Rule 133
of the
Securities and Exchange Commission

Address by
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Before
The Association of the Bar of the City of New York
Section on Banking, Corporation and Business Law

and

Section on Administrative Law

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Rule 133 of the Securities and Exchange Commission

I am very happy to be here tonight to tell you something about the thinking that has gone into the proposal to amend Rule 133 under the Securities Act of 1933. Before going much farther, however, it is necessary to inform you that the Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publication by any of its employees. The remarks I shall make here are mine. They do not necessarily represent the views of the Commission or of my colleagues on the staff of the Commission.

I wish also to take this opportunity to thank Mr. Feldman and the other members of your Committee on Administrative Law for the thoughtful and helpful letter of comment on the proposed amendment. I believe it fair to say that all of the changes suggested have merit, and they have been carefully studied. Some of you may be interested in learning something about the other comments received by the Commission. However, it seems appropriate first to review the genesis and history of the doctrine that is now Rule 133 for the benefit of the few here tonight to whom it may not be familiar.

Administration of the Securities Act of 1933 (approved May 27, 1933) was originally assigned to the Federal Trade Commission. When the question first arose whether the submission to stockholders of a plan for merger or consolidation was subject to the registration provisions of the Act, it was answered in the affirmative. And, in Release No. 167, announcing, as of May 16, 1934, the adoption of Form E-1, the registration form for

securities issued, sold, or modified in a reorganization, the Federal Trade Commission stated that a "sale" is "involved in the submission of a plan or agreement for reorganization...when an opportunity to assent or to dissent or withdraw from a plan or agreement for reorganization is given on such terms that a person so assenting or failing to dissent or withdraw within a limited time will be bound, so far as he personally is concerned, to accept such securities,..."

"Reorganization" was in turn defined to include a merger, consolidation and other transactions of the character described in Rule 133. About two weeks earlier, on or about May 1, 1934, a special committee of the American Bar Association had submitted to the Commission a report which recommended complete revision of the Act. Certain amendments were offered, pending a thoroughgoing revision, including a suggestion to "broaden this exemption [Section 4(3) (now Section 3(a)(9)] to include the issuance of securities to holders of securities of all persons which are parties to a reorganization (including a merger or consolidation)."[1/] It was also recommended that securities issued in such exempt transactions be treated as exempt securities so that it would be clear that offers of the securities in subsequent transactions would be exempt. A similar recommendation for amendment of the statute was submitted in 1935 after Section 4(3) had become Section 3(a)(9) without adoption of the changes earlier recommended.[2/] However, in November, 1934, the Securities and Exchange Commission, which by this time had succeeded to the job of administering the Act, had determined not to object to consummation of at least two corporate combinations without prior registration under the Act. One of these involved a merger and the other consolidation.

1/ Report of the Special Committee of the American Bar Association on Amendments to the Securities Act of 1933 (1934) at p. 7.

2/ Report of the Special Committee of the American Bar Association on Amendments to the Securities Act of 1933 (1935) at p. 5.

The basis for these decisions was articulated on September 19, 1935, in an amendment of Form E-1 which indicated that the Commission deemed "no sales to stockholders of a corporation to be involved when pursuant to statutory provisions or provisions contained in the certificate of incorporation, there is submitted to a vote of such stockholders a proposal for the transfer of assets of such corporation to another person in consideration of the issuance of the securities of such other person, or a plan or agreement of a statutory merger or consolidation, provided the vote of a required favorable majority" would operate to authorize the transaction and bind all stockholders except for appraisal rights of dissenters.[3/] These provisions continued in effect until 1947 when the Commission announced the repeal of Form E-1.[4/] Despite repeal of the Form, the view expressed in the Note was continued as a matter of administrative interpretation until 1951 when it was decided that in fairness to industry, since the interpretation was in fact being followed, the protection afforded by a rule was justified. Before dealing with certain events leading to this decision, it is important to understand the distinction which must be drawn between the so-called "no-sale" theory and what is popularly referred to as the "no-sale" rule. The distinction is vital to an understanding of the entire problem.

The Commission's briefs in the Leland Stanford[5/] case in 1941 and 1943 had urged two propositions upon the court: (1) the "no-sale" theory, that is, that the consolidation in that case did not involve a "sale"

3/ Securities Act Release No. 493 (September 19, 1935).
4/ Securities Act Release No. 3211 (April 14, 1947).
5/ Leland Stanford Junior University v. National Supply Co., 46 F. Supp. 389 (N.D. Cal.,1942), rev'd., 134 F. 2d 689 (C.A. 9, 1943), cert. den., 320 U.S. 773 (1943).

within the meaning of the definition of that term in Section 2(3) for any purpose under the Act; and (2) even though the Court might not agree with this proposition that the "no-sale" rule which was then embodied in the Note to Form E-1 was limited by its terms to questions as to the application of the registration provisions of the Act to the transactions of submission and consummation of mergers, consolidations and similar plans and, therefore, could properly be relied upon as making registration unnecessary. It was further expressly stated in these briefs that, while reliance on the "no-sale" registration rule in the Note afforded protection from civil liability under Section 12(1) of the Act because of failure to register, if the Court did not agree with the "no-sale" theory, the rule would provide no protection under Section 19 from the anti-fraud, civil and criminal liability provisions of Sections 12(2) and 17.

The Court of Appeals decided the case on other grounds and then referred to the Commission's arguments in phraseology which, it is generally urged, suggests that the Court accepted the "no-sale" theory. Following this discussion, the distinctions between the rule and the theory, so ably argued in our briefs, and their implications apparently were not fully appreciated, or were glossed over. At least I have found no evidence that they received very much attention until much later.

In 1951, one of our Regional Administrators advised that he had received complaints regarding certain mergers brewing in his area. He referred to the repeal of Form E-1 in 1947 and sought instructions whether it was appropriate to investigate these matters since the anti-fraud

provisions of Section 17 related only to "sales". About this time a case had also arisen under Section 16(b) of the Securities Exchange Act of 1934 in which one issue was whether the acquisition of securities in a merger could be treated as a purchase and matched with a sale of these securities within 6 months.[6/]

The Commission determined to appear in the Section 16(b) case amicus curiae to urge that a "purchase" within the meaning of Section 16(b) had taken place and that the "no-sale" theory which had been raised by way of defense had no application under the 1934 Act. The Commission at the same time directed the staff to draft a rule under Section 16(b) which would restrict the recoverability of profits to certain types of exchanges involved in mergers and related transactions.[7/] The Commission also directed that the Regional Administrator be advised that the position previously reflected in the Note to Form E-1, which had been rescinded, should not be construed as in any way limiting the Commission's jurisdiction under Section 17 of the Act or Section 10 of the Securities Exchange Act of 1934. Ultimately, the Commission determined to express the administrative interpretation in a rule which would make clear that the submission and consummation of mergers and similar transactions are deemed not to involve an offer or sale for purposes of Section 5 only.[8/] Rule 133 in essentially its present form, was adopted on August 2, 1951.[9/]

6/ Blau v. Hodginson, 100 F. Supp. 361 (S.D. N.Y., 1951).

7/ See Rule 16b-7 under the Securities Exchange Act of 1934.

8/ It is interesting to note that two early expressions by the Commission frequently cited as support for the "no-sale" theory are in fact limited to the "no-sale" rule. "The Commission has interpreted the Act as not requiring registration in such situations....The Commission felt that the language and structure of the Act pointed to this result." Report of the Securities and Exchange Commission on Proposals For Amendments to the Securities Act of 1933 and the Securities Exchange Act of 1934 (1941) at p.25. See also SEC Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees, Part VII, p. 249, n.172 (1938).

9/ Securities Act Release No. 3420. The rule was amended after (see p. 6)

In 1956 the Commission announced that it had under consideration a proposal to revise Rule 133 to provide affirmatively that transactions of the character described in the Rule involve the offer and sale of securities.[10] Following a public hearing held in January, 1957,[11] the Commission announced that it was deferring action on the proposal pending further study.[12]

In April, 1957, in its Opinion in the Sweet Grass case[13] and in October, 1957, in the Schering-White release,[14] the Commission discussed the scope and limitations of Rule 133. In substance, the Commission indicated that (1) Rule 133, where applicable, merely provides that registration of securities, and presentation of a prospectus to the security holders, is not required in connection with the submission of a plan of merger or other transaction specified in the rule and the receipt of securities in consummation of the plan, (2) this does not mean that the securities issued in such a plan are "free" securities which need not be registered insofar as subsequent offers and sales of such securities are concerned; that is, that registration would be required for any subsequent

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9/ (contd) enactment of the Internal Revenue Act of 1954. Securities Act Release No. 3522 (1954). Certain other transactions, such as distributions of stock dividends, are not deemed to involve a sale within the meaning of Section 5. Securities Act Release No. 929 (1936).

10/ Securities Act Release No. 3698, (October 2, 1956).

11/ Securities Act Release No. 3728, (December 17, 1956).

12/ Securities Act Release No. 3761, (March 15, 1957).

13/ Great Sweet Grass Oils Limited and Kroy Oils Limited, 37 SEC 683 (1957), affirmed per curiam sub nom. Great Sweet Grass Oils Limited v. S.E.C., 256 F. 2d 893 (C.A. D.C., 1958)

14/ Securities Act Release No. 3846, (October 10, 1957)

offer and sale unless such activity were limited to casual sales by non-controlling security holders which might fairly be described as trading transactions not involving a distribution or unless other exemption were available, and (3) Rule 133 provides no exemption from the registration and prospectus requirements of the Act with respect to any public distribution of the securities received by a security holder who might be deemed to be a statutory underwriter.[15/]

Reference was also made to the language in the opinion of the United States District Court for the Southern District of New York, in S.E.C. v. Micro-Moisture Controls, Inc., that Rule 133 is not applicable to an exchange of assets for stock which is but a step in the major activity of selling the stock.[16/]

Early in the Spring of 1958, the Commission directed three of its principal staff officers to undertake a detailed study of the matter, including all relevant materials and prior positions taken by the Commission and the staff, and the views expressed in response to the Commission invitation for comment on the 1956 proposal and otherwise. A summary of the conclusions and recommendations contained in the resulting report appears in the published announcement of the proposed amendment of Rule 133.[17/]

15/ See also Intermountain Petroleum, Inc., (Securities Exchange Act Release No. 5753, August 11, 1958) and North American Resources Corp., (Securities Exchange Act Release No. 5756, August 20, 1958).

16/ 148 F. Supp. 558 (S.D. N.Y., 1957). This opinion was written in connection with the issuance of a preliminary injunction. On March 31, 1958, the Court issued its Findings of Fact and Conclusions of Law supporting the entry of a permanent injunction upon the ground that the stock sold to the public was the stock of persons in a control relationship with the issuer and that certain of the defendants acted as underwriters in the sale of such stock. S.E.C. v. Micro-Moisture Controls, Inc., 167 F. Supp. 716 (S.D. N.Y., 1958) appeal pending.

17/ Securities Act Release No. 3965 (September 15, 1958). Time extended for submitting comments. (Securities Act Release No. 3990, November 4, 1958).

Restated briefly, the proposal would retain the present rule that registration is not required with respect to the submission to security holders and consummation of transactions specified in the rule; additional provisions would make clear that subsequent transactions in the securities so issued are not necessarily free of registration; that any person in a control relationship with a constituent corporation, as defined, who takes securities in the merger transaction with a view to their distribution is deemed to be an underwriter, thus requiring prior registration, except with regard to certain limited transactions defined as not amounting to a distribution; and that, if the issuer arranges for a public distribution of shares issued in the merger (whether or not limited to shares of persons in a control relationship to a constituent corporation), prior registration is required.

I turn now to the comments on the pending proposal.

For the statistically minded I should first mention that 27 letters were received. Most submitted one or more suggestions or raised some question of interpretation. Many caught drafting bugs. Each was helpful and we are grateful to all who so generously gave of their time and experience to assist us in the difficult task of drafting a workable rule.

Comments were submitted by 15 law firms, eight of which generally opposed the proposal. Seven favored it or were inclined to accept it as reasonable. At least one of those who agreed with the proposal nevertheless questioned the premises and rationale. In addition to the letter from your Committee, two other associations of lawyers commented. An American Bar

Association committee opposed the proposed amendment and a committee of the New York County Lawyers Association submitted a neutral comment. One stock exchange, two mining associations and two other professional organizations commented. One letter was received from a firm in the securities business, and three from issuers in some phase of the oil business. Apart from the lawyers and the bar associations, only the letter of one of the mining associations indicated an overall view as to the proposed amendment. It opposed the proposal.

I shall not here attempt to restate or to respond to all of the comments made. They are a matter of public record and you can obtain copies of them if you wish. It may be helpful to note some of the more important general comments submitted and questions raised so that you may consider them in the context of my remarks upon the proposed amendment.

Approval was indicated of the Commission's attempt to crystallize and to codify its views. Some commentators noted in this connection, apparently with approval, that the proposed amendment does not go as far as certain of the statements contained in the Great Sweet Grass opinion or the Schering-White release seemed to indicate. It was suggested that the rule be reviewed after a year and views then be solicited as to its operation and effect. Others wished to withhold final comment until they have had an opportunity to review the proposed form permitting use of a proxy statement as the major part of the registration statement.

Question was raised whether the proposed rule was fairly within the rule making authority of the Commission and whether, in fact the proposal does not amount to an attempt to amend the Act. It was stated that

the proposal is unnecessary to carry out the Commission's purpose to prevent improper evasion of the registration provisions of the Act and that existing authority and court decisions afford ample basis for preventing abuses. More concretely, it was questioned how transactions which are deemed not to constitute "sales" to security holders for the purposes of Section 5 can nevertheless be deemed to be "purchases" for some other purpose; how "purchases" by security holders can be deemed to be purchases for the purpose of determining whether the security holders are "underwriters" only in the case of security holders who are in control of a constituent corporation; and how resales of a given number of shares of a successor corporation by a controlling security holder of a constituent corporation can be said to represent a "distribution" when resales of a much larger number of shares of the same class even immediately after the same corporate transaction by a non-controlling stockholder of the successor corporation would be said not to be a "distribution."

I hope tonight to provide acceptable answers to some of these questions. Time does not permit me to address myself to all of them. Before undertaking this task I wish to dispose of one matter. While the proposed amendment does not deal specifically with the question whether a transaction subject to registration results from the distribution to its shareholders of stock received by a company upon the sale of its assets to another company in a transaction within Rule 133, it is posited upon the proposition, which we thought well settled and generally known, that such a distribution does not involve a "sale" requiring prior

registration. Some of you sought reassurance on this point.

The considerations which have given rise to the Commission's desire to specify with clarity the meaning and the limitations of the "no-sale" rule are well known. Some of you may have been in this hall about a year ago when the Director of the Division of Corporation Finance of the Commission, my boss, Mr.Byron D. Woodside, and Mr. Arthur H. Dean used this platform to discuss Rule 133 and Section 3(a)(9) of the Act. You may recall the remarks then made by each of these gentlemen. I hope you will forgive me, however, if I use some of Mr. Woodside's words to set the tone for the staff approach to this aim. Mr. Woodside said on January 14, 1958:

> "It seems clear that, whatever the scope of the theory underlying the original version of the rule, the purpose of Rule 133 was to limit its operations to the mechanics of soliciting and securing the action of security holders and the issuance of the security in the Rule 133 transaction itself for purposes of Section 5 of the Act.18/ It does not purport to deal with subsequent transactions or other actions by stockholders, nor to provide that there cannot also be activities, negotiations and conduct on the part of an issuer and other persons in connection with a merger negotiation (including stockholders who may have voted for or against the merger or not have voted at all) which might raise a question as to the need for registration with respect to a public distribution of a security by persons receiving such security pursuant to the terms of the merger.
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> "If securities issued in a Rule 133 transaction should be regarded as 'exempted' securities, Sections 4 and 5 may be ignored entirely. Under these circumstances, the witness in an investigation of possible violation of Section 5 might with considerable confidence assert that his stock, being merger stock, was 'free' stock.

18/ "In 1952, the Commission ruled that Rule 133 would not operate to relieve an issuer of the necessity of qualifying an indenture under the Trust Indenture Act of 1939. In this connection, consideration was given to the interrelations of the two statutes and the express purpose of the 1951 restatement of the rul [Reference should also be made to the opinion in the DuPont case under the Investment Company Act of 1940, 34 S.E.C. 531 (1953), in which the Commission expressly overruled its earlier application of the "no-sale" doctrine to Section 17 of that Act. SEE Phoenix Securities Corporation, 9 S.E.C. 241(1941)

> "If, however, the rule merely provides a means of escaping registration for the transaction of merger and should therefore be viewed as tantamount to a 'transaction' exemption, it would seem to follow that consideration must be given to Section 4(1) and Section 5 with respect to any contemplated public distribution following the merger." 19/

Since that time a very considerable amount of additional research has been made. The legislative history of the statute has again been traced minutely. Prior utterances by the Commission, its members and employees, past and present, have been further reviewed. Comments, arguments, petitions and other materials in the Commission's files and in the literature, lay and legal, have once more been combed. Relevant definitions and interpretations, current at the time of enactment of the Securities Act and since, have been carefully considered. Many items in this vast amount of material are persuasive that the Congress did not intend to exclude entirely from the ambit of the statute securities issued in merger and similar transactions. 20/ The legislative history also reveals, however, that the specific question as to mergers and consolidations was presented to the Congress late in the legislative consideration of the original bills. 21/ It has been suggested, therefore, that the question whether the operative and liability provisions of the Act could fairly and effectively be brought to bear, in the event registration were deemed a

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19/ Address at The Association of the Bar of the City of New York by Byron D. Woodside, Mergers, Consolidations and the SEC with Particular Emphasis on Rule 133 and Section 3(a)(9) of the Securities Act of 1933 (January 14, 1958) at pp. 7-8 (mimeo.).

20/ "Reorganizations carried out without such judicial supervision possesses all the dangers implicit in the issuance of new securities and are, therefore, not exempt from the Act. For the same reason the provision [Section 4(3)] is not broad enough to include mergers or consolidations of corporations entered into without judicial supervision." H.Rept. No. 85, 73d Cong., 1st Sess. (May 4, 1933) at p. 16.

21/ See infra. Note 27/.

requisite to the submission and consummation of a plan of merger, was perhaps, not fully explored at that time. It has also been suggested that the Congress may have left this problem, as it did others, to be worked out by the Commission pursuant to rule making power to achieve a result consistent with the broad statutory objectives. It does seem consistent with the Congressional intention, as reflected in the provisions of Sections 3(a)(9) and 3(a)(10) (then Section 4(3)), the so-called reorganization provisions of the Act, and in the provisions of Section 4(1), to suggest that, while registration was not intended for the mechanics of the mergers, they were to be subject to the anti-fraud provisions of the Act, and that freedom from registration for subsequent transactions in the securities had to be bottomed upon exemptions relevant and appropriate to those transactions. The first part of this conclusion, I hasten to admit, requires the finding of a "sale."

The staff report rejected the view that the issuance of securities in Rule 133 transactions does not involve a Securities Act sale for any purpose for a number of reasons. It was testified in the hearings on the original bills that the term "sale" was taken as nearly as possible from the then current Uniform Sale of Securities Act.[22/] The definition in Section 2(3) of the Act and the definition contained in the Uniform Act, adopted in October, 1929,[23/] and reapproved after minor changes in 1930,[24/]

22/ Hearings before the Committee on Banking and Currency, U. S. Senate, 73d Cong., 1st Sess., on S. 875 (April 3, 1933), p. 76.

23/ Handbook, Proceedings of National Conference of Commissioners on Uniform State Laws (1929) at p. 173.

24/ Handbook, Proceedings of National Conference of Commissioners on Uniform State Laws (1930), p. 233.

are remarkably similar. The Uniform Act also included in Section 5 under the caption "Exempt Transactions" the following:

> "The transfer or exchange by one corporation to another corporation of their own securities in connection with a consolidation or merger of such corporations." 25/

This followed the pattern of the Blue Sky laws. I do not believe that any state then excluded mergers or consolidations from the definition of "sale" although a majority of the states treated them as exempt transactions. The situation is not much different today. 26/

I have already adverted to the fact that the Congress had before it a proposal, specifically concerned with mergers, submitted by counsel for the Investment Bankers Association of America. 27/ While our records are not clear, it appears that a memorandum was submitted on or about April 18, 1933, after the hearings had been concluded. The proposal, which took the form of a substitute for the original provision of what is now Section 3(a)(9) and Section 3(a)(10), and the reasons for it were:

> ". . .the present exemption in behalf of corporate reorganizations needs to be clarified to include those cases where the reorganization involves the organizing of a new company or the binding together of several new companies. The definition of reorganization used by the Federal Income Tax Law is a precedent.
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> "Therefore, to cover both of the above features, we propose a substitute provision for subsection (d), as follows:
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> " '(d). . .the distribution of securities issued under a merger or consolidation, or reorganization or recapitalization by a corporation or corporations party thereto or formed pursuant thereto or in connection therewith. . .."

25/ Paragraph (f), Ibid., Section 5, at p. 181 (1929) and p. 243 (1930).

26/ "Thirty-odd statutes exempt some or all of the corporate events specified [in Rule 133], although the exemption is occasionally conditioned on some sort of filing." Loss & Cowett, Blue Sky Law (Little, Brown & Company, 1958) at p. 346.

27/ This was in the form of a memorandum entitled "Senate Bill 875, Securities Bill (Reprint No. 3) Proposed Amendments, Submitted by Counsel For The Investment Bankers of America."

Apart from these and earlier references to legislative and other indications, there is serious question on theoretical grounds whether the accepted rationale for the view that a "sale" within the meaning of the Act is not involved in the submission, voting upon and consummation of a merger or similar transaction, is justifiable. The staff report refers, in part, to this matter as follows:

> "The 'no sale theory' has been based on the rationale that a merger and the other types of transactions specified in Rule 133 are essentially corporate acts and there is absent the volitional act on the part of the individual stockholder required for a 'sale' in the generally accepted meaning of that term. The basis of this theory is that the exchange or alteration of the stockholder's security occurs not because he consents thereto but because the corporate action, authorized by a specified majority of the interests affected, converts his security into a different security. This approach, in our view, overlooks the substance of its transaction and ignores the fundamental nature of the relationship between the stockholders and the corporation and between stockholders. It does not seem to us that the mere fact that the relationships are in part controlled by statutory provisions of the state of incorporation must as a matter of law preclude the application of the broad concept of sale as contained in Section 2(3) for all purposes.
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> "The concepts of 'offer' and 'sale' in Section 2(3) are broader than the commercial or common-law contractual meanings of these terms and embrace situations which would not be regarded as sales in the commercial sense . . .
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> "Transactions of the character described in Rule 133 do not, as is often urged,occur solely by operation of law and without the element of individual stockholder volition. On the contrary, the common law and statutory law recognize that mergers and similar transactions are possible only within the framework of the contractual relationships between the corporation, the state and the individual stockholders. . .
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"... .The 'operation of law' of the merger transaction merely reflects the fact that when, pursuant to a provision of the contract (whether so stated in the charter or in the state law or constitution) made when he acquired his shares, a specified majority of his fellow shareholders have, in the exercise of their individual discretion, approved a certain type of corporate reorganization, such reorganization is effected 'by operation of law' which is a term of his contract. In hard fact, however, only the shareholder who voluntarily accepts the new security or who negligently fails to avail himself of the alternative right to cash payment, and may be deemed therefor to have assented, is 'bound' by the action of the majority.

. . . .

"It seems basic that the stockholder faced with a Rule 133 proposal must decide on his own volition whether or not the proposal is one in his own best interests. He is bound by his own action or failure to act. Every merger involves an attempt to dispose of a security--there is an attempt to place a new security in the hands of at least some of the shareholders to whom the proposal is made. Assuming a public offering, the only other problem one faces is whether or not the disposition is one for 'value.' In voting for a consolidation or for a merger, the shareholder of a disappearing corporation is giving up valueable existing rights in that company, certainly value within the meaning of Section 2(3). Should shareholders dissent, in compliance with statutory procedure, they generally command cash payment. Where the right to demand an appraisal exists, the stockholder who votes for the plan voluntarily gives up that right. Thus, where there is an acceptance of the offer by a shareholder either specifically by an affirmative vote, or by implied assent through neglect to assert other rights, there is certainly a sale in the Securities Act sense.

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"We believe that the transactions covered by Rule 133 are not excluded from the term 'sale' as defined in Section 2, and we see no reason why as a matter of statutory construction or policy the Commission should take any position which might foreclose or prejudice any rights which a person might have under Sections 12(2) or 17 in a transaction of the type specified in the rule."

Having reached this conclusion the question properly arises why the staff proposal does not recommend outright repeal of Rule 133. After detailed analysis of the provisions, definitions and requirements of the operative provisions of the Act, as well as the civil liability provisions, it was concluded that the existing rule represents a reasonable interpretation of the Act in the application of the procedural provisions of Section 4 and Section 5 to merger and similar transactions; that it is not inconsistent with the broad purposes of the Act; and that it represents a proper exercise of the Commission's rule making authority.

Section 2(3), by its terms, reflects the fact that a particular transaction may be "sale" for one purpose under the statute but not for others.[28/] A specific illustration is found on the face of the statute. An agreement of sale between an issuer and an underwriter is excluded from the term "sale" in Section 2(3), but it nevertheless must be a sale for purposes of Section 2(11) which defines who is an underwriter. Would the issuer urge, and the underwriter accept, the view that Sections 12(2) and 17 should not apply? The exclusion of this transaction from the provisions of Section 5, whether by express statutory provision or by interpretation of the phrase "unless the context otherwise requires," is necessary because neither the first nor second clauses of Section 4(1) provide an exemption for this first step in what is normally a two-step procedure leading to a public offering of securities.

28/ In Schillner v. H. Vaughan Clarke Co., 134 F. 2d 875, 878 (C.A. 2, 1943), the Court relied on the phrase ". . .unless the context otherwise requires . ." in the opening clauses of Section 2 to justify the conclusion that the word "sale" in Section 2(3) has a broader meaning for Section 12(2) than for Section 5.

The staff recommendation should not be understood to reflect the view that there would be insurmountable difficulties in devising rules which would require the filing of a registration statement in respect of a Rule 133 transaction and prescribe appropriate standards of disclosure consistent with the provisions of the statute. It is based upon an analysis of the manner in which other provisions and requirements would operate which persuaded the staff to the view that the prohibitions of Section 5 would not operate effectively and reasonably in Rule 133 transactions.[29] As already noted, such a conclusion was given public expression by the Commission in 1941 in its Report to the Congress on proposed amendments of the Act.[30]

We may turn now to the question which some of you have raised. How can someone who acquires shares in a "no-sale" transaction be a purchaser of those shares? I have already noted that the legislative history of the statute supports the view that Congress intended that mergers and other similar transactions be subject to the Act. And I hope you will agree that, as a matter of legal analysis, the merger transaction is fairly within the very broad definition of the term "sale" as used in the Act. At least since 1951, the Commission has said that the "no-sale" doctrine, as reflected in the Commission's Rule 133, is of limited application and that, as the Commission stated when it adopted Rule 133, "Whether or not a sale is involved for any other purpose will depend upon the statutory context, and the question should in no sense be influenced by the rule".[31]

29/ For excellent discussions of problems which would arise if the registration and prospectus provisions were applicable, see Throop, In Defense of Rule 133, A case for Administrative Self-Restraint, 13 The Business Lawyer 389 (1958) at pp. 395-399, 410-416; Purcell, A Consideration of the No-Sale Theory Under The Securities Act of 1933, 24 Brooklyn Law Review 254 (1958) at pp. 282-7.

30/ S.E.C. Report, op. cit. supra., Note 8/, at p. 25.

31/ Securities Act Release No. 3420 (1951).

The situation is analagous in many respects to that which arises from the making by an issuer of a contract to sell or, indeed, an actual sale, to an investment banker. This is, as we have noted, defined in Section 2(3) as not being a sale when everyone will agree that it is, and no one would suggest that it does not result in the investment banker becoming a purchaser for purposes of Section 2(11) or otherwise. If he purchases with a view to distribution he becomes an underwriter within the meaning of Sections 2(11) and 4(1). It would surprise me a great deal if an underwriter who has been held liable in a suit under Section 12(2), based upon a misstatement in a prospectus, would feel that he could not sue the issuer because the latter had not "sold" to him.

This leads me to your next question: Why does the proposed amendment of Rule 133 define some of the purchasers as underwriters, if they take with a view to distribution, and not others? Before treating with this question I would like to restate it. Section 2(11) provides that <u>any</u> person who takes with a view to distribution is an underwriter. Leaving aside for the moment the problem of defining what is a distribution, the question should therefore be why are not all persons who take shares in the merger with a view to distribution underwriters? In other words, why does the proposed rule identify only some of these persons as underwriters and in effect except all the others from language that seems to fit all? To refine the question further, I think all of you will agree that, if a person acquiring shares in a Rule 133 transaction is in a control relationship with the issuer, any intermediary distributing such securities for him is clearly an underwriter in view of the last sentence of Section 2(11).

It can not seriously be urged that Rule 133 affects this statutory scheme. I hope you will also agree that there is no basis for suggesting that Rule 133 justifies the view that merely because a security is issued in a transaction within the rule it is thereafter to be treated as an exempt security.

While all of us would agree that a deliberate intention to evade registration will vitiate reliance on the rule, this is not a criterion which is satisfactory for determining whether Section 5 shall apply to subsequent transactions. In many cases a transaction is put into a Rule 133 mold as an alternative to a sale for cash by the issuer to provide the funds which the stockholders of the disappearing company really want and have bargained for. Our experience indicates that in many cases it is understood, if it is not a sine qua non, that the stockholders of the selling or disappearing corporation are to be in a position to dispose promptly of all or a part of the shares received. In other cases tax or other business reasons determine the form of the transaction.

It does not necessarily follow, however, that every stockholder, who acquires shares in a Rule 133 transaction and intends to resell them, is a statutory underwriter, even if the number of shares involved and the manner of sale would in fact amount to a "distribution". Such a literal construction of Section 2(11) would in many cases be inconsistent with the purposes and policies of the Act. The Commission has not construed Section 2(11) to identify as underwriters public stockholders who intend to distribute shares acquired in a registered rights or other public offering, or in a transaction exempt under Sections 3(a)(9), 3(a)(10), or 3(b).

In some of these situations, substantial blocks of securities, amounting to a "distribution" by any test, are in fact redistributed. It would be an inversion of the purposes and provisions of the Act, however, to subject members of the public, for whose protection the Act is designed, to the duties, responsibilities and liabilities of an underwriter. An important justification for the imposition of such duties and liabilities is that the persons who may be identified as underwriters are in a position to protect themselves in the negotiations and contracts with the issuer which are effected on their behalf. While the Commission has not publicly drawn the line which separates the underwriter-distributor from the non-underwriter-distributor in all of the situations mentioned, it is considered appropriate to recommend that the Commission do so in the circumstances of Rule 133 transactions.[32/] The amendment suggested by the staff proposes to identify essentially two categories of persons who may be considered as underwriters. The first includes the person who, pursuant to some arrangement with the issuer related to the Rule 133 transaction, or with a person in a control relationship with the issuer, proposes to effect a public distribution on behalf of all or some of the persons to whom the shares are issued. In such a situation the issuer apparently has such an interest or obligation to provide for conversion of the shares into cash as to arrange for the distribution--a situation which has the flavor and the substance if not the precise words of "selling for" an issuer, as spelled out in Section 2(11). In any event it is difficult to support the view that the issuer's relationship to the public offering is so remote as to suggest the availability of an exemption under Section 4.

32/ For similar actions by the Commission see Rules 140-143 and the proposed new Rule 144 under the Securities Act.

The second category includes the persons who are in a control relationship with a constituent corporation. These persons by virtue of their positions and relationships, are in a position to negotiate for and to insist upon registration.[33] Of course, these "purchasers" in the Rule 133 transactions are underwriters only if they take with a view to distribution. It is necessary, therefore, to consider this term. While distribution has frequently been considered as synonymous with the term public offering, it is not necessarily always the same thing. An offer to sell 10 shares of a heavily traded stock of a large corporation through a broker using the facilities of a national securities exchange is undoubtedly a public offer. It does not necessarily lead to the conclusion that the broker is effecting a distribution within the meaning of Section 2(11) of the Act. In an attempt to give effect to the distinction between trading and distribution which is fundamental under the statute,[34] the staff has relied on the pattern established in Rule 154 which was designed as a reasonable compromise to solve a similar problem.[35] While this formula does not resolve all the questions and, indeed, raises a number of problems, it does provide a reasonable guide which has proved to be useful and workable.

It was recognized that, as many of you have suggested, the rule as proposed to be amended may permit substantial distributions free of registration by persons not within these categories, that is, by persons who are not underwriters. This is, however, a situation which you and we meet every day in other contexts. The statute is not designed to reach

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33/ For a legislative proposal (and a criticism of it) that persons in a control relationship with a constituent corporation be defined as "issuers" of the security issued to them in the merger by the surviving company, see Purcell, op. cit. supra, note 29/ at pp. 287-290.

34/ ". . .the Act is, in the main, concerned with the problem of distribution as distinguished from trading." H.Rept. No. 85, 73d Cong., 1st Sess., (1933) at p. 15.

35/ Securities Act Release No. 3525 (1954).

every distribution of a security. It is believed probable that under the rule, if amended as proposed, major redistributions will be subject to the registration provisions of the Act.

I must now remind you that I did not promise to answer all your questions. I hope that I have provided you with acceptable answers to some of them; that more of you are persuaded that the proposed amendment of Rule 133 is, in the words of Chester Lane, your former chairman, ". . .analytically justifiable, and a proper exercise of the Commission's rule making power"; and that all of you will agree the staff proposal is no more legislative in nature than was the adoption of the Note to Form E-1 or Rule 133 itself.