CURRENT PROBLEMS IN FEDERAL REGULATION ON THE SALE OF MINING INDUSTRY SECURITIES

Address of

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Washington, C. C.

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It is a great pleasure and a high privilege for me to address the Sixty-Second National Western Mining Conference here in Denver today. I might say that it seems to me to be particularly apt that you have held your conference in this fine city at this time because Denver, I am told, is this year celebrating the hundredth anniversary of the finding of gold in Cherry Creek and the establishing of the city formerly known as Auroria. It is interesting to note that following the discovery of gold the entire mining industry was injected with stupendous impetus causing properties to change hands overnight in exchange for thousands of dollars paid on the barrelhead, so to speak. Such was the activity that a mining exchange was established on Fifteenth Street where trading in gold and silver shares occurred for some considerable time thereafter. I have also been informed that the mining exchange building is undergoing renovation under the auspices of the Denver Mining Club so that the old days of 1889, when the stock exchange call room was one of the most beautiful sights in Denver, can be more easily recalled.

I also have particular interest in being here because of the significance which the mining industry plays in the international problems which our country faces in the cold war. We all are well aware of the tremendous importance to our country which sound development and production of mining properties and the obtaining of metals has when considered against or in competition with the production in other countries where miners are employed by the government and are offered cheap wages. We know too that continued mining requires prospecting and exploration predicated on sound financial structures.

Before getting into the remarks which I would like to make today, I would first like to point out that on many occasions in the recent past the Securities and Exchange Commission has recognized the desire of your group to make its wishes and views known to the Commission and the importance of our understanding your problems and explaining to you the Commission's responsibilities. Last year at this time my colleague Edward N. Gadsby, of Massachusetts, the Chairman of our Commission, spoke at your 61st National Western Mining Conference. Two years ago my colleague Commissioner Orrick, of California, enjoyed the privilege which I now enjoy. Commissioner Earl F. Hastings, of Arizona, who as you all must know is a registered mining engineer, has discussed many of our mutual problems on different occasions.

I have heard it said that there are many persons in the mining field who have expressed their opinions that the Securities and Exchange Commission looks with disfavor upon mining securities or upon mining ventures. Nothing could be further from the truth. Let me at the outset dispel any beliefs which any of you may have that any member of our Commission or its staff is in any way lacking in concern for the welfare of the mining industry or is unaware of the vital interest such industry has and the great contribution which it makes to our over-all national economy.

While I am aware that over the years there have been accusations emanating from the mining industry that the Securities and Exchange Commission has been unfair or unfriendly towards mining ventures and that it has forced upon your industry burdensome, impracticable, time-consuming, expensive and unnecessary procedures, I would like to express to you my fervent belief that since its formation in 1934 the Commission and its staff have given more patient thought and comprehensive study to the problems besetting promotional securities than to any other type of original issue. I am sure you appreciate that the Commission has the statutory duty to consider the interests and rights of both issuers and investors. We have always tried to hew a center line between these somewhat divergent and conflicting interests and I suppose we will always be charged with certain shortcomings by both.

Whatever your feelings for or against the Commission may be, and whatever your sentiments may be about any statements I make here today, I am going to try to strike out at what I consider to be the heart of the problem facing mining financing at the present time.

While I am fairly familiar with the areas of disagreement which exist between us, I am sure that we are entirely in agreement as to ultimate objectives. All of us want to see this great country's mineral resources intelligently, economically, and thoroughly exploited. Our sole purpose is to see that exploration or development projects, which for their success depend upon public investors for necessary capital, obtain their capital funds free from suspicion and without adversely affecting the confidence of the potential investors in mining ventures as media of investment.

The mining industry, which in 1957 contributed $6.2 billion towards our national income, which includes all wages paid and profits made, as against a total of $364 billion by all industries, has a material effect upon the national interest, and a solution of its financing problem deserves careful and sympathetic study. Furthermore, I might say that mining financing possesses characteristics somewhat different from those commonly present in ordinary industrial financing. Generally speaking, in manufacturing industries success depends upon the manufacture of a product which can be distributed, whereas in metal mining the discovering and development of a source of supply are paramount.

A mere recitation of this difference emphasizes the ever present demand for new sources of supply and the injection of this factor into mining and its financing tends toward the stimulation of a greater speculative element than is generally present in other industries. This very fact has, as you all know, been seized upon by some unscrupulous promoters dishonestly to further their insidious schemes. On occasions it is most apparent that what is really mined is the public's pocketbook and not the property involved. Promises mean nothing to these fast talking swindlers; they are devoid of conscience. At the base of every rainbow there is a post of gold or

uranium. They impose criminally upon the credulity and the needs of old men and women, widows and orphans, who are lied to, cheated and robbed. It is of vital concern to all of you always to recognize that the very nature of your industry makes it possible for a few men of no conscience to bring discredit upon it. From the unscrupulous, everyone suffers. Money is diverted from legitimate industry and legitimate speculation, crying out for encouragement, directly into the coffers of those whose only concern is to get for themselves just as much money as the traffic will bear.

To a very large extent the differences which exist between the mining industry and the SEC, in my judgment, are the result of a misconception or a misunderstanding of our statutory duties, obligations and functions. Although the Securities and Exchange Commission is trying to foster sounder mining financing, I have heard it said that the present requirements for registration or for putting small issues to market under our exemptive provisions of Regulation A or Regulation A-M as administered by the Commission, represent needless and oppressive burdens upon the mining industry. I believe that such controls as are employed in relation to the mining industry are not oppressive; that they are necessary; and that their enforcement does benefit the entire mining industry whose spokesmen over the years have vigorously condemned them. When prices for metal products are right and when there is a public appetite for low-priced securities, the SEC regulations do not seem to impede anyone from selling great quantities of mining securities. It is also my belief that your industry would suffer without some effective controls comparable to those minimal requirements of the Securities Act of 1933. Let me illustrate for a few moments.

History will indicate that long prior to black Thursday in October of 1929, when the stock market crash occurred, there were a great many rumblings and danger signs pointing to unsound financial procedures. Securities of all types of industries were traded mostly on the basis of inside information, hot tips, or purely speculative "get-rich-quick" schemes. There was little or no disclosure of the basic financial facts and figures as to companies whose securities were traded in the capital markets. These situations could not last and they didn't.

As of September 1, 1929, prior to the crash, the value of all stocks listed on the New York Stock Exchange totalled $89 billion. By 1932 this aggregate figure was down to $15 billion, reflecting a total loss in such value of $74 billion in this two and a half year period. In addition, there were equally significant losses on investments in foreign securities. In the twelve years between 1919 and 1931, more than $50 billion in securities were sold to United States investors and $20 billion of them were worthless.

These figures unquestionably emphasize the completely demoralized capital formation process in which investor confidence in the integrity and honesty of the capital markets had all but completely

been destroyed. During the depths of that depression, few persons considered equity securities, or even debt securities, to be proper media of investment.

Into this completely demoralized financial picture came the Securities Act of 1933 which had as its basic Congressional purpose the requirement that corporations seeking to raise capital through the issuance of new securities to public investors in the capital markets must make certain basic disclosure of the corporation's background, its aims and purposes. Gradually, and at first very slowly, public investors began to rely upon and to trust the fairness and dependability of the disclosures required by both the Securities Act of 1933 and the Securities Exchange Act of 1934 to be made in registration statements. As a result, faith and confidence in the integrity and honesty of the capital markets have today been restored so that corporate securities in tremendous quantities and values are being distributed to public investors on a daily basis. The value of all stocks listed on the New York Stock Exchange is now in excess of $250 billion.

There is today an enormous amount of capital being raised to meet the expansion and development needs of American corporations. In annual 1953 there were securities registered with our Commission for subsequent sale to public investors in a total dollar amount of $7.3 billion.

In successive years from 1955 through 1957 this figure rose from $12.1 billion to $13.3 billion to $16 billion and then in 1958 to $17.3. The same type of growth did not occur in the mining field. In 1955 the total dollar value of mining issues registered with our Commission was $251 million. This figure fell to $121 million in 1956 but rose again to $242 million in 1957 and then dropped to $87 million in 1958. While the mining industry between 1953 and 1957 did raise through public sales of securities, either by registration or pursuant to the exemptive provisions of Regulation A, a total dollar value of almost $825 million and its production is presently at a rate almost twice that of 1929, nevertheless we note with no little concern a marked decrease in the number of Regulation A filings. From a high point in fiscal 1955, when 529 mining issues were filed under this Regulation in a total amount of $116 million, these figures fell to 56 mining issues in a total dollar amount of $11 million in 1958.

What is the real cause for these large fluctuations and the decrease in the amount of money raised by mining ventures in these times when other industries are seeking and obtaining larger and larger capital funds from public investors? It is my belief that it is not a question of onerous burdens imposed by registration under the 1933 Act or under the provisions of Regulation A or A-M; it is not the result of any over-meticulousness or equivocations by the Securities and Exchange Commission; it is the result of a lessened demand for speculative mining securities, coupled with the economic factor that

at today's market the current price for copper, lead, zinc and other non-ferrous ores is so low as to make exploration mining largely impracticable. Certainly the breaking of the uranium bubble did not help your industry nor does the reduction in Government stockpiling. But these are matters unrelated to the jurisdiction of the Securities and Exchange Commission. I would suspect, however, that all of you would accept the need for adequate disclosure of the financial and other corporate information of the mining company, so that public investors seeking to put money into mining ventures will be in a position to make an informed judgment as to the risk he takes. I think it can be said that the need for adequate disclosure of information increases in importance as the speculative boundaries of the enterprise are widened. Of course, all mining ventures are not destined for success and investors prone towards investment are often aware of, or should be made aware of, this truism. Losses are never easy to take and losses are inevitable, but losses resulting from deception or from insufficient disclosure are within control. To the extent that this type of loss can be avoided, both the industry and investors are served. The problem and its solution are not ours alone; they are also yours. That we may assist in solving them is our earnest desire. That its solution is of greater importance to your industry than any of us realize is my sincere belief.

Recently we have received a great many complaints from public investors in two areas of our jurisdiction, i.e., the Rule 133 "no-sale" theory relating to mergers or consolidations, etc., and the Rules 136 and 140 relating to assessable stock. When we see public investors losing money or being taken advantage of, we are duty-bound to take a hard look at the problem to determine whether there is an abuse and, if so, to eliminate it. We do so always with the provisions of the Administrative Procedure Act clearly in mind. By that I mean, we initially formulate a proposal which will put a stop to the particular unfair course of conduct and then we disseminate this proposal to all interested persons in order to seek their comments and their views as to the workability of the proposal. Our aim is not to place any undue burdens upon, or complex obstacles in the path of, the legitimate mining industry. In the case of assessments and in the Rule 133 merger area, we followed these procedures which in a real sense were designed to insure you fair treatment by the administrative agency. Where the comments are adverse, we may hold a public hearing before adopting any new rule. I might say, parenthetically, that I have read all the many comments which many members of the mining industry have sent to us with respect to the proposal by our Commission to make certain revisions in this Rule 133 and with respect to its proposed new Rules 136 and 140. In a somewhat facetious sense, I might say that I feel a little bit like Daniel who has now entered the lion's den.

I certainly hope all of you have recognized the advantage and protection which has directly flowed to you from this administrative procedure requirement that Federal Regulatory Agencies such as ours put out for comment proposals of any changes in their rules which affect the regulated industry. In keeping with the fundamental concepts of

fairness implicit in this Administrative Procedure Act, we proposed these changes in order to meet a serious problem which has affected not only these particular areas but your industry as a whole. Let me elucidate.

In the assessable stock area your comments have to some extent been very helpful and constructive because you by and large have re-emphasized the difficulties and financial burdens inherent in requiring a small mining company to engage counsel to prepare a full-scale registration under the 1933 Act.

With regard to the Commission's actual proposed revisions concerning assessable stock, as of June 6, 1958 we postponed action upon these matters indefinitely. We did so primarily because we felt that they should have more study and that the Commission should move cautiously and carefully in dealing with the problem. However, we have not completely dropped these matters. This proposed new Rule 136 would operate to make the levying of assessments on assessable stock subject to the disclosure requirements of the Securities Act of 1933, either by way of registration under the '33 Act or upon compliance with the terms or conditions of an appropriate exemption presently under study at the Commission. The proposed amendment to Rule 140 aims at clarifying the application of that Rule by specifically defining as an underwriter any company which is chiefly engaged in levying assessments on its assessable stock in order to purchase the securities of another issuer or two or more affiliated issuers. As to this latter proposed amendment, let me say that the underlying transactions covered by the Rule are nothing more than gimmicks for, in fact, the securities which are really being sold through the use of this assessment device are the securities of the other issuer, or issuers, and registration should be required.

It has been quite apparent to us that a few fraud artists and swindlers have purchased control of old, almost completely dormant, companies which have assessable charter privileges and that, through such control, these persons have caused these companies to continue to levy assessments to the maximum extent permitted by State statutes against the stockholders without disclosing one iota of information as to the status of the company or the purpose for which the proceeds of the assessments are to be used, and without indicating at all whether or not in fact the proceeds of the assessment would be productive of any present or potential benefit to the stockholders against whom the levies are made. We have also had indications that the money raised through assessments is in fact being used by the corporate insiders for nothing more than high off the hog living expenses. We even found in one case that money obtained from assessments was actually passing across the gambling tables at Las Vegas. Here's the fraud with which we are concerned.

In the Rule 140 area we have been informed of instances where companies having assessable stock outstanding are being used merely as vehicles for raising funds for other companies which are unwilling or unable to seek funds directly from the public, none of which is

disclosed in any degree whatsoever to the stockholders who are being assessed. We have had many complaints by stockholders in these areas indicating arbitrary, unreasonable, and unfair treatment by corporate insiders who refuse to give any information whatsoever as to the company's status or the purposes of these assessments. These incidents cause untold harm to the mining industry and we, as the statutory protectors of public investors, are duty-bound to take some action.

What do these stockholders in their letters complain about? Essentially, they ask why they cannot be informed as to the use to which the money raised by the assessment is being put and they ask us to eliminate fraud in the use of the proceeds from assessments levied against them. Aren't these requests reasonable? If any of you here were the holders of assessable stock, wouldn't you at the very least desire to have some bare, minimal amounts of information available to you as to what the proceeds of a new assessment were going to be used for before you would agree to pay the assessment? Now, how are we going to accomplish these salutary objectives without imposing burdens or impediments upon the process of raising capital by the mining industry?

Obviously we do not derive any pleasure in proposing to adopt rules which may impede in any degree the process of money raising by any segment of the mining industry, but at the same time we are faced with the real necessity for effecting certain minimal controls over sharp promoters who are abusing the assessable privilege for their own sordid purposes and who are taking advantage of investors who believe in, and want to invest their funds in mining ventures. We have made these proposals which, sitting in our lofty towers in Washington, seem to answer the problem from the regulation point of view in keeping with the interests of public investors.

We are considering the advisability of requiring mining and industrial assessable companies levying assessments on their assessable stock to disclose the use to which they are going to put the proceeds of the assessment before any exemption from registration under the 1933 Act would be available. We might have to require that some form of simple notification setting forth a few facts as to the issues, its management, and its recent and proposed assessments be filed. We might even require that sales literature or brochures accompanying the legal statutory notice of assessment be filed with the Commission. Certainly such requirements as these, in my view, do not impose any undue or unreasonable burden, financial or otherwise, upon the issuer.

These suggestions have as their basic design the requirement that persons seeking to raise money by assessments do so for legitimate purposes. It would permit the Commission to take prompt action against the swindlers and the fraudulent promoters which our investigators have encountered in the course of our enforcement work. Unless you and we can together eliminate unfairness and fraud from transactions in this assessable area, the mining industry itself will inevitably suffer.

I hope that you who are concerned about this problem will discuss with me today or will write to us in the spirit of trying to understand the problem we face and the ends we seek to accomplish; that is, to protect public investors by making available to them at least some minimal information about the companies into which they are asked by assessment to put their money. When we see fraud, we must all act to eliminate it; for, in the last analysis, a person who buys securities through fraud or misrepresentation, or who buys when he doesn't have any idea of what he has bought, is going to hesitate, if not completely withdraw from the capital markets if the speculative venture collapses, and your industry will then have lost a potential investor.

Some of you have raised the question as to whether an assessment involves the sale of a security. Let me remind you, in the first instance, that the definition of a security in the 1933 Act is extremely broad and that the United States Supreme Court in its interpretations of that definition has given an all-encompassing meaning, especially with regard to the words "investment contract." In substance, the Supreme Court has stated that, where investors provide the capital and share in the earnings and profits, and the promoters manage, control and operate the enterprise, there is involved a security irrespective of the existence of any formal certificates or other evidence of nominal interest in the physical assets employed in the enterprise. In my judgment, whether the investor is asked to put up the money by way of an assessment or not would make little difference in the Court's decision.

When an assessment is levied and paid, the stockholder gets a receipt from the company which is attached to his stock certificate. In essence the receipt itself is in effect evidence of this new security interest. It validates the certificate and brokers who make transactions in assessable stock following the levying of the assessment accept only the certificate which has an attached assessment receipt showing payment or showing an issue date after the last prior assessment sale. However, if the assessment is not paid, the company auctions off sufficient shares to pay the assessment. In many cases this means all the shares, since the stock usually has a market value of only a few cents and is worth less than the amount of the assessment. In the usual situation, the stockholder whose shares are auctioned off holds nothing but a certificate which the company has cancelled on its books. The purchaser in an assessment sale obtains a new certificate representing the number of shares acquired by him. If, on the other hand, the bid at the auction sale did not exhaust the number of shares owned by the original stockholder, then a new certificate is also issued to him for the residual balance of his shares.

In either event, whether the assessment is paid or not, a transaction has occurred affecting the stockholder's interest. Where he has paid the assessment, the stockholder has in effect made an additional investment in the company evidenced by the certificate

showing the payment of the assessment. Where he has not paid the assessment, the company has in effect acquired his interest and he is either issued a new certificate representing a smaller interest or his entire interest is sold out to the company or bidding purchaser. Certainly when an assessment is levied the stockholder is obliged to make an election involving the making of an investment decision, which, as in the case of the original acquisition, should be made on the basis of an informed understanding of certain minimal facts and circumstances. Putting it another way, when the levy is sent to the stockholder, there is an offer and, when it is paid, there is an acceptance within the definition of a sale in the Security Act where the meaning of sale is much broader than the Common Law definition.

This is no entirely new concept. For many years, since 1945, there has been an exemptive Regulation A--Regulation A-M--covering the original issue of assessable stocks of mining and of industrial companies. Under the terms of this exemptive regulation there is included an undertaking that in the levying of subsequent assessment the company will supply the stockholders with certain specific information of a nature needed by him to reach an informed jugment as to whether to pay the assessment or not. The proposed new rule is to provide like essential information to the stockholders in respect of mining and industrial companies, the assessable shares of which were issued and outstanding prior to the adoption of Regulation A-M.

The concept embodied in Rule 133 has had a long history. The Federal Trade Commission, which first administered the Securities Act of 1933, initially determined that securities issued in mergers and the like were "dispositions of securities for value" within the meaning of those words as used in the Act. Subsequently, this position was reversed and the SEC by a note to the original registration for corporate reorganizations excluded such securities issued in mergers, et al., from the registration process. In 1947 this form for registration, together with the note, was withdrawn but the Commission as a part of its administrative practice continued to permit the issuance of securities in mergers, et al., without registration. In 1951 Rule 133 itself was adopted as an interpretative expression of the word "sale" as defined by Section 2(3) of the Act.

This Rule provides that, for the purpose of determining the application of the registration and prospectus provisions of Section 5 of the Act, no "offer" or "sale" shall be deemed to be involved, so far as stockholders of a corporation are concerned, where, pursuant to statutory provisions or provisions contained in a certificate of incorporation, there is submitted to a vote of the stockholders a plan involving a statutory merger, consolidation, reclassification of securities or transfer of assets of the corporation in exchange for the issuance of securities of the acquiring corporation.

The theory of Rule 133 is that no sale to stockholders is involved where the vote of stockholders as a group authorizes a

corporate act such as a transfer of assets for stock of another corporation, a merger or a consolidation because there is not present the element of individual or volitional consent ordinarily required for a "sale" in the contractual sense. However, this does not mean that the stock issued under such a plan is "free" stock which need not be registered insofar as subsequent sales are concerned. Unless the Securities Act provides an exemption for a subsequent sale of such non-registered stock, registration would be required. Of course, subsequent casual sales of such stock by non-controlling stockholders which follow the normal pattern of trading in the stock would be deemed exempt from the provisions of Section 5 of that Act as transactions not involving an issuer, underwriter or dealer under the first clause of Section 4(1) of the Securities Act. However, if the issuer or persons acting on its behalf participate in arrangements for a distribution to the public of any of the stock issued to stockholders or have knowledge of a plan of distribution by, or concerted action on the part of, such stockholders to effect a public distribution in connection with the transaction, a Section 4(1) exemption would not be available since an underwriting within the meaning of the statute would be involved.

In 1956 we invited comments on a proposal, the effect of which would have been to repeal Rule 133 and to provide that transactions of the character referred to in the Rule involve an "offer" and "sale" of a security subject to the registration and prospectus provisions of the Act. The reason for this proposed action was that we had encountered numerous uses of Rule 133 as a guise to effectuate illegal distributions of stock, many of which were worthless, without disclosing any financial or other type of corporate information to the purchasing investors. We received numerous comprehensive comments and a public hearing was held. Action was then deferred on this proposal pending further study, and that proposal was subsequently withdrawn.

In September of this year we invited comments on proposed amendments to this Rule, which amendments would retain the existing Rule, but would incorporate into it certain provisions which would make it clear that registration is required in certain cases where a public distribution of securities initially acquired in transactions exempted by the Rule is subsequently made by a person defined as a statutory underwriter in the proposed amendments.

Though we have received some comments, there was no request for a public hearing on this matter which the Commission presently has under consideration.

I might also say that there are certain exemptions written into the Act such as the intrastate exemption, Section 3(a)(11), and Section 4(1) private offering exemption. Under these exemptions there always seem to be troublesome problems arising from failure to meet the specific requirements of these exemptions and each year issuers of mining securities attempting to avail themselves of these exemptions seem to find themselves subject to more civil and criminal liabilities

than do issuers who register. There is a widespread belief abroad that merely by complying with the provisions of an exemption the Commission is without jurisdiction. This is not true, for the civil liability Section 12 (except as regards a government issued security) and Section 17 (the fraud or misrepresentation provision) acknowledge no exemption. A mere reading of the Congressional history which preceded the adoption of the 1933 Act should convince you that Congress in providing for these certain exemptions was essentially trying to provide a simple procedure for local financing for local purposes and was not trying to exempt large nation-wide securities offerings which should be subject to registration.

In conclusion I would like to say that we at the SEC recognize that the mining industry, if it is to prosper, can do so only if there is ready availability of risk capital from large numbers of public investors who have confidence and faith in the honesty and integrity of the mining industry. I hope that you can continue to lend us assistance in our attempts to eliminate from your own industry certain types of practices considered by your own leadership to impair the capital markets for legitimate mining ventures. Perhaps you can go even further by helping us to eliminate from this field those individuals who consciously use promotional ventures primarily in their own interests as meal tickets rather than in the interests of the public investors whose money has been raised. Only if such activities are eliminated can the mining industry attract to itself the large amounts of capital which are needed if our national resources are to be properly exploited.