PRACTICAL PROBLEMS FOR THE PRACTICING LAWYER UNDER THE SECURITIES ACT

ADDRESS OF

THOMAS G. MEEKER

GENERAL COUNSEL

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C.

Before the

SEATTLE BAR ASSOCIATION

Seattle, Washington
September 11, 1957

PRACTICAL PROBLEMS FOR THE PRACTICING LAWYER UNDER THE SECURITIES ACT

It is indeed a pleasure for me to have this opportunity to enter my appearance here before the opening luncheon session of your Association for the fall term. It is seldom that we on the East Coast have a chance to chat with our colleagues in the great Northwest. I am indebted indeed to your President and our Regional Administrator and your colleague in this Association, Jim Newton, for arranging my appearance here.[1/]

Too many people, both lay and professional, erroneously assume that the business of advising a client on a securities law question requires that the practicing lawyer have a special competence in the field of federal securities regulation. Similarly, many are convinced that it is not in their client's best interest for the lawyer inexperienced in this area to approach the administrative body unless his or her expertise can match that of the members of the Commission or its staff. In my opinion, you need have no fears on either score. As the senior partner in my former firm in New Haven advised me on my first day, the shortest route to the answer to a legal problem in most cases is to look at the

---

1/ The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publication by any of its employees. The views expressed herein are those of the author, and do not necessarily reflect the views of the Commission or of the author's colleagues upon the staff of the Commission.

governing statute and rules or regulations thereunder. Such advice is particularly appropriate in rendering advice on a securities law problem.

My talk to you will cover briefly a few of the situations in which the average general practitioner may have occasion to consider the federal securities laws. I could not, in a short talk, possibly cover all of the six statutes and part of a seventh that are administered by the SEC, nor would it serve any real purpose here, since many of the provisions would be of importance only to attorneys who represent clients engaged in some aspect of the securities industry, and they, I am sure, are fully conversant with the statutes. Those of you, therefore, who are experts in the field will, I hope, bear with me if I seem to dwell on matters which, to you, are elementary, but which may be of some help to the lawyer who has only an occasional contact with these topics.

At the outset, I would like to correct a wide misapprehension as to the function of our agency. The lawyer who has not had any experience in dealing with the SEC frequently has the impression that we are a sort of special police force solely intent on detective work to punish violators of the securities laws, and that anyone dealing in securities is ipso facto suspect. While we are ever alert to protect the investing public from securities frauds, our functions are not so restricted. We, at the SEC, have always recognized that our American capitalistic system is based upon the participation by millions of our citizens in the industrial progress of our nation. We conceive it as our function to encourage the spread of industrial ownership to large segments of the population. The securities acts are intended to facilitate the honest distribution of

securities to the public, and to protect the investing public with a minimum of interference with the legitimate expansion of our capital markets.

The attorney, therefore, who has occasion to consult with us, should not look upon the SEC lawyer as merely another potential adversary, as one whose opinions on particular matters will be given grudgingly or antagonistically. If that has been your impression, you will be surprised, if you consult us, to find that you will receive a cordial reception and an earnest desire to assist you with your problems.

Private practitioners can better represent their clients when confronted with problems involving securities laws if they proceed on the assumption that we are ready and willing to assist them in achieving resolution of their problems. The statutes and rules administered by the Commission deal with relatively complex matters; and although the Commission has recently exerted every effort to simplify its own rules insofar as it is practicable to do so, these statutes and rules may, at times, be a little difficult for a lawyer to grasp who is not versed in the field of securities regulation. Indeed, there are times when even the specialists and the SEC lawyers struggle with interpretative problems presented in particular cases. It may surprise you to learn that after 22 years of Commission administration of the act we are still confronted with novel questions as to what is or is not a security. Not long ago we obtained a consent decree in connection with the sale of certain types of mortgage notes.[2/] Recently a group of food dealers associations submitted a brief

---

2/ SEC v. Mortgage Clubs, Inc., District Court, District of Massachusetts, Civil Action No. 57-385-W.

to the Commission contending that trading stamps should be held to be securities.

Whether the problem be simple or difficult, however, the Commission's staff is always available to assist in its solution -- not because of any legal requirement to do so, but as a matter of sound administrative policy. The Commission believes that persons affected by the statutes and rules it administers should be assisted in understanding them and their application in particular cases. It is also motivated, in part, by the fact that this is an important factor in obtaining compliance with the law.

There is no fixed requirement as to the method of seeking interpretative or other assistance. Inquiry may be made by letter, telephone or personal visit. Many, if not most, inquiries can be handled by the nearest SEC regional or branch office.[3/] Matters which these offices do not handle will be referred by them to the headquarters office in Washington.

Direct inquiry, of course, may be made of the headquarters office.[4/] There, each division of the Commission has lawyers who render assistance on the statutes and rules for whose administration their particular division is responsible. Novel and particularly difficult questions of interpretation are referred by them to the Office of the General Counsel.

3/ Regional offices are maintained in Atlanta, Boston, Chicago, Denver, the District of Columbia, Fort Worth, New York City, San Francisco and Seattle. Branch offices are located in Cleveland, Detroit, Los Angeles, St. Paul and Salt Lake City.

4/ 425 Second Street, Washington 25, D. C.

When a private practitioner seeks an interpretation, it is extremely important that his factual statement be adequate. For this reason it is often helpful to arrange a conference with staff personnel who will have responsibility for preparing the interpretative letter.

Any inquiry seeking an opinion with respect to particular transactions should be in writing and include an adequate statement of the facts of the matter. Private practitioners sometimes express surprise at the staff member's insistence upon receiving all of the facts, including the name of the corporation or individual involved. One reason for this requirement is a natural reluctance to advise on hypothetical situations. Another is the possibility that the Commission's files contain specific information concerning the client which might make the particular problem more concrete to the staff lawyer who will be analyzing it. Thirdly, the Commission feels that adequate protection and public interest makes it undesirable for it to foster a situation where a person planning to engage in a particular transaction may, in the event of an unfavorable opinion, be able to place his unidentified client in a position to claim that the Commission never rendered any opinion with respect to him or his particular problem, and that he never had any wrongful intent in engaging in the transaction in question. Thus, interpretative assistance is limited to those persons who are honestly attempting to comply with the law.

To encourage affected persons and their lawyers to discuss their problems freely, the Commission's policy is to treat their inquiries and the responses thereto as non-public. No correspondence or memoranda

dealing with interpretative matters are placed in the Commission's public files.[5/]

Interpretations concerning questions of general importance are sometimes published for the information of the industry and the bar generally. On such occasions, however, names and other identifying data are omitted if there is objection to their publication. Administrative interpretations, however, should not be confused with the decisions rendered by the Commission itself in administrative proceedings of a quasi-judicial nature. The Commission's findings and opinions in such proceedings are, of course, matters of public record and are always published.

Interpretations rendered by staff lawyers are just that -- and nothing more. However, they do represent the considered judgment of responsible officials familiar with the statute or rule involved. The ultimate construction of the statutes and rules administered by the Commission, of course, is for the courts. The answers to most questions are found either in the language of the statute or rule or in court decisions. In these instances the task of the staff lawyer is relatively simple, i.e., simply explaining the statute or rule, and calling attention to the particular language thereof or the court decisions construing the same. There are, of course, other instances where the applicability of a statute or rule in particular circumstances has not been settled and may be the subject of a reasonable amount of dispute. The staff's opinion, or for that matter the Commission's, of course is not binding as a matter of law.

5/ Moreover, the Commission has been successful in resisting subpoenas seeking the production of this non-public material. For example, in Pergaments v. Frazer, (Unreported, S.D. N.Y., Civil Action No. M8-85, May 5, 1950), Judge Medina quashed a subpoena duces tecum demanding copies of interpretative letters on certain stabilization questions.

Although an administrative agency's consistent construction of a statute administered by it is entitled to great weight in the courts,[6] and with regard to its own rules is entitled to even greater weight,[7] as previously noted the ultimate decision is for the courts. Hence, private practitioners who receive what they regard as favorable opinions from the Commission or its staff must realize that such opinions may not be binding in any private litigation arising out of the particular transactions involved.

It is interesting to note that the interpretative assistance rendered by SEC lawyers was commended by the Hoover Commission, which described it as "an excellent practice * * * most effectively used."[8]

One other misapprehension, I believe, needs correction. There is a widespread belief that the sale or distribution of securities is not subject to Federal jurisdiction unless it is of national importance involving millions of dollars. Nothing could be farther from the truth. If, at any point in the offer or sale of a security, there is any use of the mails or of the facilities of interstate commerce, and it is almost inconceivable in our modern age that such use can be avoided, the federal securities act comes into play. A single fraudulent sale of one share of stock violates the act. And even in the absence of fraud, any offering to the public, in any amount, is subject to the act, unless otherwise exempted.

6/ See U. S. v. American Trucking Ass'ns, Inc., 310 U.S. 534, 549 (1940).

7/ See Bowles v. Seminole Rock & Sand Co., 325 U.S. 410, 414 (1941).

8/ United States Commission on Organization of the Executive Branch of the Government, Report on Legal Services and Procedures (March, 1955) 67.

Moreover, when we speak of a public offering, it does not mean necessarily that to be public it must be an offer to the whole world. The Court of Appeals of this Circuit has aptly pointed out that "an offering of securities to all red-headed men, to all residents of Chicago or San Francisco, to all existing stockholders of the General Motors Corporation * * * is no less 'public' in every realistic sense of the word, than an unrestricted offering to the world at large."[9/] The Supreme Court has laid down even a much stricter test. It has held that whether the number of offerees is few or many, if they are persons who do not have access to the information which registration would give them, the offering is a public one. Consequently, even an offering to key employees of the issuer may be a public offering.[10/]

There have been many attempts to evade the registration requirements of the Act, but the Commission has insisted that if the net effect of the transaction is a public distribution, no technical devices can change the basic purpose of the offering. Only recently the Commission made it clear that one may not separate parts of a series of related transactions and try to establish that a certain part is a private transaction if the whole involves a public offering. In that case a company issued debentures immediately convertible into stock. The debentures were sold as a private placement but the purchaser then converted them into stock and sold the stock widely.[11/]

9/ SEC v. Sunbeam Gold Mines, 95 F. 2d 699 (1938).

10/ SEC v. Ralston Purina Company, 346 U.S. 119 (1953).

11/ Crowell-Collier Publishing Co., Securities Act Release No. 3825.

Let us assume, now, that a client, who has a small but growing business, consults you on the possibility of raising new capital by the offering of stock to the public. You will no doubt consider the applicability of the securities laws of your state. I will not discuss state requirements except to point out that in no way does the federal law supplant or obviate compliance with any state securities law. But you should recognize at once that the federal securities act must also be considered.

There are, of course, a number of exemptions from the registration requirements of the act, most of which would not be applicable to the ordinary situation. But there are a couple I should mention. One is the intra-state exemption. This exempts from the registration requirements any security which is part of an issue sold only to persons resident in a single state where the issuer is incorporated in that state and does a substantial part of its business in that state. I think I should make it clear to you, however, if you should be consulted by a client who wishes to rely upon this exemption, that there are certain risks involved. First of all, the issuer must be certain that all of the purchasers intend to take the securities for investment. If, within a short period, one or more of the purchasers should resell to a non-resident, the purchaser might be considered an underwriter within the definition of the Act and the exemption will be destroyed. Secondly, it should be noted that the exemption is available only if <u>all</u> of the issue is sold intra-state. If any part is sold to a non-resident the entire exemption is lost and all of the sales, even those to residents, become unlawful. This could be of serious import to your client. The sale to the non-resident might even be inadvertent, and

even if it should not warrant criminal action, should the stock decline in value, all who participated in the sale would be subject to civil liability at the suit of all of the investors.[12/]

The next question you will want to consider is the amount of capital that is needed. If the amount is under $300,000, your client might be well advised to take advantage of a special exemption Congress provided primarily as an aid to small business.[13/] I hasten to add that this exemption is not an automatic one. It becomes operative only after certain information, including a notification and offering circular, is filed with the Commission and upon the performance of certain conditions imposed by the Commission's regulation.[14/]

In order to make this exemption readily available to small businesses where expenses must be kept to a minimum, the Commission has provided that the necessary filings are to be made in the regional office of the Commission in the region where the principal place of business is located and they are examined by our staff there. You are fortunate in having one of our nine regional offices located right here in Seattle. I urge you to visit our office here, as the first step in your offering and talk to one of our attorneys. He will be glad to give you a set of forms and instructions and to answer any questions or to explain the laws, regulations or procedure to you.

12/ Section 12(1), 15 U.S.C. 771(1).

13/ Section 3(b), 15 U.S.C. 77c(b).

14/ Regulation A, 17 CFR 230.215.

I think you will find that the information needed is not unreasonable nor the requirements onerous. Your client should have no difficulty supplying you with the data for preparing the filings.

If the capital needed is in excess of $300,000, then a full registration statement is required. In general, the registration forms call for disclosure of information such as (1) a description of the registrant's properties and business, (2) a description of the significant provisions of the security to be offered for sale and its relationship to the registrant's other capital securities, (3) information as to the management of the registrant, and (4) certified financial statements. To facilitate the registration of securities by different types of issuing companies, the Commission has prepared special registration forms which vary in their disclosure requirements so as to provide maximum disclosure of the essential facts pertinent in a given type of case while at the same time minimizing the burden and expense of compliance with the law. For example, the Commission has a special Form S-3 for shares of mining corporations in the promotional stage. Obviously the information required for such filing is far different from that for an established manufacturing company.

It may be that you are consulted by a client as regards the other side of the coin. He may have been sold a security, feels that he has been "taken" and asks you what his remedies may be. Depending upon the facts, the act provides certain civil remedies. First of all, if you find that there has been any misrepresentation or omission to state material facts, or any type of fraud or overreaching, you have a civil remedy against everyone

who participated in the fraud whether or not the securities were registered or whether or not they were exempt from the registration requirements. I want to emphasize again that there are no exemptions whatever from the anti-fraud provisions of the Act.[15/]

Moreover, even if you are unable to find evidence of fraud, there is still available to you a civil remedy for any loss if there has been any violation of the registration requirements. I should mention, however, that in such situation it is necessary that you take action very promptly since the statute of limitations prescribed by the act is a very short one, under some circumstances, only one year from the offering.[16/]

In any event, if you are consulted on any such matter, I urge you to bring it to our attention immediately. We have additional remedies including the criminal provisions of the statute. Any action we might take, of course, might not result directly in your client's recovery of damages, although under some circumstances, restitution has been effected as a result. Occasionally, also, private law suits may present for determination interpretative issues important to the Commission in its own administration of the statute or statutes involved. In appropriate cases, the Commission files briefs or memoranda of law and participates in oral arguments on such questions. Although the effect of Commission's participation in such cases may be to aid the party whose position accords with that

---

15/ Section 12(2), 15 U.S.C. 771(2). See also Fischman v. Raytheon Mfg. Co., 188 F. 2d 783, 786-88 (C.A. 2, 1951).

16/ Section 13, 15 U.S.C. 77m.

of the Commission, the purpose of such participation is solely to assist the court to arrive at a correct construction of the statute.

Since the participation of the Commission as amicus curiae might be of great value to the party with whom it agrees on an interpretative question, private practitioners frequently request the Commission to participate. Commission participation, however, is not dependent on the request of counsel for one of the parties. Whenever the Commission is apprised of the case involving the construction of one or more of the statutes it administers and which it feels warrants its participation, it will seek in the public interest to participate as amicus curiae, regardless of whether any of the parties request or desire it to do so. In many instances the Commission's only knowledge of the pendency of particular litigation comes from the private practitioner involved therein. Accordingly, the Commission is always glad to be apprised of the pendency of litigation under its statutes, irrespective of any desire on the part of counsel for its participation and irrespective of whether it may ultimately decide to participate.

As a matter of policy the Commission, as amicus curiae, avoids involvement in any disputes of fact, and makes no factual assertions of its own. Nor does the Commission become involved in legal questions which do not pertain to the construction of the statutes it administers or which do not affect it in its administration of these statutes.[17/]

17/ Pursuant to the special request of a court, the Commission has on occasion briefed questions wholly peculiar to the private civil recovery provisions of the federal securities laws.

It may be, also, that you are consulted by a client whose activities are being investigated by the Commission. If you are satisfied of his innocence, frank disclosure to the staff of all the facts will be to the client's advantage, since the Commission is not interested in continuing an investigation of an innocent person. Although it is not my intention to devise methods by which a guilty client may evade any of the sanctions imposed upon violators of the securities laws, full disclosure may also be to his interest even in the case of a technical violation where the facts indicate the absence of intentional wrongdoing.

There are one or two other situations which I will mention briefly which you should be alert to recognize when a client consults you as to corporate matters. If he should wish to solicit proxies your first inquiry should be whether the company is listed on an exchange or whether it is an investment company or public utility company subject to our jurisdiction. If so, he may not do so without prior compliance with our proxy rules.[18] Also you should be familiar with the fact that if your client is an officer, director, or ten percent stockholder of any such company, he must report promptly every sale or purchase by him of the company's stock; and if he should effect both a sale and purchase within a six month's period, any profit is subject to recovery by the company at the instance of any stockholder.[19] In such case, he may lose not only his profit but the income tax he has paid on it.[20]

18/ Regulation X-14.

19/ Section 16 of the Securities Exchange Act of 1934, 15 U.S.C. 78p.

20/ See American Investors Co. v. Commissioner of Internal Revenue, 211 F. 2d 522, 523 (C.A. 2, 1954); Park & Tilford v. United States, 107 F. Supp. 941, 944 (Ct. Cl. 1952).

In this connection, a recent decision may be of interest to you as an illustration of our participation in private lawsuits. Congress had authorized the Commission to exempt from this six months short-swing profits provision any transactions not comprehended within the purpose of the Act. The Commission accordingly exempted, among others, stock acquired as a result of certain types of option and retirement plans.[21] In a recent case, suit was brought for the recovery of profits realized in the sale of stock so acquired. The Commission did not participate although it indicated to the parties that it would do so if requested by the Court. The lower court, pursuant to the exemption granted by the rule, gave judgment for the defendant. On appeal the Court of Appeals for the Second Circuit by a divided court expressed doubts as to the validity of the rule but affirmed[22] on the basis of another provision of the statute[23] which precludes liability if action is taken in reliance on a rule even if the rule is subsequently held invalid. In view of the uncertainty created by this decision, the Commission asked leave to file a brief, amicus curiae, on rehearing. This was granted and we filed our brief. Unfortunately, we were not successful in convincing the majority of the validity of the rule so it will now be incumbent on the Commission to reexamine the rule in the light of the Court's opinion.

21/ Rule X-16B-3.

22/ Greene v. Dietz, No. 121.

23/ Section 23, 15 U.S.C. 78w.

Certainly if you take away from this luncheon meeting anything in the way of a conviction about the problems of the practicing lawyer in rendering advice on the federal securities laws, I believe that you can safely leave here with the impression that the Securities and Exchange Commission and its staff are always anxious and willing to be of assistance to the private practitioner in achieving for his client compliance with the several statutes which we administer. You can readily understand that in a short time such as I have had today I could not possibly allude to all of the practical problems which may confront the member of the bar who may be encountering for the first time a question under the federal securities law or who may be for the fiftieth time seeking some clarification on a securities problem. We at the Commission are convinced that one of the most important functions of an agency administering powers delegated to it by the Congress is to render assistance to those subject to the regulation in order that they may fully comply with the mandates contained in the Acts.