ADDRESS

of

CHESTER T. LANE

Assistant General Counsel

Securities and Exchange Commission

before

THE MINING ASSOCIATION OF MONTANA

Butte, Montana

Thursday, March 17, 1938

It is with great pleasure that I welcome this opportunity of talking with you about some of our common problems. I am not a mining man, as you know, but a lawyer who, if asked upon the stand, would have to admit that he couldn't tell the difference between a gold mine and an oil well - or even worse, that he didn't know whether he could or not, because he had never seen either. A Commission like ours has to make use of a great many varied talents - we have accountants, economists, securities trading experts; we even have mining engineers; and we have a great many lawyers. It is only as a lawyer that I want to speak to you tonight - a lawyer whose job is not to run mines, or tell other people how to run them - or even how to finance them - but is to try to tell people - Securities and Exchange Commissioners, securities dealers and mining men alike, just what the law means and what they have to do to keep within it.

I would not be realistic if I didn't appreciate that there has been a great deal of confusion in your territory as to just what the Securities Act means, and how it works in the practical situations which confront you every day. To some extent this confusion may have been due to us - or at least we may have failed to do our full part in clearing it up. But, without criticism, it is certainly due in part to you. I do not believe that all of you, or even most of you, have approached the Act and the Commission's rules - particularly the rules exempting small issues from registration - as barriers intentionally and maliciously interposed by an unsympathetic Commission between the mining man looking for capital and the public looking for an investment or an interesting speculation; but certainly some of you have. I have had letters from some of you telling me that the Commission has some kind of grudge against the mining industry, and that its rules are merely designed to prevent mining financing. What you have said to each other about us probably wouldn't bear repeating.

The charge that the Commission has a grudge against the mining industry is to me ridiculous on its face, for no conceivable reason suggests itself to me why any such prejudice should exist. But this charge is not what I want to discuss today, for if you believe it, I couldn't change your minds by merely talking; you would wait for more concrete gestures of friendliness and cooperation before being convinced. Instead, I want to stick more closely to my own job, which, as I told you, is to try to tell everyone who has a concrete, specific problem involving securities just what he can and should do to comply with the law. I want to assume, and to have you assume, that there are no differences of policy between us, and that the only thing we are interested in is in finding out what the law and the rules are, and in complying with them.

Perhaps the simplest way to begin is with a description of just what the Securities Act is and how it works in the ordinary case. Most of you probably know; but if we first draw the outline of the picture it will make it easier to see where some of the details fit in.

In its general scheme the Securities Act is not a very complicated piece of legislation. It has often been called the "Truth in Securities Act", and that is just what it is. Only instead of merely making it unlawful, in general terms, to sell securities by fraud, the Act seeks to go further, and to set up specific standards and mechanics of disclosure, so that the buyer of securities, whether he be investor or speculator, may have some chance of knowing what he is buying.

So in general, and without the exceptions, which I will come to later, the Act says this: anyone who wants to sell securities by mail or in interstate commerce shall first file with the Securities and Exchange Commission a registration statement containing all the information about what he is selling that the buyer would need as a basis for deciding intelligently whether or not he wants to buy it: who the issuer is, what kind of business he is in, what property he owns, what is his present financial condition, what rights the buyer will get if he buys the security, how much of the money he pays will go into the enterprise and how much to the promoter and underwriter, and a lot of similar things. All this information the Commission is required to keep available for public inspection in its public reference room in Washington, and at the end of twenty days, unless amendments are filed in the meantime or the Commission on examining the statement thinks that it is incomplete or contains untrue or misleading statements, it becomes automatically effective without any action by the Commission. It is very important to remember that the Securities Act gives the Commission no authority whatsoever to approve or disapprove of security issues, or to pass upon their merits in any way - in fact it is a crime for anyone selling a registered security to represent that its registration carries with it any kind of Commission approval. A security may be the wildest kind of gamble, or may be sold purely for the purpose of helping the company's president buy himself a new house or support his mistress in better style, but so long as those and the other relevant facts are honestly and fully revealed in the registration statement and prospectus the Securities Act has done its work. It is then up to the prospective purchaser to decide whether he wants to put in his money on these conditions.

This, then, is the process of registration - a process which has become surrounded by many unfounded legends of doubt and difficulty, to such an extent, I have been told, that some of you have come to believe that unless a security could be sold under Rule 200 or Rule 202 it couldn't legally be sold at all. Nothing could be further from the truth. Of course problems have arisen between registrants who, however honest, are anxious to paint as rosy a picture as possible, and a Commission which is intent primarily on assuring to the investor, and even the speculator, a fair chance to know where his money is going; and even apart from problems of that kind, there has undoubtedly been much honest inability, on both sides, to see the other's point of view. But we in the Commission feel that we are progressing all the time towards a greater understanding of the difficulties of mining issues, and if I can do nothing else I can assure you of our earnest desire to cooperate with you in meeting those difficulties. In support of that statement I can at least point to the recently adopted Form AO-1 - the form for registration of the stock of mining companies still in the promotional stage. For several years such issues had to be registered on Form A-1 - the catch-all form for use where no special form was provided; and neither our experience nor yours was very happy under that form. A tabulation compiled about a year ago by someone not on the Commission's staff indicated that of registration statements filed for gold mining issues in the three years ending June 20, 1936, probably more than a third had for one reason or another never become effective, or, if effective, had ceased to be so by reason of withdrawal or stop order. This, it must be confessed, was by far the largest percentage of unsuccessful issues of any industry in the country. Presumably the great majority of these statements were filed on Form A-1. By adopting Form AO-1 the Commission has provided a form which undoubtedly calls for more complete disclosure in some respects, but is at the same time more specifically adapted to the problems of the mining industry, so that it is a great deal easier to tell just what information is called for in the form. We have had too little time as yet to judge accurately the effect of this form, but I think that we are at least going in the right direction.

A little while back I referred to the fact that the requirement of registration under the Securities Act was subject to some exceptions, and it is of these exceptions that I want to talk principally. These exceptions are of various kinds, and some of them would be of very little interest to you. However, I think that everyone interested in selling mining securities is vitally interested in at least one group of the exemptions - those covering issues of $100,000 or less: the exemptions generally known as Rules 200, 201 and 202.

Unlike the other exemptions from registration, these exemptions for small issues are not specifically provided in the Act itself, but are the product of a discretion which the Act confers upon the Commission to exempt small issues from the registration and prospectus requirements of the Act. The precise language of this discretionary power is often very important, and so I will read it to you

> "3(b). The Commission may from time to time by its rules and regulations, and subject to such terms and conditions as may be prescribed therein, add any class of securities to the securities exempted as provided in this section, if it finds that the enforcement of this title with respect to such securities is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering; but no issue of securities shall be exempted under this subsection where the aggregate amount at which such issue is offered to the public exceeds $100,000."

The first thing to note is that this section (which gives the Commission the only discretion it has under the Act to grant exemptions) is not a discretion to exempt any particular issue from registration. The Commission cannot look at an individual issue and decide that registration is for some special reason unnecessary or inappropriate; it can only adopt general rules laying down the terms and conditions upon which issues will be exempt from the registration requirements. However, if an issue complies with the provisions of a particular rule it is automatically exempt from registration just as much as if it were specifically named in the Act as exempt, and without any further action by the Commission.

The second thing to remember is that even though an issue comes within one of the Commission's rules and is therefore exempt from registration under the Act, that exemption has nothing to do with Sections 12 and 17, the sections imposing civil and criminal liability for fraud in the sale of securities. It is just as easy to go to jail for selling an exempted security by fraud as it is if the security is registered under the Act.

In the third place, it is important to appreciate that the exemptions provided by these 3(b) rules have no relation whatever to the so-called "intrastate exemption". That exemption is provided by Section 3(a)(11) of the Act itself, not by any rule of the Commission; it exempts any security where the entire issue is sold exclusively to residents of the state where the issuer is incorporated and doing business. The meaning of Section 3(a)(11), and the conditions which have to be observed in operating under it, are discussed at length in an opinion of the Commission's General Counsel published in Securities Act Release No. 1459, and I suggest that if you plan to issue securities in reliance on this exemption you first study carefully that opinion. For my present purposes, it is enough to point out that if the entire issue is sold to residents in accordance with the conditions of Section 3(a)(11), the issue is exempt from registration regardless of its size; and, conversely, if an issue is exempt under one of the 3(b) rules, because of its small size, it may be sold to anybody, regardless of residence. The two types of exemption are entirely independent of each other.

There are quite a few rules under Section 3(b) dealing with particular types of securities and with special situations. The most important for your purposes, however, are Rules 200, 201 and 202, the three rules under which the great bulk of small corporate issues are sold. I would like to discuss these three rules in detail.

Although I know that some people believe that these rules, or at least parts of them, are complicated and obscure in their meaning, they have always seemed to me pretty logical and simple, and except in peculiar situations easy to apply. Nothing could be simpler, for instance, in the usual case than Rule 200, which exempts, with only one condition or restriction, any issue of securities of the ordinary type - stocks, bonds and the like - where the aggregate offering price to the public does not exceed $30,000.

Almost the only troubles with Rule 200 come from the one exception or condition. That is, that in determining how large an issue may be sold under the Rule it is necessary to deduct from $30,000 the amount of any offering made in the past year of securities of the same issuer, or anyone else controlling, controlled by or under common control with the issuer. The securities which have to be deducted, you must remember, are not just other securities of the same class but all securities (with two exceptions which aren't important) issued by the same company or anybody in the same control family.

Surely the reason for this condition is obvious. Congress in authorizing the Commission to exempt small issues clearly intended that this power should be exercised carefully, and should be so limited that only financing which was really small financing could come in under the umbrella. For the Commission to exempt freely all offerings of $30,000 or less would open up the door to far more unregistered securities than could have been contemplated by Congress; for such an exemption would make it perfectly possible for a company to raise $150,000, $200,000, or even larger amounts without registration by the simple process of offering $30,000 this week, $30,000 next week, and so on, until the desired amount had been sold. Or, if a slightly less crude device were wanted, it would be possible to form a mining company and sell $30,000 of its stock, then form another company, sell its assets to it, and have that company sell $30,000 of its stock, and so on indefinitely. In either event the result might be the raising of large sums of money without registration and without any protection to the public at all. It is in order to prevent this kind of evasion of the purposes of the Act that the rule is so drafted that the unrestricted exemption which it provides is made available only for a single $30,000 offering each year by any company or group of companies or individuals.

In working under the Rule, you must remember that what your company may now offer is $30,000 less any amount your company or any other company related to it by practical control, up, down, or sideways, has offered during the past year. The amounts which have to be deducted include private offerings as well as public; for example, if the promoter takes 51% of the stock in exchange for property, the company can't then go ahead and sell the balance for $30,000; it can sell only $30,000 worth less the amount taken by the promoter. In getting the dollar value of "the amount taken by the promoter", you have to take the actual value of the property which he gives for his shares, if you can establish any actual value. If you can't - as is usually the case - you have to value the shares issued to the promoter at the same price per share as the price at which you offer the balance of the shares to the public, or else at their par value, whichever is the higher. Of course, if the shares issued to the promoter are valued on the company's books at par when the shares offered to the public are sold below par, that valuation may in itself be misleading; but if the company actually sets up a misleading valuation it can't be allowed to claim a lower value for the purpose of increasing the amount of exemption available under Rule 200.

By "aggregate offering price to the public" we mean just that - the amount the public has to pay, not the amount the company receives after payment of underwriters' commissions or other expenses.

And by "control" we mean just that too. In spite of all the criticism I have heard of the vagueness of the rule, it isn't very difficult to decide in most cases whether control in fact exists. If a promoter forms a corporation, and sells a mining property to it for 51% of the stock, becomes the president of the company and generally dictates its policies, he is in control of that company. If he does the same thing with another company, he is in control of that one too. And the two corporations are under common control, and between them can make only one $30,000 offering of securities under Rule 200 in a single year. Similarly, even if before he forms the second corporation the first has folded up and disappeared, the securities offered by the first have to be deducted in deciding how much the second may offer, for at the time the first made its offering it was controlled by the person who now controls the second. The same thing might be true even if he didn't take 51% of the stock; 25% or 10% might be enough to give working control if the rest were scattered in smaller blocks. By "control" we mean control in fact - actual power to control the policies and management. Some of the confusion has perhaps been caused by the fact that we in the Commission often are not in a position to say whether or not control exists. That isn't because there is any real difficulty in the concept, but because actual power to control depends on facts which the people involved know and which we don't and can't. When you come to me and ask whether you control the X company, it may be possible for me to answer; if you are the president and a director and hold 60% of the stock it is self-evident that you do, and I tell you so. But maybe you only hold 30%, and it isn't clear on the face. In such cases all I can say is: "Well, are you in control or aren't you? You're the man who knows." True, I may have to advise you that if it is a close question it is safer to assume that control does exist; but in the great majority of cases, so far as I have been able to tell, the question isn't a close one - it is perfectly obvious, one way or the other, to anyone who really knows the facts.

So much for Rule 200. Rule 201 is a little different - in some ways broader and in some ways narrower. It covers issues of almost every kind, and all the way up to $100,000, the top limit of the Commission's powers. Like Rule 200, it has no prospectus requirements, no escrow provisions, no restrictions on the way the securities may be sold. But the Commission felt that if it was to grant a blanket exemption of this kind for issues larger than the $30,000 allowed under Rule 200, it should do so only for securities of what you might call investment grade. Of course there is no way of being sure just what will turn out to be sound non-speculative investment, but the rule tries to set up at least a few sign posts. For one thing the securities have to have relatively high par values or denominations - $100 for stock, $500 for bonds - no bargain basement stuff. They have to be sold at not less than par or face value (except for bonds, which, to meet present day market tendencies, can be sold at 90). They have to be sold for cash, and, to keep out too much water, be part of a class which has not been sold except for cash during the past year. (This is subject to one exception which isn't very important). They have to be the kind of securities which can be sold without too much sales effort - the rule doesn't cover them if the issuer has to pay more than 10% in underwriting and distribution costs. All this because the Commission felt that it shouldn't waive the entire scheme of buyer protection contemplated by the Act for issues between $30,000 and $100,000 unless it could ensure the existence of some sort of safeguard as to the kind of security involved.

As in the case of Rule 200, you have to deduct from the top limit allowable the amount of other securities offered - including those still being offered - during the past year; but in two respects this requirement is less strict than Rule 200. In the first place, you don't have to worry about any "control" problem under Rule 201, for that rule requires deduction of past issues only if they were securities of the same issuer. And secondly, you don't have to deduct past issues which were registered under the Act, or were issued under some other exemption, such as the private offering exemption of Section 4(1), or the intra-state exemption of Section 3(a)(11). Past issues have to be deducted only if "exempted from registration solely by reason of this or any other rule under section 3(b) of the Act". Thus, you would not have to deduct securities issued to promoters for property, at least if the promoters took for investment, since that would be a transaction "not involving any public offering", and so exempt under Section 4(1) - although you shouldn't forget that if the promoters' securities were of the same class they would have been issued "otherwise than for cash", and that fact would defeat the exemption under Rule 201.

Rule 201, however, doesn't do a great deal of good for the average mining issue, for mining stocks aren't often sold in $100 shares, or on a mere 10% underwriting spread. Rule 202 is the mining company's home field. Let me go through its requirements one by one.

First: Rule 202 applies only to shares of stock in a corporation or similar interests in a trust or unincorporated association. And by "similar" we mean similar; we don't mean a beneficiary's interest in a testamentary trust, or a bondholder's interest in property subject to a corporate mortgage. The only similarity those things would have to a share of stock is that they would probably all be securities. We mean interests which carry rights, analogous to stockholders' rights, in business enterprises organized along the same general lines as corporations. For instance, we mean the type of interest that a shareholder has in a Massachusetts business trust - an enterprise which is a corporation in everything except the technical form of its organization.

Second: Rule 202 has no maximum par or stated value requirement. You can sell one cent par value stocks under it. But whatever your par or stated value is, you can't put your public offering price below it, whether it is a cent or a hundred dollars. Not even by such devices as selling to the promoters at par and getting the stock donated back, or selling one share at par and "giving" another away, can you get around this requirement. The "not less than par" requirement is waived only in the case of treasury stock reacquired for cash or its equivalent at the current bona fide market or selling price.

Third: As under Rules 200 and 201, you can't sell successive weekly editions of stock. This provision, however, follows the lines of Rule 201 rather than Rule 200; you don't have to worry about issues of other companies in the same "control" family, and you don't have to worry about issues which were registered or had some other ground for exemption than the 3(b) rules. All you have to deduct is offerings of the same company which were made during the past year, and which were exempt only under Rule 202 or one of the other 3(b) rules.

One point might be made here, which is equally applicable to Rules 200 and 201. When we talk about offerings of securities made during the past year, we mean primarily offerings initially made or commenced during the past year. Any such offering which was exempt solely under one of the 3(b) rules (and in the case of Rule 200 any such offering at all) must be deducted, except to the extent that it remains unsold and has been withdrawn. Offerings begun more than a year ago don't count, even though they may have been carried over into the year. However, if an offering begun more than a year ago under Rule 202 is still open at the time you are starting your new offering under the rule, the amount remaining unsold and still being offered would have to be deducted, since you can't offer more than $100,000 under Rule 202 at any one time.

Fourth: Distribution expenses must not exceed 25% of the public offering price. In other words, if the issue is to be free from the registration requirements, the buyer is to be assured that at least three-quarters of his money goes into the enterprise. This provision can't be evaded by "giving" the underwriter some additional bonus stock, for calling a thing a "bonus" doesn't prevent the so-called gift from being one of the company's expenses of distribution.

Fifth: Promoters' securities issued for services rendered in excess of the promoters' actual expenses or for property in excess of its fair value must be tied up in such a way that they can't be disposed of or liquidated until the company shows a year's operating profits. In other words, the public stockholders, who as likely as not have put up all the working capital, must be given a fair chance to see whether it will work, before the promoters can be allowed to pull out and take their profit with them.

Sixth: A prospectus, containing a bare minimum of factual information, must be filed with the Commission and used in every sale. What must go in the prospectus is set out in the rule in full; it is very simple and I won't go over it. When you've got all that in you can put in anything else you like, so long as you keep it honest - for as I said before these exemptions aren't exemptions from the fraud provisions of the Act. This prospectus must be given to every prospective customer at the time you first approach him; no "come-on" letters, telling a wide mailing list to write for a prospectus if interested, are permitted. And furthermore, no advertising in newspapers is permitted unless in the form of a re-print of the prospectus. The first time you approach the customer, whether by mail, newspaper advertisement, radio or personal interview, you must give him the prospectus.

In connection with the filing of the prospectus, I might point out that, unlike the registration requirements themselves, there is no waiting period in Rule 202 prospectuses. The requirement is only that three copies of the prospectus be filed, and as soon as it is filed it may be used. However, as most of you probably know, the Commission does as a matter of practice go over the prospectuses filed with it, and if it sees anything obviously wrong - either something left out or something apparently untrue or misleading - it writes a letter pointing out what it thinks is wrong. A letter of this kind, either criticising the prospectus or advising you that it seems to comply with the formal requirements of the Rule, gets out in anywhere from four days to two weeks, depending on the number of prospectuses which have piled up for examination. So, although there is nothing in the rule about waiting any period of time for clearance from the Commission, it is just as well from your own point of view to wait for a couple of weeks and see if the Commission has any comments.

Incidentally, I might say that it is perfectly proper under the rule to file your prospectus in typewritten form in the first instance, and have the printing done and the final copies filed after you have got your letter from the Commission.

This, I think, completes the picture of the differences between the three Rules - Rules 200, 201 and 202. Before I close I would like to discuss one or two problems that arise equally under all three rules.

The first of these problems concerns the extent to which exemptions under these rules may be combined with exemptions under other provisions of the Act, or with the registration of other securities of the same class. For instance, we are often asked whether it is possible to sell, say $200,000 worth of securities at the same time, offering $100,000 worth to residents of the home state and selling the other $100,000 under Rule 202. Or we are asked whether it is possible to file a registration statement covering the whole $200,000 worth and while waiting for it to become effective start the sales campaign with a $30,000 offering under Rule 200. To both of these, and all similar questions, we are obliged to say no, not just to be obstructive, but because with the Act as it is we have no choice. Section 3(b), under which all of these rules are adopted, is quite specific on the point; it forbids us to exempt any "issue of securities . . . . where the aggregate amount at which such issue is offered to the public exceeds $100,000". In the cases I have given, it seems perfectly clear that the "issue" is one which exceeds $100,000 in aggregate offering price. Securities of the same class, offered on the same general terms to the public as a part of a single integrated financing program, cannot be segregated into separate "issues" merely by announcing that one part will be registered and another qualified under Rule 202. Nothing can be clearer than that our exempting power was designed to cover small financing, not small portions of large financing operations. The exemptions provided by these rules can be used only if the total amount of securities of the same class involved in the same general financing plan or transaction falls within the maximum allowed by the particular rule concerned - $30,000 or $100,000, as the case may be.

The second general problem is that of assessable stock. I have received letters accusing the Commission of forbidding the sale of assessable stock. This is not true. What the Commission has done is to prohibit the use of these rules for the exemption of assessable stock from registration where the total amount of assessments which may legally be levied is more than the $30,000 or $100,000 top limit allowed by the rules. Stock assessable above these limits may be registered under the Act as any other stock may, and then offered to the public in the same manner as non-assessable stock.

This exclusion of fully assessable stock from the benefit of the exemption rules is not based on an uninformed prejudice on the Commission's part. The Commission knows that, although assessable stock has been unscrupulously used many times as a means of stripping the ignorant of all their loose pennies without leaving them anything more than an engraved piece of paper to show for it, it nevertheless has a legitimate place in the honest financing of mining development. But here again we are driven back to the limitations imposed by the Act upon the Commission's exempting power: the "aggregate amount at which" an exempt issue may be "offered to the public" may not exceed $100,000. When you "give" away a share of assessable stock, on an agreement to pay such assessments as may thereafter be levied, or even without such an agreement, it isn't really a gift, for in order to keep what you have purported to give him the recipient must pay such amounts as you may see fit to levy on him as assessments. The same is true if you purport to sell the stock to him at some nominal figure. In either case, the actual offering price, from any realistic point of view, is not the original cash paid, if any, but the amount which by the terms of the stock the buyer may be made to pay in the future if he is to keep his stock. When that amount is unlimited, the aggregate offering price for the purposes of the rule is likewise unlimited, and no exemption is available.

This view has now been indicated expressly in the rules, by amendments adopted last October which specifically state that the "aggregate offering price" of assessable stock for the purposes of the rules "shall be taken as the sum of the offering price thereof determined as hereinafter provided, and the aggregate amount of all assessments that may legally be levied thereon". So far as the Commission is concerned, however, these amendments did not change the effect of the rules as they stood before the amendments; so far as I am aware, the Commission never understood the rules to exempt stock issues which were assessable above the exemption limits. The amendments were merely intended to make clear what seemed to us the obvious effect of the rules even prior to the amendments.

Now, I think I have taken up enough time in discussion of the particular requirements of the exempting rules which are most often applicable to mining securities. As I said earlier, the rules in general seem to me pretty simple and easy to understand, at least if you read them carefully. Of course, I don't mean that peculiar situations may not come up - situations which just weren't thought of when the rules were drafted. When situations of that sort come up the thing to do is not just to swear at the rules, but to come in and ask us what we think about it. We in Washington, and the Commission's Regional Administrators, are always glad to try and find the answer to any problem when it is a specific, concrete problem where we know all the facts. Talk to the Regional Administrator for your region, or, if you prefer, write a letter to him, giving him exactly what you want to do and what your difficulty is, and he or the other men in his office will spend all the time necessary to try to find the answer. That is what he is there for. If you will do that, I think we will all find it easier to get on together.

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