoid the rule. With regard to the "issued to" wording it would seem that if the transferee from the issuer is a mere conduit to the intended holders the securities would in fact be "issued to" these intended holders. In other words, the escrow provisions are included in the revised regulation to accomplish a very practical protection for investors—to keep off the market securities that were issued to insiders and others who often contribute very little for them.

These so-called "escrow provisions" include securities "proposed to be issued, pursuant to options or otherwise," as well as securities issued when the filing is made. Of course, warrants or some other form of right to acquire securities which are evidenced by a certificate can easily be included in an escrow arrangement as they can be physically transferred to the escrow agent. But what course should be followed when the securities "proposed to be issued" are found in an option arrangement set forth only in a resolution of the issuing corporation's board of directors, or when the option to purchase securities depends on the occurence of certain conditions precedent which are beyond the control of the parties concerned?

The easiest answer to this problem is to provide in the escrow agreement that any securities issued in the one-year period pursuant to option to any of the persons covered by the rule will be placed directly into the hands of the escrow agent. For this purpose the issuing corporation, as well as the escrow agent and any person subject to the escrow provisions, should be made a party to the escrow agreement. These steps should be taken even though the option might be nontransferable, nonassignable and nonexercisable for a period of one year, for the reason that the option agreement may be changed. This consideration may be especially critical if the optionee controls the issuer. Since many options are also securities, they are subject to the terms of the rule, and all options should, therefore, be specifically included in the escrow agreement along with the condition that the option holders are not to transfer the option within one-year period. Similarly, it should be understood by all of the parties that their interest in the escrow agreement itself may not be assigned or transferred inasmuch as this would probably be considered a transfer of an interest in a security.

II

Often attorneys and their clients encounter problems involving the term "underwriter" when preparing a regulation A offering. Inasmuch as that term involves some of the most complex problems that arise under the federal securities laws, a complete treatment of the subject is beyond the scope of this article.[5] However, the following brief discussion regarding the term "underwriter," limited to certain situations involving distributions of new offerings, is presented to point out some of the problems to be considered in connection with the distribution of a regulation A offering.

Initially, the attorney should be aware that determination of whether a person distributing the issuer's securities is an "underwriter" as that term is defined in section 2(11) of the Securities Act of 1933, as amended,[6] is important for two reasons. First, if the distributor is an "underwriter" the provisions of paragraphs (d) and (e) of rule 252 of regulation A become significant.[7]

Generally, paragraph (d) indicates that the exemption under regulation A is not available if any underwriter of the securities to be offered has been convicted, within ten years prior to the filing, of any crime of offense involving the purchase or sale of any security, or arising out of such person's conduct as an underwriter, broker-dealer, or investment adviser; is subject to any order

5 See generally Loss, Securities Regulation (1951, Supp. 1955).

6 48 Stat. 75, as amended, 15 U.S.C. § 77b(11) (1958), in relevant part reads as follows:

"The term 'underwriter' means any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission. . . ."

It would be well to note that prior to the 1956 revision, regulation A was primarily concerned only with the "principal underwriter" of an offering and that term was defined in 17 C.F.R. § 230.215(c) (1933), as:

"an underwriter who is a party to the underwriting agreement (whether written or oral) with the issuer or other person on whose behalf the securities are offered hereunder. 'Underwriter' shall have the meaning given in Section 2(11) of the Act."

7 SEC Reg. A, 17 C.F.R. §§ 230.252(d)-(e) (Supp. 1959).

enjoining or restraining him from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security or arising out of his conduct as an underwriter, broker-dealer or investment adviser; is subject to an order of the Securities and Exchange Commission entered pursuant to section 15 (b) of the Securities Exchange Act of 1934[8] (denial, revocation, or cancellation of a broker-dealer registration); has been found by the Commission to be a cause of any such order which is still in effect, or is subject to an order of the Commission pursuant to section 203 (d) or (e) of the Investment Advisers Act of 1940;[9] is suspended or expelled from membership in a national or provincial securities association, or a national securities exchange or a Canadian securities exchange for conduct inconsistent with just and equitable principles of the trade; or is subject to a United States Post Office fraud order.

In general, paragraph (e) provides that the exemption shall not be available for the securities of the issuer if any underwriter of those securities was an underwriter or was named as an underwriter of any securities covered by any registration statement which is the subject of any proceeding or examination under section 8 of the Securities Act of 1933, as amended,[10] or which is the subject of any refusal order or stop order entered under that section of the act within five years prior to the proposed filing; or was the underwriter or was named as the underwriter of any securities covered by any filing which is subject to pending proceedings under rule 261 of regulation A[11] (provisions regarding suspension of the availability of the exemption provided by regulation A) or any similar rule adopted under section 3 (b) of the Securities Act[12] or to an order entered thereunder within five years prior to the filing.

When reviewing the above so-called "disabilities" denying the use of the regulation, it would be well to note that a conviction received more than ten years before the filing is in itself immaterial in determining the availability of the regulation, but an injunction or restraining order entered at any time prior to the filing makes regulation A unavailable if the underwriter is still subject to that order.

Secondly, regulation A calls for disclosure of the name and address of each underwriter in the offering circular.[13] Failure to disclose one or more underwriters may be a material omission on which could be based an order suspending the availability of the exemption for the proposed offering.

If the distributor of the securities offered is a broker-dealer who engages in the business of selling securities issued by others, there is little doubt that its operations bring it clearly within the definition of "underwriter" as contained in the Securities Act of 1933, as amended. On the other hand, if the president of the issuer in his spare time sells the issuer's securities with all proceeds going to the issuer he would probably not be an underwriter because in

8 48 Stat. 881, as amended, 15 U.S.C. § 78o(b) (1958).
9 54 Stat. 851, 15 U.S.C. §§ 80b-3(d)-(e) (1958).
10 48 Stat. 79, as amended, 15 U.S.C. § 77h (1958).
11 SEC Reg. A, 17 C.F.R. § 230.261 (Supp. 1959).
12 48 Stat. 76, as amended, 15 U.S.C. § 77c(b) (1958).
13 SEC. Reg. A, Form 1-A (Schedule I, paragraph 5), 17 C.F.R. § 230.255 (Supp. 1959).

the contemplation of the statutory definition it seems he would be acting in his normal corporate capacity as the issuer's agent rather than engaging in the distribution solely to directly benefit himself as an individual. It should be noted that, ordinarily, an issuer would not be considered an underwriter of its own securities.[14]

Unfortunately, the facts are not always as clear as those in these two illustrations. Consider a situation in which officers are to distribute the issuer's securities at the same commission rate and during the same period of time as securities dealers under contract. The Securities and Exchange Commission in its decision in *American Tung Grove Developments, Inc.*[15] held that officers under certain circumstances are underwriters. In substance, the reason given for holding officers to be underwriters in that case were: it appeared they were to spend a major portion of their time in making the offering; and they were to be compensated at the same rate for their sales as professional securities brokers and dealers. Thus, they were acting as independent contractors rather than officers acting on behalf of the company.

14 The only exception to this conclusion might be found in rule 140 of the General Rules and Regulations under the Securities Act of 1933, as amended, 17 C.F.R. § 230.140 (1949), which reads as follows:

"A person, the chief part of the business of which consists in the purchase of the securities of any one issuer, its subsidiary and/or affiliate and in the sale of its own securities to furnish the proceeds with which to acquire the securities of such issuer, subsidiary and/or affiliate, is to be regarded as engaged in the distribution of the securities of such issuer, subsidiary and/or affiliate within the meaning of section 2(11)."

15 8 S.E.C. 51 (1940).

In an early decision the Commission held that salesmen specially engaged by the issuer to distribute an offering on a commission basis were underwriters.[16] An interesting decision by the Commission illustrating that each case must be considered on its own facts is *Comstock-Dexter Mines, Inc.*[17] It appeared that one of the promoters of the company was hired to prepare sales literature for use in the distribution of the securities and to supervise the sale of stock. He was also to render his best services in bringing about the sale of the stock and was to be compensated for his services in stock if the offering were successful. If the agreement had been fully performed, the Commission indicated that the promoter would be considered an underwriter. However, it was shown that he prepared the sales materials which were used directly by the issuer without referring to himself as the author of those materials. If he had referred to himself as author, it would have suggested that he was dealing in the securities as an underwriter. It was also shown that he merely acted as an adviser to the issuer in the distribution of the securities but did not personally offer to sell any of the securities. As a result, the Commission held that he was not acting as an underwriter since evidence was lacking that he actually supervised the issuer's sales activities.

Although it appears that a person distributing the issuer's securities is an underwriter, if he is paid a commission or similar remuneration, it does not necessarily follow that if the total proceeds of the offering are received by the issuer, there is no underwriter. For example, in the case of *SEC v. Chinese Consolidated Benevolent Ass'n.*[18] it was held that the association was an underwriter within the definition given in the Securities Act of 1933, as amended, even though it appeared the association was not receiving a commission or other tangible compensation for services rendered in connection with a public distribution of unregistered Chinese government bonds. Of importance is the fact that the association was not related officially or contractually to the Chinese government. The services consisted of stimulating public interest in the bonds and in accepting orders and payments for them. Clearly the association's activities were those of an underwriter, the only unusual factor being the lack of compensation flowing to it.

Thus, two prime considerations in determining whether a person is an underwriter are: the presence or absence of a commission or other similar compensation, and the capacity in which the person works—*i.e.*, whether he acts as an agent of the issuer or as an independent distributor of the securities. In any event, it seems clear that the facts of each situation must be carefully studied in the light of the meaning of "underwriter" as set forth in the Securities Act. Any person, other than one receiving "a commission from an underwriter or dealer not in excess of the usual and customary distributor's or seller's commissions," may be an underwriter if he offers or sells for an issuer, and this disclosure should

16 American Gyro Company, 1 S.E.C. 83 (1935).
17 10 S.E.C. 358 (1941).
18 120 F.2d 738 (2d Cir. 1941).

be made under regulation A.

Again, it should be pointed out that this brief treatment of some of the problems connected with the term "underwriter" applies only to new offerings by an issuer. No attempt has been made to discuss some of the other problems arising in connection with that term in the Securities Act of 1933, as amended, such as the ramifications of a sale of an issuer's securities owned by a person controlling that issuer. The discussion here is intended solely to point out that there are certain problems in deciding whether or not a person selected to assist in distributing the offering is an underwriter, and whether disclosure concerning arrangements of the offering must be made in the material filed under regulation A.

III

Other problems arise in connection with the appropriate time to commence the offering pursuant to regulation A, the manner of making the offering, and restrictions on the content and use of sales material supplementing the offering circular.

Regulation A provides for nothing comparable to the "red herring" or preliminary prospectus used in connection with registered offerings, as implicitly allowed under the terms of section 5(b) of the Securities Act,[19] and as expressly permitted by rule 433 thereunder.[20] Under regulation A no offering may be made prior to the expiration of the ten-day waiting period imposed by rule 255(a)[21] unless the Commission authorizes the commencement of the offering prior to the expiration of that period. In other words, no use can be made of any communication that could be deemed an "offer" as that term is defined in section 2(3) of the Securities Act,[22] including the solicitation of "indications of interest," unless and until the waiting provisions of regulation A have been observed or waived by Commission action.

Furthermore, counsel and the issuer should be satisfied prior to the commencement of the offering that the exemption provided by regulation A is available. The review by the staff of the regional offices provides assistance in this regard but should not be relied upon as being final or conclusive, since it is generally understood that the burden of complying with the regulation and sustaining the availability of the exemption rests upon the person claiming it.[23] This burden is in no way lessened or shifted by the staff's advisory review.

For some time the Securities and Exchange Commission has been concerned with the problem of the use of press and other

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19 Securities Act of 1933, 48 Stat. 77, as amended, 15 U.S.C. § 77e(b) (1958).

20 SEC Reg. C, 17 C.F.R. § 230.433 (Supp. 1959) (prospectus for use prior to registration).

21 SEC Reg. A, 17 C.F.R. § 230.255(a) (Supp. 1959):

"At least 10 days (Saturdays, Sundays, and holidays excluded) prior to the date on which the initial offering of any securities is to be made under this regulation, there shall be filed with the Regional Office of the Commission specified below four copies of a notification on Form 1-A. The Commission may, however, in its discretion, authorize the commencement of the offering prior to the expiration of such 10-day period upon a written request for such authorization."

22 Securities Act of 1933, 48 Stat. 74, as amended, 15 U.S.C. § 77b(3) (1958):

"The term 'offer to sell', 'offer for sale', or 'offer' shall include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value . . . ."

23 See SEC v. Ralston Purina Company, 346 U.S. 119 (1953).

public information releases by issuers and their underwriters prior to or during a public distribution of securities.[24] Basically, the question is whether the publicity is in fact information not meeting the statutory requirements[25] of a prospectus, in violation of section 5 (b) of the Securities Act of 1933, as amended.[26] The Commission on October 8, 1957, in Securities Act Release No. 3844 discussed the coverage of section 5 and presented illustrative cases which in its opinion were or were not offers in violation of that section. Among those illustrated was a situation involving a brokerage firm which planned to underwrite a proposed offering. Prior to the filing with the Commission the firm distributed to its clientele an informational brochure describing in glowing terms the general industry represented in its proposed underwriting. Although no particular issuer or security was discussed in the brochure the circumstances clearly indicated a first step in the public offering of securities and thus, in the opinion of the Commission, an offering in violation of section 5 of the Securities Act. Another situation considered to be in violation of that section involved a promotional mining company which, in conjunction with the proposed underwriter, issued a series of press releases on the activities of the company, its estimated ore reserves and its proposed development program, prior to the filing of the notification under regulation A. The releases contained representations which could not have been supported by reliable data for inclusion in an offering circular. In addition to the violation of section 5, the Commission also felt that the offering had been made in violation of the "anti-fraud" provisions of section 17 (a) of the Securities Act,[27] thereby subjecting the offerors to additional civil and criminal penalties. The issuer, its underwriter and their counsel should, in the light of these pronouncements, be extremely careful to avoid initiating an offering through public relations efforts that are not in strict compliance with the statute and the rules. In addition, it should be borne in mind that the intent if not the letter of the act requires the disclosure of the whole truth in making the offer to the investor and, therefore, an offer telling only half of the truth, no matter how innocuous that half-truth appears, probably violates the spirit of the act. Of course, the problem of early and misleading offers goes far beyond the realm of regulation A but it is sufficiently extensive in scope to require the above brief coverage.

Sales material to be used in connection with the regulation A offering must be filed under the requirements set forth in rule 258.[28] Sales material is defined in that rule to include: "(a) every advertisement, article or other communication proposed to be published in any newspaper, magazine or other periodical; (b) the script of every radio or television broadcast; and (c) every letter, circular or other written communication proposed to be sent, given or otherwise communicated to more than ten persons . . ."

The best general guide to follow in the preparation of this

24 For the Commission's most recent significant opinion on this question, see Carl M. Loeb, Rhodes & Co., SEC Securities Exchange Act Release No. 5871 (February 10, 1959).
25 Securities Act of 1933, § 10, 48 Stat. 81, as amended, 15 U.S.C. §77j (1958).
26 48 Stat. 77, as amended, 15 U.S.C. § 77e(b) (1958).
27 48 Stat. 84, as amended, 15 U.S.C. § 77q(a) (1958).
28 SEC Reg. A, 17 C.F.R. § 230.258 (Supp. 1959).

material is the "full disclosure" philosophy of the Securities Act and it would be well not to overlook the so-called "anti-fraud" provisions of section 17 of that act.[29] It would appear that information that could be contained in the offering circular is proper for use in sales material although one would not have to include all the information required to be contained in the offering circular. In this regard it should be noted that an offering circular meeting the requirements of rule 256(a) must be given to an individual prior to or with the delivery of sales material directed to that person since such sales material would constitute a written offer.[30] The only exceptions to this requirement of delivery of an offering circular to an offeree are the simple advertisement merely announcing the offering, requirements of which are set forth in rule 256(c),[31] and situations where the issuer complies with the provisions of rule 257 which exempts the issuer from the requirements of using an offering circular in offerings not exceeding $50,000.[32]

IV

If the issuer has recently made a public offering claiming the exemption from the registration requirements of the Securities Act of 1933, as amended, provided by section 3(a)(11) thereof[33] (the so-called "intra-state" offering exemption), additional problems may be raised in preparing the filing and making the offering under regulation A. In general, that section exempts from the registration requirements of the act, securities that are part of a public issue offered and sold only to residents of the state where the issuer resides or, if a corporation, its state of incorporation. The issuer must also perform a substantial portion of its business operations within that state. Although the mails and any of the means and instruments of interstate commerce may be used in making the offering and although there is no stated dollar limitation on the amount of the offering, the section 3(a)(11) exemption is gen-

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29 Securities Act of 1933, § 17, 48 Stat. 84, 15 U.S.C. § 77(q) (1958).

30 SEC Reg. A, 17 C.F.R. § 230.256(a) (Supp. 1959):

"Except as provided in paragraph (c) of this section and in . . . (Rule 257)—

(1) no written offer of securities of any issuer shall be made under . . . (this regulation) unless an offering circular containing the information specified in Schedule I of Form 1-A is concurrently given or has previously been given to the person to whom the offer is made, or has been sent to such person under such circumstances that it would normally have been received by him at or prior to the time of such written offer; and

(2) no securities of such issuer shall be sold under . . . (this regulation) unless such an offering circular is given to the person to whom the securities were sold, or is sent to such person under such circumstances that it would normally be received by him, with or prior to any confirmation of the sale, or prior to the payment by him of all or any part of the purchase price of the securities, whichever first occurs."

31 SEC Reg. A, 17 C.F.R. § 230.256(c) (Supp. 1959), which reads:

"Any written advertisement or other written communication, or any radio or television broadcast, which states from whom an offering circular containing the information specified in Schedule I of Form 1-A may be obtained and in addition contains no more than the following information may be published, distributed or broadcast at or after the commencement of the public offering to any person prior to sending or giving such person a copy of such circular:

(1) the name of the issuer of such security;

(2) the title of the security, the amount being offered, and the per-unit offering price to the public;

(3) the identity of the general type of business of the issuer; and

(4) a brief statement as to the general character and location of its property."

32 SEC Reg. A, 17 C.F.R. § 230.257 (Supp. 1959).

33 48 Stat. 75, as amended, 15 U.S.C. § 77c(a)(11) (1958):

"(Except as hereinafter expressly provided, the provisions of this title shall not apply to any of the following classes of securities. . .)"

"Any security which is a part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within, or, if a corporation, incorporated by and doing business within, such State or Territory."

erally regarded as being somewhat hazardous.[34] Several reasons for this general opinion are: it is difficult from a practical standpoint to limit offers solely to residents; the issuer may unknowingly sell to a person who is merely acting as an agent for a nonresident principal; and the offer or sale of one of the securities to a nonresident would vitiate the exemption for a sale that had been made pursuant to a good exemption many months before. Loss of the exemption results in a situation of probably having sold in violation of the registration requirements of the act and would probably subject the issuer and possibly others to civil suit under the civil liability provisions of the act.

Once it is determined that the exemption offered by section 3(a) (11) has been claimed for the public offering, an immediate question is raised concerning its validity in light of the proposed offering under regulation A.[35] upon reading that section it becomes clear that the problem involves the wording itself, which requires that all offers and sales of the total issue of securities be confined solely to residents of the state where the issuer resides, or is incorporated, and does business. In other words, the entire issue offered for sale under section 3(a) (11) must be confined to residents of the particular state and this exemption may not be used in combination with any other exemption or registered offering which would result in a public offering of a part of the issue to nonresidents. Initially, it must be realized that the term "issue" has a specialized meaning. If offerings by an issuer which are separate can be considered integrated because of, among other things, the similarity of the security offered, the similarity of purpose and use of receipts of the offering, the similarity of the consideration received, or the nearness in time of the offerings, then the offerings would probably be part of the same issue. Conversely, each offering would be considered a separate issue if they were sufficiently different to be non-integrated. Thus, it is apparent that if the recent offering to residents under the section 3(a) (11) exemption may be integrated with the offering pursuant to regulation A which may constitute an offer to nonresidents, the issuer loses the exemption for the previous offering to residents as soon as an offer is made to a nonresident even though that subsequent offer is made pursuant to another exemption. Therefore, since the exemption is considered lost for prior sales, it follows that those prior sales may have been made in violation of the registration requirements of the Securities Act.

There are several consequences that flow from this conclusion. Under the terms and conditions of regulation A, specifically rule 254(a) (3) thereof,[36] the issuer must include, for purposes of computing the total amount of securities being offered, all securities sold

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34 For a recent interesting case pointing out some of the hazards of this exemption, see *SEC v. Hillsborough Investment Corp.*, 173 F. Supp. 86 (D.N.H. 1958).

35 The question is raised by the mechanics of item 9 of Form 1-A under regulation A, which requires the disclosure of certain information regarding the issuance of any securities by the issuer and certain others within the one year prior to the filing of the Form 1-A. At this point the number of shares issued, the consideration received and an indication of whether or not the issuance involved a public offering are revealed. The statement required by item 9(c) provides the crux of the problem. There the issuer is required to state the exemption relied upon for the sales listed in item 9(a).

36 SEC Reg. A, 17 C.F.R. § 230.254(a)(3) (Supp. 1959).

in violation of section 5(a) of the act[37] within one year prior to the commencement of the proposed offering. Therefore, if the issuer had sold $100,000 of stock to residents of its state of residence or incorporation within the one-year period claiming the section 3(a)(11) exemption and if that offering and the proposed offering are integrated, it could now only offer $200,000 of stock claiming the exemption provided by regulation A, in order to stay within its $300,000 limitation.

The second major consequence arises in connection with necessary disclosures to be contained in the offering circular. If, under the above suggested circumstances, the issuer should determine that it has in fact sold securities in violation of section 5 of the Securities Act, it would probably follow that the issuer would be liable to all of the purchasers of the securities sold in violation, under the provisions of section 12 of the act[38] if suit were appropriately brought by them. Thus, for adequate disclosure, it would ordinarily be necessary to reflect the total amount of such contingent liability at an appropriate place in the offering circular.

CONCLUSION

It is hoped the foregoing discussion will aid those attorneys who are faced with the prospect of advising and assisting a client who is making a public offering pursuant to regulation A. While the problems raised and analyzed are common, they by no means pervade every offering carried out under regulation A. The normal filing and offering, if approached with a minimum amount of caution and preparation, should not pose any great difficulty from the standpoint of the regulation and its background statute. The attorney facing the prospect of a regulation A offering for the first time may gain confidence from the fact that the staff of the Commission's regional offices are usually available to provide assistance prior to the time any filing is made. Finally, even though the preparation and guidance of a regulation A offering does entail some work, it is the conclusion of most thoughtful attorneys that the exemption provides the most satisfactory solution short of the burdensome requirements of registration while still providing the investor the protection that he deserves.

37 Securities Act of 1933, § 5(a), 48 Stat. 77, as amended, 15 U.S.C. § 77e(a) (1958) (prohibitions relating to interstate commerce and the mail).
38 Securities Act of 1933, 48 Stat. 84, as amended, 15 U.S.C. § 77l (1958).