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Issuer Registration and Distributions

LEE B. SPENCER, JR.*

I. Introduction

I will be speaking on the part of the proposed Code which governs company registration, Part IV.¹ I will also be discussing the concept of the one-year registrant, an important innovation under the Code.² The one-year registrant provisions affect, among other things, the operation of many of the Code's filing provisions, which I will discuss shortly. Let me begin by briefly describing Part IV of the Code, since this general background is helpful in understanding the one-year registrant concept.

II. A Comparison of Registration Procedures Under the Code and Under Present Law

Part IV of the Code effects a major conceptual change in today's law by requiring the registration of companies rather than of securities.³ Company registration provides the foundation for the Code's continuous disclosure system; registered companies are subject to the periodic reporting,⁴ proxy,⁵ tender offer⁶ and insider filing provisions⁷ of Part VI of the Code. Under

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1. ALI FED. SEC. CODE (1980) (Official Draft). References in this speech are to the 1980 draft of the Proposed Code.

2. See notes 49-53 and accompanying text *infra*.

3. ALI FED. SEC. CODE § 402(a) (1980). This section requires a person to register. A person is defined in section 202(121) as a "natural person, company, government, or political subdivision, agency, or corporate or other instrumentality of a government." *Id.* § 202(121).

4. *Id.* § 602.

5. *Id.* § 603.

6. *Id.* § 606.

the Code, registration of the company can occur in any one of four ways.

First, section 402(a) requires registration of a company "within one hundred twenty days after the last day of the first fiscal year in which it has at least \$1,000,000 of total assets and 500 holders of its securities (other than exempted securities within Section 302)."⁸ This section drops all reference to "class" and to "equity," references contained in section 12(g) of the Securities Exchange Act of 1934 (the 1934 Act).⁹ Therefore, as the comment to section 402 notes, a company could have 250 non-convertible debt holders and 250 equity holders and still be required to register under the Code;¹⁰ this is not the case under present law which requires 500 holders of a "class of equity" securities.¹¹ Thus the Code, drawing in part on the logic of section 15(d) of the 1934 Act¹² (which is not limited to equity), eliminates the artificial class requirement of section 12(g).¹³ The comment states that it is the number of public security holders, not the class characterization of the holders, that should trigger registration requirements.¹⁴

Section 402 excludes "exempted securities" from the 500 holder count. Exempted securities are listed in Part III of the Code.¹⁵ While a detailed discussion of Part III is beyond the scope of my remarks, Part III is generally patterned after section

7. *Id.* § 605.

8. *Id.* § 402(a).

9. Securities Exchange Act of 1934, § 12(g), 15 U.S.C. § 78l(g) (1976). Section 78l(g)(1)(B) requires registration only of issuers with total assets exceeding \$1,000,000 "and a class of equity security (other than an exempted security) held of record by five hundred or more. . . ." *Id.* § 78l(g)(1)(B).

10. ALI FED. SEC. CODE § 402(a), Comment (1) (1980).

11. Securities Exchange Act of 1934, § 12(g), 15 U.S.C. § 78l(g) (1976).

12. *Id.* § 15(d), 15 U.S.C. § 78o(d) (1976).

13. *Id.* § 12(g), 15 U.S.C. § 78l(g) (1976).

14. ALI FED. SEC. CODE § 402(a), Comment (1) (1980).

15. ALI FED. SEC. CODE § 302 (1980). These exempted securities include the securities of American governments, of certain indigenous bodies, of certain international banks, and banks generally, as well as interests or participations in bank common trust funds, in employee plans, in pensions or similar arrangements. Also exempted would be securities of savings and loan associations, securities issued under certain indentures, securities issued by a cooperative or a nonprofit company, commercial paper, railroad equipment trust certificates, and debt securities issued by a receiver with the approval of a court.

3 of the Securities Act of 1933 (the 1933 Act),¹⁶ and in addition, contains a grant of broad authority to the Commission to exempt by rule or order securities, persons, and transactions.¹⁷ Part IV, however, does not exempt insurance companies from registration, as does the 1934 Act,¹⁸ and it does not shift jurisdiction over banks to banking regulatory agencies, as does the 1934 Act.¹⁹

In order to ease entry into the reporting system under the proposed Code, section 402(a) does not require new filings from companies with existing registration statements under the 1934, 1935 and 1940 Acts, or companies subject to section 15(d) reporting obligations.²⁰ The Commission does, however, have rule-making authority under section 602(b) to require presently reporting companies to file reports containing whatever additional information is necessary to implement the Code's disclosure system.²¹

Second, the registration of a company can occur under the Code pursuant to section 403.²² Section 403 provides that a person who is not already a registrant must file a registration statement by the time an "offering statement" is required to be filed under section 502(a) or 502(b).²³ Section 502 will be discussed in detail later.²⁴ It is sufficient to say here that "offering statements" are essentially equivalent to present registration state-

16. Securities Act of 1933, § 3, 15 U.S.C. § 77(c) (1976).

17. ALI FED. SEC. CODE § 303(a) (1980). This section provides:

(a) COMMISSION.—The Commission, by rule or order, may exempt any person, security, or transaction, or any class of persons, securities, or transactions, from any or all of the provisions of this Code, except that section 303(a) does not apply with respect to (1) section 1506 or 1904, (2) a provision that prohibits the fixing of minimum profits or the imposition of any schedule, or the fixing of rates, of commissions, allowances, discounts, or other fees, or (3) a rule of a bank regulator.

18. Securities Exchange Act of 1934, § 12(g)(2)(G), 15 U.S.C. § 78l(g)(2)(G) (1976).

19. *Id.* § 12(i), 15 U.S.C. § 78l(i) (1976).

20. ALI FED. SEC. CODE § 402(a) (1980).

21. *Id.* § 602(b). This section provides:

(b) INTEGRATION OF FILINGS.—The Commission, by rule, may require the annual reports, at specified intervals, to integrate and replace the registration statement and all reports filed since the registration statement, or the last filing under section 602(b).

22. *Id.* § 403.

23. *Id.*

24. See notes 64 & 67-71 and accompanying text *infra*.

ments under the 1933 Act.²⁵ Therefore, a company is required to register at the time it makes its first non-exempt sale of securities. The comment to section 403 indicates that the registration statement and offering statement could be filed with the Commission as a single document, and both would become effective simultaneously.²⁶ Furthermore, section 403 is somewhat similar to section 15(d) of the 1934 Act in that it imposes a subsequent reporting requirement.²⁷ Section 403, however, goes further than section 15(d) by subjecting a company to proxy, tender offer and short-swing profit provisions, while section 15(d), rule 13e-4 notwithstanding, does not.²⁸

Third, section 902 of the Code requires a company to register before its securities may be traded on a national securities exchange or quoted in an electronic interdealer quotations system.²⁹ This section is the analogue of section 12(b) of the 1934 Act.³⁰

Fourth, a company may register voluntarily under section 402(b), unless the Commission "provides otherwise by rule or order."³¹ Present law also permits voluntary registration.³²

25. See ALI FED. SEC. CODE § 502(a), Comment 2 (1980).

26. *Id.* § 403, Comment.

27. *Id.* § 403. This section provides:

In the absence of an exemption under section 512 or 514, a person that is not already a registrant shall file a registration statement not later than the time when it is required by section 502(a) or (b) to file an offering statement.

For the provision which relates to subsequent reporting in current law, see 15 U.S.C. § 78o (1976).

28. *Id.*

29. ALI FED. SEC. CODE § 902(a) (1980). This section provides:

(a) EXCHANGE TRADING: GENERAL.—It is unlawful for a national securities exchange to permit trading in a security (other than a Government or municipal security) unless (1) its issuer is a registrant, and . . . (B) the Commission, by order, permits the extension of unlisted trading privileges on application of the exchange and on a finding that such action will be consistent with the maintenance of fair and orderly markets.

30. Securities Exchange Act of 1934, § 12(b), 15 U.S.C. § 78l(b) (1976).

31. ALI FED. SEC. CODE § 402(b) (1980). This section provides:

(b) VOLUNTARY REGISTRATION.—Except to the extent that the Commission provides otherwise by rule or order, a person may file a registration statement under section 402 although it is not required to do so.

32. The Securities Exchange Act of 1934, § 12(g)(1)(A), 15 U.S.C. § 78l(g)(1)(A) (1976). This section provides for permissive filing:

[A]ny issuer may register any class of equity security not required to be registered by filing a registration statement pursuant to the provisions of this paragraph.

III. The Proposed Code: Content, Effectiveness and Termination of Registration

A. Content

With this general overview in mind, I would like to turn to the specific provisions dealing with content, effectiveness and termination of registration statements. Section 404 governs the content of issuer registration statements and states that such statement "shall contain whatever information, financial statements, material contracts, and other documents the Commission specifies by rule."³³ As noted in the comments to this section, section 404 represents an effort to streamline present statutory disclosure requirements.³⁴ In this regard, the Commission would be granted rule-making authority by Part XVIII to determine when certification of financial statements is required, and also to control format, to classify registration statements, and to permit or require incorporation by reference.³⁵

B. Effectiveness

With respect to effectiveness, section 405 states that a registration statement "becomes effective on the thirtieth day after filing of the registration statement or the last pre-effective amendment," absent a stop order proceeding pursuant to section 1808(d).³⁶ The Code has shortened the waiting period for effectiveness to 30 days from the 60 days which are currently required under section 12(g) of the 1934 Act.³⁷ By contrast, with respect to offering statements filed under Part V of the Code, the waiting period has been extended to 30 days from the present 20 days under the 1933 Act.³⁸

33. ALI FED. SEC. CODE § 404 (1980).

34. *Id.* § 404, Comment (1). The requirements which will be streamlined by this section include those found in section 7, schedules A and B of the 1933 Act, and section 12(b) of the 1934 Act. Section 505(a) acts in a similar fashion to streamline the content of offering statements. *Id.* § 505(a).

35. *Id.* § 1805.

36. *Id.* § 405. Section 1808(d) allows the Commission to suspend an offering or a distribution when the statement contains a misrepresentation or omits a document or a required material fact. *Id.* § 1808(d).

37. Securities Exchange Act of 1934, § 12(g), 15 U.S.C. § 78l(g) (1976).

38. Compare ALI FED. SEC. CODE § 405 (1980) with Securities Act of 1933, § 8(a), 15 U.S.C. § 77h(a) (1976).

Section 2003(b) contains the authority for the Commission's general acceleration power for "any filing, taking into consideration the facility with which the contents of the filing can be understood and, when the filing relates to an issuer, the adequacy of the publicly available information with respect to the issuer."³⁹ The source reference of section 2003 indicates that this general provision replaces the "or within such shorter time as the Commission may direct" language of the 1934 Act, section 12(g)(1).⁴⁰ With respect to liability, section 1704(a), like section 18 of the 1934 Act, applies only to effective registration statements.⁴¹

C. Termination

Finally, section 406 provides that registration under section 402 or section 403 generally terminates on the 90th day after the company certifies that, as of the last day of its last preceding fiscal year, the number of holders of all its nonexempt securities was less than 300.⁴² If, however, the Commission brings a proceeding to terminate registration of a company with less than 300 holders⁴³ or a compliance order proceeding to require the company to register, file reports or file additional information in connection with a deficient registration statement,⁴⁴ registration

39. ALI FED. SEC. CODE § 2003(b) (1980).

40. *Id.* § 2003(b), Source Statement.

41. *Id.* § 1704(a). Compare this section of the proposed Code with Securities Exchange Act of 1934, § 18, 15 U.S.C. § 78(r) (1976).

42. ALI FED. SEC. CODE § 406(a) (1980). This section provides:

(a) DATE OF TERMINATION.—A registration under section 402 or 403 terminates on the ninetieth day after the issuer files a certification with the Commission that the number of holders of all its securities (other than exempted securities within section 302) was less than three hundred as of the last day of its last preceding fiscal year, unless a proceeding under section 1808(b) or (c) is pending or instituted before that ninetieth day, in which event the registration terminates (1) on the ninetieth day after dismissal of the proceeding if it is dismissed, or (2) otherwise whenever and on whatever conditions the Commission determines by order.

43. *Id.* § 1808(b). This section provides:

(b) FEWER THAN THREE HUNDRED HOLDERS.—If the Commission finds that a registrant under section 402 or 403 has fewer than three hundred holders of its securities (other than exempted securities within section 302), the Commission, by order, may terminate the registration.

44. *Id.* § 1808(c). This section provides:

(c) COMPLIANCE ORDERS.—If the Commission finds (1) that an issuer is in vio-

cannot terminate until 90 days after the proceeding is terminated or whenever, and upon whatever conditions, the Commission orders.⁴⁵ The comment to this section notes that this provision is designed to prevent voluntary termination "under fire."⁴⁶

A registration statement may be withdrawn pursuant to section 406(b) if it was filed by an initial section 403 registrant⁴⁷ whose offering statement is withdrawn with the Commission's consent, or if it was filed pursuant to section 902 because of an application for listing on a national securities exchange or inclusion in an interdealer quotations system, which application is denied or withdrawn.⁴⁸

IV. The One-Year Registrant

A. Definition

My discussion up to this point has given you a general idea of how company registration operates under the Code. Before looking at sales of securities under the Code, it is worthwhile to stop and note a very important concept in the Code which derives from registration — the one-year registrant status. Section 202(113) defines a one-year registrant as a "registrant that has been continuously a registrant for one year."⁴⁹ This status is au-

lation of section 402(a) or 602, or (2) that a registration statement or report filed by an issuer (or material incorporated therein by reference) contains a misrepresentation, or omits a document or material fact required, the Commission, by order, may require the issuer to file within a specified time whatever is necessary.

45. *Id.* § 406(a). For the text of this section, see note 42 *supra*.

46. *Id.* § 406(a), Comment 5.

47. See note 27 *supra*.

48. ALI FED. SEC. CODE § 406(b) (1980). This section provides:

(b) WITHDRAWAL OF REGISTRATION STATEMENT.—A registration statement under section 403 may be withdrawn (1) when the Commission consents to withdrawal of the related offering statement under section 502(e), or (2) if it is filed solely to comply with section 902(a)(1) or 902(c) and an application for listing on a national securities exchange or inclusion in an electronic interdealer quotations system is denied or withdrawn.

49. *Id.* § 202(113). This section provides:

(113) ONE-YEAR REGISTRANT.—"One-year registrant" means a registrant that has been continuously a registrant for one year. That status is automatically suspended (except with respect to a defendant under section 1702 who proves that he reasonably believed, at the time of the transaction alleged to create liability, that there was no such suspension of status) while a suspension of trading under section 903(d)(2), a stop order under section 1808(d) or (e) with respect to an offering statement, or a suspension of an investment company's registration under section

tomatically suspended if there is a trading suspension or a stop order, except with respect to a defendant under Code section 1702 who proves he reasonably believed that there was no such suspension of status. Moreover, unless the Commission provides otherwise, a company may not "tack" its previous status as a one-year registrant upon regaining such status, *i.e.*, the one-year period starts anew after suspension.⁵⁰

The one-year registrant concept relates to notions of the efficient market theory, which postulates that information filed with the Commission is adequately reflected in the market price of the security. Since that information has been absorbed into the market, there is no real reason to require a company to reiterate that information in a prospectus. This is similar to the notion that the Commission has already used in its Form S-16 registration statement, which basically does no more than require a company to describe the offering, again on the theory that the market has already absorbed the relevant information.⁵¹ This theory is generally accurate, since these S-16 companies have a large following of market analysts who pour over the annual reports on form 10-K and the quarterly reports on form 10-Q.

B. *Benefits Which Attach to One-Year Registrant Status*

The broad benefits which attach to the one-year registrant status are essentially in the form of reduced reporting and filing

1808(i) is in effect. Unless the Commission provides otherwise in vacating such a suspension or stop order or an order under section 1808(a), a company does not become a one-year registrant (whether or not it previously had that status) until it is continuously a registrant for one year thereafter.

50. *Id.* See note 49 *supra*.

51. The Commission has reflected its reliance on this theory in its continuing effort to integrate the disclosure provisions of the 1933 and 1934 Acts and in important releases such as SEC Sec. Act Release No. 33-6176, 19 SEC Docket 186 (1980), in which we proposed a new scheme of integration of the 1933 and 1934 Acts in connection with proposed revisions to the Annual Report on Form 10-K.

Subsequent to this presentation, certain of the previously proposed amendments aimed at integrating the 1933 and 1934 Acts were adopted by the Commission. In this regard, see 20 SEC Docket 1057, 1059, 1092, 1115 (1980): SEC Sec. Act Release No. 33-6231 (concerning Form 10-K); SEC Sec. Act Release No. 33-6232 (concerning Form S-15); SEC Sec. Act Release No. 33-6233 (concerning Reg. S-X). In addition, the Commission, in a further effort to integrate the disclosure system under the federal securities laws, published for comment three new forms to be used to register offerings of securities under the 1933 Act. See SEC Sec. Act Release No. 33-6235, 20 SEC Docket 1175 (1980).

requirements. For example, the trading transaction and limited offering exemptions, as well as the provisions relating to secondary distributions and the content of offering statements and prospectuses, are applied less strictly to one-year registrants.⁵²

Similar benefits, such as use of abbreviated forms, are presently available to companies that meet certain qualifications set out by the Commission.⁵³ These qualifications are of a type which tend to indicate either that the issuer is a solvent company or that the issuer's stock is widely traded. Both of these factors would logically dictate a reduction in prospectus disclosure.

Let me emphasize, however, that the one-year registrant concept goes much further than the theories employed to date by the Commission in establishing these qualifications. The present Commission guidelines are based on the assumption that logical lines can still be drawn between those companies whose periodic information can be digested by the market and other companies for which it is unrealistic to make such an assumption. The one-year registrant notion abandons the need to draw those lines, and I am not sure that logic supports this result. There is not, to my mind, a complete identity between the companies which will receive one-year status under the Code and those for which the market can readily assimilate information.

V. Proposed Registration Procedures for Public Offerings and Sales

I will turn now to the next portion of my talk which deals with Part V of the Code,⁵⁴ and will again touch on some of the consequences of one-year registrant status.⁵⁵ The Code's registration procedure for public offerings and sales of securities would operate in a manner substantially different from that of today's registration procedures.

52. ALI FED. SEC. CODE § 202(113), Comment, (1980). This comment states: Because of the Code's shift in emphasis from the state's disclosure concept of the 1933 Act to the continual disclosure concept of the 1934 Act, the successor provisions to the 1933 Act are applied less strictly in a number of respects to one-year registrants.

53. See note 51 *supra*.

54. See ALI FED. SEC. CODE §§ 501-515 (1980).

55. For the definition of the one-year registrant, see note 49 *supra*.

A. *Distribution*

The key element in Part V, and perhaps one of the most important changes from present law effected by the Code, is the concept of distribution. The term distribution is defined by the Code as "an offering other than a limited offering, or an offering made by means of one or more trading transactions."⁵⁶ The limited offering exemption⁵⁷ under the definition of distribution is essentially the Code analogue of the section 4(2) exemption under the 1933 Act,⁵⁸ while the trading transaction exemption is derived from sections 4(1)⁵⁹ and 4(4) of the 1933 Act.⁶⁰

It is essential to realize that, under the distribution definition, the Code abandons the concept of control in determining whether or not an offering statement must be filed.⁶¹ The notion

56. ALI FED. SEC. CODE § 202(41) (1980). The version of the proposed Code which incorporated changes agreed upon by Professor Loss and the Commission adds a subsection, § 202(41)(B)(iv), granting the Commission rule-making authority to require, under some circumstances, further distribution of the corporation's reports. The comment to this change explains that this clause "reflects the view that those conditions should add to the 'one-year registrant's' continuous disclosure rationale some assurance that the market adequately reflects that disclosure." SEC Sec. Act. Release No. 33-6242, 20 SEC Docket 1483, 1486 (1980).

57. *Id.* § 202(41)(B)(i). This section provides:

(B) LIMITED OFFERING.—(i) A "limited offering" is one in which the following conditions are satisfied: (I) the initial buyers of the securities are institutional investors or not more than thirty-five other persons or both, or the seller reasonably so believes; (II) resales of any of the securities (otherwise than pursuant to an offering statement or an exemption) within three years after the last sale (in the sense of contract to sell) to any of the initial buyers other than institutional investors do not result in more than thirty-five owners of those securities (apart from any institutional investors and persons who become owners otherwise than by purchase) at any one time; and (III) the seller and all resellers comply with any rules adopted under section 202(41)(B)(iv).

58. Securities Act of 1933, § 4(2), 15 U.S.C. § 77d(2) (1976). This section provides: The provisions of section 77e of this title shall not apply to—

...

(2) transactions by an issuer not involving any public offering.

59. Securities Act of 1933, § 4(1), 15 U.S.C. § 77d(1) (1976). This section provides: The provisions of section 77e of this title shall not apply to—

(1) transactions by any person other than an issuer, underwriter, or dealer.

60. Securities Act of 1933, § 4(4), 15 U.S.C. § 77d(4) (1976). This section provides: The provisions of section 77e of this title shall not apply to—

...

(4) brokers' transactions executed upon customers' orders on any exchange or in the over-the-counter market but not the solicitation of such orders.

61. ALI FED. SEC. CODE § 202(41) (1980).

of control, which is so prevalent and sometimes troublesome in today's securities laws, essentially would be gone.⁶² This means, for example, that all secondary nonexempt distributions would be required to be registered regardless of whether or not the offering person is an affiliate of the issuer. The premise of the proposed Code's distribution theory is that anyone selling a share of stock, unless he can find an exemption, is engaged in a distribution and must therefore register the stock. The theory which has supported the control concept in present law is that a seller may not be able effectively to ensure that a registration statement is filed if that seller is not in control of the issuer.⁶³ It has thus been thought only fair to place the filing obligation upon a person who has control. The Code makes a major change here and broadens present law. The seller's relationship to the issuer is no longer relevant under the Code; only the volume of securities to be sold and the manner of sale are important.⁶⁴

B. *Filing on Demand*

Section 502(b)⁶⁵ of the Code deals with "filing on demand." This procedure permits a holder of non-one-year registrant securities to force the issuer to make the filing necessary to effect a distribution of those securities. This section, which has no counterpart in the 1933 Act, is necessary because the Code subjects all nonexempt secondary distributions, regardless of the control status of the holder, to the filing provisions of Part V. Without the filing on demand provision, a noncontrolling shareholder (who is not in a position to compel the issuer to file) could be locked into his investment, unable to distribute without a filing and yet powerless to submit or compel that filing.⁶⁶

If the filing on demand procedure is invoked, there are several provisions regarding its operation which must be satisfied

62. Compare Securities Act of 1933, § 2(11), 15 U.S.C. 77b(11) with ALI FED. SEC. CODE § 202(41) (1980). For a discussion of recent law in this respect, see Campbell, *Defining Control in Secondary Distributions*, 18 B.C. INDUS. & COM. L. REV. 37 (1976).

63. See Note, *The Meaning of "Control" in the Protection of Investors*, 60 YALE L. J. 311, 321 (1951).

64. ALI FED. SEC. CODE § 202(41) (1980).

65. *Id.* § 502(b).

66. This locked-in effect would only occur if no exemption provisions are available. See *id.* §§ 302, 512, 514.

by the seller of securities who wishes to make a public offering or distribution under the Code. First, the seller must bear the cost of the offering and deposit an amount sufficient to cover the cost with the company in advance of the offering. Second, the seller must supply an opinion of counsel that the distribution is required to be registered. Third, this procedure is not available to a person who has executed an express waiver of his rights, or who has received stock with legally binding restrictions on transfer.⁶⁷

Assuming the conditions for filing on demand are satisfied, the issuer, under the Code's complex scheme, must file an offering statement and, if not already a registrant, a registration statement within sixteen months after demand⁶⁸ and use his best efforts to have the offering statement declared effective.⁶⁹ There is also a provision that would, in effect, allow the company to buy back the securities from the person wishing to sell should the issuer wish to avoid becoming subject to the consequences of registration.⁷⁰

C. *The Offering Statement*

Under the Code, the offering statement replaces today's 1933 Act registration statement, and the filing of such statement is governed by section 502(a).⁷¹ This section is similar to section

67. *Id.* § 502(b)(6)(A). This section provides that section 502(b) is inapplicable

(A) with respect to securities held by a person who (i) executed an express waiver of his rights, (ii) is contractually or legally bound by a restriction on transfer that would be violated by the proposed distribution, or (iii) acquired the securities with knowledge that the person from whom he acquired them or a prior owner had executed such a waiver, or with knowledge of such a restriction that purported to bind transferees (except that knowledge need not be shown if the waiver or restriction is noted conspicuously on the securities).

68. *Id.* § 502(b)(1)(A).

69. *Id.* § 502(b)(1)(B).

70. *Id.* § 502(b)(6)(C).

71. *Id.* § 502(a). This section provides:

(a) **FILING REQUIREMENT.**—It is unlawful for any person in connection with a distribution by him or resulting from his offer (or for an underwriter, broker, or dealer in connection with a distribution by any person) to offer a security, or for a broker or dealer to offer to buy a security from an underwriter in connection with a distribution by or through the underwriter, (1) unless the issuer has filed an offering statement with respect to the distribution, or (2) while an offering statement with respect to the distribution is the subject of a stop order under section 1808(d) or (e) or (before the effectiveness of the offering statement) a public pro-

5(c) of the 1933 Act⁷² and provides that it is "unlawful for any person in connection with a distribution by him or resulting from his offer," or for an underwriter, broker, or dealer in connection therewith, to offer a security unless the issuer has filed an offering statement.⁷³

I would like to note here that section 202(110)(A) of the Code defines "offering" to include, as separate offerings, offers of securities of different classes. Under the Code definition, if the offering is of a different class of securities, it is simply a separate offering.⁷⁴ Perhaps the definition of "class of securities" in section 202(20), which states that securities of substantially similar character and rights are one class of securities, will alleviate any possibility of abuse.⁷⁵

The content of the offering statement is governed by section 502(c)⁷⁶ which specifies that such statement should include a prospectus and any other information, financial statements, material contracts, or documents the Commission, by rule, requires. A relatively broad flexibility is given to the Commission by this section. This paragraph, however, specifically states that Commission rules should be "designed to avoid unnecessary repetition of matters contained in prior filings."⁷⁷ The comment to this latter provision notes approvingly Form S-16, the short-form registration concept that the Commission has already devised under current law, and, therefore, the use of that form presumably would be continued.⁷⁸

Section 505⁷⁹ would give the Commission general rule-mak-

ceeding under either section or a public investigation under section 1806(d)(1).

72. Securities Act of 1933, § 5(c), 15 U.S.C. § 77e(c) (1976). This section provides: It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 77h of this title.

73. See note 71 *supra*.

74. ALI FED. SEC. CODE § 202(110)(A) (1980).

75. *Id.* § 202(20).

76. *Id.* § 502(c).

77. *Id.*

78. *Id.* § 502(c)(1), Comment.

79. *Id.* § 505(a). This section provides:

ing authority to prescribe the contents of the prospectus. In addition, this section requires the Commission to tailor the content requirement according to whether or not the issuer is a one-year registrant.⁸⁰

There are no notable changes from current law with respect to offers during the waiting period and after the onset of effectiveness, and I will not discuss these provisions in detail.⁸¹ I would, however, like to mention one difference. Section 504⁸² varies from present law in that it permits a confirmation of sale to be made with the preliminary prospectus. This is not to say that delivery of securities or acceptance of payment, whichever occurs first, can be made before delivery of a definitive prospectus; they cannot. But a confirmation can be, and this possibility is something new. The comment indicates that this change is meant to resolve the problem which arises from the difficulty of getting prospectuses out in time.⁸³

In passing, I might also mention that Part V of the Code codifies the time as of which an offering statement speaks.⁸⁴

D. *The Privilege of Disaffirmance*

Section 504(b) contains a provision without precedent in the present law — the privilege of disaffirmance.⁸⁵ This privilege

(a) **CONTENTS.**—The Commission by rule (1) shall specify how much of the contents of the offering statement and prior filings shall be included in a prospectus, and (2) may require the inclusion of an introductory summary.

80. *Id.* § 505(a)(2). This section provides:

In implementing section 505(a), the Commission shall consider whether the issuer is a one-year registrant.

81. *See id.* § 503; Securities Act of 1933, §§ 2(10), 5(b)(1), 15 U.S.C. §§ 77b(10), 77e(b)(1) (1976).

82. ALI FED. SEC. CODE § 504 (1980).

83. *Id.* § 504(a), Comment (1).

84. *Id.* § 509.

85. *Id.* § 504(b). This section provides:

(b) **PRIVILEGE OF DISAFFIRMANCE.**—When the issuer is not a one-year registrant at the time of the sale, and in other cases in which the Commission provides by rule or order, a sale that is subject to section 503(a)(1) is not binding on the buyer if he proves that notice of disaffirmance was delivered to the seller's business address not later than five o'clock in the afternoon (legal time at the seller's address) of the second business day after the date of the buyer's receipt of a prospectus and notice of his right under section 504(b); but (1) section 504(b) does not apply if the seller proves that the latest available prospectus or preliminary prospectus at the time of the sale was given to the buyer or delivered at the ad-

gives the buyer, under certain circumstances, an opportunity to renege on his purchase. This privilege is available when the issuer is not a one-year registrant, and, in other cases, if the Commission so provides.⁸⁶ A person wishing to exercise this privilege must show that he did not receive the prospectus more than two days in advance of the date of sale.⁸⁷

This provision is similar to current guidelines which require a first-time registrant to deliver a preliminary prospectus at least 48 hours before the final sale.⁸⁸ It is an attempt to grapple with what is thought to be a quirk in the present law, *i.e.*, the only time a purchaser receives the prospectus is after he has bought his security.⁸⁹ In practice, the preliminary prospectus is circulated, and the final prospectus is usually sent only after an investment decision has been made. The privilege of disaffirmance for non-one-year registrants would be a change and would give purchasers a right to back out for two days after the buyer's receipt of the prospectus.

Some believe that current law on the privilege of disaffirmance is unclear, because the area is not now specifically covered by federal statute. The Uniform Commercial Code could have relevance here, though its application is not exactly certain. I recall one case, some years back, involving a bank holding company which made a large number of changes in the final prospectus. Subsequently, purchasers sued for an injunction just before the closing on the deal. The request for an injunction was not granted by the judge, on the theory that purchasers could elect not to pay at the closing, along the lines of Uniform Commercial Code provisions dealing with "nonconforming" goods.⁹⁰

dress furnished by him not later than the second business day before the date of the sale, and (2) the period with respect to receipt of notice of disaffirmance is the first instead of the second full business day if the seller proves that such a document was so given or delivered not later than the first full business day before the date of the sale.

86. *Id.*

87. *Id.*

88. SEC Sec. Act Release No. 33-4968, 34 Fed. Reg. 7235 (1969).

89. See, *e.g.*, Lobell, *Revision of the Securities Act*, 48 COLUM. L. REV. 313 (1948). "For fear of not getting a good buy investors forego or are tempted to forego early receipt of a prospectus. Distributors can legally withhold prospectuses until the acts of salesmanship or economic pressure have committed the purchaser to the transaction." *Id.* at 323.

90. A buyer may reject goods that "fail in any respect to conform to the contract."

This area is a little bit opaque under current law. The proposed provision would, as a matter of statute, resolve the issue for the non-one-year registrant.

E. *Post-Effective Amendments*

Section 508(a)(1)(B) requires the filing of a post-effective amendment when a "subsequent event" makes an offering statement misleading.⁹¹ As the comment notes, this reflects the explicit duty to correct found in section 1602(b).⁹² Unless a post-effective amendment is required by Commission rule or order in the case of a continuous or deferred distribution, section 508(a) specifically provides that post-effective amendments are only required so long as sales are being made or confirmed.⁹³ If a post-effective amendment is filed only to correct a deficiency or to supplement or change the prospectus, it becomes effective upon sending or delivery. In other words, if the issuer is making an offering and a material change occurs, then he has to supplement his registration statement by a post-effective amendment which becomes effective automatically.

VI. Secondary Sales

I would like to close with a few words on secondary sales. As previously noted, the Code abandons the control concept and subjects all nonexempt secondary distributions to filing.⁹⁴ A secondary distributor is any person, other than the issuer, "by whom or for whose account or benefit a distribution is made."⁹⁵ Assuming that there is no exemption from filing and that the issuer is a one-year registrant, section 510 essentially treats the secondary distributor as the issuer.⁹⁶

A secondary distributor may elect to comply with a simplified filing procedure.⁹⁷ If he so elects, he must file a short docu-

UCC § 2-601. Goods conform if they "are in accordance with the obligations under the contract." UCC 2-106.

91. ALI FED. SEC. CODE § 508(a)(1)(B) (1980).

92. *Id.* § 508(a), Comment (2).

93. *Id.* § 508(a).

94. See notes 61 & 62 *supra*.

95. ALI FED. SEC. CODE § 202(148) (1980).

96. *Id.* § 510.

97. *Id.*

ment (a "distribution statement") which basically describes who he is, what the offering is, and any additional information that he would like to include. The rest of the description of the company is, in effect, provided in the company's periodic filings.

The distribution statement as filed must contain a certification⁹⁸ that the secondary distributor does not know of any additional information that he would otherwise have to disclose under either the provisions which prohibit fraud and misrepresentation or the provisions on insider trading.⁹⁹ It is logical to assume that such additional information would rarely be known by someone who does not control or have any real relationship to the company. On the other hand, if one in control did know more about the security than was disclosed in the public record filed with the Commission, he would be compelled to include that information or would be subject to civil and criminal penalties. In this respect, the certification requirement preserves a bit of the distinction between controlling and noncontrolling persons. There may, however, be no real duty under this section to do an independent investigation before certification.

If the issuer does not have \$100,000 in assets and at least 1,000 holders of its nonexempt securities, the Commission may require that the company's most recent annual report and all subsequent reports filed under section 602(a)¹⁰⁰ be attached to the distribution statement for physical delivery.¹⁰¹ This is an in-

98. The certification need not be delivered to the public in the distribution statement. *Id.* § 510(d).

99. *Id.* § 510(c).

100. *Id.* § 602(a). This section provides that a registrant shall

- (1) file;
- (2) send to every record holder of whatever classes of the registrant's securities (other than commercial paper) the Commission prescribes by rule;
- (3) keep for whatever periods the Commission prescribes by rule; and
- (4) publish (through press releases or otherwise), whatever annual reports (with financial statements), quarterly reports, and other reports the Commission requires by rule to keep reasonably current the information and documents contained in the registration statement or to keep investors reasonably informed with respect to the registrant.

101. As a result of discussions between Professor Loss and his advisers and the Commission and its staff, it has been proposed to amend section 510 of the Official Draft to permit the Commission, by rule, to require that the issuer's most recent annual report to security holders and all subsequent reports sent to security holders be physically attached to the distribution statement if (1) the issuer has fewer than one thousand security holders, and (2) the aggregate market value of the issuer's outstanding voting securi-

teresting concept, but, again, it is applied only to very small companies. \$100,000 in assets and 1,000 security holders would not include many companies otherwise subject to this secondary distribution provision. The general concept, however, is good. In recent Commission proposals, we state that in certain cases that type of information should be physically delivered — not for large S-16 type companies, but for certain companies which simply are not followed by analysts and whose stock prices do not reflect the information contained in the periodic reports.¹⁰² In the latter case, I do think there should be physical delivery of documents of a somewhat broader category of issuers than this section would appear to require.

VII. Summary

In summary, I think that the one-year registrant concept has some merit, but I think it has not been fully thought through and analytically justified. The notion of reliance on public reports is there, but it has to be more finely tuned, I would think, than the one-year registrant concept is in the Code today. I believe, for example, that one should consider how broadly the stock is traded and how much it is followed in the market before moving to this type of system.

VIII. Discussion

Question: The 1933 Act now establishes standards under which the Commission decides what sort of disclosure it is going to require in a particular case. While I have the greatest respect for the Commission and its staff, and history certainly justifies

ties held by non-controlling persons is not equal to whatever amount the Commission specifies by rule (which could be, for example, the \$50,000,000 figure currently used for primary offerings in Form S-16). See SEC Sec. Act Release No. 33-6242, 20 SEC Docket 1483, 1490 (1980).

102. See SEC Sec. Act Release No. 33-6235, 20 SEC Docket 1175 (1980). This release proposes three new forms (A, B and C) to be used to register offerings of securities under the Securities Act of 1933. The three proposed forms would classify issuers—on the basis of factors such as longevity of reporting, dissemination and analysis of information by the market, and financial stability—and this classification “would determine what information would be required to be presented in the prospectus or otherwise delivered to potential investors, and what already-disseminated information could be relied on, by incorporation by reference, in place of actual delivery in or with the prospectus.” *Id.*

that, I think I would like to see some standards expressed in the statute rather than total discretion being given to the Commission. I would like to know whether you have a view about section 404 in this respect.

Mr. Spencer: I do not agree. The statement, "we cannot give so much discretion," is what I call a private sector motherhood-and-the-flag issue. Yet this position has sometimes worked to the detriment of the private sector. For example, we at the Commission have experienced difficulties when we have tried intelligently and in good faith to modify the statute for current times in an effort to reduce the burdens of regulation. With changes over time, the statute with its precise standards has been more of a roadblock. In other words, I worry about a strait-jacket in these times when the staff needs to make legitimate adjustments to regulatory requirements. I think, if you get away from what I call a philosophic argument of delegation of authority to an agency, that the Commission's record in this regard has been rather good. Particularly in the area of contents of registration statements over the last ten or fifteen years, there has been a remarkable tailoring and, I think, an imaginative use of the forms to create an easier and more effective system. I would prefer to see reasonably broad discretion, though I acknowledge there is a very strong countervailing argument that an administrative agency should not be given that degree of power.

I think another aspect of your point is troublesome. There has been significant debate on disclosure in the last few years, and it would be a shame if some of that could not be put into a new law. However, I do not think anyone has the right answer on which precise items should be written into a statute. With all due respect, I do not think we would get the same ten items from any ten people on the Street about what the statutory items should be. Concrete standards, like those in Schedule A, were thought to be particularly relevant back in 1933, but they may bear little relevance to what we now think is important in light of current conditions. Yet, the statutory items remain. I can tell you, the staff is worried about what it says in Schedule A, and we wonder how we can eliminate those items we no longer believe are pertinent.

Mr. Lowenfels: But the staff has promulgated rules that would change statutory requirements. Take, as an example, an

item which appears in Schedule A because it is mandated by statute. There is a statutory command, but you fellows just ignore that. Your changes may be merited by economic conditions but shouldn't the Congress, not the Commission, amend that?

Mr. Spencer: I should be more specific. Under section 7 of the 1933 Act, we can under certain circumstances amend Schedule A by rule. Schedule A is not the problem; the specific problem is the ad hoc determination. The Commission's staff also points to other places where it does not have as much flexibility as it would like. My own view is that this particular area of information and registration statements is an area where there has been a long experience of practice and a pattern of approach, and because of the particular difficulties in the registration context, I think the strait-jacket here is perhaps arguably different from a fraud rule. Of course, I am more comfortable in the registration context because this is what I do, not the other.