

ADDRESS DELIVERED TO MONTANA MINING ASSOCIATION ON
DECEMBER 14, 1935, BY MR. ROBERT H. O'BRIEN,
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SECURITIES AND EXCHANGE COMMISSION.

Mr. Chairman, Gentlemen:

I am delighted to be with you today, and am happy that circumstances enabled us to accept the invitation you extended. It is a keen pleasure for me personally to be here, because, as many of you know, Butte is my home.

The work of the Securities and Exchange Commission which is of primary interest to you men is that which has to do with administration of the Securities Act of 1933 and the Securities Exchange Act of 1934. The Federal Congress, in passing this legislation, sought to prevent the continued practice of certain financial methods which had resulted in disaster to thousands of investors and impairment of the confidence of the public in our financial institutions. The skepticism of the public extended without discrimination, to almost all enterprises, both good and bad. It was apparent that an enduring financial recovery could not be achieved unless the way were opened to rebuilding public confidence, and public confidence could not be rebuilt unless a source of reliance other and greater than that which had culminated in such bitter disappointment were created. The Acts provided the means to bring about a restoration of public confidence, and already they have proved to be of immeasurable benefit both to persons seeking to invest their savings, and to business concerns which deal frankly and fairly with those whom they invite to become associates in a common venture.

The primary objects sought to be attained by the Acts are full and fair disclosure of all the material facts surrounding the issuance and offering for sale to the public of securities, and the preventing of fraudulent, deceptive and unfair practices and methods in the sale of and dealing in securities. Neither Act is prohibitory; any security may be offered for sale to the public if its nature and character are clearly and accurately described. The Acts assume the ability of the average investor to act prudently and intelligently if he is furnished with a reasonable amount of accurate and reliable information concerning the enterprise in which he is asked to participate.

The means of disclosure to a prospective investor of the material facts relative to a new issue of securities, proposed to be offered for sale to the public, are the registration statement and the prospectus. The Securities Act requires that a registration statement shall be filed with the Commission and have become effective before a public offering of securities may be made. Various forms for registration of securities have been adopted by the Commission, the appropriate form for a particular registration being determinable either by the nature of the transaction or the type of security involved. Each form contains a number of items which call for certain specific information, the same information, with unimportant exceptions, to be included in the prospectus, but not necessarily in the same sequence or order that it appears in answer to the individual items

of the registration statement. The Commission recognizes that the prospectus is essentially a sales document. A copy of the final prospectus on file with the Commission must be delivered to each person to whom an offer to sell, or sale of, the securities is made. The Act gives the purchaser a right of action for recovery of damages from those who have sold him securities without truthfully disclosing the material facts. In addition, the Act provides that the distribution and sale of securities in violation of the requirements as to registration and delivery of a prospectus may be stopped by injunctive proceedings and may subject the violator to criminal prosecution.

The Securities Exchange Act of 1934 requires that any exchange, except exempt exchanges, which conducts dealings in securities shall file a registration statement with the Commission giving certain information about the exchange, its members, and the rules and regulations governing trading on the exchange. The issuer of every security listed or admitted to unlisted trading privileges on the exchange must also file an application with the exchange and the Commission and include in such application certain specified information about the issuer and the security. If the application filed with the Commission and exchange contains untrue or misleading statements the Commission may refuse to register the security or securities concerned. The Commission also has authority to suspend or withdraw from registration any security where fraudulent or unfair trading practices are being employed.

However, the Commission is not authorized to pass judgment on the soundness or investment value of securities, nor does the Commission guarantee the truth and accuracy of the representations in a registration statement. Those people concerned in the issuance of a security, with the exceptions of the issuer, are not guarantors of the accuracy of the statements made or the information furnished in the registration statement; in general, their responsibility is to exercise due care that the statements made are accurate, with due regard to the trust and reliance placed in them by investors. The degree of care is that which may reasonably be expected of persons in their relationship to the registrant, the degree of care that is required of a prudent man in supervision and management of his own affairs. Anything less would be useless.

To contend that such a standard is too strict amounts to a denial of the experience with all our law governing relations between individuals; and it would be better to forego seeking information unless definite sanctions assuring the truth and accuracy of the information sought are set up. However, the sanction of public faith and confidence in the wisdom of legislation and the intelligence of its administration is far more effective than the threat of any pain or penalty for non-compliance with its terms. It is the object of the Securities and Exchange Commission, and one which I believe is being attained, to prove to the people of this country that this legislation represents no startling departure from accepted American standards of fairness and honesty and that its administration is to be conducted along lines of sympathy and cooperation.

The Acts do not make the Commission, as is sometimes asserted, a "wet-nurse" to the investor. He still must rely on his own judgment of the merits

of a given venture, but in forming his opinion there is available to him, by virtue of the information contained in the registration statement and prospectus, the material facts and features of that enterprise. Neither does this legislation prohibit the conception and execution of any project. It recognizes the diverse tastes and inclinations of human beings. The public, not the Commission, determines whether it shall contribute its money to the execution of any program.

I take it that the major interest of this group is in the requirements of the Securities Act of 1933 and the particular administrative methods and policies which the Commission has so far developed to bring about compliance with its requirements, and, rather than a general discussion of registration under the Act, I assume that you would prefer a somewhat detailed treatment of the registration of securities issues of mining companies. While the same specific object is sought to be attained in registering any securities, namely, full and fair disclosure of the material facts, the Commission recognizes that the method employed to achieve this object must vary with the nature of the business engaged in by the issuer. Mining is a business and is, of course, treated as such by the Securities and Exchange Commission. In the course of administration of the Securities Act of 1933, for a period of about two and one-half years, certain definite principles to be followed by an issuer in registering mining securities have been established by the Commission. In the process of evolution of these principles, certain methods which have at least the dignity and standing of long and continued usage were found to involve features which may at times seem to make difficult the full and fair disclosure contemplated by the Act. A literal statement in description of certain transactions between the corporation and the promoter often results in only a half-truth, and the purchaser is not fully informed either as to the precise nature of the transaction or its implications. The Commission has gradually and carefully developed methods to be used by the registrant to reveal to a prospective purchaser the essential character of certain transactions. Again, you will observe that the effect is revelation, not prohibition. The Commission does not say "You may not do it"; it only says "You may do it but you must not misrepresent what you do".

You are all acquainted with the common practice of donating to the corporation a portion of the stock received by the promoter in consideration of the transfer of assets. The Commission declared in an opinion that the inclusion of shares issued and concurrently donated back to the issuer as required by the purchase contract, were improperly included in the original cost of property, even if the effect of such a transaction under the applicable State law was to render such shares fully paid and non-assessable. The practice is not prohibited; the method of representation of the effect of the transaction is criticized. If, upon the execution of a purchase, the purchaser is out-of-pocket but \$10 he may not represent that the article purchased cost him \$15. Another principle established in the same opinion is that when stock, issued in part payment for property, is valued at par in the determining of the cost of such property, such valuation is false and misleading when all other sales of the same stock were at varying prices, all considerably below par. - In the same case, the Commission ruled that "prospective value" does not afford a scientific basis for the actual valuation of property at the time of its acquisition by the registrant.

Certain well-defined principles in connection with the preparation of the financial statements in a registration statement have been built up. As stated before, the issuer may not include in the figure given as cost of its property, the par value of stock which has been donated back to the treasury. Property held under lease and option may not be represented as an asset of the value of the purchase price specified in the lease and option agreement. If a portion of the purchase price has been paid, it would seem such amount may be carried on the balance sheet as an asset with an appropriate footnote to disclose the precise nature of the ownership. In promotional enterprises, a footnote to the balance sheet showing the cost of the assets to the vendor of the properties should be included. The value of a lease capitalized is best shown under "Intangibles" but under certain circumstances, and, if properly labeled, might be acceptable under "Fixed Assets".

In connection with capital stock, it is required that stock issued for cash, services or property be shown separately. Treasury stock donated back is best shown as unissued and deducted from authorized stock. It will, however, in some cases be acceptable if shown as "treasury stock" deducted from authorized stock, with the results shown as "net stock outstanding". The source of any class of surplus should be stated on the face of the balance sheet.

Many of you are primarily interested in the role the expert plays in the registration of securities. In the presentation of facts surrounding the issuance of securities of a mining company, the expression of opinion of a mining engineer relative to the properties is of primary significance. Without minimizing the importance of other factors it may be said that the nature and character of the mining property itself is of fundamental importance to the investor. There is no specific requirement as to the extent of the information which must be given; the degree of development of the particular property shapes the limits of the requirement. The extent of the information available varies from property to property.

Section 7 of the Securities Act imposes a definite responsibility upon the expert and provides for liability to a purchaser unless that responsibility is faithfully discharged. This responsibility is not unduly burdensome. An engineer or a mining expert who conducts his examination and reports his conclusions in accordance with sound and commonly accepted standards of his profession need have no fear of unhappy consequences as a result of his report being used in connection with the distribution and sale of mining securities. Happily, as was expected, the majority of reports submitted by mining engineers of this country to the Commission reflect the skill and integrity for which that profession is justly renowned. The standards of skill and conduct generally subscribed to by the men engaged in mining engineering are not less exacting than the standards erected by the Securities Act. However, the Commission, unfortunately, has been confronted with expressions of opinion of engineers, which, either by inadvertence and lack of skill, or by design, mislead the prospective investor as to the possibilities of the venture. In these instances, the Commission has protected the public either by institution of stop-order proceedings under Section 8(d) of the Act to suspend the effectiveness of the particular registration statement containing the misrepresentations or by injunctive proceedings to restrain continued offering of the stock for sale.

At times an engineer is employed to make an investigation of the physical assets of a particular venture for the exclusive purpose of placing a value upon such assets; at other times, as is the case with mining prospects, to determine whether the evidence available and open to observation is sufficient to warrant the expending of money in development of the prospect. Whether the examination is undertaken with a view to a final expression of the results of such examination in terms of dollars and cents or with a view to expressing conclusions in general comments and recommendations the details of the procedure followed in the course of the examination are the same. An appraisal expert, whether he be engaged in the examination of mining properties, real estate, industrial plants or whatnot, is presumed to adhere to well established and recognized norms of engineering technique. The Commission expects, as does the engineering profession itself, that one who puts forward a report which purports to reflect the result of accepted appraisal and examination practices must, in the course of his examination, have followed accepted methods. The Commission takes the view that valuations contained in such a report, even though in the final analysis they represent merely informed judgments, nevertheless are representations that these accepted methods have been accurately and fairly followed. If such accepted methods have not actually been followed the valuations finally arrived at are in essence misrepresentations of fact, because they untruthfully describe the basis upon which judgment has been exercised. The same may be said whether the valuation is stated in a definite figure or as a matter of general descriptive comment.

An engineer may not present a report which has been prepared in neglect of fundamental principles of scientific method and in disregard of the standards he expressly or impliedly purported to follow.

Any action of the Commission which has the effect of discouraging the preparation and dissemination of false and misleading engineers' reports on mining problems should, and I believe does, receive the approbation and commendation of a group such as yours. In its insistence that the recognized standards of the engineering profession be followed in the drafting of reports to be used in connection with the distribution of securities to the public, the Securities and Exchange Commission is allied with every mining association and mining society which has as its aim the maintenance of the high standards quite uniformly adhered to by engineers in America. In a real sense, and to a substantial degree, the objects of this and every other forward looking progressive mining group in this country are being furthered by the activities of the Securities and Exchange Commission. It may also be said that a voluntary association of mining men, such as your own, organized for the purpose of dissemination of technical knowledge and improvement of technical practices, makes a useful contribution toward achievement of the results sought to be attained through the administration of the Securities Act.