THE FEDERAL SECURITIES LAWS AND SOME TROUBLESOME EXEMPTIONS

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It is helpful to begin any discussion of the Federal securities laws with references to the state "Blue Sky Laws," since these laws were the antecedents of the Federal Acts. The first state to adopt such a law was Kansas, in 1911. The name Blue Sky Law is attributed to a proponent of that statute who is reported to have stated that the legislation was needed because some companies were seeking to "sell building lots in the blue skies." There are times when I think things haven't changed too much in the intervening 54 years. Webster defines "blue sky law" as: "A law enacted to provide for the regulation and supervision of the sale of stocks, bonds or other securities, so as to protect the public against such as are obviously unsound or do not meet certain standards . . ." This definition recognizes and requires a degree of paternalism. The degree, of course, varies from state to state. Virtually all state securities laws impose some qualitative standards, and forbid the public sale within the state of securities which do not meet those standards.

Arising as it did in the depths of the Great Depression, and resulting from Congressional hearings which revealed substantial fraudulent activity throughout the national securities markets, the Securities Act of 1933 could well have been quite paternalistic in character. As a matter of fact, in its initial draft the Act was in actuality a Federal "Blue Sky Law." Legend has it that only the firm intervention of President Roosevelt prevented its being enacted in that form. As finally adopted, the Act codified the belief that access to the interstate capital markets of this country should be available to all, subject only to the requirement that investors and prospective investors be given "the truth, the whole truth, and nothing but the truth"; this is the essence of the pure disclosure concept, which is basic to the Federal securities laws.

In 1933, the Congress undoubtedly recognized that insoluble problems would have been created by the imposition of paternalistic standards on a nationwide basis. These problems can be graphically illustrated by one example which comes to mind: When the Oklahoma Securities Act was enacted in 1959, it differed in certain respects from its model, the Uniform Securities Act. One of the differences was the specific exemption of interests in oil, gas and mining titles and leases from registration under the Act. Although exempted from registration these interests clearly fell within the definition of "security." Any person, therefore, who made a business of dealing in the interests was required to register under the Act as a broker-dealer. As most of you know, this revelation created no small furor among the oil and gas people around the state. It quickly became apparent that this result was not intended by the 1959 Legislature. In recognition of this fact, the Act was amended in 1961, through legislation drafted and sponsored by Commissioner Owens, who was then Administrator of the Oklahoma Act. This legislation amended the definition of "security" to exclude these interests from it. It also repealed the exemption from registration, since it was then meaningless. Since 1961, therefore, oil, gas and mining titles and leases have been outside the jurisdiction of the Oklahoma Securities Commission, and one problem peculiar to a state with a vital and active oil and gas industry was solved. On the other end of the regulatory spectrum, in the State of Connecticut such interests are not only defined as securities, but are the <u>only</u> securities which are required to be registered prior to public offering and sale within that state. In the view of the Connecticut Legislature, this solved a problem for the citizens of that state characterized by unscrupulous promoters who in some instances preyed upon persons who were completely unsophisticated insofar as oil and gas were concerned. The registration requirement serves to keep out the unscrupulous promoter, while not preventing the legitimate operator from seeking promotional capital.

From this example it becomes clear that the Congress could not have solved the completely different problems of these two states through a single enactment, or even through administrative fiat. Individual states have widely divergent interests and problems, and only they can satisfactorily cope with them.

What the Congress could, and did, accomplish, however, was to provide that prospective purchasers of securities offered or sold in interstate commerce be provided full disclosure of all material facts--about management, the issuer itself, the enterprise in which it proposes to engage, and all other factors relevant to an informed investment decision.

Lest I leave a wrong impression, I should acknowledge that, in addition to being more or less paternalistic, the great majority of Blue Sky Laws, including Oklahoma's, employ the philosophy of full disclosure as their primary administrative tool, and they do an excellent job.

Congress, in the Securities Act, specifically recognized the need for, and the effectiveness of, state regulation, which had existed in some states for many years. Section 18 of the Act reserves jurisdiction to the states "over any security or any person." The Congress did not, as it could have done, entirely pre-empt the field of securities regulation. It chose the middle road of concurrent jurisdiction, so long as Federal and state laws were not in conflict. The dual Federal-State regulatory pattern which exists today, therefore, was intended. It is a good system, and has become more and more effective over the years.

The disclosure concepts of the Securities Act were carried over, in part, to the Securities Exchange Act of 1934. This Act, not so incidentally, created the five-member Securities and Exchange Commission. The Securities Act had been administered in its first year by the Federal Trade Commission. The Exchange Act reporting and proxy provisions which have been described by Commissioner Owens are essentially disclosure provisions. They are directed toward existing, as well as prospective, shareholders. The initial disclosures required by the Securities Act would be rendered ineffective by the mere passage of time if issuers were not required to periodically inform shareholders as to financial condition, operating results and basic policy changes, all of which may affect their investment.

Other provisions of the Exchange Act tend more toward the regulatory. The insider trading provisions are a good example of disclosure and regulation working together toward a beneficial result.

The national securities exchanges were allowed to continue as self-regulatory entities, but with Commission oversight being provided to prevent recurrences of the abuses which were rampant in the 20's. Some of the most flagrant of these involved misuse of inside information, and this fact formed the basis for the insider trading provisions of the Exchange Act. When he was Chairman of the SEC, Supreme Court

Justice William O. Douglas described the SEC's role in exchange oversight in terms of a well-oiled, loaded shotgun held behind the door, ready at all times for use, but with the hope that it would never have to be used.

Brokers and dealers operating interstate are required to be registered with the SEC, and are subject to Commission regulation of their activities. The Maloney Act of 1938 authorized the creation, under the Exchange Act, of self-regulatory associations of securities firms outside the exchange markets, again subject to Commission oversight. The result, of course, was today's National Association of Securities Dealers--the NASD. Many of the Exchange Act provisions have been recently strengthened, by the 1964 Amendments and by rule-making action pursuant to recommendations of the Special Study of Securities Markets.

As you have heard this morning, the 1964 Amendments extend the investor protections of the Exchange Act to certain widely held issuers whose securities are traded "over-the-counter." The vehicle for this extension, registration under Section 12(g), had the almost universal support of members of the securities community and allied groups. Questions arose only when it came to determining who should be exempt from the registration requirement.

As originally submitted by the Commission, the bill proposed certain exemptions from 12(g) registration. It exempted securities listed on a national securities exchange, which were already subject to the Exchange Act, and to rather stringent exchange rules as well. Also exempted were securities issued by an investment company registered under the Investment Company Act of 1940, which provides comprehensive disclosure and regulatory protections; securities issued by savings and loan and building and loan institutions, other than permanent or guaranty stock, neither of which are issued by Oklahoma institutions; and securities of issuers organized and operated exclusively for charitable or similar purposes, as described in the Act. The latter two categories include securities not generally traded publicly, and therefore it was felt that the additional protections were unnecessary.

The original draft of the bill also provided that as to banks which would be subject to 12(g) registration, the powers, functions and duties of the Commission under the Exchange Act would be delegated in whole or in part to the applicable Federal bank regulatory agency, but only upon the request of the agency. This was not an exemption, but merely an authorization for transfer of functions.

As you know, there are three Federal agencies or offices which have primary or concurrent jurisdiction over banks--the Federal Reserve Board, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation. In the Senate Subcommittee on Securities, four varying views were presented. The first was the voluntary delegation view of the draft bill. Second, the Federal Reserve Board presented the view that banks should be subject to registration under the Act but that the SEC should be given <u>sole</u> jurisdiction and responsibility for administration. This view recognized the expertise of the SEC in these areas, as well as the problems which could arise in separate administration. Third, the Comptroller of the Currency expressed the view that banks should be totally exempted from the bill. He felt that the bank regulatory agencies already possessed sufficient power to provide the necessary shareholder protections. If this power were found lacking, he urged that the banking acts be amended. The American Bankers Association presented the fourth view--that banks be made subject to the provisions, but that jurisdiction for administration be <u>vested</u> in the three banking agencies. The Association feared that the formula in the draft bill could result in some banks being subject to SEC rules, with others being subject to the rules of one or more banking agencies. After the hearings, the Senate Subcommittee adopted the fourth approach, vesting jurisdiction in the banking agencies. The bill was ultimately adopted in this form.

Notable by their absence from the specific exemptions provided in the draft bill were the stock insurance companies. The insurance industry, however, was quick to assert its claim for a statutory exemption. The primary concern voiced by the industry at the hearings was that the Commission might require that reports filed with it be based upon accounting systems inconsistent with state-prescribed systems. The Commission answered that under the Exchange Act its requirements had not caused any basic modification in insurance company accounting. The Commission also pointed out that state regulation was traditionally, <u>and primarily</u>, directed toward protection of policyholders, and that shareholders of over-the-counter insurance companies received far fewer protections and far less information than shareholders of companies subject to the Exchange Act. The Senate Subcommittee determined that, in the absence of comprehensive investor protections under state law, it would be in the public interest for insurance companies to remain within the coverage of the bill. The bill was passed by the Senate without an exemption for insurance companies.

The National Association of Insurance Commissioners then began the spadework toward providing shareholder protections under state law which would be comparable to those provided by the bill. The NAIC, recognizing that these protections had been something less than ideal, requested the opportunity to work through its state-commissioner members to develop and administer such protections. The House Committee which was then considering the bill concluded that they should be given this chance, analogizing this situation with that concerning banks, where administration was placed in the hands of the agencies charged with administrative responsibility over the industry.

The House, therefore, granted insurance companies a conditional exemption from Section 12(g) registration under the Exchange Act. Three conditions must be met. They are: First, that its state of domicile requires the insurance company to file an annual report with its Commissioner of Insurance, conforming to that prescribed by the NAIC; second, that the company is subject to regulation in its state of domicile as to proxies, consents or authorizations in respect of its securities, conforming to that prescribed by the NAIC; and third, that, after July 1, 1966, the purchase and sale of the company's securities by "insiders" are subject to regulation and reporting by the state of domicile substantially in the manner provided in Section 16 of the Exchange Act.

The first condition was immediately met. All states and the District of Columbia have for many years required detailed reporting in conformity with NAIC standards. The second condition, relating to proxy regulation, has presented some difficulty. The NAIC has adopted a comprehensive regulation which could be adopted by all state commissioners. This regulation is quite similar to our proxy regulations, and actually goes beyond what 12(g) registration would entail--it is applicable to all domestic stock insurance companies with more than 100 shareholders, and without regard to the total assets of the company. You will recall that Section 12(g) presently affects issuers with 750 or more shareholders, and $1,000,000 in total assets.

Many states felt that implementation of this regulation required legislation, as the existing insurance codes may not have been broad enough to encompass proxy regulation within general rule-making powers. Even in some states where the statute was thought to be sufficiently broad, legislation was proposed as an abundance of caution. Therefore, legislation was introduced in many states, including Oklahoma. In most cases, it conforms to a model bill drafted by the NAIC, with appropriate modifications for eccentricities of the several insurance codes. Basically, it is very similar to the relatively simple language of Sections 14(a) and 14(c) of the Exchange Act, reserving broad rule-making power under which the model regulation could be adopted.

Since the various legislatures are faced with a great many problems this year, it became apparent that the requisite legislation would not be passed in all states prior to the April 30 deadline for Section 12(g) filings. Rather than give piecemeal extensions for companies domiciled in states which had <u>not</u> implemented the regulation, the Commission adopted a blanket exemption for insurance companies until December 31, 1965. This means that no 12(g) registration statement will have to be filed by an insurance company otherwise subject to registration until at least April 30, 1966.

The third condition contains a built-in delay until July 1, 1966. The Congress saw that legislation would be necessary in <u>all</u> jurisdictions in order to impose insider reporting and liability provisions "in the manner provided by Section 16" of the Exchange Act. The implementing legislation in this area, as proposed by the NAIC, is quite similar to Section 16 itself. Again, the model is applicable to all companies with <u>100</u> or more shareholders, without regard to total assets. This legislation has been introduced in most of the states, and passed in many.

It now appears that this conditional exemption will be available to virtually all insurance companies prior to the dual deadlines of April 30 and July 1, 1966.

I think it is clear that the Congress, though strongly urged to the contrary, adopted the basic premise of the Commission's proposals in the bank and insurance areas. That premise was essentially that public investors in these two vital industries should receive disclosures and protections at least equivalent to those received by shareholders in other industries. Existing regulation in both spheres simply did not meet this test. If it can be met through regulation by the authorities traditionally responsible for these industries, then neither the Congress nor the Commission will have cause for complaint. It should be noted, however, that the Congress added a provision to the draft bill requiring the Commission to report in each of the next three years the effects of, and the progress under, these Amendments. The Committees of both Houses have indicated that the effectiveness of bank and insurance company regulation in these new areas would be of primary concern to them in their oversight of Commission activities.

There is also a general exemptive provision, Section 12(h), which allows the Commission to exempt, after notice and opportunity for hearing, any issuer or class of issuers from the registration requirement, or from the reporting, proxy or insider provisions. This provision will not be employed lightly, but may be used by the Commission in cases where the imposition of the Exchange Act provisions would appear unnecessary in all the circumstances. Any application under this provision would be judged by its consistency with the two primary responsibilities of the Commission--the public interest and the protection of investors. To date, the Commission has temporarily exempted insurance companies, as I have mentioned. It has also exempted certain non-transferable employee plans; common trust funds and certain other funds maintained by banks, as limited by the exemption; and any class of equity security which would not be outstanding 60 days after a registration statement would have to be filed. This latter category was necessary because the prerequisites for registration are judged as of the last day of the issuer's fiscal year, rather than being continuous in their operation. Applicable situations coming to mind are imminent mergers or liquidations, and redemptions of equity securities.

Commissioner Owens has mentioned the temporary exemption of pre-registration transactions from the liability provisions of Section 16(b). The only other exemptive action taken has been the temporary exemption of foreign securities pending a study to determine which of these securities should and which should not be exempt from registration under Section 12(g).

Of course, an exemption from 12(g) registration does not exempt securities from the provisions of the Securities Act. If securities are publicly offered or sold, they must either be registered under that Act or find an exemption there.

The Securities Act exemptions, in Sections 3 and 4, are infinitely more complex than those provided by Section 12 of the Exchange Act. These provisions exempt either certain types of securities or securities transactions from the registration requirements of that Act. I cannot discuss all of them, but some which are widely relied upon, and subject to misconstruction, do require discussion. These exemptions can be, at the risk of being over-dramatic, fraught with dangers for the unwary. Let me warn you in advance that there are no pat answers, but I will at least try to outline some of the many problems which may accompany these exemptions.

First, it should be made clear that the civil liabilities which may result from false or misleading statements or omissions in the offer or sale of securities are applicable whether or not registration is required. The same is true of the anti-fraud provisions of the Securities Act and the Exchange Act, under which the courts have liberally implied rights of action by damaged shareholders. A dramatic illustration of this occurred less than two months ago in an action by three mutual funds against an individual from whom they had purchased securities. The United States District Court in New York found that material misrepresentations were made to the funds by the seller. It also found that the sale was exempt from registration under the Securities Act, as a private offering, which I will discuss in a moment. In view of the false statements, and without regard to the exemption, the court ordered rescission of the sale. The defendant, in return for stock presently worth about \$65,000, must now refund the purchase price--\$3,247,000. (The Value Line Fund, Inc. v. Marcus, U.S.D.C., N.Y., No. Civ. 121.97, ___ F. Supp. ___, March 31, 1965.) The existence of an exemption from registration clearly, therefore, does not insulate the seller from liability under other provisions of the Federal securities laws. While this fact may be relatively common knowledge within this room, it is not so widely known, I am afraid, by those who issue and sell securities throughout the country.

Unlike most Blue Sky Laws, the Securities Act contains no so-called isolated transaction exemption. The purpose is served, however, by the first two clauses of Section 4. These clauses exempt transactions by any person other than an issuer, underwriter or dealer, and transactions by an issuer not involving any public offering. Transactions by a dealer not exempted here are taken care of in a later clause of Section 4 subject to delivery of a currently effective prospectus during the early days of a distribution. The plot thickens, however, when we must determine just who is an underwriter or issuer for purposes of these provisions. The term "underwriter" is not limited to a broker or dealer who takes securities of the issuer, either as principal or agent, and distributes them to customers. Underwriters in this context, of course, are included, but the real problems arise over the so-called "statutory underwriter," who is quite often neither a broker nor a dealer. Section 2(11) of the Act, in pertinent part, defines underwriter to mean "any person who has purchased from an issuer with a view to the distribution of any security."

We ordinarily conceive of an "issuer" as the entity _issuing_ securities. But, for purposes of determining whether someone is an underwriter, Section 2(11) expands the concept of issuer to include so-called "control persons" as follows: "As used in this paragraph the term 'issuer' shall include . . . any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer." Without attempting discussion of the limitless situations which may be posed by this definition, I would cite one recent case decided in Federal District Court in Oklahoma City. This was _S.E.C._ v. _Bond and Share Corporation, et al._, 229 F. Supp. 88 (1963), in which the Commission sought to enjoin a corporation and certain individual respondents from further offer and sale of Hydramotive Corporation common stock in violation of the registration and anti-fraud provisions of the Federal securities laws. Certain of the individual defendants had caused large amounts of outstanding stock of Hydramotive, until them a dormant uranium corporation, to be transferred to brokers and others, without consideration. These shares were then offered and sold to public investors without having been registered with the Commission and by means of false and misleading representations. Among other things, the defendants claimed that no issuer or underwriter was involved in the transactions and that, therefore, they were exempted by Section 4. The court quite correctly ruled that there were, in fact, underwriters involved in the transactions. Citing numerous judicial authorities, and the Commission's Rule 405, the court held that "control," as used in Section 2(11), should be broadly defined to permit the effective application of the Act wherever the <u>fact</u> of control exists. In this case, it clearly did exist. The controlling persons, therefore, were "issuers" and the persons who took from them with a view to distribution were "underwriters." The injunction which the Commission sought was issued!

The problems of "control" persons and distributions of securities by them are, obviously, many and varied. Seminars and treatises have been devoted entirely to this subject. Of equal importance, however, is the fact that the definition of "underwriter" may include persons who purchase from an issuer with a view to distribution, even if there is no control relationship whatever. Such persons, if they sell their holdings, do so at their peril, since, as underwriters, they are required to deliver a currently effective prospectus to purchasers, indicating, among other things, their underwriter relationship. While the SEC may not be on hand to enjoin sales by such underwriters, this does not mean that purchasers will not avail themselves of the civil liability provisions through suits for rescission or for damages. These may be based solely upon the unregistered sale, and do not require proof of false or misleading statements.

Many persons ask for, and receive, a so-called "no-action" letter from the Commission in such situations. This is nothing more or less than an indication by the staff of the Commission, based solely upon the facts submitted by the person requesting the letter, that, in the event of sales as described, the staff would not recommend that the Commission take action against the seller. Assuming that the facts have been fully, and truthfully, set out in the request, this letter commits the staff. Although undoubtedly persuasive, it is not binding on the Commission itself. Further, it is not a defense against civil actions by purchasers. Many attorneys feel that such a letter would be <u>persuasive</u> in the defense of any such action, even though it would be only evidentiary in nature. I cannot dispute this judgment, nor can I confirm it. Obviously, it would be better for all concerned if the question never arose.

The landmark case in the "private offering" area would have to the Supreme Court decision in S.E.C. v. Ralston Purina Co., decided in 1953, and reported at 346 U.S. 119 (1953). The Commission sought to enjoin the issuer from offering its own stock to its own employees without Securities Act registration. The issuer defended on the basis that its offer to employees was one "not involving any public offering." Among other things, they contended that the offer was to key employees. However, the evidence showed that this term covered an extremely large and diverse group. The District Court in which the action was brought nevertheless found the exemption applicable and dismissed, and the Court of Appeals affirmed. The Supreme Court granted certiorari in order "to define the scope of the private offering exemption." In the course of reversing, the court stated that the applicability of the transaction exemption should turn on whether the particular class of persons affected needs the protection of the Act, and that "an offering to those who are shown to be able to fend for themselves" would probably qualify for the exemption. The court observed that an offering to executive personnel who have access to the same information which would be disclosed through a registration statement would be such an offering, but that, absent such a showing, "employees are just as much members of the investing 'public' as any of their neighbors in the community."

That this opinion was to reach far beyond the situation of an offer to employees was apparent in this statement: "Once it is seen that the exemption question turns on the knowledge of the offerees, the issuer's motives, laudable though they may be, fade into irrelevance. The focus of inquiry should be on the need of the offerees for the protections afforded by registration." Along the same lines, the fact that the issuer voluntarily provides the requisite information would not change the result. If it could, then the issuer would virtually have a choice between voluntary, unregulated disclosure and registration. This could effectively undermine the whole purpose and effectiveness of the registration process.

Many other factors may be relevant in determining the availability of the exemption, any one of which may destroy the exemption. Necessarily, then, its existence must be determined on an ad hoc basis. As I have noted, the existence of an underwriter, whether or not known to the issuer, and a later distribution to public investors, would destroy the exemption as to all.

One further reference to the recent rescission case (The Value Line Fund, Inc. v. Marcus, supra), which I mentioned before, is appropriate at this point. The mutual fund plaintiffs there joined, as defendant, a brokerage firm which acted as a conduit for the individual seller. They asked rescission from this firm as well, claiming that the firm was an underwriter, and therefore that the transaction was not exempt. The court found that the sale by the conduit broker did not involve a distribution. It noted that the term distribution is substantially equivalent to the term public offering in Section 4, and that the mutual fund plaintiffs were sophisticated institutional investors, able to fend for themselves. Since there was no public offering, the firm did not take the securities with a view to distribution and was not an underwriter under Section 2(11), and plaintiffs recovered only against the individual seller.

The "private offering" exemption was designed to be, and is, just what it says it is. It has been, and will continue to be, narrowly construed with the burden of proof always resting with the one claiming the exemption. Counsel should be fully aware of these facts, and with the consequences which can result if the exemption is later held unavailable. Armed with this knowledge, clients may be fully advised of the dangers involved, so that they may be weighed against the advantages.

Another exemption which is deceptively simple, and therefore widely misunderstood, is the so-called "intrastate" exemption found in Section 3(a)(11). While many large offerings have been made in purported reliance upon this exemption, its legislative history and the decided cases make it clear that it is designed to apply only to local financing which may practicably be entirely consummated within the "home" state of the issuer. If the intrastate offering is shown to be a part of a single plan of financing, the remainder of which involves offers or sales to non-residents, the exemption will not be available. If a prior, or subsequent, offering involving the same class of securities is relatively close in point of time, or is made for the same general purposes, the two may be treated as part of a single issue. These and other criteria may be applied singly or in conjunction in making the determination.

The issuer, if a corporation, must be incorporated and doing business in the state where the offering is to take place. While the issuer need not be doing business exclusively within the state, it is clear that the securities offered may not represent an interest in a business which is predominantly out-of-state. In this connection, counsel should become acquainted with S.E.C. v. Truckee Showboat, Inc., decided in 1957 in United States District Court in California, and reported at 157 F. Supp. 824. This case involved a California corporation selling only to California residents. However, the proceeds of the offering were to be used to purchase a Las Vegas, Nevada hotel. The exemption was not available. Taking both the "single issue" and the "doing business" concepts together, it is clear that the exemption should not be relied upon for each of a series of corporations from different states where there is, in fact and purpose, a single business venture. This would be the case whether or not merger or consolidation of the various entities is planned at some later date.

The exemption requires that all offers and sales be made to "persons resident" within a single jurisdiction. This has been construed as being virtually synonymous with domicile, which immediately points up a problem existing throughout the law as to transients, and especially as to military personnel. The mere obtaining of representations of residency and agreements not to re-sell to non-residents should not be relied upon, especially where the purchaser is not personally known to the salesman. Since salesmen generally are paid commissions based on sales volume, strict supervision is an absolute necessity. Even then, if the exemption is later found to have not been available, all the supervision in the world won't restore it.

It is established law that the exemption is available only if the entire offering has "come to rest" in the hands of residents prior to any offer or sale to a non-resident. If part of the offering is sold to a resident who took with a view to re-sale or distribution, he would be an underwriter, and any sale to a non-resident by him or on his behalf would destroy the exemption as to the entire offering. If the complex question of whether the offering has "come to rest" may be answered in the affirmative, then interstate trading may be accomplished by or for the resident purchasers. However, and this is only one of many examples which could be given, re-sales to non-residents in a short time would militate against an affirmative answer and, therefore, against the exemption.

This exemption, like all others, will be strictly construed <u>against</u> the person claiming it, and the burden of affirmatively showing its applicability is likewise on the claimant. The <u>de minimus</u> doctrine has no application here, and a single <u>offer or sale</u> to a non-resident will destroy the exemption. Of course, if the exemption is not available, the securities have been sold in violation of the Securities Act, thereby giving rise to the civil liability provisions which I have mentioned, in addition to the Commission's power to seek injunctive relief.

Further, and this has happened on several occasions recently, the issuer might decide to offer rescission to all who purchased under the purported exemption. For instance, if a capitalization program to be accomplished intrastate was too conservative, or if it simply did not sell, the issuer may determine that an interstate offering is the only feasible approach to raising the needed capital. Whether the subsequent offering is registered or accomplished through a Regulation A exemption, disclosure will be required of the previous offering, and of the Securities Act violation--based upon the "single issue" theory. To avoid having to defend the spate of law suits which this disclosure could precipitate, the issuer may decide to offer rescission to all investors under the prior offering.

The same result could obtain in a future unrelated offering if it appeared that for any reason the exemption had not been available. For instance, a statutory underwriter may have been hiding in the background. Obviously, such a result could be disastrous.

In summary, there are serious questions raised if a purported intrastate offering goes beyond <u>strictly</u> <u>local</u> financing by <u>local</u> industries, carried out through <u>local</u> investment. It is almost inconceivable, for instance, that an offering of unseasoned, low priced securities to several thousand persons could come to rest only in the hands of residents.

I have discussed only two of the Securities Act exemptions, primarily because I feel that they are the most likely to be a source of problems to counsel and, more important, to their clients.

The regulation A exemption, which was designed for interstate offerings of $300,000 or less, is, of course, also a very important one. It is sometimes described as a small-scale registration, since the rules under it parallel the requirements of full registration. It does, however, allow the use of unaudited financial statements, although many of the states do not. Also, the applicable civil liability provisions are somewhat less stringent. Regulation A and the rules under it could be the subject of an entire Institute, and you obviously don't have that kind of time. However, counsel should be conversant with it, since offerings which would be questionable if made under another exemption are quite often made under Regulation A, thereby avoiding possible Securities Act violations and the problems which they would inevitably create.

I have also passed over the so-called "broker's exemption" in Section 4, and the highly complex rules which deal with it. This exemption is available only to the broker in brokerage transactions, and the seller must find his exemption elsewhere. Many of the problems under this exemption concern "control" persons. As I have mentioned, these problems are legion, and don't lend themselves to cursory discussion.

I have tried to indicate here, basically, that the exemptions under the Securities Act should never be taken for granted. This is true of exemptions from any remedial legislation. Of course, there are many, many offerings each year which are made under perfectly valid exemptions. However, as I have also tried to point out, circumstances beyond the issuer's control may vitiate an otherwise valid exemption.

The courts and the Commission will interpret these exemptions strictly, resolving any uncertainties against those claiming them. I believe that attorneys would be wise to employ the same rationale in advising clients as to the availability of the exemptions. Registration with the Commission is, of course, not as simple as doing nothing at all. However, in the event of uncertainties concerning an exemption, registration is considerably less burdensome than defending myriad law suits for rescission or damages. Further, if the amount of the offering is less than $300,000, a Regulation A exemption may be obtained with even less effort through one of our Regional Offices. In your case, this would be in Fort Worth.

One commentator recently said that in discussing Securities Act exemptions with clients, counsel must necessarily sound like an oracle of doom. If, after being fully informed as to the possible dangers involved, the client insists upon proceeding under an exemption, counsel is then somewhat confined. There are some things, however, upon which he should insist. The subscription agreement under which the securities are to be sold should contain as many safeguards as possible, including really meaningful investment or residency representations by the purchaser. Residency should, if at all possible, be verified by the issuer in intrastate offerings, and this should be done <u>prior to any offer</u>, and <u>not</u> merely after a sale. The client's selling enthusiasm, as expressed in the prospectus or offering circular, should be tempered by counsel. This should be accomplished <u>before</u> any registration is filed with state authorities, regardless of the state involved. Outlandish statements in a prospectus can result, in some states, in an out-of-hand denial, rather than the traditional "letter of comment."

Having done all this, to the best of his ability, counsel may lean back and fervently keep his fingers crossed.